CapFinancial Securities, LLC
Procedures Manual

Version 3-2020

Denise Buchanan, Chief Compliance Officer

CapFinancial Securities, LLC
4208 Six Forks Road, Suite 1700
Raleigh, NC 27609
Phone: (919) 870-6822
Fax: (919) 870-8891

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1. INTRODUCTION

CapFinancial Securities, LLC (the "Firm" or "Company") has established and implemented a system to supervise the activities of each registered representative and associated person. This system of supervision is reasonably designed to achieve compliance with applicable federal and state securities laws and regulations, and with the rules of any self-regulatory organization governing the Firm's business as a broker-dealer.

1.1 Need for Written Supervisory Procedures

Establishing, maintaining, and enforcing written supervisory procedures is a cornerstone of self-regulation within the securities industry. Supervisory procedures that are reasonably designed to achieve compliance with applicable rules, and to detect and deter rule violations, enable the Firm to identify and respond to regulatory concerns in a manner that can reduce the risk of disciplinary action.

Moreover, appropriately designed and implemented supervisory systems and written supervisory procedures serve as a "frontline" defense to protect investors from fraudulent trading practices and help to ensure that associated persons are complying with rules designed to promote the transparency and integrity of the market. Supervisory systems enhance investor confidence and, in turn, promote the fairness, liquidity, and efficiency of the market for the benefit of all market participants.

1.2 Purpose of Written Supervisory Procedures

This written supervisory procedures manual ("Procedures Manual") is designed to comply with applicable laws, rules, and regulations, and is implemented with the aim of exceeding industry standards and best practices. This Procedures Manual is intended to serve as an internal compliance guide for associated persons, and to provide general supervisory and procedural assistance for those who have been assigned a supervisory responsibility (such as "Designated Principals" or "DP") over other associated persons. Associated Persons must adhere to this Procedures Manual and any other written supervisory procedures issued to them.

1.3 Issuance of Procedures

Each registered representative, independent contractor, or other associated person of the Firm, upon employment or affiliation, will receive a current copy of this Procedures

Manual with relevant updates. The Procedures Manual may be delivered electronically or as a hard copy.

1.4 Updates and Amendments

The Firm is required to amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations. This Procedures Manual will be periodically updated and amended as needed based on material changes or amendments to corresponding laws, regulations, or rules. Other factors, such as a change in the Firm's business, could warrant an amendment to the policies and procedures governing the conduct of associated persons. The Firm may deliver updates to its associated persons through any acceptable means, which may include electronic delivery of replacement pages or sections.

Periodically, the Firm may deliver a memorandum or similar notice to associated persons in an effort to provide clarification or guidance concerning the Firm's policies and procedures. Associated persons are expected to read each memorandum and adhere to any mandate contained therein. Each memorandum is considered a part of the Firm's written supervisory procedures. Consequently, failure to follow instructions contained in a memorandum will be deemed a violation of the Firm's procedures.

1.5 *Duty to Review and Comply with Procedures*

Associated Persons have the duty to make certain that all laws, regulations, rules, and policies applicable to the Firm's business are observed in the office(s) where they are employed, which consequently obligates such persons to be familiar with and to remain current concerning the Firm's policies and procedures. Each Associated Person is expected to fully comprehend and be thoroughly familiar with these procedures before conducting any business on behalf of the Firm.

1.6 *Enforcement of Procedures*

An Associated Person's failure to follow the Firm's policies and procedures may result in internal disciplinary action, which may include fines, suspensions, and/or termination. The Firm reserves the right to reflect any violation of its policies and procedures on an Associated Person's Form U-5. The Firm, through it Chief Compliance Officer ("CCO"), is committed to implementing and enforcing these procedures.

1.7 *Exceptions to the Procedures*

From time to time, situations may arise where it is appropriate to deviate from the procedures found in this manual. For example, an exception may be warranted when

strict adherence to the procedures in this manual would be to the detriment of the customer and a deviation from the procedures would actually benefit the customer. As another example, a deviation from these procedures may be warranted when the Firm determines that alternative or more stringent requirements should be placed on certain Associated Persons to better supervise their conduct. Deviations from required procedures will be permitted only with the approval of the CCO. Approvals should be documented, along with information concerning the rationale for the deviation. In no case will an approval except or excuse an Associated Person from compliance with any law, rule, or regulatory requirement.

1.8 Questions and Additional Guidance

This Procedures Manual does not attempt to set forth all of the rules and regulations with which associated persons must be familiar, nor does it attempt to deal with all situations involving unusual circumstances. When questions arise, Associated Persons should direct their questions to Compliance Department for assistance.

1.9 Investment Adviser Representatives

The Firm is affiliated with a federally registered investment adviser and some of its associated persons may be investment adviser representatives. If the Firm's written supervisory procedures conflict in any way with applicable investment advisory procedures, associated persons must adhere to the more stringent procedures.

2. General Policies and Procedures

2.1 Standards of Conduct

In accordance with FINRA Rule 2010, the Firm requires its Associated Persons to conduct business with "high standards of commercial honor and just and equitable principles of trade." FINRA Rule 2010 governs the general conduct of associated persons. Although the Firm's policies and procedures provide guidance concerning the conduct expected of all Associated Persons, the Firm reminds its Associated Persons that general conduct is learned from many different sources, including, among other things, industry news, periodicals, qualification examinations, training, continuing education, and personal experience. An Associated Person should consult with the Designated Principal if he has any questions concerning the conduct expected of him.

2.2 Hiring (Rule3110e)

The Designated Principal is ultimately responsible for the hiring of any Associated Person and for filing the Form U-4 upon hiring and the Form U-5 upon termination. Prior to employing Associated Persons, the Designated Principal should obtain written approval from such individuals to review their CRD file (pre-hire authorization) and to perform any other background searches that may be required to verify the accuracy and completeness of the information contained in an applicant's form U4 by no later than 30 calendar days after an initial or transfer Form U4 is filed with FINRA. A complete copy of the file and the steps taken to verify should be generated, reviewed, and maintained in the Associated Person's employment file.

The Designated Principal is responsible for ensuring that all Form U-4 disclosure items are current based on the Associated Person's attestations and other information known by the Firm. As a condition of employment, the Firm has the right to carry out the following reviews: background checks, screenings, drug tests, credit checks, verification of previous employment, and/or other reviews as deemed appropriate.

A background check should be conducted in order to evaluate the credentials of the Associated Person and substantiate information about the Associated Person. The background check looks for negative information, including bankruptcy, an arrest record, involvement in any securities industry disciplinary proceedings, and major customer complaints. The Designated Principal is responsible for determining the type of background check required and ensuring that information about the Associated Persons is reviewed and verified.

The Designated Principal must verify the information within the Form U4 through a national search of reasonably available public records which must include criminal records, bankruptcy records and judgments and liens. Information related to the background check performed by the Firm including the steps taken to verify the information pursuant to FINRA Rule 3110(e) may include:

a. Reviewing a credit report from a major national credit reporting agency that contains public record information (such as bankruptcies, judgments and liens) **and** the applicant's fingerprint results; or

b. Searching a reputable national public records database, such as LexisNexis, a division of Reed Elsevier, Inc., **and** reviewing the applicant's fingerprint results; or

c. Reviewing a consolidated report from a specialized provider, such as Business Information Group, Inc. ("BIG") or Sterling Backcheck, which includes criminal and financial public records.

Should verifying all of the information in the Form U4 not be reasonable or practical, the Designated Principal should document that the information could not be verified and the reasons (including the steps taken to verify the information) why.

The Designated Principal must complete the verification process by no later than 30 calendar days after filing the Form U4 with FINRA, with the understanding that if they become aware of any discrepancies as a result of the verification process conducted after the filing of the Form U4, they will be required to file an amended Form U4.

Fingerprints are to be taken for all Associated Persons with access to the original books and records of the Firm or access to customer funds or securities. Fingerprint cards will be submitted to FINRA for both registered and non-registered persons that are required to be fingerprinted pursuant to SEC Rule 17f-2. FINRA will conduct an additional criminal search on these persons; therefore, the Firm must ensure that no required disclosures have been omitted.

If the Associated Persons is approved for hire, the Designated Principal will oversee the filing of Form U-4 through the Web CRD system and the subsequent verification of the information contained within. The Designated Principal is responsible for maintaining the following in each Associated Person's file:

1. CRD [pre-hire] authorization letter (if applicable);
2. Form U-4 with the Associated Person's signature of acknowledgement that all disclosures are current;
3. A copy of the Form U-5;
4. A copy of the fingerprint card on a standard bar-coded card provided by FINRA;

5. Information related to the background check performed by the Firm including the steps taken to verify the information pursuant to FINRA Rule 3110(e).

2.3 Regulatory Investigations and Communications

The Firm encourages complete cooperation with regulatory authorities. Associated persons must immediately notify the designated principal prior to any discussions with regulatory authorities regarding matters such as regulatory examinations or regulatory inquiries. There are no exceptions to this matter, even when the inquiry concerns activities conducted at another firm. All new hires are expected to notify the Firm of any pending regulatory matters or investigations so that the Firm can anticipate calls from the regulators performing the investigation.

In the event of a formal or informal inquiry made by any federal, state, self-regulatory organization, or other regulatory authority, the designated principal will be responsible for forwarding all calls or other requests to the Compliance Department. If the Firm receives a request from FINRA pursuant to FINRA Rule 8210, the designated principal will ensure that any files sent to FINRA via a portable media device is properly encrypted with strong encryption (256-bit or higher encryption). The designated principal will provide FINRA staff with a confidential process or key regarding the encryption in a communication separate from the encrypted information itself (*e.g.,* a separate email, fax, or letter).

2.4 Terminations

The Firm reserves the right to terminate an Associated Person at any time. Such terminations may be reported to FINRA as a termination for cause, if justified. Upon termination, Associated Persons are required to return all of the Firm's property, files, and documents. An Associated Person's failure to return the Firm's property, including books and records, will warrant disclosure to regulators and may result in the Firm or another party taking legal action against the Associated Person. The Designated Principal is responsible for ensuring that a Form U-5 is filed within 30 days of the termination date of a registered person. The Firm will send, within 30 days of termination, a copy of Form U-5 to the former employee's last address of record as reflected on CRD.

2.5 Customer Complaints and Reporting

Associated persons must promptly report any complaint to the Firm. A "complaint" is formally defined as any written statement of a customer or any person acting on behalf

of a customer alleging a grievance involving the activities of those persons under the control of the Firm in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer. Although the formal definition specifies that a complaint be in writing, the Firm also requires associated persons to promptly report oral complaints or grievances. Associated persons should not attempt to resolve a complaint on their own.

The designated principal is responsible for educating associated persons on the procedures to follow if they receive a customer complaint. The designated principal will train an employee to open the mail, recognize a customer complaint, and forward the complaint to the appropriate registered principal. The designated principal will ensure that all associated persons understand the Firm's electronic communication policy and that such persons forward any customer complaints that they receive electronically to the designated principal.

Receipt and Forwarding of Complaints

The recipient of a written complaint must forward the complaint and documentation directly to the designated principal for immediate review. Oral complaints made by customers should be forwarded to the designated principal by providing a summary of the oral complaint and the facts and circumstances leading to the complaint. The designated principal must determine whether each complaint is an operational issue (such as a late check or dividend, or other minor issue) or a sales practice issue that warrants a formal investigation. All complaints will be maintained in a separate complaint file for further research and review purposes.

Internal Investigation of Complaints

The designated principal will review all customer complaints and maintain a log of complaints received. The designated principal will make copies of the customer complaint and may forward a copy to the registered representative and any persons assisting in the investigation. A copy of the complaint should be placed in the customer complaint file.

With the aim of quickly resolving the complaint, the designated principal or designee should contact the customer, acknowledge receipt of the complaint, and follow-up the conversation in writing. The designated principal should keep the customer apprised of the status of the complaint during the investigation, and provide the customer with his name and telephone number in case the customer has any future questions about the investigation.

The designated principal will contact the registered representative and all appropriate departments to obtain documentation or evidence related to the complaint. The

designated principal will typically request some or all of the following items: the new account form and other new account documentation, customer account agreement, option agreement (if applicable), discretionary agreement (if applicable), order tickets, trade confirmations, account statements, account detail history, commission history, copies of any customer acknowledgment or disclosure forms, and any record of conversations between the Firm and the customer. Depending on the nature of these allegations, the designated principal should review these items to assess, among other things, the suitability of any transaction, the customer's investment objectives, the use of any discretion, withdrawal of any funds, patterns of trading, commissions paid by the customer, and whether the trade was solicited or unsolicited.

Once the designated principal has reviewed all the pertinent documents and facts, the designated principal may contact the registered representative to discuss (or further discuss) the allegations of the complaint. After the discussion with the registered representative, the designated principal may contact the customer and obtain any further information that pertains to the investigation.

The designated principal will render a decision after reviewing all the above information and circumstances. The designated principal will evaluate whether any FINRA, SEC, or state rules and regulations have been violated. If necessary, the designated principal will contact legal counsel. If the disposition of the complaint could have a major impact on the company's finances, reputation, or future operations, the designated principal will meet with the management to discuss the findings.

Upon concluding the investigation of the complaint, the designated principal should apprise the registered representative of the findings. The Firm should notify the customer in writing of the findings and its determination. In cases where the customer has a valid complaint, the designated principal may attempt to negotiate a settlement with the customer. If the customer is unwilling to reach a settlement, the matter will be referred to legal counsel for final resolution. If necessary, the Form U-4 of the registered representative will be amended and appropriate regulatory action will be initiated.

In addition to investigating complaints as they are received, the designated principal should look for patterns of complaints such as:

- Does one registered representative have a large number of complaints?
- Do a disproportionate number of complaints come from a particular branch?
- Do a disproportionate number of complaints come from the registered representatives assigned to a particular principal?

Recordkeeping

The designated principal should establish and maintain a separate customer complaint file for each customer complaint. This file should contain, at a minimum, the following items:

1. A copy of the complaint;
2. A record of the complainant's name, address, and account number; the date the complaint was received; and the name of any other associated person identified in the complaint;
3. A description of the nature of the complaint;
4. Any correspondence relating to the complaint;
5. Any actions taken to resolve the complaint;
6. Details of the final disposition of the complaint; and
7. Copy of the FINRA Rule 4530 filing for written complaints.

2.6 Outside Business Activities

In accordance with FINRA Rule 3270, "No registered person may be an employee, independent contractor, sole proprietor, officer, director or partner of another person, or be compensated, or have the reasonable expectation of compensation, from any other person as a result of any business activity outside the scope of the relationship with his or her member firm, unless he or she has provided prior written notice to the member, in such form as specified by the member." Some typical examples of outside business activities conducted by registered representatives are insurance sales, tax preparation, acting as a mortgage broker, acting as a finder which may include the acceptance and receipt of a finder's fee, and serving as an active or passive partner, officer or board member of another organization. There are various forms of compensation for outside business activities, which include, but are not limited to, a paid salary, commissions, issuance of a finder's fee, referral fee, stock options, and/or warrants.

Persons Required to Comply with the Firm's Policy

Although FINRA Rule 3270 uses the term "registered person," the Firm's policy concerning outside business activities applies to each Associated Person of the Firm, regardless of the whether or not the Associated Person currently maintains a registration. An Associated Person is defined as any person engaged in the investment banking or securities business who is directly or indirectly controlled by a FINRA member, whether or not he is registered or exempt from registration with FINRA. An

Associated Person includes, but is not limited to, every sole proprietor, partner, officer, director, or branch manager of any FINRA member.

Notice and Approval of Outside Business Activities

An Associated Person must provide written notice to the Firm prior to engaging in any outside business activities. Upon receipt of a written notice for an outside business activity, the Firm will consider whether the proposed activity will:

- Interfere with or otherwise compromise the Associated Person's responsibilities to the Firm or its customers, or
- Be viewed by customers or the public as part of the Firm's business based upon, among other factors, the nature of the proposed activity and the manner in which it will be offered.

Based on the Firm's review of such factors, the Firm will evaluate:

- The advisability of imposing specific conditions or limitations on an Associated Person's outside business activity, including where circumstances warrant, prohibiting the activity, and
- The proposed activity to determine whether the activity properly is characterized as an outside business activity or whether it should be treated as an outside securities activity subject to the requirements of FINRA Rule 3280.

The Compliance Officer will evidence approval of the outside business activity either in writing, electronically, or by approving, signing and submitting the amended Form U4 containing then required disclosure of the OBA. ***All Associated Persons are prohibited from engaging in any outside business activities until the Firm has provided written approval.***

Disclosure of Outside Business Activities

Upon hire and annually thereafter, all Associated Persons must complete attestations and compliance forms certifying that all required disclosures have been made. These attestations apply to all business activities in which an Associated Person may be involved and are not limited to the investment banking or securities business. Associated Persons are reminded that prior approval must be obtained before entering into any outside business activities.

Form U-4 Update

Associated Persons are responsible for communicating their involvement in any outside business activities to the CCO and immediately updating their Form U-4s. It is the responsibility of each Associated Person to periodically review his Form U-4 and verify

that all disclosures, including outside business activities, are adequately reported on the Form U-4.

2.7 Private Securities Transactions

In accordance with FINRA Rule 3280, Prior to participating in any private securities transaction, an associated person shall provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction; provided however that, in the case of a series of related transactions in which no selling compensation has been or will be received, an associated person may provide a single written notice. ***All Associated Persons, whether registered or not, are prohibited from directly or indirectly participating in any type of securities business away from the Firm without prior written approval.***

Persons Required to Comply with the Firm's Policy

The Firm's policy on private securities transactions applies to all Associated Persons of the Firm. An Associated Person is any person engaged in the investment banking or securities business who is directly or indirectly controlled by a FINRA member, whether or not he is registered or exempt from registration with FINRA. An Associated Person includes, but is not limited to, every sole proprietor, partner, officer, director, or branch manager of any FINRA member.

Notice of Private Securities Transactions

An associated person must provide written notice to the Firm prior to engaging in any private securities transactions. The notice should describe in detail the proposed transaction and the associated person's proposed role therein. Upon receipt of a written notification by an associated person that involves private securities transactions, the Firm will issue a written response clearly stating its position on the proposed transaction. ***Associated Persons are prohibited from engaging in any private securities transactions until the Firm has provided written approval.***

Non-Compensated Transactions

Upon receipt of a notification from an Associated Person for a private securities transaction in which such person has not and will not receive any selling compensation, the Firm will issue a prompt written response acknowledging such notification, and may also place certain requirements and restrictions on such person in connection with his participation in the transaction.

Supervision

The Firm will supervise all private securities transactions as if such transactions were conducted by the Firm. The Designated Principal will monitor Associated Persons for any suspicion of unauthorized private securities transactions. Additionally, the Firm encourages Associated Persons to report any unauthorized private securities transactions effected by any other Associated Persons of the Firm. Any information pertaining to unauthorized private securities transactions is to be stored in the personnel file of the respective Associated Person.

All Associated Persons are required to complete annual attestations acknowledging adherence to this policy. All Associated Persons must notify and receive approval from the CCO prior to engaging in any private securities transaction. One method of detecting violations of Firm policy will be through correspondence reviews. It is important for the Designated Principal and Associated Persons to understand that all investment-related activities (including private securities transactions) are to be supervised by the Firm.

2.8 Outside Accounts

In accordance with FINRA Rule 3210, (a) No person associated with a member ("employer member") shall, without the prior written consent of the member, open or otherwise establish at a member other than the employer member ("executing member"), or at any other financial institution, any account in which securities transactions can be effected and in which the associated person has a beneficial interest.

(b) Any associated person, prior to opening or otherwise establishing an account subject to this Rule, shall notify in writing the executing member, or other financial institution, of his or her association with the employer member.

(c) An executing member shall, upon written request by an employer member, transmit duplicate copies of confirmations and statements, or the transactional data contained therein, with respect to an account subject to this Rule.

.01 Account Opened Prior to Association With Employer Member. If the account was opened or otherwise established prior to the person's association with the employer member, the associated person, within 30 calendar days of becoming so associated, shall obtain the written consent of the employer member to maintain the account and shall notify in writing the executing member or other financial institution of his or her association with the employer member.

.02 Related and Other Persons. For purposes of this Rule, the associated person shall be presumed to have a beneficial interest in, and to have established, any account that is held by:

(a) the spouse of the associated person;

(b) a child of the associated person or of the associated person's spouse, provided that the child resides in the same household as or is financially dependent upon the associated person;

(c) any other related individual over whose account the associated person has control; or

(d) any other individual over whose account the associated person has control and to whose financial support the associated person materially contributes.

For purposes of paragraphs (a) and (b) of this Supplementary Material .02, an associated person need not be presumed to have a beneficial interest in, or to have established, an account if the associated person demonstrates, to the reasonable satisfaction of the employer member, that the associated person derives no economic benefit from, and exercises no control over, the account.

.03 Transactions and Accounts Not Subject To This Rule. The requirements of this Rule shall not apply to transactions in unit investment trusts, municipal fund securities as defined under MSRB Rule D-12, qualified tuition programs pursuant to Section 529 of the Internal Revenue Code and variable contracts or redeemable securities of companies registered under the Investment Company Act, as amended, or to accounts that are limited to transactions in such securities, or to Monthly Investment Plan type accounts.

.04 Accounts At a Financial Institution Other Than a Member. With respect to an account subject to this Rule at a financial institution other than a member, the employer member shall consider the extent to which it will be able to obtain, upon written request, duplicate copies of confirmations and statements, or the transactional data contained therein, directly from the non-member financial institution in determining whether to provide its written consent to an associated person to open or maintain such account.

.05 Other Financial Institution. For purposes of this Rule, the terms "other financial institution" and "financial institution other than a member" include, but are not limited to, any broker-dealer that is registered pursuant to Section 15(b)(11) of the Exchange Act, domestic or foreign non-member broker-dealer, investment adviser, bank, insurance company, trust company, credit union and investment company.

General Requirements

Each associated person must provide notice in writing (i) prior to opening or placing an initial order in a securities account with another broker-dealer firm, and (ii) to the executing broker-dealer of his or her association with the employer broker-dealer. This will require notice only prior to the opening of an account and the execution of the initial order. Written notification will not be required for any subsequent trades.

It is the sole responsibility of the associated person to notify the Compliance Department if an account is maintained or established at another firm. The associated person is responsible for arranging delivery of quarterly electronic or hard copy statements.

Supervision

The Designated Principal is responsible for monitoring and reviewing accounts for Associated Persons that are held with other brokerage firms or financial institutions. The designated principal will be responsible for monitoring and closely reviewing any activity within outside accounts. The designated principal should examine the confirmations and/or statements in the following areas:

- Excessive trading;
- Excessive losses;
- Insider trading;
- Conflicts of interest;
- Money laundering;
- Restricted transactions;
- Adherence to any pre-approval requirements;
- Transfers of money or securities from other accounts or customers;
- Cash receipts from other accounts or customers; and
- Cash disbursements to other accounts or customers.

This list is not exhaustive. All questionable trading or activity noticed in the account should be brought to the attention of the CCO.

Evidence of Review

The designated principal is responsible for the review of outside accounts and should document his review on the account statement or a review log, or by any other acceptable means.

Securities Transactions for Personal and Family-Related Accounts

All transactions for personal and family-related accounts must be done in an account that is disclosed to the Firm. Such disclosure is to be done through the Firm's outside securities accounts disclosure form and/or code of ethics. An Associated Person's failure to maintain such approval may indicate that such account was never disclosed to the Firm.

2.9 Execution of Orders for Persons Affiliated with Other Broker-Dealers

All accounts opened for persons associated with other broker-dealers must be pre-approved by the Designated Principal. In accordance with FINRA Rule 3210, a broker-dealer ("executing member") who knowingly executes a securities transaction for the account of a person associated ("associated person") with another FINRA member ("employer member"), or any account over which the associated person has any discretionary authority, shall use reasonable diligence to determine that such execution will not adversely affect the interests of the other FINRA member.

Obligations of Executing Member

- The executing member must notify the employer member in writing of the executing member's intention to open or maintain an account in which the associated person has a financial interest or over which he has discretionary authority. Such notice must be given prior to the execution of any transaction in the account.
- Upon the employer member's written request, the executing member must transmit duplicate copies of confirmations, statements, or other information regarding such account.
- The executing member must notify the associated person of the executing member's intent to provide the foregoing notice and information to the associated person's employer.

Obligations of Associated Persons Concerning an Account with a Member

FINRA Rule 3201 imposes parallel disclosure obligations on associated persons who seek to do business through FINRA members other than employers. A person associated with a member, prior to opening an account or placing an initial order for the purchase or sale of securities with another member, shall notify both the employer member and the executing member in writing of his or her association with the other member. If the account was established prior to association of the person with the employer member, the associated person shall notify both members in writing promptly after becoming associated. The associated person's obligations arise only with respect to accounts or orders in which the associated person has a financial interest or over which he has discretionary authority.

Obligations of Associated Persons Concerning an Account with an Investment Adviser, Bank, or Other Financial Institution

Where the associated person opens a securities account with an investment adviser, bank, or other financial institution which is not a FINRA member, the associated person must give written notice to his employer of his intent to open the account or place the order, prior to the execution of the initial transaction. Upon written request from the employer member, the associated person also must request in writing and ensure that the investment adviser, bank, or other institution provides the employer with duplicate copies of confirmations, statements, or other relevant information. The associated person's obligations arise only with respect to accounts or orders in which the associated person has a financial interest or over which he has discretionary authority.

Exemptions for Transactions in Investment Companies and Unit Investment Trusts

The provisions of FINRA Rule 3210 do not apply to transactions in investment company shares, unit investment trusts, variable contracts or redeemable securities in companies registered under the Investment Company Act of 1940.

2.10 Transactions Involving FINRA Employees

In accordance with FINRA Rule 2070, the Firm—when having actual notice that a customer is a FINRA employee and has a financial interest in, or controls trading in, an account—will promptly obtain and implement an instruction from the FINRA employee directing the Firm to provide duplicate account statements to FINRA. A copy of the notification from the employee and evidence of instruction for duplicate statements will be retained in the customer file.

Additionally, the Firm will not directly or indirectly make any loan of money or securities to any FINRA employee. The Firm will periodically review any FINRA employee accounts to ensure that no impermissible loans of money or securities have been given to the FINRA employee.

The Firm will further monitor the accounts of any FINRA employee to ensure that anything given directly or indirectly to the FINRA employee does not exceed nominal value. The Firm will provide training to any registered representative servicing the account of a FINRA employee.

2.11 Requirements of Associated Persons

Associated Persons are required to:

- Adhere to the Firm's written supervisory procedures and other policies (which may be communicated orally);
- Disclose all outside business activities and private securities transactions;
- Cooperate with all supervisors and/or designated persons;
- Monitor accounts for suspicious activities;
- Adhere to any written agreements between the Firm and the associated person;
- Disclose all securities accounts;
- Disclose any accounts of other registered representatives from different broker-dealers;
- Update the Firm if any event occurs that becomes reportable on Form U-4;
- Immediately report any convictions;
- Immediately report any regulatory investigations;
- Report any suspicious activity of other associated persons and/or violations of the Firm's policies and procedures;
- Immediately report any misconduct of associated persons;
- Self-report their own violations, regardless of whether such violations were inadvertent or intentional;
- Receive and disclose prior approval of all compensation and/or payment arrangements, including all soft dollar arrangements received and/or paid;
- Disclose all companies of which they are an officer, director, or 5% shareholder. Additional disclosures are to be made for any such ownership by spouses and/or any members of the associated person’s immediate family living in the same home.

- Ensure that all securities liquidations, especially of insiders, are unrestricted, in accordance with Section 5 of the Securities Act of 1933, SEC Rule 144.
- Report to the Compliance Department all gifts at the time they are given or received, including gifts to and from customers and/or other entities that engage in investment-related activities.
- Receive written approval from the CCO prior to sharing in the profits or losses in a customer's account (performance accounts);
- Handle all customer accounts in a confidential manner, discussing information and transactions only with persons having a reasonable need to know for valid business or regulatory purposes.
- Adhere to the Firm's insider trading policies and refrain from discussing any nonpublic information with any other persons without prior notification to the Compliance Department.
- Promptly report (defined as by noon the next business day) any complaints and/or grievances to the Compliance Department.
- Immediately notify the Compliance Department if he or she has been the subject of any order or proceeding by the SEC, FINRA, any state, any court, any previous broker-dealer, or any foreign government relating to securities activities.
- Immediately report any of the following events: if he or she is indicted, is convicted of, has pleaded guilty to, or has pleaded no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, misappropriation of funds or securities, a conspiracy to commit any of these offenses, or substantially equivalent activity in any domestic, military, or foreign court.

When an action results in a reporting or disclosure requirement, the CCO is responsible for filing the report or making the disclosure.

2.12 Prohibited Activities

Although the following list covers a number of prohibited activities, it is not exhaustive. Associated persons are prohibited from:

- Conducting unauthorized private securities transactions (selling away);
- Borrowing money or securities from customers;
- Lending money or securities to customers;
- Depositing personal funds into a customer's account;

- Rebating commissions and/or fees to customers;
- Guaranteeing profits;
- Guaranteeing the present or future value or price of any securities, or that any company or issuer of securities will meet specified promises or obligations.
- Agreeing to repurchase a security at a future date;
- Accepting cash or a check payable to the associated person;
- Conducting undisclosed outside business activities;
- Exercising discretion without prior approval of a principal and a letter of authorization;
- Settling a customer complaint or dispute;
- Distributing internal materials marked “For Internal Use Only";
- Engaging in forgery;
- Entering false information on any account documents.
- Engaging in any sales contests not pre-approved by the Compliance Department.
- Giving tax or legal advice;
- Acting on, passing on, or discussing any inside information;
- Entering into financial arrangements with customers or issuers;
- Engaging in market manipulation, which includes entering a purchase or sell order that is designed to raise or lower the price of a security or to give the appearance of trading for purposes of inducing others to buy and sell;
- Front running;
- Participating in any new issues that are immediately traded in the secondary market and considered to be a “hot issue.” Additionally, associated persons must not sell a “hot issue” to any restricted persons, including persons employed by another broker-dealer.
- Selling a security for an accountholder that does not have the certificate (bona fide short sale transactions are exempt);
- Parking securities in order to conceal true ownership;
- Communicating with regulators without prior approval from the Firm;
- Interpositioning;
- Paying any party for referral services, also known as a referral fee, without prior approval from the Compliance Department.

- Collecting secret profits, which includes charging a mark-up or mark-down in addition to a commission on a transaction;
- Engaging in adjusted trading, which involves the sale of a security by a customer for a price above the prevailing market price and the simultaneous purchase of a different security at a price lower than the prevailing market price.

2.13 Purchases of Public Offerings—"Freeriding and Withholding"

Broker-dealers are prohibited from retaining certain public offering securities known as "hot issues" in their own accounts, and from selling such securities to directors, officers, general partners, employees or agents and associated persons of any broker-dealer. "Hot issues" are securities of a public offering where the securities open for trading in the after-market or secondary market at a premium. In general, if shares purchased in a public offering can be sold at a profit immediately in the secondary market, FINRA will consider them to be a "hot issue." These basic prohibitions also cover sales of "hot issues" to accounts in which any restricted person may have a beneficial interest and, with limited exceptions, to members of the immediate family of restricted persons.

The overall purpose of this prohibition, known as the "freeriding and withholding" rule, is to protect the integrity of the public offering process by requiring that FINRA members make a bona fide public distribution of securities by not withholding such securities for their own benefit or using the securities to reward other persons who are in a position to direct future business to the Firm. To ensure compliance with the "freeriding and withholding" rules, Associated Persons of the Firm and their immediate family members are prohibited from purchasing securities in public offerings of equity or debt securities.

Restricted Accounts

Accounts of all persons associated with the Firm and their immediate families are restricted from purchasing "hot issues." The term "immediate family" includes parents, mothers-in-law, fathers-in-law, spouses, siblings, brothers-in-law, sisters-in-law, children and their spouses, and any other person who is supported (directly or indirectly) to a material extent by Associated Persons.

Supervision

The Designated Principal is responsible for communicating this policy to all Associated Persons and ensuring that all accounts and trading activity are monitored for "freeriding and withholding."

2.14 Sharing in the Profits and Losses in a Customer's Account

Associated persons are prohibited from sharing in the profits and losses in a customer's account. Exceptions to this policy may be granted by the designated principal if an associated person is an owner of the account and the associated person shares in the profits and losses commensurate with the monetary contribution, or if an associated person acts as an investment adviser and receives compensation based on a share in the profits or gains in a customer's account in accordance with rules governing such compensation arrangements. Before sharing in profits and losses in customer accounts, an associated person must obtain the prior written authorization of the Firm. Additionally, the Firm and the associated person must obtain the prior written authorization of the customer.

2.15 Borrowing from or Lending to a Customer

No registered person may borrow money from or lend money to any customer (including immediate family members) without prior written approval of the CCO. A request to enter into a borrowing or lending arrangement with a customer must be made in writing and include the nature and terms of the arrangement and a description of the registered person's relationship to the customer. No loan will be approved unless it clearly falls within one of five permissible types of lending arrangements described below:

1. The customer is a member of the registered person's immediate family;
2. The customer (i) is a financial institution regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business and (ii) is acting in the course of such business;
3. The customer and registered person are both registered persons of the same firm;
4. The lending arrangement is based on a personal relationship with the customer, such that the loan would not have been solicited, offered, or given had the customer and the registered person not maintained a relationship outside of the broker-customer relationship; or
5. The lending arrangement is based on a business relationship outside of the broker-customer relationship.

The Firm generally does not permit borrowing or lending arrangements between its registered persons and customers. Any permitted arrangements will be pre-approved in writing. If an arrangement is approved, the registered person will be further required to notify the Firm and obtain prior written approval for any modifications to such arrangement, including any extension of the duration of such arrangement. The Firm will preserve the written pre-approval for any borrowing or lending arrangement for at least three years after the date that the borrowing or lending arrangement has terminated or for at least three years after the registered person's association with the Firm has terminated.

2.16 Soft Dollar and Commission Recapture Arrangements

Neither the Firm nor its Associated Persons may enter into a soft dollar or commission recapture arrangement with a customer of the Firm without the prior written approval of the CCO.

Soft-Dollar Arrangements

A soft dollar arrangement is any arrangement in which the Firm or its Associated Persons provide services or products to a customer in exchange for the customer directing securities transactions to the Firm. The Firm's policy is to prohibit all soft dollar arrangements unless pre-approved in writing by the CCO. An Associated Person wishing to have the Firm consider a soft dollar arrangement must submit a written request to the Compliance Department. The CCO will approve or deny the request in writing. Prior to approving a soft dollar arrangement, the CCO should notify the FINOP and seek guidance on any potential net capital implications arising from the proposed soft dollar arrangement. The CCO will be responsible for drafting amendments to the Firm's procedures and ensuring compliance with the rules and regulations governing soft dollar arrangements.

Commission Recapture

A broker-dealer that rebates any portion of the commissions it receives is engaging in a practice referred to as commission recapture. The Firm strictly prohibits any commission recapture program or arrangement. Any exceptions must be pre-approved in writing by the CCO. Prior to approving any arrangement, the CCO should consult with the FINOP to ensure that the Firm implements procedures reasonably designed to comply with all applicable rules, including SEC Rule 15c3-1 and SEC Rule 15c3-1.

Important: Broker-dealers typically need to maintain a net capital requirement of $250,000 in order to participate in commission recapture programs with their customers.

2.17 Commission and Markup Policy

The Firm and its registered representatives must ensure that they apply fair prices and commissions to securities transactions. FINRA Rule 2121 requires firms which execute securities transactions to determine whether remuneration and pricing is "fair and reasonable" given the specific circumstances of the transaction. FINRA has long held to a "5% guideline." While 5% is the official guideline, the actual basis for determining mark-ups and markdowns varies widely and has been established through a complex set of rule interpretations and disciplinary actions.

Principal Transactions

In accordance with FINRA Rule 2121, if the Firm ever buys from a customer or sells to a customer listed or unlisted securities from its own account, the Firm will ensure that it buys or sells at a fair price, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that the Firm is entitled to a profit.

Agency Transactions

When the Firm acts as an agent for its customer in a securities transaction, the Firm will not charge its customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order, and the value of any service the registered representative may have rendered by reason of his experience in and knowledge of such security and the market.

Commission and Mark-Up Policy ("5% Policy")

The 5% Policy applies to commissions on agency trades and on mark-ups or mark-downs on principal transactions. The Firm will not enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security. Registered representative must charge commissions that are reasonable. With the adoption of the 5% Policy, the following details apply to commission charges and mark-ups/mark-downs:

- The 5% Policy is a guide, not a rule;
- The Firm may not justify mark-ups on the basis of expenses which are excessive;

- The mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions. In the absence of other bona fide evidence of the prevailing market, the Firm's own contemporaneous cost is the best indication of the prevailing market price of a security;
- A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the 5% Policy;
- Determination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one.

Relevant Factors

Registered representatives must take into consideration the following factors in determining the fairness of a commission or mark-up/mark-down:

- **Type of Security Involved—**Some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size. Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to sales of common stock.
- **Availability of the Security in the Market—**In the case of an inactive security, the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified.
- **Price of the Security—**While there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a wider spread.
- **Amount of Money Involved in a Transaction—**A transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling.
- **Disclosure—**Any disclosure to the customer, before the transaction is effected, of information which would indicate (1) the amount of commission charged in an agency transaction or (2) mark-up made in a principal transaction is a factor to be considered. Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in light of all other relevant circumstances.
- **Pattern of Mark-Ups—**While each transaction must meet the test of fairness, particular attention should be given to the pattern of mark-ups.

- **Nature of the Firm's Business**—There are certain differences in the services and facilities which are needed by, and provided for, customers of firms. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of the Firm's mark-ups.

Transactions to Which the Policy is Applicable

The 5% Policy applies to all securities in the following types of transactions:

- A transaction in which the Firm buys a security to fill an order for the same security previously received from a customer. This transaction would include the so-called "riskless," "riskless principal," or "simultaneous" transaction.
- A transaction in which the Firm sells a security to a customer from inventory. In such a case, the amount of the mark-up would be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the Firm from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up.
- A transaction in which the Firm purchases a security from a customer. The price paid to the customer or the mark-down applied by the Firm must be reasonably related to the prevailing market price of the security.
- A transaction in which the Firm acts as agent. In such a case, the commission charged the customer must be fair in light of all relevant circumstances.
- Transactions wherein a customer sells securities to, or through, the Firm, the proceeds from which are utilized to pay for other securities purchased from, or through, the Firm at or about the same time. In such instances, the mark-up must be computed in the same way as if the customer had purchased for cash and in computing the mark-up the Firm must include any profit or commission realized by the Firm on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.

Transactions to Which the Policy is Not Applicable

The 5% Policy does not apply to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price.

Commission Schedules

The Designated Principal will establish the commission schedule charged to customers for the handling of securities transactions. Although the clearing firm may implement the commission schedule, the Designated Principal is responsible for ensuring the proper commission charges are applied.

Supervisory Review

The Designated Principal will document review of any commissions and markup/markdown through any acceptable means, such as signing or initialing the daily trading blotter or order ticket. Alternatively, the Designated Principal may document his review through the completion of a task. Questionable commissions or markups/markdowns that are approved should be documented with a reason justifying the commission or markup/markdown. A record will be kept of the securities transactions reviewed and what action, if any, was taken.

2.18 Gifts and Gratuities

FINRA Rule 3220 provides: "No member or person associated with a member shall, directly or indirectly, give or permit to be given anything of value, including gratuities, in excess of one hundred dollars per individual per year to any person, principal, proprietor, employee, agent or representative of another person where such payment or gratuity is in relation to the business of the employer of the recipient of the payment or gratuity. A gift of any kind is considered a gratuity." The rule is intended to protect against improprieties that might arise when associated persons give substantial gifts or monetary payments to certain persons without the knowledge of the Firm.

Policy

Anything of value that is given to or received from any person or entity in relation to business must be disclosed and approved and such approval must be documented in writing. The CCO is responsible for such approval and maintaining a gifts and gratuities log. This log must contain all disclosures and approvals.

Aggregation of Gifts

FINRA Rule 3220 imposes a gift limit of $100 per individual recipient per year. To ensure compliance with this $100 limit, the Firm must aggregate all gifts given by the Firm and each associated person to a particular recipient over the course of a year. In addition, the Firm must decide whether it is aggregating all gifts given by the Firm and its associated persons on a calendar year, fiscal year, or on a rolling basis beginning with the first gift to any particular recipient. The method of aggregating gifts should remain consistent.

Valuation of Gifts

In general, gifts should be valued at the higher of cost or market value, exclusive of tax and delivery charges. If gifts are given to multiple recipients, the Firm should record the names of each recipient and calculate and record the value of the gift on a pro rata per recipient basis, for purposes of ensuring compliance with the $100 limit. A gift basket

worth $250 delivered to an office of three individuals for the benefit of each individual would be permissible.

Business Entertainment

FINRA Rule 3220 does not limit ordinary and usual business entertainment provided by a member or its associated persons to the member's customers and their guests. Thus, when the Firm or its associated persons are hosting customers and their guests at an occasional meal, sporting event, theater production, or comparable entertainment event, FINRA would not regard such business entertainment as governed by FINRA Rule 3220 so long as it is neither so frequent nor so extensive as to raise any question of propriety.

On the other hand, if a person associated with the Firm is not personally hosting the business entertainment, the provision of tickets to sporting events, the theater, and other comparable entertainment events would be governed by FINRA Rule 3220. Thus, such gratuities may not exceed the value permitted under FINRA Rule 3220, must be valued at cost, and may not be discounted on the theory that they would not otherwise be used.

Gifts Incidental to Business Entertainment-

There is no express exclusion from FINRA Rule 3220 for gifts given during the course of business entertainment and conferences. Thus, for example, purchasing an umbrella during a round of golf would be considered a gift. Associated persons must report these gifts, and the Firm must record the value of such gifts.

De minimis and Promotional Items

FINRA Rule 3220 does not apply to gifts of *de minimis* value (*e.g.*, pens, notepads, or modest desk ornaments) or to promotional items of nominal value that display the firm's logo (*e.g.*, umbrellas, tote bags, or shirts). In order for a promotional item to fall within this exclusion, its value must be substantially below the $100 limit. FINRA also generally does not apply the prohibition in FINRA Rule 3220 to customary Lucite tombstones, plaques or other similar solely decorative items commemorating a business transaction, even when such items have a cost of more than $100. FINRA does not believe such gifts are items of value within the scope of FINRA Rule 3220. The restrictions of FINRA Rule 3220 would apply, however, where the item is not solely decorative, irrespective of whether the item was intended to commemorate a business transaction.

2.18.1 Charitable Donations

Associated Persons may not make contributions to charities with the intention of influencing such charities to become customers of the Firm. Associated Persons are encouraged to notify the CCO if they perceive an actual or apparent conflict of interest in connection with any charitable contribution.

Political Contributions and "Pay-to-Play" Policies

Financial institutions that seek to influence government officials' awards of business contracts by making or soliciting political contributions to those officials are engaging in an unethical and often illegal practice known as "pay-to-play." The Firm and its Associated Persons are strictly prohibited from making political contributions with the intent to influence government officials who are in a position to award business to the Firm.

Considerations Concerning Political Contributions

- Any Associated Person involved in soliciting the business of municipalities must be mindful of MSRB Rule G-37 and should keep political contributions below $250 to avoid triggering restrictions on their business.
- An Associated Person who is a supervised person of a registered investment adviser should not make political contributions without first considering whether the policies and procedures of his investment adviser require pre-clearance for or place limitations on political contributions.

3. Registration and Licensing

Most states have enacted laws regulating the sale of securities and the activities of broker-dealers in securities. These laws, commonly known as "Blue Sky Laws," provide in most states that (a) no securities dealer or securities salesperson may sell securities in a particular state unless the firm and the salesperson are registered under state law, and (b) no security may be sold in a particular state unless the security is registered or qualified for sale (unless a specific exemption applies). Registration or licensing under federal law does not necessarily exempt the securities or the securities broker-dealer from registration or licensing by various state regulatory commissions.

State securities laws generally deal with fraudulent or other prohibited practices, registration of broker-dealers and investment advisers, and registration of specific securities. Violations may be subject to both civil and criminal action. In most states, a firm whose only securities transactions are conducted with issuers or other broker-dealers does not fall within the definition of "dealer" if that firm does not maintain an office within a particular state. Some broker-dealers and their associated persons are not required to register in such states.

State registrations are effected via CRD. Most states also require registrants to pass the Uniform Securities Agent State Law examination (Series 63). All representatives are responsible for their own licenses. There are some states that do not require state licensing for Registered Representatives. In the event that a Representative's home state does not require the license examination, registration may lapse in 2 years. To avoid registration lapses, Representatives are encouraged to ensure that their registrations are held by a state that requires the qualification examination. Additionally, Representatives are to be familiar with public disclosure and accessing their state registration information.

No orders should be accepted for any public retail customer, or institutional account, or for a security in which the firm is not permitted to sell. This restriction also applies to retail sub-accounts received from main accounts located either outside or within these particular states. For example, if an order is received from a money manager who later indicates that part of the order applies to a retail account located in one of the above states, the Firm would not be allowed to accept the order for that particular account.

Transactions in states in which the Firm is not registered as a broker-dealer or in states that do not contain an exemption could result in penalties and fines, in addition to the denial of future applications as a broker-dealer in these and other states. Representatives are required to register in a state prior to establishing a client account in the respective state. Some states have very stringent policies related to state licensing

and will discipline firms and individuals for any transactions, including dividend reinvestments. All requests for registration exemption will be verified by compliance, and correspondence will be sent via e-mail confirming such exemption. Some states allow for a de minimis transaction.

4. Training and Education

4.1 Regulatory Element of Continuing Education

All Registered Representatives will be notified of their respective anniversary dates via telephone and/or e-mail. Each Registered Representative will be responsible for compliance with the Regulatory Element. Individuals who do not successfully complete their regulatory element by the deadline will be terminated if it is found that the reason(s) for their failure to comply is/are not acceptable.

All Registered Representatives are responsible for ensuring that no securities-related business is conducted during any inactive period. Individuals placed on inactive status due to their failure to complete the Regulatory Element in a timely fashion will not receive commissions from any securities activities during the period they are on inactive status within the CRD system.

The Regulatory Element of Continuing Education must be completed within the time frame. A passing score is not required, but good performance is encouraged. All scores are reviewed by the Compliance Department (including aggregate performance compared with respective peer groups), and each general area covered is considered for future training needs.

4.2 Firm Element of Continuing Education

All Registered Representatives are required to fulfill the Firm's training mandates.

Requirement

The CCO is required to conduct a needs analysis and written training plan at least annually. Representatives who deal with the public and their immediate supervisors are to be included in the Firm's ongoing training plan. Other Associated Persons may be included in the plan on a case-by-case basis.

Feedback

Registered and Associated Persons will be requested to provide feedback to the CCO and/or their respective DPs regarding the Firm's upcoming training plan. All persons will be requested to provide this feedback during the Annual Compliance Meeting and on an ongoing basis. All Associated Persons are encouraged to submit any requests in writing, and all such requests will be considered.

Methods of Training and Plan to Implement Actual Training

Methods of training may be delivered directly by the CCO, the DP, outside consultants, and/or third party vendors. The CCO is the person responsible for reviewing the needs analysis and the written training plan to ensure that delivery of the training is adequate. Additional methods of training may include seminars, forums, classes, lectures, web-based training programs, self-study programs, etc. All training materials are to be maintained for at least three years. Different methods will be used to evidence completion, including attendance sheets, acknowledgments, certificates of completion, etc.

Disciplinary Action

Failure to complete required training may subject individuals to disciplinary action, including termination, suspension, withholding of compensation, and/or warnings.

4.3 Annual Compliance Meeting / Attestations and Disclosures

The Firm requires all Associated Persons to attend an annual compliance meeting. The CCO is responsible for coordinating this meeting and notifying all Covered Persons. Registered Representatives are required to attend the meeting. Failure to attend the annual compliance meeting may result in disciplinary action, including fines and/or termination for cause.

The annual compliance meeting is for discussion of compliance matters relevant to the activities of the Registered Representative. This meeting can be done in person (group or one-on-one), over the telephone, via conference call, or over the Internet. It will be interactive so as to allow all parties to participate.

At the annual compliance meeting, or more frequently if necessary, all Associated Persons will be required to complete the Firm's annual attestations and disclosure forms.

4.4 Relief from CE Requirements for Active Duty Professionals

Securities industry professionals who volunteer or are called into active military duty ("Active Duty Professionals") will be placed in a specially designated "inactive" status once FINRA is notified of their military service, but will remain registered for FINRA purposes. Active Duty Professionals are given the following relief:

- **Regulatory Element Relief—**Because it is generally not practical for Active Duty Professionals to be at a facility that delivers the Regulatory Element, Active Duty Professionals are relieved from fulfilling the Regulatory Element requirements that arise during the period of time that they are on active duty.
- **Firm Element Relief**—Active Duty Professionals are excluded from the Firm Element requirements because they do not have contact with customers. Active Duty Professionals are not required to complete either of the Regulatory or Firm Elements of the continuing education requirements during their pending inactive status.

The designated principal will review the Firm's list of associated persons and identify those who volunteered for military service or were called into active military duty. The Firm will make the proper notifications and relieve such persons from CE requirements during their period(s) of duty. The Firm will document any determination that a person is an Active Duty Professional who qualifies for exemption from continuing education requirements.

5. Customer Privacy

The Firm or any of its Associated Persons may not share nonpublic personal information of consumers with nonaffiliated third parties, except if it is required in order to provide the services offered.

The Firm must provide consumers who are customers with an initial privacy notice and thereafter, annual privacy notices. The DP is responsible for compliance with Regulation S-P, including the following:

- An initial notice is provided to each customer.
- An annual notice is sent to customers (excluding institutional investors) as long as the customer relationship continues.
- Customer records and information are safeguarded.
- Notices to consumers and customers contain all of the required disclosures and information.

Customer information will be safeguarded by restricting access to the information to only employees who need access in order to service the customer's account. Representatives will be responsible for ensuring that security controls are adequate for protecting unauthorized persons from accessing any hardware devices that may contain customer information. Such devices include, but are not limited to, hard drives, CDs, flash drives, floppy disks, laptops, and/or PDAs. Please note that any such devices containing client information will be inspected during on-site inspections to ensure adequate security and restricted access. Violations of this policy will be taken very seriously as all Associated Persons at the Firm are responsible for safeguarding client information. All hard copy documents that contain private information must be secured by locking the file cabinet and/or office in which they are stored. Information kept on the Firm's computers will be password-protected and secured behind the Firm's firewalls. Any devices taken off site must be secured and not left unattended.

Each branch office is to have one designated person and a backup (in case the designated individual is not in the office) who will open all mail and distribute it to a DP. When incoming mail is received from customers, the designated individual will open the mail and process such mail in accordance with the Firm's correspondence procedures. Following review and processing, the designated person in each branch will distribute the mail to the appropriate party. The CCO or DP will provide training/instruction to the individuals responsible for collecting and distributing all incoming customer mail to ensure that they understand the confidentiality of customer information. Only certain

employees will receive privileged access based on the services they provide. All employees will be required to sign annual attestations of compliance.

The CCO is responsible for ensuring that the Firm either internally audits or uses a third party to test such safeguards and systems to protect client information.

A paper shredder is to be used for destruction of all client-related documents. Any document to be destroyed with nonpublic client information is to be shredded. Any devices, including CDs, flash drives, floppy disks, laptops, and PDAs, must be pre-approved by the CCO prior to discarding such device. There are no exceptions and the Representative must retain evidence of CCO approval. The CCO will be responsible for ensuring any devices that contain customer information are destroyed in their entirety and in no way can be accessed.

The CCO will ensure new technology is appropriately tested to ensure that adequate safeguards are in place to protect client sensitive data. Such testing is to be documented and approved by the CCO or designee.

If at any time an employee suspects the misuse or mishandling of confidential customer information or identity theft, he or she is to immediately notify a DP and/or the CCO. The CCO will then promptly report any suspected identity theft to the SEC and the Federal Trade Commission and retain copies for the files. The CCO is ultimately responsible for ensuring compliance with Regulation S-P.

6. INSIDER TRADING

The definition of insider trading has evolved through case law and administrative proceedings and has included:

- Buying or selling securities on the basis of material non-public information. This would include 1) purchasing or selling for an Associated Person's own account or for one in which the Associated Person has a financial interest or 2) for the firm's inventory account. If any Associated Person is uncertain as to whether information is "material" or "non-public," the DP should be immediately consulted.
- Disclosing insider information to inappropriate personnel, whether for consideration or not (i.e., tipping). Insider information must be disseminated only to appropriate personnel on a "need to know" basis. Again, a DP of the Firm should be consulted whenever questions arise.

Material Information is information that investors would most likely consider important in making their investment decisions, or information that is reasonably certain to have a substantial effect on the price of a company's securities, regardless of whether the information is related directly to the company's business.

Nonpublic Information is information that has not been communicated to the public.

6.1 Policy

The Firm's policies, procedures, and training program are designed to do the following:

1. Establish written policies and supervision for insider trading.
2. Identify personnel to whom the Firm's insider trading policies apply.
3. Educate Associated Persons on what constitutes insider trading.
4. Provide communication of insider trading policies to the Firm's Associated Persons.
5. Establish "Chinese Wall" when and where applicable.
6. Identify responsibilities of the Firm's Associated Persons and supervisors.
7. Define sanctions for non-compliance with the Insider Trading Act.
8. Provide an overview of the Firm's current business

Firm policy prohibits Associated Persons from effecting securities transactions while in the possession of material, nonpublic information. Associated Persons are also prohibited from disclosing such information to others. The prohibition against insider

trading applies not only to the security to which the inside information directly relates, but also to related securities, such as options or convertible securities.

If Associated Persons receive inside information, they must immediately notify only the Compliance Department and/or members of Senior Management. They are prohibited from trading on that information, whether for the account of the Firm or any customer, or their own account, any accounts in which they have direct or indirect beneficial interest (including accounts for family members) or any other account over which they have control, discretionary authority or power of attorney.

Any restricted securities will be announced to all Associated Persons. A memorandum will be created and passed to all Associated Persons identifying the restricted company's name and stock symbol. The company will also be added to the restricted stock list. The CCO and/or the DP will create and circulate this memorandum, keeping a copy to evidence the restriction of stock trading. When the availability of material nonpublic information has passed, a memo can be circulated to reinstate the restricted company's securities for trading. A copy of the reinstatement memo will also be kept in the restricted list file.

6.2 Personnel to Whom Insider Trading Policies Apply

This policy applies to all Associated Persons of the Firm. An Associated Person is any person engaged in the investment banking or securities business who is directly or indirectly controlled by a FINRA member, whether or not he is registered or exempt from registration with FINRA. An Associated Person includes, but is not limited to, every sole proprietor, partner, officer, director, or branch manager of any FINRA member.

6.3 Responsibilities of Associated Persons

All Associated Persons are required to sign attestations initially upon hire and thereafter, on an annual basis at the Annual Compliance Meeting. The DP will maintain these statements in each individual's personnel file.

All Associated Persons must make a diligent effort to ensure that a violation of the Insider Trading Act does not occur, either intentionally or inadvertently. In this regard, Associated Persons are responsible for:

1. Reading, understanding, and consenting to comply with the insider trading information contained in this section. Associated Persons will be requested to acknowledge and affirm that they have read and understood their responsibilities.

2. Ensuring that no trading occurs in their account or in any account in which they have a beneficial interest, or in securities for which they have insider information.
3. Not disclosing any insider information obtained from any source whatsoever to inappropriate persons. Disclosure to family, friends, or acquaintances can be grounds for immediate termination.
4. Consulting a DP whenever any questions may arise regarding insider trading or whenever a potential insider trading violation is expected.
5. Ensuring that the Firm receives copies of confirmations and statements from both internal and external brokerage firms regarding the Associated Persons and their immediate families (including spouses and any relatives living in their households).
6. Advising the DP of all outside activities, directorships, or major ownership in a public company over 5%. No employee may engage in any outside activities as employee, proprietor, partner, consultant, trustee, officer, or director without prior written consent from the Compliance Department.
7. Being aware of and monitoring any clients who are shareholders, directors, or senior officers of public companies. Any unusual activity or purchase or sale of restricted stock must be brought to the attention of a DP.

6.4 Preserving Confidentiality of Insider Information

If an Associated Person is in a position within the Firm to access inside information, the following steps should be taken to preserve the confidentiality of inside information:

1. Material inside information should be communicated only when there exists a justifiable reason to do so on a "need to know" basis inside or outside the Firm. Before such information is communicated to persons within the Firm or another person who purportedly needs to know, contact the department manager or the Compliance Department.
2. Do not discuss confidential matters in elevators, hallways, restaurants, airplanes, taxicabs or any place where discussion can be overheard.
3. Do not leave sensitive memoranda on desks or in other places where others can read them. Do not leave a computer terminal without exiting the file.
4. Do not read confidential documents in public places or discard them where others can retrieve them. Do not carry confidential documents in an exposed manner.
5. On drafts of sensitive documents use code names or delete names to avoid identification of participants.

6. Avoid even the appearance of impropriety. Serious repercussions may follow from insider trading and the law proscribing insider trading can change at any time. Since it is often difficult to determine what constitutes insider trading, Associated Persons should consult with the Compliance Department whenever they have questions about this subject.
7. Do not discuss confidential business information with spouses, other relatives, or friends.

All Associated Persons are obligated to immediately report all situations that they are aware of relating to insider trading, including any suspicions. Failure to report any information can result in disciplinary action including termination and could be reported to regulatory authorities. Such reports will be treated as highly confidential.

6.5 Supervision

The CCO is responsible for implementing procedures to protect against insider trading. The CCO is also responsible for detecting and preventing possible abuses based on the use of material nonpublic information. This includes all accounts of Associated Persons both held at the Firm and away from the Firm; family-related accounts; accounts controlled by Associated Persons; and all accounts held at the Firm.

During the periodic review of customer accounts and the review and approval of securities transactions, the CCO or designee should note any unusual activity, such as short term profits or profits taken before major news announcements. Investigation of insider trading will include, but is not limited to, interviewing representatives and/or clients, reviewing transactions in the same security, checking to see whether any nominee accounts have been established, and reviewing outside brokerage accounts of any suspected representatives. Known accounts of "insiders" should be reviewed more frequently than other customer accounts. In addition, transactions in employee and proprietary accounts will be reviewed for insider trading on a trade-by-trade basis. Evidence of this review is to be made on a supervision system and/or insider-trading log. These records should be maintained for three years past the life of the account.

The CCO or designee should closely supervise accounts of customers who are known to be senior officers or directors of any publicly traded company or are owned by individuals who control more than 5% of any publicly traded company. In addition, the accounts of employees and any proprietary accounts of the Firm must be reviewed for insider trading activities. The Firm will note, on the new account form, such accounts of known insiders.

The CCO will consider providing educational material geared toward familiarizing all Associated Persons with insider trading upon hire and at the Annual Compliance Meeting.

The CCO and/or DP will be responsible for taking measures to detect and prevent insider trading abuses. Such measures will include:

1. Creating and modifying the policies concerning insider trading.
2. Communicating the insider trading policies to employees upon hire and at the Annual Compliance Meeting.
3. Obtaining written acknowledgment and consent forms.
4. Reviewing employee confirmations and statements for potential insider trading violations and noting evidence of such reviews.
5. Answering questions from employees regarding insider trading.
6. Documenting any investigation of possible insider trading, noting the following items:
    - Name of security
    - Date investigation commenced
    - Accounts reviewed
    - Summary of disposition
7. Initiating disciplinary action against any Associated Person who is in violation of the Insider Trading Act.

6.6 Investigations of Trading Activities

Requests for information should be referred directly to the CCO.

The investigation of an employee transaction will be determined by reasonable criteria, including consideration of the timing or unusual nature of the transaction. All investigations initiated must be documented. At minimum, the record will include:

1. The name of the security;
2. The date the investigation commenced;
3. An identification of the accounts involved; and
4. A summary of the investigation disposition.

The CCO and/or DP shall create a memo for every investigation and attach any exhibits found necessary to evidence a detailed investigation of the trading activity. The CCO and/or DP shall date and sign the memo to record the evidence of the investigation.

6.7 Disciplinary Actions

Violations of the Insider Trading Act can result in severe penalties to the Firm, DPs, and the individuals violating the Act. Violations (whether inadvertent or intentional) will not be tolerated by the Firm and will result in severe disciplinary action including immediate termination.

6.8 Training

The Firm will educate Associated Persons on prohibited activities upon hire and annually at the Annual Compliance Meeting/Interview. All Associated Persons must complete an attestation, which is required annually.

The Firm's initial training will give an overview of the Firm's insider trading procedures. All new hires are responsible for reviewing the Firm's insider trading procedures. Evidence of such review will be documented when the new hire signs the Firm's attestations.

The CCO is responsible for ensuring that all new and revised insider trading regulations are communicated to the appropriate Associated Persons. It is the responsibility of all Associated Persons to review and familiarize themselves with new or revised insider trading regulations. Evidence of training should be documented in the Firm's compliance files.

7. COMMUNICATIONS WITH THE PUBLIC

Below is an explanation of communications procedures and guidelines. These procedures apply not only to communications with the public, but also to internal communications among Associated Persons. The Firm's training program is designed to summarize many of these areas as well as provide additional requirements.

7.1 General Requirements

All Associated Persons are required to:

- Adhere to the Firm's procedures;
- Use only authorized communications (including only authorized email accounts and fax machines);
- Immediately report any oral or written customer complaints to the CCO;
- Follow content requirements for both oral and written communications; and
- Sign and abide by the Communications Agreement.

Failure to follow the Firm's supervisory and review procedures and regulations in general may subject the Associated Person to internal and/or regulatory disciplinary action. All supervisory approvals are to be documented in writing by the DP.

Initial and annual communications training is required for all Associated Persons.

Supervisors and designated persons are not to assume any responsibilities unless adequate training has been delivered.

All current procedures are in effect until amended. All issues relating to non-compliance are to be immediately reported to the CCO. Supervisors and/or Associated Persons may not approve their own correspondence.

7.2 Approved Venues of Communications

The Communications Agreement defines all venues of communications including:

- Email
- Written correspondence
- Advertising / sales literature
- Other pre-approved electronic means of communication
- Telephone calls or personal meetings, while not reviewable, are subject to the same restrictions as defined in this document.

Associated Persons are responsible for ensuring that duplicate copies of all communications are provided to the DP.

7.3 Minimum Training Requirement

All communications must be pre-approved by the DP until the individual has taken the communications training and has been cleared by the CCO. All Associated Persons are responsible for reviewing, understanding, and acknowledging compliance with the FINRA Training Guide. This will be documented in the Communications Agreement.

7.4 Pre-Approval Requirements

The following areas must be approved by the DP prior to use:

- Advertisements, including print, radio, television, or video
- Sales literature
- Press releases
- Research reports
- Rankings
- Independently prepared reprints
- Scripts
- Websites
- Testimonials
- Instant messaging
- Text messaging
- Social networking sites (*e.g.,* LinkedIn)
- Other areas as specified in the Communications Agreement

7.5 Correspondence Procedures

- All Associated Persons are to adhere to the content standards and guidelines below. The Communications Agreement defines all approved venues of communication. For any content requiring pre-approval, such materials are to be emailed, faxed, or otherwise delivered to the DP prior to distribution or publication. Additional training is always available upon request.
- Associated Persons are responsible for maintaining evidence of principal approval.

- All communications are subject to internal review.
- Failure to adhere to the Firm's procedures may result in disciplinary action.

7.6 Specific Requirements of Communications

Communications with the public must:

- Be based on principles of fair dealing and not omit material information, including risk disclosure;
- Not make exaggerated, unwarranted, or misleading claims;
- Give the investor a sound basis for making an investment decision;
- Not contain predictions or projections of investment results; and
- Not guarantee any investment results.

7.7 Content Standards

All communications with the public must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading.

No Associated Person may make any false, exaggerated, unwarranted, or misleading statement or claim in any communication with the public. No member may publish, circulate, or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion, or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy.

7.8 Guidelines to Ensure Communications Are Not Misleading

Statements must not be misleading in the context they are made. A statement made in one context may be misleading even though it could be appropriate in another context. An essential test for this principle is the balanced treatment of risks and potential benefits. Communications should be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return, and yield inherent to investments.

The nature of the audience to which the communication will be directed must always be considered. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed. Additional information or a different presentation of information may be required depending upon the medium used for a particular communication and the possibility that the communication might reach a larger or different audience than the one initially targeted.

Communications must be clear. A statement made in an unclear manner can cause a misunderstanding. A complex or overly technical explanation may be more confusing than too little information.

With public communications, income or investment returns may not be characterized as tax-free or exempt from income tax when tax liability is merely postponed or deferred, such as when taxes are payable upon redemption.

In advertisements and sales literature, references to tax-free or tax-exempt income must indicate which income taxes apply, or which do not, unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds is subject to state or local income taxes, this fact must be stated, or the illustration must otherwise make it clear that income is free only from federal income tax.

7.9 Recommendations

In making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose any of the following situations which are applicable:

- Whether the member was making a market in the securities being recommended or in the underlying security if the recommended security is an option or security future, or that the member or associated persons will sell to or buy from customers on a principal basis.

- That the member and/or its officers or partners have a financial interest in any of the securities of the issuer whose securities are recommended and the nature of the financial interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position), unless the extent of the financial interest is nominal.
- That the member was manager or co-manager of a public offering of any securities of the recommended issuer within the past 12 months.
- That a security may provide certain tax benefits to clients based upon current tax structure, and that there can be no guarantee that tax rules will not change and render these benefits useless during the term of this investment.

The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendation.

Recommendations on behalf of corporate equities must provide the price at the time the recommendation is made.

7.10 Referencing Past Recommendations

Any communications referring to past recommendations must set forth all recommendations as to the same type, kind, grade, or classification of securities made by the Firm within the last year. Longer periods of years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended and give the date and nature of each recommendation (i.e., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and the general market conditions during the period covered.

Also permitted is material that makes no specific recommendation but which offers to furnish a list of all recommendations made by a member within the past year or over longer periods of consecutive years, including the most recent year, if this list contains all the information specified in the paragraph above.

Neither the list of recommendations, nor material offering such list, shall imply comparable future performance. Reference to the results of a previous specific recommendation, including such a reference in a follow-up research report or market letter, is prohibited if the intent or the effect is to show the success of a past recommendation, unless all of the foregoing requirements with respect to past recommendations are met.

7.11 Public Appearances

"Public appearances" are defined as a type of communication with the public. All content standards that apply to general communications also apply to public appearances. Consequently, public appearances are subject to strict content requirements.

Public appearances include participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity. For the purposes of NASD Rule 2210, since "public appearance" is defined to include an interactive electronic forum, Internet chat rooms constitute public appearances rather than advertisements or sales literature.

Any Associated Person engaging in public appearances must get prior approval from the DP. An outline and all materials that are to be used must be provided prior to all speaking engagements. The DP must train Associated Persons to ensure that there are no discussions that would require pre-filing with FINRA.

7.12 Supervisory Review Procedures

- All DPs responsible for reviewing correspondence are to receive adequate training related to supervisory reviews. Such training is to be conducted initially upon designation as a DP and periodically thereafter.
- The DP may utilize designees to assist in conducting reviews. Very extensive training must be delivered to and documented for any such designee. All content requiring supervisory approval must be immediately delivered to the DP. Although designees may be utilized, the DP must also take independent samples to include all Associated Persons assigned to such DP. All designee and DP reviews are to be documented on a review log, the item of correspondence, or another acceptable form of documentation. Designees are not to act in any supervisory capacities. DPs are to review and approve all designee reviews.
- Any issues related to non-compliance are to be handled by the DP and CCO.
- Such reviews are not required to be carried out in real time; however, they must be timely in order to take corrective actions in any problematic areas.
- Sample sizes are to be reviewed by the CCO, and the CCO is responsible for ensuring that such reviews are appropriate given the Firm’s business and risk.

7.13 Email Supervisory Reviews

- Evidence of email reviews is to be maintained in an email review log that should detail the number of emails reviewed, sampling methodology, review notes, and/or concerns noted.
- In the event that the Firm uses sampling procedures, the sampling methodology must be documented on the supervisory log. Sampling methodology should ensure that all Associated Persons are subject to review.
- Keyword searches shall be used to complement such reviews if sampling procedures are used.
- Reviewers will look for content standards and other compliance issues, including outside business activities, private securities transactions, selling away, manipulation, etc.

7.14 Incoming Correspondence

- Incoming correspondence is to include incoming mail and/or faxes.
- All incoming correspondence is to be reviewed by the DP, or designee, prior to distribution. 100% of all incoming correspondence is to be reviewed. Evidence of review will be on an incoming mail log, on the piece of incoming correspondence, or another acceptable form of documentation.
- All incoming correspondence will be copied prior to distribution and maintained in order to comply with Rule 17a-4 under the Securities Exchange Act of 1934.
- The DP must inform the CCO if there are any customer complaints and/or grievance items or issues relating to the handling of customer funds and/or securities. All designees are to communicate all such issues to the DP.
- Associated Persons are not to directly receive any incoming correspondence unless exceptions are made in branch office procedures.
- The CCO is responsible for ensuring that internal inspections are conducted to review incoming correspondence.

7.15 Outgoing Correspondence

Associated Persons are responsible for ensuring that copies of all communications are delivered to their assigned DP and all letters requiring prior approval are properly handled. Associated Persons are not permitted to send letters from any venues other than approved venues of communication (see Communications Agreement). All outgoing correspondence will be subject to supervisory review.

For any emails, letters, faxes, or other correspondence sent to more than one recipient, a list of all intended recipients must be attached.

7.16 Advertisements[1] and/or Sales Literature[2]

- All advertisements and/or pieces of sales literature must be pre-approved by the DP.
- All advertising or sales literature is to be approved on the Firm's Advertising Approval Form or the piece of advertising or sales literature.
- Institutional sales materials are excluded from the FINRA filing requirements; however, they still require pre-approval by the DP.
- Sales literature includes any piece of sales literature sent to more than 25 clients or prospective clients.

7.17 Research Reports

"Research report" is defined as "a written or electronic communication that includes an analysis of equity securities or individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision." Previously, the definition also required that the communication include a recommendation.

A research analyst is any associated person of a member who is primarily responsible for the preparation of the substance of a research report on equity securities or whose name appears on a research report on equity securities. For the purposes of determining who needs to register as a research analyst, the term "research report" has the same meaning as it does in Rule 2711(a)(8): **"a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment**

[1] "**Advertisement**" Any material, other than an independently prepared reprint and institutional sales material, that is published, or used in any electronic or other public media, including any Web site newspaper, magazine or other periodical, publicly available web sites, bulletin board postings, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories (other than routine listings).

[2] "**Sales Literature**" Any written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made generally available to customers or the public, including circulars, research reports, market letters performance reports or summaries, form letters, telemarketing scripts, seminar texts, reprints (that are not independently prepared reprints) or excerpts of any other advertisement, sales literature or published article, and press releases concerning a member's products or services.

decision." Notices to Members 02-39 and 04-18 should be referred to for interpretation of the definition of a "research report" under 2711(a)(8).

Prohibition from Issuing Research

The Firm prohibits Associated Persons from producing any research reports unless they qualify through the Series 86 and 87 examinations and receive approval from the Compliance Department. In the event that research is offered, the Firm will implement additional procedures to be followed by research analysts.

Research Report Exceptions

The following are exceptions to the definition of research report:

- Reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index, that do not recommend or rate individual securities.
- Reports commenting on economic, political or market conditions that do not recommend or rate individual securities.
- Technical analysis concerning the demand and supply for a sector, index or industry based on trading volume and price.
- Statistical summaries of multiple companies' financial data (including listings of current ratings) that do not include any narrative discussion or analysis of individual companies' data.
- Reports that recommend increasing or decreasing holdings in particular industries or sectors but that do not contain recommendations or ratings for individual securities.
- Notices of ratings or price target changes that do not contain any narrative discussion or analysis of the company, provided that the member simultaneously directs the readers of the notice as to where they may obtain the most recent research report on the subject company that includes the disclosures required by the SRO Rules. In no event should such a notice refer to a research report that contains materially misleading disclosure, i.e., where disclosures are no longer applicable or new disclosures would pertain.
- An analysis prepared by a registered representative for a specific customer's account.
- Internal communications that are not given to customers.

A client communication that analyzes individual securities or companies will be considered a research report if it provides information reasonably sufficient upon which to base an investment decision and is distributed to at least 15 persons. This conclusion

applies even if the author of the communication does not hold the title of "research analyst" and does not work in the Firm's research department.

Financial Interest

Associated Persons must disclose if the member or its officers or partners have a financial interest in any of the recommended issuer's securities, and the nature of the financial interest, unless the extent of the financial interest is nominal. A member that discloses in its research reports that it owns one percent or more of any class of common equity securities of a recommended issuer will be deemed to be in compliance with the requirement to disclose its financial interest.

7.18 Social Media

Any website or webpage that allows for interactive electronic communications is considered social media, regardless of whether such website is known as a social media or social networking site. Websites like Facebook, LinkedIn, and Twitter are clearly social media sites. However, other websites that are not typically considered social media may have components that are social media. For example, a website that has a chat forum would be deemed social media. Even a news website could be deemed social media if it allows readers to post comments about articles or otherwise communicate with other readers or the public.

Social Media Policy

Associated Persons are prohibited from using social media to conduct business unless they obtain the prior written approval of the Designated Principal. Associated Persons wishing to utilize social media in any way for business purposes should submit a written request to the Designated Principal. The Designated Principal will formally approve or deny the request in writing. The Firm will not approve any form of social media that it cannot reasonably supervise.

Recordkeeping

The Firm must maintain records of communications made through social media. Due to the technical difficulty of enforcing this requirement, the Firm will not approve the use of social media unless it has a means to capture records of communications. The approval of social media will generally necessitate the use of a third party vendor, such as Global Relay or SMARSH, to archive electronic communications. The Firm will make sure it files the electronic storage media notifications prior to relying on a third party for the storage of electronic media.

Recommendations

Registered Representatives may not use social media for making investment recommendations unless the Designated Principal has previously approved both the content of the communication and the Associated Person's use of social media.

Static and Interactive Electronic Forums

A "blog" is generally defined as a website that contains an online personal journal with reflections, comments, and often hyperlinks provided by the writer. Historically, some blogs have consisted of static content posted by the blogger. FINRA considers static postings to constitute "advertisements." If an Associated Person sponsors such a blog, he must obtain prior principal approval of every posting. However, many blogs now enable users to engage in real-time interactive communications. If the blog were used to engage in real-time interactive communications, FINRA would consider the blog to be an interactive electronic forum.

Social networking sites typically contain both static and interactive content. The static content remains posted until it is changed by the Firm or the individual who established the account on the site. Generally, static content is accessible to all visitors to the site. Examples of static content typically available through social networking sites include profile, background, or wall information. As with other web-based communications such as banner advertisements, the Designated Principal must approve all static content on a page of a social networking site established by the Firm or an Associated Person before it is posted.

Social networking sites also contain non-static, real-time communications, such as interactive posts on sites such as Twitter and Facebook. The portion of a social networking site that provides for these interactive communications constitutes an interactive electronic forum. The Firm will supervise the use of an approved interactive electronic forum in a manner reasonably designed to ensure that its Associated Persons do not violate the content requirements of FINRA's communications rules.

Third-Party Posts

If the Firm's customer or other third party posts content on a social media site established by the Firm or its personnel, FINRA generally will not treat posts by customers or other third parties as the Firm's communication with the public. Thus, the prior principal approval, content, and filing requirement generally do not apply to these posts. Under certain circumstances, however, third-party posts may become attributable to the Firm. Whether third-party content is attributable to the Firm will depend on whether the Firm has (1) involved itself in the preparation of the content or (2) explicitly or implicitly endorsed or approved the content.

The SEC has referred to the circumstance in (1) above as the "entanglement" theory (*i.e.*, the Firm or its personnel is entangled with the preparation of the third-party post) and in (2) as the "adoption" theory (*i.e*., the Firm or its personnel has adopted its content). Although the SEC has employed these theories as a basis for a company's responsibility for third-party information that is hyperlinked to its website, a similar analysis would apply to third-party posts on a social media site established by the Firm or its personnel. FINRA would not consider a third-party post to be a communication with the public unless the Firm or its personnel either is entangled with the preparation of the third-party post or has adopted its content.

Testimonials

Associated Persons are prohibited from inducing others to post content on a website. Moreover, Associated Persons who are permitted to use social media may not display any testimonial or recommendation, regardless of whether or not the Associated Person requested the testimonial or recommendation.

Supervision of Social Media

The Firm will adopt policies and procedures reasonably designed to ensure that its Associated Persons who use social media for business purposes are appropriately supervised, have the necessary training and background to engage in such activities, and do not present undue risks to investors. The Firm's general policy prohibits any Associated Person from engaging in business communications in a social media site without obtaining prior written approval. Associated Persons approved to use social media will receive adequate training on the Firm's policies and procedures regarding interactive electronic communications before engaging in such communications. The training will generally be individualized based on the type of social media approved.

The Firm will employ risk-based principles to determine the extent to which the review of incoming, outgoing, and internal electronic communications is necessary for the proper supervision of business. For example, the Firm may adopt procedures that require principal review of some or all interactive electronic communications prior to use or may adopt various methods of post-use review, including sampling and lexicon-based search methodologies. The Designated Principal will determine the type of review based on his or her assessment of risk. The Firm may consider strictly prohibiting or placing severe restrictions on any Associated Person who has presented compliance risks in the past, particularly compliance risks concerning sales practices, from establishing accounts with a social media site.

7.19 SIPC Disclosure

The Designated Principal will ensure that the Firm, as a member of SIPC, continuously displays, in a prominent place, the official symbol at its principal place of business and at each branch office. In addition, the Firm will include in all advertising any required reproduction of the official symbol or the official advertising statement or the official explanatory statement. Furthermore, when the official symbol is used on the internet, "SIPC" will contain a hyperlink to SIPC's website. The following is a list of some of definitions as set forth by SIPC:

- **Advertising -**The term "advertising" as used means promotional material used in or on any newspaper, magazine, or other periodical, radio, television, telephone or tape recording, videotape display, motion picture, slide presentation, telephone directory, sign or billboard, electronic or other public media.
- **Branch Office -** The term "branch office" means any office of a member which is registered with or designated as a branch office with any self-regulatory organization.
- **Official Brochure -** The term "official brochure" means any publication so designated by SIPC which explains the purposes of SIPC and the protections it affords and which is authorized for public distribution.
- **Official Advertising Statement –** The statement is "Member of the Securities Investor Protection Corporation." The word "the" or the words "of the" may be omitted. The words "This firm is a" may be added before the word "member." The short title "Member of SIPC" or "Member SIPC" may be used by members at their option as the official advertising statement. When the official advertising statement is used on the internet, the words "Securities Investor Protection Corporation" and "SIPC" must contain a hyperlink to SIPC's website.
- **Official Explanatory Statement -** The term "official explanatory statement" means either: (1) "Member of SIPC, which protects securities customers of its members up to $500,000 (including $250,000 for claims for cash). Explanatory brochure available upon request or at www.sipc.org." or (2) "Member of SIPC. Securities in your account protected up to $500,000. For details, please see www.sipc.org." The words "Member of SIPC" may be omitted if the official explanatory statement is used in conjunction with the official symbol. When the official explanatory statement is used on the Internet, "SIPC" and "www.sipc.org" must contain a hyperlink to SIPC's website.
- **Official Symbol** - The term "official symbol," which may be displayed in a variety of sizes, colors or materials, should be of the following design:

When the symbol is so reduced in size that the words "member" and "Securities Investor Protection Corporation" are illegible, these words may be omitted. When the official symbol is used on the internet, "SIPC" must contain a hyperlink to SIPC's website.

The Designated Principal will ensure that the Firm is operating according to SIPC requirements. Specifically, the Firm will continuously display in a prominent place the official symbol at its principal place of business and at each designated branch office location. In addition, Firm will include in applicable advertising a reproduction of the official symbol or the official advertising statement or the official explanatory statement. Furthermore, when the official symbol is used on the Internet, "SIPC" will contain a hyperlink to SIPC's website.

7.20 Telemarketing and Cold Calling

Any Registered Representative wishing to engage in cold calling must contact the Compliance Department, and separate procedures will be drafted. These procedures will include a requirement to maintain a “Do Not Call” list. Upkeep and maintenance of the “Do Not Call” list should be done whenever someone requests that a Registered Representative not call again.

General Requirements

In the event that the Firm allows cold calling, Associated Persons are prohibited from initiating any telephone solicitation to:

- Any residence of a person before the hours of 8 a.m. or after 9 p.m. (local time at the called party's location), unless it has received that person's prior consent, or the person called is a broker-dealer;
- Any person that previously has stated that he or she does not wish to receive an outbound telephone call made by or on behalf of the Firm; or
- Any person who has registered his or her telephone number on the Federal Trade Commission's national do-not-call registry.

Additionally, the following information must be disclosed when cold calling:

- The identity of the caller and the Firm;
- The telephone number or address where the caller may be contacted; and

- That the purpose of the call is to “solicit the purchase of securities or related services.”

Supervision and Approval

All cold calling scripts must be pre-approved by the Designated Principal. The Designated Principal will be responsible for approving calling scripts as soon as they are created or revised and before they are used. Evidence of review will be documented and maintained in the approved scripts file.

8. Account Procedures

NASD Rule 3110 requires each firm to maintain records of customers' accounts. The new account form and other account documents will support investment recommendations and suitability of investments. This information must be updated whenever an investment recommendation is not consistent with the client's investment objectives, income, net worth, and/or other essential suitability related information. These variables are essential to document if they are changed. Clients must be informed to notify the Firm of any significant changes in their investor profile information.

8.1 New Account Profile Requirements

The following information must be documented upon opening a new account and updated whenever it is changed:

> Customer's or owner's name, tax identification number, address, telephone number, date of birth, employment status (including occupation and whether the customer is an associated person of a member, broker or dealer), annual income, net worth (excluding value of primary residence), and the account's investment objectives. In the case of a joint account, the account record must include personal information for each joint owner who is a natural person; however, financial information for the individual joint owners may be combined. The account record shall indicate whether it has been signed by the Associated Person responsible for the account, if any, and approved or accepted by a principal of the member, broker or dealer.

For **INSTITUTIONAL ACCOUNTS**[3], it should be documented who the control persons and/or authorized persons are and that they are capable of evaluating the investment risks. Additional reviews are to be done in accordance with CIP Procedures.

For **JOINT ACCOUNTS**, the account record must include personal information for each joint owner who is a natural person; however, financial information for the individual joint owners may be combined.

[3] (A) A bank, savings and loan association, insurance company, or registered investment company; (B) An investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (C) Any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

8.2 Responsibilities of the Registered Representative

The Registered Representative is responsible for determining whether sufficient information has been obtained from the client to determine the suitability of securities transactions. The Client Profile information must be updated at least every 3 years (see Client Verification Procedures below). Changes in client profile information are to be immediately reported to the Registered Representative and the Representative is responsible for making certain the Firm's records are updated.

For all new accounts that are opened, Registered Representatives should complete a New Account Profile. Representatives must sign and date (hard copy or electronically) New Account Profiles.

Each Registered Representative must verify the following information is complete (as stated in SEC Rule 17a-3(a)(17)):

- The customer's or owner's name;
- The customer's or owner's tax identification number;
- The customer's or owner's address;
- The customer's or owner's telephone number;
- The customer's or owner's date of birth;
- The customer's or owner's employment status (including occupation and whether the customer is an associated person of a broker/dealer);
- The customer's or owner's annual income;
- The customer's or owner's net worth (excluding value of a primary residence);
- The account's investment objectives;
- An indication of whether the record has been signed by the Associated Person responsible for the account, if any, and approved or accepted by a DP of the Firm;
- If the account is a discretionary account, the dated signature of each customer or owner granting the authority and the dated signature of each natural person to whom discretionary authority was granted.

8.3 Discretionary Accounts

All discretionary accounts are to be pre-approved by the DP. Prior to opening a discretionary account, a Power of Attorney (see below) must be completed and approved by the DP.

Power of Attorney

There are two types of power, which a customer may give to another party:

1. **Limited**—trading authorization limited to security transactions.
2. **Full**—authorization to trade, deposit, and withdraw securities and funds.

These respective authorizations must be specified in the client agreement (Power of Attorney). Registered Representatives are not authorized to have full discretionary authority (except for employee-related accounts for members of the immediate family). All such accounts are to be pre-approved by the DP.

Third Party Discretionary Accounts

A third party account is one in which trading authority is vested in someone other than an Associated Person of the Firm. Primary account holders may issue either a "limited" or "full" power trading authorization to a third party. Trading authorizations must be obtained stating the type of power being granted, the name of the principal for whom the agent is acting, and written evidence of the agent's authority. Such authorization is to be approved by the DP and approved in accordance with the Firm's Customer Identification Procedures.

8.4 Exceptions

The SEC's Interpretive Release notes that the account record requirement of Rule 17a-3(a)(17) does not apply to accounts for which the customer or owner is not a natural person, such as the accounts of:

- Corporations
- Partnerships
- Limited liability companies
- REITs
- Accounts owned by the trustees of the trust or a trust that is a legal entity separate from the holders of its beneficial interests (which may be natural persons).

8.5 Welcome Letter

The Firm will send a welcome letter to all clients with a regulatory disclosure brochure containing the following: Margin Disclosure, Privacy Disclosure, AML Disclosure, Identification of Compliance Contact for Customer Complaints (address and telephone number), Options Disclosure (if applicable), and Business Continuity Summary.

8.6 Customer Address Changes/Change in Investment Objective

The DP is responsible for monitoring and detecting any suspicious activity in regard to address changes or changes in a customer's investment objective. It is the responsibility of the Registered Representative to submit changes of address or investment objective to a DP for approval. Changes in address and investment objective must be verified by the Registered Representative with the customer. Verification is done in writing to the customer, to the existing and new address. The verification packet is sent out by the clearing firm. When a client moves to a different state, the Registered Representative servicing the account must verify that he is registered with the new state before conducting or soliciting securities business. Registered Representatives are prohibited from conducting or soliciting business in any states with which they are not registered.

8.7 Approval and Documentation Procedures for Changes in Account Name/Designation

Under amended NASD Rule 3110, before a customer order is executed, the account name or designation must be placed on each order ticket/memoranda for each transaction. Upon the change in an account name or designation on a customer order, the Registered Representative is responsible for obtaining approval by a DP. Only a DP may approve any changes in account name or designations. The DP must document the essential facts relied upon in approving the changes and maintain the record in a central location. A member must preserve any account designation change documentation for a period of no less than three years, with the documentation preserved for the first two years in an easily accessible place, as the term "easily accessible place" is used in SEC Rule 17a-4.

8.8 P.O. Boxes

Each branch manager or DP is to approve all PO Boxes in accordance with the Anti-Money Laundering Procedures. Such approval is to consider the type of account, the relationship with the Registered Representative, the funding of the account, and any other relevant factors.

8.9 Death of a Customer

All orders and instructions of a customer should be canceled upon notification of his/her death. The account should not be liquidated nor should any further action be taken until instructions and the necessary documents are obtained from the accredited

representative of the estate (administrator or executor). No order should be taken in an estate account until all the stocks have been transferred into street name. Any open positions that are subject to market volatility (e.g., naked option positions) should be monitored and immediately reported to the CCO for further review.

8.10 Customer Account Transfers

The broker is required, upon receipt of a transfer instruction, to validate or reject such instruction within five (5) business days, and to ensure the actual transfer of all security and money balances, within five (5) business days after validation. All brokerage account transfers are handled by the clearing firm.

8.11 Furnishing the Account Record

The Registered Representative is responsible for ensuring that, for each account with a natural person as a customer or owner, there is a record indicating that:

- The Firm has furnished each customer who opens an account with a copy of the account record that includes the suitability information required above (or an alternative document containing that information) within 30 days of the opening of the account, and at least every 36 months thereafter. The Firm may choose to exclude any tax identification number and date of birth from the account record or alternative document furnished to the customer or owner.
- The Firm has obtained account record information for each customer or owner of every account in existence before May 2, 2003, and furnished the customer with a copy of the account record (or an alternative document containing that information) by May 2, 2006.
- The Firm has included an explanation of any terms regarding investment objectives with the account record or alternative document provided to each customer or owner.
- The Firm has included with the account record or alternative document prominent statements that the customer or owner should mark any corrections and return the account record or alternative document to the Firm, and that the customer or owner should notify the Firm of any future changes to information contained in the account record.
- The Firm has furnished the customer or each joint owner, and the Associated Person responsible for that account (if any), with notification of any change in the account record to the name or address of the customer or owner on or before the 30th day after the date the Firm received notice of the change. If it is an address change, the notifications should be sent to that customer's old address.

- For each change in an account's investment objectives, the Firm has furnished each customer or owner, and the Associated Person responsible for that account (if any), with a copy of the updated customer account record that includes the information required above (or an alternative document containing that information), on or before the 30th day after the date the Firm received notice of the change (or, if the account was updated for some reason other than the Firm receiving notice of a change, after the date the account record was updated).
- Each customer has been provided a copy of each written agreement entered into on or after May 2, 2003 pertaining to the account and, if requested by the customer, he or she was furnished with a fully executed copy of each agreement. "Written agreements" include customer account agreements, margin agreements, options agreements, or securities lending agreements.
- Each customer has been provided with a notice containing the address and telephone number of the department of the Firm to which any complaints concerning the account may be directed.

8.12 Multiple Accounts

The SEC posed the following question and answer regarding multiple accounts: If one customer has a personal account, a separate IRA account, and a trust account for his child at the same broker/dealer, and has agreed in writing to receive account-related documentation, such as account statements, on a combined basis, may the firm meet its requirements under Rule 17a-3(a)(17) by combining in one mailing the account record information for all three accounts? Would the answer be different if spouses living at the same address each had a personal account and agreed to receive account documents on a combined basis for their personal accounts?

In response, the SEC stated that if the customer has agreed in writing to receive account-related documentation on a combined basis for multiple accounts at the same address, the broker/dealer may send account record information regarding each of those accounts to the customer in a combined mailing. However, the account record information should be separated by account so the customer can easily identify the account record information that relates to each account. If spouses living at the same address have agreed to receive account documents on a combined basis for their personal accounts, the firm may send account record information regarding each of those accounts to the customer in a combined mailing.

8.13 Exemption from the Account Record Information and Furnishing Requirements

The account record and furnishing requirements of Rule 17a-3(a)(17) will only apply to accounts for which the Firm is, or has within the past 36 months been, required to make a suitability determination under the federal securities laws or under the requirements of a self-regulatory organization of which it is a member.

8.14 Margin and Regulation T

Registered Representatives should discuss with customers opening margin accounts the interest charges, initial and maintenance margin requirements, and sell-out procedures applicable to margin accounts. When opening a margin account, a DP must approve the account prior to a margin transaction. A signed margin agreement must be received from the customer no later than 15 calendar days after the initial transaction in the account.

Regulation T (Reg T) is a rule of the Federal Reserve Board (FRB) which governs the extension of credit from any financial institution to any customer for the purchase of securities. Brokerage firms are directly limited in their ability to finance their customer's securities transactions through an extension of credit. The DP is responsible for supervising and overseeing the application of Reg T. The Principal manager will work in conjunction with the trading area or margin manager to monitor the uses and abuses of margin accounts. The Principal is also responsible for monitoring the activities of the representatives to detect and prevent any inappropriate margin or credit agreements between the representative and his customers. The activities, transactions, and correspondence between a representative and his client should be reviewed with regard to the improper extension of credit to customers. Representatives may not arrange for financing or loans to customers outside of the Firm's standard margin policies. Representatives may not make private loans to customers either through the Firm or through any other private or public financing means.

During the customer account review, the method and timing of payments should be reviewed to ensure that there is no excessive or improper use of margin for the payment of securities transactions. Customer correspondence should be reviewed for any mention of loans or guarantees of payment or other methods of creative financing which would circumvent Reg T. During the periodic review of the representative's business activities any evidence of loan agreements or promissory notes between the representative and a customer or any other entity should be thoroughly reviewed and the information forwarded to the CCO. In addition, any customer transaction or debit

paid for by an account of any Associated Person of the Firm or any account controlled by an Associated Person should be carefully scrutinized and brought to the attention of the Compliance Department.

The DP is responsible for ensuring that all margin agreements are signed by the client and in the respective client's file prior to any margin activity. All margin and Reg T records for the firm should be maintained for a minimum of three years, with the first two years being a readily accessible place.

8.15 Maintenance of Order Tickets

According to SEC Rule 17a-3, broker-dealers are required to make and maintain, "A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted."

The DP is responsible for ensuring that order tickets contain all required information. The DP is also responsible for prompt review and approval of each order ticket. Most of the Firm's order tickets are automatically generated upon entering into the back office clearing system. It is important to document the following information:

- Customer name and account number
- Trade date
- Security, quantity, price
- Fair pricing
- CUSIP if applicable
- Type of transaction - buy, short sale, long sale
- Affirmative determination if it is a short sale
- Solicited or unsolicited transaction
- Registered representative
- Name of person entering the order (if not the Registered Representative)
- Name of all other persons handling the order
- Time stamps for all material events (*i.e.,* acceptance, entry, execution)

The DP is responsible for reviewing the order tickets for proper completion. This review should include verification of the necessary time stamps and, for each customer sell order, the location of the security. Order tickets must contain the information listed above.

The DP shall promptly review and approve each order ticket, noting that affirmative determination has been made on each short sell order. This order ticket review and approval shall be evidenced at the time of approval of daily trading activity.

On the day after the transaction (T +1), the DP (or Registered Representative if delegated) will receive and review the execution report provided by the clearing firm and compare it to any order tickets. By matching the order ticket to the execution report, it is evidenced that the order ticket and the confirmation have been reviewed and compared. Prompt review and approval of the order ticket is defined as the next business day. Exceptions are to be requested in writing.

8.16 Confirmation Disclosures

The Firm is required to send confirmations upon the completion of each transaction pursuant to SEC Rule 10b-10. Confirmations shall contain the date of the transaction, the identity, price, and number of shares or units of such security purchased or sold by the customer, along with any other disclosures required according to Rule 10b-10.

8.17 Sale of Restricted Securities

SEC Rule 144 provides a method for the resale of restricted or control securities. Rule 144 provides a safe harbor for the resale of restricted and control securities. It includes conditions, which, if satisfied, permit holders of such securities to sell them publicly without registration and without being deemed underwriters. Rule 145 governs the offer or sale of securities received in connection with reclassifications, mergers, consolidations, and asset transfers. Sellers under Rule 145 are afforded a similar safe harbor to Rule 144 sellers.

Trading should be consulted directly for assistance regarding the processing of Rule 144 and Rule 145 sales. Copies of paperwork regarding Rule 144 and Rule 145 transactions should be kept at the branch and a copy should be forwarded to the Compliance Department.

Restricted securities generally are securities that were:

- Acquired directly or indirectly from the issuer or from an affiliate of the issuer in a transaction or series of transactions not involving a public offering.
- Acquired from the issuer and are subject to the resale limitations of Regulation D under the Securities Act of 1933 or acquired in a transaction or series of transactions not involving a public offering subject to the resale limitations of Regulation D.

The CCO is responsible for the review and approval of any transaction conducted in restricted securities. All paperwork associated with the sale of restricted securities (primarily Form 144) will be forwarded to the CCO for review. The CCO will review the paperwork for completeness and for the proper documentation necessary for the transfer agent to make an appropriate decision about the transferability of the certificates.

Any obvious restriction to the immediate transfer of the securities will be noted and the explanation will be provided to the customer. If the restriction requires the opinion of counsel of the issuer, the CCO will instruct the customer on the requirements of the Rule and will instruct the customer to provide all necessary Rule 144 paperwork prior to the selling the security. In no instance will the Firm allow the execution of a short sale to precede the clearance of restricted securities.

The approval of the sale of restricted securities will be evidenced by the initialing of the Form 144 and any other paperwork submitted with the transaction including the order ticket. A copy of all such paperwork will be maintained in a separate Rule 144 file by the Compliance Department. This review and approval is to be conducted on a trade-by-trade basis.

9. HANDLING OF CUSTOMER FUNDS AND SECURITIES

9.1 Handling of Customer Funds

The following procedures govern the handling of customer funds at all branch office locations.

Receipt of Customer Funds

The Firm may receive customer checks made payable to an appropriate third party (*e.g.,* clearing firm, insurance company, investment company). The Firm may also receive customer checks made payable CapFinancial Securities LLC.

Verifying that Checks are in Good Order

All checks must be reviewed to ensure that they are in good order and do not contain any "red flags." A check is considered to be in good order if it is:

- signed by the check holder
- dated
- the area for the written amount of the check is completed
- the payee line is complete
- the check does not appear fraudulent or contain any red flags

Direct Business

Customer checks for direct business must be made payable to the appropriate third party, which is typically an investment company or insurance company.

Clearing Firm Business

Customers checks for clearing firm business may be made payable either directly to the clearing firm or to CapFinancial Securities LLC.

Third Party Checks

Third party checks[4] may be accepted; however, a third party check must be scrutinized because the check is drawn on an account not belonging to the customer (*i.e.,* the check writer, or the drawer of the check, is not the customer). Since the check writer is unknown to the Firm, third party checks should be reviewed for anti-money laundering

[4] A third party check is any check that is drawn on an account with a name that is not identical to the name on the customer's account.

(AML) concerns, including the source of the funds and an OFAC search of the check writer.

Double-Endorsed and Multiple-Endorsed Checks

The Firm discourages the acceptance of checks endorsed over to a customer[5]. The acceptance of such checks must be approved by a supervisor and documented. The Firm must follow the clearing firm's guidelines on endorsing customer checks.

Checks Made Payable to the Firm

Checks made payable to CapFinancial Securities LLC may be accepted for clearing firm business only.

Unacceptable Forms of Customer Deposits

The following customer deposits are unacceptable and must be returned to the customer:

1. Coin or currency;
2. Foreign instruments;
3. Thrift withdrawal orders;
4. Domestic drafts;
5. Checks not endorsed in accordance with the Uniform Commercial Code;
6. Checks referring to more than one account (the clearing firm does not split proceeds from one check into multiple accounts);
7. Checks from minors;
8. Stale-dated checks (over three months old);
9. Any checks from federal, state, or local entities;
10. Travelers checks; and
11. Credit card checks.

[5] The Uniform Commercial Code allows a check to be transferred to a new owner any number of times. In practice, however, double-endorsed and multiple-endorsed checks are uncommon since it is difficult to verify the signatures of all endorsers. The Firm discourages the acceptance of any checks endorsed over to a customer because such checks require not only an AML review of the check writer but also a review of the payee(s) who endorsed the check over to the customer.

Cash and Cash Equivalents

The Firm prohibits the receipt of cash and all cash equivalents. A Registered Representative should immediately notify the Firm's Anti-Money Laundering Compliance Officer (AMLCO) if a customer requests that the Firm accept cash.

Checks for Investment Advisory Services

Any checks that are received for investment advisory services may be made payable to the Investment Advisor so long as the advisory agreement stipulates the fee structure and services to be provided. Separate files and blotters should be maintained for check received for investment advisory services. The Investment Advisers Act of 1940 further defines "custody," and Associated Persons should refer to the Firm's Registered Investment Adviser Procedures Manual (RIA Procedures Manual).

Checks Made Payable to Other Parties

The Firm does not accept customer checks made payable to any other parties (*e.g.,* an Associated Person or a business controlled by an Associated Person).

Processing of Checks

All checks for clearing firm accounts received at the branch office must be promptly deposited (no later than noon of the following business day) to the respective customer account. Any checks that are held overnight are to be safeguarded. For all checks received, a blotter must be maintained containing the following data: customer account number, dollar amount, date received, and date forwarded. Although the Operations Personnel maintains this blotter, the Supervisor is ultimately responsible for overseeing the proper processing of checks.

The Firm's checks received and forwarded blotter is maintained in a "unit system" format. This "unit system" must include all required information. The Operations Personnel is to attach the daily deposit slip, which will evidence that the deposits were made by noon the next business day. Exceptions should be reported to the CCO and the Financial and Operations Principal (FINOP).

For any checks that are not for the clearing firm (including mutual funds, variable annuities, etc.), Operations Personnel will maintain a traditional blotter, which includes account number, dollar amount, date received, and date forwarded. The Operations Personnel is to make a best effort to forward all such non-clearing firm checks the same day that they are received. For any exceptions, evidence must be maintained to verify that the check was forwarded no later than noon of the next business day.

Wires

Approval of all wires to and from third parties must be approved by the DP. A Letter of Authorization (LOA) is required for all outgoing wires to a third party. Operations Personnel will document approval of wires after the firm considers anti-money laundering concerns. Registered Representatives, in addition to the main office, are responsible for verifying the legitimacy of wires.

Verification of Third Party Funds

Operations Personnel shall use discretion and verify any third party checks prior to acceptance. In such situations, the Operations Personnel is to verify that the check is valid by calling the appropriate bank and confirming that the check number is valid and funds are available. Any immediate disbursements shall be pre-approved by the Designated Principal.

9.2 Handling of Securities

The branch office is permitted to receive stock certificates so long as the certificates are promptly forwarded to the clearing firm on the day they are received. Any exceptions to this policy must be communicated immediately to the Supervisor; however, no exceptions will be granted for securities held later than noon of the following business day. The Operations Personnel should copy certificates (front and back) and maintain a blotter of securities received. The firm will maintain a Securities Received and Forwarded Blotter, which will record the account number, date received, quantity, name of security, certificate number, CUSIP (if available), and date forwarded. The Operations Personnel is to enter the certificate into the customer account using the back office system and print a receipt of this entry. All certificates are sent to the clearing firm via overnight mail (the receipt must be maintained). The blotter is to be completed and the certificates and receipts are to be filed.

The registration on all incoming securities must be identical to the registration on the account to which they are being deposited. For example, securities registered to a sole owner must be submitted for deposit to the identically-registered account; jointly-registered securities must be submitted for deposit only to an identically-registered account. The stock certificate should not be endorsed. The certificate should be accompanied by a stock power which assigns the stock to the clearing firm.

10. Sales Practice Guidance for Registered Representatives

The foundation of the securities industry is fair dealing with customers. Whether your work is with individuals, institutions, or business entities, your obligation as a Registered Representative is to serve your customers with honesty and integrity by putting their interests first and foremost.

The first step in serving your customers properly is to obtain a clear understanding of each customer's financial condition. You will obtain some of this information when opening a new customer's account. You may learn other information through conversations with your customer or checks the Firm makes with credit agencies or other financial institutions. Because a customer's financial status is constantly changing, account records should be updated whenever necessary.

The second step in serving customers properly is for both you and the customer to have a clear understanding of the customer's investment objectives. As a Registered Representative, you are trained to recognize the risks of various types of investments and to discuss with the customer which strategies are most suitable. Once you determine these objectives and record them in your customer's account records, you must make certain that specific recommendations for that customer fall within these objectives and would, therefore, be suitable. Just as your customer's financial position may change, your customer's investment objectives may change as well. You should, therefore, review your customer's investment objectives periodically, and make a written record of any changes as they occur.

The final step is to serve the client observing just and equitable principles of trade. This section of the Procedures Manual will provide guidance to Representatives as it relates to following appropriate guidelines to avoid problematic activity. The conduct and examples used are not inclusive. Engaging in other inappropriate conduct could lead to violations. It is important for Representatives to ask their supervisor or those in compliance when they are faced with decisions and/or challenges and allow for others to help evaluate the situation and to assist with determining the proper course of action. In conclusion, Representatives are expected to apply information that is learned from training and qualification examinations (including FINRA and State) to determine other inappropriate activities that should be avoided.

10.1 Examples of Sales Practice Violations

A customer may file a complaint against a Registered Representative alleging a sales practice violation. Such complaint would be required to be disclosed on the respective Representative(s) Form U-4. The following is how the relevant Form U-4 question reads:

Within the past twenty four (24) months, have you been the subject of an investment-related, consumer-initiated, written complaint, not otherwise reported under question 14I(1) or (2) above, which:

a) alleged that you were *involved* in one or more *sales practice violations* and contained a claim for compensatory damages of $5,000 or more (if no damage amount is alleged, the complaint must be reported unless the *firm* has made a good faith determination that the damages from the alleged conduct would be less than $5,000), or;

b) alleged that you were *involved* in forgery, theft, misappropriation or conversion of funds or securities?

The bottom line is that if a sales practice allegation (see definition below) is made, regardless of its merits, it must be disclosed if a good faith determination is made that the damages incurred was $5,000 or more. The following is the Form U-4 definition of Sales Practice Violation:

> ***SALES PRACTICE VIOLATIONS*** *shall include any conduct directed at or involving a customer which would constitute a violation of: any rules for which a person could be disciplined by any self-regulatory organization; any provision of the Securities Exchange Act of 1934; or any state statute prohibiting fraudulent conduct in connection with the offer, sale or purchase of a security or in connection with the rendering of investment advice.*

The following are examples of sales practice violations and Representatives are not to engage in such activities*:*

Misrepresentation

Representatives are not to provide false or misleading statements, claims, comparisons or omissions of material facts. This includes, but is not limited to, assurances and guarantees which are part of either oral or written communications or correspondence. Additionally, Representatives have a duty to disclose all material facts. Failure to disclose material facts also would be considered to be misrepresentation.

Unauthorized Trading

Representatives are not to effect any transactions without the customer's specific knowledge and approval. (***Note***: Margin liquidation and/or dividend reinvestments are not included.)

Excessive Trading

Representatives are not to effect trades that are excessive given the size, frequency, and character of the account in which trading was done solely to generate commissions or other compensation with disregard to the customer's investment objectives.

Suitability

Representatives are not to recommend any transaction unless there is a reasonable basis for believing, at the time of the transaction, that the customer had sufficient knowledge and experience in financial matters to reasonably be expected to be capable of evaluating the risks of the recommended transaction(s) and was financially able to bear those risks.

Failure to Follow Instructions

Representatives are to follow specific instructions from a customer, proper power of attorney holder, or other authorized parties.

Misappropriation/Forgery

Representatives are not to engage in any dishonest activities, including misappropriation of funds/securities or forgery.

Disclosure of Fees

Representatives have a duty to disclose all fees to clients. Representatives should inform clients when appropriate of any back-end fees associated with products. Examples include Contingent Deferred Sales Charges (CDSC) and/or surrender penalties.

10.2 High Standards and Just Principles

Each Registered Representative shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business. Acts and practices, including but not limited to the following, are considered contrary to such standards and may constitute grounds for disciplinary action, including termination.

1. Inducing trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account;

2. Recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the Representative;
3. Executing a transaction on behalf of a customer without authorization to do so;
4. Exercising any discretionary power in effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time and/or price for the executing of orders;
5. Executing any transaction in a margin account without securing from the customer a properly executed written margin agreement promptly after the initial transaction in the account;
6. Entering into a transaction with or for a customer at a price not reasonably related to the current market price of the security or receiving an unreasonable commission or profit;
7. Failing to furnish to a customer purchasing securities in an offering, no later than the due date of confirmation of the transaction, either a final prospectus or a preliminary prospectus and an additional document, which together include all information set forth in the final prospectus;
8. Charging unreasonable and inequitable fees for services performed, including miscellaneous services such as collection of monies due for principal, dividends or interest, exchange or transfer of securities, appraisals, safekeeping, or custody of securities and other services related to securities business;
9. Offering to buy from or sell to any person any security at a stated price unless prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell;
10. Representing that a security is being offered to a customer "at the market" or a price relevant to the market price unless the broker-dealer knows or has reasonable grounds to believe that a market for such security exists other than that made, created or controlled by such broker/dealer, or by any such person for whom he is acting or with whom he is associated in such distribution, or any person controlled by, controlling or under common control with such broker-dealer;
11. Effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive or fraudulent device, practice, plan, program, design or contrivance, which may include but not be limited to;

a. Effecting any transaction in a security which involves no change in the beneficial ownership thereof;

b. Entering an order or orders for the purchase or sale of any security with the knowledge that an order or orders of substantially the same size, at substantially the same time and substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties for the purpose of creating a false or misleading appearance of active trading in the security or a false or misleading appearance with respect to the market for the security; provided, however, nothing shall prohibit a broker-dealer from entering bona fide agency cross transactions for its customers;

c. Effecting, alone or with one or more other persons, a series of transactions in any security creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others;

12. Guaranteeing a customer against loss in any securities account of such customer carried by the broker-dealer or in any securities transaction effected by the broker-dealer or in any securities transaction effected by the broker-dealer with or for such customer;

13. Publishing or circulating, or causing to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to report any transaction as a purchase or sale of any security unless such broker/dealer believes that such transaction was a bona fide purchase or sale or such security; or which purports to quote the bid price or asked price for any security, unless such broker/dealer believes that such quotation represents a bona fide bid for, or offer of, such security;

14. Using any advertising or sales presentation in such a fashion as to be deceptive or misleading. An example of such practice would be a distribution of any nonfactual data, material or presentation based on conjecture, unfounded or unrealistic claims or assertions in any brochure, flyer, or display by words, pictures, graphs or otherwise designed to supplement, detract from, supersede or defeat the purpose or effect of any prospectus or disclosure; or

15. Failing to disclose that the broker-dealer is controlled by, controlling, affiliated with or under common control with the issuer of any security before entering into any contract with or for a customer for the purchase or sale of such security, the existence of such control to such customer, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction;

16. Failing to make a bona fide public offering of all of the securities allotted to a broker-dealer for distribution, whether acquired as an underwriter, a selling group member, or from a member participating in the distribution as an underwriter or selling group member; or
17. Failure or refusal to furnish a customer, upon reasonable request, information to which he is entitled, or to respond to a formal written request or complaint.
18. Engaging in the practice of lending or borrowing money or securities from a customer, or acting as a custodian for money, securities or an executed stock power of a customer;
19. Effecting securities transactions not recorded on the regular books or records of the broker/dealer which the agent represents, unless the transactions are authorized in writing by the broker-dealer prior to execution of the transaction;
20. Establishing or maintaining an account containing fictitious information in order to execute transactions which would otherwise be prohibited;
21. Sharing directly or indirectly in profits or losses in the account of any customer without the written authorization of the customer and the broker-dealer which the agent represents;
22. Dividing or otherwise splitting the agent's commissions, profits or other compensation from the purchase or sale of securities with any person not also registered as an agent for the same broker-dealer, or for a broker-dealer under direct or indirect common control;

The conduct set forth above is not inclusive. Engaging in other conduct such as forgery, embezzlement, nondisclosure, incomplete disclosure or misstatement of material facts, or manipulative or deceptive practices shall also be grounds for suspension or revocation of registration.

10.3 Fiduciary Duties

A person who is a fiduciary to an account has a duty to act primarily for the benefit of its clients. While the extent and nature of this duty varies according to the nature of the relationship between the Firm or a representative and its clients and the circumstances of each case, the Firm and its representatives shall not engage in unethical business practices, including the following:

1. Recommending to a client the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client’s investment objectives, financial situation and needs, and any other information known.

2. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.
3. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account in light of the fact that the Firm or a representative in such situations can directly benefit from the number of securities transactions effected in a client's account. The rule appropriately forbids an excessive number of transaction orders to be induced by a representative for a "customer's account."
4. Placing an order to purchase or sell a security for the account of a client without authority to do so.
5. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.
6. Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the Firm, or a financial institution engaged in the business of loaning funds.
7. Loaning money to a client unless the Firm is a financial institution engaged in the business of loaning funds or the client is an affiliate of the Firm.
8. Misrepresenting to any client, or prospective client, the qualifications of the Firm or any employee of the Firm, or misrepresenting the nature of the services being offered or fees to be charged for such service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.
9. Providing a report or recommendation to any client prepared by someone other than the representative without disclosing that fact. (This prohibition does not apply to a situation where the Firm or a representative uses published research reports or statistical analyses to render advice or where the Firm or a representative orders such a report in the normal course of providing service.)
10. Charging a client an unreasonable fee.
11. Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the Firm, or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

a. Compensation arrangements connected with services to clients which are in addition to compensation from such clients for such services; and

b. Charging a client a fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the Firm or its employees.

12. Guaranteeing a client that a specific result will be achieved (gain or no loss) with advice which will be rendered.

13. Represents that any report, analysis, or other service will be furnished for free or without charge, unless such report, analysis, or other service actually is or will be furnished entirely free and without any direct or indirect condition or obligation

14. Produce any untrue statement of a material fact, or that is otherwise false or misleading.

15. Disclosing the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client.

16. Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the Firm may be deemed to have custody or possession of such securities or funds without the approval of compliance.

17. Entering into, extending or renewing any advisory contract, unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or non-performance, whether the contract grants discretionary power to the Firm and representative and that no assignment of such contract shall be made by the Firm without the consent of the other party to the contract.

18. Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contrary to industry rules and regulations.

19. Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this act or any rule or regulation thereunder.

The conduct set forth above is not inclusive. Engaging in other conduct such as non-disclosure, incomplete disclosure, or deceptive practices shall be deemed an unethical business practice.

10.4 Sharing in the Profits and Losses in a Customer's Account

Associated persons are prohibited from sharing in the profits and/or losses in a customer's account. Exceptions to this policy may be granted by the designated principal if an associated person is an owner of the account and the associated person shares in the profits and/or losses commensurate with the monetary contribution, or if an associated person acts as an investment adviser and receives compensation based on a share in the profits or gains in a customer's account in accordance with rules governing such compensation arrangements. Before sharing in profits and losses in customer accounts, an associated person must obtain the prior written authorization of the Firm. Additionally, the Firm and the associated person must obtain the prior written authorization of the customer.

10.5 Requirements of Associated Persons

The Firm requires its associated persons to:

- Adhere to the Firm's written supervisory procedures and other policies (which may be communicated orally);
- Disclose all outside business activities and private securities transactions;
- Cooperate with all supervisors and/or designated persons;
- Monitor accounts for suspicious activities;
- Adhere to any written agreements between the Firm and the associated person;
- Disclose all securities accounts;
- Disclose any accounts of other registered representatives from different broker-dealers;
- Update the Firm if any event occurs that becomes reportable on Form U-4;
- Immediately report any convictions;
- Immediately report any regulatory investigations;
- Report any suspicious activity of other associated persons and/or violations of the Firm's policies and procedures;
- Immediately report any misconduct of associated persons;
- Self-report their own violations, regardless of whether such violations were inadvertent or intentional;

- Receive and disclose prior approval of all compensation and/or payment arrangements, including all soft dollar arrangements received and/or paid;
- Disclose all companies of which they are an officer, director, or 5% shareholder. Additional disclosures are to be made for any such ownership by spouses and/or any members of the associated person's immediate family living in the same home.
- Ensure that all securities liquidations, especially of insiders, are unrestricted, in accordance with Section 5 of the Securities Act of 1933, SEC Rule 144.
- Report to the Compliance Department all gifts at the time they are given or received, including gifts to and from customers and/or other entities that engage in investment-related activities.
- Receive written approval from the CCO prior to sharing in the profits or losses in a customer's account (performance accounts);
- Handle all customer accounts in a confidential manner, discussing information and transactions only with persons having a reasonable need to know for valid business or regulatory purposes.
- Adhere to the Firm's insider trading policies and refrain from discussing any nonpublic information with any other persons without prior notification to the Compliance Department.
- Promptly report (defined as by noon the next business day) any complaints and/or grievances to the Compliance Department.
- Immediately notify the Compliance Department if he or she has been the subject of any order or proceeding by the SEC, FINRA, any state, any court, any previous broker-dealer, or any foreign government relating to securities activities.
- Immediately report any of the following events: if he or she is indicted, is convicted of, has pleaded guilty to, or has pleaded no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, misappropriation of funds or securities, a conspiracy to commit any of these offenses, or substantially equivalent activity in any domestic, military, or foreign court.

When an action results in a reporting or disclosure requirement, the CCO is responsible for filing the report or making the disclosure.

10.6 Prohibited Activities

Although the following list covers a number of prohibited activities, it is not exhaustive. Associated persons are prohibited from:

- Conducting unauthorized private securities transactions (selling away);
- Borrowing money or securities from customers;
- Lending money or securities to customers;
- Depositing personal funds into a customer's account;
- Rebating commissions and/or fees to customers;
- Guaranteeing profits;
- Guaranteeing the present or future value or price of any securities, or that any company or issuer of securities will meet specified promises or obligations.
- Agreeing to repurchase a security at a future date;
- Accepting cash or a check payable to the associated person;
- Conducting undisclosed outside business activities;
- Exercising discretion without prior approval of a principal and a letter of authorization;
- Settling a customer complaint or dispute;
- Distributing internal materials marked "For Internal Use Only";
- Engaging in forgery;
- Entering false information on any account documents.
- Engaging in any sales contests not pre-approved by the Compliance Department.
- Giving tax or legal advice;
- Acting on, passing on, or discussing any inside information;
- Entering into financial arrangements with customers or issuers;
- Engaging in market manipulation, which includes entering a purchase or sell order that is designed to raise or lower the price of a security or to give the appearance of trading for purposes of inducing others to buy and sell;
- Front running;
- Participating in any new issues that are immediately traded in the secondary market and considered to be a "hot issue." Additionally, associated persons must

not sell a “hot issue” to any restricted persons, including persons employed by another broker-dealer.

- Selling a security for an accountholder that does not have the certificate (bona fide short sale transactions are exempt);
- Parking securities in order to conceal true ownership;
- Communicating with regulators without prior approval from the Firm;
- Interpositioning;
- Paying any party for referral services, also known as a referral fee, without prior approval from the Compliance Department.
- Collecting secret profits, which includes charging a mark-up or mark-down in addition to a commission on a transaction;
- Engaging in adjusted trading, which involves the sale of a security by a customer for a price above the prevailing market price and the simultaneous purchase of a different security at a price lower than the prevailing market price.

Misrepresentations and Material Omissions

Misrepresentations and material omissions occur when a registered representative provides a customer with misleading, incomplete, inaccurate, baseless, and/or false statements or information. Registered representatives are not to provide false or misleading statements, claims, comparisons, or omissions of material facts. This includes, but is not limited to, assurances and guarantees which are part of either oral or written communications or correspondence. Additionally, registered representatives have a duty to disclose all material facts. Failure to disclose material facts also would be considered to be misrepresentation.

The following is a list of common types of misrepresentation or material omissions:

- False, misleading or inaccurate representations were made to the customer;
- The registered representative should have had knowledge or should have had knowledge that false, misleading, or inaccurate representations were made to a customer;
- Oral or written material misrepresentations and/or omissions were made in recommending securities transactions; and
- High-pressure sales techniques using material misrepresentations or omissions.

The designated principal will review sales literature, advertising materials, and samples of general correspondence in an effort to ensure that all securities products and services are properly represented. All relevant documentation will be initialed and dated as

evidence of review. In the event that an instance of misrepresentation and/or material omission is discovered, the Firm's CCO should be notified.

Conversion, Misappropriation, and Misuse

Conversion and misappropriation occurs when an associated person deprives the proper owner of the use of funds and/or securities. The following information details some of the differences among the three violations of conversion and misappropriation and misuse:

- The term "conversion" refers to actual theft of the funds or securities where an associated person converts the property for his/her own use or retains possession of the property. Conversion is often used synonymously with embezzlement in a business context;
- The term "misappropriation" is the intentional, illegal, or fraudulent treatment of the property or funds of customer for another person's own use or other unauthorized purpose; and
- The term "misuse" is the misapplication or improper use of customer funds, or borrowing of customer funds or securities.

The designated principal will review relevant documentation such as the checks received and forwarded blotter (daily), exception reports (monthly), trade blotters (daily), and/or commission statements (monthly) in an attempt to identify any sales practice violations or other potential violations of securities rules and regulations. All relevant documentation will be initialed and dated as evidence of review.

Excessive Trading

Excessive trading occurs when a registered representative actively trades securities in an account in order to increase the receipt of trading commissions rather than customer profits. The following is a summary of some of the main elements of excessive trading:

- The registered representative exercised control over the trading account;
- Excessive trading took place in the customer's account contrary to the customer's objectives; and
- The registered representative acted with the intent to defraud or with willful and reckless disregard for the interests of the customer

The determination of excessive trading is based on the level of trading activity in the account. All trades must be consistent with the financial circumstances and investment objectives of the customer. A registered representative must be aware of the customer's financial situation and trading objectives and have reason to believe that all purchases, solicited and unsolicited, are suitable to the customer's needs.

Unauthorized Trading

Unauthorized trading occurs when a registered representative effects one or more transactions for a customer's account without the prior consent of the customer. With the exception of certain types of discretionary accounts, a registered representative does not have the authority to enter trades in a customer account without specific written authorization. Some signs of unauthorized trading activity include a high frequency of transactions, high commission payouts to registered representatives, excessive cancels and rebills, or other similar activity which may appear unusual or suspicious in nature.

On an as needed, or at least monthly basis, the designated principal will review relevant documentation such as error statements (daily), exception reports (daily, monthly, quarterly), trade blotters (daily), and commission reports (monthly) in an effort to discover the presence of any potential or actual unauthorized trading. All relevant documentation will be initialed as evidence of review.

Switching

Switching can be defined as the inappropriate exchange or replacement of one investment for another. The designated principal will review relevant documentation such as new account forms, exception reports, and authorizations in an effort to detect the presence of any unauthorized or unsuitable switching in customer accounts.

Insider Trading

The Firm is required to establish, maintain, and enforce supervisory procedures that are reasonably designed to prevent the misuse of non-public information. All registered representatives are strictly prohibited from trading on any information that could be construed as material, non-public (insider) information as well as disclosing such information to others. Such trading activity may not occur in any account that is controlled directly or indirectly by the registered person.

Confidential Information and "Chinese Wall" Procedures

All customers of the Firm have a reasonable expectation and belief that all information provided by them or related to the business they conduct with the Firm will be maintained in absolute confidence. The Firm's designated principal will ensure that all associated persons understand the Firm's policies and procedures regarding the following areas:

- Insider trading policies and procedures;
- Training requirements, including attendance roster and training materials;

- "Need to Know" policies to ensure information is shared only with authorized personnel;
- "Chinese Wall" policies and procedures; and
- Security and restricted access to sensitive files.

If any associated person believes that he/she or someone else may have obtained or disclosed inside or proprietary information in a manner not permitted by the Firm, the associated person should immediately contact the designated principal and refrain from using or further disclosing such information.

In protecting the Firm's confidential or other proprietary documentation, the designated principal will ensure that every registered representative signs an Insider Trading Statement or other similar documentation upon employment with the Firm, and each year thereafter. Each signed form will be initialed and dated as evidence of receipt and review. All signed forms will be maintained at the main office for review and retention purposes.

Parking Securities

The "parking" of securities is the manipulative practice used by firms in an attempt to conceal ownership of securities. The Firm will maintain adequate procedures to monitor the opening of new customer accounts and the supervision and compliance review of large dollar transactions and high volume accounts in order to detect such parking of securities. Additionally, special attention should be given to trading activity at or near the end of an accounting period for possible signs of parking securities.

The designated principal will review exception reports (daily, monthly, quarterly), error statements (daily), and employee account statements (monthly) to ensure that the Firm's registered representatives are not parking securities. The designated principal will initial batched documentation as evidence of review.

Adjusted Trading

Adjusted trading is the manipulative practice of executing transactions between parties with the intent to hide losses on securities positions. Adjusted trading transactions are normally between a broker-dealer firm and a customer, financial institution, publicly traded company, or another broker-dealer firm. The transaction is usually initiated by the party who owns a security that has suffered a loss. Broker-dealers will then purchase the security for a price that is higher than the current market value in order to hide the loss. In return, the entity that sold the security will simultaneously purchase another security at a price that is higher than the current market value. Therefore, the

broker-dealer does not incur any loss and the selling party can hide the losses on its security position.

During a review of trade blotters, order tickets, and exception reports, the Firm's designated principal should investigate large transactions or any series of smaller transactions in the same security whose sum would equal a large transaction at or near a calendar or fiscal period end. If there is a subsequent purchase of another security with a like dollar amount, then the designated principal should ensure that both transactions were executed at the market price. The Firm's designated principals should also review the same type of activity for transactions with publicly traded companies and other broker-dealers.

The designated principal will review relevant documentation such as the Firm's trading blotters and error statements and approve all adjusted trades to ensure that there are no potential violations of securities rules or regulations. Additionally, the designated principal will ensure that the customer receives the best price available and or price correction as needed.

Sharing Commissions/Fees with Non-Registered Persons

All registered representatives are strictly prohibited from sharing any commissions or fees with non-registered persons.

Front Running

The term "front running" refers to any situation that occurs when a securities or commodities broker-dealer that has private information about the direction of movement of an asset takes a position in a security in order to take advantage of a large upcoming transaction of which the broker-dealer or associated person is aware. It is a violation of just and equitable principles of trade for the Firm or any of its associated persons to conduct the following actions for any customer account, account in which it maintains an interest, or exercises investment discretion:

- to effect an order to buy or sell an option when the Firm or any of its associated persons causing such order to be executed has material, non-public market information concerning an imminent block transaction in the underlying security, or when a customer has been provided such material non-public market information by the member or any person associated with a member; or
- to effect an order to buy or sell an underlying security when the Firm or any of its associated persons causing such order to be executed has material, non-public market information concerning an imminent block transaction in an option overlying that security, or when a customer has been provided such material, non-public market information by the Firm or any of its associated

persons; prior to the time information concerning the block transaction has been made publicly available

The violative practice noted above may include transactions which are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently.

Exemptions

These general prohibitions do not apply to transactions executed by broker-dealers participating in automatic execution systems in those instances where participants must accept automatic executions. These prohibitions also do not include situations in which a broker-dealer or associated person receives a customer's order of block size relating to both an option and the underlying security. In such cases, the broker-dealer and associated persons may position the other side of one or both components of the order. However, in these instances, the broker-dealer and associated persons would not be able to cover any resulting proprietary position(s) by entering an offsetting order until information concerning the block transaction involved has been made publicly available.

Limitations

The application of this front running policy is limited to transactions that are required to be reported on the last sale reporting systems administered by Nasdaq, Consolidated Tape Association (CTA), or Option Price Reporting Authority (OPRA).

Block Transactions

Information as to a block transaction will be considered to be publicly available when it has been disseminated via the tape or high speed communications line of one of those systems or of a third-party news wire service. A transaction involving 10,000 shares or more of an underlying security or options covering such number of shares is generally deemed to be a block transaction, although a transaction of less than 10,000 shares could be considered a block transaction in appropriate cases. A block transaction that has been agreed upon does not lose its identity as such by arranging for partial executions of the full transaction in portions which themselves are not of block size if the execution of the full transaction may have a material impact on the market. In this situation, the requirement that information concerning the block transaction be made publicly available will not be satisfied until the entire block transaction has been completed and publicly reported.

Purchases and Sales of Initial Equity Public Offerings

Associated persons may not sell, or cause to be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted

herein. Associated persons may not purchase a new issue in any account in which such associated person has a beneficial interest, except as otherwise permitted herein. The Firm may not continue to hold new issues acquired by the Firm as an underwriter, selling group member or otherwise, except as otherwise permitted herein.

These restrictions do not prohibit: (i) sales or purchases from one member of the selling group to another member of the selling group that are incidental to the distribution of a new issue to a non-restricted person at the public offering price; (ii) sales or purchases by a broker-dealer of a new issue at the public offering price as part of an accommodation to a non-restricted person customer of the broker-dealer; or (iii) purchases by a broker-dealer (or owner of a broker-dealer), organized as an investment partnership, of a new issue at the public offering price, provided such purchases are credited to the capital accounts of its partners.

Preconditions for Sale

Before selling a new issue to any account, the Firm must in good faith have obtained within the twelve months prior to such sale, a representation from:

- **Beneficial Owners-** The account holder(s), or a person authorized to represent the beneficial owners of the account, that the account is eligible to purchase new issues; or
- **Conduits**- a bank, foreign bank, broker-dealer, or investment adviser or other conduit that all purchases of new issues are in compliance.

The Firm may not rely upon any representation that it believes, or has reason to believe, is inaccurate. The Firm must maintain a copy of all records and information relating to whether an account is eligible to purchase new issues in its files for at least three years following the Firm's last sale of a new issue to that account.

Before selling a new issue to any account, the designated principal must ensure that the Firm meets certain “preconditions for sale,” which generally require the Firm to obtain a representation from the beneficial owner of the account that the account is eligible to purchase new issues. The Firm will not sell new issues to any account unless within the previous 12 months it has in good faith obtained a representation from either (1) the beneficial owners of the account, or a person authorized to represent the beneficial owners of an account, that the account is eligible to purchase new issues in accordance with the Rule, or (2) certain conduits (such as a bank, foreign bank, broker/dealer, or investment adviser) that all purchases of new issues are compliant. Additionally, the Firm may not rely upon any representation that it believes, or has reason to believe, is inaccurate.

FINRA requires the initial verification of an account's status under FINRA Rule 5130 to be a positive affirmation from the beneficial owners, person authorized to act on their behalf, or a conduit. However, the FINRA will permit firms to conduct the annual verification of an account's status through the use of negative consent letters. Therefore, the Firm will conduct its annual verification of an account's status through the use of negative consent letters. The Firm will furnish a customer with account information on record used to determine that the account is eligible to purchase new issues and ask the customer to indicate whether anything has changed to make the account restricted. In the absence of any response from the customer, the Firm will continue to deem the account as non-restricted. The Firm will not permit customers to verify customer account information orally. All initial and annual verifications will be maintained in accordance with books and records requirements.

Guarantees against Loss of Investment

Associated persons are prohibited from making any guarantees against the monetary loss of an investment product.

High Pressure Sales Tactics

Associated persons are strictly prohibited from using high-pressure sales tactics in the solicitation of a securities transaction. High-pressure sales tactics include, but are not limited to, excessive phone calls and falsely implying a sense of urgency or demand for a security.

Personal Loans with Customers

No associated person in any registered capacity may borrow money from or lend money to a customer unless the Firm has written procedures allowing such lending arrangements; the loan falls within one of five prescribed permissible types of lending arrangements as described below; and the member pre-approves the loan in writing:

- The customer is a member of the registered person's immediate family;
- The customer is in the business of lending money;
- The customer and registered person are both registered persons of the same firm;
- The lending arrangement is based on a personal relationship outside of the broker-customer relationship; or
- The lending arrangement is based on a business relationship outside of the broker-customer relationship.

The Firm does not permit lending arrangements between its registered persons and customers. However, in the event that Firm permits lending arrangements between its

registered persons and customers, all registered persons who wish to borrow from or lend to customers will be required to provide prior notice of the lending arrangement to the Firm unless the lender is regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business. Upon receipt of the written notification by the registered representative, the Firm will approve or deny the loan in writing depending on the facts and circumstances of the loan. The Firm will be permitted to approve loans only if the loan falls within one of the five types of permissible lending arrangements as specified above. All requests for loans will be reviewed by the designated principal. Each approved loan will be properly evidenced by the designated supervisor's initials and date of review/approval.

11. Customer Identification Program (CIP)

In addition to the information that must be collected under NASD Rules 2110 (Standards of Commercial Honor and Principles of Trade), FINRA Rules 2111 (Recommendations to Customer—Suitability) and 4512 (Books and Records – Customer Account Information), and SEC Rules 17a-3(a)(9) (Beneficial Ownership regarding Cash and Margin Accounts) and 17a-3(a)(17) (Customer Accounts), the Firm has established, documented, and maintained a written Customer Identification Program (CIP). The Firm will collect certain minimum customer identification information from each customer who opens an account; utilize risk-based measures to verify the identity of each customer who opens an account; record customer identification information and the verification methods and results; provide notice to customers that we will seek identification information; and compare customer identification information with government-provided lists of suspected terrorists.

Note: The CIP rule applies only to "customers" who open new "accounts" with a broker-dealer. Specifically, the CIP rule defines a "customer" as (1) a person that opens a new account or (2) an individual who opens a new account for an individual who lacks legal capacity or for an entity that is not a legal person. "Customer" does not refer to persons who fill out account opening paperwork or who provide information necessary to establish an account, if such persons are not the accountholder as well.

Accordingly, a broker-dealer is not required to verify the identities of persons with existing accounts at the firm, as long as the broker-dealer has a reasonable belief that it knows the true identity of the customer.

For purposes of the CIP rule, an "account" is defined as a formal relationship with a broker-dealer established to effect transactions in securities, including, but not limited to, the purchase or sale of securities, securities loan and borrowing activity, and the holding of securities or other assets for safekeeping or as collateral. The following are excluded from the definition of "account": (1) an account that the broker-dealer acquires through any acquisition, merger, purchase of assets or assumption of liabilities and (2) an account opened for the purpose of participating in an employee benefit plan established under the Employee Retirement Income Security Act of 1974 (ERISA).

11.1 Verifying Information

The information gathered should vary according to the risks posed by the account type. The purpose of verification is to ensure reasonable belief and knowledge of each customer's true identity, all control persons over the account, and all persons with discretionary authority. As a general rule, anyone associated with an account should be

considered in the due diligence process. Among the risks to consider are the various types of accounts maintained by the Firm, the various methods of opening accounts provided by the Firm, the various types of identifying information available, and the Firm's size, location, and customer base. If there is reason to believe that some of these risk factors increase the likelihood that more information will be needed to know the true identity of a customer, it should be determined what additional identifying information might be necessary to establish a reasonable belief that the true identity of the customer is known. ***OFAC reviews on all control persons of accounts are mandatory.***

Based on the risk, and to the extent that is reasonable and practicable, the Firm will ensure that it has a reasonable belief that it knows the true identity of customers by using risk-based procedures to verify and document the accuracy of the information obtained about customers. In verifying customer identity, the Firm will analyze any logical inconsistencies in the information obtained.

The Firm will verify customer identity through ***documentary evidence, non-documentary evidence, or both*****.** The Firm will use documents to verify customer identity when appropriate documents are available. In light of increasing identity fraud, the Firm will supplement the use of documentary evidence by using non-documentary evidence if it is still uncertain of the customer's true identity. In analyzing the verification information, the Firm will consider whether there is a logical consistency to the identifying information provided, such as the customer's name, street address, zip code, telephone number (if provided), date of birth, and social security number.

The Firm understands that it is not required to take steps to determine whether the document that the customer has provided for identity verification has been validly issued. From time to time, the Firm may rely on a government-issued identification as verification of a customer's identity. If, however, the Firm notes that the document shows obvious signs of fraud, it must consider that factor in determining whether it can form a reasonable belief that it knows the customer's true identity.

The Firm will use non-documentary methods of verification in the following situations: (1) when the customer is unable to present an unexpired government-issued identification document with a photograph or other similar safeguard; (2) when the Firm is unfamiliar with the documents the customer presents for identification verification; (3) when the customer and the Firm do not have face-to-face contact; and (4) when there are other circumstances that increase the risk that the Firm will be unable to verify the customer's true identity through documentary means.

The Firm will verify the information within a reasonable time frame before or after the account is opened. Depending on the nature of the account and requested transactions,

the Firm may refuse to complete a transaction before it has verified the information, or in some instances when it needs more time, it may, pending verification, restrict the types or dollar amount of transactions. If the Firm finds suspicious information that indicates possible money laundering or terrorist financing activity, it will, after internal consultation with the AML Compliance Officer, file a SAR-SF in accordance with applicable law and regulations. ***In the event that the Firm or any of its employees suspect terrorist activities, the AMLCO shall contact federal authorities and, upon consultation, take immediate action to freeze the account and prohibit any transactions.***

The Firm recognizes that the risk that it may not know the customer's true identity may be heightened for certain types of accounts, such as an account opened in the name of a corporation, partnership, or trust that is created or conducts substantial business in a jurisdiction that has been designated by the U.S. as a key area of money laundering concern or has been designated as non-cooperative by an international body. The Firm will identify customers that pose a heightened risk of not being properly identified, and will take additional measures to obtain information about the identity of the individuals associated with the customer when standard documentary methods prove to be insufficient. Additional measures may include background verifications and the use of databases to compile the background data.

For the most current updates to the Non-Cooperative Countries and Territories (NCCT) list, visit the website of the Financial Action Task Force (FATF) at http://www.fatf-gafi.org.

11.2 Reliance on another Financial Institution for Identity Verification

The Firm does not rely on another financial institution for verifying the identity of customers; however, the clearing firm does perform additional account reviews that augment the Firm's Customer Identification Program. The clearing firm communicates any inquiries via e-mail.

11.3 Independent Background Verifications

Documentary Evidence

Individuals

- A copy of driver's license, passport, or government identification documents (mandatory)

- OFAC review (mandatory)
- Customer Identification Form (for new clients)
- W8 or W9

Note: External vendor background reports may be done on foreign accounts or any flagged accounts as warranted.

Non-Individuals

Non-individuals include corporations, partnerships, trusts, hedge funds, investment clubs, etc. The Registered Representative should obtain one of the following for non-individual accounts:

- Articles of incorporation
- A government-issued business license
- A partnership agreement
- A trust instrument
- Corporate Resolution
- Government Identification Documents for all signatories over the account.

For all non-individual accounts, the identity of all control persons and owners must be clearly identified. Once all individuals are identified, please refer to the individual CIP requirements for individuals listed above.

Non-Documentary Evidence

For any accounts in which documentary evidence cannot be obtained or additional risk is identified, the Firm will obtain additional non-documentary evidence. This includes any combination of the following:

- Contacting the customer
- Independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database, or other source (e.g., LexisNexis)
- Checking references with other financial institutions
- Obtaining a financial statement

If after non-documentary evidence is obtained, and concerns are noted as to the identity of the customer, or if an AML red flag is noted on the account, the Firm will utilize additional documentary means to determine the identity of the customer.

11.4 Due Diligence on Customer Accounts

Any additional due diligence that is performed on an account will be maintained in the respective customer file.

11.5 Lack of Verification

When the Firm cannot form a reasonable belief that it knows a customer's true identity, it will do the following: (A) not open an account; (B) impose the terms under which a customer may conduct transactions while it attempts to verify the customer's identity; (C) close an account after attempts to verify a customer's identity fail; or (D) file a SAR-SF in accordance with applicable law and regulations.

11.6 Customers Who Refuse to Provide Information

If a potential or existing customer refuses to provide the information described above when requested, or appears to have intentionally provided misleading information, the Firm will not open a new account and, after considering the risks involved, consider closing any existing accounts. In either case, the AML Compliance Officer will be notified so that the Firm can determine whether it should report the situation to FinCEN (i.e., file a Form SAR-SF).

11.7 Required Account Information

Individual Accounts

For accounts opened by an individual, the Firm will undertake reasonable efforts to obtain the following information at the commencement of the business relationship:

- The customer's name and address;
- The customer's date of birth;
- The customer's investment experience and objectives, if applicable;
- The customer's social security number or taxpayer identification number, including U.S. tax forms;
- The customer's net worth and annual income;
- The customer's occupation and employment data, such as the employer's address (generally understood to be the customer's source of income); and
- The names of all authorized persons.

If an individual has applied for, but not received a taxpayer identification number, then the AML Compliance Officer will have discretion as to whether the account is opened

and the type of trading approved. A reasonable amount of time must be provided to obtain the taxpayer identification number.

Non-Resident Accounts

In addition to all the information obtained for individual accounts, the Firm should record a current passport number or other valid government identification number and obtain all necessary U.S. tax forms. Additional due diligence may be warranted depending on a number of factors, including the country of origin of the non-resident account ("NRA"). The AMLCO is to review such accounts and consider additional due diligence for such accounts.

Domestically Operating or Commercial Entities

The Firm shall ascertain the identity of any corporate or business entity establishing the business relationship and the authority of the business representative. All control persons and/or associated persons of such account are to be considered in the due diligence process. Articles of incorporation are recommended as the means to identify all officers and directors of the respective entity.

Domestic Trusts

The Firm will identify the principal ownership of all trusts. In addition, the Firm should obtain information regarding the authorized activity of the trust and the persons authorized to act on behalf of the trust.

Foreign Operating Commercial Entities and/or Financial Institutions

The Firm will take into account various factors, including the entity's country of incorporation and the foreign or offshore jurisdiction in which the business is located. The Firm will undertake appropriate internal processes for corporations or entities established or located in jurisdictions outside of the United States. The Firm will not establish, maintain, administer, or manage an account in the United States for, or on behalf of, a foreign shell bank. When opening an account for a foreign business or enterprise that does not have identification number, the Firm will request alternative government-issued documentation certifying the existence of the business or enterprise. The AMLCO is responsible for determining the level of due diligence needed in order to verify all control persons of the account. ***The AMLCO is responsible for ensuring that such due diligence is adequate for identifying whether such accounts may belong to foreign banks, foreign correspondent accounts, and/or associated with foreign political figures.***

Foreign Financial Institutions/Foreign Bank Correspondent Accounts

The Firm will not open or maintain correspondent accounts for foreign banks or foreign financial institutions (foreign banks, foreign broker/dealers, foreign IBs and FCMs, or foreign mutual funds). All Associated Persons must immediately report any attempts made to open such an account to the AMLCO. If the Firm changes its policy, it will implement procedures complying with the regulations issued pursuant to Section 312 of the USA Patriot Act.

Personal Investment Corporations or Personal Holding Companies

The Firm will identify the principal beneficial owner(s) of offshore corporate accounts consisting of personal investment corporations or personal holding companies. The Firm will strive to obtain sufficient documentation regarding the principal beneficial owner(s) of the account. Additional due diligence may also be warranted depending on a number of factors, including the location of the offshore entity and the location of the principal owner(s).

Offshore Trusts

The Firm will identify the principal ownership of a trust established in a foreign jurisdiction. Additional due diligence will be conducted for trusts established in jurisdictions which lack regulatory oversight over trust formation. The Firm will strive to obtain sufficient documentation regarding the principal ownership of the account. Additional due diligence may also be warranted depending on a number of factors, including the location of the offshore entity and the location of the principal owner(s).

Institutional Accounts, Hedge Funds, Investment Funds, and Other Intermediary Relationships

The Firm will conduct due diligence on institutional/intermediary accounts depending on the nature of the entity. Institutional accounts may require more or less scrutiny than the accounts detailed above. The Firm will ascertain via representation, or otherwise, the institution's/intermediary's authority to act on behalf of the underlying client, whether the institutional client/intermediary has policies and procedures to know its own clients, where appropriate. Due diligence factors may include the following:

- Whether the institution/intermediary has established anti-money laundering policies and procedures;
- Whether the Firm has historical experience with the institution/intermediary;

- Whether the institution/intermediary is a registered financial institution based in a major regulated financial center or is a registered financial institution located in a Financial Action Task Force jurisdiction;
- Whether the institution/intermediary has a reputable history in the investment business;
- Whether the institution/intermediary is from a jurisdiction characterized as an offshore banking or secrecy haven or is designated as a non-cooperative country by credible international organizations or multilateral expert groups.

11.8 Private Banking Accounts/Foreign Officials

The Firm has an enhanced due diligence program for identifying private banking accounts for non-U.S. persons. This due diligence program has been reasonably designed to detect and report any known or suspected money laundering conducted through or involving any private banking account maintained by or on behalf of a non-U.S. person, as well as the existence of the proceeds of foreign corruption in any such account. This requirement applies to all private banking accounts for non-U.S. persons, regardless of when they were opened. Accounts requested or maintained by or on behalf of senior foreign political figures (including their family members and close associates) require enhanced scrutiny. At the outset, decisions to open accounts for senior foreign political figures and/or private banking accounts should be approved by the AML CCO.

A private banking account is an account (or any combination of accounts) that requires a minimum aggregate deposit of $1,000,000, is established for one or more individuals, and is assigned to or administered or managed by, in whole or in part, an officer, employee, or agent of a financial institution acting as a liaison between the financial institution and the direct or beneficial owner of the account.

A senior foreign political figure includes a current or former senior official in the executive, legislative, administrative, military, or judicial branches of a foreign government (whether elected or not), a senior official of a major foreign political party, or a senior executive of a foreign government-owned commercial enterprise; a corporation, business, or other entity formed by or for the benefit of any such individual; an immediate family member of such an individual; or any individual publicly known (or actually known by the Firm) to be a close personal or professional associate of such an individual.

The AMLCO will review all accounts to determine whether they are private banking accounts, and will conduct due diligence on such accounts. The due diligence process will include, at minimum, the following:

1. Ascertaining the identity of all nominal holders and holders of any beneficial ownership interest in the account (including information on those holders' lines of business and sources of wealth);
2. Ascertaining the source of funds deposited into the account;
3. Ascertaining whether any such holder may be a senior foreign political figure;
4. Detecting and reporting, in accordance with applicable law and regulations, any known or suspected money laundering and/or use of the proceeds of foreign corruption.

The Firm will review public information, including information available in Internet databases, to determine whether any private banking account holders are senior foreign political figures. If the Firm discovers information indicating that a particular private banking account holder may be a senior foreign political figure, and upon taking additional reasonable steps to confirm this information, it determines that the individual is in fact a senior foreign political figure, it will conduct additional enhanced due diligence to detect and report transactions that may involve money laundering or the proceeds of foreign corruption.

In so doing, the Firm will consider the risks that the funds in the account may be the proceeds of foreign corruption, including the purpose and use of the private banking account, location of the account holder(s), source of funds in the account, type of transactions conducted through the account, and jurisdictions involved in such transactions. The degree of scrutiny will depend on various risk factors, which include, but are not limited to, whether the jurisdiction of the senior foreign political figure is one in which current or former political figures have been implicated in corruption and the length of time that a former political figure was in office. The Firm's enhanced due diligence might include, depending on the risk factors, verifying the account holder's employment history, scrutinizing the account holder's sources of funds, monitoring transactions to the extent necessary to detect and report proceeds of foreign corruption, and reviewing monies coming from government, government-controlled, or government enterprise accounts (beyond salary amounts).

If the Firm finds no information indicating that a private banking account holder is a senior foreign political figure, and the account holder states that he or she is not a senior foreign political figure, then additional enhanced due diligence is not required.

In either case, if due diligence (or the required enhanced due diligence, if the account holder is a senior foreign political figure) cannot be performed adequately, the Firm will, after consultation with the AML Compliance Officer and as appropriate, not open the account, suspend the transaction activity, file a SAR, or close the account.

11.9 Risk-Based Measures

Here are some of the factors the Firm should consider in assessing the risk posed by particular customers or transactions:

- The account type and how the client became a customer of the Firm;
- Whether the customer's business, or the particular account type, is the type more likely to be involved in illicit activity (e.g., a cash-intensive business);
- Whether the customer's home country is a member of the Financial Action Task Force ("FATF") or is otherwise subject to anti-money laundering controls in its home jurisdiction; and
- Whether the customer resides in, is incorporated in, or operates from a jurisdiction with bank secrecy laws, or one which has otherwise been identified as an area worthy of enhanced scrutiny.

11.10 Recordkeeping

The Firm will document its verification, including all identifying information provided by a customer, the methods used and results of verification, and the resolution of any discrepancy in the identifying information. The Firm will keep records containing a description of any document relied upon to verify a customer's identity, noting the type of document, any identification number contained in the document, and the place of issuance. With respect to non-documentary verification, the Firm will retain documents that describe the methods and the results of any measures taken to verify a customer's identity. The Firm will maintain records of all identification information for five years after the account has been closed, and retain records on verification of the customer's identity for five years after the record is made.

Definitions

CUSTOMER: (1) a person who opens a new account or (2) an individual who opens a new account for an individual who lacks legal capacity or for an entity that is not a legal person. The following entities, however, are excluded from the definition of "customer": a financial institution regulated by a Federal functional regulator or a bank regulated by a state bank regulator; a department or agency of the United States, of any State, or of any political subdivision of any State; any entity established under the laws of the United States, of any State, or of any political subdivision of a State that exercises governmental authority on behalf of the United States, any State, or any political subdivision of a State; any entity, other than a bank, whose common stock or analogous equity interests are listed on the New York Stock Exchange or the American Stock Exchange or have been designated as a Nasdaq National Market Security listed on

NASDAQ (but only to the extent of domestic operations for any such persons that are financial institutions, other than banks), and a person that has an existing account with the broker/dealer, provided that the broker/dealer has a reasonable belief that it knows the true identity of the person.

ACCOUNT: An “account” is defined as a formal relationship with a broker/dealer established to effect transactions in securities, including, but not limited to, the purchase or sale of securities, securities loan and borrow activity, and the holding of securities or other assets for safekeeping or as collateral. The following are excluded from the definition of "account": (1) an account that the broker/dealer acquires through any acquisition, merger, purchase of assets, or assumption of liabilities, and (2) an account opened for the purpose of participating in an employee benefit plan established under the Employee Retirement Income Security Act of 1974 (ERISA).

12. FinCEN Customer Due Diligence Rule

12.1 FINCEN Customer Due Diligence Rule ("CDD")

The Bank Secrecy Act and FINRA Rule 3310 requires financial institutions such as broker/dealers to develop and implement AML programs to help prevent Anti-Money Laundering. FinCEN, the bureau of the Department of Treasury responsible for administering the BSA and regulations, created the customer due diligence rule ("CDD Rule") to clarify and strengthen customer due diligence for covered financial institutions. Under the new CDD Rule, collecting, maintaining and reporting of beneficial ownership information is a requirement for financial institutions. Specifically, our Firm must identify and verify the identity of the beneficial owners of all legal entity customers at the time a new account is opened. The new CDD rule is similar in nature to Customer Identification Program (CIP) requirements for individuals, but extended to the actual beneficial owner of the entity.

12.2 Overview of the CDD Rule

FinCEN's CDD Rule indicates that customer due diligence information should consist, at a minimum, four core elements:

- Customer identification and verification;
- Beneficial ownership identification and verification;
- Understanding the nature and purpose of customer relationships to develop a customer risk profile; and
- Ongoing monitoring for reporting suspicious transactions and, on a risk-basis, maintaining and updating customer information.

12.3 Customer Identification and Verification

The Firm has implemented a Customer Identification Program ("CIP") in accordance with the BSA and FINRA rules and regulations. Please see the CIP section of the Firm's procedures for further details.

12.4 Covered Financial Institutions

Under the CDD Rule, the term covered account includes the same language as the CIP rules for banks, brokers or dealers in securities, mutual funds, and futures commission merchants and introducing brokers in commodities.

12.5 Accounts Not Covered by the CDD Rule

There are several types of accounts that are not covered by the CDD Rule. Therefore, our Firm is not required to identify and verify the identity of the beneficial owner(s) of a legal entity customer when the customer opens any of the following four categories of accounts:

- accounts established at the point-of-sale to provide credit products, solely for the purchase of retail goods and/or services at these retailers, up to a limit of $50,000;

- accounts established to finance the purchase of postage and for which payments are remitted directly by the financial institution to the provider of the postage products;
- accounts established to finance insurance premiums and for which payments are remitted directly by the financial institution to the insurance provider or broker; and,

- accounts established to finance the purchase or lease of equipment and for which payments are remitted directly by the financial institution to the vendor or lessor of this equipment.

These exemptions will not apply under either of the following two circumstances:

- If the accounts are transaction accounts through which a legal entity customer can make payments to, or receive payments from, third parties.

- If there is the possibility of a cash refund for accounts opened to finance purchase of postage, insurance premium, or equipment leasing. If there's the possibility of a cash refund, the financial institution must identify and verify the identity of the beneficial owner(s) either at the initial remittance, or at the time such refund occurs.

12.6 Exclusion from the Definition of a Legal Entity Customer

CDD Rule excludes from the definition of legal entity customer certain entities that are subject to Federal or State regulation and for which information about their beneficial ownership and management is available from the Federal or State agencies, such as:

- A financial institution regulated by a Federal functional regulator or a bank regulated by a State bank regulator;

- An issuer of a class of securities registered under section 12 of the Securities Exchange Act of 1934 or that is required to file reports under section 15(d) of that Act;

- An investment company, as defined in section 3 of the Investment Company Act of 1940, that is registered with the Securities and Exchange Commission under that Act;

- An investment adviser, as defined in section 202(a)(11) of the Investment Advisers Act of 1940, that is registered with the Securities and Exchange Commission under that Act;

- An exchange or clearing agency, as defined in section 3 of the Securities Exchange Act of 1934, that is registered under section 6 or 17A of that Act;

- Any other entity registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934;

- A registered entity, commodity pool operator, commodity trading advisor, retail foreign exchange dealer, swap dealer, or major swap participant, each as defined in section 1a of the Commodity Exchange Act, that is registered with the Commodity Futures Trading Commission;
- A public accounting firm registered under section 102 of the Sarbanes-Oxley Act;

- A bank holding company, as defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) or savings and loan holding company, as defined in section 10(n) of the Home Owners' Loan Act (12 U.S.C 1467a(n));

- A pooled investment vehicle that is operated or advised by an excluded financial institution;

- An insurance company that is regulated by a State;

- A financial market utility designated by the Financial Stability Oversight Council under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010;

- A foreign financial institution established in a jurisdiction where the regulator of such institution maintains beneficial ownership information regarding such institution;

- A non-U.S. governmental department, agency or political subdivision that engages only in governmental rather than commercial activities; and

- Any legal entity only to the extent that it opens a private banking account.

As such, the Firm need not conduct any actions to identify and verify the identity of any such entities.

Further, the following legal entity customers are subject only to the control prong of the beneficial ownership requirement:

- A pooled investment vehicle that is operated or advised by a financial institution not excluded above; and

- Any legal entity that is established as a nonprofit corporation or similar entity and has filed its organizational documents with the appropriate State authority as necessary.

12.7 Identifying and Verifying the Identity of Beneficial Owners of Legal Entity Customers

The CDD Rule requires our firm to establish and maintain written procedures as part of their AML programs that are reasonably designed to identify and verify the identities of beneficial owners of "legal entity customers," which are defined within the CDD Rule as a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entity formed under the laws of a foreign jurisdiction that opens an account.

The CDD Rule establishes two independent tests for determining who qualifies as a beneficial owner.

1. Financial institutions must collect information in order to verify the identity of each individual who directly or indirectly owns twenty-five percent (25%) or more of the equity interests of such legal entity customer. For a legal entity customer there may be none, or multiple beneficial owners; and, (Ownership Prong)

2. Financial institutions must collect information in order to verify the identity of at least one individual with significant responsibility to control, manage or direct a legal entity customer. (Control Prong)

It is important to note; our Firm must complete both the first and second prong specified above.

Under the CDD Rule, the Firm must obtain from the natural person opening the account on behalf of the legal entity customer, the identity of the beneficial owners of the entity. In addition, that individual must certify, to the best of his or her knowledge, as to the accuracy of the information provided to our Firm.

The CDD Rule requires that we collect certain specified information, including the name, date of birth, address and Social Security number or other government identification number of the legal entity's beneficial owners and maintain records of the beneficial ownership information they obtain.

Once our Firm obtains the required beneficial ownership information, the CDD Rule requires that we verify the identity of the beneficial owner(s). In other words, that the beneficial owners actually are who they say they are. Our Firm can accomplish this through risk-based procedures that include the elements required for the Firm's CIP procedures for verifying the identity of individual customers.

Our Firm will ensure that such required identity verification is completed within a reasonable time after account opening. The Firm may rely on the beneficial ownership information supplied by the individual on behalf of the legal entity customer, provided that we have no knowledge of facts that would reasonably call into question the reliability of that information.

12.8 Understanding the Nature and Purpose of Customer Relationships

Under the CDD Rule, our Firm is required to have an understanding of the nature and purpose of the customer relationship in order to determine whether a transaction is potentially suspicious and, in turn, to fulfill our suspicious activity reporting obligations. The CDD Rule requires that we develop a customer risk profile, or information gathered about a customer to form the baseline against which customer activity is assessed for suspicious transaction reporting.

In accordance with the CDD Rule, we will review and monitor customer information, which may include such information as the type of customer, account or service offered, and the customer's income, net worth, domicile, or principal occupation or business, as well as, in the case of existing customers, the customer's history of activity.

12.9 Ongoing Monitoring

As part of the Firm's customer due diligence and AML requirements, our Firm is required to perform ongoing monitoring to identify and report suspicious transactions and on a risk basis, to maintain and update customer account information including the beneficial ownership of legal entity customers. Our Firm will perform ongoing monitoring which may consist of; reviewing exception, periodic account reviews/updates of customer account information, OFAC screening or random searches. In the event of our normal monitoring we detect information that is relevant in which the beneficial ownership needs to be updated and reviewed, the Firm and Designated Principal will perform such review and maintain the updated information in the files.

12.10 Books and Records

For each new account opened, the Firm will obtain the required beneficial ownership information on either the Pershing New Account Form or in the case of Direct Business, the CFS New Account Form. A copy of the Pershing New Account Form or CFS New Account Form will be completed within a reasonable time from account opening. A copy of the applicable new account form along with the new account opening documents, OFAC review and relevant CIP documentation will be kept as part of the Firm's books and records.

13. ANTI-MONEY LAUNDERING (AML) PROGRAM

13.1 Firm Policy

It is the policy of the Firm to prohibit and actively prevent money laundering and any activity that facilitates money laundering or the funding of terrorist or criminal activities. Money laundering is generally defined as actions designed to conceal or disguise the true origins of criminally derived proceeds so that the unlawful proceeds appear to be from legitimate origins or to constitute legitimate assets. Generally, money laundering occurs in three stages. Cash generated from criminal activities first enters the financial system at the "placement" stage, where it is converted into monetary instruments, such as money orders or traveler's checks, or deposited into accounts at financial institutions. At the "layering" stage, the funds are transferred or moved into other accounts or other financial institutions to further separate the money from its criminal origin. At the "integration" stage, the funds are reintroduced into the economy and used to purchase legitimate assets or to fund other criminal activities or legitimate businesses. Terrorist financing may not involve the proceeds of criminal conduct, but rather an attempt to conceal the origin or intended use of the funds, which will later be used for criminal purposes.

13.2 AML Compliance Officer Designation and Duties

Refer to the Firm's organization chart and FINRA Contact Information for the designation of its Anti-Money Laundering Program Compliance Officer (AMLCO) and AML Contact Person, with full responsibility for the Firm's AML program.

The AMLCO is responsible for establishing and implementing policies and procedures that can be reasonably expected to detect and cause the reporting of suspicious activities. The duties of the AMLCO will include monitoring the Firm's compliance with AML obligations, overseeing communication and training for employees, and ensuring that Suspicious Activity Reports (SAR-SFs) are filed. The Firm will provide FINRA with contact information for the AML Compliance Officer, including name, title, mailing address, e-mail address, telephone number, facsimile number, and designate a backup AML Contact Person on the FINRA Contact System. The Firm will promptly update the FINRA Contact System with any changes to the AML Contacts of the Firm. The AMLCO will receive e-mail notifications from FINRA and should stay on top of any rule amendments to the Bank Secrecy Act or the USA PATRIOT Act.

13.3 Training Programs

The Firm will develop ongoing employee training under the leadership of the AMLCO and senior management. Training will cover all new employees and will take place at least annually for all employees. It will be based on the Firm's size, its customer base, and its resources. Training will include, at minimum, the following: how to identify red flags and signs of money laundering that arise during the course of employee duties; what to do once the risk is identified; what the employee's role is in the Firm's compliance efforts and how to carry it out; the Firm's record retention policy; and the disciplinary consequences (including civil and criminal penalties) for non-compliance with the PATRIOT Act. The Firm will develop training or contract for it. Delivery of the training may include educational pamphlets, webcasts, podcasts, and training memos. The Firm will maintain records to show the persons trained, the dates of training, and the subject matter of their training. The Firm will review compliance and operations to see if certain employees require specialized additional training.

13.4 Additional Areas of Risk

Additional areas of risk will be evaluated during the Firm's AML Audit. Additionally, the AMLCO is to review for additional areas of risk related to AML and request that the procedures be updated accordingly. High-risk areas should be included in the Firm's training program.

The AMLCO will ensure procedures are updated in accordance with current events and regulatory notices pertinent to AML. In addition to current events, the Firm receives important AML updates and notices from its clearing firm and AML experts that are contracted to keep the Firm updated with such events.

13.5 Bank Secrecy Act

The Financial Record Keeping and Reporting of Currency and Foreign Transactions Act of 1970 is now referred to as the Bank Secrecy Act (BSA). Its purpose is to require financial institutions to maintain appropriate records and file certain reports with a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. Law enforcement agencies have found currency transaction reports to be extremely valuable in tracking the huge amounts of cash generated by illicit drug traffickers. For this reason and because of the seriousness of the drug trafficking problem, comprehensive examination procedures were developed to detect possible instances of money laundering in federally insured financial institutions.

The BSA consists of two parts: Title I—Financial Record Keeping, and Title II—Reports of Currency and Foreign Transactions. Title I authorizes the Secretary of the Treasury to issue regulations that require insured financial institutions to maintain certain records. Title II directs the Treasury Department to prescribe regulations governing the reporting of certain transactions by and through financial institutions in excess of $10,000 into, out of, and within the United States.

The Firm's AMLCO is responsible for compliance with the BSA. The Firm prohibits the receipt of currency and has procedures in place to prevent its receipt. The Designated Principal (1) reviews the check received blotter to ensure no cash has been received from a client and (2) obtains an annual attestation from each Registered Representative that he or she has not accepted any cash or currency from a customer. If the Firm discovers currency has been received, it will file currency transaction reports (CTRs) with the Financial Crimes Enforcement Network (FinCEN) for transactions involving currency that exceed $10,000. Multiple transactions will be treated as a single transaction if they total more than $10,000 during any one business day.

Associated Persons are to immediately notify the AMLCO if a client (or prospective client) makes suspicious inquiries about currency deposits. The AMLCO should take appropriate action (such as notifying authorities or reporting the activity).

13.6 Giving AML Information to Federal Law Enforcement Agencies and Other Financial Institutions

FinCEN Requests under PATRIOT Act Section 314

The Firm will respond to a FinCEN request about accounts or transactions by immediately searching records to determine whether it maintains or has maintained any account for, or has engaged in any transaction with, any individual, entity, or organization named in a FinCEN request. Upon receiving an information request, the Firm will designate one person to be the point of contact regarding the request and to receive similar requests in the future. Accounts are to be reviewed in accordance with the request.

If the Firm finds a match, it will report it to FinCEN pursuant to the instructions below. If the search parameters differ (for example, if FinCEN requests longer periods of time or limits the search to a geographic location), the Firm will limit its search accordingly. If the Firm searches its records and does not uncover a matching account or transaction, it will not reply to a 314(a) request. The Firm will not disclose the fact that FinCEN has requested or obtained information from it, except to the extent necessary to comply with the information request. The Firm will protect the security and confidentiality of all

requests from FinCEN. The Firm will direct any questions it has about FinCEN requests to the requesting federal law enforcement agency as designated in the 314(a) request. Unless otherwise stated in the information request, the Firm will not be required to treat the information request as continuing in nature. The Firm will not use information provided to FinCEN for any purpose other than (1) to report to FinCEN as required under Section 314 of the PATRIOT Act; (2) to determine whether to establish or maintain an account or to engage in a transaction; or (3) to assist the Firm in complying with any requirement of Section 314 of the PATRIOT Act.

Documentation

All FinCEN reviews are to be evidenced by completion and submission of the FinCEN logs. Such reviews and logs are to be completed for every two-week period.

What to Do with a Match

If the Firm finds a match with a named subject, it should stop its search on that subject; the Firm is not required to search its records further for other matches with that subject unless and until it has been contacted by the requesting federal law enforcement agency for additional information. If the 314(a) request contains multiple subjects, the Firm must continue to search its records for an account or transaction matching any of the other named subjects. After the Firm has completed its search on all the subjects listed in the 314(a) request, it must report any match to FinCEN. If the search does not uncover any matching account or transaction, the Firm need not reply to the 314(a) request.

To Report a Match on a Person

- Select "View Person List" from the appropriate transmission date.
- Highlight the button next to "Positive" for each subject for which you have a match. (If you need to enter a comment, do so in the "Comment" field.)
- Scroll to the bottom of the page and press the "Review Responses" button.
- Review your selections.
- Press "Send to FinCEN" button at the bottom of the page.

To Report a Match on a Business

- Select "View Business List" from the appropriate transmission date.
- Highlight the button next to "Positive" for each subject for which you have a match. (If you need to enter a comment, do so in the "Comment" field.)
- Scroll to the bottom of the page and press the "Review Responses" button.
- Review your selections.

- Press "Send to FinCEN" button at the bottom of the page.

Compliance with FinCEN's Issuance of Special Measures Against Foreign Jurisdictions, Financial Institutions or International Transactions of Primary Money Laundering Concern

We do not maintain any accounts (including correspondent accounts) with any foreign jurisdiction or financial institution. However, if FinCEN issues a final rule imposing a special measure against one or more foreign jurisdictions or financial institutions, classes of international transactions or types of accounts deeming them to be of primary money laundering concern, we understand that we must read FinCEN's final rule and follow any prescriptions or prohibitions contained in that rule.

National Security Letters

National Security Letters (NSLs) are written investigative demands that may be issued by the local Federal Bureau of Investigation and other federal government authorities conducting counterintelligence and counterterrorism investigations to obtain, among other things, financial records of broker-dealers. **NSLs are highly confidential. No broker-dealer, officer, employee or agent of the broker-dealer can disclose to any person that a government authority or the FBI has sought or obtained access to records.** If our Firm receives an NSL, it will only be received and handled by the AMLCO to ensure the confidentiality of the NSL. If we file a Suspicious Activity Report (SAR-SF) after receiving a NSL, the SAR-SF will not contain any reference to the receipt or existence of the NSL.

Grand Jury Subpoenas

We understand that the receipt of a grand jury subpoena concerning a customer does not in itself require that we file a Suspicious Activity Report (SAR-SF). When we receive a grand jury subpoena, we will conduct a risk assessment of the customer subject to the subpoena as well as review the customer's account activity. If we uncover suspicious activity during our risk assessment and review, we will elevate that customer's risk assessment and file a SAR-SF in accordance with the SAR-SF filing requirements. We understand that none of our officers, employees or agents may directly or indirectly disclose to the person who is the subject of the subpoena, its existence, its contents or the information we used to respond to it. To maintain the confidentiality of any grand jury subpoena we receive, we will process and maintain the subpoena by putting the subpoena in a hard copy file to be stored with the AMLCO. If we file a SAR-SF after receiving a grand jury subpoena, the SAR-SF will not contain any reference to the receipt or existence of the subpoena. The SAR-SF will only contain detailed information about the facts and circumstances of the detected suspicious activity.

Voluntary Information Sharing With Other Financial Institutions Under USA PATRIOT Act Section 314(b)

We will share information with other financial institutions regarding individuals, entities, organizations and countries for purposes of identifying and, where appropriate, reporting activities that we suspect may involve possible terrorist activity or money laundering. The AMLCO will ensure that the firm files with FinCEN an initial notice before any sharing occurs and annual notices thereafter. We will use the notice form found at FinCEN's web site (www.fincen.gov). Before we share information with another financial institution, we will take reasonable steps to verify that the other financial institution has submitted the requisite notice to FinCEN, either by obtaining confirmation from the financial institution or by consulting a list of such financial institutions that FinCEN will make available. We understand that this requirement applies even to financial institutions with which we are affiliated and that we will obtain the requisite notices from affiliates and follow all required procedures.

We will employ strict procedures both to ensure that only relevant information is shared and to protect the security and confidentiality of this information, for example, by segregating it from the firm's other books and records and ensuring that the AMLCO handles the relevant information and that it is kept in a secure location. We also will employ procedures to ensure that any information received from another financial institution shall not be used for any purpose other than:

- identifying and, where appropriate, reporting on money laundering or terrorist activities;
- determining whether to establish or maintain an account, or to engage in a transaction; or
- assisting the financial institution in complying with performing such activities.

Joint Filing of SARs by Broker-Dealers and Other Financial Institutions

We will share information about particular suspicious transactions with our clearing broker for purposes of determining whether we and our clearing broker will file jointly a SAR-SF. In cases in which we file a joint SAR-SF for a transaction that has been handled both by us and by the clearing broker, we may share with the clearing broker a copy of the filed SAR-SF. If we determine it is appropriate to jointly file a SAR-SF, we understand that we cannot disclose that we have filed a SAR-SF to any financial institution except the financial institution that is filing jointly. If we determine it is not appropriate to file jointly (*e.g.*, because the SAR-SF concerns the other broker-dealer or one of its

employees), we understand that we cannot disclose that we have filed a SAR-SF to any other financial institution or insurance company.

Change in Review Procedures

In the event that there is a change to the FinCEN policies or reviews, the AMLCO will receive notification. The AMLCO is required to monitor all e-mails from FinCEN and communicate such information to any affected persons.

13.7 Due Diligence and Enhanced Due Diligence Requirements for Correspondent Accounts of Foreign Financial Institutions.

We will conduct an inquiry to determine whether a foreign financial institution has a correspondent account established, maintained, administered or managed by the firm.

If we have correspondent accounts for foreign financial institutions, we will assess the money laundering risk posed, based on a consideration of relevant risk factors. We can apply all or a subset of these risk factors depending on the nature of the foreign financial institutions and the relative money laundering risk posed by such institutions.

The relevant risk factors can include:

- the nature of the foreign financial institution's business and the markets it serves;
- the type, purpose and anticipated activity of such correspondent account;
- the nature and duration of the firm's relationship with the foreign financial institution and its affiliates;
- the anti-money laundering and supervisory regime of the jurisdiction that issued the foreign financial institution's charter or license and, to the extent reasonably available, the jurisdiction in which any company that is an owner of the foreign financial institution is incorporated or chartered; and
- information known or reasonably available to the covered financial institution about the foreign financial institution's anti-money laundering record.

In addition, our due diligence program will consider additional factors that have not been enumerated above when assessing foreign financial institutions that pose a higher risk of money laundering.

We will apply our risk-based due diligence procedures and controls to each financial foreign institution correspondent account on an ongoing basis. This includes periodically reviewing the activity of each foreign financial institution correspondent sufficient to ensure whether the nature and volume of account activity is generally consistent with the information regarding the purpose and expected account activity and to ensure that

the firm can adequately identify suspicious transactions. Ordinarily, we will not conduct this periodic review by scrutinizing every transaction taking place within the account. One procedure we may use instead is to use any account profiles for our correspondent accounts (to the extent we maintain these) that we ordinarily use to anticipate how the account might be used and the expected volume of activity to help establish baselines for detecting unusual activity.

Enhanced Due Diligence

We will assess any correspondent accounts for foreign financial institutions to determine whether they are correspondent accounts that have been established, maintained, administered or managed for any foreign bank that operates under:

- an offshore banking license;
- a banking license issued by a foreign country that has been designated as non-cooperative with international anti-money laundering principles or procedures by an intergovernmental group or organization of which the United States is a member and with which designation the U.S. representative to the group or organization concurs; or
- a banking license issued by a foreign country that has been designated by the Secretary of the Treasury as warranting special measures due to money laundering concerns.

If we determine that we have any correspondent accounts for these specified foreign banks, we will perform enhanced due diligence on these correspondent accounts. The enhanced due diligence that we will perform for each correspondent account will include, at a minimum, procedures to take reasonable steps to:

- Conduct enhanced scrutiny of the correspondent account to guard against money laundering and to identify and report any suspicious transactions. Such scrutiny will not only reflect the risk assessment that is described in Section 8.a. above, but will also include procedures to, as appropriate:
- obtain (*e.g.,* using a questionnaire) and consider information related to the foreign bank's AML program to assess the extent to which the foreign bank's correspondent account may expose us to any risk of money laundering;
- monitor transactions to, from or through the correspondent account in a manner reasonably designed to detect money laundering and suspicious activity (this monitoring may be conducted manually or electronically and may be done on an individual account basis or by product activity); and
- obtain information from the foreign bank about the identity of any person with authority to direct transactions through any correspondent account that is a

payable-through account (a correspondent account maintained for a foreign bank through which the foreign bank permits its customer to engage, either directly or through a subaccount, in banking activities) and the sources and beneficial owners of funds or other assets in the payable-through account.

- determine whether the foreign bank maintains correspondent accounts for other foreign banks that enable those other foreign banks to gain access to the correspondent account under review and, if so, to take reasonable steps to obtain information to assess and mitigate the money laundering risks associated with such accounts, including, as appropriate, the identity of those other foreign banks; and
- if the foreign bank's shares are not publicly traded, determine the identity of each owner and the nature and extent of each owner's ownership interest. We understand that for purposes of determining a private foreign bank's ownership, an "owner" is any person who directly or indirectly owns, controls or has the power to vote 10 percent or more of any class of securities of a foreign bank. We also understand that members of the same family shall be considered to be one person.

13.8 Office of Foreign Assets Control (OFAC)

Checking the OFAC List

Before opening an account, and on an ongoing basis, the Firm will check to ensure that a customer does not appear on the Treasury's OFAC "Specifically Designated Nationals and Blocked Persons" List (SDN List). In the event the Firm determines that a customer, or someone with or for whom the customer is transacting, is on the SDN List (posted at ofac.finra.org) or is from or engaging in transactions with a person or entity located in an embargoed country or region, the Firm will reject the transaction and/or block the customer's assets and file a blocked assets and/or rejected transaction form with OFAC. The Firm will also call the OFAC Hotline at 1-800-540-6322. Our review will include customer accounts, transactions involving customers (including activity that passes through the firm such as wires) and the review of customer transactions that involve physical security certificates or application-based investments (*e.g.*, mutual funds).

Documentation

Evidence of the OFAC review should be documented (typically by using an AML Compliance Form). Any matches and/or questions ought to be directed toward the AMLCO.

Comparison with Government-Provided Lists of Terrorists and Other Criminals

From time to time, the Firm may receive notice that a federal government agency has issued a list of known or suspected terrorists. Within a reasonable period of time after an account is opened (or earlier, if required by another federal law or regulation or federal directive issued in connection with an applicable list), the Firm will determine whether a customer appears on any such list of known or suspected terrorists or terrorist organizations issued by any federal government agency and designated as such by Treasury in consultation with the Federal functional regulators. The Firm will follow all federal directives issued in connection with such lists. The Firm will continue to comply with Treasury's Office of Foreign Asset Control rules prohibiting transactions with certain foreign countries or foreign nationals.

Monitoring and Required Action

Monitoring Accounts for Suspicious Activity

The Firm will manually monitor a sufficient amount of account activity to permit identification of patterns of unusual size or volume, pattern or type of transactions, geographic factors such as whether jurisdictions designated as "non-cooperative" are involved, or any of the "red flags" identified below. The Firm will look at transactions, including trading and wire transfers, in the context of other account activity to determine if a transaction lacks financial sense or is suspicious because it is an unusual transaction or strategy for that customer. The AMLCO or his designee will be responsible for this monitoring and will report suspicious activities to the appropriate authorities. Among the information used to determine whether to file a Form SAR-SF are exception reports that include transaction size, location, type, number, and nature of the activity. The Firm will create employee guidelines with examples of suspicious money laundering activity and lists of high-risk clients whose accounts may warrant further scrutiny. The AMLCO will conduct an appropriate investigation before an SAR is filed. All employees are instructed to notify the AMLCO of any suspicious activities. The AMLCO is responsible for the filing of the SAR, if warranted.

Monitoring the Conduct and Accounts of Associated Persons

The Firm will subject all accounts of Associated Persons to the same AML procedures as customer accounts.

Emergency Notification to the Government by Telephone

When conducting due diligence or opening an account, the Firm will immediately call federal law enforcement when necessary, and especially in these emergencies: when a legal or beneficial account holder or person with whom the account holder is engaged in

a transaction is listed on or located in a country or region listed on the OFAC list; when an account is held by an entity that is owned or controlled by a person or entity listed on the OFAC list; when a customer tries to use bribery, coercion, or similar means to open an account or carry out a suspicious activity; when the Firm has reason to believe the customer is trying to move illicit cash out of the government's reach; or when it has reason to believe the customer is about to use the funds to further an act of terrorism. The Firm will first call the OFAC Hotline at 1-800-540-6322. The Firm will also use the contact numbers for the Financial Institutions Hotline (1-866-556-3974), the local U.S. Attorney's Office, the local FBI Office, and the local SEC Office.

Responding to Red Flags and Suspicious Activity

Red flags signaling possible money laundering or terrorist financing are detailed in the Firm's training materials. The purpose of these red flags is to assist Associated Persons in identifying issues that may be indicative of AML. When Associated Persons detect potential red flags, they are to consider reporting problematic situations to the AMLCO. It is not mandatory to report red flags that do not raise concerns so long as Associated Persons are considering AML issues. If reported to the AMLCO, the AMLCO is to document the event, including all of the details surrounding the event and any justification for not filing the report. If a SARs report is filed, please refer to the appropriate section in these procedures.

The Firm has established an extensive training program to educate its representatives regarding AML and CIP. During the training, examples are used to demonstrate and assist in identifying suspicious activities. All Associated Persons are reminded that they are the first line of defense.

Although not an exhaustive list, red flags may include instances related to the following:

The Firm has established an extensive training program to educate its representatives regarding AML and CIP. During the training, examples are used to demonstrate and assist in identifying suspicious activities. All Associated Persons are reminded that they are the first line of defense.

Although not an exhaustive list, red flags may include instances related to the following:

Customers – Insufficient or Suspicious Information

- Provides unusual or suspicious identification documents that cannot be readily verified.
- Reluctant to provide complete information about nature and purpose of usiness, prior banking relationships, anticipated account activity, officers and directors or business location.

- Refuses to identify a legitimate source for funds or information is false, misleading or substantially incorrect.
- Background is questionable or differs from expectations based on business activities.
- Customer with no discernable reason for using the firm's service.

Efforts to Avoid Reporting and Recordkeeping

- Reluctant to provide information needed to file reports or fails to proceed with transaction.
- Tries to persuade an employee not to file required reports or not to maintain required records.
- "Structures" deposits, withdrawals or purchase of monetary instruments below a certain amount to avoid reporting or recordkeeping requirements.
- Unusual concern with the firm's compliance with government reporting requirements and firm's AML policies.

Certain Funds Transfer Activities

- Wire transfers to/from financial secrecy havens or high-risk geographic location without an apparent business reason.
- Many small, incoming wire transfers or deposits made using checks and money orders. Almost immediately withdrawn or wired out in manner inconsistent with customer's business or history. May indicate a Ponzi scheme.
- Wire activity that is unexplained, repetitive, unusually large or shows unusual patterns or with no apparent business purpose.

Certain Deposits or Dispositions of Physical Certificates

- Physical certificate is titled differently than the account.
- Physical certificate does not bear a restrictive legend, but based on history of the stock and/or volume of shares trading, it should have such a legend.
- Customer's explanation of how he or she acquired the certificate does not make sense or changes.
- Customer deposits the certificate with a request to journal the shares to multiple accounts, or to sell or otherwise transfer ownership of the shares.

Certain Securities Transactions

- Customer engages in prearranged or other non-competitive trading, including wash or cross trades of illiquid securities.
- Two or more accounts trade an illiquid stock suddenly and simultaneously.
- Customer journals securities between unrelated accounts for no apparent business reason.
- Customer has opened multiple accounts with the same beneficial owners or controlling parties for no apparent business reason.
- Customer transactions include a pattern of receiving stock in physical form or the incoming transfer of shares, selling the position and wiring out proceeds.
- Customer's trading patterns suggest that he or she may have inside information.

Transactions Involving Penny Stock Companies

- Company has no business, no revenues and no product.
- Company has experienced frequent or continuous changes in its business structure.
- Officers or insiders of the issuer are associated with multiple penny stock issuers.
- Company undergoes frequent material changes in business strategy or its line of business.
- Officers or insiders of the issuer have a history of securities violations.
- Company has not made disclosures in SEC or other regulatory filings.
- Company has been the subject of a prior trading suspension.

Transactions Involving Insurance Products

- Cancels an insurance contract and directs funds to a third party.
- Structures withdrawals of funds following deposits of insurance annuity checks signaling an effort to avoid BSA reporting requirements.
- Rapidly withdraws funds shortly after a deposit of a large insurance check when the purpose of the fund withdrawal cannot be determined.
- Cancels annuity products within the free look period which, although could be legitimate, may signal a method of laundering funds if accompanied with other suspicious indicia.

- Opens and closes accounts with one insurance company then reopens a new account shortly thereafter with the same insurance company, each time with new ownership information.
- Purchases an insurance product with no concern for investment objective or performance.
- Purchases an insurance product with unknown or unverifiable sources of funds, such as cash, official checks or sequentially numbered money orders.

Activity Inconsistent With Business

- Transactions patterns show a sudden change inconsistent with normal activities.
- Unusual transfers of funds or journal entries among accounts without any apparent business purpose.
- Maintains multiple accounts, or maintains accounts in the names of family members or corporate entities with no apparent business or other purpose.
- Appears to be acting as an agent for an undisclosed principal, but is reluctant to provide information.

Other Suspicious Customer Activity

- Unexplained high level of account activity with very low levels of securities transactions.
- Funds deposits for purchase of a long-term investment followed shortly by a request to liquidate the position and transfer the proceeds out of the account.
- Law enforcement subpoenas.
- Large numbers of securities transactions across a number of jurisdictions.
- Buying and selling securities with no purpose or in unusual circumstances (*e.g.*, churning at customer's request).
- Payment by third-party check or money transfer without an apparent connection to the customer.
- Payments to third-party without apparent connection to customer.
- No concern regarding the cost of transactions or fees (*i.e.*, surrender fees, higher than necessary commissions, etc.).

This list of money laundering red flags is not exhaustive; however, an awareness of the red flags will help ensure that Firm personnel can identify circumstances warranting further due diligence.

Confidential Reporting of AML Non-Compliance

Associated Persons will report any violations of the Firm's AML compliance program to the AMLCO, unless the violations implicate the Compliance Officer, in which case such activity is to be reported to another member of the Firm's senior management. Such reports will be confidential, and the employee will suffer no retaliation for making them.

13.9 Filing Reports

Filing a Form SAR-SF

The Firm will file Form SAR-SFs for any account activity (including deposits and transfers) conducted or attempted through the Firm involving (or in the aggregate) $5,000 or more of funds or assets where it knows, suspects, or has reason to suspect the following:

1. The transaction involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade federal law or regulations or to avoid any transaction reporting requirement under federal law or regulations;
2. The transaction is designed, whether through structuring or otherwise, to evade any requirements of the BSA regulations;
3. The transaction has no business or apparent lawful purpose or is not the sort in which the customer would normally be expected to engage, and the Firm has been unable to determine any reasonable explanation for the transaction after examining the background, possible purpose of the transaction and other facts; or
4. The transaction involves the use of the Firm to facilitate criminal activity.

The Firm will not base its decision on whether to file a SAR-SF solely on whether the transaction falls above a set threshold. The Firm will file a SAR-SF and notify law enforcement of all transactions that raise an identifiable suspicion of criminal, terrorist, or corrupt activities.

In high-risk situations, the Firm will notify the government immediately and file a SAR-SF with FinCEN. Consequently, whenever any type of transaction report under the Bank Secrecy Act is filed with the federal government, the Firm should undertake efforts to analyze relevant state law to ascertain whether a duplicate or comparable form needs to be filed with a state authority. The Firm will not file SAR-SFs to report violations of federal securities laws or SRO rules by its Associated Persons that do not involve money laundering or terrorism, but it will report them to the SEC or the SRO.

All SAR-SFs will be immediately reported to the board of directors or senior management, with a clear reminder of the need to maintain the confidentiality of the SAR-SF. The Firm will report suspicious transactions by completing a SAR-SF, and collect and maintain supporting documentation as required by the BSA regulations. The Firm will file a SAR-SF no later than 30 calendar days after the date of initial discovery of the facts that constitute a basis for filing a SAR-SF. If no suspect is identified on the date of initial discovery, the Firm may delay filing the SAR-SF for an additional 30 calendar days pending identification of a suspect, but in no case will the reporting be delayed by more than 60 calendar days after the date of initial detection.

The Firm will retain copies of any filed SAR-SFs and the original or business record equivalent of any supporting documentation for five years from the date of filing the SAR-SF. The Firm will identify and maintain supporting documentation and make such information available to FinCEN, any other appropriate law enforcement agencies, or federal or state securities regulators, upon request.

The Firm will not notify any person involved in the transaction that the transaction has been reported, except as permitted by the BSA regulations. The Firm understands that anyone who is subpoenaed or required to disclose a SAR-SF or the information contained in the SAR-SF, except where disclosure is requested by FinCEN, the SEC, or another appropriate law enforcement or regulatory agency or an SRO registered with the SEC, will decline to produce the SAR-SF or to provide any information that would disclose that a SAR-SF was prepared or filed. The Firm will notify FinCEN of any such request and our response.

Repeated SAR Filings on the Same Activity

Should suspicious activities continue over a period of time, it is useful for such information to be made known to law enforcement (and the supervisors). As a general rule of thumb, the Firm should report continuing suspicious activity with a report being filed at least every 90 days. This will serve the purposes of notifying law enforcement of the continuing nature of the activity, as well as provide a reminder to the Firm that it must continue to review the suspicious activity to determine if other actions may be appropriate, such as terminating its relationship with the customer or employee that is the subject of the filing.

FinCEN's website contains additional information (see www.fincen.gov), including annual SAR Activity Reviews and SAR Bulletins, which discuss trends in suspicious reporting and give helpful tips.

Currency Transaction Reports (CTRs)

The Firm prohibits the receipt of currency. If the Firm discovers an attempt to deposit currency, it will file CTRs with FinCEN for transactions involving currency in excess of $10,000. Multiple transactions will be treated as a single transaction if they total more than $10,000 during any one business day.

Currency and Monetary Instrument Transportation Reports (CMIRs)

CMIRs are filed for certain transactions involving "monetary instruments." "Monetary instruments" include the following: currency; traveler's checks in any form; all negotiable instruments (including personal and business checks, official bank checks, cashier's checks, third party checks, promissory notes, and money orders) that are either in bearer form, endorsed without restriction, made out to a fictitious payee, or otherwise in such form that title passes upon delivery; incomplete negotiable instruments that are signed but omit the payee's name; and securities or stock in bearer form or otherwise in such form that title passes upon delivery. ***The Firm prohibits the receipt of currency*** and has established procedures to prevent its receipt. The Firm will file a CMIR with the Commissioner of Customs whenever the Firm transports, mails, ships or receives, or causes or attempts to transport, mail, ship, or receive monetary instruments of more than $10,000 at one time (on one calendar day or, if for the purpose of evading the reporting requirements, on one or more days) in or out of the United States. The Firm will file a CMIR for all such shipments or receipts of monetary instruments, except for currency or monetary instruments shipped or mailed through the postal service or by common carrier. The Firm will, however, file a CMIR for such receipts of currency and monetary instruments and for shipments and deliveries made by the Firm by means other than the postal service or common carrier, even when such shipment or transport is made by the Firm to an office of the Firm located outside the U.S.

Foreign Bank and Financial Accounts Reports (FBARs)

The Firm will file an FBAR with FinCEN for any financial accounts of more than $10,000 that it holds, or over which it holds signature or other authority, in a foreign country.

Transfers of $3,000 or More under the Joint and Travel Rule

When the Firm transfer funds of $3,000 or more, it will record the following information on the transmittal order, at minimum: the name of the transmitter and recipient, the amount of the transmittal order, the identity of the recipient's financial institution, and the account number of the recipient (if wired) or address (if a physical check is sent). The AMLCO (or designee) is to check all "red flag" recipients and/or transmitters against the OFAC list to verify that they are not suspected terrorists. Any patterns of wire

activity and/or transfers of funds are to be reported to the AMLCO and documented. If suspicious activities are noted, the AMLCO will make the appropriate filings.

AML Record Keeping—SAR-SF Maintenance and Confidentiality

The Firm holds SAR-SFs and any supporting documentation confidential. The Firm will not inform anyone outside of a law enforcement, regulatory agency, or securities regulator about a SAR-SF. The Firm will refuse any subpoena requests for SAR-SFs or SAR-SF information and immediately tell FinCEN of any such subpoena it receives. The Firm will segregate SAR-SF filings and copies of supporting documentation from other Firm books and records to avoid disclosing SAR-SF filings. The AMLCO will handle all subpoenas or other requests for SAR-SFs. The Firm will share information with its clearing firm about suspicious transactions in order to determine when a SAR-SF should be filed. As mentioned earlier, the Firm may share a copy of the filed SAR-SF with the clearing firm unless it would be inappropriate to do so under the circumstances, such as when the Firm files a SAR-SF concerning the clearing firm or its Associated Persons.

13.10 Books and Records

Responsibility for AML Records and SAR Filing

The AMLCO or his designee will be responsible for ensuring that AML records are maintained properly and that SARs are filed as required. All records will be maintained for at least a five-year period.

Required Records

As part of the AML program, the Firm will create and maintain SAR-SFs, CTRs, CMIRs, FBARs, and relevant documentation on customer identity and verification and funds transfers and transmittals, as well as any records related to customers listed on the OFAC list. The Firm will maintain SAR-SFs and their accompanying documentation for at least five years. The Firm will keep other documents according to existing BSA regulations and other record keeping requirements, including certain SEC rules that require retention of records for six years.

Foreign Correspondent Accounts and Foreign Shell Banks

Detecting and Closing Correspondent Accounts of Unregulated Foreign Shell Banks

The Firm prohibits the opening of accounts for foreign shell banks. The AMLCO is responsible for reviewing all new accounts and all CIP-related documents. If a new account is identified as being associated with a foreign shell bank, the AMLCO must immediately take action to close the account.

Broker/dealers are prohibited from establishing, maintaining, administering, or managing correspondent accounts for unregulated foreign shell banks. Foreign shell banks are foreign banks without a physical presence in any country. A "foreign bank" is any bank organized under foreign law or an agency, branch, or office of a bank located outside the U.S. The term does not include an agent, agency, branch, or office within the U.S. of a bank organized under foreign law. A "regulated affiliate" of a foreign bank is a foreign bank that (1) is an affiliate of a depository institution, credit union, or foreign bank that maintains a physical presence in the U.S. or a foreign country and (2) is subject to supervision by a banking authority in the country regulating such affiliated depository institution, credit union, or foreign bank. The prohibition does not include foreign shell banks that are affiliates of a depository institution, credit union, or foreign bank that maintains a physical presence in the U.S. or a foreign country, and are subject to supervision by a banking authority in the country regulating that affiliated depository institution, credit union, or foreign bank. Foreign branches of a U.S. broker/dealer are not subject to this requirement, and "correspondent accounts" of foreign banks that are clearly established, maintained, administered, or managed only at foreign branches are not subject to this regulation.

The Firm does not establish, maintain, administer, or manage correspondent accounts for unregulated foreign shell banks.

Upon finding or suspecting such accounts, Firm employees will notify the AMLCO, who will terminate any verified correspondent account in the United States for an unregulated foreign shell bank. The Firm will also terminate any correspondent account that it has determined is not maintained by an unregulated foreign shell bank but is being used to provide services to such a shell bank.

Certifications from Foreign Bank Account Holders

Foreign bank account holders must complete model certifications issued by the Treasury and provided by the Firm. These forms require foreign account holders to certify that they are not shell banks and to provide ownership and agent information. The Firm will require foreign account holders to re-certify whenever it believes that the information is no longer accurate, and at least once every three years.

Summons or Subpoenas of Foreign Bank Records; Termination of Correspondent Relationships

When the Firm receives a written request from a federal law enforcement officer for information concerning correspondent accounts, it will provide that information to the requesting officer no later than 7 days after receipt of the request. The Firm will close, within 10 days, any account for a bank that, according to the Treasury Department or

the Department of Justice, has failed to comply with a summons or has contested a summons. The Firm will scrutinize any account activity during that 10-day period to ensure that any suspicious activity is appropriately reported and to ensure that no new positions are established in these accounts.

13.11 Information Sharing

Clearing/Introducing Firm Relationships

The Firm will work closely with its clearing firm to detect money laundering. The Firm will exchange information, records, data, and exception reports as necessary to comply with AML laws. We will obtain and use exception reports, (if offered by our clearing firm) in order to monitor customer activity and we will provide our clearing firm with proper customer identification and due diligence information as required to successfully monitor customer transactions. The Firm has set out these responsibilities in its clearing agreement under NASD Rule 3230. The Firm understands that the agreement will not relieve either organization from their respective obligations to comply with AML laws.

Sharing Information with Other Financial Institutions

The Firm will share information with other financial institutions; however, for purposes of determining whether to file an SAR-SF, it will share information about particular suspicious transactions with its clearing firm. In cases where the Firm files a SAR-SF for a transaction that has been handled both by the Firm and by its clearing firm, the Firm may share a copy of the filed SAR-SF with the clearing firm, unless it would be inappropriate to do so under the circumstances, such as when the SAR-SF pertains to the clearing firm or one of its employees.

13.12 Independent Testing

FINRA Rule 3310, which superseded NASD Rule 3011, requires that member firms provide for an independent testing function to review and assess the adequacy of and level of compliance with the Firm's AML compliance program. The rule will allow for either internal testing by qualified personnel or the use of a qualified outside party. If a firm uses internal personnel, sufficient separation of functions should be maintained to ensure the independence of the internal testing personnel. The independent testing should be performed annually. After a test is complete, the auditor should report findings to senior management or to an internal audit committee, as appropriate.

The AMLCO is responsible for ensuring that any corrective actions are taken related to the auditor's recommendations. The AMLCO is to make all final decisions related to the person or independent auditor that conducts the annual AML Audit. The main focus

should be on the separation of functions so that the individual(s) testing the AML program are not involved in monitoring day-to-day AML compliance functions.

13.13 Monitoring Employee Conduct and Accounts

We will subject employee accounts to the same AML procedures as customer accounts, under the supervision of the AML Compliance Officer. We will also review the AML performance of supervisors, as part of their annual performance review. The AML Compliance Officer's accounts will be reviewed by their Designated Principal.

13.14 Approval of AML Procedures

The Firm's AMLCO is to approve AML procedures reasonably designed to achieve and monitor ongoing compliance with the requirements of the BSA and the implementing regulations under the BSA.

14. IDENTITY THEFT PREVENTION PROGRAM (ITPP)

14.1 Firm Policy

The purpose of the program is to establish an Identity Theft Prevention Program designed to detect, prevent and mitigate identity theft in connection with the opening of a covered account or an existing covered account and to provide for continued administration of the Program in compliance with Part 681 of Title 16 of the Code of Federal Regulations implementing Sections 114 and 315 of the Fair and Accurate Credit Transactions Act (FACTA) of 2003. This Identity Theft Program includes policies and procedures to:

1. Identify relevant red flags for covered accounts it offers or maintains and incorporate those red flags into the program;
2. Detect red flags that have been incorporated into the Program;
3. Respond appropriately to any red flags that are detected to prevent and mitigate identity theft; and
4. Ensure the Program is updated to reflect changes in risks to customers and to the safety and soundness of the creditor from identity theft.

Our identity theft policies, procedures and internal controls will be reviewed and updated periodically to ensure they account for changes both in regulations and in our business.

Defining Financial Institution vs. Creditor

A firm is a "financial institution" if it provides, either directly or indirectly through a clearing firm, consumer "transaction accounts," which are accounts that allow account holders to make withdrawals for payment or transfer of funds to third parties by telephone transfers, checks, debit cards or similar means. Since "consumer" is defined as an individual, a firm without individuals as clients would not be a financial institution under this definition.

The term "creditor" means any person who regularly extends, renews, or continues credit or regularly arranges for the extension, renewal or continuation of credit. A member firm, acting as either an introducing or clearing firm, that provides a customer with margin, will be deemed a creditor for purposes of the "Red Flag" rule.

Covered Accounts

A "covered account" is defined as (1) an account offered or maintained primarily for personal, family, or household purposes that is designed to permit multiple payments

for transactions; or (2) any other account for which there is a reasonably foreseeable risk to customer or safety and soundness of the member firm from identity theft, including financial, operational, compliance, reputation, or litigation risks. Covered accounts generally apply only to retail accounts; the alternative definition would also include any type of account, including institutional accounts, if the member firm determines that those accounts pose a reasonably foreseeable risk to its customer or to its own safety or soundness from identity theft.

Firm Applicability

Our firm has thoroughly reviewed the Red Flag Rule and determined the Red Flag rule does apply. Our firm is defined as a "financial institution" because we act as an introducing broker/dealer whom indirectly holds transaction accounts for customers. Our customers who have a transaction account may make withdrawals for payment or transfer to third parties of securities or funds via written request or telephone transfer. Our clearing firm holds the transaction accounts for our customers and facilitates the withdrawals for payment and transfers to third parties. It is noted that FTC regulations governing the issuance of credit or debit cards are not applicable to our firm. The oversight and review of our debit card issuance and maintenance would be done by our clearing firm.

We are also deemed a "creditor" as defined by the rule because we arrange for the extension and continuation of credit (margin) to our customers through our clearing firm. Our clearing firm maintains all of the margin accounts and extends the credit to our customers on our behalf.

14.2 ITPP Approval and Administration

The firm will designate the firm's CCO as the person who will be responsible for the oversight, development, implementation and administration of the written identity theft program. The designated person has reviewed and approved the firm's initial Identity Theft and Prevention Program and shall be responsible for:

- The initial and ongoing training of personnel regarding the firm's identity theft program to effectively implement the Program;
- Review and exercise appropriate and effective oversight of service provider arrangements.
- Assignment of specific responsibility for implementation of the Program to designated persons;
- Review reports prepared by compliance; and

- Approval of changes to the Program as necessary to address changing risks of identity theft.

14.3 Relationship to Other Firm Programs

We have reviewed other policies, procedures and plans required by regulations regarding the protection of our customer information, including our policies and procedures under Regulation S-P, our CIP and red flags detection under our AML Compliance Program in the formulation of this ITPP to minimize inconsistencies and duplicative efforts.

We believe that our ITP program in conjunction with our firm's policies and procedures governing the protection of customer data under Regulation S-P ensure the data safekeeping and disposal of customer information. Under Regulation S-P, our customer information is safeguarded by restricting access to the information only to employees who need access in order to service the customer's account. A paper shredder is used for destruction of all client related documents. Any devices including CDs, flash drives, floppy disks, laptops, PDAs must be approved by the CCO prior to discarding such device. The CCO will ensure adequate testing of new technology is completed and safeguards in place to protect client sensitive data for new technology. Registered Persons are responsible for attesting annually to the confidentiality, protection, and destruction of customer information.

Under the firm's CIP program, the firm obtains documentary and non-documentary evidence for all new customer accounts, as well as running an OFAC check for each account. The firm makes every attempt to verify the identity of each customer of the firm. If the firm cannot identify the customer's identity then we will not open the account. We review our new accounts and existing accounts at all time for Red Flags in accordance with our AML procedures and utilize all resources available to cross-review for any identity theft red flags.

14.4 Identifying Relevant Red Flags

In order to identify relevant Red Flags, the firm has considered the types of covered accounts that it offers and maintains, the methods it provides to open its accounts, the methods it provides to access its accounts and its previous experience with Identify Theft. The firm identifies the following red flags, in each of the listed categories:

A. Notifications and Warnings from Clearing Firm and/or Custodian:

- Report of fraud accompanying a credit report;
- Notice or report of a credit freeze on a customer or applicant; and

- Indication of activity that is inconsistent with a customer's usual pattern or activity.

B. Suspicious Documents

- Identification document that appears to be forged, altered or inauthentic;
- Identification document on which a person's photograph or physical description is not consistent with the person presenting the document;
- Other document with information that is not consistent with existing customer information (such as if a person's signature on a check appears forged); and
- Application for service that appears to have been altered or forged.

C. Suspicious Personal Identifying Information

- Identifying information presented that is inconsistent with other information the customer provides (example: inconsistent birth dates);
- Identifying information presented that is inconsistent with other sources of information (for instance, an address not matching an address on the credit report);
- Identifying information presented that is the same as information shown on other applications that were found to be fraudulent;
- Identifying information presented that is consistent with fraudulent activity (such as an invalid phone number or fictitious billing address);
- Social Security number presented that is the same as one given by another customer;
- An address or phone number presented that is the same as that of another person;
- A person fails to provide complete personal identifying information on an application when reminded to do so (however, by law social security numbers must not be required); and
- A person's identifying information is not consistent with the information that is on file for the customer.

D. Suspicious Account Activity or Unusual Use of Account

- Change of address for an account followed by a request to change the account holder's name;

- Payments stop on an otherwise consistently up-to-date account;
- Account used in a way that is not consistent with prior use (example: very high activity);
- Mail sent to the account holder is repeatedly returned as undeliverable;
- Notice to the firm that a customer is not receiving mail sent by the firm;
- Notice to the firm that an account has unauthorized activity:
- Breach in the firm's computer system security; or
- Unauthorized access to or use of customer account information.

E. Alerts from Others

- Notice to the firm from a customer, identity theft victim, law enforcement or other person that it has opened or is maintaining a fraudulent account for a person engaged in Identity Theft.

14.5 Detecting Red Flags

New Accounts

In order to detect any of the Red Flags identified above associated with the opening of a new account, the firm will take the following steps to obtain and verify the identity of the person opening the account:

- Require certain identifying information per the firm's AML/CIP Procedures.
- Following existing documentary and non-documentary means of verification as defined in the AML/CIP Procedures.

Existing Accounts

In order to detect any of the Red Flags identified above for an existing account, the firm will take the following steps to monitor transactions with an account:

- Verify the customer is actually the person making all requests;
- Verify the validity of requests to change billing addresses; and
- Verify changes in banking information given for billing and payment purposes.

For any customer address changes, the firm verifies the change in address by sending a notice of change of address to the old address and new address of record. For any changes in banking information given for billing and payment purposes, the firm will require that the Representative verify all such requests.

We have included in the second column ("Detecting the Red Flag") of the attached Grid how we will detect each of our firm's identified Red Flags.

14.6 Preventing and Mitigating Identity Theft

When we have been notified of a Red Flag or our detection procedures show evidence of a Red Flag, associated persons will immediately notify the Chief Compliance Officer (CCO). After the CCO is notified, the following steps may be taken depending on the degree of risk posed by the red flag:

Applicants

For Red Flags raised by someone applying for an account:

1. Review the application. We will review the applicant's information collected for our CIP under our AML Compliance Program (e.g., name, date of birth, address, and an identification number such as a Social Security Number or Taxpayer Identification Number).
2. Get government identification. If the applicant is applying in person, we will also check a current government-issued identification card, such as a driver's license or passport.
3. Seek additional verification. If the potential risk of identity theft indicated by the Red Flag is probable or large in impact, we may also verify the person's identity through non-documentary CIP methods, including:
    a. Contacting the customer
    b. Independently verifying the customer's information by comparing it with information from a credit reporting agency, public database or other source such as a data broker [or] the Social Security Number Death Master File
    c. Checking references with other affiliated financial institutions, or
    d. Obtaining a financial statement.
4. Deny the application. If we find that the applicant is using an identity other than his or her own, we will deny the account.
5. Report. If we find that the applicant is using an identity other than his or her own, we will report it to appropriate local and state law enforcement; where organized or wide spread crime is suspected, the FBI or Secret Service; and if mail is involved, the US Postal Inspector. We may also, as recommended by FINRA's Customer Information Protection web page's "Firm Checklist for

Compromised Accounts," report it to our FINRA coordinator; the SEC; State regulatory authorities, such as the state securities commission; and our clearing firm.

6. Notification. If we determine personally identifiable information has been accessed, we will prepare any specific notice to customers or other required notice under state law.

Access Seekers.

For Red Flags raised by someone seeking to access an existing customer's account:

1. Watch. We will monitor, limit, or temporarily suspend activity in the account until the situation is resolved.
2. Check with the customer. We will contact the customer using our CIP information for them, describe what we have found and verify with them that there has been an attempt at identify theft.
3. Heightened risk. We will determine if there is a particular reason that makes it easier for an intruder to seek access, such as a customer's lost wallet, mail theft, a data security incident, or the customer's giving account information to an imposter pretending to represent the firm or to a fraudulent web site.
4. Check similar accounts. We will review similar accounts the firm has to see if there have been attempts to access them without authorization.
5. Collect incident information. For a serious threat of unauthorized account access we may, as recommended by FINRA's Customer Information Protection web page's "Firm Checklist for Compromised Accounts," collect if available:
    a. Firm information (both introducing and clearing firms):
        i. Firm name and CRD number
        ii. Firm contact name and telephone number
    b. Dates and times of activity
    c. Securities involved (name and symbol)
    d. Details of trades or unexecuted orders
    e. Details of any wire transfer activity
    f. Customer accounts affected by the activity, including name and account number, and
    g. Whether the customer will be reimbursed and by whom.

6. Report. If we find unauthorized account access, we will report it to appropriate local and state law enforcement; where organized or wide spread crime is suspected, the FBI or Secret Service; and if mail is involved, the US Postal Inspector. We may also, as recommended by FINRA's Customer Information Protection web page's "Firm Checklist for Compromised Accounts," report it to our FINRA coordinator; the SEC; State regulatory authorities, such as the state securities commission; and our clearing firm.
7. Notification. If we determine personally identifiable information has been accessed that results in a foreseeable risk for identity theft, we will prepare any specific notice to customers or other required under state law.
8. Review our insurance policy. Since insurance policies may require timely notice or prior consent for any settlement, we will review our insurance policy to ensure that our response to a data breach does not limit or eliminate our insurance coverage.
9. Assist the customer. We will work with our customers to minimize the impact of identity theft by taking the following actions, as applicable:
    a. Offering to change the password, security codes or other ways to access the threatened account;
    b. Offering to close the account;
    c. Offering to reopen the account with a new account number;
    d. Not collecting on the account or selling it to a debt collector; and
    e. Instructing the customer to go to the FTC Identity Theft Web Site to learn what steps to take to recover from identity theft, including filing a complaint using its online complaint form, calling the FTC's Identity Theft Hotline 1-877-ID-THEFT (438-4338), TTY 1-866-653-4261, or writing to Identity Theft Clearinghouse, FTC, 6000 Pennsylvania Avenue, NW, Washington, DC 20580.

In order to prevent the likelihood of identity theft occurring with respect to data transmission, the firm will take the following steps with respect to its internal operating procedures to protect customer identifying information:

- Ensure that its website is secure or provide clear notice that the website is not secure;
- Ensure complete and secure destruction of paper documents and computer files containing customer information;

- Ensure that the office computers are password protected and that computer screens lock after a set period of time;
- Keep offices clear of papers containing customer information;
- Request only the last 4 digits of social security numbers (if any);
- Ensure computer virus protection is up to date;
- Limit the use of unsecured e-mail to transmit customer data or if confidential customer information is sent, ensure it is encrypted; and
- Require and keep only the kinds of customer information that are necessary for utility purposes.

14.7 Clearing Firm and Other Service Providers

Our firm uses a clearing firm in connection with our covered accounts. We have a process to confirm that our clearing firm and any other service provider that performs activities in connection with our covered accounts, especially other service providers that are not otherwise regulated, comply with reasonable policies and procedures designed to detect, prevent and mitigate identity theft by contractually requiring them to have policies and procedures to detect Red Flags contained in our Grid and report detected Red Flags to us or take appropriate steps of their own to prevent or mitigate the identify theft or both. We maintain a list which contains our clearing firm's name, address, phone number, e-mail address, web site, our contact person (which includes their name, phone number, and e-mail), and any service providers that perform activities in connection with our covered accounts (which includes their name, address and phone number, and e-mail address).

In the event the firm engages a service provider to perform an activity in connection with one or more accounts, we will take the following steps to ensure the service provider performs its activity in accordance with policies and procedures designed to detect, prevent, and mitigate identity theft.

- Perform due-diligence on such company;
- Ensure that such information sharing is permitted in accordance with the firm's privacy policy;
- Maintain a record of any customer document that is taken offsite; and
- Supervise such activity at all times.

14.8 Internal Compliance Reporting

Annually, the CCO and our compliance staff responsible for developing, implementing and administering our firm's Identity Theft Program will prepare a report regarding the firm's Identity Theft Program and compliance with the FTC's Red Flags Rule. The compliance report will include but are not limited to:

- The effectiveness of the policies and procedures in addressing the risk of identity theft in connection with the opening of covered accounts and with respect to existing covered accounts;
- Service provider agreements;
- Significant incidents involving identity theft and management's response (if any) and;
- Recommendations for material changes to the Program.

14.9 Supervision and Record Retention

In accordance with FINRA and the FACTA of 2003, the firm will retain copies of the following books and records and evidence of supervisory approval will be retained (if required). This list includes, but is not limited to the following:

- Initial Identity Theft written program with evidence of principal approval.
- Training provided to firm employees regarding the firm's written identity theft program.
- Annual compliance reports regarding an evaluation of the firm's written program.
- Annual review of the firm's written plan

14.10 Updates and Annual Review

The Program shall be updated as needed to reflect material changes in our operations, structure, business or location of our clearing firm, risks to customers or to the safety and soundness of the organization from identity theft based on factors such as:

- The experiences of the organization with identity theft;
- Changes in methods of identity theft;
- Changes in methods to detect, prevent and mitigate identity theft;
- Changes in the types of accounts that the organization offers or maintains;

- Changes in the business arrangements of the organization, including mergers, acquisitions, alliances, joint ventures and service provider arrangements.

Our firm will also follow new ways that identities can be compromised and evaluate the risk they pose for our firm. In addition, our firm will review this ITPP annually to modify it for any changes in our operations, structure, business, or location or substantive changes to our relationship with our clearing firm.

14.11 Approval

This Identity Theft Prevention Program has been approved as being reasonably designed to enable our firm to detect, prevent and mitigate identity theft.

14.12 Red Flag Identification and Detection Grid

Red Flag	Detecting the Red Flag
Category: Suspicious Documents	
1. Identification presented looks altered or forged.	Our staff who deals with customers and their supervisors will scrutinize identification presented in person to make sure it is not altered or forged. If the person feels the identification has been altered or forged, they will consult with their supervisory principal and the compliance department if needed. If the supervisory principal and compliance department determine there is identity theft involved, the account will not be opened and reported to local authorities if warranted.
2. The identification presenter does not look like the identification's photograph or physical description.	Our staff who deals with customers and their supervisors will ensure that the photograph and the physical description on the identification match the person presenting it. The staff person may request additional forms of photo identification to verify the identity of the customer. If questions still remain, the supervisory principal and compliance

Red Flag	Detecting the Red Flag
	may be involved. If there are still questions regarding the presenter's identity, and determine there is identity theft, then the account will not be opened and we will report the breach to local authorities if warranted.
3. Information on the identification differs from what the identification presenter is saying.	Our staff who deals with customers and their supervisors will ensure that the identification and the statements of the person presenting it are consistent. If the staff and supervisor determine that the identification and statements of the person continue to be different or other information is suspicious, then the account will not be opened, and we will report the breach to local authorities if warranted.
4. Information on the identification does not match other information our firm has on file for the presenter, like the original account application, signature card or a recent check.	Our staff who deals with customers and their supervisors will ensure that the identification presented and other information we have on file from the account, such as the new account form, and other forms of documentary and non-documentary evidence are consistent. If questions arise that the information on the identification presented is different, the staff will discuss with the supervisory principal and compliance department to determine if a breach in customer identity has occurred and/or if the account needs to be frozen or closed and the customer contacted.
5. The application looks like it has been altered, forged or torn up and reassembled.	Our staff who deals with customers and their supervisors will scrutinize each application to make sure it is not altered,

Red Flag	Detecting the Red Flag
	forged, or torn up and reassembled. The staff will compare the signature on the application to other forms of identification with signatures and photo identification to determine if it is consistent. If there is any question that the application has been altered in any way or forged, the account will not be opened.
Category: Suspicious Personal Identifying Information	
6. Inconsistencies exist between the information presented and other things we know about the presenter or can find out by checking readily available external sources, such as an address that does not match a consumer credit report, or the Social Security Number (SSN) has not been issued or is listed on the Social Security Administration's (SSA's) Death Master File.	Our staff will check personal identifying information presented to us to ensure that the SSN given has been issued but is not listed on the SSA's Master Death File. If we receive a consumer credit report, they will check to see if the addresses on the application and the consumer report match. If we determine the addresses do not match, we will attempt to contact the customer to verify the source and red flag. If we determine that the SSN given is on the SSA's Master Death list, then we will not open the account/or freeze the account and report identity theft to local authorities.
7. Inconsistencies exist in the information that the customer gives us, such as a date of birth that does not fall within the number range on the SSA's issuance tables.	Our staff will check personal identifying information presented to us to make sure that it is internally consistent by comparing the date of birth to see that it falls within the number range on the SSA's issuance tables.
8. Personal identifying information presented has been used on an account our firm knows was fraudulent.	Our staff will compare the information presented with addresses and phone

Red Flag	Detecting the Red Flag
	numbers on accounts or applications we found or were reported were fraudulent.
9. Personal identifying information presented suggests fraud, such as an address that is fictitious, a mail drop, or a prison; or a phone number is invalid, or is for a pager or answering service.	Our staff will validate the information presented when opening an account by looking up addresses on the Internet to ensure they are real and not for a mail drop or a prison, and will call the phone numbers given to ensure they are valid and not for pagers or answering services.
10. The SSN presented was used by someone else opening an account or other customers.	Our staff will compare the SSNs presented to see if they were given by others opening accounts or other customers.
11. The address or telephone number presented has been used by many other people opening accounts or other customers.	Our staff will compare address and telephone number information to see if they were used by other applicants and customers.
12. A person who omits required information on an application or other form does not provide it when told it is incomplete.	Our staff will track when applicants or customers have not responded to requests for required information and will follow up with the applicants or customers to determine why they have not responded.
13. Inconsistencies exist between what is presented and what our firm has on file.	Our staff will verify key items from the data presented with information we have on file.
14. A person making an account application or seeking access cannot provide authenticating information beyond what would be found in a wallet or consumer credit report, or cannot answer a challenge question.	Our staff will authenticate identities for existing customers by asking challenging questions that have been prearranged with the customer and for applicants or customers by asking questions that require information beyond what is readily available from a wallet or a

Red Flag	Detecting the Red Flag
	consumer credit report. If the questions are unable to be answered by a new customer, we will refuse to open the account.
Category: Suspicious Account Activity	
15. Soon after our firm gets a change of address request for an account, we are asked to add additional access means (such as debit cards or checks) or authorized users for the account.	We will verify change of address requests by sending a notice of the change to both the new and old addresses so the customer will learn of any unauthorized changes and can notify us. If the customer notifies us that they did not make a change of address, we will freeze the account and wait for further instructions from the customer.
16. A new account exhibits fraud patterns, such as where a first payment is not made or only the first payment is made, or the use of credit for cash advances and securities easily converted into cash.	We will review new account activity to ensure that first and subsequent payments are made, and that credit is primarily used for other than cash advances and securities easily converted into cash. If we notice any changes out of the ordinary, we will contact the customer to verify the activity.
17. An account develops new patterns of activity, such as nonpayment inconsistent with prior history, a material increase in credit use, or a material change in spending or electronic fund transfers.	We will review our accounts on at least a monthly basis and check for suspicious new patterns of activity such as nonpayment, a large increase in credit use, or a big change in spending or electronic fund transfers. We will make every attempt to contact the customer to verify the new patterns noted. If the customer indicates they did not do the trades and we determine a case of possible identity theft, we will freeze the account.

Red Flag	Detecting the Red Flag
18. An account that is inactive for a long time is suddenly used again.	We will review our accounts on at least a monthly basis to see if long inactive accounts become very active. We will monitor the account if it does become active and contact the customer to get a customer update form and ensure their objective is the same or changed. If we determine the activity was not authorized, we will work with the customer to reverse the transactions, freeze the account or close.
19. Mail our firm sends to a customer is returned repeatedly as undeliverable even though the account remains active.	We will note any returned mail for an account and immediately check the account's activity. We will contact all telephone numbers we have for the customer to attempt to get a correct address and verify the activity. If after repeated attempts we are unsuccessful, we will freeze the account due to the activity of the account and our inability to contact the customer to verify the activity.
20. We learn that a customer is not getting his or her paper account statements.	We will record on the account any report that the customer is not receiving paper statements and immediately investigate them. We will verify with the customer the address on record for account statements and freeze the account if it is requested by the customer.
21. We are notified that there are unauthorized charges or transactions to the account.	We will verify if the notification is legitimate and involves a firm account, and then investigate the report. We will contact the customer and freeze their account to ensure no other unauthorized charges or transactions

Red Flag	Detecting the Red Flag
	occur. We will close the account at the customer's request.
Category: Notice From Other Sources	
22. We are told that an account has been opened or used fraudulently by a customer, an identity theft victim, or law enforcement.	We will verify that the notification is legitimate and involves a firm account, and then investigate the report. If we determine that it does involve e a firm account, then we will freeze the account and report to law enforcement authorities.
23. We learn that unauthorized access to the customer's personal information took place or became likely due to data loss (e.g., loss of wallet, birth certificate, or laptop), leakage, or breach.	We will contact the customer to learn the details of the unauthorized access to determine if other steps are warranted. We will assist the customer in every way by providing them contact numbers for identity theft victims and freeze all accounts at our firm. If the client has any account access which would require a password, then all passwords will be reset.
Category: Alerts, Notifications or Warnings from a Consumer Credit Reporting Agency	
24. A fraud or active duty alert is included on a consumer credit report.	We will verify that the fraud or active duty alert covers an applicant or customer and review the allegations in the alert. We will contact our customer to confirm the fraud alert on the account to ensure a potential identity theft alert is pertinent.
25. A notice of credit freeze is given in response to a request for a consumer credit report.	We will verify that the credit freeze covers an applicant or customer and review the freeze.
26. A notice of address or other discrepancy is provided by a consumer credit reporting agency.	We will verify that the notice of address or other discrepancy covers an applicant

Red Flag	Detecting the Red Flag
	or customer and review the address discrepancy.
27. A consumer credit report shows a pattern inconsistent with the person's history, such as a big increase in the volume of inquiries or use of credit, especially on new accounts; an unusual number of recently established credit relationships; or an account closed because of an abuse of account privileges.	We will verify that the consumer credit report covers an applicant or customer, and review the degree of inconsistency with prior history.
Category: Email	
28. We receive an emailed request that is out of the ordinary.	We will verbally confirm the request by calling the customer.
29. We receive an emailed request that does not make sense (*e.g.,* a request to withdraw funds from an account that holds no customer assets other than illiquid securities, such as restricted securities acquired through a private placement);	We will verbally confirm the request by calling the customer.
30. We receive an emailed request to transfer funds to an unfamiliar third party account.	We will verbally confirm the request by calling the customer.
31. We receive an emailed request that purports to be urgent or otherwise appears designed to impede verification of the instruction.	We will verbally confirm the request by calling the customer.
Approved  Denise M. Buchanan Chief Compliance Officer	March 31, 2020

15. SUITABILITY GUIDELINES

The Registered Representative is responsible for determining suitability of all investments in light of the client risk tolerance and profile. The "know your customer rule" applies to all transactions, and each customer has individual needs and all Registered Representatives are to act in the customer's best interest. FINRA Rule 2111 "Know Your Customer" rule requires a firm or associated person to "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." The rule further explains that a "customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."

The rule continues to use a broker's "recommendation" as the triggering event for application of the rule and continues to apply a flexible "facts and circumstances" approach to determining what communications constitute such a recommendation. The new rule also applies to recommended investment strategies, clarifies the types of information that brokers must attempt to obtain and analyze, and discusses the three main suitability obligations. Finally, the new rule modifies the institutional-investor exemption in a number of important ways.

15.1 Recommendations

Several guiding principles are relevant to determining whether a particular communication could be viewed as a recommendation for purposes of the suitability rule. For instance, a communication's content, context and presentation are important aspects of the inquiry. The determination of whether a "recommendation" has been made, moreover, is an objective rather than subjective inquiry. An important factor in this regard is whether—given its content, context and manner of presentation—a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy. In addition, the more individually tailored the communication is to a particular customer or customers about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation. Furthermore, a series of actions that may not constitute

recommendations when viewed individually may amount to a recommendation when considered in the aggregate.

15.2 Strategies

The know your customer explicitly applies to recommended investment strategies involving a security or securities. The rule emphasizes that the term "strategy" should be interpreted broadly. The rule is triggered when a firm or associated person recommends a security or strategy regardless of whether the recommendation results in a transaction. Among other things, the term "strategy" would capture a broker's *explicit* recommendation to hold a security or securities.

15.3 Customer's Investment Profile

The know your customer rule includes an expanded list of explicit types of information that firms and associated persons must attempt to gather and analyze as part of a suitability analysis. The new rule essentially adds age, investment experience, time horizon, liquidity needs and risk tolerance to the existing list (other holdings, financial situation and needs, tax status and investment objectives).

15.4 Main Suitability Obligations

- Reasonable-basis suitability requires a broker to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and the firm's or associated person's familiarity with the security or investment strategy. A firm's or associated person's reasonable diligence must provide the firm or associated person with an understanding of the potential risks and rewards associated with the recommended security or strategy.
- Customer-specific suitability requires that a broker have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile. As noted above, the new rule requires a broker to attempt to obtain and analyze a broad array of customer-specific factors.
- Quantitative suitability requires a broker who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the

customer's investment profile. Factors such as turnover rate, cost-equity ratio and use of in-and-out trading in a customer's account may provide a basis for finding that the activity at issue was excessive.

The new rule makes clear that a broker must have a firm understanding of both the product and the customer. It also makes clear that the lack of such an understanding itself violates the suitability rule.

15.5 Suitability for Institutional Transactions

Before making any recommendations to institutional customers, the Firm is required to evaluate the extent of its obligation for determining suitability for institutional customers. During this process, it is the responsibility of the Firm to determine whether the institutional customer is capable of independently evaluating its investment risks, as well as its ability to exercise independent judgment in evaluating the Firm's recommendation.

The following is a summary of some of the factors in the ability to evaluate risk:

- Understanding of the investment product's economic features;
- Complexity and specialization of the investment product;
- The use of financial consultants and/or advisors;
- Independent evaluation of market effects on investment product; and
- General and specific investment experience.

When making an independent judgment in evaluating an investment recommendation, other factors may include the use of written or oral agreement between the Firm and institutional customer, and the use of in-depth market analyses from other broker/dealers.

FINRA Rule 2111(b) provides an exemption to customer-specific suitability for recommendations to institutional customers under certain circumstances. The exemption's main focus is whether the broker has a reasonable basis to believe the customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies, and whether the institutional customer affirmatively acknowledges that it is exercising independent judgment.

The designated principal will review each customer's new account form for suitability of each transaction. All relevant customer account information and documentation will be properly evidenced as indication of review.

Other considerations that may be involved in determining suitability of an investment are as follows:

- **Investor Considerations.** Annual income, net worth, liquid net worth, tax status, investment objective, risk tolerance, investment horizon, diversification, liquidity, credit rating (if applicable), investment experience and sophistication
- **Securities Considerations.** Listed vs. non-listed, complexity of product, frequency of trading (short-term vs. long-term), fee vs. commission, use of margin, asset allocation (target vs. current), current and historical performance, , disclosures, expense ratios, and sales charges
- **Conflicts of Interest.** Any conflicts of interest should be considered and disclosed prior to the transaction

All Registered Representatives are to ensure that all account objectives are consistent with the type of trading that is effected. Based on the client's profile, the Registered Representative should ensure that he/she understands the suitability guidelines. It is the responsibility of the Registered Representative to ensure that any changes in account information are updated promptly and retained in the client's file. For institutional accounts, it is the responsibility of the Registered Representative to ensure that the trading in the account by the Investment Manager is consistent with the account's investment objectives.

15.6 Suitability for Senior Investors

FINRA Rule 2310 requires that in recommending "the purchase, sale or exchange of any security, the Firm must have reasonable grounds for believing that the recommendation is suitable" for that customer, based on "the facts, if any, disclosed by such customer as to his other security holding and as to his financial situation and needs." The rule also mandates that, before executing a recommended transaction, the Firm must make reasonable efforts to obtain information concerning the customer's financial status, tax status, investment objectives, and "such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer."

Although the rule does not explicitly refer to a customer's age or life stage, both are important factors to consider in performing a suitability analysis. As investors age, their investment time horizons, goals, risk tolerance, and tax status may change. Liquidity often takes on added significance; and, depending on their particular circumstances, seniors and retirees may have less tolerance for certain types of risk than other investors. For example, retirees living solely on fixed incomes may be more vulnerable to inflation risk than those who are still in the workforce, depending on the number of

years those retirees are likely to rely on fixed incomes. Similarly, investors whose investment time horizons afford less time or opportunity to recover investment losses may be disproportionately affected by market fluctuations.

Since a registered representative cannot adequately assess the suitability of a product or transaction for a particular customer without making reasonable efforts to obtain information about the customer's age, life stage, and liquidity needs, register representatives should consider the following questions:

- Is the customer currently employed? If so, how much longer does he or she plan to work?
- What are the customer's primary expenses? For example, does the customer still have a mortgage?
- What are the customer's sources of income? Is the customer living on a fixed income or does he anticipate doing so in the future?
- How much income does the customer need to meet fixed or anticipated expenses?
- How much has the customer saved for retirement? How are those assets invested?
- How important is the liquidity of income-generating assets to the customer?
- What are the customer's financial and investment goals? For example, how important is generating income, preserving capital, or accumulating assets for heirs?
- What health care insurance does the customer have? Will the customer by relying on investment assets for anticipated and unanticipated health costs?

Register representatives should carefully consider the risk of a product with the age and retirement status of the customer. Investments involve varying degrees of risk and reward. For many investors at or nearing retirement, there can be a desire for high yields to maximize retirement income without a full appreciation of the accompanying risks, especially when the investor is concerned about running out of money. When investment strategies or products involve retirement accounts or lump-sum pension plan payments, taking undue risk with funds needed to last a lifetime can be financially ruinous.

The designated principal will review and screen transaction information and new account information related to senior investors. When a transaction involves a senior investor (generally 65 years or older), the designated principal will monitor the registered representative to verify that he is making appropriate disclosures to provide the customer with a fair and balanced picture of the risks, costs, and benefits associated

with the product or transaction. The designated principal will ensure that the registered representative recommends only those products that are suitable in light of the customer's financial goals and needs.

The designated principal should conduct reviews with greater scrutiny when a recommendation involves any of the following products:

- Products that have withdrawal penalties or otherwise lack liquidity, such as deferred variable annuities, equity indexed annuities, real estate investments and limited partnerships;
- Variable life settlements;
- Complex structured products, such as collateralized debt obligations (CDOs);
- Mortgaging home equity for investment purposes.

The Firm will maintain relevant records pertaining to each customer trade and/or account data in accordance with books and records requirements.

16. INTERNET TRADING

16.1 New Account Approval and Suitability

It is the firm's responsibility to ensure that online/day trades are handled appropriately in terms of suitability and principal approval. All customers will receive appropriate written risk disclosures based upon the language contained in the NASD's risk disclosure rule concerning day trading accounts – (NASD Rule 2361). Particular emphasis will be placed on disclosures to the customer of the risks relating to short sales and margin loans. In addition to new account documents, all customers will be required to sign a copy of the "Day-Trading Risk Disclosure Statement", which will contain, among other disclosures, appropriate risk disclosures relating to on-line/day trading. Copies of all new account documents, including the Day-Trading Risk Disclosure Statement and margin account agreement, must be signed by the customer, registered representative and the approving principal and will be maintained in the customer files. The firm does not make any recommendations to customers; its suitability obligations relate to the suitability of online/day trading for that particular customer.

The following account opening parameters will be observed by the firm when approving new day trading accounts:

- Only sophisticated traders will be approved for day trading accounts;
- A customer's minimum annual income will be $25,000;
- A customer's minimum liquid net worth will be $25,000;
- If the customer's annual income is less than $25,000, then their liquid net worth must be in excess of $50,000.

The firm reserves the right to place gross trading limits on an account (such limits may be placed on an account for any number of reasons including, but not limited to: spike in account losses, unusual trading volume, or other pattern of unusual activity).

The Designated Principal will be responsible for determining if any trading limit is to be placed on an account. If a trading limit is placed on an account, it will be evidenced in the new account agreement and/or in a separate memorandum, either of which will be maintained in the customer's file.

16.2 Best Execution

It is our responsibility to provide to on-line/day trading customers information concerning best execution efforts undertaken by the firm, including the execution quality available on different market centers and our order handling practices. While

price is a predominant element, a best execution evaluation will also address the following items, as appropriate:

- price improvement opportunities across markets;
- procedures for handling limit orders and the likelihood of execution; accessibility of competing systems and costs;
- confidentiality of trades;
- ability to handle orders of certain sizes.

It is significant to note that all firm and customer orders are routed electronically through our clearing firm for execution, as well as trade reporting. This order routing and execution process does not involve any manual intervention, i.e. creation of manual order

16.3 Systems Capacity

We must ensure that we have adequate systems capacity to meet all customer demands for on-line trading. Such assurance(s) can be obtained by (a) maintaining and testing contingency plans should "outages" occur and (b) conducting regular systems testing and evaluations. The Designated Principal is responsible for ensuring that records are maintained concerning any significant systems outages.

16.4 Privacy & Security

All trades using a User ID and Password will be verified by our clearing firm's computer programs. Only customers or firm traders with a user ID and Password can access a terminal to place a trade. All other access to the system, i.e. unauthorized access, will be blocked by the system. Moreover, physical access to our office by visitors is monitored at all times by supervisory personnel – only day trading customers or firm traders will be allowed on or near the trading desk. Once a trade is placed, the trade will be checked for the following by an internal computer program:

- Authentication ensures communication with the entitled computer or server. Therefore, no one can place a trade for any account unless he/she knows the customer's Password and User ID.
- Regarding Stolen User IDs: If a client feels that his/her Password and User ID are no longer known exclusively to him/her, notification must be made to the firm IMMEDIATELY.. The client will be responsible for any and all trades executed prior to notifying the Firm. Upon cancellation, a new User ID and Password -- selected by the client-- will be issued by the firm or its clearing agent. The client

must then begin the use of the new User ID and Password upon receipt of such User ID and Password.

- Encryption "scrambles" the transferred data so that eavesdroppers will not understand the information being transmitted.
- Data Integrity requires assurance that any data sent between the Firm and investors was not altered during the transfer. It will also indicate if anyone has added or removed any data from the transmission. Upon such realization, the User ID and Password will be terminated and notification sent to the client immediately.

The programs will store the following information in detail:

- A log of what date and time an investor places a trade and the type of trade that was placed. The system will automatically reject an incomplete trade.
- The programs will also give us a log indicating from which computer or server the trade was placed. The client may specify in writing that only trades from a particular computer or server should be acknowledged as bona fide trades.

16.5 Surveillance for Online/Day Trading Accounts

The firm's compliance department will use a number of surveillance reports, provided by our clearing firm, to monitor customer day trading account activity. (These reports will also be used to monitor proprietary trading accounts.)

- Maintenance margin levels will be monitored daily on a real time basis using our clearing firm's exception reports (Equity Ranges Report). When the equity in an account falls below 35% of market value ("house level") Equity Trading will contact the customer via phone and/or e-mail and request additional funds and/or securities.
- Any account that falls below the house level will be placed on an in-house, online alert list until the account is returned to the required minimum equity level by an infusion of funds and/or securities from the customer. If the customer does not provide the additional funds and/or securities within three business days, our clearing firm will sell securities in that account to meet the margin requirement. Evidence of all actions taken will be maintained, in writing, in the customer's file and/or Compliance/Operations files.
- Changes in customer account equity will be monitored on a daily basis to track any significant spikes in profits or losses, which may be an indicator of abnormal trading practices. Various clearing firm exception reports will be used to monitor customer account activity including the: Unsecured Accounts report; Open Margin Call report; Money Line by RR report. Evidence of all actions taken will be

maintained, in writing, in the customer's file and/or Compliance/Operations files.

- Changes in customer account trading volume will be monitored on a daily basis to detect any indications of unauthorized trading or insider trading. Evidence of all actions taken will be maintained, in writing, in the customer's file and/or Compliance/Operations files.
- Commission summaries reflecting (by customer account) daily trading activities, total commissions and month/year to date data, will be reviewed, monthly or more frequently if needed by compliance. These commission summaries, in conjunction with other trading blotters, will be reviewed for any suspect activities including, but not limited to, patterns of: Regulation T extensions, cancellations, as-of trades and security concentrations. Evidence of all actions taken will be maintained, in writing, in the customer's file and/or Compliance/Operations files.

The firm has a responsibility for information given by other sources, but available through our home page, as such "linked" information could be viewed as sales literature offered by us as a broker/dealer. All such instances will have to be reviewed and cleared by a principal of this firm before permitting the linking of other sites and/or information. The same rule of thumb is to be used as in "paper-based" advertisements. When such advertisements refer to another source, FINRA, before approving the advertisement for our use, wants to see the referred-to information. Cyberspace is no different and hyper-linked information is to be treated exactly as all other advertising/correspondence.

16.6 SIPC Disclosure

All material classified as advertising appearing on the Internet must contain language required to disclose the fact that the Firm is a SIPC member.

17. Mutual Funds

Mutual funds, for purposes of these policies and procedures, refer to the shares offered by open-end investment companies. Registered representatives are responsible for recommending mutual fund transactions in compliance with these policies. At the end of these mutual fund procedures are sections on closed-end funds and unit investment trusts (UITs), both of which also are investment company securities but are not considered "mutual funds."

17.1 Licensing and Registration

The Firm generally requires its registered representatives who recommend and conduct mutual fund transactions to maintain the Series 7. At the discretion of the CCO, the Firm may allow a registered representative without the Series 7 to sell mutual funds if he holds the Series 6. In addition to holding either the Series 6 or Series 7, registered representatives are responsible for maintaining appropriate state registrations. The designated principal must hold either the Series 24 or Series 26.

17.2 Mutual Fund Classes

Mutual funds generally offer (at minimum) three classes of shares that are based on the same mutual fund portfolio but differ regarding costs incurred by the customer. Registered representatives are responsible for understanding and conveying to customers the advantages and disadvantages of the various share classes. Described in the following sections are the Firm's procedures governing the sale of each of the three common classes of shares.

Class A Shares or Front-end Load Funds

This share class generally imposes a front-end sales load and no (or a low) ongoing fee to pay for sales and marketing expenses (Rule 12b-1 fees). Usually the front-end sales load will decrease at certain breakpoints depending on the size of the purchase and whether the purchase qualifies for a letter of intent (LOI) or rights of accumulation (ROA). A front-end sales charge means some of the customer's funds are not invested and instead pay the front-end charge.

It is the responsibility of the register representative to ensure that each purchase of Class A shares is suitable and that the customer receives the lowest available sales charge. Registered representatives must consider all factors that might result in a reduced sales charge to the customer. Therefore, registered representatives must fully understand the availability of breakpoints, rights of accumulation, rights of reinstatement (ROR), and letters of intent for each mutual fund recommended to a

customer. Registered representatives are responsible for determining, among other things, what accounts can be linked and how each account should be valued (current value or historical cost).

The registered representative must ensure that he links related accounts in an appropriate manner. The designated principal is responsible for training registered representatives on how to properly link related accounts. Although the proper linking of related accounts reduces the risk that a customer will miss a sales charge discount on future orders within the same fund family, registered representatives remain responsible for ensuring that the best available sales charge discount is applied to each of the customer's orders. For this reason, registered representatives are encouraged, though not required, to use the breakpoint worksheet as a tool for all of the customer's subsequent Class A share purchases within the same fund family.

Registered representatives must consider all items on it and perform the following functions:

- Obtain assurance from customer that the previously provided information remains accurate.
- Verify that there are no new or previously undisclosed related accounts that should be linked. (A new or updated breakpoint worksheet should be prepared to report additional accounts.)
- Ensure that all related accounts are properly linked and valued to qualify the customer for the lowest sales charge. (Registered representatives should not assume that the sales charge discounts computed by a fund company, the fund's administrator, or the Firm's systems are always accurate.)
- Determine if the investor anticipates making additional purchases in the near future and whether it would be advantageous for the customer to execute a letter of intent;
- Inquire whether the customer recently liquidated any mutual funds and, if so, consider rights of reinstatement (also called reinstatement privileges);
- Ensure that the proper sale charge discount is applied at the time of the customer's order.

Notwithstanding the optional use of the breakpoint worksheet on subsequent orders within a fund family, the designated principal has the authority to require its use for any Class A share purchase. The use of the breakpoint worksheet will become mandatory for any registered representative who establishes a pattern of missing sales charge discounts.

Class B Shares or Back-end Load Funds

This share class generally does not impose a front-end sales charge but may impose a contingent deferred sales charge (CDSC) on share redemption and relatively high 12b-1 fees or other asset-based fees. The amount of the CDSC usually declines the longer the shares are held. Class B shares often automatically convert to Class A shares (with lower asset-based fees) after a period of time, usually after the CDSC declines to zero. Although all of the customer's funds are invested at the time of purchase, registered representatives may not refer to Class B Shares as no-load funds.

It is the responsibility of the register representative to ensure that each purchase of Class B shares is suitable and that the customer fully understands the fees associated with this share class. Before recommending a purchase of Class B shares registered representatives should consider whether the customer meets any of the qualifications for a reduced sales charge through the purchase of Class A shares either in the same fund family or in another fund family. The availability of discounts through the purchase of Class A shares should compel the registered representative to more thoroughly compare share classes prior to making a formal recommendation to purchase Class B shares.

On a customer’s initial purchase of Class B Shares, the registered representative must perform an analysis using the FINRA Fund Analyzer (or similar analysis) to compare Class B shares with other share classes offered by the same fund. If appropriate, registered representatives should also compare the recommended Class B shares with Class B shares of similar funds from different families. When comparing share classes or funds with the FINRA Fund Analyzer, registered representatives must specify the investment amount, use a reasonable figure for the return percentage, and insert a holding period consistent with the customer’s time horizon for the proposed purchase. Although the FINRA Fund Analyzer is a powerful tool for comparing mutual funds, registered representatives must still utilize their investment expertise to ensure that they are inputting appropriate data, comparing relevant funds and share classes, and correctly interpreting the results.

After a customer’s initial purchase of Class B shares in a fund family, the registered representative should continue to use the FINRA Fund Analyzer and/or another analytical method to determine whether subsequent purchases of Class B shares remain suitable. The registered representative should also continue to considerwhether changes in the customer’s situation may, at some point, render purchases of Class B shares unsuitable, especially when a customer’s cumulative purchases of Class B shares qualify him for rights of accumulation and a lower sales charge on Class A shares.

Class C Shares or Level-load Funds

This share class has different expense features than Class A and Class B shares. Class C shares may include no front-end load or back-end load (or a small back-end load) and higher 12b-1 fees or other asset-based fees. Class C shares may be appropriate for shorter term holding periods and certain asset allocation purposes.

As with Class B shares, register representatives are responsible for ensuring that each purchase of Class C shares is suitable and that the customer fully understands the fees associated with this share class. Before recommending the purchase of Class C shares to a customer, registered representatives should consider breakpoints . The registered representative should assess whether customers meet any of the qualifications for a reduced sales charge through the purchase of Class A shares either in the same fund family or in another fund family. The availability of discounts through the purchase of Class A shares should compel the registered representative to more thoroughly compare share classes prior to making a formal recommendation to purchase Class C shares. Understanding that customers of the Firm are exclusively clients of the affiliated investment adviser (CAPTRUST), some customers may choose to purchase C shares in lieu of front or back load funds. Registered reps should document the discussions with customers in connection with a choice to utilize C shares.

For a customer's initial purchases of Class C shares within a fund family, the registered representative must perform an analysis using the FINRA Fund Analyzer (or similar analysis) to compare Class C shares with other share classes offered by the same fund. If appropriate, registered representatives should also compare the recommended Class C shares with level-load shares of similar funds from different families. After a customer's initial purchase of Class C shares in a fund family, the registered representative should continue to use the FINRA Fund Analyzer and/or another analytical method to determine whether subsequent purchases of Class C shares remain suitable. An increase in the customer's time horizon is one factor that could render subsequent purchases of Class C shares unsuitable.

Other Share Classes

Some mutual funds offer other classes that impose no front-end or back-end sales charges and relatively low asset-based fees. These shares classes are typically made available to limited types of purchasers, such as retirement plans or institutional investors. Registered representatives are responsible for determining whether a customer qualifies for and would benefit from one of these share classes.

17.3 Sales Charges

Mutual funds (other than no-load funds) generally have a sales charge that is a cost to the customer. Because sales charges can vary greatly among funds, share classes, and fund families, registered representatives have a duty to understand the sales charges and other costs associated with any mutual fund recommended to a customer. Mutual funds sold with a front-end load often offer investors the opportunity to pay reduced sales charges based on the amount invested, cumulative investments in the fund or the family of funds, or the intent to invest a certain dollar amount that qualifies the purchaser for a reduced sales load. Registered representatives are responsible for understanding the availability of such options and giving the customer the opportunity to purchase the fund under the most favorable terms available.

Deferred Sales Charges

For purchases of shares of a mutual fund that impose a deferred sales charge on redemption, customers will receive a written confirmation that will include the following legend: "On selling your shares, you may pay a sales charge. For the charge and other fees, see the prospectus." The legend must appear on the front of the confirmation and in 8-point type or greater. The disclosure of the deferred sales charge on confirmations does not relieve the registered representative of his duty to disclose and explain these charges to customers.

17.4 Breakpoints

For many mutual funds, front-end sales charges decrease as the dollar amount invested increases. These thresholds for reduced sales charges are called breakpoints. Different fund families establish different opportunities to link accounts, transactions, and share classes to qualify purchasers for reduced sales charges. The registered representative has an obligation to disclose the existence of breakpoints to enable the customer to evaluate the desirability of making a qualifying purchase. The registered representative must indicate on the mutual fund order if the customer qualifies for a breakpoint because of linked accounts, transactions, or share classes, or any other basis for meeting a breakpoint by linking the customer's transaction with another.

Breakpoint Sales

The Firm prohibits “breakpoint sales” and any other sales of mutual funds that oppose the customer’s best interests, such as selling an amount close to but below a breakpoint with the aim of maximizing the commissions earned by the registered representative. Similarly, recommending diversification among several funds with similar investment

objectives, particularly if sales occur in amounts just below the breakpoints of one or more funds, may not be in the best interests of the customer.

Disclosure of Breakpoints

Upon an initial mutual fund purchase, customers will receive a disclosure statement explaining breakpoints and other discounts available to mutual fund purchasers. The Firm must maintain a record to evidence that it provided this disclosure statement to customers.

Breakpoint Worksheets

Registered representatives are required to complete a breakpoint worksheet when a customer makes an initial purchase of front-end load funds (Class A shares) within a fund family. After the customer's initial purchase of Class A shares, the registered representative may use the breakpoint worksheet as a tool to help him fulfill his obligation to obtain the lowest sales charge on all of the customer's subsequent purchases within the same fund family. An additional breakpoint worksheet must be completed if the customer diversifies into another fund family. The breakpoint worksheet accompanies the mutual fund order and must be maintained in the customer's file.

Breakpoint Supervisory Reviews

The designated principal is responsible for reviewing mutual fund purchases for potential breakpoint sales. In addition to reviewing exception reports, the designated principal should look for the following during his reviews of mutual fund transactions:

- Purchases near but below common breakpoint levels (*e.g.,* $25,000, $50,000, $100,000).
- Multiple purchases of mutual funds that, if aggregated, would have qualified the customer for a breakpoint if one or fewer funds were purchased.

The designated principal should confer with the registered representative to determine the basis for any purchase made slightly below a breakpoint. If the transaction is justified, the designated principal should ensure that the registered representative obtained the customer's acknowledgment of the missed breakpoint. If the transaction is not justified, the designated principal should contact the customer to suggest cancelling the order and adding additional funds to qualify for the breakpoint. When appropriate, the designated principal must correct the customer's transaction(s) and take corrective action with the registered representative.

Breakpoint Refunds

The Financial and Operations Principal (FINOP) should be notified if the Firm determines that it owes a customer a refund for a missed breakpoint. The FINOP will ensure that the Firm segregates the amount to be refunded from the Firm's assets and that the refund is made in accordance with SEC Rule 15c3-1.

17.5 Rights of Accumulation

Aggregating purchases of a particular fund or family of funds by one investor (and sometimes family-related purchases) may qualify for rights of accumulation. A lower sales charge may apply based upon the total dollar amount invested. The registered representative must determine if the customer has other holdings in the fund or fund family to assess whether rights of accumulation may be available to the customer. Registered representatives should consider all accounts that might qualify for rights of accumulation, such as outside holdings in 401(k) plans, 529 plans, trusts, education accounts, and variable product sub-accounts. The mutual fund purchase should indicate rights of accumulation (if available) and the customer's desire to aggregate purchases to qualify for a lower sales charge.

In reviewing mutual fund transactions, the designated principal will do the following:

- Look for indications that a customer may qualify for rights of accumulation.
- Verify that the proper discount is applied based on rights of accumulation.
- Crosscheck clearing firm systems and direct business systems.
- If appropriate, verify the accuracy of information with the fund company.

The designated principal must evidence his reviews and take corrective action with any registered representative who fails to properly compute a customer's reduced sales charge based on rights of accumulation. Completion of the breakpoint worksheet become mandatory on all mutual fund purchases for registered representatives who repeatedly miss sale charge discounts.

17.6 Letters of Intent

A letter of intent is an investor's written statement of intent to purchase a specified dollar amount of a single mutual fund or funds within a single fund family over a specific period of time. The aggregate investment over time may qualify for a breakpoint and a lower sales charge. Registered representatives must inform their customers about the availability of letters of intents, especially when the customers is making a purchase slightly below a breakpoint. Purchases for mutual funds should indicate if the customer

is relying on a letter of intent to obtain a lower sales charge. Prior to submitting any mutual fund order, registered representatives should determine whether the customer has a current letter of intent.

When delivering a letter of intent to a customer, the Firm includes a cover letter that provides disclosure concerning the effect of a letter of intent and the length of time the customer has to avail himself of its benefits. The Firm's letter also encourages the customer to review the prospectus carefully regarding sales charges. Registered representatives are responsible for following up with the customer and ensuring the he understands the letter of intent and has no further questions. Registered representatives are expected to remind customers when a letter of intent is within two months of expiration.

17.7 Reinstatement Privilege

Some funds offer shareholders a reinstatement privilege (also called rights of reinstatement), allowing the shareholder to reinvest some or all proceeds from a prior liquidation of the fund within a specified time period (e.g., 180 days) at a reduced load or no sales load. For all mutual fund purchases, registered representative should determine whether the customer qualifies for a reinvestment privilege and, if so, note this on the order at the time of entry.

17.8 Switching

Switching refers to the selling or redemption of one mutual fund (or other long-term investment) to buy another mutual fund (or other long-term investment). Based on the potential for additional sales charges and tax implications, registered representatives are responsible for establishing a justification for the switch in addition to ensuring that the new investment is suitable. Switches may result in the customer incurring multiple sales charges or becoming subject to an extended holding period. There may also be significant tax consequences arising from a switch. Switching among certain fund types may be difficult to justify if the financial gain or investment objective to be achieved by the switch is undermined by the fees and taxes arising from the switch.

Registered representatives are strictly prohibited from recommending switches based on the compensation to be received by the registered representative or the Firm as a result of effecting the switch. As with all recommendations, the registered representative must have a reasonable basis for believing the switch is suitable for and in the best interests of the customer.

Mutual Fund Switch Letter

The Firm requires registered representatives to use a mutual fund switch form for switches involving mutual funds and other long-term investments including, but not limited to, unit investment trusts, annuities, and insurance products. Sufficiently prior to any switch, the registered representative should warn the customer about potential tax consequences and refer the customer to a tax advisor if appropriate. Registered representatives must send the completed mutual fund switch form to their designated principal for review. A copy of the mutual fund switch form should be maintained in the customer's file. It is the designated principal's responsibility to ensure that the registered representative has obtained a signed mutual fund switch form from the customer. The Firm prohibits the use of "negative consent letters" to advise customers of switch transactions.

Exceptions to Using the *Mutual Fund Switch Form*

In recognition that it might not always be necessary or desirable to obtain a mutual fund switch form from a customer, the Firm has set a policy that makes the mutual fund switch form optional under the following exceptions:

- Switches among funds within a family that result in no sales charge;
- Switches between Class C shares if the original investment has been held over 1 year;
- Switches involving Class A or B shares that have been held at least 4 years and do not establish a pattern;
- Switches triggering a contingent deferred sales charge of 1.00% or less.

If a registered representative fails to obtain a signed mutual fund switch form when one is required, the Firm will cite the registered representative with a violation of procedures and may discipline the registered representative by, among other things, requiring him to use the mutual fund switch form for all switches. The CCO is responsible for periodically assessing the effectiveness of the Firm's switch policy and changing it if appropriate.

Review of Switches

The designated principal will review mutual fund orders during his trade reviews in an effort to detect mutual fund switches. When a switch is identified, the designated principal should verify that the registered representative has obtained a signed mutual fund switch form from the customer or that an exception to the requirement to use one is available. The designated principal must document his review of switches.

Supervision of Newly Associated Registered Representatives

When a registered representative leaves another firm and associates with the Firm, his customers often follow him and transfer their assets and accounts to the Firm. On occasion, the registered representative's customers will want to transfer previously purchased mutual funds but will be unable to do so for various reasons. For example, the Firm may not have a dealer agreement in place with the fund company or the customer's mutual funds are not transferable.

For a customer's mutual funds that are deemed nontransferable because the Firm is unable to secure a dealer agreement with the fund company, the Firm will provide the customer with a list of the mutual funds and request, in writing, further instructions from the customer with respect to the disposition of the mutual funds. The request should, where applicable, provide the customer with the following alternative methods of disposition for the nontransferable mutual funds:

- Liquidation. The Firm must indicate that redemption or other fees may result from the liquidation and refer the customer to the fund prospectus.
- Retention by the carrying member for the customer's benefit.
- Shipment, physically or directly, in the customer's name to the customer.
- Transfer to the fund company that is the original source of the mutual fund, for credit to an account opened by the customer with that fund company.

Newly hired registered representatives with an established customer base have a strong incentive to transfer their customers' accounts and holdings to the Firm. The registered representative may be tempted to switch customers out of previously sold mutual funds when the mutual funds are nontransferable or when the prior firm has a contractual claim to all of the trail commissions on previously sold mutual funds. Registered representatives are strictly prohibited from recommending that their customers switch into new mutual funds solely on the basis that the replacement of a mutual fund will yield greater remuneration to the registered representative or the Firm. Recommendations should not be a function of the desire of the registered representative to obtain compensation that he would not otherwise receive were the customer to retain the previous mutual funds.

For a minimum of 30 days following the association of a new representative, the designated principal will review switches recommended by the registered representative with a view to identify any recommendations to liquidate or surrender mutual funds and other products that may be inconsistent with the customer's investment needs and objectives or that have not been preceded by appropriate disclosure.

17.9 Suitability

Registered representatives are responsible for recommending suitable mutual fund transactions and should match the customer's objectives with the stated objective and investment strategy of the recommended fund. Suitability determinations for mutual funds entail not only identifying mutual funds that are suitable for each customer but also determining the share class within each mutual fund that is most advantageous to the customer. In making a suitability determination, the registered representative should:

- Understand the advantages and disadvantages of different mutual funds and their share classes.
- Consider differences among mutual funds and share classes based on factors such as the customer's investment objectives, amount to be invested, and the customer's time horizon for the investment.
- Consider that Class B or C shares generally should not be recommended to customers who make large purchases and qualify for sales charge discounts based on breakpoints, letters of intent, or rights of accumulation.

Suitability Reviews

The designated principal is responsible for reviewing the suitability of mutual fund transactions with particular attention to the following:

- **Funds with high risk objectives—**Is the investment consistent with the customer’s investment objectives?
- **Purchases of multiple funds in different families that may result in higher sales charges—**Is diversification among funds justifiable and does the customer understand the potentially higher fees?
- **Large purchases of Class B or C shares that may qualify for lower sales charges if purchased as Class A shares—**Is this really the best share class for the customer and has the customer received disclosure of the fees?
- **Purchases of the same fund (or funds within a family) by several of a registered representative’s customers**—Is this fund (or family of funds) really the most suitable for each customer or is the registered representative simply recommending this fund (or family of funds) to all of his customers without making a customer-specific suitability determination?

If the designated principal’s review of a mutual fund transaction raises questions concerning the suitability of the recommendation, the designated principal will confer with the registered representative with the aim of verifying that the transaction is

indeed suitable and that the customer has acknowledged the transaction's costs. The designated principal should cancel any transactions that are unsuitable. The designated principal is responsible for documenting his reviews and following up on any issues identified during these reviews.

17.10 Disclosure of Material Facts

When recommending mutual funds, registered representatives are required to disclose material facts to customers. Items to be disclosed, if applicable or appropriate, include:

- The fund's investment objective
- The fund's portfolio
- Historical income or capital appreciation
- The fund's expense ratio and sales charges
- Risks of investing in the fund relative to other investments
- The fund's hedging or risk management strategy
- Information regarding the structure of multi-class and master-feeder funds sufficient so the customer may understand and evaluate the structure
- Potential tax consequences including tax on distributions and capital gains subject to tax
- Potential risks if a fund invests in financial derivatives
- If an expense ratio is represented as an advantage of a particular fund, it is explained in the context of and compared with other mutual fund expense ratios

The mutual fund's prospectus and other sales literature generally include many, if not most, of these disclosures. Registered representatives are expected to fully understand the material facts of a recommend mutual fund and convey such information to their customers. It is the responsibility of the registered representative to discuss all relevant facts and to explain the investment risks to the customer. Registered representatives should give their customers the opportunity to ask questions concerning a mutual fund and its prospectus.

17.11 Prospectus Delivery

When recommending the purchase of a mutual fund, registered representatives must ensure that the customer receives a copy of the prospectus. If required by the Firm, the registered representative must obtain an acknowledgement that the customer received the prospectus. The designated principal is responsible for establishing procedures to

ensure that a prospectus is delivered to each purchaser of a mutual fund. If the Firm is going to rely on a clearing firm or fund company to meet the prospectus delivery requirement, the CCO must ensure that the clearing firm or mutual fund company has agreed to deliver prospectuses.

17.12 Cash Compensation

Cash compensation is any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override, or cash employee benefit received in connection with the sale and distribution of investment company securities. With limited exception, all cash compensation must be described in the current prospectus of the investment company. Registered representatives are prohibited from accepting cash compensation from anyone other than the Firm.

17.13 Non-Cash Compensation

Non-cash compensation is any form of compensation received in connection with the sale and distribution of investment company securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals, and lodging. Registered representatives are prohibited from, directly or indirectly, accepting or making payments of any non-cash compensation in connection with the sale of investment company securities, except under the following conditions:

- **Gifts**—The gift must not exceed an annual amount of $100 per person and must not be preconditioned on achievement of a sales target. Registered representatives are responsible for adhering to the Firm's policies and procedures concerning gifts and their reporting.
- **Occasional meal, ticket to a sporting event or the theater, or comparable entertainment**—Such non-cash compensation must not be so frequent or extensive as to raise questions of propriety, and it must not be preconditioned on achievement of a sales target. If required by the Firm, such non-cash compensation should be reported.
- **Payments or reimbursements for training or education**—This form of non-cash compensation is permissible only if stringent requirements are met. For this reason, registered representatives must obtain pre-approval from the Compliance Department if anyone is going to pay or reimburse the Firm or its associated persons for the expenses related to training or education.

Registered representatives should refer to the Firm's policies and procedures on gifts and gratuities for additional information concerning the receipt or payment of non-cash compensation.

17.14 Market Timing and Late Trading

Market timing and late trading are two mutual fund trading activities that may result in violations of rules when the registered representative initiates the activity or knowingly facilitates the activity by assisting a fund manager, an investment adviser, a fund sponsor, a customer, or someone else in engaging in these activities.

Market Timing

Most mutual funds are intended for long-term investment purposes only and not for market timing or excessive trading. Consequently, market timing activity may be disadvantageous to a fund and its shareholders. Market timers seek potential price differentials that may occur with securities that trade in a different time zone. The potential for these price differentials is more prevalent in international funds. For that reason, the Firm monitors any international stock funds more extensively than other funds for market timing violations.

The Firm is contractually obligated to, and pursuant to applicable rules and regulations (including Rule 22c-1under the Investment Company Act of 1940), required to comply with each fund's prospectus, including each fund's policies and procedures regarding market timing. The Firm will diligently investigate any possible or actual violations and consider any appropriate remedies. While frequent trading of a mutual fund, in and of itself, is not illegal, it often violates restrictions established by the fund on short-term market timing trades. For this reason, registered representatives are prohibited from recommending market timing transactions or knowingly aiding a customer in activity that violates a mutual fund's trading guidelines.

The designated principal monitors market timing activity on a regular basis by reviewing trading activity reports, contacting funds to investigate a customer's market timer status, and/or maintaining a directory of known market timers to the extent reasonable and practical under the circumstances. The Firm may reject any purchase order (including exchange transactions) by any customer at any time for any reason, including, in particular, purchase orders that may be attributable to market timers or are otherwise excessive or potentially disruptive to a fund. Orders placed by investors in violation of a particular fund's excessive trading policies or by customers that the Firm believes are market timers may be revoked or cancelled by either the Firm or the fund on or by the next business day after receipt of the order. For transactions placed directly with a fund, the fund may consider the trading history of accounts under common ownership or control for the purpose of enforcing the fund's excessive trading policy. All relevant documentation pertaining to any internal investigations concerning potential

market timing activities will be properly documented and maintained in accordance with recordkeeping requirements.

Late Trading

Late trading is the practice of effecting an after-close mutual fund purchase or redemption at the same day's net asset value (NAV). NAV is usually calculated at 4:00 pm Eastern Standard Time, the close of the trading day, and orders received after the close are effected at the next day's closing NAV. Late trading is a violation of fair practices because it potentially permits someone to take advantage of market movements known after the 4:00 pm deadline and gives the person an advantage in determining whether to buy or sell a fund based on an already established price. Engaging in late trading or enabling someone else to engage in late trading is prohibited.

The Firm's clearing firm does not permit after-close (generally after 4:00 pm EST) mutual fund purchases or redemptions to receive the same day's NAV. Therefore, any trades that are entered after the close receive the following day's NAV price. As an added measure of supervisory control, the designated principal will scrutinize any trade that is time stamped before or at the close but entered or executed after the close. Moreover, the designated principal will ensure that all systems to correct errors after the close cannot be misused for the purposes of effecting late trading.

Receipt of "Block Letters"

Some firms have been accused of effecting mutual fund exchanges that exceeded, or were otherwise inconsistent, with a fund's annual exchange limit as stated in the prospectus. In such cases, the fund may issue a "block letter." In the event that the Firm receives a "block letter" for suspected market timing and/or excessive trading/exchange activities (which exceed or are otherwise inconsistent with a fund's annual exchange limit), the Firm will immediately investigate and halt such trading activity to prevent further violations. Furthermore, the designated principal will review additional accounts in the customer's name and look for other accounts that may have been opened to circumvent the block restrictions on the account. The Firm must document its investigation of any customer account that becomes subject to a block letter or similar restriction.

17.15 Selling Dividends

Selling dividends is the prohibited practice of recommending the purchase of a mutual fund based on an imminent dividend distribution. Since the price of a mutual fund is reduced by the amount of the dividend, there is no benefit to the customer unless there is a specific tax advantage (or other advantage) to the customer. In fact, the transaction

often results in an increased tax liability for the customer. Another related concern that is also prohibited by the Firm is the representation that distributions of long term capital gains by the mutual fund are or could be viewed as part of the income yield from the mutual fund.

17.16 Misrepresenting "No-Load" Funds

Certain mutual funds impose a sales charge when the customer redeems or liquidates an investment. These back-end loads generally decrease the longer the mutual fund is held. Other mutual funds have a combined asset-based sales charge and/or service fee exceeding 0.25% of average annual net assets. Mutual funds with back-end loads or asset-based sales or service fees exceeding 0.25% of average annual net assets may not be described as "no-load" or having “no sales charge.”

17.17 Overdiversification

A customer with investments in many funds may be overdiversified and, consequently, unable to reach breakpoints that would otherwise be available to him had he invested in fewer funds or fund families. Registered representatives are prohibited from recommending mutual fund transactions that would result in overdiversification. The designated principal is responsible for periodically reviewing customer accounts and ensuring that customers are not overdiversified. When overdiversification is detected, the designated principal should review communications and disclosures made to the customer to ensure that the registered representative advised the customer about the availability of breakpoints.

17.18 Certificates of Deposit

When funds from maturing certificates of deposit (CDs) are used for the purchase of mutual funds (including money market funds), registered representatives should advise the customer of the material differences between CDs and mutual funds, particularly the greater risk to the customer's capital and the absence of any federal insurance or guarantee for assets placed into mutual funds. When recommending a switch from a CD to a mutual fund, registered representatives should consider the penalty (if any) the customer will incur on withdrawing money from the CD. In low interest rate environments, registered representatives should be careful in recommending a switch into a bond fund as a means to increase yield, since a customer wishing to preserve capital could become dissatisfied when a subsequent increase of interest rates results in the bond fund losing value.

17.19 Correspondence

The designated principal will be watchful for the following considerations in performing reviews of correspondence:

- Selling dividends
- Describing a back-end load fund as "no-load" or as having “no sales charge”
- Describing a fund with an asset-based sales or service fee exceeding 0.25% of average annual net assets as "no-load" or as having “no sales charge”
- Misrepresentations concerning yield. Because there are specific requirements regarding quotation of yields, registered representatives should use materials provided by the fund or pre-approved by the Firm.
- Recommendations that include switching or appear to recommend unsuitable diversification among funds.
- Communications that include excerpts from the prospectus that would be misleading when taken out of context.
- Disclosures, as applicable.
- Accurate representation of performance that is consistent with rule requirements regarding yield and return.
- “Dealer Use Only” materials that should not be distributed to the public.

17.20 Performance Information

Registered representatives should generally limit the discussion of a fund's performance and simply refer the customer to the prospectus for performance information. Registered representatives should explain to their customers that total return measures overall performance, while current yield represents only the interest or dividend paid by the fund. If appropriate, registered representatives should explain the difference between return of principal and return on principal. When providing information regarding distribution rates, the registered representative is responsible for explaining the difference between distribution rate and current yield.

17.21 Advertising and Sales Literature

There are specific requirements for advertising and sales literature regarding mutual funds. Mutual fund advertisements and sales literature are often required to be filed with FINRA prior to use. Also, there are mandated guidelines on representations regarding performance and yield. Registered representatives may use only approved

materials provided by the fund or the Firm. Any other advertising or sales literature must be approved by the Compliance Department prior to use.

17.22 Seminars and Other Public Presentations

Seminars and public presentations must be pre-approved. The following guidelines will apply if a registered representative or the Firm sponsors a seminar for customers or prospective customers and mutual funds are the subject of the seminar:

- An outline of the seminar must be provided to the Compliance Department sufficiently prior to the seminar.
- If specific mutual funds are recommended, prospectuses must be provided to those who attend and a list retained of individuals to whom prospectuses were provided. A copy of the list is to be provided to the Compliance Department after the seminar.
- If a wholesaler makes a presentation at the seminar, the sales materials used must be pre-approved by the Compliance Department.

The CCO is responsible for approving and filing the outline of the seminar and a copy of the prospectus list, if applicable. The Compliance Department is responsible for approving any wholesaler sales materials and making any required filings with the FINRA Advertising Department.

17.23 "Dealer Use Only" Material

Registered representatives must not deliver to the public any material marked "Dealer Use Only." Such material is intended for distribution only to dealers and registered representatives and has not been subjected to the screening and filing requirements associated with sales literature intended for the public. Fund sponsors, dealers, and wholesalers often use this material to educate sales personnel about the benefits of a fund and to provide marketing ideas. This material is not required to be filed with FINRA as "sales literature" because it is considered an internal communication and is exempt from filing requirements.

Registered representatives should not make oral presentations based on information contained in dealer-use-only material. This practice could present a potential regulatory problem, as there can be no assurance that the information provided to investors is in accordance with applicable rules. The designated principal is responsible for the compliant use of dealer-use-only materials.

17.24 Sales Contests and Incentive Programs

The Firm currently does not participate in sales contests. If the Firm approves a sales contest or incentive program, the following guidelines will apply when mutual funds are the subject of the contest or program:

- All sales contests must be pre-approved by the Compliance Department.
- Contests may not be based on the amount of brokerage commissions received or expected to be received from investment companies.
- If the Firm acts as underwriter of investment company shares, the Firm may not sponsor a contest or other incentive campaign of another broker-dealer with respect to the sale of shares of the investment company.
- Registered representatives may not accept (directly or indirectly) cash or non-cash compensation from outside the Firm for sales contests.

17.25 Due Diligence of Mutual Funds Offered by the Firm

The CCO is responsible for ensuring that the Firm conducts due diligence reviews on investment companies and their fund offerings. These reviews should encompass, at a minimum, an examination of prospectuses and other information provided by the mutual fund companies or other distributors. The Firm must look for any special sales programs or promotions that may violate the anti-reciprocal rule. An officer of the Firm must ultimately approve the offering of a mutual fund by executing a selling agreement (also referred to as a dealer agreement). The Firm must maintain the following records related to approved offerings: information used to determine which funds to sell, a signed selling agreement, and, if applicable, a record of any special sales programs or promotions.

17.26 Anti-Reciprocal Rules

NASD Rule 2830(k)

The CCO is responsible for monitoring compliance with FINRA's anti-reciprocal rule and ensuring that the selection and offer of mutual funds complies with the anti-reciprocal prohibitions. Specifically, the Firm will not:

- Favor or disfavor the sale or distribution of share of any particular investment company (or group of investment companies) on the basis of brokerage commissions received by the Firm from the investment company or any other source.

- Sell shares of, or act as underwriter for, an investment company if the Firm knows or has reason to know that such investment company (or an investment adviser or principal underwriter of the company) has a written or oral agreement or understanding under which the company directs portfolio securities transactions to a broker or a dealer in consideration for the promotion or sale of shares issued by the company or any other registered investment company.
- Demand or require brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company.
- Offer to or request from another dealer, brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company.
- Circulate information about commissions received from an investment company, other than to senior managers for purposes of managing the Firm's business.
- Sponsor or encourage an incentive campaign or special sales effort of another dealer based upon or financed by brokerage commissions related to the sale of investment company shares.

With respect to the Firm's retail sales or distribution of investment company shares, the Firm will not:

- Provide any incentive or additional compensation for the sale of shares of specific investment companies based on the amount of brokerage commissions from any source.
- Recommend specific investment companies or establish recommended, selected, or preferred lists of investment companies based on brokerage commissions.
- Allow registered representatives or other sales personnel to participate in commissions received from portfolio transactions of investment companies.
- Use the sale of investment company shares to negotiate the price of, or amount of brokerage commissions to be paid on, portfolio transactions of investment companies.

Compliance with the anti-reciprocal rule does not prohibit the Firm from executing portfolio transactions of investment companies whose shares are sold by the Firm. Moreover, adherence to the anti-reciprocal rule does not prevent the Firm from compensating its registered representatives and managers for sales attributable to them through the use of overrides, accounting credits, or other compensation methods, provided the compensation does not favor or disfavor the sales of shares of particular investment companies or violate the anti-reciprocal rule in any other way.

MSRB Rule G-31—Reciprocal Dealings with Municipal Securities Investment Companies

Under the anti-reciprocal rule of the Municipal Securities Rulemaking Board, the Firm is prohibited from soliciting transactions in municipal securities with or for the account of an investment company as compensation for the Firm's sale of shares, participations, or units of the investment company.

17.27 Funds of Hedge Funds

A fund of hedge funds is an investment company that invests in multiple hedge funds and provides diversification through the underlying investments. A fund of hedge funds allows retail investors who would not otherwise qualify to invest in a hedge fund to do so through the fund. Because the underlying securities (hedge funds) may be unregistered and high-risk securities, registered representatives must consider the risk of the underlying hedge funds prior to recommending the fund to customers. While a fund of hedge funds provides diversification, the underlying funds represent a higher level of risk that should be considered and explained to the customer. Hedge funds have the following general characteristics and risks:

- Hedge funds are not registered under the Investment Company Act of 1940 and are exempt from registration under the Securities Act of 1933.
- Hedge funds have high minimum investments, often $1,000,000 or more.
- There are wide differences in the fees for investments in registered vs. unregistered hedge funds. Managers of unregistered hedge funds often receive both a management fee and a direct percentage of the profits earned.
- Hedge funds often engage in leveraging and speculative investment practices that may increase the risk of investment loss.
- Hedge funds can be highly illiquid.
- Hedge funds may not be required to provide periodic pricing or valuation information to investors.
- Hedge funds may have complex tax structures that cause a delay in the distribution of important tax information.
- Hedge funds are not subject to the same regulatory requirements as mutual funds.
- Hedge funds often charge high fees to their direct investors.

Registered representatives should refrain from recommending fund of hedge funds to any customers who cannot understand the risks of the fund and its underlying hedge funds.

17.28 Redemption of Outside Mutual Funds

For direct business with a mutual fund company (non-clearing firm business), the Firm's policy is to have the redemption request made directly with the fund family through telephone or other acceptable means. Because the Firm's involvement as an intermediary in a redemption could cause delay, registered representatives should instruct customers to contact the fund family directly for expedited processing. Registered representatives are responsible for noting any redemptions made by their customers and periodically inquiring whether their customers have made any redemptions. Reinstatement privileges should be considered for customers who have made recent redemptions.

17.29 Verification of Changes to Customer Accounts

The designated principal is responsible for validating customer address changes and changes in customer account information. The designated principal will ensure that the Firm sends a notification letter to the last known residential address of record for the customer, as found on the Firm's record of account information for the customer. The letter requires a response from the customer only if the information contained in the notification letter is incorrect. The Firm will send a similar letter to the customer's new and/or current residential address to confirm the change. Alternatively, the Firm may contact the customer directly via telephone and obtain oral confirmation of the change. All methods of verification must be documented and retained. The CCO is required to periodically test the effectiveness of the Firm's procedures with respect to validating customer address changes and changes in customer account information.

17.30 Training

The CCO is responsible for coordinating training for associated persons involved in the Firm's sale of mutual funds. At a minimum, training should cover breakpoints, switches, and suitability. The CCO should periodically evaluate the risks related to the Firm's mutual fund business and assign training to address any areas of concern.

18. Closed-End Funds

Closed-end funds are investment companies that issue a finite number of shares that trade in the open market, usually on a stock exchange. Because closed-end funds trade like other stocks, certain requirements that apply to mutual funds generally do not apply to closed-end funds. Certain mutual fund features—such as breakpoints, letters of intent, and rights of accumulation—are usually not important considerations in the sale of closed-end funds. As for all investment recommendations, however, registered representatives are responsible for making a suitability determination prior to making a recommendation to a customer. The Series 6 does not qualify a registered representative to trade closed-end funds in the secondary market.

Here are some of the traditional and distinguishing characteristics of closed-end funds:

- Closed-end funds generally do not continuously offer their shares for sale. Rather, they sell a fixed number of shares at one time (in the initial public offering), after which the shares typically trade on a secondary market, such as the New York Stock Exchange or the NASDAQ Stock Market.
- The price of closed-end fund shares that trade on a secondary market after their initial public offering is determined by the market and may be greater or less than the shares' net asset value.
- Closed-end fund shares generally are not redeemable. That is, a closed-end fund is not required to buy its shares back from investors upon request. Some closed-end funds, commonly referred to as interval funds, offer to repurchase their shares at specified intervals.
- The investment portfolios of closed-end funds generally are managed by separate entities known as investment advisers that are registered with the SEC.
- Closed-end funds also are permitted to invest in a greater amount of illiquid securities than mutual funds. (An illiquid security generally is considered to be a security that cannot be sold within seven days at the approximate price used by the fund in determining NAV.) Because of this feature, funds that seek to invest in markets where the securities tend to be more illiquid are typically organized as closed-end funds.

18.1 Initial Offering

A closed-end fund will have an initial public offering of its shares at which it will sell a specific number of shares at a specified price. The money raised from the initial public offering is what the fund manager will use to invest in the fund. At that point, however, the fund's shares begin to trade on a secondary market, typically the NYSE or the AMEX

for American closed-end funds. Any investor who wishes to buy or sell fund shares at that point will have to do so on the secondary market. Only under exceptional circumstances will a closed-end fund redeem its own shares. Also, they typically do not sell more shares after the initial offering (although they may issue preferred stock, in essence taking out a loan secured by the portfolio).

18.2 Secondary Market

Closed-end fund shares trade continually at whatever price the market will support. They also qualify for advanced types of orders such as limit orders and stop orders. The price of a closed-end fund is completely determined by the valuation of the market, and this price often diverges substantially from the NAV of the fund assets.

18.3 Suitability

Closed-end funds come in many varieties and can have different investment objectives, strategies, and investment portfolios. They also can be subject to different risks, volatility, fees, and expenses. Investing in closed-end funds is more appropriate for seasoned investors. Depending on the funds underlying portfolio, closed-ended funds can be volatile and their value can fluctuate drastically, whether in the initial offering or the secondary markets. Shares can trade at a significant discount and can deprive an investor from realizing the true value of their shares. Since there is not as much liquidity in closed-ended funds as open-ended funds, it is extremely important that each registered representative evaluate the customer's investment objectives, strategies, risk tolerance, and time horizon before recommending the purchase of a closed-end fund. Additionally, it is the responsibility of the registered representative to ensure that the risks, fees, and expenses have been fully explained to the customer prior to the purchase.

18.4 Supervisory Reviews

The designated principal will review transactions in closed-end funds for suitability and other sales practice concerns. The designated principal must document his reviews and any corrective actions.

19. Unit Investment Trusts

Unit investment trusts (UITs) are investment company securities that invest in a fixed portfolio of securities that may include corporate, municipal, or government bonds; mortgage-backed securities; common or preferred stock; or shares in other investment companies. Unit holders receive an undivided interest in both the principal and the income portion of the portfolio in proportion to the amount of money invested. UITs have a finite life that ends when securities in the portfolio have matured or are liquidated per the terms of the trust. The Series 6 does not qualify a registered representative to trade UITs in the secondary market.

19.1 Suitability

As with all other securities, the registered representative is responsible for making a suitability determination prior to recommending a UIT to a customer. Considerations include the types and safety of securities in the UIT, call features of the trust, and the maturity date for the trust. The length of time the investor intends to hold the investment should be considered when recommending a UIT, since a secondary market for the UIT is not assured and prices in the secondary market may vary considerably from the liquidation value of the trust.

19.2 Primary Offerings

While UITs are not "mutual funds," they have some features similar to mutual funds, particularly during the initial offering of a UIT. The purchaser of a new UIT may pay a load or other charges as described in the prospectus. Registered representatives must review the prospectus and fully understand the sale charges before recommending that a customer purchase a UIT in a primary offering.

19.3 Secondary Market

A secondary market exists for many UITs. Customers may liquidate or purchase a UIT by placing an order to sell or buy it in the secondary market, if one exists. Because the price the investor pays to purchase in the secondary market may include a premium based on the market value of the securities in the portfolio, the customer may not recover that amount when the trust matures or is called.

Registered representatives must ensure that customers are not misled regarding the potential return of UITs purchased in the secondary market. Any communication regarding the estimated current return should be accompanied by a quotation of the UIT's long-term yield or internal rate of return. Registered representatives should

ensure that customers who purchases UITs in the secondary market receive a copy of the UIT's prospectus at time of purchase.

A customer liquidating a UIT (or other long-term investment) to purchase a UIT (or other long-term investment) may be required to sign an acknowledgment concerning the switch transaction. Registered representatives are required to consider all relevant factors when recommending purchases or switches involving UITs.

19.4 Supervisory Reviews

The designated principal will review transactions in UITs for suitability and other sales practice concerns. The designated principal must document his reviews and any corrective actions.

20. Exchange-Traded Funds (ETFs)

Exchange traded funds (ETFs) are typically registered unit investment trusts (UITs) or open-ended companies whose shares represent an interest in a portfolio of securities that track an underlying benchmark or index. However, some ETFs that invest in commodities, currencies, or commodity- or-currency-based instruments are not registered as investment companies. Unlike traditional UITs or mutual funds, shares of ETFs typically trade throughout the day on an exchange at prices established by the market.

Exchange-traded funds that offer leverage or that are designed to perform inversely to the index or benchmark they track—or both—are growing in number and popularity. While such products may be useful in some sophisticated trading strategies, they are highly complex financial instruments that are typically designed to achieve their stated objectives on a daily basis. Due to the effects of compounding, their performance over longer periods of time can differ significantly from their stated daily objective. Therefore, inverse and leveraged ETFs that are reset daily typically are unsuitable for retail investors who plan to hold them for longer than one trading session, particularly in volatile markets.

20.1 Leveraged ETFs vs. Inverse ETFs

Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Inverse ETFs (also called "short" funds) seek to deliver the opposite of the performance of the index or benchmark they track. Like traditional ETFs, some leveraged and inverse ETFs track broad indices, some are sector-specific, and others are linked to commodities, currencies, or some other benchmark. Inverse ETFs often are marketed as a way for investors to profit from, or at least hedge their exposure to, downward moving markets.

Leveraged inverse ETFs (also known as "ultra short" funds) seek to achieve a return that is a multiple of the inverse performance of the underlying index. An inverse ETF that tracks a particular index, for example, seeks to deliver the inverse of the performance of that index, while a 2x (two times) leveraged inverse ETF seeks to deliver double the opposite of that index's performance. To accomplish their objectives, leveraged and inverse ETFs pursue a range of investment strategies through the use of swaps, futures contracts, and other derivative instruments.

Most leveraged and inverse ETFs "reset" daily, meaning that they are designed to achieve their stated objectives on a daily basis. Their performance over longer periods of time—over weeks or months or years—can differ significantly from the performance

(or inverse of the performance) of their underlying index or benchmark during the same period of time. This effect can be magnified in volatile markets. As the examples below demonstrate, an ETF that is set up to deliver twice the performance of a benchmark from the close of trading on Day 1 to the close of trading on Day 2 will not necessarily achieve that goal over weeks, months, or years.

20.2 Suitability

Generally, the Firm utilizes leveraged ETF's for hedging purposes. When recommending to customers, the Firm must determine that the strategy is suitable for the client. Such recommendation should be based on a full understanding of the terms and features of the product recommended. With respect to leveraged and inverse ETFs, the Registered Representative should understand the terms and features of the funds, including how they are designed to perform, how they achieve that objective, the impact that market volatility, the ETF's use of leverage, and the customer's intended holding period will have on their performance.

In determining if an ETF is suitable for a customer, the Registered Representative must perform an analysis which includes making a reasonable effort to obtain information concerning the customer's financial status, tax status, investment objectives, and such other information used or considered to be reasonable. While customer-specific suitability analysis depends on the investor's particular circumstances, inverse and leveraged ETFs typically are not suitable for retail investors who plan to hold them for more than one trading sessions, particularly in volatile markets.

Prior to recommending the purchase of an ETF to a customer, the Registered Representative should discuss the following information:

- **Customer's Investment Objectives--**Explain to the customer whether or how the purchase of the ETF fits with their objectives.
- **Prospectus—**Provide a prospectus to the customer which provides detailed information related to the ETFs' investment objectives, principal investment strategies, risks, and costs.
- **Objectives of the ETF—**Explain to the customer how the ETF achieves its stated objectives and the risks of the ETF—be sure the customer understands the techniques the ETF uses to achieve its goals. For example, engaging in short sales and using swaps, futures contracts, and other derivatives can expose the ETF—and by extension ETF investors—to a host of risks.
- **Holding Period—**While there may be trading and hedging strategies that justify holding these investments longer than a day, buy-and-hold investors with an intermediate or long-term time horizon should carefully consider whether these

ETFs are appropriate for their portfolio. Because leveraged and inverse ETFs reset each day, their performance can quickly diverge from the performance of the underlying index or benchmark. In other words, it is possible that the customer could suffer significant losses even if the long-term performance of the index showed a gain.

- **ETF Risks to the customer—**There is always a risk that not every leveraged or inverse ETF will meet its stated objective on any given trading day. Be sure the customer understands the impact an investment in the ETF could have on the performance of their portfolio, taking into consideration their goals and their tolerance for risk.
- **Costs of the ETF—**Explain any costs that will be passed to the customer when purchasing an ETF. Leveraged or inverse ETFs may be more costly than traditional ETFs.
- **Tax Consequences—**Leveraged or inverse ETFs may be less tax-efficient than traditional ETFs, in part because daily resets can cause the ETF to realize significant short-term capital gains that may not be offset by a loss. However, the client would need to check with their tax advisor about the consequences of investing in a leveraged or inverse ETF.

20.3 Communications with the Public

All sales materials and oral presentations used by our firm regarding leveraged and inverse ETFs must present a fair and balanced picture of both the risks and benefits of the funds, and may not omit any material fact or qualification that would cause such a communication to be misleading. All appropriate risk disclosures must be made in the sales material. All sales material to be used in conjunction with the sale of an ETF to a customer must be submitted to a Designated Principal for review and approval. Evidence of supervisory approval will be made either on the sales material piece, or the sales material approval form.

20.4 Supervision

The Designated Principal is responsible for reviewing and approving the ETF purchased by the customer to ensure the investment was suitable. The Designated Principal approval will be evidenced on the daily review log.

20.5 Training

The Firm will distribute these procedures to appropriate representatives. The designated principal should periodically assess whether additional training should be

directed to any specific individuals. Any training is to be documented in the Firm's training file.

21. Variable Annuities

Variable annuities are hybrid investments with both securities and insurance features. Variable annuities are among the most complex financial products sold to individual investors. This complexity and the risk of inappropriate replacements have led to increased scrutiny by regulators.

21.1 Features of Variable Annuities

Registered representatives should fully understand a variable annuity before recommending it to a customer. Extensive knowledge of the product is critical to determining if it is a suitable investment vehicle for the customer. Variable annuities may have some features that are similar in many respects to those of mutual funds, but it would be misleading for a registered representative to describe these products as similar without making it clear to the customer how they differ. Variable annuities typically offer three basic features not found in mutual funds or other investment vehicles:

1. Tax-deferred treatment of earnings.
2. A death benefit.
3. Annuity payout options that can provide income for life.

21.2 Accumulation and Distribution Phases

Generally, variable annuities have two phases:

- **Accumulation—**The accumulation phase is when the investor's contributions (known as premiums) are allocated among subaccounts and earnings accumulate on the investor's portfolio.
- **Distribution—**The distribution phase is when the investor withdraws money, typically as a lump sum or through various annuity payment options.

In the accumulation phase, the customer's premium payments to purchase a variable annuity are allocated to the subaccounts. The variable annuity contract may include a guaranteed fixed interest subaccount that is part of the general account of the insurer. The general account is composed of the assets of the insurance company issuing the contract. The value of the underlying subaccounts that are not guaranteed will fluctuate in response to market changes and other factors.

The underlying subaccounts that are not guaranteed are funded by a separate account of a life insurance company that, absent an exemption, is required to be registered as an investment company under the Investment Company Act of 1940. Variable annuities

assess various fees related to insurance features (*e.g.*, lifetime annuitization and the death benefit), which are typically deducted from customer's assets in the separate account

21.3 Regulatory Oversight

As its name implies, a variable annuity's rate of return is not stable, but varies with the stock, bond, and money market subaccounts that the customer chooses as investment options. There is no guarantee that the customer will earn any return on his investment. In fact, the customer assumes the risk that he will lose money. Because of this risk, variable annuities are considered securities and must be registered with the Securities and Exchange Commission (SEC).

A distributor of variable annuity contracts to individuals is required to register as a broker-dealer under the Securities Exchange Act of 1934 and become a member of FINRA. Variable annuities and variable insurance products are heavily regulated by FINRA, the SEC, and the state securities and insurance regulators. For this reason, a registered representative who commits a sales practice violation involving variable products is subject to disciplinary action from multiple regulators.

21.4 Variable Life Insurance

Variable life contracts include two types of policies: variable life and variable universal life (VUL). Both allow the policyholder to invest part of the premium in subaccounts. Variable life policies may require fixed premiums; variable universal life policies allow the policyholder to vary payments. Variable life insurance offers a death benefit, similar to traditional life insurance. The cash value generated by the investment element is not guaranteed by the insurance company and can fluctuate depending on the performance of the subaccounts. The attraction of this particular product is the capital growth opportunity. Like variable annuities, variable life and variable universal life are securities. The Firm's procedures for variable annuities generally apply also to variable life and VUL products, with some variation in the forms used and the disclosures to customers. Registered representatives are responsible for knowing when a state or insurance carrier requires the completion of an additional replacement form.

21.5 Licensing and Registration

Registered representatives may not engage in the sale of variable products or receive commissions from such sales unless they are properly licensed and appointed. A registered representative engaged in the sale of variable products requires the following:

- **FINRA Registration—**Registered representatives must maintain the Series 6 or 7 license.
- **State Securities Registration**—The registered representative must be registered with (1) the state in which he resides; (2) the state in which the customer resides; (3) the state in which his assigned branch office is located; (4) the state in which the application is signed; and (5) all states in which he conducts securities business (*i.e.*, states in which he maintains an office, sends securities-related information, discusses securities, or engages in securities solicitation activities).
- **State Insurance Licensing**—The registered representative must have a life insurance and variable annuity license issued by the insurance department from the following states: (1) the state in which he resides; (2) the state in which the customer resides; (3) the state in which his assigned branch office is located; (4) the state in which the application is signed; and (5) all states in which he conducts business (*i.e.*, states in which he maintains an office, sends information regarding variable products, discusses variable products, or engages in solicitation activities).
- **Appointment**—The registered representative must be appointed with the insurance company whose product is being sold. Insurance business cannot be offered prior to the registered representative's appointment in certain states.
- **Continuing Education—**Depending on the state, the registered representative may need to complete a continuing education requirement.

Registered representatives are responsible for requesting the appropriate registrations upon hire, and they have a continuing obligation to obtain additional registrations as they become needed. Moreover, registered representatives must verify, no less frequently than quarterly, that the Firm is maintaining the appropriate licenses for them. (Registration can be verified by reviewing the Form U-4 or using FINRA's BrokerCheck.) The designated principal will periodically review each registered representative's license and registration information to verify compliance with applicable requirements.

Requests for Licenses

Registered representatives should contact the Firm to request securities registration, insurance licensing, and appointment. The registered representative will be notified when registrations and insurance licenses are effective. Licenses are typically sent to the registered representative's home by the state licensing agency, and a copy should be forwarded to the Firm as soon as possible following receipt.

Non-Resident Licenses

The Firm's insurance agency may not be licensed in all 50 states. If the agency is not licensed in a certain state, that state may allow the registered representative to obtain a non-resident license. Registered representatives must notify the designated principal to clarify requirements before soliciting or attempting to service insurance products to "out-of-state" customers.

Unsolicited Insurance Transactions

If a registered representative without an insurance license receives an unsolicited order to purchase a variable product, the transaction must be referred to a properly licensed registered representative. Commissions will not be transferred to or split with a registered representative lacking the proper insurance licenses.

Additions to Existing Annuity Policies

If a customer wishes to make an additional contribution to an existing annuity policy, the registered representative must be licensed in the state where the customer currently resides.

21.6 Approved Products

Registered representatives are permitted to sell only those products approved by the Firm. The designated principal is responsible for evaluating and selecting products based on considerations such as:

- The insurance company's rating by a nationally recognized rating service.
- Availability of similar products from other insurance companies.
- Pricing of the product, including premium rates, compared with competitor's products.
- Sales support provided by the insurance company.
- When available, the number and substance of material complaints against the company and existence of criminal judgments against the company or its senior management.
- Other due diligence concerns deemed important by the designated principal.

The designated principal is responsible for (1) reviewing proposed products and maintaining a record of the information reviewed, and (2) approval of the product as well as the contract executed with the insurance company. The Firm will maintain a record of its product reviews and the selling agreements it enters into with product providers.

21.7 Suitability

Registered representatives must have a thorough understanding of the issues regarding suitability and disclosure before selling variable annuities. Registered representatives have a responsibility to understand what questions are useful in determining a customer's suitability, under what conditions a sale is appropriate, what features help determine whether or not a customer would find a variable annuity beneficial, and what disclosures must be made to help the customer make the decision. The information and recommendations registered representatives provide carry a great deal of weight with the customers, and each registered representative must make recommendations that put the customer's needs ahead of his own or the Firm's.

In recommending to a customer the purchase, sale, or exchange of any variable product, the registered representative must have reasonable grounds for believing that the recommendation is suitable for the customer based upon the facts disclosed by such customer about his other investments, risk profile, investment objective(s), and financial situation and needs. The registered representative must make reasonable efforts to obtain information concerning the customer's financial status, tax status, investment objectives, risk tolerance, and such other information that he intends to use in making recommendations to a customer.

The registered representative must review a customer's suitability information in light of each proposed investment recommendation to be sure that each investment is suitable for the customer. Information that a registered representative obtains relating to his customer's qualifications must be based upon information derived directly from the customer or from his authorized representatives (*e.g.,* accountants, lawyers, bankers). The information must be accurate to the best of the registered representative's knowledge. To the extent a registered representative becomes aware, or has reason to believe, that such information is no longer accurate, he must obtain current and accurate information from the customer.

The presence of a security on the Firm's approved product list does not mean that it is a suitable investment for all customers; nor is it a basis, in itself, to recommend that product to a particular customer.

Reasonable Basis

Prior to recommending the purchase of any security, the registered representative must have a reasonable basis for his recommendation, which requires a reasonable knowledge of any securities product he proposes to recommend. All registered representatives engaged in variable product transactions, and the designated principals responsible for overseeing such activity, must be thoroughly familiar with the features

and costs associated with each recommended variable product, including surrender charges, premium and cash value charges, separate account charges, underlying fund fees, subaccount investment options, loan provisions, free-look periods, and policy premium lapse periods. This information must be clearly conveyed to the customer so that the customer can make an informed investment decision regarding the recommended product.

Suitability of Variable Annuities

The complexity of variable annuities, with their combination of insurance and investment components, makes a suitability determination critical. When recommending variable annuities, registered representatives must adhere to the following guidelines:

- In determining the suitability of a particular subaccount, the registered representative must consider a variety of factors, including the following: investment objective, portfolio holdings, historical income or capital appreciation, expense ratio and sales charges, hedging and risk management strategies, and risks relative to other subaccounts.
- A variable annuity is unsuitable if the customer demonstrates an inability to understand the complexity of the investment, cannot appreciate the allocation of premium, or cannot understand the fees, expenses, or investment objectives of the subaccounts.
- Variable annuities are generally not suitable for clients with short-term objectives because: (1) a minimum holding period is often necessary before the tax benefits are likely to outweigh the often higher fees imposed upon variable annuities relative to alternative investments; (2) withdrawal and surrender charges inhibit liquidity; and (3) withdrawals prior to age 59 ½ are generally subject to a 10% penalty.
- If a registered representative recommends a variable annuity to a customer over age 59 ½, he must make sure that the customer understands that, even though there are no tax penalties for redemption, surrender charges may apply. Simply because a customer is below the maximum issue age does not mean a variable annuity is suitable.

Suitability of Variable Life Insurance

The following considerations should be made when recommending variable life insurance to a customer:

- Variable life insurance is inherently unsuitable for a customer who, even after discussion and education, (1) represents that his insurance needs are already

met or (2) expresses a preference for an investment product and not an insurance product.

- Determining that a customer meets the issuer's underwriting guidelines does not fulfill the registered representative's suitability obligation. The registered representative must make an independent customer-specific suitability determination.
- A registered representative must consider the customer's income and net worth to make sure that the premium is affordable, and that assets are properly diversified. Special scrutiny will be given to variable product transactions that fall outside of the suitability guidelines established by the Firm.
- Variable life insurance cannot be sold as an "investment," a "college funding plan," a "retirement account," a "pension plan," a "tax free investment," or "tax sheltered mutual funds." If the registered representative or the application indicates that a VUL was sold for something other than life insurance, then the transaction is unsuitable.
- Registered representatives should not recommend that a customer finance a variable life insurance policy from the value of another insurance policy or annuity, such as through the use of loans or cash values, without prior approval. It may be difficult to justify such a financing arrangement and the practice will be closely scrutinized.

Know Your Product

Variable annuities typically offer a wide range of optional contract features. To "know your product" means to understand every facet of a particular variable annuity contract, including the features and options, costs and fees, and potential risks. To know your product also means to become well versed in all state-specific insurance issues that may apply to a variable annuity contract, such as the free-look period. Registered representatives must have a reasonable basis to believe that the customer has been informed of the various features of any recommended variable annuity.

Customer-Specific Recommendations

FINRA regulations require that all variable annuity transaction recommendations be suitable for the customer. Therefore, recommendations must be customer specific. Registered representatives should make every effort to establish a comprehensive customer profile, and to consider all information before recommending the purchase or exchange of a variable annuity. Registered representatives must ensure that current information about each customer is reflected in the customer's account profile and in the submitted application package.

Know Your Customer

To "know you customer" means to have a thorough understanding of the customer's financial background and current investment needs. The registered representative must make reasonable efforts to obtain and consider information such as:

- **Age—**Variable annuities are long-term investments. Sales to customers over age 75 are generally not appropriate. Registered representatives should consider whether the Firm, the designated principal, or the product provider has implemented any age restrictions on the sale of variable products.
- **Net Worth**—This is the amount by which assets exceed liabilities, ***excluding the value of the customer's primary residence*****.** For an individual, it is the total value of all possessions—such as personal property, stocks, bonds and other securities—minus all outstanding debts.
- **Liquid Net Worth**—Assets that are in cash equivalents (money market, CD, bank account) plus those assets that are easily liquidated at current market prices (stocks, bonds, mutual funds). Liquid net worth does not include those assets that are illiquid, will be subject to large penalties if liquidated prior to maturity, or will reduce insurance coverage if liquidated. Examples of assets that are considered illiquid are investments in real estate, a VUL, or assets within qualified retirement plans, IRAs, or 401(k)s.
- **Liquidity Needs**—Assess the customer's need for liquidity and determine whether he has an emergency fund to meet short-term cash needs.
- **Annual Income—**The amount of recurring income from earned wages plus recurring income payments from investments such as bond payments, stock dividends, mutual fund dividends, and rental property. Consider job security and the stability of income sources. For trusts, organizations, or guardian accounts, list the annual net income.
- **Income Needs**—Consider obligations such as alimony or child support. If the customer has dependent children, consider college costs. It is also important to consider whether the customer is providing for an elderly parent.
- **Monthly Discretionary Income—**This is the amount of the customer's income available after essentials such as food, housing, utilities, and prior commitments are considered.
- **Insurance Needs—**Consider existing insurance coverage (term life, whole life, universal life) and whether the customer even needs life insurance. Health and long-term care insurance are also a consideration.

- **Retirement Needs—**Inquire as to when the customer would like to retire and evaluate how much income the customer will need during retirement.
- **Investment Experience—**Try to determine the customer's experience with variable annuities or other complex investments. This is very important as it can help the registered representative appreciate the customer's understanding of and level of comfort with different products. Investment experience should include the customer's experience with all the investments he owns or has owned, whether or not the investments were purchased through the Firm.
- **Investment Objectives**—Determine the customer's distinct needs, objectives, and preferences. The investment objective selected is the customer's objective for the contract he is buying.
- **Intended Use of Variable Annuity—**Determine the customer's specific intention(s) with respect to the variable annuity.
- **Existing Annuities—**Consider both fixed and variable annuities. A customer's total investments in annuities (fixed and variable) should generally not exceed 50% of net worth (exclusive of primary residence).
- **Existing Life Insurance—**Consider term life, whole life, universal life, and VUL.
- **Retirement Holdings—**Determine whether the customer is making the maximum contribution to his retirement accounts, such as 401(k)s, 401(b)s, and IRAs. If the customer is married, look at the spouse's contributions to retirement accounts.
- **Other Holdings—**Consider all of the customer's assets.
- **Degree of Diversification—**Evaluate how well the customer is diversified.
- **Risk Tolerance—**Determine the risk tolerance of the customer with respect to the variable annuity. For example, do not assume that a customer with a high tolerance for risk in a brokerage account has the same tolerance of risk with respect to his variable annuity subaccounts.
- **Tax Bracket—**This is the point on the income tax rate schedules where the customer taxable income is located—also known as the marginal tax bracket. The customer's tax bracket is a percentage to be applied to each additional dollar the customer earns over the base amount for that bracket.
- **Tax status**—Consider the customer's sources of taxable, tax-exempt, and non-taxable income.
- **Investment Time Horizon**—Determine the customer's time horizon specifically for the variable product and make sure it exceeds the length of the surrender

period. Variable annuity and variable universal life accounts are generally designed to be long-term investment vehicles. They are typically not appropriate for short-term or most intermediate-term objectives.

- **Highest Level of Education**—Try to determine a customer's education to assess how easily he will be able to comprehend the complex features of variable annuities.
- **Occupation—**Like education, a customer's occupation might provide clues as to what level of explanation is needed to allow the customer to make an informed decision to invest in a variable annuity.

Registered representatives must use the Firm's annuity purchase form and the customer's account profile to document their consideration of important factors and information relevant to the suitability determination. The annuity purchase form must be signed by the customer and the registered representative recommending the transaction.

Special Types of Accounts

Registered representatives must adhere to these procedures concerning the following accounts:

- **Trusts—**There are different types of trusts but all trusts have some common pieces to them including the trust date, a tax ID, a trustee, and a trust document that specifies the financial activities in which the trust may engage. Additionally, these transactions require the registered representative to obtain a copy of the trust or an affidavit of trust. If the registered representative is not working with the account's trustee or the trustee does not have specific authorization to engage in the financial activity specified, the registered representative may be conducting an illegal or unauthorized transaction.
- **Corporate Accounts—**These types of accounts require the representative to obtain a corporate resolution that specifies the person who is authorized to sign and approve investment activities on behalf of the corporation. A copy of the articles of incorporation must also be submitted with the application.
- **UGMA and UTMA Accounts—**Guardian accounts are different from custodial accounts and may require court documents authorizing certain types of transactions.
- **Joint Tenants in Common and JTWROS—**There is a distinct difference between these two types of accounts and laws governing them may vary from state to state.

- **IRA Transfer and an IRA Rollover:** Some companies require a minor's W-2 for an educational IRA. A regular IRA that is converted to a Roth IRA may require a conversion analysis to determine if the change is suitable for the customer.

Additional Reminders

Registered representatives should consider these additional details when obtaining customer information and completing an application:

- A joint account requires two signatures—one for each person listed—on all paperwork requiring a signature.
- The social security or tax identification number for the owner and joint owner is required.
- The street address must be a physical location and not a P.O. Box number. If the customer wants his statements mailed to a P.O. Box, list it as the mailing address. The address must be in the United States.
- Remember to indicate the customer's marital status and number of dependents.
- If the customer and/or joint owner are retired, please write "retired" on the paperwork. If the customer or joint owner is a homemaker, indicate this on the paperwork. If the customer is unemployed, indicate "unemployed."

21.8 Informing Your Customer

Registered representatives must have a reasonable basis to believe customer is informed of each recommended annuity's features, including:

- **Surrender Periods and Charges**—Explain the surrender charges or other penalties if the customer withdraws funds from the investment earlier than anticipated.
- **Applicable Tax Penalties for Sale or Redemption—**Withdrawals before age 59 ½ have a 10% penalty on earnings.
- **Living and Death Benefits**—Explain all benefits for the contract and make sure the customer needs them.
- **Mortality and Expense Fees—**Explain the amount and significance of these fees.
- **Features and Charges for Riders—**Explain that all riders and enhancements come at a cost. Describe each rider and enhancement so the customer can decide whether or not it is needed. Any riders or similar enhancements must be suitable. Registered representatives should perform an analysis to determine whether each rider's benefit is good enough to justify the additional cost.

- **Information about the Insurance and Investment Components of the Contract**
- **Market Risk**—Make it clear to the customer that he is risking a loss of his investment due to market risk.
- **All Fees and Charges—**Explain all fees and expenses, no matter how nominal they may seem.
- **Free Look Period**—The "free look" period varies from state to state. The free-look period allows the customer to terminate the contract and receive a refund without paying any surrender charges. The actual time frame will vary from state to state, but it is usually 10-20 days. During this period, some states will require that the seller return the contract's principal, while other states only require return of market value. Thus, customers could be exposed to market risk during this free-look period.
- **After-Tax Contributions—**Unlike contributions to retirement accounts, investments in variable annuities are made with after-tax contributions that do not reduce current taxable income. Make sure the customer and his spouse are making maximum contributions to retirement plans.
- **Tax Treatment of Withdrawals—**Withdrawals of earnings are taxed as ordinary income, rather than at the lower long-term capital gains rates that apply to non-tax-deferred vehicles held more than one year.
- **No Step-up—**Proceeds of most variable annuities do not receive a "step-up" in cost basis when the owner dies.
- **Tax-Qualified Accounts—**If the customer is purchasing a variable annuity within a tax-qualified account, make sure the customer understands that he is obtaining no additional tax-deferral benefit.
- **Spousal Continuation Feature**—This allows the surviving spouse to continue the contract in his or her name.
- **Annuitization Option—**Explain how the customer may receive payments in the distribution phase.
- **Guaranteed Minimum Income Benefit—**This features locks in an income base from which the future income stream will be established upon annuitization, but it does not protect against a lower annuitization base due to fluctuations in the market value of the contract. The customer has to annuitize the contract in order to receive the benefits of this feature. Typically, the customer must hold the annuity for at least 10 years before he can annuitize the guaranteed minimum income benefit base. Accruals to the guaranteed benefits base stop at certain percentage caps, as well as certain age limits, usually 80. Withdrawals during the

accumulation phase reduce the guaranteed income base by more than the amount actually withdrawn. A well-diversified subaccount allocation may be better at mitigating the impact of major market swings on the contract value or annuitization base.

- **Guaranteed Minimum Withdrawal Benefit (GMWB)**—This feature provides a guarantee of withdrawal of principal, regardless of the performance of the subaccounts. The guaranteed withdrawal is made gradually over a withdrawal period (*e.g.*, 5% every year for twenty years). This feature does not guarantee income during retirement, but only the withdrawal of original principal over the guaranteed withdrawal period. Make sure the risk of investment loss is high enough to justify this feature.
- **Guaranteed Minimum Accumulation Method**
- **Stepped-up Death Benefits**
- **Long-term Care Insurance**
- **Principal Protection**
- **Earnings Enhanced Benefit (EEB)—**This feature provides a higher death benefit than the standard benefit by providing an additional percentage of contract earnings to beneficiaries upon death of the annuitant. This feature is generally not appropriate if the customer has no one needing a death benefit.

21.9 Recommendations

When recommending a variable annuity transaction, the registered representative must:

- Make a reasonable effort to obtain and consider various types of customer-specific information, including age, income, financial situation and needs, investment experience and objectives, intended use of the variable annuity, investment time horizon, existing assets, liquidity needs, liquid net worth, risk tolerance, and tax status.
- Have a reasonable basis to believe that the customer has been informed of material features of a variable annuity, such as a potential surrender period and charge, potential tax penalty, various fees and costs, insurance and investment components of the contract, charges for and features of enhanced riders, and market risk.
- Have a reasonable basis to believe that the customer would benefit from certain features of variable annuities, such as tax-deferred growth, annuitization, or death or living benefits.

- Make a customer suitability determination as to the investment in the variable annuity, the investments in the underlying subaccounts at the time of the purchase or exchange, and all riders and other product enhancements and features contained in the annuity contract.
- Have a reasonable basis to believe that a variable annuity exchange transaction is suitable for the particular customer, considering, among other factors, whether the customer would incur a surrender charge, be subject to a new surrender period, lose existing benefits, be subject to increased fees or charges, and whether the customer has had another exchange within the preceding 36 months.

The registered representative should not recommend a variable annuity to a customer unless he has determined that the variable annuity as a whole, the underlying subaccounts, and any features or riders are suitable for the customer based on the customer's financial situation and needs. It is the registered representative's responsibility to help the customer choose only those features where the benefits justify the costs, given the customer's financial situation and investment objectives. The benefits of any enhanced features or rider should match the needs of the customer because the customer is paying for each optional feature. The costs of the added features should be disclosed to the customer, as well as any special conditions or limitations that may apply. In addition, the registered representative should check the specific contract carefully, as the names and provisions of enhanced living benefit riders often vary from contract to contract.

21.10 Prospectus Delivery

The registered representative must deliver a current prospectus to the customer prior to, or at the time of, his sales presentation. Prospectuses should be obtained from product sponsors. The registered representative must make sure that (1) the prospectus is not more than 13 months old, (2) the customer has a reasonable opportunity to review the material; (3) all required supplements are delivered along with the prospectus; and (4) the Statement of Additional Information is provided upon the customer's request. Additionally, the registered representative must not alter, highlight or mark the prospectus, or state or imply that the SEC has approved the product.

21.11 Tax-Deferred Savings

One reason that customers may wish to consider a variable annuity is to accumulate savings on a tax-deferred basis. A variable annuity may be a suitable means of adding tax-deferred savings, as the earnings, if any, grow free of taxes until withdrawals are

made. However, when withdrawals begin, all earnings will be taxed as ordinary income tax rates rather than at lower long-term capital gains tax rates. Also, unlike other tax-advantaged investments, variable annuities do not allow for a step-up basis upon death of the annuitant. Therefore, the tax-deferral features may not necessarily overcome the higher fees and costs associated with variable annuities.

Other tax-advantaged options, such as 401(k) plans, may have lower fees and charges than variable annuities. Registered representatives should consider whether it is in the customer's best interest to maximize investments in existing tax-advantaged vehicles before looking at additional products such as variable annuities.

If the customer wants other features of the variable annuity unrelated to tax deferral, then the registered representative should consider whether it is in the best interest to buy the annuity after full disclosure of all applicable fees, expenses, surrender charges, limits on liquidity, etc. Registered representatives should always be sure to document the customer's investment objectives and personal intentions in order to protect himself and the Firm.

21.12 Long-term Investment Vehicles

Variable annuities are generally long-term investment vehicles. They are typically used as part of a strategy to provide future income, such as a tax-deferred investment strategy to provide income during retirement. The relatively high costs and fees coupled with surrender charges and potential tax penalties generally make variable annuities unsuitable short-term investments.

Therefore, registered representatives should consider whether the customer has a long-term time horizon before recommending a variable annuity. Since the tax-deferred accumulation of earnings is often the key benefit obtained from a variable annuity investment, a customer who does not make this investment for the long-term will not receive the full benefit of tax-deferred compounding of earnings. In addition, the customer may be liable for potential fees, such as surrender charges, as well as tax implications of liquidating the investment. Red flags indicating that a customer has an inappropriate time horizon include a time horizon that is shorter than the surrender charge period or one that is before the customer would attain age 59 ½.

21.13 Subaccount Allocation and Market Risk

The dollar amounts invested in a variable annuity are placed in subaccounts selected by the contract owner. Each subaccount is advised by an investment manager who selects investments based on the focus and investment policies of the subaccount portfolio. The rate of return provided by the variable annuity is based on the returns of the

subaccounts in which the funds are invested; therefore, variable annuities are subject to market risk.

Generally, the customer, and not the insurance company, bears this risk. A registered representative's presentation to customers should include a review of each risk involved in the purchase of a variable annuity contract, including market risk. It is also the responsibility of the registered representative to ensure that the subaccount allocation recommendations are appropriate for the customer's investment objectives, risk tolerance, and time horizon.

In addition, once the initial allocation is set, the registered representative should meet periodically with the customer to review the allocation, determine if it is still appropriate, and rebalance it if needed. It is a good practice to provide the customer with a breakdown of the fees for the subaccount choices and a computation of the weighted average of the fees for the subaccounts. Here is an example:

Subaccount	Allocation	Fees
Income bond fund	20%	.90%
Domestic equity fund	60%	1.1%
International equity fund	20%	1.4%

In this example, the weighted average is 1.12%, which is computed as follows: (0.20)(.90) + (0.60)(1.1) + (0.20)(1.4)). Unlike a simple average, the weighted average applies more importance (weight) to the subaccounts with higher allocations. For this reason, registered representatives are encouraged to consider the weighted average when assessing the impact of fees on a customer's subaccount allocations.

21.14 Disclosure of Features

Registered representatives should disclose the many features and options associated with a variable annuity to the customer. It is the registered representative's responsibility to provide customers with a fair, accurate, and balanced description of each optional benefit and its associated cost.

Many features and riders carry an additional cost for the contract owner and serve to reduce the accumulated value of the variable annuity contract. In addition, riders frequently have certain conditions and limitations, which vary by company. Therefore,

customers should be reminded of any conditions or limitations, as well as the fact that they are paying for each additional benefit they elect to receive.

It is essential that the registered representative help the customer determine just how necessary any of these additional benefits are in relation to the customer's overall financial plan; in other words, each rider must be suitable for the customer. Bear in mind that in some instances it may be more beneficial to purchase a different investment vehicle rather than adding a rider. In addition, if a customer is risk averse, a variable annuity may not be appropriate, regardless of the guarantees offered.

21.15 Disclosure of Costs and Fees

When recommending a variable annuity, the registered representative should fully discuss all relevant facts regarding the contract with the customer, including all of the costs and fees associated with a particular contract. Variable annuities are not usually low-cost investments, often because they include multiple features and benefits that have associated costs. These fees and costs can be higher than in other investments. Therefore, the broad range of charges that apply to variable annuity contracts should be clearly explained to customers who may be considering them as investment vehicles.

An accurate and full disclosure of each individual fee should be made to the customer, not simply a total fee. It is best to provide a breakdown of fees in a manner that clearly discloses each cost that is a component of total cost. Registered representatives may also want to provide the breakdown of fees in a manner that compares one or more variable annuities under consideration. Here is a simple example:

Feature/Benefit	Cost for Contract A	Cost for Contract B
Annual contract fee	$30	$50
M&E charges	1.2%	1.0%
Administration charge	0.15%	0.20%
Guaranteed minimum income benefit	0.60%	0.50%
Total fee (excluding subaccount and annual contract fees)	**1.95%**	**1.70%**

The types of fees and other costs that should be disclosed include:

Insurance-Related Fees (M&E and Administrative)

While the actual amount of insurance-related fees will vary from contract to contract, they generally include administrative fees and so-called mortality and expense fees, or "M&E" fees. The M&E fee is assessed by the issuing insurance company to pay for guaranteed death benefits, annuity payment options that can provide an income for life (or a stated period selected by the contract owner) at rates established in the contract when purchased, and a guaranteed cap on administrative charges related to the variable annuity. Administrative fees are assessed to pay for the servicing and maintenance of the variable annuity contracts. The servicing and maintenance features include statement preparation, mailings, and other customer service items. They may also include a contract fee, which is generally assessed at some flat rate per year. The contract fee may be waived for those contracts above a certain dollar amount. Also, if more than a stated number of transfers are made per year, the issuing company may impose a transfer fee as well. Insurance-related fees must be disclosed to the customer.

Investment Management or Subaccount Fees

Investment management or subaccount fees are charged to pay for portfolio management and other expenses tied to the ongoing management of the underlying subaccounts for the variable annuity. These fees are similar to those associated with mutual fund portfolio management because many of the same companies handling the investment management of mutual fund families also manage the subaccount investment portfolios for issuers of variable annuities. Investment management or subaccount fees must be disclosed to customers.

Potential Surrender Charges

Variable annuities do not carry up-front sales charges. However, like Class B share investments in mutual funds, they carry a surrender penalty or "back-end load" or "contingent deferred sales charge," if the variable annuity is surrendered in the first several years of the contract. The surrender period may last as long as nine or ten years. Surrender charges can start as high as six to nine percent and decrease over a period of time until they reach zero percent. The surrender charge penalizes the investor for terminating the contract early and helps the issuing insurance company recover some of the payment made to the registered representative who sold the variable annuity. At a minimum, a customer should be able to hold the variable annuity at least until the surrender charge period has ended before terminating the investment. Surrender charges make a variable annuity investment an unsuitable investment for a customer seeking current income or a short-term investment. Surrender charges must be disclosed to the customer.

Tax Implications

Variable annuities are tax-deferred investments and they carry tax implications that must be fully understood by the customer. Tax implications required to be disclosed include:

- Withdrawals of earnings from a variable annuity are taxed as ordinary income at the rate of the tax bracket of the contract owner, not at the long-term capital gains tax rate.
- Generally, if withdrawals are made before age 59 ½, the IRS assesses a ten percent penalty against any portion deemed earnings.
- If premature or non-qualified withdrawals are made, the amounts withdrawn are presumed "interest earned" first and fully taxable.
- If the contract owner dies, the value of the variable annuity contract is included in the contract owner's gross estate for tax purposes and withdrawals of earnings are taxed as ordinary income to the beneficiary.
- Non-natural persons, such as trusts and corporations, are subject to annual taxation on variable annuity interest earned, unless the variable annuity is used to fund a qualified retirement plan or meets limited exceptions.

Fees and Charges for Special Features

Most variable annuity contracts offer special features such as long-term care insurance, principal protection, or a guaranteed minimum income benefit. A fee is generally assessed for each of these special features selected by the contract owner. These charges will reduce the value of the variable annuity contract and therefore should be selected only if they carry a genuine benefit that is actually needed by the contract owner or annuitant. Benefits and fees will vary from variable annuity to variable annuity. Therefore, it is important for both the registered representative and the customer to review the contract in detail before a recommendation is made.

21.16 Bonus Annuities

Some insurance contracts offer a bonus credit feature where the insurance company promises to add a bonus to a variable annuity policyholder's contract value based on a specified percentage (typically 1% to 5%) of purchase payments. Registered representatives must be aware that there may be disadvantages and added costs that could more than offset the benefit to the customer. For example, as compared to a variable annuity that does not have a bonus feature, the bonus annuity may have higher surrender charges, longer surrender periods, and higher mortality and expense charges or other charges. The registered representative is responsible for understanding the

benefits and disadvantages of a bonus product before making a recommendation to a customer.

21.17 Sales in Qualified Plans

Some tax-qualified retirement plans (*e.g.*, 401(k) plans) provide customers with an option to make investment choices among variable annuities. While these variable annuities provide most of the same benefits to investors as variable annuities offered outside of a tax-qualified retirement plan, they *do not* provide any additional tax deferred treatment of earnings beyond the treatment provided by the tax-qualified retirement plan itself. A variable annuity can offer many features other than the tax deferral benefit that are advantageous to the customer when purchased inside a tax qualified plan. Some of these features include a death benefit, living benefits, certain forms of asset protection, and the ability to provide an income that cannot be outlived. It is important to carefully document the reasons why a variable annuity is chosen as the investment vehicle to fund a tax-qualified plan and to disclose to the customer that they will not receive any additional tax-deferred benefits beyond the tax treatment provided by the tax-qualified retirement plan itself.

21.18 Cash Compensation

Cash compensation is any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override, or cash employee benefit received in connection with the sale and distribution of variable products. With limited exception, all cash compensation must be described in the current prospectus of the product provider. Registered representatives are prohibited from accepting cash compensation from anyone other than the Firm.

21.19 Non-Cash Compensation

Non-cash compensation is any form of compensation received in connection with the sale and distribution of variable products that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals, and lodging. Registered representatives are prohibited from, directly or indirectly, accepting or making payments of any non-cash compensation in connection with the sale of variable products, except under the following conditions:

- **Gifts**—The gift must not exceed an annual amount of $100 per person and must not be preconditioned on achievement of a sales target. Registered representatives are responsible for adhering to the Firm's policies and procedures concerning gifts and their reporting.

- **Occasional meal, ticket to a sporting event or the theater, or comparable entertainment**—Such non-cash compensation must not be so frequent or extensive as to raise questions of propriety, and it must not be preconditioned on achievement of a sales target. If required by the Firm, such non-cash compensation should be reported.
- **Payments or reimbursements for training or education**—This form of non-cash compensation is permissible only if stringent requirements are met. For this reason, registered representatives must obtain pre-approval from the Compliance Department if anyone is going to pay or reimburse the Firm or its associated persons for the expenses related to training or education.

Registered representatives should refer to the Firm's policies and procedures on gifts and gratuities for additional information concerning the receipt or payment of non-cash compensation.

21.20 Replacements

The term "replacement" is broadly defined as any transaction in which new life insurance or a new annuity is to be purchased, and the registered representative knows or should have known, that by reason of such transaction, the existing life insurance or annuity has been or will be:

- Lapsed, surrendered, partially surrendered, forfeited, assigned to the insurer replacing the life insurance or annuity contract, or otherwise terminated;
- Changed or modified into paid-up insurance, continued as extended term insurance or other form of nonforfeiture benefit, or otherwise reduced in value by the use of nonforfeiture benefits, dividend accumulations, dividend cash values, or other cash values;
- Changed or modified so as to effect a reduction either in the amount of existing life insurance or annuity benefit or in the period of time the existing life insurance or annuity will continue in force;
- Reissued with a reduction in amount such that any cash values are released, including all transactions wherein an amount of dividend accumulations or paid-up additions is to be released on one or more of the existing policies;
- Assigned as collateral for a loan or made subject to borrowing or withdrawal of any portion of the loan value, including all transactions wherein any amount of dividend accumulations or paid-up additions is to be borrowed or withdrawn on one or more existing policies; or

- Continued with a stoppage of premium payments or reduction in the amount of premium paid.

Common transactions that constitute replacements include 1035 Exchanges (explained in detail below); loans on existing life insurance policies used to fund new purchases; and other transactions involving the same insurer (commonly known as internal replacements), depending on state law. Also considered a replacement by the Firm is the redemption of mutual funds to purchase variable products. Recommendation of a replacement should be suitable for the customer and justified based on the reasons for the replacement. Considerations include the age of the customer, the cost involved, and what benefit is derived from the replacement.

Suitability of Replacements

The registered representative must have a reasonable basis for recommending a replacement. A replacement may not always be in the customer's best interest. For example, a customer may incur new fees, extended surrender charge periods, higher insurance risk rating due to ill health, and new suicide and incontestability periods. There may also be unfavorable tax consequences.

Before recommending the replacement of an existing contract, a registered representative should give careful consideration to the possible consequences, including, without limitation, the following:

- Changes in age and health resulting in higher premiums;
- New sales loads and other expenses;
- Lower policy guarantees and assumption of additional risks by the customer;
- Loss of important grandfather rights, if applicable;
- The issuer's right to challenge a death claim generally within two years from date of issue;
- Surrender or early withdrawal charges;
- Loss of potential policy enhancements;
- Income tax consequences;
- Loss of a lower policy loan interest rate and loss of other favorable policy provisions.

Each registered representative must provide a written explanation of the transaction and the reasons for the product selection on the annuity purchase form. There are a variety of reasons that a replacement may be appropriate for a customer, and some of the possible explanations are provided below:

- Customer requires immediate benefits unavailable from current issuer;
- Higher rating of issuer;
- More favorable underwriting classification;
- Premium bonus to customer;
- Reduced costs to customer;
- Bonus interest to customer;
- Loss of confidence in the existing insurer or its sales personnel;
- Estate planning;
- Higher guarantee rate;
- Dissatisfaction with current policy holder service or policy administration;
- Consolidation of coverage with one insurer;
- Ability to convert a heavily loaned policy into a new policy;
- Availability of new coverage or improved benefits and features;
- Historical premium funding of existing policy will not support current death benefit;
- Customer expressed need for increased coverage;
- Dissatisfaction with the current insurer's ratings;
- Dissatisfaction with the current insurer's claims policies, procedures, and turnaround time;
- Ability to obtain the same or increased coverage without an increase in projected cost;
- Type of product needed has changed;
- Restructuring ownership and existing policy cannot be transformed to meet current needs;
- Ability to obtain cheaper coverage based on guaranteed values and benefits;
- Ability to obtain cheaper coverage based on illustrated non-guaranteed values and benefits;
- Dissatisfaction with the current insurer's dividend history;
- Better reputation, name recognition, and/or rating with new insurer;
- Concern over adverse publicity relating to existing insurer;

- The current carrier was unable or unwilling to modify existing policy/annuity to meet the customer's objectives;
- Current carrier was unable or unwilling to match the new underwriting classification;
- Availability of additional or alternative investment subaccounts;
- Unsolicited request by customer.

Although replacements can be a legitimate part of selling variable products, the main focus is whether the replacement is appropriate for the customer. Registered representatives are reminded that the Firm's primary concern is the best interests of each customer.

Replacement of Variable Annuities

Registered representatives should carefully consider whether a replacement for a variable annuity is suitable for the customer and take into consideration the following:

- What is the composition of the customer's overall portfolio? Will a new variable annuity represent a significant asset in the portfolio?
- Has the surrender charge period in the old annuity expired?
- Will the customer need the money soon? What is the length of the surrender charge period in the new annuity? To what extent does the new annuity provide access to funds without penalty or hinder the insured's liquidity needs?
- Is disclosure to the customer clear that all investment risk in a variable contract is borne by the customer?
- What is the customer's age? Older customers may have greater liquidity needs.
- A comparison of penalties for both the new and the old policy.
- What are the surrender or withdrawal charges for the existing policy?
- Will new commissions be charged for the purchase of the new policy?
- A comparison of fees and charges for both policies (administrative, M&E, investment advisory fees, riders, etc.).
- Is there a reduction or loss of death or living benefits?
- Are there potential tax consequences for surrender of the old policy?
- Insurance and investment components of the variable annuity.

Replacement of Variable Life Insurance

If a new life insurance policy provides a higher death benefit for truly the same or lower premium cost than under the old life insurance policy, then a replacement may be a reasonable consideration for the customer. Registered representatives should consider the following factors when determining if a replacement of a variable life insurance policy for a client is suitable:

- Surrender charges on the old policy.
- Surrender charges, and duration, in the new policy.
- Sales charges on the new policy.
- Liquidity of the new policy.
- Tax treatment on the exchange or surrender of the old policy.
- Imposition of new contestability/suicide period. Has there been a change in the customer's health?
- Evidence of insurability.
- Costs, duration, and fees for each policy.
- Comparison of cash value under the old and new policies.
- Costs of borrowing from the policies.
- The advantage, if any, of modifying the existing policy.
- Premium payment period of the new policy compared to the old policy.
- Possible variability of future premium payments.

Replacement Procedures

If a replacement is to be effected, the registered representative must:

- Be appointed with the new insurance company and licensed in the state of the customer's residence prior to effecting the replacement.
- Complete the appropriate insurance or annuity application.
- Determine whether the insurance carrier requires its own surrender form or state replacement form.
- Complete a state replacement form when required.
- Obtain the surrendering carrier's original policy or complete a lost policy statement that is signed by the customer.
- Deliver all paperwork for processing.

- Promptly effect the switch after obtaining approval.

State-Mandated Replacement Forms

Most states have laws or regulations governing the replacement of insurance products. In addition to knowing and complying with the Firm's existing policies and procedures governing replacements, each registered representative is also responsible for knowing and complying with all applicable state replacement laws and regulations concerning replacements, including that portion of those laws and regulations that require registered representatives to obtain state-mandated replacement forms and the customer's signature on such forms. In some cases, the state form is not required for variable annuities if the replacement or exchange is performed in compliance with FINRA's rules governing exchanges. Registered representatives are responsible for knowing when to use any forms required by a state's insurance department. Like certain states, some insurance providers may require additional documents and/or disclosures for replacement transactions.

21.21 1035 Exchanges

A 1035 Exchange is a special type of replacement with tax advantages. 1035 Exchanges are governed by Section 1035 of the Internal Revenue Code. Section 1035 allows for tax-free exchanges to be made from an existing insurance contract to fund a new life insurance or annuity contract without paying tax on the accrued income and investment gains earned during the life of the original contract. One annuity can be exchanged for another, and the investor's earnings can thus continue their tax-deferred growth.

A 1035 Exchange is a "like kind" exchange of insurance contracts. The following exchanges, among others, may be made without current income taxation:

- Annuity contract for an annuity contract.
- Life insurance policy for an annuity contract.
- Life insurance policy for another life insurance policy.

With 1035 Exchanges, an annuity contract cannot be exchanged for a life insurance policy. It is also important to note that a 1035 Exchange does not allow the policyholder to receive a check and apply the proceeds to the purchase of a new insurance or annuity contract.

1035 Exchanges can also include partial exchanges, which are "like kind" exchanges of a portion of the value of an annuity contract where the proceeds are sent directly to another company for the purchase of a new annuity contract. 1035 Exchanges are part of a larger universe of activity that includes trustee-to-trustee transfers and the use of

free withdrawals and surrenders to fund new insurance products from existing insurance products. Many of the suitability and disclosure issues discussed in these procedures apply to these other switches as well.

Recommending an Exchange

Recommending an exchange requires consideration similar to a cost-benefit analysis. The registered representative must thoroughly evaluate any recommended exchange by considering the following:

- Does the exchange trigger a surrender charge or start a new surrender period?
- Would the customer lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements)?
- Would the customer benefit from any product enhancements and improvements offered by the new product?
- Has the customer made another deferred variable annuity exchange within the last 36 months at the Firm or any other broker-dealer?

Registered representatives must document the factors considered in recommending an exchange by completing and signing the annuity purchase form. Registered representatives are encouraged to use additional means to document their evaluation of a recommended exchange.

Suitability Analysis of 1035 Exchanges

A new suitability determination must be done for the new contract created by the 1035 Exchange. Recommended exchanges and switches must be suitable. The mere fact that an exchange is allowed by tax law as a tax-free exchange is not a basis for a suitable exchange. Similarly, switching brokerage firms is also not sufficient justification for an exchange, and does not permit across-the-board switching when an exchange is not in the customer's best interest. While registered representatives may believe that they can no longer service the customer's current annuity if the Firm does not support it, many insurance companies will work to keep a customer by accommodating a limited agreement.

A switch from one annuity to another should identify and address specific needs that are different from those that the customer had when the original annuity was sold. Determining suitability necessitates answering such questions as:

- What are the specific benefits of the exchange?

- Are those benefits consistent with the customer's objectives and needs?
- What will the total cost of the exchange be to the customer?
- Does the exchange trigger a surrender charge or start a new surrender period?
- If the customer ends up paying a surrender charge and then going into a new annuity, does the cost of the surrender charge undermine the benefits of the new contract?
- Will the customer lose existing benefits or be subject to increased fees or charges?
- Does the loss of existing benefits and guarantees under the first contract outweigh the benefits of the new contract?

A thorough suitability analysis requires a clear understanding of the customer's needs and how the current and new annuity fit those needs. The customer profile should be thoroughly reviewed and analyzed with respect to the customer's age, annual income, financial situation and needs, investment experience, investment objectives, investment time horizon, existing assets (*e.g.*, investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, and tax status. Registered representatives should be prepared to answer questions such as:

- Does the current annuity comport with the customer's intended uses and investment objectives?
- Why did the customer purchase the annuity in the first place? Has the need changed in some way?
- What percentage of the customer's current investments and net worth does this transaction represent?
- If the customer's investment needs and/or objectives have changed, can the existing product be revised to meet those needs?
- If the customer's circumstances, such as net worth or income, have changed, will the new product meet the customer's needs?
- Is the customer's time horizon sufficiently long enough to handle a new surrender period?
- Does the customer's age raise any concerns regarding the exchange?
- How was the customer's need for a new annuity uncovered?
- How has the customer's need and total cost of the transaction been documented?

- What is the justification for an exchange?

Know Your Product

As part of the suitability analysis, registered representatives must compare the contracts involved to identify the various components and features of each contract. While contracts may have different optional benefits, as well as different names and descriptions for the benefits offered, a good comparison will review the contracts feature-by-feature to the extent possible. In other words, registered representatives must compare "apples to apples" and not "apples to oranges."

A good starting point is the current contract. Registered representatives should consider what it includes and excludes, which can be problematic if neither the Firm nor the registered representative has information regarding the initial transaction. In order to compare policies, the registered representative may have to research the specifics of the original contract and obtain as much paperwork as possible from the original purchase. If the customer does not have this information, the registered representative, in coordination with the customer, should contact the existing carrier.

In the final analysis, suitability requires a consideration of all of these factors in relation to the specific needs and objectives of the particular customer. Some of the most important factors to consider when comparing contracts are discussed below.

- **Product Enhancement, Improvements, and Their Costs—**New variable annuity products and new types of features are constantly being created. But no matter how appealing new benefits may sound, they may not be suitable for a particular customer. An important consideration should be whether the customer may benefit from the extra features and whether the existing contract features are in line with the customer's current objectives and needs. In addition, registered representatives should consider the potential loss of existing living and death benefits from surrendering the existing contract. In almost all instances, these new benefits will come with costs and the customer's benefit derived from the features must justify the additional cost. However, additional cost does not automatically make a 1035 Exchange unsuitable.
- **Subaccount Options**—A new annuity may offer more competitive or diversified subaccount options. If the customer has, since the purchase of the original annuity, moved from a moderate to a fairly aggressive risk tolerance, the customer could need or want new subaccounts in his new annuity. The registered representative must determine whether existing subaccounts may fulfill the customer's current investment objective.
- **Company Solvency and Rating Agency Changes—**The financial strength of the current insurance company can change over time. It is possible that the company

may be less solvent at the present time than when the annuity was originally purchased. Careful suitability consideration must nevertheless by given if a 1035 Exchange is recommended due to the possibility of company insolvency or significant rating agency change, particularly since these points affect only the contract guarantees or fixed subaccounts.

- **Fees**—Registered representatives should focus on the components as well as the totality of the annuity costs and subaccount fees. The cost comparison between contracts will be skewed if expenses are included on one side and not the other. For this reason, registered representatives must include all fees and expenses when comparing the costs of two contracts.
- **Surrender Charge and New Surrender Period**—A surrender charge may be levied against the customer for an early withdrawal of funds from his annuity contract. The registered representative must understand the possible surrender charges and fully disclose them to the customer. In addition, the registered representative should always make the customer aware that once a new contract has been purchased, an entirely new surrender period will begin for the new annuity. This factor should be considered in light of the customer's stated liquidity needs.

Tax Implications

Variable annuities by nature hold tax implications for customers, who should be advised to consult with their tax advisors regarding a 1035 Exchange. An understanding of taxation issues relevant to the product will aid the registered representative in fulfilling his obligation to provide fair and balanced disclosure of the tax implications of 1035 Exchanges. Registered representatives must consider the following tax implications:

- If an individual under 59 ½ years old makes a premature withdrawal, a ten percent penalty will generally apply to the earnings only.
- Specific tax benefits may be associated with contracts issued prior to 1982.
- Partial 1035 Exchanges require additional considerations.

A registered representative may consult with the designated principal concerning tax implications of a transaction. However, if the matter of taxation remains in question or is complex, the registered representative must instruct the customer to seek the guidance of a professional tax advisor. Registered representatives are prohibited from acting as tax advisors.

Variable Annuity Exchanges to Other Products

When recommending a 1035 Exchange from a fixed annuity to a variable annuity, the registered representative must determine whether the customer has the necessary risk tolerance for investing in securities, even if guarantees are offered in a variable annuity rider. Riders may have restrictions that may not be applicable in a fixed annuity.

When a registered representative recommends a 1035 Exchange from a variable annuity to a fixed or equity indexed annuity, the same need for a suitability review exists as in the case of fixed to variable transactions. Such an exchange is usually indicative of a change in customer investment objective or perhaps signals an attempt to mitigate loss within a variable contract.

FINRA has jurisdiction over any 1035 Exchange that involves a security on one side of the transaction. Therefore, any recommendation to liquidate or surrender a registered security—such as a mutual fund, variable annuity, or variable life contract—must be suitable, including when such liquidation or surrender is for the purpose of funding the purchase of a fixed annuity or equity indexed annuity. Furthermore, transactions from a variable annuity to other annuity products may trigger suitability review obligations and must conform to any individual state insurance requirements concerning replacement disclosures and/or suitability analysis.

Disclosures Regarding 1035 Exchanges

The registered representative is obligated to provide fair and balanced disclosure—including all advantages and disadvantages of the transaction and resulting new annuity—with each 1035 Exchange. Although the offering documents/prospectus will include various disclosures, merely delivering a prospectus is not sufficient. The registered representative must seek to ensure that the customer understands and is comfortable with information disclosed. Registered representatives should encourage the customer to ask questions. The following factors must be disclosed and fully explained for 1035 Exchange:

Existing Contract

- Changes in benefits from the existing contract to similar benefits in the new contract.
- Loss of existing benefits.
- Effect of surrender terms, such as the new surrender window that starts with the new contract.
- Differences between existing contract and new contract fees.
- Costs associated with the surrender of the existing product or contract.

- Product features and subaccounts.
- Consequences of early withdrawal from the new contract, such as charges or penalties.
- Difference in fees, with focus on the component costs as well as the totality of the annuity costs, especially the costs of any new features or riders.

Documenting Exchanges

Documentation is an important part of disclosure. Registered representatives must take the time to carefully document their work, as well as go through the documentation of both the current and the new annuity with the customer. The Firm's annuity purchase form helps to document the exchange and the comparison of the contracts. In addition to completing the annuity purchase form (a required form), registered representatives may document their side-by-side comparison through other means (*e.g.,* Excel worksheet). Any additional documentation, if shown or provided to the customer, must comply with the Firm's procedures on communications with the public.

When recommending a 1035 Exchange to a variable annuity, the registered representative must document and sign his suitability determination. By signing the annuity purchase form*,* the registered representative is certifying that he has performed a suitability determination in compliance with all applicable rules. Although the customer's signature on the annuity purchase form offers some protection to the registered representative and the Firm, it will not protect the registered representative from liability if he failed to discuss and explain the disclosures to the customer or he was negligent in performing the suitability analysis.

Gathering of Information Regarding Customer Exchanges

The Firm and its registered representatives must consider whether the customer has had another deferred variable annuity exchange within the preceding 36 months. The Firm documents the nature of this inquiry and the customer's response on the annuity purchase form.

21.22 Certificates of Deposit

When funds from maturing certificates of deposit (CDs) are used for the purchase of a variable annuity, registered representatives should advise the customer of the material differences between CDs and variable annuities, particularly the greater risk to the customer's capital and the absence of any federal deposit insurance or guarantee for assets placed into subaccounts. When recommending a switch from a CD to a variable

annuity, registered representatives should consider any penalty the customer would incur on withdrawing money from the CD.

21.23 Prohibited Business Practices

Registered representatives who sell variable products are prohibited from engaging in any business practice that violates any law, rule, or regulation. The following practices are prohibited:

- **Projection of Returns**—Registered representatives are prohibited from projecting returns for variable products to customers. Illustrations may be used to show customers how a policy or contract works, but not how they perform. If a registered representative wishes to use illustrations, he must be adequately trained (usually by the designated principal) to use the illustrations in a manner that is not misleading.
- **Twisting**—Registered representatives are prohibited from engaging in the practice of convincing a customer to surrender one variable product only to replace it with a similar variable product from a different company for the purpose of generating a new commission. This unethical practice is known as "twisting" and will not be tolerated.
- **Multiple Contracts**—Registered representatives are prohibited from recommending the purchase of multiple insurance contracts or policies, resulting in a higher costs to the customer, when one contract or policy will meet the customer's needs.

There are numerous other prohibited business practices. Registered representatives are prohibited from:

- Concealing (or suggesting or encouraging the concealment) of any material facts that could affect the underwriting decision. Each registered representative has the obligation to disclose all information that may potentially affect the underwriting decision.
- Changing the customer's address on any account to reflect the registered representative's own address, place of business, or any other address over which the registered representative exercises direct or indirect control.
- Receiving third-party checks, starter checks, or any other checks deemed not to be acceptable to the issuing company. Registered representatives must ensure that the customer's check is made payable to the specific issuing company.
- Submitting applications on behalf of themselves, family members, or other customers knowing that they will be rescinded or lapsed after the qualification

period, or engaging in any other unethical conduct for the purposes of qualifying for a prize, reward, or other type of compensation structure.

- Disclosing any personal, medical, financial, or any other non-public information about any customer or prospective customer to an unauthorized third-party.
- Signing a customer's name on a check, application, replacement form, loan request form, policy receipt, or any other document.
- Guaranteeing future performance on any product.
- Designating oneself as a contract beneficiary without prior approval (except in family situations).
- Selling or attempting to sell any securities or insurance products from companies that are not approved by the Firm.
- Allowing unregistered personnel to sell variable products.
- Using unapproved sales literature or misleading correspondence.
- Using fear-inducing tactics to scare the customer into making a decision.
- Discussing the features and costs of a variable annuity without first obtaining enough information to determine if a variable annuity is even a suitable investment for a customer.
- Relying on suitability information that is not current.
- Failing to properly document the suitability review.
- Comparing variable product subaccounts to mutual funds without explaining the material differences.
- Failing to disclose and explain the cost of enhanced benefits.

With respect to variable life insurance, registered representatives are prohibited from:

- Indicating that new policies could be acquired by customers already owning life insurance by using cash values or future dividends from customers' existing policies, for little or no additional cash payment.
- Indicating that the premium payments would end, or "vanish," after a certain number of years.
- Stating that variable life policies are not insurance but an "investment," "savings," or "retirement plan."
- Making unsuitable sales to customers, including retirees and persons who did not know that they were purchasing insurance or did not want life insurance.

21.24 Communications with the Public

Advertising and Sales Literature

Any material created by a product provider may only be used by registered representatives after it has been approved by the designated principal. The designated principal will obtain the FINRA approval letter (also called a review letter or clean letter) showing that the material was reviewed by FINRA and is consistent with applicable standards. Copies of the FINRA approval letter should be maintained along with evidence of the designated principal's review and approval.

Any material created by the Firm or a registered representative must be pre-approved by the designated principal prior to use with the public. Most advertising and sales literature related to variable products is required to be filed with FINRA 10 days prior to first use. The designated principal is to obtain FINRA approval letters for any advertising or sales literature prior to first use.

Correspondence

All incoming and outgoing correspondence (written and electronic) related to variable products is subject to the Firm's procedures governing general correspondence.

Sales Seminars and Public Presentations

Any seminars or presentations that mention or include variable products must be pre-approved by the designated principal. A registered representative who wishes to participate in or host a seminar or sales presentation must provide for review and approval by the designated principal an outline of the topics to be discussed and any materials to be used in the presentation or seminar. Copies of the materials used and a roster of attendees should be retained in the files along with evidence of the designated principal's review and approval of the material used and the event itself.

21.25 Delivery of Contract and Policies

The designated principal is responsible for ensuring that all variable annuity contracts and variable life insurance policies are promptly delivered to the customer upon issuance by the insurance company. A delivery receipt should be signed by the customer and placed in the customer's file at the branch office to document that the contract or policy was delivered to the customer.

Many states offer statutory rescissions to customers if a delivery receipt is not signed by the customer and retained by the Firm. The delivery receipt protects the registered representative and the Firm by documenting that the variable contract or variable life insurance policy was delivered to the customer.

The designated principal is also responsible for ensuring that customer account information required by SEC Rule 17a-3(a)(17)(i)(a) and collected from the customer at the time the account is opened is delivered to the customer within 30 days of the date the account is opened. This requirement may be satisfied by giving the customer a copy of the new account form or by giving the customer an alternative document that contains the required information.

21.26 Redemptions

To redeem a variable annuity, the customer must sign any required redemption forms. When required, the customer must obtain a signature guarantee.

21.27 Supervisory Reviews and Documentation

The designated principal is responsible for ensuring that each individual involved in variable product transactions has a thorough understanding of variable products and the risks associated with the underlying investment vehicle (*i.e.,* subaccounts). The designated principal will review each variable product transaction in accordance with the Firm's transaction review guidelines to ensure that it is suitable for the customer.

The registered representative must transmit completed applications and associated documents to the designated principal for review. The designated principal must review all transactions submitted by registered representatives promptly and document his review by signing and dating the annuity purchase form and other applicable account and trade documents. The designated principal's review is designed to assess the suitability of the transaction, to detect possible sales improprieties, and to confirm that all necessary documents are complete and have been provided. An acceptable transaction should satisfy the suitability factors discussed above. The principal review must be done prior to transmitting a customer's application to the issuing insurance company for processing, but no later than seven business days after an office of supervisory jurisdiction receives a complete and correct application package.

If the designated principal determines that the transaction is acceptable, he must sign the annuity purchase form and any other documentation required to facilitate the transaction and evidence his approval. The designated principal will promptly notify the registered representative that the transaction has been approved. Upon approval by the designated principal, the registered representative will promptly forward the product application and the payment to the product provider. Copies of all transaction documents will be maintained at the branch office along with evidence of approval of the transaction. Copies of the transaction documents will also be maintained at the main office.

Alternatively, the designated principal may determine that the transaction is unacceptable for a variety of reasons: unsuitability, deficient registration or licensing of the registered representative, improper payment, missing required information, etc. If possible, the designated principal should attempt to correct the deficiency, either by contacting the registered representative or the customer directly. If the application/transaction cannot be corrected, the designated principal must document the determination with his signature and record the transaction on a blotter that reflects that the transaction was rejected. Additionally, the designated principal should maintain a copy of the annuity purchase form in a file for rejected transactions. The designated principal should maintain a written explanation of the reason for the rejection with these forms.

21.28 Written Supervisory Procedures

The Firm has implemented surveillance procedures to spot if representatives do an unusually high volume of variable annuity exchange business. The designated principal is responsible for ensuring that these surveillance procedures are reasonably designed to identify inappropriate exchanges. The designated principal is responsible for monitoring the volume and frequency of exchanges by registered representatives. The designated principal should summarize the results of his surveillance on a regular basis, usually quarterly. The designated principal should promptly report any inappropriate exchanges to the CCO. The CCO must take corrective measures to address any inappropriate exchanges.

The Firm currently uses a manual system to monitor for excessive rates of exchanges. If the Firm elects to use an automated system of surveillance in the future, the designated principal will be responsible for reviewing and approving the system's criteria and parameters, periodically testing the system, updating it when needed, and reviewing the exception reports generated by the system.

21.29 Training

The Firm has a specific training plan for registered representatives who sell variable annuities and the designated principals who approve these transactions. Registered representatives who effect variable annuity transactions and their supervisors must complete all required training. As a minimum training requirement, the Firm expects each registered representative and designated principal to read and study the Firm's variable annuity procedures on an annual basis (or more frequently if warranted). Additional training may include webcasts, podcasts, seminars, licensing exams, instructor-led training sessions, or the product training delivered by sponsors.

Designated principals who review transactions in variable annuity must complete a higher level of training. This additional training includes, among other things, reading industry publications and compliance notices as they become available. Designated principals are expected to stay abreast of developments in the securities and insurance industries that relate to variable products.

The Firm will generally include a variety of topics in its initial and ongoing training efforts. Areas of concern regarding the sale of variable products (suitability, switching, twisting, prospectus delivery, age of the investor, replacements, financing, and sales in tax-qualified plans) should be addressed in these training sessions. Training will also ensure that registered representatives offering variable life insurance are sufficiently educated in the difference between variable annuities and variable life insurance products and what disclosures are required for each.

The CCO or designee will ensure that the Firm is maintaining records of training. Each record of training should include the date(s) of training, copies of the training materials, the method of delivery (*e.g.,* CE, annual compliance meeting, on-line training), and a list of all individuals who received the training.

The designated principal will monitor registered representatives' compliance with applicable rules governing the sale of variable annuities to detect any deficiencies. A one-time deficiency or a recurring deficiency isolated to one registered representative will result in the Firm providing the responsible registered representative with personalized training. If the Firm detects any pattern of deficiencies stemming from multiple registered representatives, the designated principal will develop and implement a comprehensive training plan to be administered to all registered representatives who effect variable annuity transactions.

22. Variable Annuity Transaction Review Guidelines

The designated principal is responsible for ensuring that securities transactions are compliant and suitable. The Firm offers an outline of the transaction review process in the following document to provide a framework for the diligent supervision of accounts. From time to time, the designated principal may refine the review process to better carry out his supervisory obligations.

This step-by-step process is for use by the designated principal who reviews variable product applications and signs as the principal. This document is also meant to be used as a resource for registered representatives, helping them better evaluate the suitability of a customer order and ensure all submitted paperwork is complete. These guidelines are meant to be used in addition to the Firm's written supervisory procedures.

22.1 Step 1: Confirm Appropriate Registrations and Licenses

After verifying that a submitted application is for an approved product and the registered representative is appointed with the insurance company, the designated principal must ensure that the registered representative holds an active securities registration and insurance license in the:

- **State of Sale:** This is the state(s) in which the presentation took place and the application was completed and signed.
- **Customer's State of Residence:** This is the customer's primary state of residency, if different from the state of sale. If the customer has a residence in more than one state, then the state of residence is the one in which the customer holds a valid driver's license. If the customer does not have a driver's license, please contact the Compliance Department for a decision on the customer's state of residence ***prior*** to approval of the transaction.
- **Registered Representative's State of Residence.**
- **State Where the Registered Representative's Assigned Branch Office is Located.**

Important: Accounts and policies split between two or more representatives require all representatives to be registered in the customer's state of residence and the state of sale. Split sales require the registration of both the writing agent and the split agent, at the time of the sales presentation. If the writing representative was not properly qualified at the time, the transaction documents will be returned. If the split agent is not

properly qualified, the Firm's registration department will attempt to remedy the deficiency. If the deficiency can be remedied within one business day, the trade will be processed and both representatives credited. Otherwise, the split agent will be removed from the trade and will receive neither a commission nor any other compensation. Only the writing agent will receive compensation for the trade.

22.2 Step 2: Confirm Completion of Training Requirement

Registered representatives who sell variable annuities must complete any training required by the Firm. The designated principal should verify that the registered representative is meeting his training requirements with respect to variable annuities. At a minimum, the Firm should have a record that it has trained the registered representative with respect to the Firm's procedures for selling variable annuities. If the registered representative is behind in training, the designated principal may approve the transaction but must ensure that the registered representative soon completes his required training.

22.3 Step 3: Ensure Complete and Accurate Application Information

The designated principal must ensure that the application is complete because he cannot assess the suitability of the transaction without a complete application. In many cases, the designated principal has no knowledge of the customer's personal and financial situation unless this information is included with the application.

Required Paperwork

Every application for new business should include:

- Annuity Purchase Form—This form must be complete. If the information/answer is zero (0), none, or not applicable, the registered representative should clearly mark it as such. To be safe, the designated principal should presume that a blank is an incomplete answer. The designated should not assume that a blank answer means none or not applicable.
- Current documentation related to the customer profile and suitability information for the customer. This may be obtained from a new account form.
- Complete paperwork for the product provider.

Other Paperwork

The following information may be required and/or accompanied with some applications:

- A copy of the most recent account statement for the product being switched.
- A written explanation from the registered representative documenting suitability.
- An illustration of a VUL policy.
- Documentation regarding the account owner, such as a W-8, corporate resolution, trust or guardianship documents, corporate investment policy, or partnership agreement.
- If the account registration is in the name of a corporation, a copy of the articles of incorporation must be submitted along with the corporate resolution.

Points to Remember

- Whether the transaction is appropriate for the type of account (*e.g*., IRA, TSA, Roth IRA).
- The transaction paperwork is appropriate for the contract state and the required state forms, such as replacement forms, are included.
- The transaction paperwork is appropriate for the type of customer—*e.g.,* corporation, partnership, trust—and the required ancillary documents are attached.
- The annuity purchase form is complete, and signed by the customer and the registered representative.
- The dates on the annuity purchase form, check, and product application are recent.
- The customer is age 18 or older. If the customer is under the age of 18, ensure the purchase is made under the Uniform Gift to Minors Act, by a court appointed custodian, or properly appointed trustee.
- The product is appropriate for the customer's age. Sales to older customers must be carefully scrutinized.
- A non-resident alien or a United States citizen living abroad must be present in the United States at the time of the transaction. Determine if the customer has a federal tax identification number or, in the case of a citizen living abroad, a social security number and an address in the United States to which to send the transaction information, confirmations, and statements.

- Ensure the product purchased is consistent with the customer's financial status, tax status, investment objectives, age, time horizon, risk tolerance, etc.
- Confirm that the client received a current prospectus for the product being purchased.
- Verify the address to which confirmations, statements, and other communications regarding the account are to be sent. An address other than the customer's residence requires documentation noting the reason for using the alternative address. The address cannot be an address of the registered representative or an entity he controls.
- If the transaction is conducted by an individual other than the customer (*e.g.,* through a third-party trading authorization, power of attorney, or other fiduciary representative), ensure the person is allowed to conduct the transaction and that the appropriate documents are included with the submitted paperwork.
- Make sure an appropriate beneficiary is named on the account. The beneficiary cannot be the registered representative setting up the account.
- Incomplete applications may not be processed or could cause a delay in processing.
- Verify the information on the application against the customer's file, any financial questionnaires, and other account records.
- Evaluate whether the appropriate disclosures were made to the customer.

22.4 Step 4: Confirm Suitability

Consider all of the following in reviewing the transaction and confirming suitability:

- Did the registered representative have a reasonable basis to believe the customer was informed of the variable annuity's features?
- Was the customer informed of surrender periods, charges, tax penalties for sale or redemption, mortality and expense fees, features and charges for riders, insurance and investment components of contract, and market risk?
- Is there ample documentation that the registered representative explained the contract to the customer? Merely delivering the prospectus is not enough.
- Did the registered representative have a reasonable basis to believe the customer can benefit from the features of the variable annuity, such as living or death benefits, annuitization option, or tax-deferred growth?
- Is there evidence that the registered representative considered suitability from several different perspectives?

- Was the variable annuity suitable as a whole?
- Is the initial allocation to the underlying subaccounts suitable?
- Are any riders or enhancements suitable?

- Verify that the customer can benefit from the features of the variable annuity.
- Look at customer-specific factors, such as age, liquidity, investment objectives, and ensure the recommendation is appropriate given these factors.
- Look at and verify the suitability of the initial subaccount allocation and applicable riders
- For exchanges, see if the transaction triggers a surrender charge or new surrender period, the customer would lose existing benefits or be subject to increased fees or charges, the customer would benefit from enhancements and features in the new contract, and the customer has made another variable annuity exchange in the last 36 months.

Variable Annuities

The designated principal should consider the following during his review of variable annuities:

- **Legitimate Need**—While having similar market risks to mutual funds, variable annuities are more expensive because of the annual policy, mortality and expense, and administrative fees. This product is only suitable for a customer if he has a need for a tax deferral, a guaranteed death benefit, certain guaranteed living benefits that are available from some providers, or the ability to annuitize. Additionally, the customer should have a long-term investment goal because high surrender fees may be charged if the policy is cashed out early. Sales of variable annuities to customers more than 65 years old must be carefully scrutinized.
- **Liquidity—**It is a critical part of the suitability determination to assess the customer's liquidity needs. A variable annuity is generally not appropriate for a customer who has immediate liquidity needs. Careful scrutiny of the customer's liquidity needs compared with the features of the proposed variable annuity, such as the "free withdrawal allowance," is required to determine whether a particular variable annuity is suitable for the customer. If a registered representative submits a transaction where the proposed investment in a variable annuity exceeds established thresholds, then a letter of explanation should accompany the application stating the reasons that the registered representative believes the transaction is suitable.

- **Immediate Distributions under the 72(t) or 72(q) Provisions**—A variable annuity application that makes immediate payments to fund a VUL is rarely suitable. A letter of explanation must accompany these applications and, if it is a 72(q) distribution, a planned distribution schedule from the provider company must be included. To ensure this in an appropriate transaction, the customer should consult with his tax advisor.
- **Tax-Qualified Retirement Plan**—If the application is for a tax-qualified retirement plan, the customer must understand that a variable annuity does not provide added tax benefits. For this trade to be suitable, there must be a unique feature of a variable annuity that is valuable to the customer. Documentation of the reason for the trade being effected in a tax-qualified plan must be clearly indicated on the annuity purchase form and must be included with the transaction paperwork.
- **Subaccounts**—It is important to remember that the allocation to various subaccounts in a variable contract must be suitable for the customer in light of various financial and suitability information that is collected from the customer. The subaccount allocations must always be consistent with the customer's investment objectives and risk tolerance.

Variable Life

- **Need for Life Insurance**—There are various methods for calculating insurable need and the writing representative must use one with the customer. If there is not a need for life insurance, the transaction is unsuitable and the representative should recommend a more appropriate product. If the face amount of the policy is more than 10 times the customer's gross income or greater than the customer's net worth, an explanation of insurable need must accompany the application. This does ***not*** mean that insurance with face amounts less than or equal to 10 times the customer's gross income or equal to the customer's net worth are suitable. If a registered representative submits a transaction where the proposed investment in variable life insurance exceeds the established thresholds, then a letter of explanation should accompany the application stating the reasons that the registered representative believes the transaction is suitable. Remember that a VUL policy is a security; therefore, it cannot be owned or jointly owned by anyone under age 18.
- **Affording a VUL Policy**—A legitimate need for a certain amount of life insurance does not make a VUL policy suitable. The owner must be able to pay premiums and keep the policy in force. Premium payments less than the target premium do not allow the policy to build cash value in an acceptable manner. All premium payments that are more than 10 percent of the customer's gross income or

under the target premium must have a letter of explanation from the writing representative. This does not mean that payments under 10 percent of the customer's gross income or greater than the target premium make the VUL policy suitable. Under no circumstance should a VUL be funded with a home equity loan, interest-only, negative amortization, or mortgage of any kind.

- **VUL is Life Insurance**—A VUL cannot be sold as an "investment," a "college funding plan," a "retirement account," a "pension plan," a "tax free investment," or "tax sheltered mutual funds." If the registered representative or the application indicates that a VUL was sold for something other than life insurance, the transaction is unsuitable. If the customer's goal is to accumulate cash during a certain time frame, then other financial vehicles are usually more appropriate. If the VUL illustration does not show a reasonable rate of accumulation in the customer's required time frame at a hypothetical rate of return that is consistent with the customer's risk tolerance, then the transaction is not suitable.

- **Customer's Ability to Understand the VUL and Assume Certain Risks**—A VUL is one of the most complicated financial products sold. If a customer does not have the knowledge, experience, or ability to fully understand the product, then it is not a suitable sale. Additionally, the customer must be able to understand and assume the risks associated with purchasing this product. This includes the possibility that, in an adverse market, there may be little or no cash value in the policy and the customer may be required to pay higher premiums to keep the policy in force.

- **Registered Representative's Knowledge and Understanding of the VUL**—A registered representative selling a VUL must be able to give a complete and unbiased presentation of all the product's features. If the designated principal believes that the registered representative does not have the knowledge necessary to sell a VUL, then he should contact the customer before approving a VUL to discuss the transaction and answer any questions.

- **Subaccounts**—It is important to remember that the allocation to various subaccounts in a VUL policy must be suitable for the customer in light of various financial and suitability information that is collected from the customer. The subaccount allocations must always be consistent with the customer's investment objectives and risk tolerance.

- **Replacement**—If the VUL replaces another investment, a copy of the most recent account statement for the product being switched should be submitted. If the submitted VUL is replacing a cash value insurance policy there must be a cost benefit for the replacement. Stating that a VUL is better than a universal life or whole life policy is not a sufficient reason to switch. The registered

representative must explain why it is economically better for the customer to replace his existing policy.

- **Current Insurance**—The application must state the amount of insurance, if any, the customer currently owns. This amount must be used to determine the customer's total need for life insurance.

Exchange Transactions, Switches, and Replacements

Many factors contribute to the determination of whether it is suitable for the registered representative to recommend that the customer surrender one variable contract and purchase another variable contract. The only valid reason to recommend a switch is based on cost or benefits that are not available in the current product. In other words, the new product must provide the customer with significant and reasonable cost savings over the old product or it should offer additional benefits or enhancements, not available in the old product, that are of significant importance to the client.

Anytime a switch from one variable contract to another is recommended to the customer, a complete and full disclosure about the new product must be provided regarding:

- Penalties
- Surrender charges or withdrawal charges
- New commissions
- Increased fees and charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements)
- Commencement of a new surrender period
- Reduction or loss of benefits (such as death, living, or other contractual benefits)
- Potential tax consequences
- Market risk
- Insurance and investment components of the variable annuity

All of the above noted factors must be considered when determining whether an exchange of a variable contract is suitable for a customer. It is very important that the switch is supported by adequate documentation. Disclosing to the customer the above noted issues may fulfill the registered representative's disclosure responsibility but it does not necessarily meet his responsibility to execute only those transactions that are suitable for the customer. Disclosure and suitability are different issues. A customer stating that he "wants this transaction" does not make it suitable. The registered

representative has the obligation to say "no" to the client if he cannot establish that the transaction is suitable for the customer.

Replacing Mutual Funds with Variable Annuities

A registered representative recommending a switch from a mutual fund to a variable annuity needs to remember the purpose of an annuity. Although it is true that a "benefit" of an annuity is providing a death benefit, it is not the product's primary objective. An annuity is a tax deferred insurance contract that is designed to help accumulate assets for use at a later time either as a lump sum or as an income stream. If the client's primary objective is a death benefit, a life insurance product may be more appropriate. An annuity should not be used solely as a death benefit contract. Replacing mutual fund IRAs with variable annuities in an IRA requires extra scrutiny because variable annuities have higher fees and do not offer additional tax advantages.

Replacing Variable Annuities with Variable Annuities

A change of investment objectives and performance of subaccounts are not always appropriate reasons for a customer to switch from one variable annuity to another. The registered representative should consider changing subaccounts for the existing variable annuity in order to meet the customer’s needs prior to recommending that the customer switch variable annuities. Additionally, because a new product has bonuses or enhanced features is not always an appropriate reason for a customer to switch since many of these products have higher charges or new extended withdrawal periods. Any switch must put the customer into a better position than he currently is in with the existing product.

The Firm must have documentation showing that the registered representative asked the customer about any other variable annuity exchanges within the last 36 months. If the registered representative was hired within the last 36 months, the designated principal should consider verifying that the registered representative did not conduct a switch for this customer at another firm.

Replacing Life Insurance

When replacing a life insurance policy with a VUL, the registered representative must submit a cost benefit analysis, signed by the customer, showing the advantage of the replacement. The registered representative cannot assume that replacing a whole life, universal life, or variable life policy with a variable universal life policy is suitable for the customer. Older policies may be better because they have lower costs of insurance, may be paid up, or the client may be in a different rating class.

The cost/benefit analysis must show the customer the advantages and disadvantages of making the switch. Areas of analysis should include:

- Surrender charges on the existing policy
- Sales charges on the new policy
- Liquidity of the new policy
- Tax treatment on the exchange or surrender of the old policy
- New contestable or suicide periods
- Evidence of insurability
- Costs, duration, and fees for each policy
- Comparison of cash value under the old and new policies
- Costs of borrowing from the policies
- The advantage, if any, of modifying the existing policy

22.5 Step 5: Ensure Correct Payment

All payments for variable contracts should be payable to the appropriate insurance carrier. If the product provider receives a check made payable to an entity other than the provider, the check will be returned, along with all paperwork, to have the registered representative obtain payment from the customer written to the appropriate entity.

Acceptable Forms of Payment

The anti-money laundering rules have increased the responsibility of registered representatives and Firm to know the customer. This responsibility is greater when it comes to understanding the source of funds used by the customer to make a purchase. Forms of payment accepted by the Firm include:

- **Personal Checks:** Personal imprinted checks are acceptable forms of payment. The name imprinted on the check must match the name on the account, except in the case of gifts to minors. If the address on the checks differs from the address given on the application, the registered representative should include a written explanation with the transaction documents.
- **Third Party Checks:** This type of check may be accepted only if it represents proceeds from a qualified investment that is being rolled into a new qualified investment.

Unacceptable Forms of Payment

The Firm does not accept cash; counter checks; starter checks; money orders; travelers' checks; and in most cases, third party checks.

Source of Funds

Review and ensure the source of funds is appropriate and consistent with the customer's investment objectives. It is inappropriate to use the proceeds of a mortgage, including interest only or negative amortization loans, to purchase variable products.

22.6 Step 6: Document the Review and Approve or Deny the Transaction

From the time the OSJ receives a complete and correct application package, the designated principal has seven days to approve or deny the transaction. The designated principal must document his review of each variable annuity transaction, and his determination whether to approve or deny the transaction must be signed. The designated principal should sign and date the annuity purchase form, new account application, and, if necessary, the application, when he is satisfied that the registered representative has complied with all transaction submission requirements. For denied transactions, the designated principal must document his denial with a signature and date. The Firm must maintain records of every transaction reviewed by the designated principal, regardless of whether it was approved or denied.

22.7 Step 7: Ensure Prompt Processing of Application and Proper Handling of Funds

Registered representatives must promptly transmit a complete application to the designated principal for review. The designated principal must maintain a record of when the Office of Supervisory Jurisdiction received a complete and correct copy of the application package. The registered representative must copy the check and maintain a record of when it was received. For denied transactions, the check must be returned to the customer promptly. Returned checks must be recorded on a checks received and forwarded blotter.

23. EQUITY INDEXED ANNUITIES

Equity-indexed annuities ("EIAs")—also known as "fixed-indexed insurance products" and "indexed annuities"—are financial instruments in which the issuer, usually an insurance company, guarantees a stated interest rate and some protection from loss of principal, and provides an opportunity to earn additional interest based on the performance of a securities market index. Some EIAs are not registered under the Securities Act of 1933 (the Securities Act) based on a determination that they are insurance products that fall within that statute's Section 3(a)(8) exemption and therefore are not considered to be securities.

23.1 Status of Unregistered Equity-Indexed Annuities

The question of whether a particular EIA is an insurance product or a security is complicated and depends upon the particular facts and circumstances concerning the instrument offered or sold. The following, a brief summary of the applicable provisions of the federal securities laws, may be useful. Section 2(a)(1) of the Securities Act broadly defines "security" to include such financial instruments as evidence of indebtedness, participation in profit-sharing agreements, and investment contracts. Section 3(a)(8) generally exempts from the Securities Act any security that is an "insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia."

In 1986, the Commission adopted Rule 151, a "safe harbor" under the Securities Act, which clarifies when certain annuity contracts are exempted securities under Section 3(a)(8). The fundamental construct of Rule 151 is derived from prior judicial interpretations of Section 3(a)(8). Consequently, the Commission has stated that the rationale underlying the conditions set forth in the rule are, along with applicable judicial interpretations, relevant to any Section 3(a)(8) analysis.

In order for the Rule 151 "safe harbor" to apply:

- The product must be issued by an insurer that is subject to state insurance regulation;
- The insurer must assume investment risk, as provided in paragraph (b) of the rule; and
- The product may not be marketed primarily as an investment.

In summary, the status of any particular EIA under the safe harbor (or under Section 3(a)(8)) will depend on the facts and circumstances.

23.2 Regulatory Focus

Regulators are focused on the manner in which registered persons are marketing and selling unregistered EIAs, and the absence of adequate supervision of these sales practices. Sales material for unregistered EIAs must fully describe the features and risks of the product. Examples of forbidden representations include the following:

- "What if the market goes down? You would lose nothing. The market goes up - you gain!"
- "A Win/Win Investment Vehicle!"
- "How Your Retirement Funds Can Have: Security of Principal, Higher Than CD Rates of Interest, Opportunity for Growth (No Losses)."
- "Pick up where Social Security leaves off with NEW tax-deferred annuities … featuring … 2 indexed accounts linked to a popular stock market index."
- If you're looking for upside potential and no market downside look no further than [name of EIA]. This fixed annuity … enables you to make the most of S&P 500 Index gains …"
- "Growth Potential *without* Market Risk."

23.3 Sales Materials

All indexed annuities sales materials must include a balanced description of the features and risks of the product. Moreover, because of the product's complexity, it is important that each Associated Person understand all of the features of the product to determine the extent to which those features meet the customer's needs. While unregistered EIAs may be appropriate for some retail investors, they are not suitable for all investors. For example, possible surrender charges and the combination of caps and participation rates associated with a particular product are factors that must be considered in any suitability determination. All indexed annuities sales materials must be submitted to the Compliance Department for review and will be maintained in the home office files.

23.4 Supervision of Sales Activities

It is the responsibility of each Associated Person selling EIAs to ensure it qualifies for an exemption under Section 3(a)(8). The analysis is made on a case-by-case basis, and marketing of such materials may be restricted to maintain exemptive status.

Only unregistered EIAs can be sold in the Associated Person's capacity as insurance agent and as an **outside business activity,** which does not require that the firm supervise the activity. **The firm should be promptly notified in writing when an Associated Person intends to sell unregistered EIAs and is engaging in a business activity outside the scope of his or her relationship with the firm.**

If a particular EIA is a security, this security transaction must be conducted through the firm and supervised like any other securities business conducted at the firm. This also means that all revenues from registered EIAs must flow through the firm.

Although the sale of unregistered EIAs is neither conducted nor supervised through the firm, all Representatives must make a reasonable basis suitability determination to ensure that the product is suitable. Additionally, the Representative should ensure that the associated risks, liquidity features, and fee structures are disclosed to the customer. Representatives are expected to have the appropriate insurance licensing, which must be in good standing. All Representatives must make sure that all of their respective sales of unregistered EIAs are acknowledged by the respective customer as not being offered by the firm (please see attached Unregistered EIA Acknowledgement Form).

23.5 Liquidations for the Purpose of Funding a Purchase

Whether EIAs are registered or unregistered, all recommendations to liquidate or surrender a registered security such as a mutual fund, variable annuity, or variable life contract must be pre-approved by the Designated Principal if such liquidation or surrender is for the purpose of funding the purchase of an EIA (registered or unregistered).

23.6 Approved Product List

The firm will maintain a list of unregistered EIAs that are acceptable for selling outside of the firm. The firm will not conduct any due diligence for such products, but will request that the Representative provide an Unregistered EIA Form, which will provide assurance to the firm that the Representative has properly determined that the EIA is not a security.

23.7 Training Requirements

The designated principal in charge of oversight of Outside Business Activities will require any representative wishing to engage in the sale of unregistered EIAs to acknowledge receipt of this procedure and to attest compliance with all provisions.

24. Private Placements and Unregistered Securities Offerings

24.1 Private Placements

Section 4(2) of the Securities Act of 1933 provides for an exemption from registration for securities, which are not distributed in a public offering. These securities are referred to as private placements and they are often in the form of stock offerings or limited partnerships. Private placements are made under strictly defined conditions which involve factors, such as the nature of the issuer, the value of the securities offered, the number, nature and residences of offerees and purchasers, the information disclosed to purchasers, filings made with the SEC and certain blue-sky authorities, and the manner in which offerees are solicited. Private placements frequently involve products that are more complex than other securities. The relative investor risks and tax consequences of private placements may have a wide range of implications. Accordingly, private placements shall not be offered by any registered representative of the Firm without the consent of the appropriate Designated Principal. A general explanation of the regulations and major exemptions from registration that are applicable to the offering and sale of private placements and a discussion of how this Firm will ensure that it complies with such, follow.

24.2 Regulation D

Regulation D, which contains a series of eight rules (Rules 501- 508), is a safe harbor for private placement offerings. By complying with the applicable rules, an issuer will not be required to go through the registration process of public offerings. If the provisions of Rules 501-508 are not followed, the offering may still be eligible for private placement status, but it will have to rely on another exemption or on the case law and interpretations of section 4(2) of the Securities Act of 1933. Regulation D and Rules 501-508 largely replace the exemptions formerly provided under Rules 146, 240 and 242 of the 1933 Act. Note that certain state securities regulations (commonly referred to as the "Uniform Limited Offering Exemptions"), usually parallel Regulation D, but often impose more stringent requirements on issuers.

Rule 501

Rule 501 of Regulation D sets forth definitions and terms applicable to the regulation. Perhaps the most important definition is that for the term "accredited investor." This definition provides that certain categories of accredited investors are excluded for

purposes of determining whether the number of purchasers of a privately placed security exceeds the applicable limit. Accredited investors include:

1. a bank, insurance company, registered investment company, business development company, or small business investment company;
2. an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;
3. a charitable organization, corporation, or partnership with assets exceeding $5 million;
4. a director, executive officer, or general partner of the company selling the securities;
5. a business in which all the equity owners are accredited investors;
6. a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase, excluding the value of the primary residence of such person;
7. a natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or
8. a trust with assets in excess of $5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes.

Note: The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Act") changed the definition of accredited investor. Prior to the enactment of the Act, an accredited investor could use the value of their primary residence to compute the $1,000,000 net worth requirement. Now, investors may not use the value of their primary residence to determine their net worth. The new definition became effective upon the signing of the bill into law which was July 24, 2010. The law also requires the SEC to review the definition of accredited investor no less frequently than once every four years and to revise the definition as necessary.

Rule 502

Rule 502 describes general conditions applicable to the regulation. This Rule provides a "safe harbor" from the integration of sales of securities by the issuer made six months prior to or six months after a Regulation D offering. The rule also describes when and

what type of disclosure must be furnished and provides guidance on applicable limitations on resale.

Rule 503

Rule 503 mandates that a Uniform Notice of Sale Form (Form D) be filed by the issuer with the SEC. The form must be filed no later than 15 days after the first sale, then every six months after the first sale, and 30 days after the last sale.

Rule 504

Rule 504 concerns Small Corporate Offering Registrations (SCOR), pursuant to which an issuer can raise up to an aggregate amount of $1,000,000 in any consecutive twelve-month period. While there is no cap on the number of investors, which may participate in the offering, and the payment of commissions is permitted, a minimum offering price of $5 per share is imposed. Rule 504 essentially shifts the administration of such smaller offerings to the states, with the significant proviso that these offerings remain subject to federal anti-fraud and civil liability provisions of the 1933 Act.

Rule 505

An offering exempt from registration, pursuant to Rule 505, may not raise more than $5,000,000 in any consecutive 12-month period. The rule imposes a limitation of 35 non-accredited investors in the issue with no limitation on accredited investors. The rule permits the payment of commissions, but precludes the general solicitation of sales.

Rule 506

Rule 506 provides an exemption from registration similar to Rule 505, except there is no limit on the amount of funds that may be raised and the issuer must reasonably believe, prior to making the sale, that the non-accredited persons, either alone or in conjunction with purchaser representatives, understand the merits and risks of their investment.

Rule 507

Rule 507 states that the Reg D exemption is not available to the issuer if the issuer, any of its predecessors or any of its affiliates have been subject to a court order, judgment or decree enjoining such person for failure to comply with Rule 503.

Rule 508

Rule 508 covers the circumstances in which “Insignificant Deviations from a Term, Condition or Requirement of Regulation D” will still enable the issuer to be eligible for a Reg D exemption. If the Firm engages in a private placement and relies on Regulation D for the exemption from registration, the Designated Principal shall evidence the Company’s compliance with Regulation D offerings by initialing the Company’s file copy

of the Form D filing (if such was filed) and by his initials or signature on each subscription/placement agreement.

24.3 Regulation S Offerings

The Designated Principal or designee will ensure that if the Company claims an exemption under Regulation S, that the sales are not made to individuals in the United States, or else that the execution is done through the trading floor of a foreign exchange. This will be done by reviewing new account documents of the customer and by reviewing the order tickets. Supervision will be evidenced by initialing the order ticket.

Direct Selling Efforts – Direct selling efforts are activities undertaken for the purpose of or that could be expected to condition the market in the United States for the securities being offered overseas. Activities exempt under the definition of Direct Selling Efforts are: Advertisements required under U.S. or foreign law; Contracts excluded from the Regulation's definition of U.S. citizens; Certain tombstone advertisements; Bona fide visits to U.S. real estate and facilities conducted for a prospective investor; distribution in the U.S. of certain foreign broker/dealer's quotations by a third party system. Direct selling efforts may not take place in the United States. The Company will not engage in direct selling efforts unless such is exempt by the regulation. The Designated Principal or designee will ensure compliance with this provision by reviewing the Company's correspondence and advertising. Evidence of the review shall occur as described in the advertising and correspondence sections of this manual.

24.4 Rule 144A - Private Resale of Securities to Institutions

With respect to securities transactions subject to the restrictions of SEC Rule 144A, it shall be a policy of the Firm that all such transactions shall be reviewed and approved by The Designated Principal or designee. Evidence of the review shall consist of the reviewer's initials on the subscription/placement agreement or order ticket.

24.5 Regulation A Offerings

Regulation A permits an issuer to raise up to $5 million in a 12-month period and be exempt from the registration requirements under section 3(b) of the Securities Exchange Act of 1933. The Designated Principal or designee will ensure that the issuer of the securities meets the following criteria in order to comply with the requirements of Rule 251 of Regulation A:

- it is an entity organized under the laws of the United States or Canada, or any State, Province, Territory or possession thereof, or the District of Columbia, with its principal place of business in the United States or Canada;
- it is not subject to section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") immediately before the offering;
- it is not a development stage company that either has no specific business plan or purpose, or has indicated that its business plan is to merge with an unidentified company or companies;
- it is not an investment company registered or required to be registered under the Investment Company Act of 1940 ;
- it is not issuing fractional undivided interests in oil or gas rights as defined in Rule 300, or a similar interest in other mineral rights; and
- it is not disqualified because of Rule 262.

The Designated Principal or designee will place a memorandum to the file indicating his review of the exemption status.

An Offering Statement Form 1-A must be filed with the SEC's main office in Washington, DC. The Offering Statement is qualified without SEC action 20 calendar days after it is filed as long as there is no delaying notation on the Offering Statement. If there is a notation on the offering statement the offering can only be qualified by order of the SEC unless the notation is removed. The Designated Principal or designee will review the Offering Statement to make sure that the offering is qualified or receive a legal opinion from the issuer's attorney. The Designated Principal or designee will initial and date the Offering Circular indicating his review and approval. After the Offering Statement Form 1-A has been filed oral offers may be made; written offers under Rule 255 may be made and printed advertisement or radio or television broadcasts made if they state where the Preliminary Offering Circular or Final Offering Circular may be obtained. The Preliminary Offering Circular may be utilized prior to qualification of the offering statement but after its filing, in accordance with the requirements of Rule 255. The Preliminary Offering Circular contains substantially the information required in an offering circular by Form 1-A, except that information with respect to offering price, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices, or other matters dependent upon the offering price may be omitted. The outside front cover page of the Preliminary Offering Circular shall include a bona fide estimate of the range of the maximum offering price and maximum number of shares or other units of securities to be offered or a bona fide estimate of the principal amount of debt securities to be offered The Offering Circular is filed as a part of the Offering Statement. Solicitations of interest may be utilized prior to

an offering statement. If the issuer chooses to utilize any written document or script, the issuer should submit a copy to the SEC's main office in Washington, D.C., on or before its first date of use. The written document or script of the broadcast shall: state that no money or other consideration is being solicited, and if sent in response, will not be accepted; state that no sales of the securities will be made or commitment to purchase accepted until delivery of an offering circular that includes complete information about the issuer and the offering, state that an indication of interest made by a prospective investor involves no obligation or commitment of any kind; and identify the chief executive officer of the issuer and briefly and in general its business and products. Solicitations of interest may not be made after the filing of the offering statement. Sales may not be made until 20 calendar days after the last publication or broadcast.

Until the offering statement is qualified, no sale of a security may take place. A Preliminary Offering Circular or Final Offering Circular will be furnished to a prospective purchaser at least 48 hours prior to the mailing of the confirmation of sale to that person; and a final offering circular will be delivered to a purchaser with the confirmation of sale, unless it has been delivered to that person at an earlier time.

The Designated Principal or designee will ensure that a preliminary offering circular and a final offering circular are delivered to all prospective purchasers. A listing of the Preliminary Offering Circular and/or Final Offering Circular will be maintained including the name and the address of the purchasers and the date of the mailing. The Designated Principal or designee will initial and date the listing indicating his approval of the forwarding of the prospectuses.

The issuer and/or each selling security holder shall file seven copies of a report concerning sales and use of proceeds on Form 2-A or other prescribed form with the main office of the Commission in Washington, D.C. every six months after the qualification of the offering statement, or any amendment, until substantially, all the proceeds have been applied; and within 30 calendar days after the termination, completion or final sale of securities in the offering, or the application of the proceeds from the offering, whichever is the latest event. This report should be labeled, the final report. The Designated Principal or designee will review Form 2-A reports to make sure that they are filed on a timely basis and initial the copy of the report and place it in the deal file.

Should the Regulation A exemption be suspended a copy of the suspension order shall be placed in the deal file by the Designated Principal or designee. The Designated Principal or designee will provide notification to all representatives and a copy of the memorandum will also be placed in the deal file.

If none of the securities subject to the offering statement have been sold, the offering statement may be withdrawn with the SEC's consent. The Designated Principal or designee shall place a copy of the withdrawal order in the deal file. The Designated Principal or designee will provide notification to all representatives and a copy of the memorandum will also be placed in the deal file.

24.6 Section 4(2) Offerings

If the Company participates in a private placement and relies on Section 4(2) of the Securities Act of 1933 for the registration exemption, the offering shall be supervised by the Designated Principal or designee. The Designated Principal or designee shall ensure that the Company is eligible for the exemption and is not engaged in a public offering. To the extent that The Designated Principal or designee deems it advisable, the Designated Principal or designee shall consult an attorney for this purpose.

Compliance shall be ensured by obtaining a legal opinion or making notes of the conversation with the attorney if one was consulted, and by reviewing the offering materials, placement agreement and investor purchase agreements. Approval shall be evidenced by the reviewer's signature or initials on the reviewed documents.

24.7 Supervision Philosophy for Private Placements

All private placements that are sold by the Firm will be supervised by the Designated Principal or designee. The Designated Principal or designee will be responsible for the structuring, packaging and marketing of private placements to ensure compliance with the various rules, regulations and exemptions offered by the securities statutes.

With regard to private offerings, it is the Firm's intent from time to time to participate in the private placements of corporate debt and/or equity securities of firms within various industry groups, and limited partnerships structured for investment purposes. At such time, no participation will be conducted unless the offering complies with state and federal rules and regulations. In accordance with the exemptive provisions of SEC Rules 15c3-1 and 15c3-3 the Firm will participate in private offerings only on a "Best Efforts" basis as a placing agent only, and will at no time participate in "Firm Commitment" underwritings. It is also the Firm's intent to spend the time and effort necessary, based on its abilities, to research and evaluate each and every security vehicle, which it intends to merchandise. Please note that the firm must request approval from the FINOP if it intends to participate in a firm commitment underwriting on a best efforts basis.

Furthermore, it is the Firm's intent to offer to its customers only those securities in which the Firm can ethically and morally have confidence. It is also the Firm's intent to

keep any and all associated persons highly informed with pertinent information related to each situation. This can be maintained through meetings, close supervision and genuine interest on the part of each designated person. The purpose of the meetings will be to discuss thoroughly the nature of any security, underwriting or offering in which the Firm participates. The discussions will include the type of investment, necessary investor suitability, special risks, financial history and other general information relative to keeping the merchandising of such vehicle on a high ethical basis.

The Firm shall use its best efforts to inquire of an issuer as to whether any associated person of the issuer will be participating in the marketing of the issue or otherwise engage in activity that would violate SEC Rule 3a4-1 (Associated Persons of an Issuer Deemed not to be Brokers).

The Firm shall use its best efforts to perform a due diligence review of all prospective issuers prior to participating in the distribution of units or securities on behalf of such issuer, in an effort to determine that said issue is in compliance with SEC Rules 10b-5 and 10b-6.

Concentration in Customer Accounts

Since the Company will target entities comprised of institutional investors, venture capital firms, merchant banking funds, private equity groups, leveraged buy-out groups, public and private companies and accredited investors as its customers, concentration of positions will not be an issue for review.

Suitability

The Firm shall use reasonable efforts to ensure that its customers that invest in private placements meet the following standards:

- The customer is in a financial position appropriate to enable him to realize, to a significant extent, the benefits described in the private placement memorandum, including the tax benefits in instances where they are a significant aspect of the program; and
- The customer has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity.

On a transactional basis, the designated principal will review all private placements and offerings to ensure that such transactions are conducted within compliance of suitability issues. Because designated principal is responsible for determining the qualifications of each investor and has the responsibility of approving all private placement transactions, the designated supervisor will ensure that all of the appropriate suitability information is obtained from each customer. The designated principal is also responsible for

ensuring that all applicable disclosure documents, offering memorandum and/or prospectus, and other disclosed information are given to each investor. A review of all relevant documentation will be properly evidenced as indication of review.

24.8 Procedures for Determining Accredited Investor Status

In order to ensure compliance with an appropriate exemption from the registration requirements of the Securities Act, the Firm shall make a determination as to the "accredited investor" status of each investor in a private placement offering. In making such determination as to the accredited investor status of the purchasers in private placement offerings, the Firm may rely on a combination of financial statements or other financial information provided by the investors and certifications or representations in the placement/subscription agreements of the investors certifying and/or representing as to their accredited investor status.

The Designated Principal or designee will review account information provided on the new account form and/or the placement/subscription agreement to ensure that the investment is suitable for the customer. The Designated Principal or designee shall evidence the review by signing or initialing the subscription/placement agreement or by signing the new account form.

24.9 Limitations on Resale

Securities sold pursuant to Reg D or other private placement exemptions of the Securities Act, cannot be resold without registration or an exemption from registration. The Company will ensure that it or the issuer will provide written notice to each purchaser prior to the consummation of the transaction that the securities have not been registered under the Securities Act and, therefore, cannot be resold unless they are registered or unless an exemption from registration is available.

24.10 General Solicitation

Neither the Company nor any Representatives may solicit the offer or sale of the securities of any issuer in a private placement offering by means of an advertisement or other form of general solicitation. In this regard, selling agreements with participating broker-dealers involved in the offer, sale and distribution of private placement offerings with respect to which the Company is acting as dealer manager shall prohibit the participating broker-dealers from offering or selling the private placement securities by means of any form of general solicitation or advertising.

No such solicitation of the sale of securities may be made in any seminar or meeting whose attendees has been invited by any form of general solicitation. In addition, the Firm's Representatives are not permitted to participate in any seminar or meeting whose attendees have been invited by any form of general solicitation at any period of time during which the Company is actively engaged in any private placement offering unless the written consent of the Chief Compliance Officer is obtained.

Substantive Defined: The substantive aspect of the issuer-investor relationship focuses on the potential investor's financial sophistication and ability to evaluate the risks and merits of the proposed offering. All Representatives must be able to demonstrate that the potential investor was sufficiently sophisticated in financial matters to participate in the private offering. Targeting accredited investors exclusively would satisfy this "substantive" requirement because accredited investors, as defined by the Securities Act, are presumed to be sophisticated for Rule 506 purposes.

Pre-Existing Defined: The relationship between the firm and the potential investor must also satisfy the requirement that it be "pre-existing." A relationship is pre-existing if it existed for some duration prior to the current private offering. A pre-existing relationship most likely exists with potential investors with whom the firm and/or Representative has a business relationship that allows one to reasonably be sure the potential investor is sufficiently sophisticated in financial matters to participate in the offering. Furthermore, a pre-existing relationship clearly exists with investors who have participated in previous offerings made by the issuer or sponsor broker/dealer.

No-action letters demonstrate that a substantive and pre-existing relationship may be developed through the use of a suitability questionnaire designed to ascertain the financial sophistication of potential investors as long as there is a "cooling-off" period between the time of the questionnaire and the private offering. In other words, a questionnaire may be used to establish the substantive aspect of the relationship, and a cooling-off period that allows the potential investor to participate only in offerings that are commenced after the establishment of the relationship.

If the firm or Representative has had absolutely no prior relationship, then no offering materials would be sent for any offering ongoing at the time of the initial solicitation, and no offering materials would be sent for at least 60 days after the initial mailing. This would serve as the first step in establishing a business relationship with new clients. The designated principal may approve exemptions based on facts and the circumstances present.

The SEC noted the following factors: (1) that the proposed solicitation would be generic in nature and would not make reference to any specific investment and (2) that the broker-dealer would implement procedures designed to insure that persons solicited

are not offered any securities that were offered or contemplated for offering at the time of solicitation. The SEC ruled that the later offers of securities "would not be deemed made by a general solicitation as a result of the initial solicitation" provided that the broker-dealer received "sufficient information to evaluate the prospective offeree's sophistication and financial circumstances." In these situations, the questionnaires must contain enough information to constitute a substantive relationship.

Questionnaires: There are two key points to ensuring that a questionnaire creates a substantive relationship. First, the questionnaire must be sufficiently detailed to properly determine the potential investor's level of sophistication in financial matters and financial circumstances. In other words, the questionnaire must be sufficient for the broker-dealer to determine the potential investor's ability to evaluate the risks and merits of the private offering and that the potential investor's financial condition is adequate.

Second, the questionnaire process must be timed in a way that allows the relationship to be pre-existing to any offering. In other words, the questionnaire process must allow, "that sufficient time will have elapsed between a respondent's completion of the questionnaire and the completion or inception of any particular offering." Under this requirement, a broker-dealer cannot establish a quick relationship with a potential investor immediately before commencing a private offering in a specific attempt to circumvent the rule. Such relationships can, however, be developed in anticipation of some future offering so long as such offerings were not initiated or under consideration during this pre-qualification review. The SEC stated the following:

> *"It is important that there be sufficient time between establishment of the relationship and an offer so that the offer is not considered made by general solicitation or advertising. In the SEC's view, if the relationship was established prior to the time [the broker/dealer or issuer] began participating in the Regulation D offering, an offer could be made to the person with whom the relationship was established without violating Rule 502(c).*

Time Period Elapsing for Pre-existing Relationship

There is little guidance on the time period that must elapse between the first introduction to a prospective investor and the offering of a security. A court has held that a one-week period between an initial "cold call" and following up on the call with a securities offering is not sufficient to establish a relationship. See S.E.C v. Credit First Fund, LP, 2006 U.S. Dist LEXIS 96697 (C.D.Cal 2006). In the Bateman Eichler no-action letter, the SEC did not object to a 45-day waiting period between the initial contact with a potential investor and a securities offering, provided the securities offering had not been initiated at the time of the initial contact. In the context of a website listing hedge

fund information which only accredited investors could access, the SEC did not object to a 30-day waiting period between the day the potential investor qualified for the website and the day the investor could invest in a fund listed on the site. In addition, since hedge funds raise money on a semi-continuous basis, the SEC allowed the offering to be ongoing at the time of the investor's qualification. See Lamp Techs., Inc., 1997 SEC No-Act. LEXIS 638 (May 29, 1997).

The designated principal must consider time of the relationship prior to approving the transaction. Approval of the nature of the relationship will be done at the same time as the approval of the transaction.

24.11 Offering Terms and Conditions in Accordance with SEC Rules 10b-5 and10b-9

In accordance with SEC Rule 10b-9(2), with respect to Min/Max offerings, the Company shall not participate in any transaction where the security being offered or sold, is being offered or sold on any other basis whereby all or part of the consideration paid for any such security will be refunded to the purchaser if all or some of the securities are not sold, unless the security is part of an offering or distribution being made on the condition that all or a specified part of the consideration paid for such security will be promptly refunded to the purchaser unless

(i) a specified number of units of the security are sold at a specified price within a specified time, and (ii) the total amount due to the seller is received by him/her by a specified date. In keeping with this provision, to the extent the minimum is not reached by the termination date of the offering, the offering shall be terminated in accordance with the provisions of SEC Rule 10b-9, unless the offering is otherwise extended, prior to the termination date, by the express written consent of all purchasers as of the date of termination. Further, any requests for permission to extend which shall be given to purchasers pursuant to this section, shall also include the ability for the customer to terminate his purchase of the offering and to receive a refund of his or her investment.

In accordance with SEC Rule 10b-5, to the extent an offering is extended, the offering documents shall be stickered accordingly to reflect the new termination date of the offering. No other changes may be made to the offering or the terms and conditions of the offering. In the event the terms of the offering are changed or otherwise amended, each purchaser shall receive a refund of their initial purchase and the opportunity to invest in the "new offering" created by the change in terms and conditions. The Designated Principal or designee shall be responsible for the Company's compliance with SEC Rules 10b-5 and 10b-9. To that end, in the event terms of an offering are changed, the Designated Principal or designee shall make a record, which shall include

the names of all pre-amendment purchasers, the amount of the refund made to each purchaser, the date that refund was made, and a notation specifying the date on which the new offer was extended to each individual purchaser.

24.12 Disclosure of Control SEC Rule 15c1-5

If the Company is involved in a distribution where there is a affiliation with the issuer, it will provide written disclosure of the affiliation prior to the completion of the transaction. A copy of the disclosure provided to the customer will be maintained in the customer file.

24.13 Disclosure of Interest in Distribution SEC Rule 15c1-6

If the Company is involved in a distribution and it receives a fee in any capacity, it will provide written disclosure to a customer at or before the completion of a transaction. A copy of the disclosure provided to the customer will be maintained in the customer file.

24.14 Handling Customer Funds and Escrow Accounts

In all instances, checks received by an associated person must be delivered same business day to the Designated Principal or designee for proper forwarding. No associated person shall hold a customer's check overnight. All customer checks will be forwarded by the Company to the appropriate recipient no later than noon of the business day following receipt by the Company or as otherwise allowed by law. To the extent a customer check and/or bank wire is received by the Company which has been made payable to the Company instead of to appropriate recipient, the Company shall return the check or wire to the customer. In the case of a bank wire made payable to the Company instead of to the appropriate recipient, such transaction will be returned to sender with correct wire transfer instructions. Further, the Designated Principal or designee on behalf of the Company, shall forward written notice to the customer advising the customer of the error in format on the check and directing the customer to make check payable directly to appropriate recipient. A copy of said correspondence shall be retained in the Company's files in accordance with SEC Rule 15c3-1, as amended.

In the case of private placement offerings where the terms of the offering specify that a certain contingency must be met prior to the release and disbursement of funds to the issuer, all customer funds received in connection with such offerings will be deposited into an escrow account in accordance with SEC Rules 15c2-4 and 10b-9 until such time as the applicable contingency has been met or the offering, by its terms, has

terminated. The Designated Principal or designee or a registered principal appointed by The Designated Principal or designee shall serve as signatory to that escrow account. .In the case of the termination of an offering prior to meeting the contingency required to break escrow, all investor funds will be promptly returned to the investors. In addition, investor checks received in connection with such offerings shall be made payable to the escrow agent or escrow account, at least until the contingency has been met. Checks received from investors in connection with such offerings which are made payable to some party other than the escrow agent or escrow account before the contingency is met shall be promptly returned to the investors.

The Designated Principal or designee shall be responsible for the Company's compliance with SEC Rules 15c2-4 and 10b-9. The Designated Principal or designee shall also see that the escrow agreement conforms to the guidelines discussed below. The Designated Principal or designee shall evidence supervision of the escrow account by signing a copy of the escrow agreement, and shall evidence oversight of the escrow account by initialing copies of the escrow account statements. The Designated Principal or designee or a registered principal appointed by the Designated Principal or designee shall serve as signatory to that escrow account.

Escrow Guidelines: In accordance with SEC Rule 15c2-4, all contingent offerings must have an independent bank escrow account established by the issuer for all broker/dealers to deposit investor subscriptions. It is noted that the broker/dealer must be a party to the escrow agreement. The bank must function as the agent over the account and it must have sole control over the disbursement of funds from escrow. Under SEC Rule 15c2-4, attorneys are not allowed to function as the escrow agent over an escrow account. Investor subscriptions in an escrow account may only be invested in bank savings accounts, bank money market accounts, short-term certificates of deposit, or short-term U.S Government Securities.

The firm's CCO or Designated Principal will ensure prior to participating in a contingent offering, that the escrow account established by the issuer is properly setup in accordance with SEC Rule 15c2-4, that the escrow agent is an independent bank, and that the issuer and broker/dealer have no control over the disbursement of funds. If the broker/dealer determines the escrow account is not setup properly, it will not participate in the offering due to an improper escrow account.

24.15 Receipt of Customer Funds in Contingent Offerings

The firm will not accept any customer checks or wires made payable to the firm. All checks must be payable to the issuer or escrow account in the event of a contingent offering. Any investor subscriptions must be deposited into escrow "promptly,"

generally by noon of the next business day. Any checks received in conjunction with a contingent offering will be recorded on a "checks received and forwarded" blotter. Checks are to be copied and maintained in the firm's books and records along with evidence of funds being promptly forwarded.

The Designated Principal will review the blotter to ensure and evidence that all funds were promptly forwarded.

24.16 SEC Rule 10b-9

If material changes to any terms of an offering occur, investors who subscribed to the offering to that point must be given a written offer of rescission and, if they so choose, have their investment returned to them in its entirety. Under Rule 10b-9, neither the broker/dealer nor the issuer should receive any money to return to investors. The escrow agent must return monies to all investors.

24.17 Supervisory Approval

In addition to the supervisory reviews and approvals noted above by the Designated Principal, the Designated Principal will periodically review the escrow account statements to ensure that funds are not distributed prior to satisfaction of the stated contingency. The broker/dealer has the right and the obligation to get copies of the statements at any time to ensure compliance with regulatory rules regarding escrow accounts.

24.18 Due Diligence Investigations

When the Company is the lead placement agent it shall ensure that an adequate due diligence review of the issuer has been conducted. The Company shall document the review by maintaining a list and or report of the items reviewed along with an analysis/discussion of the items reviewed. The actual review will depend on the specific circumstances and background of the issuer. However, the following items are topics which will typically be included in the review. (NOTE: This is not an exhaustive list as other topics may be included and some of the following topics may be excluded.)

Review of the Issuer

A reasonable investigation of the issuer and its history. Specific topics might include:

- Examining the issuer's governing documents, including any charter, bylaws and partnership agreement, noting particularly the amount of its authorized stock and any restriction on its activities.

- If the issuer is a corporation, the review should determine whether it has perpetual existence.
- Examining historical financial statements of the issuer and its affiliates, with particular focus, if available, on financial statements that have been audited by an independent certified public accountant and auditor letters to management.
- Looking for any trends indicated by the financial statements.
- Inquiring about the business of affiliates of the issuer and the extent to which any cash needs or other expectations for the affiliate might affect the business prospects of the issuer.
- Inquiring about internal audit controls of the issuer.
- Contacting customers and suppliers regarding their dealing with the issuer.
- Reviewing the issuer's contracts, leases, mortgages, financing arrangements, contractual arrangements between the issuer and its management, employment agreements and stock option plans.
- Inquiring about past securities offerings by the issuer and the degree of their success while keeping in mind that simply because a certain product or sponsor historically met obligations to investors, there are no guarantees that it will continue to do so, particularly if the issuer has been dependent on continuously raising new capital. This inquiry could be especially important for any blind pool or blank-check offering.
- Inquiring about pending litigation of the issuer or its affiliates.
- Inquiring about previous or potential regulatory or disciplinary problems of the issuer.
- The review may include a credit check of the issuer.
- Inquiring about the length of time that the issuer has been in business and whether the focus of its business is expected to change.

Review of Management

The Company shall conduct a reasonable review of the issuer's management and of management's background and qualifications. Specific topics might include:

- The Company shall attempt to judge the expertise of management for the issuer's business and the extent to which management has changed or is expected to change.
- The Company shall inquire about any regulatory or disciplinary history on the part of management and any loans or other transactions between the issuer or

its affiliates and members of management that might be inappropriate or might otherwise affect the issuer's business.

- The Company shall inquire about the forms and amount of management compensation, who determines the compensation and the extent to which the forms of compensation could present serious conflicts of interest.
- The Company shall attempt to determine the qualifications and integrity of any board of directors or similar body of the issuer.

Issuer's Business Prospects

The Company shall conduct a reasonable investigation of the issuer's business prospects, and the relationship of those prospects to the proposed price of the securities being offered. Specific topics of the investigation might include:

- Inquiring about the viability of any patent or other intellectual property rights held by the issuer.
- Inquiring about the industry in which the issuer conducts its business, the prospects for that industry, any existing or potential regulatory restrictions on that business and the competitive position of the issuer.
- Requesting any business plan, business model or other description of the business intentions of the issuer and its management and their expectations for the business, and analyzing management's assumptions upon which any business forecast is based. The Company may (but is not required) to test models with information from representative assets to validate projected returns, break-even points and similar information provided to investors.
- Requesting financial models used to generate projections or targeted returns.
- Maintaining in the Company's files a summary of the analysis that was performed on financial models provided by the issuer that detail the results of any stress tests performed on the issuer's assumptions and projections.

Issuer's Assets

The Company shall conduct a reasonable investigation of the quality of the assets and facilities of the issuer. Specific topics of the investigation might include:

- Visiting and inspecting a sample of the issuer's assets and facilities to determine whether the value of assets reflected in the financial statements is reasonable and that management's assertions concerning the condition of the issuer's physical plants and the adequacy of its equipment are accurate.
- Carefully examining any geological, land use, engineering or other reports by third-party experts that may raise red flags.

- Obtaining, with respect to energy development and exploration programs, expert opinions from engineers, geologists and others are necessary as a basis for determining the suitability of the investment prior to recommending the security to investors.

Red Flags

During the course of the Company's investigation, it must note any information that it encounters that could be considered a "red flag" that would alert a prudent person to conduct further inquiry. When presented with red flags, the Company must do more than simply rely upon representations by issuer's management, the disclosure in an offering document or even a due diligence report of issuer's counsel. The Company is obliged to conduct a further, independent investigation of the red flag and to resolve/address such in its due diligence review.

Special Considerations When the Issuer is Affiliated with the Company

Should the issuer be an affiliate of the Company and should the offering be a private placement, in addition to the procedures discussed above, the Company shall adhere to the procedures regarding "Member Private Offerings" that are included in the private placement section of this manual. Furthermore, the Designated Principal shall ensure that the Company's relationship with the issuer is disclosed to potential investors (refer to the "Disclosure of Control SEC Rule 15c1-5" and "Disclosure of Interest in Distribution SEC Rule 15c1-6" subsections in the private placement procedures of this manual).

Should the issuer be an affiliate of the Company and should the offering be a public offering, the Designated Principal shall ensure that the Company's relationship with the issuer is disclosed to potential investors via the prospectus and registration statement. A copy of same shall document adherence to this procedure.

It should be noted that simply disclosing the affiliation is not necessarily all that is required to achieve compliance with securities regulations. The Designated Principal must also ensure that the affiliation does not compromise the independence as the Designated Principal performs the due diligence reviews.

The Designated Principal must resolve any conflicts of interest that could impair the Designated Principals ability to conduct a thorough and independent investigation. If the Designated Principals is unable to do such, the Designated Principal must not approve the deal for the Company to market/distribute.

Reliance on Counsel, Experts, and Syndicate Managers

The Company may retain counsel or other experts to assist the firm in undertaking and fulfilling its reasonable investigation obligation. However, it must carefully review the qualifications and competency of counsel or experts retained to perform an investigation on its behalf and must ensure that all gaps or omissions in the investigation by such counsel or experts are separately addressed by the Company. Moreover, the use of counsel or experts does not necessarily complete the Company's investigation responsibilities, insofar as a review of the counsel's or expert's report may identify issues or concerns that require further investigation by the Company.

Should the Company merely a member of a syndicate or selling group, it may be appropriate for the Company to rely upon a reasonable investigation by the syndicate manager, provided the Company has reason to believe that the syndicate manager has the expertise and absence of conflicts to engage in a thorough and independent inquiry, and that it has in fact performed such an inquiry with respect to the particular offering. If the Company intends to rely upon the efforts of a syndicate manager it shall meet with the manager or conduct an interview of same, obtain a description of the manager's reasonable investigation efforts, and ask questions of the manager concerning the independence and thoroughness of the manager's exercise of its responsibilities. If the Company has reason to believe that the syndicate manager has not addressed a particular issue that the Company feels is material, then the Company will be responsible for conducting its own review of this item.

The Designated Principal shall be responsible for overseeing the due diligence review and the Designated Principal shall maintain the records discussed above and shall initial the due diligence report/checklist to evidence the oversight.

24.19 Blue Sky -Notice filings and Fee Payments

The Designated Principal or designee shall ensure that if a notice filing or fee payment is required in a state where the issue has been sold that such is done. This shall be documented by maintaining a file copy of any such notices that the Company files, or a copy of a letter from the issuer or its counsel that such has been filed or else that the issue is exempt from filing, or a memo to the files by the Designated Principal or designee, or the Company's counsel that a filing or fee payment is not required.

24.20 Form D Filing Requirements

Form D is a form to be used to file a notice of an exempt offering of securities with the Securities and Exchange Commission. SEC rules require the notice to be filed by companies and funds that have sold securities without registration under the Securities

Act of 1933 in an offering based on a claim of exemption under Rule 504, 505 or 506 of Regulation D or Section 4(6) of that statute. Commission rules further require the notice to be filed within 15 days after the first sale of securities in the offering. For this purpose, the date of first sale is the date on which the first investor is irrevocably contractually committed to invest. If the due date falls on a Saturday, Sunday or holiday, it is moved to the next business day.

Companies and funds must file their Form D notices and amendments with the SEC online, through the Internet, using the SEC's EDGAR (electronic gathering, analysis and retrieval) system. To file online using the EDGAR system, a company or fund must have its own filer identification number (called a "Central Index Key" or "CIK" number) and a set of password-like "access codes." One can obtain a CIK number and EDGAR access code at any time, even well before the issuer or fund is ready to file its first online Form D notice.

Additional information about the Form D, how to obtain a CIK number, filing instructions, and a compliance guide can be found at the SEC web via the following links.

http://sec.gov/info/smallbus/cfformd.htm

http://sec.gov/info/smallbus/secg/formdguide.htm

In addition to federal filing requirements, the issuer generally is required to file Form D and other documents with the appropriate state regulators within 15 days after the first sale in each state. Prior to consummating a sale of securities, The Company will review the filing requirements of the state in which the issuer has its principal place of business as well as the state or states in which the purchasers reside or have their principal place of business. While the filing of Form D is the obligation of the issuer, the Company will ensure that all appropriate filings are made with such state regulatory bodies on a timely basis. Copies of such filings will be maintained with the deal records.

24.21 Approval of Marketing Materials

All sales literature, including power point presentations and other marketing materials to be used in connection with any private placement offering in which the Company participates, shall be fair, accurate and balanced; shall be approved prior to use by the Chief Compliance Officer; and shall be maintained for a minimum of three years.

Such approval of sales literature, including power point presentations and other marketing materials, shall be evidenced by the Chief Compliance Officer or his or her designee initialing a copy of all approved marketing materials.

24.22 Compensation

While FINRA Rule 2310 only applies to public offerings that are DPPs and REITs, the Company shall nevertheless limit its organization and offering expenses (including underwriting compensation) to no more than 15% of the gross offering proceeds. Any variation from this procedure for private placements shall require written approval from the Designated Principal who shall also memorialize in writing his reasons for waiving this procedure. In order to supervise this compensation procedure, the Designated Principal shall review and approve invoices and compensation payments that are part of underwritings and evidence his approval by initialing or signing the reviewed document(s). Alternatively, he may maintain a log or spreadsheet for this purpose that lists the above referenced expenses and payments.

24.23 Non-Cash Compensation

The Designated Principal or designee will remind associated persons on the prohibitions concerning the receipt of gifts with more than a de minimis value, the prohibition of payments or reimbursements preconditioned on the achievement of a sales target, and the prohibition of payments and reimbursements for travel and meetings that are not bona fide due diligence meetings or training and education meetings. This will be enforced by reviewing the Gifts and Gratuities Log and Travel Receipts.

Non-Cash Compensation is any form of compensation received in connection with the sale and distribution of securities that is not cash, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

No FINRA member or associated person may accept or make payments or offers of payment of non-cash compensation except:

1. gifts of up to $100 per associated person annually;
2. an occasional meal, ticket to a sporting event or theater, or comparable entertainment;
3. payment or reimbursement for training and education meetings held by broker/dealers or issuers/sponsors for the purpose of educating associated persons of broker/dealers, so long as;
    a. associated persons receive prior approval from their firm and attendance is not conditioned on the achievement of a sales target;
    b. the location is appropriate to the meeting which would be the office of the issuer or an affiliate, the office of the member, or a facility located in the vicinity of the issuer or affiliate or the member, or a regional location if a regional meeting;

c. payment or reimbursement does not include guests; and

d. a sales target is not a condition for payment or reimbursement.

4. in-house sales incentive programs of broker/dealers for their own associated persons; and

5. contributions by any non-member company or other member to the Company's permissible in-house sales incentive program, provided that the non-member company does not participate in the organization of a permissible arrangement.

Expenses where payment is not permitted in connection with training and education meetings include, but are not limited to, golf outings, cruises, tours and other entertainment.

Records that must be maintained by the Company include;

- name(s) of the offerors;
- name (s) of entities making the non-cash compensation;
- names of the associated persons in attendance;
- nature and value of the non-cash compensation;
- location of training and education meetings; and
- any other pertinent information proving compliance with the rules and regulations.

24.24 Prohibition Against Payment of Referral Fees to Non-Members

The Company shall not pay commissions, referral fees or other similar transaction based compensation to any entities involved in the offer, sale or distribution of private placement securities, which are not members of FINRA or foreign broker/dealers appropriately registered in the jurisdiction where domiciled. The Designated Principal or designee will review disbursements connected with a direct participation program to ensure that payments are not made to unregistered persons or entities.

24.25 Member Private Offerings

The offering of securities by a FINRA member or a control entity of the firm in a private placement raises potential conflicts of interest. To address these concerns, FINRA Rule 5122 requires a member firm or associated person that engages in a private placement of unregistered securities issued by the firm or a control entity of such firm to:

- disclose to investors in a private placement memorandum, term sheet or other offering document the intended use of offering proceeds and the offering expenses;
- file such offering document with FINRA's Corporate Financing Department at or prior to the time it is provided to any investor; and
- commit that at least 85% of the offering proceeds will be used for business purposes, which shall not include offering costs, discounts, commissions and any other cash or non-cash sales incentives.

The Rule defines a member private offering as a private placement of unregistered securities issued by a FINRA member or a control entity. A control entity is defined to be "any entity that controls or is under common control with a [FINRA] member, or that is controlled by a member or its associated persons." Control is defined to mean "beneficial interest, as defined in Rule 5130(i)(1), of more than 50% of the outstanding voting securities of a corporation, or the right to more than 50% of the distributable profits or losses of a partnership or other non-corporate legal entity. Control will be determined immediately after the closing of an offering, and in the case of an offering with multiple intended closings, immediately following each closing." Private placement means "a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act."

Guidance concerning compliance with FINRA Rule 5122 is given in Regulatory Notice 09-27.

Rule 5122(c) exempts several member private offerings from the requirements of the rule. The primary exemptions include:

- institutional accounts, as defined in NASD Rule 3110(c)(4);
- qualified purchasers, as defined in Section 2(a)(51)(A) of the Investment Company Act;
- qualified institutional buyers, as defined in Securities Act Rule 144A;
- investment companies, as defined in Section 3 of the Investment Company Act;
- an entity composed exclusively of qualified institutional buyers, as defined in Securities Act Rule 144A; and
- banks, as defined in Section 3(a)(2) of the Securities Act.

24.26 Supervision

Should the Company or an associated person participate in a member private offering that is subject to Rule 5122, the designated principal shall oversee the Company's

compliance with said rule. In addition to the suitability requirements that are discussed earlier in this manual, he or she shall ensure that at least 85% of the proceeds from the offering are allocated to business purposes and that no more than 15% of the proceeds be used for offering costs, discounts, commissions and any other cash or non-cash sales incentives. The designated principal shall also ensure that a written offering document or term sheet is prepared and that it disclose the intended use of offering proceeds as well as offering expenses and selling compensation. Furthermore, he or she shall ensure that a copy is given to each prospective investor at or prior to their investment in the private placement. This shall be documented by maintaining a log or making a notation to this effect on the subscription agreement or purchase agreement.

The Designated Principal shall also ensure that a copy of the offering documents are submitted as PDFs to the Corporate Financing Department via email at corpfin@finra.org and that the submission include the Company's CRD number for identification purposes as part of the email submission. Submission shall be evidenced by maintaining a copy of the e-mail.

24.27 Filing Requirements Pursuant to FINRA Rule 5123

In accordance with FINRA Rule 5123, the Firm will file with FINRA a copy of any private placement memorandum, term sheet, or other offering document utilized by the Firm and its Registered Representatives within 15 calendar days of the date of first sale, or indicate that it did not use any such offering documents, unless an exemption applies.

24.28 Non-Conventional Investments

Non-Conventional Investments often have complex terms and features that are not easily understood by customers. Products that are considered to be Non-Conventional Investments include but are not limited to asset based securities, distressed debt, and derivative products. The Company will (1) conduct adequate due diligence to understand the features of the product; (2) perform a reasonable-basis suitability analysis; (3) perform customer-specific suitability analysis in connection with any recommended transactions; (4) provide a balanced disclosure of both the risks and rewards associated with the particular product, especially when selling to retail investors; (5) implement appropriate internal controls; and (6) train registered persons regarding the features, risks, and suitability of these products.

The Designated Principal or designee will conduct a due diligence review on each Non-Conventional Investment to ensure that the Designated Principal or designee understands the features of the product. The review will include but is not limited to:

- The liquidity of the product;
- The existence of a secondary market and the prospective transparency of pricing; in any secondary market transactions;
- The creditworthiness of the issuer;
- The creditworthiness and value of any underlying collateral;
- Where applicable, the creditworthiness of the counterparties;
- Principal, return, and/or interest rate risks and the factors that determine those risks;
- The tax consequences of the product; and
- The costs and fees associated with purchasing and selling the product. The Designated Principal or designee will document the review by placing an initialed copy of the review in the file.

As with other products, prior to offering a Non-Conventional Investment for sale to a customer, registered representatives will perform a customer specific suitability review on the Non-Conventional Investment. The Designated Principal or designee will review the proposed sale for appropriate suitability and approve the transaction by initialing the order ticket.

Sales material will be reviewed by the Designated Principal or designee to ensure that they present a fair and balanced representation as to the risks and rewards of each product offered for sale. The Designated Principal or designee will evidence the review by initialing the sales material and placing a copy in the advertising folder. Prior to being permitted to sell a Non-Conventional Investment all registered representatives and registered principals will be required to attend training regarding the product. Registered persons will be required to provide evidence of completing the appropriate training via a course completion certificate or attending company training.

24.29 Sale of New Products

Prior to the sale of a new product, a thorough formal review of the product will be completed. The review of any new product will be completed by the designated principal in consultation with required members of the executive team, compliance and legal department, sales department and the FINOP. A written report summarizing the findings of the designated principal will be prepared. The designated principal will either approve, deny or defer the sale of the product.

25. Direct Participation Programs

The Firm and its registered representatives are responsible for complying with all securities laws and regulations applicable to the solicitation, sale, and purchase of direct participation programs (DPPs). The designated principal is responsible for compliance with the laws and rules and specifically the provisions found in FINRA Rules 2310 and 6643. Registered representatives must adhere to the following procedures when conducting DPP business.

***Note**: Many direct participation programs are brought to market as a private placement under Regulation D (Rule 504, 505, and 506). Please refer to the Firm's procedures on private placements for further compliance and supervisory details.*

25.1 Key Definitions

Registered representatives are responsible for knowing the regulatory definitions relevant to the offering of DPPs, including these definitions found in FINRA Rule 2310.

Direct Participation Program

A direct participation program (DPP) is a program which provides for flow-through tax consequences regardless of the structure of the legal entity or vehicle for distribution including, but not limited to, the following:

- Oil and gas programs;
- Real estate programs;
- Agricultural programs;
- Cattle programs;
- Condominium securities;
- Subchapter S corporate offerings;
- Low income housing tax credit programs;
- Mortgage programs;
- Venture capital funds;
- Equipment leasing programs; and
- Other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof.

However, the definition of DPP does not apply to real estate investment trusts (REITs), tax qualified pension and profit sharing plans pursuant to Sections 401 and 403(a) of the

Internal Revenue Code and individual retirement plans under Section 408 of that Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, tax sheltered annuities pursuant to the provisions of Section 403(b) of the Internal Revenue Code, and any company including separate accounts, registered pursuant to the Investment Company Act of 1940.

Limited Partnership

A limited partnership is an unincorporated association that is a DPP organized as a limited partnership whose partners are one or more general partners and one or more limited partners, which conforms to the provisions of the Revised Uniform Limited Partnership Act or the applicable statute that regulates the organization of such partnership.

Limited Partner or Investor in a Limited Partnership

A limited partner or investor in a limited partnership is a purchaser of an interest in a direct participation program that is a limited partnership who is not involved in the day-to-day management of the limited partnership and bears limited liability

25.2 Qualification Requirements

All personnel who engage in the soliciting, purchasing, selling, and/or trading of DPPs must meet the minimum securities licensing and registration requirements of FINRA and the states. The Firm strictly prohibits any person who is not properly licensed or registered to solicit, purchase, sell, or trade DPPs until the required licensing and registrations are obtained.

Requirements for Registered Representatives

If a registered representative does not have the Series 7, he must pass the Direct Participation Programs Limited Representative Qualification Examination (Series 22) in order to engage in securities business involving DPPs. Registered representatives are responsible for ensuring that they are maintaining appropriate state registrations.

Requirements for Registered Principals

The Firm generally requires its principals supervising DPP business to have the Series 24. At the discretion of the CCO, the Firm may allow a principal to supervise DPPs if he has passed the Direct Participation Programs Limited Principal Qualification Examination (Series 39).

25.3 Approved Products

Registered representatives are prohibited from offering DPPs not approved by the Firm.

25.4 Overconcentration

To avoid overconcentration of a customer's portfolio in DPPs and other similar investments, registered representatives may not recommend investments that would cause a customer to have total holdings in DPPs, REITs, and limited partnerships exceeding 20% of net investable assets. As an additional precaution, registered representatives should ensure that holdings in any single DPP do not exceed 10% of net investable assets. Exceptions may be granted by the designated principal on a transactional basis. It is a good practice to assess whether a customer anticipates a significant reduction in net investable assets in the future (*e.g.,* purchase of vacation home with cash) and what effect this might have on the future concentration of any DPP investments in the customer's portfolio. All things remaining equal, the concentration will rise as the customer decreases his net investable assets.

25.5 Suitability for Initial Public Offerings

The Firm will not underwrite or participate in a public offering of a DPP unless minimum standards of suitability have been established by the DPP for all participants and such standards are fully disclosed in the prospectus.

25.6 Suitability Determination

In recommending the purchase, sale, or exchange of an interest in a DPP, the registered representative must obtain and consider current information about the customer's investment objectives, other investments, financial situation and needs, and any other information disclosed by the customer. Based on this information about the customer, the registered representative must have reasonable grounds to believe that:

- The customer is or will be in a financial position appropriate to enable him to realize to a significant extent the benefits described in the prospectus, including the tax benefits where they are a significant aspect of the program;
- The customer has a fair market net worth sufficient to sustain the risks inherent in the program, including loss of investment and lack of liquidity; and
- The program is otherwise suitable for the customer.

The registered representative must maintain copies of any documents used to make a suitability determination.

25.7 Subscription Agreements

Participation in a DPP transaction often entails completion of a signed subscription agreement for suitability purposes. Signed and completed subscription agreements must be kept on file.

25.8 Prospectuses

The registered representative is responsible for ensuring that each customer participating in a DPP receives a prospectus. In the case of a DPP offered through a private placement, the registered representative must deliver the private placement memorandum.

25.9 Discretionary Accounts

Registered representatives may not execute DPP transactions in a discretionary account.

25.10 Supervisory Reviews

The designated principal is responsible for reviewing all DPP and limited partnership transactions. This designated principal will review any proposed transactions by examining the prospectus and/or the offering memorandum. The designated principal will approve transactions based on suitability information found in the customer's financial profile, such as investment experience, time horizon, and investment objectives. All relevant documentation—prospectuses, subscription agreements, suitability questionnaires, disclosure documents, and other documentation—will be reviewed and properly filed as evidence of review.

25.11 Disclosure Requirements

Prior to participating in a public offering of a DPP, the Firm and its registered representatives must have reasonable grounds to believe, based on information made available by the sponsor through a prospectus or other materials, that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.

In determining the adequacy of disclosed facts, the Firm and its registered representatives must obtain information on material facts relating to the following, if relevant based on the nature of the program:

- Items of compensation.
- Physical properties.
- Tax aspects.

- Financial stability and experience of the sponsor.
- The program's conflict and risk factors.
- Appraisals and other pertinent reports.

In conjunction with the aforementioned disclosure requirements, and in the event that the Firm is a participant in the public offering of a DPP, the Firm may rely on a due diligence inquiry from another FINRA member firm if:

- There is a reasonable belief that the inquiry was conducted with due care;
- The results of the inquiry were provided to the Firm with the consent of those conducting the inquiry or directing the inquiry; and
- No FINRA member who participated in the inquiry is a sponsor of the program or an affiliate of the sponsor.

If relying on the inquiry of another FINRA member, the Firm should still consider conducting its own due diligence activities. The Firm must make an independent decision regarding whether or not to enter into a selling agreement with any given product sponsor.

The Firm will perform some or all of the following during a due diligence review for a DPP:

- Review the prospectus/offering memorandum for adequacy of disclosure.
- Review of use of proceeds, general deal terms, fees, sharing arrangements, profit participation, etc., for fairness.
- Ascertain to what degree conflicts of interest are mitigated.
- Evaluate the deal's economic merits and the sponsor's performance model, if any.
- Assess the deal's risk factors.
- Evaluate the sponsor's internal controls and financial stability.
- Evaluate the sponsor's track record and personnel.

The designated principal will review all DPP offering materials (*e.g.,* prospectuses for public DPP offerings, offering circulars for private DPP offerings) to ensure that all materials are properly disclosing relevant facts, such as the presence of any conflicts or risk factors, financial stability and experience of the sponsor, appraisals and other pertinent reports, physical properties, items of compensation, and tax aspects. The Firm's home office will maintain offering materials and related due diligence information.

When available, the Firm will request copies of third party due diligence reports. For approved products, the designated principal will note approval and update the approved product list. For unapproved products, the designated principal should note that the offering was denied. It is not necessary to specifically identify the reasons for denial. The Firm will not approve a DPP that it believes is unsuitable for any customer, regardless of whether the due diligence report is favorable. If the Firm is unable to obtain a due diligence report from its preferred provider, the Firm will request a report from another reputable source or prepare an in-house report.

Prior to executing a purchase transaction in a DPP, the registered representative must inform the prospective participant of all pertinent facts relating to the liquidity and marketability of the program during the term of the investment. The pertinent facts include information regarding whether the sponsor has offered prior programs in which the offering materials disclosed a date or time period at which the program might be liquidated, and whether the prior program(s) in fact liquidated on or around that date or during the time period. This disclosure requirement does not apply to an initial or secondary public offering of or a secondary market transaction in a unit, depositary receipt or other interest in a DPP listed on a national exchange or approved for listing on an exchange.

25.12 Advertising and Sales Literature

The Firm will file advertisements and sales literature concerning DPPs with the FINRA Advertising Regulation Department within 10 business days of first use or publication, unless the designated principal determines that the Firm can rely on an exclusion to the filing requirement. The designated principal will review and monitor DPP advertising and sales literature materials to ensure that all materials are properly filed with the FINRA Advertising Regulation Department within 10 business days of first use or publication. All relevant DPP advertising and sales literature materials shall be maintained at the main office for review and recordkeeping purposes.

25.13 Organization and Offering Fees

The Firm will not participate in the public offering of a DPP if the designated principal determines that the organization and offering expenses are not fair and reasonable after taking into consideration all relevant factors. In determining the fairness and reasonableness of organization and offering expenses (also known as O&O expenses), the Firm will consider the following arrangements presumptively unfair and unreasonable:

- The organization and offering expenses of a program in which a FINRA member or affiliate of the member is a sponsor exceeds 15% of the gross proceeds from the offering or the Firm's guidelines for such expenses.
- The total amount of all items of compensation from whatever source, including compensation paid from offering proceeds and in the form of "trail commissions," payable to underwriters, broker-dealers, or affiliates thereof exceeds 10% of the gross proceeds of the offering (excluding securities purchased through the reinvestment of dividends) or the Firm's guidelines for such expenses.
- Any compensation in connection with an offering is to be paid to underwriters, broker-dealers, or affiliates thereof out of the proceeds of the offering prior to the release of such proceeds from escrow, provided, however, that any such payments from sources other than proceeds of the offering are made only on the basis of bona fide transactions.
- Commissions or other compensation is to be paid or awarded, directly or indirectly, to any person engaged by a potential investor for investment advice as an inducement to such advisor to advise the purchaser of interests in a particular program, unless such person is a registered broker-dealer or associated person with such broker-dealer.
- The program provides for compensation of an indeterminate nature to be paid to a FINRA member or its associated persons for sales of the program, or for services of any kind rendered in connection with or related to the distribution thereof, including, but not necessarily limited to, the following: a percentage of the management fee, a profit sharing arrangement, brokerage commissions, and over-riding royalty interest, a net profits interest, a percentage of revenues, a reversionary interest, a working interest, a security or right to acquire a security having an indeterminate value, or other similar incentive items.
- The program charges a sales load or commission on securities that are purchased through the reinvestment of dividends, unless the registration statement registering the securities under the Securities Act became effective prior to August 6, 2008.
- The Firm has received reimbursement for due diligence expenses that are not included in a detailed and itemized invoice, unless the amount of the reimbursement is included in the calculation of underwriting compensation as a non-accountable expense allowance, which when aggregated with all other such non-accountable expenses, does not exceed three percent of offering proceeds.

Limitations on Organization and Operational Expenses

In connection with a public offering, the organization and offering expenses subject to the limitations described above include the following:

Issuer Expenses

Issuer expenses that are reimbursed or paid for with offering proceeds, including overhead expenses, which issuer expenses include, but are not limited to, expenses for:

- Assembling, printing and mailing offering materials, processing subscription agreements, generating advertising and sales materials;
- Legal and accounting services provided to the sponsor or issuer;
- Salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the issuer;
- Transfer agents, escrow holders depositories, engineers and other experts; and
- Registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees.

Underwriting Compensation

Underwriting compensation, which includes but is not limited to items of compensation listed in FINRA Rule 5110(c)(3) including payments:

a. To any wholesaling or retailing firm that is engaged in the solicitation, marketing, distribution or sales of the program;

b. To any registered representative of a FINRA member who receives transaction-based compensation in connection with the offering, except to the extent that such compensation has been included in a. above;

c. To any registered representative who is engaged in the solicitation, marketing, distribution or sales of the program, except:
   - to the extent that such compensation has been included in a. above;
   - for a registered representative whose functions in connection with the offering are solely and exclusively clerical or ministerial; and
   - for a registered representative whose sales activities are de minimis and incidental to his or her clerical or ministerial job functions; or

d. For training and education meetings, legal services provided to a FINRA member in connection with the offering, advertising and sales material

generated by the member and contributions to conferences and meetings held by non-affiliated members for their registered representatives.

Due Diligence Expenses

Due diligence expenses incurred when a FINRA member affirmatively discharges its responsibilities to ensure that all material facts pertaining to a program are adequately and accurately disclosed in the offering.

Review of Organization and Operation Expenses

In summary, the Firm will take into consideration all items of compensation paid by the program to underwriters, brokers-dealers, or affiliates thereof, including, but not limited to, sales commissions, wholesaling fees, due diligence expenses, other underwriter's expenses, underwriter's counsel's fees, securities or rights to acquire securities, rights of first refusal, consulting fees, finder's fees, investor relations fees, and any other items of compensation for services of any kind or description. The determination of whether compensation paid to underwriters, broker-dealers, or affiliates in connection with or related to a public offering, should be made on the basis of such factors as the timing of the transaction, the consideration rendered, the investment risk, and the role of the FINRA member or affiliate in the organization, management, and direction of the enterprise in which the sponsor is involved.

The designated principal will monitor the Firm's DPP business in an effort to detect organization and offering expenses that are unfair or unreasonable. In performing reviews, the designated principal will consider all expenses described above.

25.14 Cash Compensation

Registered representatives are prohibited from accepting cash compensation from anyone other than the Firm.

25.15 Non-Cash Compensation

Non-cash compensation is any form of compensation received in connection with the sale and distribution of DPPs that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals, and lodging. Registered representatives are prohibited from, directly or indirectly, accepting or making payments of any non-cash compensation in connection with the sale of DPPs, except under the following conditions:

- **Gifts**—The gift must not exceed an annual amount of $100 per person and must not be preconditioned on achievement of a sales target. Registered

representatives are responsible for adhering to the Firm's policies and procedures concerning gifts and their reporting.

- **Occasional meal, ticket to a sporting event or the theater, or comparable entertainment**—Such non-cash compensation must not be so frequent or extensive as to raise questions of propriety, and it must not be preconditioned on achievement of a sales target. If required by the Firm, such non-cash compensation should be reported.
- **Payments or reimbursements for training or education**—This form of non-cash compensation is permissible only if stringent requirements are met. For this reason, registered representatives must obtain pre-approval from the Compliance Department if anyone is going to pay or reimburse the Firm or its associated persons for the expenses related to training or education.

Registered representatives should refer to the Firm's policies and procedures on gifts and gratuities for additional information concerning the receipt or payment of non-cash compensation.

25.16 Reimbursements for Marketing Expenses

Some sponsors of DPPs reimburse broker-dealers for marketing expenses, including advertising, sales literature, and seminars. Registered representatives who seek reimbursements for marketing expenses must obtain pre-approval from the Compliance Department. There are two options for processing reimbursements:

1. Processing by and through the Firm's home office; or
2. Direct payment from the sponsor to the vendor, venue, or provider of the marketing expense.

The second option requires completion of a Wholesaler Reimbursement Form. Under no circumstances may a registered representative accept a reimbursement directly from the sponsor.

25.17 Limited Partnership Rollup Transactions

All limited partnership rollup transactions will be conducted in accordance with all applicable securities laws and regulations as well as the Limited Partnership Rollup Reform Act. The designated principal is responsible for ensuring proper supervision and compliance for all limited partnership rollup transactions.

As defined in FINRA Rule 2310, a limited partnership rollup transaction is a transaction involving the combination or reorganization of one or more limited partnerships, directly or indirectly, in which:

(A) Some or all of the investors in any of such limited partnerships will receive new securities, or securities in another entity, that will be reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act.

(B) Any of the investors' limited partnership securities are not, as of the date of the filing, reported under a transaction reporting plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act.

(C) Investors in any of the limited partnerships involved in the transaction are subject to a significant adverse change with respect to voting rights, the term of existence of the entity, management compensation, or investment objectives; and

(D) Any of such investors are not provided an option to receive or retain a security under substantially the same terms and conditions as the original issue. Notwithstanding the foregoing definition, a "limited partnership rollup transaction" does not include:

(i) A transaction involving only limited partnerships wherein the interests of the limited partners are repurchased, recalled or exchanged pursuant to the terms of the pre-existing limited partnership agreements for securities in an operating company specifically identified at the time of the formation of the original limited partnership;

(ii) A transaction in which the securities to be issued or exchanged are not required to be and are not registered under the Securities Act;

(iii) A transaction that involves only issuers that are not required to register or report under Section 12 of the Exchange Act, both before and after the transaction;

(iv) A transaction, except as the SEC may otherwise provide for by rule for the protection of investors, involving the combination or reorganization of one or more limited partnerships in which a non-affiliated party succeeds to the interests of the general partner or sponsor, if:

a. Such action is approved by not less than 66 2/3 percent of the outstanding units of each of the participating limited partnerships; and

b. As a result of the transaction, the existing general partners will receive only compensation to which they are entitled as expressly provided for in the pre-existing partnership agreements; or

(v) A transaction, except as the SEC may otherwise provide for by rule for the protection of investors, in which the securities offered to investors are securities of another entity that are reported under a transaction reporting

plan declared effective before January 1, 1991, by the SEC under Section 11A of the Exchange Act; if:

c. Such other entity was formed, and such class of securities was reported and regularly traded, not less than 12 months before the date on which soliciting material is mailed to investors; and

d. The securities of that entity issued to investors in the transaction do not exceed 20 percent of the total outstanding securities of the entity, exclusive of any securities of such class held by or for the account of the entity or a subsidiary of the entity.

(vi) A transaction involving only entities registered under the Investment Company Act or any Business Development Company as defined in Section 2(a)(48) of that Act.

Participation in Rollups

The Firm and its registered representatives are prohibited from participating in the solicitation of votes or tenders from limited partners in connection with a limited partnership rollup transaction, unless any compensation received by the Firm:

- Is payable and equal in amount regardless of whether the limited partner votes affirmatively or negatively in the proposed limited partnership rollup transaction;
- In the aggregate, does not exceed 2% of the exchange value of the newly created securities; and
- Is paid regardless of whether the limited partners reject the proposed limited partnership rollup transaction.

Additionally, the Firm and its registered representatives may not participate in the solicitation of limited partnership votes or tenders in connection with a rollup transaction unless the general partners or sponsors proposing the transaction agree to pay all solicitation expenses, including all preparatory work, in the event the transaction is rejected. The Firm will not participate in any rollup transaction that is deemed unfair or unreasonable by the designated principal.

Unfair and Unreasonable Conditions

The designated principal will consider the following areas during his assessment of the rollup transaction's fairness and reasonableness:

General Partners

The rollup transaction will be presumed to be unfair and unreasonable if the general partner(s):

1. Converts an equity interest in any limited partnership(s) subject to a limited partnership rollup transaction for which consideration was not paid and which was not otherwise provided for in the limited partnership agreement and disclosed to limited partners, into a voting interest in the new entity (provided, however, an interest originally obtained in order to comply with the provisions of Internal Revenue Service Revenue Proclamation 89-12 may be converted);
2. Fails to follow the valuation provisions, if any, in the limited partnership agreements of the subject limited partnerships when valuing their limited partnership interests; or
3. Utilizes a future value of their equity interest in the limited partnership rather than the current value of their equity interest when determining their interest in the new entity.

Voting Rights

The rollup transaction will be presumed to be unfair and unreasonable as to voting rights if:

1. The voting rights in the entity resulting from a limited partnership rollup transaction do not generally follow the original voting rights of the limited partnerships participating in the limited partnership rollup transaction; provided, however, that changes to voting rights may be effected if FINRA determines that such changes are not unfair or if the changes are approved by an independent committee;
2. A majority of the interests in an entity resulting from a limited partnership rollup transaction may not, without concurrence by the sponsor, general partner(s), board of directors, trustee, or similar governing entity, depending on the form of entity and to the extent not inconsistent with applicable state law, vote to:
    A. Amend the limited partnership agreement, articles of incorporation or by-laws, or indenture;
    B. Dissolve the entity;
    C. Remove the general partner, board of directors, trustee or similar governing entity, and elect a new general partner, board of directors, trustee or similar governing entity; or
    D. Approve or disapprove the sale of substantially all of the assets of the entity;
3. The general partner(s) or sponsor(s) proposing a limited partnership rollup transaction do not provide each limited partner with a document which instructs the limited partner on the proper procedure for voting against or dissenting from the transaction; or

4. The general partner(s) or sponsor(s) does not utilize an independent third party to receive and tabulate all votes and dissents in connection with the limited partnership rollup transaction, and require that the third party make the tabulation available to the general partner and any limited partner upon request at any time during and after voting occurs.

Transaction Costs

The rollup transaction will be presumed to be unfair and unreasonable as to transaction costs if:

1. Transaction costs of a rejected limited partnership rollup transaction are not apportioned between general and limited partners of the subject limited partnerships according to the final vote on the proposed transaction as follows:
   A. The general partner(s) or sponsor(s) bear all transaction costs in proportion to the total number of abstentions and votes to reject the limited partnership rollup transaction; and
   B. Limited partners bear transaction costs in proportion to the number of votes to approve the limited partnership rollup transaction; or
2. Individual limited partnerships that do not approve a limited partnership rollup transaction are required to pay any of the transaction costs, and the general partner or sponsor is not required to pay the transaction costs on behalf of the non-approving limited partnerships, in a limited partnership rollup transaction in which one or more limited partnerships determines not to approve the transaction, but where the transaction is consummated with respect to one or more approving limited partnerships.

Fees of General Partners

The rollup transaction will be presumed to be unfair and unreasonable as to fees of general partners if:

1. General partners are not prevented from receiving both unearned management fees discounted to a present value (if such fees were not previously provided for in the limited partnership agreement and disclosed to limited partners) and new asset-based fees;
2. Property management fees and other general partner fees are inappropriate, unreasonable and more than, or not competitive with, what would be paid to third parties for performing similar services; or
3. Changes in fees which are substantial and adverse to limited partners are not approved by an independent committee according to the facts and circumstances of each transaction.

If, after reviewing the aforementioned factors, the designated principal deemed the rollup transaction unfair and unreasonable, he will immediately recommend that the Firm not participate in the transaction. All documentation concerning an assessment of a rollup transactions fairness and reasonableness should be maintained in a file.

25.18 Transaction Reporting Requirements

On November 5, 2008, the SEC approved amendments to FINRA rules that replace the current market maker-based structure with a simpler, more uniform structure for purposes of reporting OTC equity transactions to FINRA. Specifically, for transactions between member firms, the "executing party" must report the trade to FINRA, and for transactions between a member firm and a non-member firm or customer, the member firm must report the trade. The "executing party" reporting structure applies to reporting trades to FINRA in NMS stocks, OTC Equity Securities, DPP securities, and PORTAL equity securities.

Definition of Executing Party

The amendments define "executing party" as the member firm that receives an order for handling or execution or is presented an order against its quote, does not subsequently re-route the order, and executes the transaction. Thus, for example, an alternative trading system (ATS) (a term that includes electronic communications networks (ECNs)) is the executing party and has the reporting obligation where the transaction is executed on the ATS. Alternatively, if an ATS routes an order to another member firm for handling and/or execution, then the ATS would not be the executing party and would not have the reporting obligation. For trades between a member firm and a non-member firm, the member firm must report the trade.

Identifying the Executing Party

In certain limited circumstances, it may not be clear which firm should be deemed the executing party for trade reporting purposes (*e.g.*, manually negotiated trades between two members via the telephone). Accordingly, for transactions between two member firms where both firms could reasonably maintain that they satisfy the definition of "executing party," the firm representing the sell-side must report the transaction to FINRA, unless the parties agree otherwise and the firm representing the sell-side contemporaneously documents such agreement. In such instances, the sell-side will be presumed to have the trade reporting obligation, unless it can demonstrate there was an agreement to the contrary (*e.g.*, contemporaneous notes of a telephone conversation or notation on the order ticket).

Reporting Trades in Non-Exchange-Listed DPP Securities

The Firm is required to report secondary market transactions in non-exchange-listed direct participation program (DPP) securities to FINRA within 30 seconds of execution. For purposes of the 30-second reporting requirement, the "date of execution" and the "time of execution" are defined under the amendments (as well as current rules) as the date and time, respectively, when the parties to a transaction in a DPP have agreed to all of the essential terms of the transaction, including the price and number of units to be traded. The Designated Principal is responsible for timely reporting any transactions in DPPs that must be reported to FINRA.

25.19 Valuation for Customer Account Statements

The Firm and its registered representatives may not participate in a public offering of DPP unless the general partner or sponsor of the program will disclose in each annual report distributed to investors pursuant to Section 13(a) of the Exchange Act a per share estimated value of the direct participation program securities, the method by which it was developed, and the date of the data used to develop the estimated value. The carrying firm of customers' accounts containing investments in DPPs must include in the customers' account statements a per-share estimate value of the program, which is typically obtained from the annual report.

Application to Real Estate Investment Trusts

The aforementioned requirement concerning customer account statements applies also to real estate investment trusts ("REITs"). The terms "real estate investment trust" or "real estate investment trust security" refer to the publicly issued equity securities of a real estate investment trust as defined in Section 856 of the Internal Revenue Code, but do not include securities on deposit in a registered securities depository and settled regular way or securities listed on a national securities exchange or NASDAQ.

26. Real Estate Investment Trusts (REITs)

A real estate investment trust ("REIT") is a company that manages a portfolio of real estate investments to earn profits for shareholders. REITs are normally publicly traded and serve as a source of long-term financing for real estate projects. A REIT pools capital in a manner similar to an investment company. Shareholders receive dividends from investment income or capital gains distributions.

26.1 Types of REITs

There are three major types of REITS:

1. **Equity REITs**—Equity REITs invest in and own properties. Their revenues come principally from their properties' rents.
2. **Mortgage REITs**—Mortgage REITs deal in investment and ownership of property mortgages. These REITs loan money for mortgages to owners of real estate, or purchase existing mortgages or mortgage-backed securities. Their revenues are generated primarily by the interest that they earn on the mortgage loans.
3. **Hybrid REITs**—Hybrid REITs combine the investment strategies of equity REITs and mortgage REITs by investing in both properties and mortgages.

REITs are organized as trusts in which investors buy shares or certificates of beneficial interest on stock exchanges, in the over-the-counter market, or through private offerings.

26.2 Tax Treatment

Under the Internal Revenue Code, a REIT can avoid being taxed as a corporation by receiving 75% or more of its income from real estate and distributing 90% or more of its taxable income to its shareholders. REITs offer dividends and gains to investors but do not pass through losses like limited partnerships, and therefore are not considered to be direct participation programs. Dividends paid by REITs are not considered qualified for purposes of the 15% maximum tax rate and are taxed at full ordinary income rates.

Note: Registered representatives must not to confuse REITs with real estate limited partnerships. Real estate limited partnerships are direct participation programs. Registered representatives selling real estate limited partnerships must adhere to the Firm's procedures for direct participation programs.

26.3 Regulatory Categories

Although all REITs must meet IRS conditions to qualify as REITs, they fall into three broad regulatory categories:

- **Publicly Traded REITs**—These REITs generally register with the SEC and trade on a national stock exchange, making them more liquid than other types of REITs.
- **Public, Non-Listed REIT—**These REITs may also be called public non-exchange traded REITs because they file with the SEC but do not trade on a national stock exchange. These REITs may offer redemption programs that allow investors to liquidate their investment after a minimum holding period. Other exit strategies may include selling to another investor in a private transaction or selling on an exchange when the REIT becomes listed.
- **Private REITs—**Referred to as non-traded REITs by FINRA, private REITs are not registered with the SEC and their shares are not traded on national stock exchanges or in the over-the-counter market. The existence of and terms of any redemption programs vary by company and are generally limited in nature. Private REITs are designed for accredited investors and generally require a high minimum investment. Registered representatives must refer to the Firm's private placement procedures when selling a REIT through a private offering.

26.4 Suitability

It is the duty of the registered representative to perform a suitability determination before recommending any type of REIT. The registered representative must know his customer and the product. REITs are total return investments that typically provide high dividends plus the potential for moderate, long-term capital appreciation. Long-term total returns of REITs are likely to be somewhat less than the returns of high-growth stocks and somewhat more than the returns of bonds. REITs may be a suitable addition to investment portfolios because there is a relatively low correlation between REITs and the returns of other market sectors.

26.5 Disclosure and Risk Factors

Registered representatives are responsible for making accurate disclosures of a recommended REIT's features and risks. All fees and expenses as well as risks should be discussed with the customer. Registered representatives must emphasize the liquidity risk associated with REITs that are not publicly traded.

26.6 Supervisory Approval

The designated principal is responsible for reviewing and approving publicly traded REIT transactions as part of the trade review process. Purchases of private REITs will be reviewed and approved in accordance with the Firm's procedures on private placements.

27. Equity Securities

These procedures govern the Firm's business in conducting transactions in equity securities. Registered representatives must adhere to these procedures regardless of whether they conduct equities transactions through a national securities exchange or in the over-the-counter ("OTC") market.

27.1 Long Sales

Registered representatives may not accept a long sale order from any customer in any security (except exempt securities other than municipals) unless:

- The Firm has possession of the security;
- The customer is long in his account with the Firm;
- The Firm or person associated with the Firm makes an affirmative determination that the customer owns the security and will deliver it in good deliverable form within three (3) business days of the execution of the order; or
- The security is on deposit in good deliverable form with a FINRA member, a member of a national securities exchange, a broker-dealer registered with the SEC, or any organization subject to state or federal banking regulations and that instructions have been forwarded to that depository to deliver the securities against payment.

27.2 Short Sales

The Firm and its registered representatives must comply with Regulation SHO, FINRA Rule 4320, and any other rules concerning short sales. FINRA Rule 4320 applies short sale delivery requirements to equity securities not otherwise covered by the close-out requirements of Regulation SHO. Among other things, FINRA Rule 4320 requires participants of registered clearing agencies to take action on failures to deliver that exist for 13 consecutive settlement days in certain non-reporting securities. In addition, if the fail to deliver position is not closed out in the requisite time period, a participant of a registered clearing agency or any broker-dealer for which it clears transactions is prohibited from effecting further short sales in the particular specified security without borrowing, or entering into a bona fide arrangement to borrow, the security until the fail to deliver position is closed out.

Customer Short Sales

The Firm and its registered representatives may not accept a short sale order for any customer in any security unless an affirmative determination is made that the Firm will

receive delivery of the security from the customer or that the Firm can borrow the security on behalf of the customer for delivery by settlement date. This requirement does not apply, however, to transactions in corporate debt securities.

Proprietary Short Sales

The Firm will not effect a short sale for its own account in any security unless the Firm makes an affirmative determination that it can borrow the securities or otherwise provide for delivery of the securities by the settlement date.

Note: This requirement will not apply to transactions in corporate debt securities, to bona fide market making transactions by a FINRA broker-dealer in securities in which it is registered as a Nasdaq market maker, to bona fide market maker transactions in non-Nasdaq securities in which the market maker publishes a two-sided quotation in an independent quotation medium, or to transactions which result in fully hedged or arbitraged positions.

27.3 Affirmative Determination

Registered representatives must ensure that sales comply with the affirmative determination requirements.

Long Sales

To satisfy the requirements for an affirmative determination for long sales, registered representatives must make a notation on the order ticket at the time the order is taken which reflects the conversation with the customer as to the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member within three (3) business days.

Short Sales

To satisfy the requirement for an affirmative determination for customer and proprietary short sales, the Firm and its registered representatives must keep a written record which includes:

- If a customer assures delivery, the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the Firm within three (3) business days; or
- If the Firm locates the stock, the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that were available for borrowing by settlement date and the number of shares needed to cover the short sale.

The Firm may rely on “blanket” or standing assurances (*i.e.,* “Easy to Borrow” lists) that securities will be available for borrowing on settlement date to satisfy the affirmative determination requirements.

For any short sales executed in Nasdaq Global Market (NGM)or national securities exchange-listed securities, the Firm may rely on “Hard to Borrow” lists indicating NGM or listed securities that are difficult to borrow or unavailable for borrowing on settlement date to satisfy their affirmative determination requirements, provided that:

- Any securities restricted pursuant to *UPC 11830* must be included on such a list;
- The creator of the list attests in writing on the document or otherwise that any NGM or listed securities not included on the list are easy to borrow or are available for borrowing.

The Firm is permitted to use Easy to Borrow or Hard to Borrow lists under the following conditions:

- The information used to generate the list is less than 24 hours old;
- The security is delivered on settlement date.

Note: "Hard to Borrow" lists only apply to Nasdaq Global Market (referred to as the National Market prior to 2006) or exchange-listed securities. They do not apply to OTCBB and Nasdaq Capital Market securities. Broker-dealers must maintain a list of all securities that are available to be borrowed in OTCBB and Nasdaq Capital Market (referred to as the Small Cap Market prior to 2005) securities.

On a transactional basis, the designated principal will verify the location of the securities in question, whether they are in good deliverable form, and the customer’s ability to deliver the securities for all securities being sold. If the Firm or a customer sells a security short, the designated principal will locate shares to borrow by using the clearing firm’s system or contacting the stock loan department for hard to borrow securities. The Firm will make a notation on the trade ticket to document the locate.

27.4 Acceptance of Orders and Delivery of Securities

The Firm and its clearing firm will ensure prompt receipt and delivery of all securities in accordance with FINRA Rule 11860 (formally NASD Rule 3370). The Firm will not accept an order from a customer, including foreign customers and/or broker-dealers trading with or through the Firm, for eligible transactions of such customers that settle in the United States, pursuant to an arrangement whereby payment for securities purchased or delivery of securities sold is to be made to or by an agent of the customer unless all of the following procedures are followed:

1. The Firm must have received from the customer prior to or at the time of accepting the order, the name and address of the agent and the time and account number of the customer on file with the agent and institution number, where appropriate.
2. Each order accepted from the customer pursuant to such an arrangement has noted thereon the fact that it is a payment on delivery (POD) or collect on delivery (COD) transaction.
3. The Firm must deliver to the customer a confirmation, or all relevant data customarily contained in a confirmation with respect to the execution of the order, in whole or in part, not later than the close of business on the next business day after any such execution.
4. The Firm must have obtained an agreement from the customer that the customer will furnish its agent instructions with respect to the receipt or delivery of the securities involved in the transaction promptly upon receipt by the customer of each confirmation, or the relevant data as to each execution, relating to such order (even though such execution represents the purchase or sale of only a part of the order), and that in any event the customer will assure that such instructions are delivered to its agent no later than:
    A. in the case of a purchase by the customer where the agent is to receive the securities against payment (COD), the close of business on the second business day after the date of execution of the trade as to which the particular confirmation relates; or
    B. in the case of a sale by the customer where the agent is to deliver the securities against payment (POD), the close of business on the first business day after the date of execution of the trade as to which the particular confirmation relates.
5. The facilities of a Clearing Agency shall be utilized for the book-entry settlement of all depository eligible transactions except transactions that are to be settled outside the United States. The facilities of either a Clearing Agency or a Qualified Vendor must be utilized for the electronic confirmation and affirmation of all depository eligible transactions.

27.5 Fair Prices and Commissions

The Firm and its registered representatives must ensure that they apply fair prices and commissions to securities transactions.

Principal Transactions

In accordance with NASD Rule 2440, if the Firm ever buys from a customer or sells to a customer listed or unlisted securities from its own account, the Firm will ensure that it

buys or sells at a fair price, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that the Firm is entitled to a profit.

Agency Transactions

When the Firm acts as an agent for its customer in a securities transaction, the Firm will not charge its customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order, and the value of any service the registered representative may have rendered by reason of his experience in and knowledge of such security and the market.

Mark-Up Policy ("5% Policy")

The 5% Policy applies to commissions on agency trades and on mark-ups or mark-downs on principal transactions. The Firm will not enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security. Registered representative must charge commissions that are reasonable. With the adoption of the 5% Policy, the following details apply to commission charges and mark-ups/mark-downs:

- The 5% Policy is a guide, not a rule;
- The Firm may not justify mark-ups on the basis of expenses which are excessive;
- The mark-up over the prevailing market price is the significant spread from the point of view of fairness of dealings with customers in principal transactions. In the absence of other bona fide evidence of the prevailing market, the Firm's own contemporaneous cost is the best indication of the prevailing market price of a security;
- A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the 5% Policy;
- Determination of the fairness of mark-ups must be based on a consideration of all the relevant factors, of which the percentage of mark-up is only one.

Relevant Factors

Registered representatives must take into consideration the following factors in determining the fairness of a commission or mark-up/mark-down:

- **Type of Security Involved—**Some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size.

Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to sales of common stock.

- **Availability of the Security in the Market—**In the case of an inactive security, the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified.
- **Price of the Security—**While there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a wider spread.
- **Amount of Money Involved in a Transaction—**A transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling.
- **Disclosure—**Any disclosure to the customer, before the transaction is effected, of information which would indicate (1) the amount of commission charged in an agency transaction or (2) mark-up made in a principal transaction is a factor to be considered. Disclosure itself, however, does not justify a commission or mark-up which is unfair or excessive in light of all other relevant circumstances.
- **Pattern of Mark-Ups—**While each transaction must meet the test of fairness, particular attention should be given to the pattern of mark-ups.
- **Nature of the Firm's Business**—There are certain differences in the services and facilities which are needed by, and provided for, customers of firms. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of the Firm's mark-ups.

Transactions to Which the Policy is Applicable

The 5% Policy applies to all securities in the following types of transactions:

- A transaction in which the Firm buys a security to fill an order for the same security previously received from a customer. This transaction would include the so-called "riskless," "riskless principal," or "simultaneous" transaction.
- A transaction in which the Firm sells a security to a customer from inventory. In such a case, the amount of the mark-up would be determined on the basis of the mark-up over the bona fide representative current market. The amount of profit or loss to the Firm from market appreciation or depreciation before, or after, the date of the transaction with the customer would not ordinarily enter into the determination of the amount or fairness of the mark-up.

- A transaction in which the Firm purchases a security from a customer. The price paid to the customer or the mark-down applied by the Firm must be reasonably related to the prevailing market price of the security.
- A transaction in which the Firm acts as agent. In such a case, the commission charged the customer must be fair in light of all relevant circumstances.
- Transactions wherein a customer sells securities to, or through, the Firm, the proceeds from which are utilized to pay for other securities purchased from, or through, the Firm at or about the same time. In such instances, the mark-up must be computed in the same way as if the customer had purchased for cash and in computing the mark-up the Firm must include any profit or commission realized by the Firm on the securities being liquidated, the proceeds of which are used to pay for securities being purchased.

Transactions to Which the Policy is Not Applicable

The 5% Policy does not apply to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price.

Review Process

On a periodic basis, the designated principal will conduct a review of the monthly commission reports, exception reports, or daily trade blotters to assess whether the commissions, mark-ups, and mark-downs charged to customers were fair and reasonable in accordance with the Firm's guidelines. Relevant documents will be initialed as evidence of review. Since the Firm is not a market maker, the mark-up or mark-down will be indicated on the customer's confirmation should a principal transaction ever be effected for an equity.

The designated principal will monitor exception reports (daily/monthly) obtained from the clearing firm. The Firm maintains a list of the reports, description, frequency, disposition, procedure for review, and the employee responsible for the review.

27.6 Order Ticket Review

On a periodic basis, the designated principal should review a representative sample of the Firm's order tickets to verify that all of the information is complete and accurate. The designated principal may document the review of order tickets by initialing the records.

27.7 Customer Confirmation Review

On a periodic basis, the designated principal should review a representative sample of the Firm's equities trade confirmations to verify that all of the information is complete and accurate.

27.8 Customer Account Review

The designated principal will conduct a periodic review of customer accounts that engage in equities transactions to determine if there are any unusual trading patterns or indications of sales practice abuses. As part of this review, the designated principal may review daily blotters, exception reports, and any other relevant records. The designated principal may evidence the review of accounts by initialing any documents reviewed, such as reports and logs.

27.9 Stock Volatility and Extreme Market Conditions

The Firm is required to have adequate systems in place to properly handle high volume or high volatility trading days. The Firm and its registered representatives have an obligation to handle orders in a fair manner and to provide adequate and clear disclosures to customers about the risks arising out of evolving volatility and volume concerns and any related constraints on the Firm's ability to process orders in a timely and orderly manner. Registered representatives should make the following types of disclosures to educate retail customers about the execution of securities transactions, particularly during volatile market conditions, along with any additional disclosures they deem appropriate.

- **Delays**—Registered representatives should consider disclosing to customers that high volumes of trading at the market opening or intra-day may cause delays in execution and executions at prices significantly away from the market price quoted or displayed at the time the order was entered. Registered representatives should also consider explaining to customers how order executions are handled by market makers, and explain that market makers may execute orders manually or reduce their size guarantees during periods of volatility, resulting in possible delays in order execution and losses.
- **Types of Orders**—Registered representatives should consider explaining in detail the difference between market and limit orders and the benefits and risks of each. In particular, registered representatives should consider disclosing that they are required to execute a market order fully and promptly without regard to price and that, while a customer may receive a prompt execution of a market order, the execution may be at a price significantly different from the current quoted price of that security. Registered representatives should tell customers

that limit orders will be executed only at a specified price or better and that, while the customer receives price protection, there is the possibility that the order will not be executed.

As a related matter, registered representatives should consider additional disclosure for customers who place market orders for initial public offering (IPO) securities trading in the secondary market, particularly those that trade at a much higher price than their offering price, or in "hot stocks" (those that have recently traded for a period of time under what is known as "fast market conditions," in which the price of the security changes so quickly that quotes for a stock do not keep pace with the trading price of the stock). Registered representatives should disclose that in such cases customers' risk of receiving an execution substantially away from the market price at the time they place the order may be significantly reduced if they also include a cap (or floor) with the order above (or below) which the order is not to be executed, by placing a limit order.

- **Access**—Registered representatives should advise customers that they may suffer market losses during periods of volatility in the price and volume of a particular stock when systems problems result in inability to place buy or sell orders.
- **Communication with the Public**—Registered representatives should take care not to exaggerate the Firm's capabilities to execute orders and handle trading in volatile markets.

27.10 Operation of Automated Order Execution Systems during Turbulent Market Conditions

The Firm directs its order flow to its clearing firm. The designated principal will consider the following guidelines when evaluating whether the clearing firm's order execution algorithms or procedures are appropriate during turbulent market conditions.

- The treatment of customer orders under any order execution algorithm or procedure must remain fair, consistent, and reasonable.
- To the extent that the clearing firm's order execution algorithm or procedures are different during turbulent market conditions, the clearing firm should disclose to its order entry firms (and customers if applicable) the differences in the procedures from normal market conditions and the circumstances in which the clearing firm may generally activate these procedures.
- Modifications to order execution algorithms or procedures designed to respond to turbulent market conditions may be implemented only when warranted by

market conditions. Accordingly, the clearing firm should document the basis for activation of its modified procedures.

- Frequent activation of modified order execution algorithms or procedures because the clearing firm has failed to maintain adequate system capacity to handle exceptional loads may raise best execution concerns.
- Failure to maintain or adequately staff an over-the-counter order room or other department assigned to execute customers' orders cannot be considered justification for executing away from the best available market.

The designated principal will monitor the clearing firm's handling of orders during turbulent market conditions.

27.11 Margin Requirements during Extreme Market Volatility

During periods of extreme market volatility, the Firm may incur additional risks from customers who effect transactions on a margin basis. General market volatility or volatility in certain stocks can dramatically increase the Firm's and the customer's risk of losses or forced liquidations due to maintenance calls. As a result, the Firm will reevaluate its margin requirements during periods of market volatility.

The designated principal will ensure that the firm has established adequate procedures to:

- Review margin limits and the various types of credit extended to customers;
- Formulate its own (house) margin requirements above those required by SEC Regulation T; and
- Evaluate the necessity for implementing higher margin requirements, mark-to-markets, and collateral deposits than are required by other rules for individual securities or customer accounts.

When considering higher margin requirements, the designated principal will examine, among other things, general market volatility, market capitalization, and fluctuations in particular stocks.

27.12 Trading Halts

When it is necessary to protect investors and the public interest, trading may be halted by Nasdaq or an exchange. Registered representatives must be aware that the following trading halts could occur:

- Halted trading in the over-the-counter market of a security listed on Nasdaq to permit the dissemination of material news;
- Halted trading in the over-the-counter market of a security listed on a national securities exchange during a trading halt imposed by such exchange to permit the dissemination of material news;
- Halted trading by CQS market makers in a CQS security when a national securities exchange imposes a trading halt in that CQS security because of an order imbalance or influx ("operational trading halt");
- Halted trading in an ADR or other security listed on Nasdaq, when the Nasdaq-listed security or the security underlying the ADR is listed on or registered with a national or foreign securities exchange or market for regulatory reasons;
- Halted trading in a security listed on Nasdaq when Nasdaq requests from the issuer information relating to material news, and
- Halted trading in a security listed on Nasdaq when extraordinary market activity in the security is occurring.

Registered representative must adhere to the following guidance and procedures during market wide trading halts:

- During market-wide trading halts of durations that will allow trading to resume on that same trading day, pending and new customer orders will be forwarded to the appropriate market for execution upon the resumption of trading. This will be done unless the Firm receives contrary instructions from the customer during the halt.
- During market-wide trading halts resulting from the triggering of circuit breakers, customer orders will be handled in the same manner as they would be handled during other regulatory trading halts concerning only individual stocks.
- During market-wide trading halts with durations that will close the market for the remainder of the trading day, pending and new customer orders should be treated as follows:
    - Unless otherwise instructed by the customer, orders that are pending at the time of the halt, and new orders received after the halt has commenced, will be treated as "Good-Til-Cancelled" orders and be held by the Firm for execution at the reopening of the next trading session.
    - "At-the-Close" orders (including "Market-at-Close" orders) pending at the time trading is halted will be treated as cancelled orders. Registered representatives should not accept, or forward to a market, any new orders related to closing prices received during a trading halt.

The designated principal is responsible for reviewing activity during a trading halt. In addition, the designated principal will reference the Firm's GTC file against all halted securities. The clearing firm will advise the Firm of open orders (whether day or GTC) for halted stocks.

27.13 Trading Ahead of Customer Orders

If the Firm accepts and holds an order in an equity security from its customer or a customer of another broker-dealer without immediately executing the order, the Firm is prohibited from trading that security on the same side of the market for its own account at a price that would satisfy the customer order, unless the Firm immediately thereafter executes the customer order up to the size and at the same or better price at which it traded for its own account.

In the event that the Firm accepts and holds a customer market order (including orders received from the Firm's own customers or customer orders received from another broker-dealer) and trades such order for its own account on the same side of the market as the customer market order at prices that would satisfy the customer's order, the Firm must immediately thereafter execute the customer market order up to the size and at the same price or better at which it traded for its own account.

Additionally, if the Firm is holding a customer market order that has not been immediately executed, the Firm is required to make every effort to match the pending market order against any market orders, marketable limit orders, or non-marketable limit orders priced better than the best bid or offer, received by the Firm on the other side of the market. Such orders must be executed at a price that is no less than the best bid, no greater than the best offer at the time the subsequent order is received by the Firm, and consistent with the terms of the pending market order. In the event that the Firm is holding multiple orders on both sides of the market that have not been executed, the Firm must make every effort to cross or otherwise execute such orders in a manner that is reasonable.

At this time, the Firm is not a market maker and it does not engage in proprietary trading. Additional procedures will be implemented if the Firm engages in market making activities or proprietary trading.

27.14 Average Price Trading

Occasionally, customers prefer to receive one confirmation representing an average price for multiple executions of the same security. SEC Rule 10b-10 mandates that broker-dealers provide confirmations for each transaction; however, the SEC has stated that it would permit average pricing of multiple executions if certain conditions are met.

The trader confirming an average price is responsible for ensuring that all of the following information is provided to the customer:

- All transactions, not just agency crosses, in Nasdaq listed and exchange-listed securities that are traded on a weighted average basis or effected based on other special pricing formula, to be reported with the .W modifier;
- The execution prices of each individual execution that filled the order must be averaged and the average price reported as the unit price on the confirmation. The confirmation must disclose that the price is an average price and that details regarding the actual process are available to the customer upon request;
- The confirmation must identify the capacity in which the Firm acted (principal; agent; or both principal and agent) and that details regarding the capacity of each execution are available upon request; and
- The commission, mark-up, mark-down, service charge, or other remuneration must be stated in a single amount for the transaction as a whole.

27.15 Volume-Weighted Average Price (VWAP) Transactions

In the event that the Firm executes a volume-weighted average price ("VWAP") or other large, potentially market-moving transactions for a customer, the Firm must not engage in proprietary trading activity that compromises a customer's interest in favor of its own proprietary trading interest. Under such circumstances, the Firm has a duty to disclose in writing to the customer that the Firm may engage in hedging or other positioning activity that could affect the market for a security that is involved in the transaction. The Firm does not currently conduct VWAP transactions. The Firm will implement additional procedures and refer to NASD Notice to Members 05-51 in the event that it chooses to engage in VWAP transactions.

27.16 Block Transactions

A "block transaction" is defined as 10,000 or more shares of a common security, or a quantity of any such security having a market value of $200,000 or more ("block size") that is traded on a qualified exchange. All appropriately licensed registered representatives of the Firm may engage in block transactions requested by customers. In order for block transactions to occur, the following conditions must be met:

- Each registered representative who receives a block transaction must obtain approval from a designated principal prior to conducting such transaction; and

- All block transaction requests from customers must be reviewed for suitability based on customer's investment experience, financial condition, and overall investment objectives.

The designated principal will review new account documents and trade orders when approving and processing a block transaction. The designated principal will document the review and maintain record of block trade order ticket(s) and other relevant records as evidence of review.

27.17 Best Execution and Interpositioning

In accordance with NASD Rule 2320, the Firm and its registered representatives have a duty to achieve best execution for customers. In order to achieve this goal, in any transaction for or with a customer, the Firm must use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions.

Reasonable Diligence Standard

The Firm has established policies and procedures to regularly and rigorously examine the execution quality obtained from the different markets or market makers trading in particular securities. This analysis entails a review of the quality of the executions the Firm is obtaining through current order routing and execution arrangements (including the internalization of order flow) to the quality of the executions that the Firm could obtain from competing markets and market centers. The Firm's aim is to continually evaluate whether opportunities exist for obtaining improved executions of customer orders.

Among the factors that the Firm considers in determining whether it or its clearing firm used "reasonable diligence" to ascertain the best market are:

- The character of the market for the security, e.g., price, volatility, relative liquidity, and pressure on available communications;
- The size and type of transaction;
- The number of primary markets checked;
- Accessibility of the quotation; and
- The terms and conditions of the order which result in the transaction, as communicated to the Firm and its associated persons.

Execution of Customer Orders

The Firm and its registered representatives will promptly process orders with the aim of obtaining execution of customer market orders or executable limit orders in less than 60 seconds under normal market conditions. Examples of unusual market conditions that may delay execution include the market open, the resumption of trading after a market halt, or any other unusual situation that disrupts normal trading activity. Registered representatives should not hold market orders and must realize that even 60 seconds may be considered too long to execute a market order.

Interpositioning

In any transaction for or with a customer, the Firm will not interject a third party between the member and the best available market except in cases where the Firm can demonstrate that to its knowledge at the time of the transaction the total cost or proceeds of the transaction, as confirmed to the Firm while acting for or with the customer, was better than the prevailing market for the security.

In the event the Firm cannot execute directly with a market maker but must employ a broker's broker or some other means in order to ensure an execution advantageous to the customer, the burden of showing the acceptable circumstances for doing so is on the retail firm. Examples of acceptable circumstances are where a customer's order is "crossed" with another retail firm which has a corresponding order on the other side, or where the identity of the retail firm, if known, would likely cause undue price movements adversely affecting the cost or proceeds to the customer.

Failure to maintain or adequately staff an over-the-counter order room or other department assigned to execute customers' orders cannot be considered justification for executing away from the best available market; nor can channeling orders through a third party as reciprocation for service or business operate to relieve the Firm of its obligations. However, the channeling of customers' orders through a broker's broker or third party pursuant to established correspondent relationships under which executions are confirmed directly to the Firm acting as agent for the customer, such as where the third party gives up the name of the retail firm, are not prohibited if the cost of such service is not borne by the customer.

The Firm must adhere to the foregoing obligations not only when it acts as agent for the account of its customer but also when retail transactions are executed as principal and contemporaneously offset.

Best Execution for Non-Exchange-Listed Securities (Three Quote Rule)

The Three Quote Rule found in NASD Rule 2320 requires broker-dealers that execute transactions in non-exchange-listed securities on behalf of customers to contact a minimum of three dealers (or all dealers if three or fewer) and obtain quotations from those dealers if there are fewer than two quotations displayed on an inter-dealer quotation system, such as the OTCBB or the electronic pink sheets, that permits quotation updates on a real-time basis. The Three Quote Rule applies only to non-exchange-listed securities with one or no public quotation. The Three Quote Rule is intended to create a standard to help ensure that broker-dealers fulfill their best execution responsibilities to customers in non-exchange-listed securities, particularly in transactions involving relatively illiquid securities lacking transparent prices.

Best Execution Reviews

On a quarterly basis, the designated principal will conduct a review and evaluation of the Firm’s order execution quality. To assist in determining market center order execution quality, the Firm receives monthly execution performance reports from its clearing firm. These reports contain valuable information such as the clearing firm’s effective spread versus industry average results. Additionally, the Firm receives a quarterly report detailing best execution quality regarding the Firm’s order routing practices. Upon review of these reports, the designated principal will use a best execution assessment checklist to conduct a quarterly internal evaluation of execution quality using one or more methods of comparison: (i) period to period (date specific evaluation); (ii) objective-based comparison/benchmarking; (iii) broker to broker comparison; (iv) trade venue comparison; or (v) trading methods. The Firm may also choose to receive and review best execution reports in its evaluation process. Any findings related to execution quality will be filed and maintained in accordance with books and records requirements. At this time, the Firm sends its order flow to its clearing firm.

Disclosure of Order Routing PracticesUnder SEC Rule 606, broker-dealers that route orders on behalf of customers will be required to prepare quarterly reports that disclose the identity of the venues to which it routed orders for execution. The reports must disclose the nature of the broker-dealer's relationship with those venues, including the existence of any internalization or payment for order flow arrangements. Additionally, broker-dealers must disclose, upon request, where they routed a customer's individual orders for execution.

Although SEC Rule 606 applies to all types of orders, broker-dealers must give an overview of their routing practices only with respect to "non-directed orders." A non-

directed order is any customer order other than a directed order. A directed order is a customer order that the customer specifically instructs the broker-dealer to route to a particular venue for execution. Consequently, all customer orders are non-directed orders in the absence of specific customer instructions on where they are to be routed.

Public Availability of Quarterly Reports

Broker-dealers must make publicly available for each calendar quarter a report on its routing of non-directed orders in covered securities. The term "make publicly available" requires the Firm to do three steps: (1) post on a free website, (2) furnish a written copy on request, and (3) notify customers at least annually that a written copy will be furnished on request. Each quarterly report must be made publicly available within one month after the end of the quarter addressed in the report.

Review of Order Routing Practices

The designated principal will ensure that the Firm is properly disclosing its order routing practices by placing the most recent quarterly report on its website. Additionally, the designated principal will furnish a written copy upon request and notify customers at least annually that a written copy will be furnished on request.

27.18 Clearing Agreements and the Clearing Firm

The Firm is required to maintain a current copy of its clearing agreement. Additionally, the designated principal should:

- Contact the clearing firm at least annually and obtain a list of all compliance and exception reports that the clearing firm offers its correspondents;
- Verify that the clearing firm is reporting all OATS information correctly;
- Verify that the clearing firm is reporting all of the Firm's trades correctly;
- Verify that the clearing firm is reporting all short positions (if applicable);
- Verify that the clearing firm is making all appropriate payment for order flow disclosures to customers annually; and
- Verify that all limit orders forwarded on to other broker-dealers are handled correctly.

As needed, the designated principal will perform the aforementioned activities. The FINOP and senior officers will review clearing agreements.

27.19 Low Price Securities Transactions (Penny Stocks)

The Firm prohibits the solicitation of penny stock transactions. Any customer wishing to purchase a penny stock must do so on an unsolicited basis. A transaction will be deemed solicited if the registered representative recommends the penny stock to a customer and the customer later enters an unsolicited order as a result of the prior recommendation. Other situations may classify a transaction as solicited, including the mailing of a research report or other written communication for the purpose of encouraging the customer to act on the information. Sending a prospectus on a new issue will be deemed a recommendation.

The Firm defines a penny stock as a security priced under five dollars and not traded on a national stock exchange or on Nasdaq. Penny stocks are commonly listed on the Pink Sheets or on the OTC Bulletin Board, largely because issuers of penny stocks typically do not meet the listing standards of NYSE or Nasdaq. A security that trades on a national exchange and whose share price drops below $5 is generally not considered a penny stock until such time that that the company is delisted from the exchange and fails to list with another national exchange or on Nasdaq.

As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, the Firm will not sell a penny stock to, or effect the purchase of a penny stock by, any person unless:

- the transaction meets an exemption; or
- prior to the transaction, the Firm has approved the person's account for transactions in penny stocks and the Firm has received from the person a written agreement to the transaction setting forth the identity and quantity of the penny stock to be purchased.

The designated principal will review penny stock transactions for customer suitability and overall compliance with all applicable penny stock rules as set forth in SEC Rule 15g-1 through SEC Rule 15g-9. Before approving an account for transactions in penny stocks, the designated principal must ensure that the Firm:

- obtains from the person information concerning the person's financial situation, investment experience, and investment objectives;
- reasonably determines, based on the information presented and any other information known by the Firm, that transactions in penny stocks are suitable for the person, and that the person (or the person's independent adviser in these transactions) has sufficient knowledge and experience in financial matters that the person (or the person's independent adviser in these transactions)

reasonably may be expected to be capable of evaluating the risks of transactions in penny stocks;

- delivers to the person a written statement; and
- obtains from the person a manually signed and dated copy of the written statement.

All relevant commission reports will be initialed as evidence of review. Relevant exception reports will be reviewed on a monthly basis.

28. OPTIONS

The Firm has developed and implemented a written program providing for the diligent supervision of all of its customer accounts, and all orders in such accounts relating to options contracts. In order to provide diligent supervision of its options business, the Firm has appropriately designated and identified a Registered Options and Security Futures Principal (ROSFP) as prescribed by applicable rules and regulations and on Schedule A of the Form BD. The following information is a description of the duties and responsibilities of the designated ROSFP for the Firm's options business.

28.1 Registered Options and Security Futures Principal (ROSFP)

A ROSFP will maintain responsibility and authority for supervision of transactions in security futures or options. The following is a list of responsibilities for the ROSFP:

- Opening, review, and approval of options accounts
- Daily review of options transactions
- Maintain options agreements
- Create and establish procedures for the supervision of options trading
- Approve all discretionary accounts
- Record and maintain all documentation on options trading
- Review and approval of advertisements, sales literature, and educational materials relating to options trading
- Review assets and recommend changes to comply with options trading practices
- Provide reports to compliance officer or management staff on the internal activities of the Firm's options trading business

28.2 Registration of Registered Options Principals

FINRA Rules require the manager of every branch office handling options transactions for public customers to be properly qualified as a ROSFP. The requirement does not apply to the manager of a branch office in which there are no more than three registered representatives handling options business provided the Firm is able to demonstrate that someone who is qualified as a ROSFP adequately supervises all of the options activity of the branch office. The Chief Compliance Officer is responsible for ensuring that each office in which more than three Registered Representatives are handling options business has a ROSFP located at the branch office.

28.3 Account Opening Process

In accordance with FINRA Rule 2360, the Firm will not accept an order from a customer to purchase or write an option contract or approve the customer's account for the trading of such option, unless the Firm furnishes the appropriate options disclosure document(s) and the customer's account has been approved for options trading.

In approving a customer's account for options trading, the Firm will exercise due diligence to ascertain the essential facts relative to the customer, their financial situation, and investment objectives. Based upon such information, the ROSFP will specifically approve or disapprove the customer's account for options trading in writing. A record of the information obtained and the approval or disapproval of each such account will be maintained by the Firm as part of its permanent records.

Upon opening a new options account, the Firm requires the customer to complete the new account application in addition to the option account application, and margin account application, if required. The Registered Representative is responsible for obtaining the following information from the customer on the account applications to determine if the customer is suitable to be trading options:

- Investment objectives (e.g., safety of principal, income, growth, trading profits, speculation)
- Employment status (name of employer, self-employed, or retired)
- Estimated annual income from all sources
- Estimated net worth (exclusive of family residence)
- Estimated liquid net worth (cash, securities, other)
- Marital status;
- Number of dependents
- Age; and
- Investment experience and knowledge (e.g., number of years, size, frequency and type of transactions) for options, stocks and bonds, commodities, others.

In addition, a customer's account records should contain the following information, if applicable:

- Source or sources of background and financial information (including estimates) concerning the customer
- Discretionary authorization agreement on file, name, relationship to customer and experience of person holding trading authority
- Date disclosure document(s) furnished to customer

- Nature and types of transactions for which account is approved (e.g., buying covered writing, uncovered writing, spreading, discretionary transactions)
- Name of registered representative
- Name of ROSFP approving account and date of approval; and
- Dates of verification of currency of account information.

The customer option agreements are maintained in the customer files along with the account application. These forms must be maintained for the life of the account, plus three years, with the first two years in a readily accessible place.

28.4 Account Acceptance and Approval

Delivery of Disclosure Documents-Account Agreement

For every new option account, the signature of the ROSFP and the date the account was approved must be noted on the option account agreement. Within 15 days after the account has been approved for options, the Firm must obtain a written account agreement signed by the customer in which the customer agrees that the account will be handled in accordance with applicable rules of the Options Clearing Corporation ("OCC") and SROs, and that the customer has received a copy of the current disclosure document(s) and is aware of and agrees to be bound by the rules of the OCC.

Verification of Customer Information

The Firm is required to send all background and financial information for every new options customer to the customer for verification within fifteen (15) days after the customer's account has been approved for options trading. All background and financial information currently on file with the Firm will also be sent to the customer for verification within fifteen (15) days after the Firm is notified or becomes aware of any material change in the customer's financial situation.

Any refusal of a customer to provide any of the required background or financial information will be properly documented and maintained in the customer's records. It should be noted that the process of verifying customer background and financial information allows the customer the opportunity to complete and/or correct information on the account.

Options Disclosure Document

An Options Disclosure Document (ODD) must be given to the customer either before or at the time the account is approved for options transactions. The Firm will send out the ODD to the customer at the time the account is approved for options and the customer

will sign on the option account application that they have received an ODD and the date they received it.

Occasionally, the Options Clearing Corporation will revise the ODD. If the ODD is revised or amended, the customer must be furnished with a copy of the new ODD or ODD supplement at the very latest by confirmation of the next option transaction. To ensure each option customer receives a copy of the ODD supplement or revision, the ROSFP sends each Registered Representative a list of their clients who have option accounts, and the Registered Representative is responsible for delivering the ODD supplement to the customer either by mail or e-mail. The ROSFP requires each Registered Representative to confirm via e-mail that all supplemental disclosures were delivered to their customers.

28.5 Transfer of Accounts (Incoming and Outgoing)

Prior to transferring any options positions to/from the Firm, the Registered Representative is to consult with the ROSFP to determine the risk associated with the positions coming into or out of the Firm. Additionally, the Registered Representative is to monitor all accounts for "naked options" contracts and/or other higher risk accounts. The Designated Principal will approve each ACAT and such acceptance of the account will be documented when the ROSFP approves the account.

28.6 Supervisory Option Account Approval

The Designated ROSFP is responsible for the review and approval of each options transaction and option account opened by a Representative on behalf of their customer. The ROSFP is responsible for the following, at a minimum, when approving option accounts and reviewing option transactions:

- Selecting the appropriate type of option strategy for the customer based on the customer's account information.
- Including the following, at minimum, on all option account forms:
    - Investment objectives, employment status, estimated annual income, estimated net worth, and estimated liquid net worth.
    - Marital status, age, number of dependents.
    - Investment experience and knowledge
- Obtaining for all option accounts, as applicable:
    - Sources of background and financial information
    - The date the ODD was sent to the customer

- The nature and type of transactions for which the account is approved
- The name of the Registered Representative handling the account
- The name of the ROSFP approving the account and the date of approval
- The written discretionary authority agreement, if a discretionary account.
- Making material purchases of "out of the money" contracts close to expiration
- Material uncovered call or put positions
- Unusual option strategies
- Suitability of transactions in the account

28.7 Suitability Guidance and Procedures

The Registered Representative is accountable for reviewing all new account information and ensuring that all account objectives are consistent with the type of trading that is effected. Based on the client's profile, the Registered Representative should ensure that he/she understands the suitability guidelines for options training. The following are general guidelines to be discussed in the Firm's training plan:

Investor Risk Tolerance	**Acceptable Trading***
Low Risk	No Options Trading
Moderate Risk	Minimal Options Trading: covered writing of equity calls and puts, buying calls and puts, and occasional covered call may be acceptable. Registered Representatives are encouraged to include either the primary or secondary investment objective as aggressive when trading options.
High Risk/Speculative	Options Trading Permitted: uncovered writing of equity calls and puts, and uncovered writing of equity straddles and combinations may be used depending on experience and other suitability parameters. The Firm does not typically allow naked call writing, but each request is handled on a case-by-case basis. The ROSFP will review the request and naked call writing must be appropriate for the client given the customer's investment objectives, risk tolerance, financial status and trading experience. If a client wants to engage in this type of speculative

	trading, the account is reviewed thoroughly by the ROSFP and may consult with the CCO in these circumstances.

* The chart above and examples therein are for discussion and training purposes only.

* Address all questions to the ROSFP prior to trading. All strategies are to be discussed and approved by the ROSFP.

* Suitability must be considered in light of the client's financial status, risk tolerance, age, and other factors. There is no formula and/or algorithm to determine suitability of securities transactions. Registered Representatives must use best judgment, but must also understand that they will be accountable. The ROSFP is responsible for documenting suitability reviews and training.

28.8 Supervisory Transaction Reviews

The ROSFP must exercise due diligence in order to determine suitability and to ascertain the essential facts relative to the customer's financial situation and investment objectives. Written approval must be received from the ROSFP in order for the customer's account to be approved for options trading. The ROSFP should consider the following criteria when reviewing customer option accounts and transactions:

- The compatibility of options transactions with the investment objectives and the transactions for which the account was approved;
- The size and frequency of options transactions;
- Commission activity in the account;
- Profit or loss in the account;
- Undue concentrations in any option class;
- Compliance with the provisions of Regulation T;
- Uncovered or short positions;
- A customer, acting alone or with others, from exceeding position limits;
- A customer, acting alone or with others, from exceeding exercise limits;
- Any order to be entered for the sale (writing) of a call option contract for the account of any corporation which is the issuer of the underlying securities;
- Excessive options trading in a Representative's or customer's account;

- Manipulation, front-running, and other employee or client actions of misconduct;
- Exceeding any position and/or exercise limits; and
- High-risk transactions.

The ROSFP is responsible for reviewing all option transactions. On a daily basis, the ROSFP reviews the Firm's blotter for all option trades done to ensure all trades were done correctly and reviews for markups/markdowns/commissions charged, ensure clients are trading within their approved levels, and ensure the trades are suitable. The ROSFP documents their review on the daily blotter/approval log.

28.9 Uncovered Short Option Contracts

FINRA Rule 2360 (B)(16)(E)(iv) requires that each firm will establish a specific minimum net equity requirements for initial requirements and maintenance of customer accounts. The ROSFP is responsible for monitoring daily trading activity and ensuring that any uncovered short positions are immediately covered. The ROSFP must closely monitor any such accounts on a continuous basis. The Firm has adopted the same requirement as the clearing firm in which these accounts are coded and automatically adjusts for current requirements. The following areas are reviewed and documented by the ROSFP:

- Specific criteria and standards to be used in evaluating the suitability of a customer for writing uncovered short option transactions.
- Minimum criteria are 5 years of experience in investments, above average level of risk, accredited investor status. Exceptions may be made by the ROSFP on a case-by-case basis. Documentation of exceptions is required on new account documentation.
- Specific procedures for approval of accounts engaged in writing uncovered short option contracts, including written approval of such accounts by the ROSFP.
- Define the type of option strategy employed by each client and position limits; trades must be consistent with this and/or pre-approval must be required.
- Designation of the ROSFP as the person responsible for approving customer accounts that do not meet specific criteria and standards for writing uncovered short option transactions and for maintaining written records of the reasons for every account so approved.
- The ROSFP will document any exceptions and maintain all supporting documents. Limitations and positions limits must be applied. The ROSFP must document all exceptions if applicable.

- Establishment of specific minimum net equity requirements for initial approval and maintenance of customer accounts writing uncovered short option transactions.
- At minimum, investor must be accredited or an employee account. Exceptions are to be documented on a case-by-case basis.
- Requirement that customers approved for writing uncovered short options transactions be provided with a special written statement for uncovered option writers approved by FINRA.
- Such disclosure must be delivered at or prior to the initial naked options transaction.

28.10 Position Limits/Exercise Limits

The Firm will incorporate Rule 2360 into the Firm's training plan to ensure that all FINRA position and exercise limits are adhered to. The ROSFP is responsible for such training and for ensuring compliance with the rule, if applicable.

28.11 Customer Complaint Records

The Firm will maintain a separate file for all options-related complaints. The file must include, at a minimum, the complainant's identity, the date the complaint was received, identity of Registered Representative servicing the account, description of the complaint; and record of what action, if any, has been taken. All option complaints must be forwarded to the ROSFP immediately upon receipt and a copy must be maintained at the branch office. The ROSFP will be responsible for researching and handling the complaint in conjunction with the Chief Compliance Officer. The Chief Compliance Officer will ensure it is filed with FINRA in accordance with FINRA Rule 4530.

28.12 Communications with the Public

Every option advertisement and all educational material is required to be submitted to FINRA's Advertising Department at least ten (10) days prior to use. Prior to sending the material, the ROSFP will review and evidence approval of the piece. The ROSFP will be responsible for submitting the piece(s) to Advertising Regulation, for making the required changes, and keeping the final copy in the firm's advertising file.

The Firm will adhere to the following standards:

1. Detailed explanation of the special risks of option transactions and the complexities of certain types of options. Such communication will include a warning that options are not suitable for all investors.

2. Presentations highlighting opportunities of options will be balanced by including the corresponding risks.
3. Advertisements will only contain a brief description of the options, and a statement that the issuer of every option is the Options Clearing Corporation.
4. Communications will indicate the address of the Firm and the location where an Options Disclosure Document can be obtained.

28.13 Option Allocation Procedures

The ROSFP is responsible for advising option clients of the method of option allocation and the exercising of option assignments. The Firm is a fully disclosed introducing broker/dealer that utilizes a clearing firm that is a member of the OCC. The ROSFP will require that the clearing firm provide the Firm with a written notice of its method of option allocation for short option positions. The Firm will utilize its clearing firm's method of option assignment. The Firm will provide its option customers information supplied by the clearing firm regarding the policies and methods of option exercise allocation. The ROSFP is responsible for any regulatory disclosures required with a change in allocation procedure, such as notification to FINRA. This method will be either a random method or a FIFO methodology.

28.14 Exercises and Assignments

Exercise and assignments will be done by the clearing firm on behalf of the Firm. The clearing firm will conduct option assignments on a random basis upon expiration or as they arise.

28.15 Confirmations

The Firm will promptly furnish to each customer a written confirmation of each transaction in option contracts for each customer's account that discloses the following information:

- Type of option
- Underlying security or index
- Expiration month
- Exercise price
- Number of option contracts
- Premium and commission
- Trade and settlement dates

- whether the transaction was a purchase or a sale (writing) transaction
- whether the transaction was an opening or a closing transaction
- whether the transaction was effected on a principal or agency basis
- Date of expiration for other than options issued by the OCC
- Use of appropriate symbols to distinguish between exchange listed and Nasdaq option transactions and other transactions in option contracts.

28.16 Reporting of Options Positions (FINRA Rule 2360))

The Firm's clearing firm will report all options transactions on behalf of the Firm. The Firm will verify each client that establishes an aggregate position of 200 or more option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security or index, combining for purposes of this subparagraph long positions in put options with short positions in call options and short positions in put options with long positions in call options.

28.17 Discretionary Accounts

All discretionary accounts are to be reviewed in accordance with the Firm's discretionary account procedures. The ROSFP must closely monitor all options accounts that are traded on discretion. Additionally, the ROSFP must establish restrictions for all accounts traded on discretion. The ROSFP's acceptance of the account must be reviewed by the ROSFP or his designee, who must be satisfied as to the reasonableness of the ROSFP's determination. A written record of the basis of the ROSFP's review must be maintained. All discretionary accounts must receive frequent supervisory review by the ROSFP.

28.18 Books & Records

The ROSFP is responsible for ensuring that all supervisory documents are maintained in accordance with the Firm's recordkeeping requirements. All client option account forms, account agreements, and disclosures are to be maintained in the client file.

29. Fixed Income Securities

Registered representatives must adhere to these procedures when conducting transactions in fixed income securities. These procedures are general in nature and apply to all fixed income securities. Registered representatives must refer to other sections of the Firm's procedures for further requirements related to transactions in specific types of fixed income securities, such as government securities and municipal bonds.

29.1 Suitability

Before making a fixed income recommendation, registered representatives must thoroughly evaluate the suitability of the proposed recommendation. A variety of factors concerning both the bond and the customer should be considered. At a minimum, the registered representative must consider the following:

- **Investment Style and Objective**—The bond should be compatible with the customer's investment style and objectives.
- **Risk Tolerance—**The customer should consider and be able to accept risks inherent in investing in recommended bonds, such as price volatility, tax implications, call risk, interest rate risk, liquidity risk, credit risk, default risk, and reinvestment risk.
- **Time Horizon**—The features of the bonds, such as its maturity and liquidity, should be consistent with the customer's intended investment horizon. Registered representatives should consider the nuances of the investment, such as the possible fluctuation of interest rates and credit profiles over time.
- **Asset Allocation**—Attention should be given to how bonds factor into a customer's overall portfolio, including how fixed income cash flow (*i.e.,* the interest) may be reinvested.

Suitability must be evaluated for each particular bond recommended to a customer. Correctly evaluating suitability requires an accurate and current client profile and a thorough understanding of the recommended bond, particularly given the complexity of many bonds. A registered representative may not recommend a bond if its complex features render him unable or unqualified to perform an appropriate suitability determination.

29.2 Risk Factors

Registered representatives are responsible for disclosing risk factors to their customers. Risk factors that must be disclosed include:

- **Interest Rate Risk**—Risk that changes in interest rates will adversely affect the value of a customer's fixed income securities.
- **Default Risk—**Possibility that a bond issuer will fail to pay principal or interest when due.
- **Credit Risk—**The possibility that the bond's issuer may default on interest payments or not be able to repay the bond's face value at maturity, or that a downgrade may cause the value of the bond to fall.
- **Call Risk—**The risk to a bondholder that a bond may be redeemed before scheduled maturity.
- **Liquidity Risk**—The risk of being unable to sell a bond quickly at its fair market value.
- **Reinvestment Risk—**The risk that rates will fall causing cash flows from a bond, assuming reinvestment, to earn less than the original investment.

29.3 Know Your Customer

A thorough suitability analysis requires a clear understanding the customer's needs and how a bond may or may not fit those needs. Registered representatives must ensure that the customer profile, including financial goals and investment objective, is current before making a recommendation. Registered representatives who recommend a fixed income security should be able to answer questions such as:

- Does the bond meet the customer's intended uses and investment objectives?
- Does the customer foresee any future need to change the investment?
- What percentage of the customer's current investments or net worth does the transaction represent?
- What expectations does the customer have from the investment?
- Will the customer rely on this investment for future income?
- What is the customer's risk tolerance and can his portfolio tolerate market price fluctuations or credit downgrades?
- Can the customer wait for the bond's full maturity?
- Are the customer's needs and total cost of the transaction properly documented?
- What is the basis for the investment?

Registered representatives must further consider any other factors disclosed by the customer.

29.4 Know Your Product

Registered representatives must be thoroughly knowledgeable about fixed income securities prior to making a recommendation. Because bonds are often perceived to be straightforward "buy-and-hold" investments, registered representatives should be sure that they are not overlooking any components of the investment. It is the registered representative's duty to thoroughly explain a product's features and potential risks and to accurate advise the customer as to its suitability. Questions registered representatives should ask when considering recommending a bond include:

- What is the bond's price and yield-to-maturity?
- What is the bond's past performance?
- Is the bond callable, and if so, what are the terms of the call and its yield-to-call?
- What are the bond's payment terms and what is the payment frequency (*e.g.,* semiannual, monthly, yearly)?
- Are there mark-ups, commissions, and/or fees that the customer will be charged when investing in the bond?
- What are the tax implications to the customer?
- How liquid is the investment?
- What are the credit ratings?
- Is there any information about the issuer's financial condition that needs to be considered?
- What fluctuation in value could occur based on the risks inherent in the recommended bond? For example, can the customer tolerate the potentially significant price volatility of long-term bonds if interest rates change?

Registered representatives should consider the aforementioned factors in relation to the specific needs and investment objective of the particular customer.

Common Types of Bonds

There are many different types of bonds, each with unique characteristics. The more thoroughly the registered representative is educated on the details of a bond, the better equipped he is to advise a customer on its suitability. At a minimum, registered representatives are expected to be familiar with these common bonds:

- **Agency Bond**—A bond issued by a U.S. government-sponsored agency. The offerings of these agencies are back by the U.S. government, but not guaranteed by the government since the agencies are private entities. Such agencies have been set up in order to allow certain groups of people to access low cost

financing, especially students and first-time home buyers. Agency bonds are usually exempt from state and local taxes, but not federal tax.

- **Corporate Bond—**A debt instrument issued by a private corporation that typically has a par value of $1,000 and pays taxable income. A corporate bond is often traded on a major exchange. Corporate bonds are either investment grade or non-investment-grade. Investment-grade bonds are ones whose issuers' prompt payment of interest and principal is considered relatively safe by a nationally recognized statistical rating agency, as indicated by a high bond rating. Non-investment-grade bonds (also known as high-yield bonds or junk bonds) are ones whose issuers' prompt payment of interest and principal is considered risky by a nationally recognized statistical rating agency, as indicated by a lower bond rating.
- **Coupon Bond**—A bond issued with detachable coupons that must be presented to a paying agent or the issuer for semiannual interest payments. Coupon bonds have become less common over the years in countries having a developed economy, but they are still prevalent in many parts of the world.
- **Government Bond**—A bond that is a U.S. government debt instrument such as a Treasury bill, note, or bond.
- **Municipal Bond**—A bond issued by states, cities, counties, and towns to fund public capital projects like road and schools, as well as operating budgets. These bonds are typically exempt from federal taxation and, for investors who reside in the state where the bond is issued, from state and local taxes too.
- **Original-Issue Discount (OID) Bond**—A bond initially issued at a dollar price less than par which qualifies for special treatment under federal tax law. Under federal tax law for tax-exempt bonds, the difference between the issue price and par value is treated as tax-exempt interest rather than a capital gain.
- **Series Bond**—A single bond issue offered to the public on multiple dates.
- **Zero Coupon Bond**—A type of bond that does not pay a coupon. Zero coupon bonds are purchased by the investor at a discount to the bond's face value and redeemed for the face value when the bond matures. Zero coupon bonds tend to fluctuate in value much more than bonds that pay regular interest.

29.5 Disclosure

Registered representatives must make sure their bond recommendations are fair and balanced, with full disclosure of all risks and clear and accurate explanations of all benefits. When making a recommendation, registered representatives should disclose the following:

- Current credit rating and anticipated prospects of the issuer;

- Interest or coupon rate and the frequency of interest payments;
- Date of maturity;
- Call provisions, as well as any sinking fund provisions;
- Yield-to-maturity, and if relevant, yield-to-call;
- Price including the mark-up or mark-down or commission and fees;
- Tax implications (*e.g.,* a municipal bond subject to the alternative minimum tax or AMT); and
- Liquidity and marketability concerns.

When confirming a sale, registered representatives should consider what is essential to disclose to the customer to ensure that the customer has a thorough understanding of the investment features and risks. Registered representatives must disclose all material terms of a bond prior to the purchase. Restating the risks of an investment to the customer at point of sale is a good practice to help ensure that recommendations are fair and balanced.

29.6 Fair Prices and Debt Mark-Ups

For fixed income transactions, registered representatives are responsible for obtaining a price for the customer that is fair and reasonable in relation to prevailing market conditions.

Markup and Markdown Guidelines

When a customer is charged a mark-up or mark-down on a fixed income transaction, not only does it have to be fair and reasonable, but the amount charged must be justifiable based on prevailing market conditions. FINRA's 5% guideline applies generally to over-the-counter equity transactions, and does not necessarily apply to fixed income securities such as corporate bonds. FINRA has advised that it is more appropriate to use a 3% guideline on mark-ups and mark-downs for fixed income transactions.

Under extenuating circumstances, registered representatives may make a request to exceed the Firm's guidelines. The request must be made in writing to the designated principal prior to the transaction and should include an explanation of the factors that would justify the additional mark-up or mark-down. Documentation related to the approval of the transaction must be retained and made available upon request.

The following criteria should be taken into consideration by registered representatives when determining the fairness and reasonableness of a mark-up or mark-down:

- The best judgment of the Firm as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction;
- The expense involved in effecting the transaction;
- The total dollar amount of the transaction;
- The availability, yield, maturity, and rating of the security;
- Existence of a sinking fund, call features, and any other relevant components of the bond;
- The resulting yield to the customer, as compared to the yield on other securities of comparable quality, maturity, coupon rate, and block size available in the market;
- The risk to the Firm in handling the transaction;
- The nature of the Firm's business with respect to the fixed income product; and
- Any other relevant facts at time of execution.

The overall responsibility for determining that mark-ups and mark-downs are fair and reasonable rests with the designated principal. The designated principal will review a sample of fixed income transactions to ensure that all mark-ups and mark-downs charged to customers are within the Firm's guidelines.

Commissions on Agency Transactions

Commissions on agency transactions in fixed income products must be fair and reasonable in consideration of the following factors:

- Availability of the securities involved in the transaction;
- Expense of executing or filling the customer's order;
- Value of the services rendered by the Firm;
- Amount of any other compensation received or to be received by the Firm in connection with the transaction; and
- Any other relevant factors at the time of execution.

The designated principal is responsible for ensuring that agency transactions are conducted at prices that are fair and reasonable to customers. The designated principal should periodically review a sample of transactions to ensure that they are compliant with the Firm's guidelines. Registered representatives wishing to charge a commission in excess of the Firm's guidelines must obtain pre-approval from the designated principal and provide an explanation of the factors justifying the higher commission. The

explanation and any other relevant documentation related to the transaction must be retained and made easily accessible.

29.7 Adjusted Trading

Registered representatives are prohibited from engaging in adjusted trading. Adjusted trading is the practice of selling a security in a manner that avoids, disguises, or postpones the true loss from the sale. To hide the loss, the investor agrees to overpay for a newly purchased security in exchange for the broker-dealer's agreement to overpay for the security that the investor wants to sell. The broker-dealer incurs a loss by purchasing the investor's underwater bond at an above-market price. At the same time, the broker-dealer offsets that loss by selling the investor a new bond at an above-market price. Thus the transactions are completely neutral from the broker-dealer's perspective. However, from the investor's perspective, the transactions effectively defer the recognition of losses on the security sold by establishing an excessively high book value for the security purchased.

Other scenarios of adjusted trading include:

- Permitting a customer to sell a security at an inflated price and re-selling the security to another customer at the inflated price; and
- Interpositioning the broker-dealer between two customers where the broker-dealer acts as a conduit allowing the two customers to "swap" losing positions by paying an inflated price for each other's securities.

These transactions are specifically prohibited by the Firm. Registered representatives must ensure that all transactions are executed at prices reasonably related to current market prices, and the Firm’s books and records must reflect an accurate price for securities purchased or sold. The designated principal is responsible for monitoring all fixed income transactions for activity that could constitute adjusted trading.

29.8 Parking Securities

No arrangement may be used to conceal the true ownership of securities through a fictitious sale or transfer to another party or nominee who agrees to later sell or transfer the securities to the true owner (or his agent) at the agreed upon time at essentially the same terms. Legitimate repurchase or "repo" transactions, usually entered into as financing transactions, are not included in this prohibition if they are not conducted for a manipulative purpose.

29.9 Secret Profits

A registered representative may not permit the charging of a mark-up or mark-down in addition to a commission on any transaction.

29.10 Errors

All errors in customer orders must be resolved immediately when discovered. No overnight positions may be maintained in the error account. Registered representatives must promptly report all errors in customer accounts to the designated principal, who is responsible for resolving the error in an appropriate manner.

29.11 Cancels and Rebills

Registered representatives are responsible for documenting the reasons for any cancellations and rebills in customer accounts. The designated principal will review and approve any cancellations and rebills involving fixed income securities.

29.12 Extended Settlements and Delayed Deliveries

Extended settlements or delayed deliveries must be reviewed by the designated principal. Variances from normal settlement or delivery is appropriate only if the designated principal is reasonably confident regarding the customer's ability and willingness to pay or deliver securities on a timely basis. Any pattern of extended settlements or delayed deliveries with a particular registered representative or customer could indicate a credit problem, potential unauthorized trading, or other improper activity and should be investigated by the designated principal.

29.13 Reporting Requirements

Registered representatives must be aware of and adhere to the Firm’s transaction reporting policies and procedures for transactions in bonds. When a trade is not reported on behalf of the Firm by its clearing firm, the registered representative must use the mandatory reporting tool applicable to the specific transaction. The reporting tool for municipal bonds is the Real-time Transaction Reporting System (RTRS), while the reporting tool for corporate bonds is the Trade Reporting and Compliance Engine (TRACE). Subject to certain exemptions, TRACE-eligible debt and municipal security transactions need to be reported with 15 minutes of trade execution. Registered representatives are responsible for ensuring that any clocks they use are synchronized.

The clearing firm currently reports TRACE transactions on behalf of the Firm. The designated principal or a qualified designee will monitor the TRACE system after order

execution to ensure proper reporting. In addition, the Firm monitors the clearing firm's exception reports and reviews the reported trade data with the aim of repairing any rejections in a timely manner. On a periodic basis, the designated principal will review a reasonable sample of transactions to verify compliance with TRACE reporting rules. All relevant documentation will be maintained as evidence of review.

29.14 Supervisory Review

The designated principal is responsible for supervising transactions in fixed income securities. During trade reviews, the designated principal will review fixed income trades to identify transactions or patterns that may violate regulatory requirements or the Firm's policies and procedures. The designated principal will closely monitor the sale of non-investment grade debt securities to ensure that the purchase of these risky bonds is consistent with the customer's risk tolerance. Additional attention will be given to cancellations and rebills, errors, extended settlements, and any transaction that appears to constitute a prohibited activity. It is the designated principal's duty to investigate any questionable activity and reporting violations to the CCO. The designated principals will document supervisory approval on the trade blotter or by any other means deemed appropriate. Approvals should include the name or initial of the principal and the date of approval.

30. GOVERNMENT SECURITIES

U.S. Government Securities are debt obligations that are incurred or guaranteed by the U.S. Government, government agencies or government-related organizations. Another form of U.S. Government securities, such as federal agency securities, represents pools of debt incurred by U.S. citizens that are guaranteed by government agencies and resold to investors. The two main types of U.S. Government securities are *Treasuries* and *Agency securities*. Therefore, the following procedures address certain U.S. Government securities as they relate to Treasuries and Agency securities in accordance with the *Government Securities Act of 1986* and *Section 15C* under the *Securities Exchange Act of 1934*, as well as other relevant rules and regulations that apply to government securities transactions.

30.1 Qualification Requirements

Registered representatives must pass a qualification examination in order to sell or trade government securities. This may be either the Series 7 Examination or the Series 72 Examination. The Government Securities Limited Representative Qualification Examination (Series 72) has been developed to qualify persons seeking registration with FINRA. Registered representatives in this limited category of registration are permitted to transact a member's business in Treasury securities, Agency securities, and Agency mortgage-backed securities. This category, by itself, does not allow registered representatives to transact a member's business in options on government securities. Candidates seeking to do transactions in this latter product also must meet additional qualification and registration standards as described below.

30.2 General Securities

The Firm will designate a government securities principal who is engaged in the management or supervision of the Firm's government securities business to include the following:

- Underwriting, trading or sales of government securities;
- Financial advisory or consultant services for issuers in connection with the issuance of government securities;
- Research or investment advice, other than general economic information or advice, with respect to government securities; or
- Responsible for supervision of the processing and clearance activities with respect to government securities or the maintenance of records involving any of the government securities activities.

Government Securities Principals are responsible for the processing and clearance activities with respect to government securities and the maintenance of records involving any of the government securities activities.

30.3 U.S Government Securities/Government-Sponsored Enterprises (GSEs)

Treasury Securities

There are three types of Treasury securities that are available to the public: Treasury bills (T-bills); Treasury notes (T-notes); and Treasury bonds (T-bonds). The following information is a brief description of the three types of Treasuries:

Treasury Bills (T-bills)

Treasury bills, or commonly called T-bills, are primarily considered *short-term* investments with maturity dates of three months (thirteen weeks), six months (twenty-six weeks), or one year (fifty-two weeks). New Treasury bills are issued at a discount from their face value and are redeemed at their full face value (or par value) at maturity. It is important to note that interest on Treasury bills is exempt from state and local taxes. This type of Treasury security is issued in increments of $1,000. Because Treasury bills are issued at a discount from face value, they do not have a stated interest rate and therefore do not pay an annual interest.

Treasury Notes (T-notes)

Treasury notes, or commonly called T-notes, are usually considered *intermediate-term* investments with maturity dates of two, three, five, and ten years. New Treasury notes typically have fixed interest rates that are based on the note's coupon rate as specified on the note, and is calculated based on a 365-day year. All interest on Treasury notes is paid on a semi-annual basis and is exempt from state and local taxes. For the purposes of issuing Treasury notes to the public, the Government typically offers two-year Treasury notes on a monthly basis, and five and ten-year notes on a quarterly basis. As with Treasury bills, Treasury notes are issued in increments of $1,000. It is also important to note that Treasury Notes are not callable.

Treasury Bonds (T-bonds)

Treasury bonds, or commonly called T-bonds, are usually considered *long-term* investments with maturity dates of ten to thirty years. T-bills typically have a fixed rate of interest that is paid on a semi-annual basis. All interest earned from T-bills is exempt from state and local taxes. As with Treasury bills, Treasury notes are issued in increments of $1,000. Similar to T-notes, T-bonds are not callable.

Government Agency Securities (Federally Sponsored)

There are four main types of *federally sponsored* Government Agency Securities: the Federal National Mortgage Association (FNMA); the Federal Home Loan Mortgage Corporation (FHLMC); and the Federal Farm Credit System. It is important to note that although these types of agency securities are sponsored by the U.S. Government, they are not are not backed by the full faith and credit of the U.S. Government. The following is a brief description of the various types of federally sponsored agency securities:

Federal National Mortgage Association (FNMA or Fannie Mae)

The Federal National Mortgage Corporation (FNMA) is a public corporation with the purpose of providing residential mortgage capital. In order to raise this type of capital, FNMA focuses on buying residential mortgages from lenders such as banks and savings and loan associations.

Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac)

The Federal Home Loan Mortgage Corporation (FHLMC) is a publicly chartered agency that was created to provide residential mortgage capital. In order to provide this capital, the FHLMC buys residential mortgages from lenders, packages and resells them in the open market in the form mortgage-backed, pass-through certificates. All income earned from securities issued by the FHLMC are taxed at the federal, state, and local level.

Student Loan Marketing Association (SLMA or Sallie Mae)

The Student Loan Marketing Association (SLMA) is a publicly traded stock corporation that provides financing to student state loan agencies by guaranteeing student loans that are traded in the secondary market. The SLMA was created to increase the availability of education-based loans to college and university students under the Guaranteed Student Loan Program (GSLP). All income earned from securities issued by the SLMA are taxed at the federal, but are exempt from the state and local level.

Federal Farm Credit System

The Federal Farm Credit System was established to provide general credit services to farmers and farm-related businesses through a network of Farm Credit Districts. In order to provide these credit services, the Federal Farm Credit System sells short-term (less than one year) notes in increments of $50,000 on a discounted basis, and also issues Federal Farm Credit System Consolidate System wide Bonds in increments of $5,000. All bonds of this type are issued with six and nine-month maturity dates.

Federal Agency Securities

There are two main types of federal agency securities: the Government National Mortgage Association (GNMA) and the Export-Import Bank (EXIM Bank). These two

types of federal agency securities are different from the federally sponsored agency securities in that they are directly backed by the full faith and credit of the U.S. Government. The following is a brief description of the two main types of federal agency securities.

Government National Mortgage Association (GNMA or Ginnie Mae)

Similar to the FNMA, the Government National Mortgage Association (GNMA) is another organization with the purpose of providing residential mortgage capital. In order to provide this capital, the GNMA buys, packages, and resells mortgages in the form of mortgage-backed securities. However, one of the distinguishing factors with the GNMA is that they are backed by the full faith and credit of the U.S. Government.

Export/Import Bank (EXIM Bank)

The Export/Import Bank (EXIM Bank) was created for the purpose of encouraging trade between the U.S. and foreign countries. Similar to the GNMA, these particular federal agency securities are backed by the full faith and credit of the U.S. Government. Additionally, all interest income on EXIM Bank securities are subject to federal, state, and local taxation.

30.4 Book-Entry Treasury Bills, Notes and Bonds

Book-Entry Securities and Systems

U.S. Treasury Securities are to be held and transferred in either of the two book-entry securities systems: TRADES or TREASURY DIRECT. Treasury securities are maintained and transferred, to the extent authorized in 31 CFR 357, in these two book-entry systems at their par amount (e.g., for inflation-indexed securities, adjustments for inflation will not be included in this amount). Treasury securities may be transferred from one system to the other in accordance with U.S. Treasury regulations governing book-entry Treasury bills, notes, and bonds.

Treasury/Reserve Automated Debt Entry System (TRADES)

TRADES is established, maintained and operated by the Federal Reserve Banks acting as fiscal agents of the United States. The Federal Reserve Banks maintain book-entry accounts for themselves, depository institutions, and other authorized entities, such as government and international agencies and foreign central banks. In their accounts, depository institutions maintain securities held for their own account and for the accounts of others, including other depository institutions and dealers, which may, in turn, maintain accounts for others. For accounts maintained in TRADES, Treasury discharges its payment obligations when payment is credited to the applicable account

maintained at a Federal Reserve Bank or payment is made in accordance with the instructions of the person or entity maintaining such account.

Treasury Direct

Treasury Direct is a system in which the book-entry securities of account holders are identified and maintained directly on the records of the Bureau of the Public Debt, Department of the Treasury. In Treasury Direct, the U.S. Treasury discharges its payment obligations when payment is made to a depository institution for credit to the account specified by the owner of the security, or when payment is made in accordance with the instructions of the owner of the security.

U.S. Treasury securities are offered exclusively in book-entry form and are direct obligations of the United States. The securities are subject to the terms and conditions set forth in this section as well as the regulations governing book-entry Treasury bills, notes, and bonds, and the offering announcements, all to the extent applicable.

- Treasury bills are issued at a discount, are redeemed at their par amount at maturity, and have maturities of not more than one year;
- Treasury notes or Treasury fixed-principal notes are issued with a stated rate of interest to be applied to the paramount, have interest payable semiannually, and are redeemed at their par amount at maturity. They are sold at discount, par, or premium, depending upon the auction results. They have maturities of at least one year, but not more than ten (10) years (*the term "fixed-principal" is used in this part to distinguish such securities from "inflation-indexed" securities. Fixed-principal notes and fixed-principal bonds are referred to as "notes" and "bonds" in official Treasury publications, such as offering announcements and auction results press releases, as well as in auction systems*);
- Treasury inflation-indexed notes are issued with a stated rate of interest to be applied to the inflation-adjusted principal on each interest payment date, have interest payable semiannually, and are redeemed at maturity at their inflation-adjusted principal, or at their par amount, whichever is greater. They are sold at discount, par, or premium, depending upon the auction results. They have maturities of at least one year, but not more than ten (10) years;
- Treasury bonds or Treasury fixed-principal bonds are issued with a stated rate of interest to be applied to the par amount, have interest payable semiannually, and are redeemed at their par amount at maturity. They are sold at discount, par, or premium, depending upon the auction results. They typically have maturities of more than ten (10) years;

- Treasury inflation-indexed bonds are issued with a stated rate of interest to be applied to the inflation-adjusted principal on each interest payment date, have interest payable semiannually, and are redeemed at maturity at their inflation-adjusted principal, or at their par amount, whichever is greater. They are sold at discount, par, or premium, depending upon the auction results. They typically have maturities of more than ten years.

STRIPS

A note or bond may be designated in the offering announcement as eligible for the STRIPS program. At the option of the holder, and generally at any time from its issue date until its call or maturity, any such security may be ``stripped,'' i.e., divided into separate principal and interest components. A short or long first interest payment and all interest payments within a callable period are not eligible to be stripped from the principal component. The CUSIP numbers and payment dates for the principal and interest components are provided in the offering announcement if not previously announced.

Treasury Fixed-Principal Securities

Minimum par amounts required for STRIPS. For a fixed-principal security to be stripped into the components described above, the par amount of the security must be in an amount that, based on its interest rate, will produce a semiannual interest payment in a multiple of $1,000. Exhibit C to this part provides the minimum par amounts required to strip a fixed-principal security at various interest rates, as well as the corresponding interest payments. Amounts greater than the minimum par amount must be in multiples of $1,000. The minimum par amount required to strip a particular security will be provided in the press release announcing the auction results

Treasury Inflation-Indexed Securities

The minimum par amount of an inflation-indexed security that may be stripped into the components described in this section is $1,000. Any par amount to be stripped above $1,000 must be in a multiple of $1,000.

30.5 New Account Opening Process

The Registered Representative is responsible for ensuring the customer has completed the new account application, providing any additional supporting documentation, and for obtaining all required information such as the:

- Customer’s name
- Address

- Occupation
- Whether he/she is employed by another broker/dealer
- Date of birth
- Financial status
- Tax bracket
- Investment objectives
- Risk tolerance; and
- Any other information that is considered useful for the Firm or the Registered Representative to make a recommendation to a customer.

The Registered Representative will send the account application to their Designated Principal for review and approval.

30.6 Review of Transactions

The two most important considerations in determining the scope of a member's suitability obligations in customer are the customer's capability to evaluate investment risk independently and the extent to which the customer is exercising independent judgment in evaluating a member's recommendation. A member must determine, based on the information available to it, the customer's capability to evaluate investment risk.

The Designated Principal is responsible for reviewing all transactions executed in the U.S. Government securities. The Designated Principal will review the blotter for all Registered Representatives and Branch Offices under their supervision for U.S Government transactions. The Designated Principal will review for sales practice issues such as unsuitable transactions, excessive activity, adjusted trading, excessive losses, day trading (Short term buying and selling), excessive securities concentration, excessive cancellations or "as-of" trades, large short positions, changes in the activity pattern, trading on rumors or inside information, and excessive mark-ups and mark-downs.

30.7 Mark-Ups and Mark-Downs

The overall responsibility for determining that markups are fair and reasonable rests with the Designated Principal. Each Designated Principal reviews the Activity Blotter for the Registered Representatives and Branches under their supervision. The Designated Principal reviews the trades to ensure they are suitable and that all markups and

markdowns charged to customers are within the Firm's guidelines and are fair and reasonable. The Designated Principal will review the blotter on a daily basis.

The following criteria should be taken into consideration by all Registered Representatives when determining the fairness and reasonableness of a markup/markdown on a U.S Government Security:

- Total dollar amount of the transaction;
- Expense involved in effecting the transaction
- The best judgment of the Firm as to the fair market value at the time of the transaction;
- Price or yield of the security
- Nature of the Firm's business;
- Availability of the security;
- Maturity of the security;
- Resulting yield, as compared to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market;
- Any other relevant facts at time of execution.

No registered representative may charge a markup or markdown that exceeds the Firm's established guidelines, nor should a markup/markdown be charged on a trade in which there is no reasonable basis for the markup/markdown. Under extenuating circumstances, a request to exceed the Firm's guidelines may be made. The request must be made in writing to the Designated Principal prior to the transaction and include an explanation of the factors that would justify the additional markup or markdown. A copy of the request and approval should be forwarded to the designated principal so they are aware of the approval. Documentation of the transaction approval must be retained with the trade and be immediately available upon request by the Compliance Department staff or a regulatory authority.

30.8 Commissions on Agency Transactions

The overall responsibility for determining that commissions charged to customer are fair and reasonable rests with the Designated Principal. Each Designated Principal reviews the blotter for the Registered Representatives and Branches under their supervision. The Designated Principal reviews the trades to ensure they are suitable and that all commissions charged to customers are within the Firm's guidelines and are fair and reasonable. The Designated Principal will review the blotter on a daily basis, and

evidence of review and approval is noted. Any exceptions noted are evidenced on the log and forwarded to Compliance.

The Designated principal of the Firm must review for excessive commissions for all trades by registered representatives. The following is a summary of relevant factors for determining excessive markups and markdowns:

- Expense of processing the order;
- Value-added services provided by the Firm;
- Amount of other remunerations received by the Firm;
- Any other relevant factors at the time of execution.

All commissions exceeding the Firm's guidelines must be pre-approved by the Designated Principal and be accompanied with an explanation explaining the factors that would justify the commission charged. This documentation must be retained with the trade and be immediately available if requested by Compliance or any regulatory authority.

31. Municipal Securities

31.1 MSRB Rules G-2/G-3

In accordance with *MSRB Rule G-2*, the Firm will not affect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security unless the Firm and its registered representatives and associated persons maintain the appropriate licensing and qualifications.

It is the responsibility of the Firm's Designated Principal to ensure that each registered representative who sells or solicits or otherwise engages in municipal securities is properly registered. This includes a successful completion of the General Securities Representative Examination (Series 7) or Series 52 and completion of any/all required apprenticeships (if applicable).

Municipal Securities Representative

Each registered representative of the Firm who wishes to engage in a municipal securities business shall take and pass the Municipal Securities Representative Qualification Examination (Series 52) or General Securities Representative (Series 7) prior to being qualified as a municipal securities representative. The responsibilities and tasks to be performed by a Municipal Securities Representative shall include one or more of the following:

- Underwriting, trading or sales of municipal securities;
- Financial advisory or consultant services for issuers in connection with the issuance of municipal securities;
- Research or investment advice with respect to municipal securities; or
- Any other activities which involve communication, directly or indirectly, with public investors in municipal securities.

Municipal Securities Principal

Each registered representative of the Firm who wishes to manage, direct or supervise a municipal securities business; including 529 plans, shall take and pass the Municipal Securities Principal Qualification Examination (Series 53) prior to being qualified as a municipal securities principal. A Municipal Securities Principal shall be defined as any properly registered person who directly engages in the management, direction or supervision of one or more of the following activities:

- Underwriting, trading or sales of municipal securities;

- Financial advisory or consultant services for issuers in connection with the issuance of municipal securities;
- Processing, clearance, and, in the case of brokers, dealers and municipal securities dealers other than bank dealers, safekeeping of municipal securities;
- Research or investment advice with respect to municipal securities;
- Any other activities which involve communication, directly or indirectly, with public investors in municipal securities;
- Maintenance of records regarding the aforementioned items;
- Training of municipal securities principals or municipal securities representatives.

31.2 MSRB Rule G-6: Fidelity Bond

As a municipal broker/dealer, the Firm is responsible for ensuring the Firm's fidelity bond meets all requirements in accordance with *MSRB Rule G-6 and FINRA Rule 4360*. The Designated Principal of the Firm shall be responsible for the continued supervision and maintenance of the fidelity bond as well as verifying the required amount for adequate coverage based on the Firm's needs.

31.3 MSRB Rule G-7: Associated Persons

For each newly hired Registered Representative, the Firm will file a Form U-4 which will contain all required information pursuant to the rule. The Firm will have the Registered Representative confirm that all information is correct and properly reported on the Form U-4.

31.4 MSRB Rules G-8/G-9: Books and Records

The Municipal Principal shall be responsible for maintaining the following books and records:

Trade Blotters

The Firm will maintain a record of all purchases and sales of municipal securities done on an agency/principal/riskless principal basis on the daily trade blotter. This shall include the account number, description of the securities, aggregate par value of the securities, the dollar price or yield, aggregate purchase or sales price, accrued interest, contra party, and trade date. Dollar price, yield, and accrued interest may not have to be included if not required on the client confirmation under MSRB Rule G-12 and G-15.

Order Tickets/Order Memoranda

Agency Transactions: The Firm will maintain a record of all purchases of sales of municipal securities done on an agency basis on the daily trade blotter. This shall show the terms and conditions of the order and instructions, and any modifications. Other items include: the account number, purchase or sale, the date and time of receipt, the date, time, and price of execution, the name of the person who entered the order, and the date of cancellation and conditions (if applicable). Discretionary Authority must be noted, if exercised. If the transaction was entered by a power of attorney or on behalf of a joint account, corporation, or partnership, the name and address (if different than the account owner) of the person who entered the order must be included.

Principal Transactions: The Firm will maintain a record of all purchases of sales of municipal securities done on a principal/riskless principal basis on the daily trade blotter. These documents shall show the terms and conditions of the order and instructions, and any modifications. Other items to be included: purchase or sale, the date and time of receipt, the date, time, and price of execution, and the name of the person who entered the order. Discretionary Authority must be noted, if exercised. If the transaction was entered by a power of attorney or on behalf of a joint account, corporation, or partnership, the name and address (if different than the account owner) of the person who entered the order must be included.

Account Records

- Confirmations: See Customer Confirmations and Rule G-15 below.
- New Account Forms and Records
- Customer Complaint File: The Firm must maintain a copy of all written customer complaints in its Customer Complaint File. Additionally, the Firm must document its response to the complaint.

31.5 MSRB Rule G-10: Municipal Securities-related Customer Complaints

The Municipal Principal shall be responsible for reviewing and handling all customer complaints related to Municipal Securities Transactions. In the event that a customer complaint is received, the Municipal Principal is responsible for delivering a copy of the MSRB Investor Brochure to the customer. Evidence of an Investor Brochure being sent to the customer will be maintained in the customer complaint file.

31.6 MSRB Rule G-14: Real-Time Reporting System (RTRS) Transaction Reporting

The Firm's procedures governing MSRB Rule G-14-Trade Reporting to the RTRS system is located in the Trade Reporting Procedure Manual.

31.7 MSRB Rule G-15: Confirmations

Each customer shall receive a written confirmation after the completion of a transaction in a municipal security. Each confirmation should include all of the items required by MSRB Rule G-12 (except the amount of concession), in addition to the capacity in which the Firm acted, a disclosure if the security is unrated, the date and price of the next call on a callable bond, and the amount of any premium paid over accreted value for a callable zero coupon bond. Customer Confirmations are sent to the customer by our clearing firm. The Municipal Principal will periodically review confirmations to ensure that they are in compliance with Rules G-12 and G-15.

31.8 MSRB Rule G-17: Disclosures

MSRB Rule G-17 provides that, in the conduct of its municipal securities activities, each dealer must deal fairly with all persons and may not engage in any deceptive, dishonest or unfair practice. The rule requires a dealer and the Registered Representative in the connection with any transaction in municipal securities to disclose to the customer, at or prior to the sale, all material facts about the transaction known by the dealer, as well as material facts about the security that are reasonable accessible to the market. This includes the obligation to give customers a complete description of the security, including a description of the features that likely would be considered significant by a reasonable investor and facts that are material to assessing the potential risks of the investment.

Each Registered Representative will be required to utilize established industry sources such as EMMA to obtain official statements, continuing disclosures, press releases, research reports and other data provided by independent sources to obtain all material information about the municipal security to ensure they have adequately disclosed all material information to their customer. The following questions are some of the questions that Registered Representatives should obtain from industry sources and be disclosed to customers:

- What is the security's key terms and features and structural characteristics, including but not limited to its issuer, source of funding (*e.g.*, general obligation or revenue bond), repayment priority, and scheduled repayment rate? Much of

this information will be in the Official Statement, which for many municipal securities can be obtained by entering the CUSIP number in the Muni Search box at *www.emma.msrb.org*. Be aware, however, data in the Official Statement may have been superseded by the issuer's on-going disclosures.)

- Does information available through EMMA or other established industry sources indicate that an issuer is delinquent in its material event notice and other continuing disclosure filings? Delinquencies should be viewed as a red flag.
- What other public material information about the security or its issuer is available through established industry sources other than EMMA?
- What is the security's rating? Has the issuer recently been downgraded? Has the issuer filed any recent default or other event notices, or has any other information become available through established industry sources that might call into question whether the published rating has been revised to take such event into consideration?
- Is the security insured, or does it benefit from liquidity support, a letter of credit or is it otherwise supported by a third party? If so, check the credit rating of the insurer or other backing, and the security's underlying rating (without third party support). If supported by a third party, review the terms and conditions under which the third party support may terminate.
- How is it priced? Be aware that a municipal security can be priced above or below its par value for many reasons, including changes in the creditworthiness of the issuer and prevailing interest rates.
- How and when will interest on the security be paid? For example most municipal bonds pay semiannually, but zero coupon municipal bonds pay all interest at the time the bond matures. Variable rate bonds typically will pay interest more frequently, usually on a monthly basis in variable amounts.
- What is the security's tax status, under both state and federal laws? Is it subject to the Federal Alternate Minimum Tax? Is it fully taxable (*e.g.*, Build America Bonds)?
- What are its call provisions? Call provisions allow the issuer to retire the security before it matures. How would a call affect expected future income?

Therefore, each Registered Representative must complete and sign a one-page disclosure, upon the sale of a municipal security to demonstrate he/she has performed the required due diligence. To assist the Representative, the firm has created two guidelines, one that tells the Representative what industry resources are available to

find information about the security and another one that describes the features that they must obtain information on. A copy of the one-page signed disclosure must be kept in the client file.

31.9 MSRB Rule G-18: Execution of Transactions

The Municipal Principal and Registered Representatives will ensure that when executing trades, a reasonable effort will be made to obtain a price that is fair and reasonable.

All Municipal Bonds placed online through our clearing firm or executed with other dealers on the street. Our OMS system will maintain how many bids were obtained and will execute to the highest bidder. If the Firm is selling bonds through the Trading Desk, the trader will obtain at least three bids and reviews the EMMA online system before execution to ensure the customer is getting best execution.

31.10 MSRB Rule G-19: Suitability and Recommendations of Transactions

Upon the opening of each new customer account, the Firm is required to obtain certain information to determine suitability of the customer. The Firm's Registered Representatives must have a reasonable basis for making municipal security recommendations to customers.

The Registered Representative is responsible for ensuring the customer has completed the new account application and obtaining all required information such as the:

- Customer's name
- Address
- Occupation
- Whether he/she is employed by another broker/dealer
- Date of birth
- Financial status
- Tax bracket
- Investment objectives
- Risk tolerance; and
- Any other information that is considered useful for the Firm or the Registered Representative to make a recommendation to a customer.

The Registered Representative will send the account application to their Designated Principal or Municipal Principal for review and approval.

The Municipal Securities Principal is responsible for reviewing all municipal security transactions. On a daily basis, the Municipal Principal reviews the Firm's "Daily Trade blotter" for all municipal trades done to ensure all trades are suitable, done correctly and reviews for markups/markdowns/commissions charged. The Municipal Principal evidences review of the blotter and any exceptions noted on the Daily Review Log.

31.11 MSRB Rule G-20: Gifts and Gratuities

No employee shall give anything in service or value, including gratuities, in excess of $100 per year to a person (other than an employee or partner of the Firm) if such payment is in relation to the employer's municipal securities activities. It is permissible to provide occasional gifts of meals or tickets to theatrical or sporting events that the IRS would recognize as deductible business expenses as long as the gifts are not frequent or expensive. All gifts and gratuities are to be recorded on a "Gift and Gratuity" log to be reviewed and approved by the Municipal Principal on a quarterly basis. Gifts and Gratuities include any Sales Contests related to Municipal Securities.

31.12 MSRB Rule G-21: Advertising

The Municipal Principal shall pre-approve all advertisements prior to use and all municipal securities correspondence will be reviewed by the Municipal Principal. All advertising related material will be submitted to FINRA if required and all approvals will be maintained in the Advertising File.

31.13 MSRB Rule G-27: Supervision

The Municipal Securities Principal is responsible for the overall supervision of the Firm's municipal securities business. The Municipal Principal will supervise the conduct of municipal activities by employees, as well as assist the CCO in reviewing and updating the Firm's written supervisory procedures as necessary. Any required amendments and/or updates are to be communicated to the Chief Compliance Officer.

A Municipal Securities Principal will be located in each OSJ branch office which engages in any of the following municipal securities activities:

- Order execution and/or market making with respect to municipal securities
- Structuring of public offerings or private placements of municipal securities
- Maintaining custody of customers' funds and/or municipal securities

- Final acceptance (approval) of new accounts holding municipal securities on behalf of the dealer
- Review and endorsement of customer orders of municipal securities
- Final approval of advertising of municipal securities for use by persons associated with the dealer
- Responsibility for supervising the municipal securities activities of persons associated with the dealer at one or more other municipal branch offices of the dealer

Annual Compliance Meeting

In accordance with Rule G-27 and NASD Rule 3010, each Registered Representative and Registered Principal that engage in Municipal Securities will be required to attend an annual compliance meeting and records will be maintained of the Representative's attendance.

Supervisory Controls

The supervisory control rule amendment under Rule G-27 parallels NASD Supervisory Control Rule 3012. On an annual basis, the firm will perform an annual review of its supervisory system and prepare an annual report to submit to senior management of the firm. Additionally, a monthly calculation will be prepared to identify any producing managers who may account for 20% or more of the firm's overall revenue; which may require heightened supervision. All required documentation will be maintained in accordance with FINRA and MSRB rules.

Assignment of Registered Persons and Qualified Individuals

The Designated Principal is responsible for ensuring all Registered Persons and Principals are properly registered to sell municipal securities and that each Registered Person is assigned to a Registered Principal.

Mandatory Branch Office Inspections & Required Content in Branch Inspections

The mandatory branch office inspection requirement parallels NASD Rule 3010. The firm will ensure that each OSJ office is reviewed annually and non-OSJ locations are reviewed at least every three years and in conjunction with the branch office schedule. All required content will be maintained in each branch office inspection report as defined in G-27 and NASD Rule 3010.

31.14 MSRB Rule G-28: Transactions with Associated Persons of Other Municipal Securities Professionals

In accordance with Rule G-28, an individual who is employed with a broker/dealer is permitted to open an account at another municipal securities firm. If the Firm opens or maintains a municipal securities account for a customer who is employed by another municipal securities firm, we will give a written notice to the customer's employer. The same procedure will be followed if we open an account for the spouse or minor child of an employee of another broker/dealer. Once the account is opened, we will send the customer's employer duplicate confirmations, and abide by any written instructions received from the customer's employer.

31.15 MSRB Rule G-29: Availability of Board Rules

A copy of the MSRB Rules will be kept in each office and made promptly available for customer examination upon request. The board rules will either be kept in a hard copy paperback rulebook, or an electronic link to the MSRB's web page at: http://www.msrb.org

31.16 MSRB Rule G-30: Price and Commissions/Markups

MSRB Rule G-30 states when a customer is charged a markup/markdown, not only does it have to be fair and reasonable, but the amount charged must be justifiable based on relevant market conditions. FINRA's 5% guideline only applies to equity transactions, and does not apply to municipal securities. FINRA and MSRB have given guidance that markups/markdowns on debt transactions should use a 3% guideline and any markup/markdown above and beyond that figure must be documented.

The overall responsibility for determining that markups are fair and reasonable rests with the Municipal Principal. The Municipal Principal reviews the Firm's Daily Trade blotter to ensure all markups/markdowns charged to customers are within the Firm's guidelines and are fair and reasonable. The following criteria should be taken into consideration by all Registered Representatives when determining the fairness and reasonableness of a markup/markdown:

- The nature and extent of services provided by the dealer. If we have provided special services to a customer in connection with a transaction, a somewhat higher markup/markdown may be justified. The fact that a trade was a "hard sell" does not justify additional compensation if no real additional service was provided;
- Block trade;

- Existence of a sinking fund;
- The rating of the security;
- Availability of the security in the market. In the case of an inactive security, the effort and cost of buying the security or any other unusual circumstances connected with the transaction may justify a higher markup/markdown. Likewise, transactions for highly liquid securities, with no other unusual circumstances connected to the transactions would have a lower markup/markdown;
- Total dollar amount and price of the transaction;
- Length of Maturity. If all other relevant factors are similar, bonds with a longer length to maturity may justify a higher markup/markdown than bonds with a shorter length to maturity;
- Rating and call features of the security;
- The dealer's best judgment as to the fair market value at the time of the transaction and the fair market value of any securities exchanged or traded in connection with the transaction;
- The yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size available in the market.

No registered representative may charge a markup or markdown that exceeds the Firm's established guidelines, nor should a markup/markdown be charged on a trade in which there is no reasonable basis for the markup/markdown. Under extenuating circumstances, a request to exceed the Firm's guidelines may be made. The request must be made in writing to the Municipal Principal prior to the transaction and include an explanation of the factors that would justify the additional markup or markdown. Documentation of the transaction approval must be retained with the trade and be immediately available upon request by the Compliance Department staff or a regulatory authority.

Commission Policy

MSRB Rule G-18 specifically indicates that "a dealer effecting a transaction on an agency transaction on behalf of a customer must undertake a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions."

When determining if the price on an agency transaction may be deemed fair and reasonable one should consider the following factors:

- The availability of the securities involved in the transaction;
- The expense of executing or filling the customer's order;
- The value of the services rendered by the dealer; and
- The amount of any other compensation received or to be received by the dealer in connection with the transaction.

It is the responsibility of the Municipal Principal to ensure that the Firm's agency transactions are at prices that are fair and equitable to customers. The Municipal Principal will review the Firm's Daily Trade blotter to ensure all transactions are in compliance with the Firm's commission guideline. The Municipal Principal will document review on the daily review log. All commissions exceeding the Firm's guidelines must be pre-approved by the Municipal Principal, and be accompanied with an explanation explaining the factors that would justify the commission charged. This documentation must be retained with the trade and be immediately available if requested by Compliance or any regulatory authority.

Error Accounts

Error accounts are used for customer accounts in which errors have occurred during the trading day. All accounts with errors should be resolved by the end of the trade day and no positions should remain in the error account overnight. Such errors are to be properly documented for an approval by a Supervisor on a cancel and re-bill or error report. Any cancel and re-bills will also be listed on the cancel and re-bill report for review and approval by the designated principal.

31.17 MSRB Rule G-37/G-38: Political Contributions/Consultants

The MSRB has promulgated Rule (G-37) for the purpose of prohibiting the practice of using political contributions as a means of improperly influencing a political candidate or official who may, directly or indirectly, be in a position to influence municipal securities issuers in granting contracts for negotiated underwriting and other related services. The purpose of this rule is to stop such practices in order to maintain investor confidence in the market and to make the issuance of municipal bonds more economically beneficial to issuers and more profitable for the underwriting community. This regulation affects municipal finance professionals, their supervisors, and anyone else involved in obtaining municipal finance business for the Firm or anyone who engages in municipal bond issuance and their affiliates.

MSRB Rule G-37 does permit firms to file Form G-37x if they do not engage in a municipal securities business as defined by the rule. Form G-37x requires the Firm to make a one-time filing with the MSRB attesting that the dealer has not engaged in a municipal securities business as defined by the rules during the eight full consecutive calendar quarters ending immediately on or prior to the date on the form.

The Firm has filed Form G-37x indicating we are not an underwriter of municipal securities nor do we speak directly to "issuers," and we are therefore exempt unless our underwriting status changes in the future.

31.18 MSRB Rule G-40: Contact Information

The Municipal Principal shall be responsible for updating the MSRB with the information contained on Form G-40, which can be obtained on the MSRB's website (http://www.msrb.org/msrb1/rulesandforms/forms/FormG-40.pdf).

31.19 SEC Rule 15c2-12-Material Event Disclosure in the Secondary Market

In January 1996, Amendment to Rule 15c2-12 Regarding Disclosure in the Secondary Market made it unlawful for any broker or dealer to recommend the sale or repurchase of a municipal security unless they have procedures in place that provide a reasonable assurance of prompt notice of any material event disclosed pursuant with the issuer's undertaking. Material events include rating changes, defeasances, bond calls, and unscheduled draws on reserves that reflect financial difficulties, nonpayment-related defaults, and principal and interest payment delinquencies.

The Municipal Principal should conduct ongoing research regarding all significant and material events affecting municipalities that are recommended to clients. Such information should be communicated in a timely fashion to the respective clients.

At the branch office level, the Registered Representative is responsible for reviewing the EMMA system (available at www.msrb.org) for material events, recent pricing and historical financial information. This review is required prior to any execution of a municipal security regardless of buying or selling. The Registered Representative is responsible for communicating the information to respective clients in a timely fashion.

31.20 New Hires – Apprentice Municipal Representatives

All newly licensed securities representatives are not permitted to function in a representative capacity without fulfilling the apprenticeship period, which lasts no less than 90 days. During this period, the Municipal Principal is responsible for training this

person, and for independently evaluating his/her skill set to determine if additional training is required. All training is to be documented in the Firm's training file. The Firm acknowledges that prior experience, of at least 90 days, as a general securities representative, limited representative in government securities will meet the requirements of such apprenticeship. The Municipal Securities Principal is responsible for the oversight of each newly hired Registered Representative during the apprenticeship period, for ensuring all requirements of the apprenticeship are met, and for maintaining documentation of successful completion of the apprenticeship in the Firm's files.

31.21 Prohibited Activities

The Firm does not engage in any of the following activities:

- Control relationships (Rule G-22)
- Use of consultants or financial advisors (Rule G-23 and G-38),
- Use of information obtained in a fiduciary capacity (Rule G-24).
- Reciprocal dealings with municipal securities and investment companies (Rule G-31).

32. 529 PLANS

529 Plans were named after the section of the federal tax code that governs them, and are financial products designed to help parents and others invest for higher education by offering an opportunity to obtain tax-free growth and distribution of the money that save and invest for college costs. Almost every state offers at least one 529 plan, and the tax advantages, investment options, restrictions, and fees can vary. Each 529 plan represents in pools of securities such as securities issued by registered investment companies, and fall under the regulatory oversight of the Municipal Securities Rulemaking Board (MSRB). Over the next few years even more choices may become available, as many colleges will be able to offer 529 plans directly to clients.

32.1 Two Types of 529 Plans

There are two types of 529 plans - Prepaid Tuition Plans and College Savings Plans. Every state offers at least one of these types of plans or is developing one. Some states offer both and many of these plans are open to non-residents. Since the firm can only offer the College Savings Plans, this bulletin will restrict its discussion to those plans. As there are so many choices with just as many features as there are plans, an investment advisor must ensure he/she is completely familiar with the 529 College Savings Plan or plans he/she wishes to offer.

Some points to consider:

- Investment time horizon
- Share Class
- Covered education expenses
- Contribution limits
- Investment options
- Investment risk
- Plan beneficiary
- Fees, charges and expenses of the plan and its investment(s)
- Enrollment fee for the plan
- Annual maintenance fee of the plan
- Administration/Management Fees and other underlying investment expenses (Expense Ratio)
- Sales charges

- Tax/Legal issues
- Federal and potential state tax benefits
- Deductibility of contributions on state tax returns
- Estate planning uses
- Interaction with other savings and tax credit programs such as
- Hope Credit
- Lifetime Learning Credit
- Coverdale Education Savings Accounts
- UGMA/UTMA

While the above list is not complete, it should be considered as an essential starting point of discussion for you and your prospective client.

32.2 Offering Statement

Each Registered Representative is responsible for discussing the 529 plan with the client as well as providing each client with a copy of the prospectus (or marketing materials regarding the fund; if the prospectus is mailed to the customer by the Fund company.) The Registered Representative is responsible for discussing the plan such as the cost/return, expenses covered by the plan, investment options, and risk of investing in the plan.

32.3 Registration and Qualification

In accordance with MSRB Rules A-12, A-14 and G-3 regarding registration and qualification, it is the responsibility of the Municipal Principal to ensure all persons who sell 529 plans are properly registered.

32.4 Advertising & Sales Material for Municipal Fund Securities

Municipal fund securities (529 Plans) are municipal securities regulated by the Municipal Securities Rulemaking Board, sales material for municipal fund securities must comply with MSRB Rules G-17 and G-21, as well as all other applicable MSRB rules. The Municipal Principal is responsible for reviewing and approving all advertising and sales literature and keeping a copy in the firm's files. The Municipal Principal is responsible for submitting any of the 529 material to FINRA Advertising for review if required.

32.5 New 529 Account Procedures

- In order to comply with suitability and books and records obligations, the client must fill out a new account application (unless the client already is a customer of the firm), the 529 plan application with the fund company, and the 529 Plan Out-of-State Disclosure Form (if an out-of-state plan is purchased). In the event that the 529 is the client's only investment, the client must still complete a new account application containing required client information. In addition, individual accounts must be opened and new account forms must be completed for each participant in a Group Plan.
- The 529 account application is reviewed and approved by the Municipal Principal or other qualified designated supervisor upon account opening to ensure the investment is suitable.
- Remember that our Firm does not offer tax or legal advice beyond the general overall characteristics of the investment plan. Please refer your client to their tax or legal advisor prior to taking any action that may have tax consequences.
- 529 Disclosure Form - In light of the potential tax consequences of purchasing a 529 college savings plan by a non-resident of the state sponsored plan, the Firm's 529 Disclosure Form must be signed by clients who are purchasing a plan which is not the resident state plan for the client or beneficiary of the plan. You may also wish to consult the websites for the state 529 Plan you plan to offer for more information regarding tax issues. The 529 College Savings Plan has many potential benefits as well as potential risks. You must be aware of them BEFORE offering this product to your clients and prospects.
- Exceptions would include: missing documentation (in particular, the 529 out of state disclosure form for 529 plan accounts outside the resident state); Cash flow (to detect if frequent withdrawals are taking places); Suitability (in light of the documented investment objectives).

32.6 Expense Analyzer

529 college savings plans have fees and expenses that are paid by investors. Because these fees and expenses can vary widely from plan to plan, FINRA has developed a 529 Expense Analyzer for use by Broker/Dealers and their Registered Representatives. This tool is designed to help customers compare the fees and expenses associated with the various 529 college savings plans and how they can reduce returns. The analyzer is designed to work with most college savings plans. It is not intended for prepaid tuition plans or the CollegeSure® CD investment option available in some college savings plans.

Registered Representatives must perform an analysis utilizing the FINRA 529 Expense Analyzer or similar tool to compare approved products to assist in determining the suitability of the proposed sales transaction. During such analysis, the Registered Representative must specify certain transaction information, including, but not limited to, investment amount, estimated return, estimated fees/expenses and holding period. Lastly, Registered Representative must maintain a copy of the Fund Analyzer in the applicable client file and submitting the original to the Municipal Principal or qualified supervisor for review along with the remaining account opening documentation.

32.7 Supervisory Approval

The Municipal Securities Principal or qualified supervisor will review and pre-approve all 529 plans. Such approval is documented on the 529 application. The Firm also requires the appropriate documentation from our A, B or C share packages. The Principal will also require a switch form is a switch from one 529 plan to another is done.

If the client is buying C shares, these should only be purchased for adolescents because not all C shares automatically covert to A shares after a specified holding period.

In connection with CAPTRUST investment advisory clients establishing 529 plan accounts under an investment advisory agreement , the financial advisor should thoroughly discuss with the client the various share classes available to be paired with a fee-based advisory agreement and document such discussion in the client's file. For example, f class

33. Collateralized Mortgage Obligations

For purposes of the following guidelines, the term "collateralized mortgage obligation" (CMO) refers to a multi-class debt instrument backed by a pool of mortgage pass-through securities or mortgage loans, including real estate mortgage investment conduits (REMICs) as defined in the Tax Reform Act of 1986.

33.1 Supervisory Responsibilities

- It is mandatory to deliver training prior to engage in any discussions with clients about CMOs.
- Review a copy of all outgoing correspondence dealing with the solicitation of CMO transactions.
- Verify that the product is referred to as “collateralized mortgage obligation”, not just the proprietary name for the CMO.
- Verify that the CMO is not compared to any other product, including CDs.
- Verify that the there is an offer to provide educational material on CMO’s.
- Verify that the communication does not indicate that the anticipated yield and average life of a CMO are assured.
- Ensure compliance with all items contained on this document.
- The Designated Principal is responsible for evidencing all required disclosure and educational materials in the respective client’s file.

33.2 Disclosure Standards and Required Educational Material

All advertisements, sales literature and correspondence concerning CMOs:

- Must include within the name of the product the term "Collateralized Mortgage Obligation";
- May not compare CMOs to any other investment vehicle, including a bank certificate of deposit;
- Must disclose, as applicable, that a government agency backing applies only to the face value of the CMO and not to any premium paid; and
- Must disclose that a CMO's yield and average life will fluctuate depending on the actual rate at which mortgage holders prepay the mortgages underlying the CMO and changes in current interest rates.

- Must be approved by the Designated Principal and maintained in the respective file.

33.3 Required Educational Material

Before the sale of a CMO to any person other than an institutional investor, a member must offer to the customer educational material that includes the following:

- Characteristics and risks of CMOs including credit quality, prepayment rates and average lives, interest rates (including their effect on value and prepayment rates), tax considerations, minimum investments, transaction costs and liquidity;
- The structure of a CMO, including the various types of tranches that may be issued and the rights and risks pertaining to each (including the fact that two CMOs with the same underlying collateral may be prepaid at different rates and may have different price volatility); and
- The relationship between mortgage loans and mortgage securities;
- Questions an investor should ask before investing; and
- A glossary of terms.

33.4 Promotion of Specific CMOs

In addition to the standards set forth above, advertisements, sales literature and correspondence that promote a specific security or contain yield information must conform to the standards set forth below. An example of a compliant communication appears at the end of this section.

The advertisement, sales literature or correspondence must present the following disclosure sections with equal prominence. The information in Sections 1 and 2 must be included. The information in Section 3 is optional; therefore, the member may elect to include any, all or none of this information. The information in Section 4 may be tailored to the member's preferred signature.

Section 1 - Title — Collateralized Mortgage Obligations

- Coupon Rate
- Anticipated Yield/Average Life
- Specific Tranche — Number & Class
- Final Maturity Date
- Underlying Collateral

Section 2 - Disclosure Statement:

"The yield and average life shown above consider prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions."

Section 3 - Product Features (Optional):

- Minimum Denominations
- Rating Disclosure
- Agency/Government Backing
- Income Payment Structure
- Generic Description of Tranche (e.g., PAC, Companion)
- Yield to Maturity of CMOs Offered at Par

Section 4 - Company Information:

- Name, Memberships
- Address
- Telephone Number
- Representative's Name

Additional Conditions

The following conditions must also be met:

(A) All figures in Section 1 must be in equal type size.

(B) The disclosure language in Section 2 may not be altered and must be given equal prominence with the information in Section 1.

(C) The prepayment assumption used to determine the yield and average life must either be obtained from a nationally recognized service or the member firm must be able to justify the assumption used. A copy of either the service's listing for the CMO or the firm's justification must be attached to the copy of the communication that is maintained in the firm's advertising files in order to verify that the prepayment scenario is reasonable.

(D) Any sales charge that the member intends to impose must be reflected in the anticipated yield.

(E) The communication must include language stating that the security is "offered subject to prior sale and price change." This language may be included in any one of the four sections.

(F) If the security is an accrual bond that does not currently distribute principal and interest payments, then Section 1 must include this information.

33.5 Radio/Television Advertisements

The firm will not utilize radio or television to advertise CMOs.

33.6 Standardized CMO Communication Example

Collateralized Mortgage Obligations

- 7.50% Coupon
- 7.75% Anticipated Yield to 22-Year Average Life
- FNMA 9532X, Final Maturity March 2023
- Collateral 100% FNMA 7.50%

The yield and average life shown above reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions.

All CMO transactions will be reviewed by a Designated Principal on the daily trade blotter/Daily review log.

34. Certificates of Deposit

A Certificate of Deposit ("CD") is a special type of deposit account with a bank or thrift institution that typically offers a higher rate of interest than a regular savings account. Unlike other investments, CDs feature federal deposit insurance up to $100,000. Investors searching for relatively low-risk investments that can easily be converted into cash often turn to certificates of deposit (CDs).

Although most investors have traditionally purchased CDs through local banks, many brokerage firms now offer CDs. Brokerage Firms that offer CD's can sometimes negotiate a higher rate of interest for a CD by promising to bring a certain amount of deposits to the institution. The brokerage firm can then offer these "brokered CDs" to their customers. There are many different types of CD's available to customer such as variable rate CDs, long-term CDs, and CDs with other special features.

The Registered Representative is responsible for knowing the different types of CD's available to customers, and the features and risks of each of them. Upon recommending a CD to a customer, the Registered Representative should explain all the features, risks, interest rates, and the maturity of the CD with the customer prior to purchasing. The following areas are examples of features and risks the Registered Representative should discuss with the customer:

- **Maturity of the CD** – Make sure the customer is aware of the maturity date for the CD to ensure they understand their money is tied up for one, five, ten, or even twenty years.
- **Call Features** – Disclose to the customer if the CD they are purchasing has any call features. The call features give the issuing bank the right to terminate-or "call"-the CD after a set period of time. If interest rates fall, the issuing bank might call the CD. In that case, the customer should receive the full amount of their original deposit plus any unpaid accrued interest. If interest rates rise, the customer will be stuck in a long-term CD paying below-market rates. In that case, if the customer wants to cash out, they will lose some of their principal.
- **Disclose To the Customer the Difference Between Call Features and Maturity** – A customer should understand that a "federally insured one-year non-callable" CD matures in one year. It doesn't. These words mean the bank cannot redeem the CD during the first year, but they have nothing to do with the CD's maturity date. A "one-year non-callable" CD may still have a maturity date 15 or 20 years in the future. Explain to the customer the CD's call features and confirm when it matures.
- **Identify the Issuer For Brokered CDs**– Because federal deposit insurance is limited to a total aggregate amount of $100,000 for each depositor in each bank

or thrift institution, it is very important that the customer knows which bank or thrift issued their CD.

- **Disclose How the CD Is Held** – Unlike traditional bank CDs, brokered CDs are sometimes held by a group of unrelated investors. Instead of owning the entire CD, each investor owns a piece. Explain to the customer how their CD is held, and be sure to provide a copy of the exact title of the CD. Make sure the account records reflect that the Firm is merely acting as an agent for the customer and the other owners. (for example, "XYZ Brokerage as Custodian for Customers"). This will ensure that the portion of the CD qualifies for up to $100,000 of FDIC coverage.
- **Disclose if Any Penalties for Early Withdrawal** – Disclose to the customer how much they will have to pay if they cash in the CD before maturity and whether they risk losing any portion of their principal. If the customer is the sole owner of a brokered CD, they may be able to pay an early withdrawal penalty to the bank that issued the CD to get their money back. But if they share the CD with other customers, the Firm will have to find a buyer for their portion. If interest rates have fallen since they purchased their CD and the bank hasn't called it, the Firm may be able to sell their portion for a profit. But if interest rates have risen, there may be less demand for their lower-yielding CD. That means the customer would have to sell the CD at a discount and lose some of their original deposit –despite no "penalty" for early withdrawal.
- **Confirm the Interest Rate They Will Receive and How They Will Be Paid** – The customer should receive a disclosure document that tells them the interest rate on the CD and whether the rate is fixed or variable. Be sure to disclose how often the bank pays interest – for example, monthly or semi-annually. Explain to the customer how they'll be paid – for example, by check or by an electronic transfer of funds.
- **Inform the Customer Whether the Interest Rate Ever Changes** – If the customer is considering investing in a variable-rate CD, make sure they understand when and how the rate can change. Some variable-rate CDs feature a "multi-step" or "bonus rate" structure in which interest rates increase or decrease over time according to a pre-set schedule. Other variable-rate CDs pay interest rates that track the performance of a specified market index, such as the S&P 500 or the Dow Jones Industrial Average.

34.1 Suitability

Prior to recommending a CD to a customer, the Registered Representative should ensure that all account paperwork to purchase the CD is obtained and have a reasonable basis for determining the CD is suitable for the customer. The Representative should pay close attention to the customer's tax status, financial

information such as annual income and net worth, investment objective and time horizon.

34.2 Supervisory Approval

A Designated Principal is responsible for reviewing and approving the CD purchased by the customer to ensure the investment was suitable. The Designated Principal will review the daily trade blotter and evidence approval on the daily review log.

35. Structured Products

These procedures are designed to set forth the firm's obligations when selling structured products, including the requirement to: (1) provide balanced disclosure in promotional efforts; (2) ascertain accounts eligible to purchase structured products; (3) deal fairly with customers with regard to derivative products; (4) perform a reasonable-basis suitability determination; (5) perform a customer-specific suitability determination; (6) supervise and maintain a supervisory control system; and (7) train associated persons.

Structured products are securities derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance, and/or a foreign currency. There are many types of structured products. Some structured products offer full protection of the principal invested, whereas others offer limited or no protection of the principal. Most structured products pay an interest or coupon rate substantially greater than the prevailing market rate. Structured products also frequently cap or limit the upside return on the underlying reference asset, particularly if some principal protection is offered or if the security pays an above-market rate of interest.

Structured products, which are typically issued by investment banks or their affiliates, have a fixed maturity. Some, but not all, structured products may be listed on a national securities exchange. Moreover, even those structured products listed on a national securities exchange may be very thinly traded.

Structured products typically have two components—a note and a derivative (often an option). The note component pays interest to the investor at a specified rate and interval. The derivative component establishes the payment at maturity. Despite their derivative components, structured products are often *incorrectly* marketed to investors as debt securities.

35.1 Regulatory Requirement

The firm adheres to all NASD rules applicable to activities involving structured products, including Rules 2110 (Standards of Commercial Honor and Principles of Trade), 2210 (Communications with the Public), 2310 (Recommendations to Customers), 2720 (Distribution of Securities of Members and Affiliates—Conflicts of Interest), 3010 (Supervision), and 3012 (Supervisory Control Systems). The application of these rules as they pertain to the firm's structured products activities is discussed in detail below.

35.2 Promotion of Structured Products

The firm approves and monitors all sale materials and oral presentations used to market structured products. The Compliance Department is responsible not only for approving the marketing materials, but also for overseeing the due diligence review. (Any qualified party may conduct due diligence, but the Compliance Department must confirm its completion before approving marketing materials.) The firm maintains a list of approved structured products. *Registered personnel are prohibited from using marketing materials not approved by the Compliance Department.*

Pursuant to Rule 2210, all sales materials and oral presentations regarding structured products must present a fair and balanced picture regarding both the risks and the benefits. For example, marketing materials should not portray structured products as "conservative" or a source of "predictable current income" unless such statements are accurate, fair, and balanced. The firm requires that any supplemental sales materials contain all risk disclosures found in the preliminary and final prospectus supplements. Additionally, the firm prohibits exaggerated statements and the omission of any material fact or qualification that would cause a communication to be misleading.

When promoting structured products, the firm adheres to a policy of disclosing all associated risks, which may include a loss of principal and the possibility that at expiration the investor will own the reference asset at a depressed price. Sales materials and oral presentations should include a description of the product's derivative component and mention any limit on the upside return on the underlying reference asset. *Structured products are not to be presented as ordinary debt securities.* In addition, a statement that a structured product has a ticker symbol or has been approved for listing on an exchange must be balanced with the risk that an active and liquid trading market may never develop. *Providing risk disclosure in a prospectus supplement will not cure otherwise deficient disclosure in sales material, even if such material is accompanied or preceded by the prospectus supplement.*

In some cases, structured products are assigned credit ratings by nationally recognized statistical rating organizations. These credit ratings typically pertain to the credit worthiness of the issuer (*i.e.,* the ability of the issuer to meet its obligations under the terms of the structured product) and are not indicative of the market risk associated with the structured product. The firm prohibits the presentation of a credit rating for a structured product if it is presented in such a way that the investor is misled into believing that the rating pertains to the safety of the principal invested. When presenting a credit rating, the firm shall address the fact that the creditworthiness of the issuer does not affect or enhance the likely performance of the investment other than the ability of the issuer to meet its obligations.

35.3 Eligible Accounts

Approved Accounts

The firm generally limits the purchase of structured products to investors having accounts approved for options trading, since many structured products (particularly those in which principal is at risk from market movements in the reference security) have risk profiles similar to those of options. This investor safeguard should not be construed has an absolute prohibition against the purchase of structured products by investors not having accounts approved for options trading. However, an investor without an options account may not purchase a structured product until after the firm has determined that the risk of such product is appropriate. The firm's basis for making such a suitability determination should be documented and maintained on file. As an additional matter, the approval of an account to purchase structured products is not a substitute for a thorough suitability analysis. *Not every structured product will be suitable for every account approved to trade structured products.*

Discretionary Accounts

The firm, although not currently using discretionary accounts, is aware of the potential for conflicts of interest. The firm shall comply with Rule 2720 (Distribution of Securities of Member and Affiliates—Conflicts of Interest) in the event that it sells structured products issued by itself or an affiliate to discretionary accounts. The firm is particularly cognizant of paragraph (I) (Discretionary Accounts), which provides that "a transaction in securities issued by a member or an affiliate of a member, or by a company with which a member has a conflict of interest shall not be executed by any member in a discretionary account without prior specific written approval of the customer." In adherence to this rule, the firm shall ensure that it requests and obtains the necessary written approval of the customer if it purchases structured products in a discretionary account. *Register personnel must disclose all conflicts of interest to the Compliance Department.*

35.4 Suitability

Reasonable Basis Suitability

The firm has an obligation to perform a reasonable basis suitability determination before recommending a structured product to investors. A reasonable basis suitability determination is necessary to ensure that a structured product is suitable for *some* investors (as opposed to the customer-specific suitability determination, which is made on an investor-by-investor basis). To fulfill its reasonable basis suitability obligation, the

firm must perform appropriate due diligence to ensure that it understands the nature of the product, as well as the potential risks and rewards.

The firm considers whether an investment in a structured product meets the reasonable basis suitability standard if the instrument is priced such that the potential yield is not an appropriate rate of return in relation to the volatility of the reference asset based upon comparable or similar investments, in terms of structure, volatility, and risk in the market as determined at the time the structured product is issued. For example, similar structured products based on reference securities that possess substantially similar volatility characteristics, but which offer materially different rates of return in the note component, would call into question whether the instrument with the lower yield meets the reasonable basis suitability standard. While an exact risk/reward calibration among different instruments or investments may not be possible, the firm exercises its market expertise to recognize those situations where the materiality of difference is not in doubt and, consequently, to identify that the lower yielding instrument does not represent a reasonable rate of return given the attendant risks as compared to other similarly composed products or direct investments in the underlying components of such products with similar risk/reward attributes.

Customer Specific Suitability

The firm also determines if a recommendation to purchase a structured product is suitable for a particular investor. Pursuant to Rule 2310, the firm ensures that a recommendation is suitable for a specific customer by examining (1) the customer's financial status, (2) the customer's tax status, (3) the customer's investment objectives, and (4) such other information used or considered to be reasonable by the firm or the registered representative in making recommendations to the customer.

The derivative component of structured products and the potential loss of the principal for many such products may make them unsuitable for investors seeking alternatives to debt securities. While structured products pay interest like debt securities, they often exhibit very different profit and loss potential. The profit and loss potential of many structured products is more akin to an option contract, particularly those where principal invested is at risk from market movements in the reference security. For such products, register representatives should consider whether the customer meets the suitability requirements for options trading. In particular, Rule 2860(b)(19)(B) requires that "no member or person associated with a member shall recommend to a customer an opening transaction in any option contract unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has *such knowledge and experience* in financial matters that he may reasonably be expected to *be capable of evaluating the risks* of the

recommended transaction, and is financially able to bear the risks of the recommended position in the option contract" (emphases added).

The firm does not make generalized conclusions about the suitability of a structured product based on the suitability of an investment in the reference asset. Registered representatives should not assume that if an investment in the reference asset is suitable, then an investment in a structured product pertaining to such reference asset also must be suitable. Moreover, registered representatives should not assume that if an investment in the structured product is suitable, then so too is an investment in the reference asset. Structured products may have very different risk-reward profiles than their reference assets. *Suitability must be determined on an investor-by-investor basis, with reference to the specific facts and circumstances of each investor.*

35.5 Training

The firm trains registered personnel about the characteristics, risks, and rewards of each structured product before allowing them to sell that product to investors. In connection with such training, the firm educates registered persons about the factors that would make such products either suitable or unsuitable for certain investors. Training is focused not only on the representatives selling structured products, but also on the supervisors of these representatives.

The firm's training emphasizes that, due to the unique nature of structured products, many investors, especially retail investors, may not understand the features of these products, and may not fully appreciate the associate risks of these investments. Furthermore, in light of the fact that investors may be turning to these products as an alternative to traditional equity and fixed income investment, the firm ensures that each registered person has a full and balanced understanding regarding both the risks and the rewards of these products. All formal training should be documented and maintained on file.

36. HEDGE FUNDS

36.1 Marketing and Advertising

General advertising and solicitation of Hedge Funds are not permitted. Reference to specific Hedge Funds must not be made in any advertising or public forums. All communications and marketing materials sent to prospective and existing clients must be pre-approved by the Designated Principal (DP). All pre-approved materials must be submitted for approval with a Marketing Approval Form.

The DP must supervise the sales efforts and ensure that Registered Persons refrain from making representations about the Hedge Fund and/or Fund of Funds other than as set forth in the offering memorandum.

The Registered Representative must document the accreditation (status) and pre-existing relationship ("Pre-Qualify"), in the client file. The Designated Principal must review such documentation and ensure that all prospective client(s) fall within the accreditation guidelines (which is disclosed in the respective Private Placement Memorandum or "PPM"). The Designated Principal is to ensure that all prospective investors are pre-qualified.

Additionally, the following procedures apply, if applicable:

- RR shall provide prospective investors (at the time of any solicitation activities) with a current copy of Hedge Fund's PPM;
- The RR shall not utilize any literature or marketing material regarding Hedge Funds without the prior written approval;
- The RR shall not hold itself out as having any relationship with Hedge Fund, it's Advisor or any of its affiliated entities or persons other than as an independent contractor to solicit prospective investors for the Hedge Fund, and shall not hold itself out as an expert regarding investment strategies and philosophies of Hedge Fund, Its Advisor or any affiliated entity or person;

36.2 Delivery of Communications

All communications (including Advertising, Sales Literature, and Correspondence) must be sent through one of the approved venues of communication (see Communications Agreement). See Communications Procedures for further information on communications with the public.

36.3 Disclosures

Any offerings of private placements that are done through marketing and/or sales literature must include approved disclosures. Such disclosures must include a summary of the pertinent risks.

36.4 Prohibition on Using Related Performance Information

The firm nor any of its Associated Persons can publish or distribute sales material for a hedge fund that presents "related" performance date, a category that includes the performance of another fund or account run by the same manager. The use of theoretical or backdated performance data is also banned. All Performance Data must be reviewed and approved by the Designated Principal. The Designated Principal must pre-approve all Performance Data prior to distribution.

36.5 Use of Related Performance Information in Sales Material for Private Equity Funds and Other Similar Funds

In particular, FINRA staff recognizes that the presentation of related performance information with respect to an unregistered private fund (including an unregistered private hedge fund) that is excluded from the definition of "investment company" under Section 3(c)(7) of the 1940 Act does not present the same investor protection concerns as the presentation of related performance information with respect to the sale of mutual fund shares. Accordingly, as a general matter, the FINRA staff would not object if a member includes related performance information in sales material for Section 3(c)(7) funds, provided that the member ensures that all recipients of such sales material are "qualified purchasers" under Section 2(a)(51) of the 1940 Act. Communications with the public may not predict or project performance, imply that past performance will recur or make any unwarranted claim, opinion or forecast.

36.6 Suitability

The Designated Principal shall ensure that all prospected investors fall within the accredited guidelines as stated in the Offering Memorandum for each respective Fund. It shall be the firm's policy to pre-qualify all prospective investors.

36.7 Documentation of Accredibility and Relationship

Prior to marketing private placement, RR must document that the Private Placement is suitable to the prospective investor. This may be done upon the Investor [Profile] Forms included the subscription package and must be submitted to the Designated Principal for approval.

Point of Sale

Prior to selling Hedge Funds and/or FOFs, a Subscription Document must be completed. The client must sign this Document followed by approval by the Designated Principal, which shall be documented by signature on the Subscription Document. Any exemptions to the Accredited Investor Guidelines are to be pre-approved by the Designated Principal.

Delivery of PPM to Limited Partners

The Registered Representative of record is responsible for delivering all fund disclosure documents (including PPM).

Offering of PPM

In accordance with the PPM, the PPM is to be offered only to qualified investors. Any offering of securities shall be made with a PPM that is distributed to the prospective investor.

36.8 Maintenance of Books and Records – Client Files

The firm must maintain the following documents in the respective client and/or prospective client files:

- Subscription Documents;
- Suitability Documentation
- New Account Form(s)

36.9 Maintenance of Books and Records

- Copy of all Offering Memorandums;
- Copies of all pre-approved Sales and Marketing Documents;
- Selling Agreements;
- Copies of all due-diligence related to the offering;
- All correspondence documents;

36.10 Training

The DP shall be responsible for keeping all associated persons highly informed with pertinent information related to Hedge Funds and/or FOFs, including product knowledge and the firm's procedures. Such training shall be documented in the firm's Continuing Education Records.

36.11 Customer Funds

The firm shall not accept any customer checks or wires made payable to the firm. All checks must be payable to the fund in accordance with the PPM.

36.12 Compensation

All compensation must be channeled through the firm unless prior notification has been given to the firm and the Chief Compliance Officer has documented approval in writing. All Hedge Funds and Fund of Funds must make payments directly to the firm, not the registered representative.

37. RESEARCH

These written supervisory procedures outline the requirements that apply to research analysts and the activities of the Research Department. The policies address disclosure requirements and restrictions to avoid conflicts of interest in the research analyst's role with the firm. Some terms used under the rules governing research are explained below.

"Investment banking services" refer to acting as underwriter or participating in a selling group in an offering for the issuer; acting as financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPEs or similar investments; or serving as placement agent for the issuer. References to "Investment Banking Department" in this chapter refer to any department or division, regardless of name, which performs investment banking services on behalf of the firm.

"Member of the research analyst's household" includes anyone whose principal residence is the same as the research analyst's. The term does not include an unrelated person who shares the same residence as the analyst provided the analyst and the unrelated person are financially independent of one another.

"Research analyst" includes any employee who is principally responsible for preparation of a research report or whose name appears on the research report, whether or not the employee has the title of research analyst. The term also includes any employee who reports directly or indirectly to a research analyst in connection with the preparation of the substance of a research report. **"Research analyst"** does not include every registered person who may express an opinion on an equity security, as long as they do not prepare research reports. Also excluded are investment advisers, such as mutual fund portfolio managers, not principally responsible for preparing the substance of a research report.

"Research report" means any written (including electronic) communication which includes an analysis of securities of individual companies or industries, and which provides information reasonably sufficient on which to base an investment decision. **This term does not include communications limited to:**

- discussions of broad-based indices;
- commentaries on economic, political or market conditions;
- technical analyses concerning the demand and supply for a sector, index or industry based on trading volume and price;
- statistical summaries of multiple companies' financial data, including listings of current ratings;

- recommendations regarding increasing or decreasing holdings in particular industries or sectors; or,
- notices of ratings or price target changes, provided the reader is directed to the most recent subject company research report that includes all current applicable required disclosures and that the report does not contain materially misleading disclosure including outdated or inapplicable disclosures.

This term also does not include the following communications (even if they include analysis of an individual equity security and information reasonably sufficient upon which to base an investment decision):

- any communication distributed to fewer than 15 persons;
- periodic reports or other communications prepared for investment company shareholders or discretionary investment account clients that discuss individual securities in the context of a fund's or account's past performance or the basis for previously made discretionary investment decisions; or
- internal communications not given to current or prospective customers; and
- communications that constitute statutory prospectuses filed as part of the registration statement.

The term "subject company" in this chapter refers to a company whose equity securities are the subject of a research report or recommendation in a public appearance. "Equity securities" also include convertible debt offerings.

37.1 Registration And Supervision Of Research Analysts/Registration Of Analysts

Research analysts are required to become registered through successful completion of the required examinations. This requirement applies to an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on the research report. Qualifications must be satisfied **prior to** acting as a research analyst. Prospective research analysts are required to successfully complete the following examinations:

- General Securities Registered Representative (Series 7); or Limited Registered Representative (Series 17); or the Canada Module of Series 7 (Series 37 or 38). This is a prerequisite to taking the research analyst examination.
- Research Analyst Qualification Examination (Series 86/87).

- An analyst who has passed both Level I and Level II of the Chartered Financial Analyst (CFA) Examination and analysts who prepare only technical research reports and have passed both Levels I and II of the Chartered Market Technician (CMT) Examination Program may request an exemption from Part I (Series 86). To qualify for the exemption, the analyst must have either (1) functioned continuously as a research analyst since having passed Level II of the CFA exam or (2) have passed Level II within 2 years of application for registration as a research analyst.
- Under certain circumstances, foreign research analysts employed by non-member affiliates are exempt from examination requirements. SRO interpretations should be consulted for specific requirements.

The following provides other general guidance regarding the requirements; questions about registration requirements should be referred to Compliance.

- The requirement for registration does not depend on the person's title but rather the functions he or she performs. The following activities by research personnel require registration:
- communicating directly with customers or prospective customers, including institutional customers, whether alone or accompanied by registered sales personnel
- authoring a research report or other research communication that is distributed to the public and where the author is identified by name (any employee whose name appears on the report is required to be registered, regardless of their role)
- receiving transaction-based compensation (based on the sale of securities, volume of sales, *etc.*) is an indicator that the recipient should be registered
- The supervisor who reviews and approves publicly-distributed research must be registered as a qualified supervisor.

37.2 Supervision of Research Analysts

FINRA requires that supervisors of equity research analysts satisfy the following requirements to qualify as a Research Principal:

- qualify as a General Securities Principal (qualification as a registered representative is a prerequisite)

- pass either the Series 87 examination (the regulatory portion of the research analyst examination) or the NYSE Series 16 Supervisory Analyst examination

37.3 Supervision Restrictions

The firm's Research analysts who are registered are supervised by a designated registered supervisor. The firm's research analysts are not be subject to the supervision or control of any employee of the firm's Investment Banking Department.

37.4 Research Analyst Compensation

Research analyst compensation is subject to limitations prescribed by rule; which are discussed below.

37.5 Prohibition Against Compensation Based On Investment Banking Business

The firm is prohibited from paying a bonus, salary, or other form of compensation based on a specific investment banking services transaction.

37.6 Compensation Committee

It is the Compensation Committee's responsibility to review compensation records such as compensation surveys compared with peers, other relevant information, research reports, and evaluations from customers, sales personnel, peers and independent rating services. The Compensation Review Committee will review the Research Analyst's compensation on an annual basis.

The review will include consideration of the following factors (when applicable):

- Individual performance including productivity and quality of research;
- Correlation between the analyst's recommendations and stock price performance; and,
- Overall ratings received from customers; sales personnel; peers independent of investment banking; and other independent ratings services.

Reviews will specifically **exclude** the analyst's contribution to investment banking business.

The Compensation Committee will document the basis of the compensation, approve or disapprove the compensation, and include the Committee's approval and documentation in accordance with the annual 2711 attestation to FINRA. All records will

be retained in a Research Analyst Compensation Review file along with all documents and the 2711 annual attestation.

37.7 Confidentiality of Research Activities

The designated supervisor is responsible for establishing procedures to maintain the confidentiality of research activities until recommendations are publicly disseminated. Such procedures include the following:

- Maintaining files on work-in-progress in locked file drawers and/or other secured locations
- Limiting access to research computer files to authorized persons with passwords
- Research personnel may not discuss research recommendations not yet publicly disseminated, except with the designated supervisor or other authorized research personnel. This is confirmed on a periodic basis by the CEO and CCO of the firm.

37.8 Information Barriers

We have procedures regarding Chinese Wall and Insider Trading in a different section of our procedure manual which discusses Information Barriers which outlines the Firm's procedures for maintaining the confidentiality of material, non-public information obtained in the Firm's role in investment banking. Analysts are restricted from engaging in discussions with Investment Banking about proposed or pending research reports or activities of the Investment Banking Department. Review of pending research reports by Investment Banking personnel is restricted to allowed activities described in the section *Review Of Research Reports* later in this chapter. Involving a research analyst in confidential, investment banking discussions may inhibit that analyst's ability to issue future research reports and requires the participation and **prior approval** of Compliance. Adherence to the Firm's policy "Bringing An Employee Over The Wall" is important and strictly enforced.

37.9 Regulation FD

Regulation FD (Fair Disclosure) governs the release by public companies of information that may reasonably be expected to affect the market price of securities issued by the public company. This Regulation is discussed in more detail in the Firm's Insider Trading Policy in *Regulation FD (Fair Disclosure)*. If a research analyst becomes aware of material, non-public information, this information must not be communicated to others or used in developing research recommendations or reports. Compliance should be

contacted immediately for advice regarding how the analyst may proceed. It may be necessary to restrict the analyst's communications regarding the public company until the inside information becomes public or is no longer considered material. These restrictions are sometimes necessary to protect the analyst and the Firm from later being charged with using inside information.

37.10 Standards For Research Reports

37.10.1 General Standards

The general guidelines that apply to advertising also apply to research reports. Projections or predictions must include the bases or assumptions upon which they are made. Reasonable estimates of a company's earnings or fair stock price targets based on historic trading ranges are permitted. The report should include the basis for such estimates as well as a statement that any such estimates or forecasts may not be met. General standards include the following:

- Sound basis for evaluating the facts
- A reasonable basis for making a recommendation
- Inclusion of material facts or qualification of facts which, if excluded, would cause the research to be misleading
- No exaggerated, unwarranted, or misleading statements or claims

37.10.2 Specific Standards

All research reports must include the following:

- The name of the Firm
- The date when the report is first published, circulated, or distributed
- Any comparison of the Firm’s service, personnel, facilities or charges with those of other firms must be supported by fact

Research reports that include recommendations must include the following:

- If the information is not current, a statement that it is not
- Historical performance should include current information about sudden, more recent performance changes
- A statement that, upon request, further information will be provided
- The price at the time the recommendation is made

- For reports that include past recommendations, specific information must be included*
- For reports or other communications offering to furnish a list of all recommendations by firm within the past year or more, specific information must be included*
- No reference to prior recommendations may imply comparable future performance
- Research recommendations may not include promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions without a reasonable basis, or forecasts of future events which are unwarranted.

*Specific rule requirements should be consulted or contact the Research supervisor or Compliance if there are questions regarding required information.

37.11 Disclosures And Statements

Research reports are required to include certain disclosures. Disclosures appear either on the front page of the research report or the front page refers to the page on which disclosures are found, labeled prominently with a heading such as "Important Disclosures" or "Required Disclosures." Where the front page refers the reader to disclosures elsewhere in the report, the references are separated from the report's body text and in larger font than the body text and include specific page numbers (or a specific section such as an appendix) where disclosures may be found.

Hyperlinks may not be used to replace written disclosures in hard-copy reports. Electronic research may use hyperlinks for disclosures; hyperlinks must appear clearly and prominently on the first screen the investor sees. When hyperlinks are not possible (as for a PDF format), the requirements for paper reports must be followed. For reports covering 6 or more companies (a "compendium report"), the report may clearly direct the reader to where they may obtain applicable current disclosures. Electronic compendium reports may include a hyperlink to the required disclosures. Paper-based compendium reports must provide either a toll-free number to call or a postal address to write for the required disclosures and may also include a web address of the member where the disclosures can be found. Stock symbols may not be used in the required disclosures section of the report unless the reader is directed to where in the report the subject companies represented by the symbols are identified by proper names.

The following sections list the types of disclosure required by research rules. Other requirements under SRO rules may apply depending on the type of security included in a report or public appearance. Questions should be referred to Compliance.

37.12 Ownership And Material Conflicts Of Interest

- Any financial interest the research analyst or a member of the research analyst's household has in the securities of the subject company, and the nature of the financial interest (whether an option, right, warrant, future, long or short position).
- Ownership by the Firm or its affiliates of 1% or more of any class of common equity securities of the subject company (based on the same standards as Section 13(d) of the Exchange Act). This ownership is as of the end of the month immediately preceding the date of publication of the research report or end of the 2nd most recent month if publication is less than 10 calendar days after the end of the most recent month.
- Any other actual, material conflict of interest of the research analyst or the firm known at the time of publication of the report. (This includes only conflicts where the analyst has actual knowledge of those conflicts that should be reasonably discovered in the ordinary course of business.)

37.13 Receipt Of Compensation

- Research analyst received any compensation based on (among other factors) the Firm's investment banking revenues or from the subject company in the past 12 months.
- The Firm or any affiliate managed or co-managed a public offering of securities for the subject company in the past 12 months. (This disclosure is not required if the disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.)
- The Firm or any affiliate received compensation for investment banking services from the subject company in the past 12 months.
- The Firm or any affiliate expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.
- As of the end of the month immediately preceding the date of publication of the report (or the end of the 2nd most recent month if publication date is less than

30 calendar days after the end of the most recent month) to the extent the Firm, the research analyst or other employee with the ability to influence the substance of research knows:

- The Firm or any affiliate received compensation for investment banking services.
- The Firm received compensation for other products or services from the subject company in the past 12 months. The types of services provided to the subject company must be described as investment banking services, non-investment banking securities-related services, or non-securities services.
- The subject company currently is, or during the 12-month period preceding distribution of the report, was a client of the Firm.
- An affiliate received compensation for non-investment banking services from the subject company during the past 12 months.

37.14 Position as Officer or Director

The research analyst or a member of the research analyst's household serves as an officer, director, or advisory director of the subject company. The disclosure will specify what position the individual holds with the subject company.

37.15 Meaning and Distribution of Ratings

Research reports must define the meaning of each rating used in the Firm's rating system, consistent with its plain meaning. For ratings that do not use the terms "buy," "hold/neutral," or "sell," these words must be combined with the Firm's alternative rating language. For example, the use of the term "overweight" to denote "buy" would appear as "buy/overweight." In addition, each research report must include the percentage of:

- All securities rated by the Firm to which a "buy," "hold/neutral," or "sell" rating is assigned; and,
- the percentage of companies within each category for whom the Firm provided investment banking services within the previous 12 months.

This information must be current as of the end of the most recent calendar quarter (or the 2nd most recent calendar quarter if publication date is less than 15 calendar days after the most recent calendar quarter) and must reflect the distribution of the most

recent ratings issued by the Firm for all subject companies, unless the most recent rating was issued more than 12 months ago. If a report does not contain an express or implied rating of the subject company's stock, the report is not required to include the ratings distribution information.

37.16 Price Charts

If a research report includes either a rating or a price target and the Firm has assigned a rating or price target to the subject company's securities for at least 1 year, the research report must include a line graph of the security's daily closing prices for the period of the assigned rating or price target or for a 3-year period, whichever is shorter. Rules specify how this information must be presented; Compliance should be consulted for guidance where necessary. If a report does not include either a rating or a price target for the subject company's stock, the report is not required to include a price chart.

37.17 Price Targets

When price targets are included in research reports, they must have a reasonable basis, and the valuation methods to determine the price target must be disclosed as well as risks that may impede achievement of the price.

37.18 Market Making

Research reports must disclose if the Firm is a market maker in the subject company's securities at the time the research report is published.

37.19 Analyst Certification

Research reports will include the research analyst certification as follows:

- a statement by the analyst that the views in the report accurately reflect the analyst's personal views about the subject securities or issuers; and,
- a statement by the analyst whether the analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views in the report. If related compensation was received, this statement will include the source, amount, and purpose of the compensation and disclosure that the compensation may influence the recommendation in the research report.

37.20 Disclaimers and Hedge Clauses

Research may not include cautionary statements or caveats if they are misleading or are inconsistent with the content of the material. General or specific disclaimers cannot contradict or be inconsistent with SRO-required disclosures. Disclosures or disclaimers **not** required by SRO rules will be clearly separated and appropriately labeled such as "Other Disclosures" or "Disclaimers."

37.21 Third Party Research

When distributing or making available research provided by third parties (a non-affiliate broker/dealer, a non-member affiliated broker-dealer, or an independent third party), the following apply:

- Prior written approval by a registered principal or supervisory analyst approved under NYSE Rule 344.
- Written applicable disclosures to accompany the report. Disclosures are not required for independent third-party research reports made available to customers either upon request or on the Firm's web site. Disclosure requirements apply when third-party research is distributed through a soft dollar arrangement.

37.22 Public Appearances of Research Analysts

Public appearances by research analysts are subject to disclosure and recordkeeping requirements. "Public appearance" includes participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons or before one or more representatives of the media, radio, television, or print media interview, or the writing of a print media article in which the analyst makes a recommendation or offers an opinion concerning an equity security. This term does not include a password-protected Webcast, conference call, or similar event with 15 or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains the required applicable disclosures, and that the research analyst appearing at the event corrects and updates during the public appearance any disclosures in the research report that are inaccurate, misleading or no longer applicable.

37.23 Public Appearances Require Approval

Public appearances must be cleared with the designated supervisor or compliance prior to participation. The designated supervisor or compliance department may authorize

certain analysts to engage in public appearances on a recurring basis without prior clearance for each appearance, if the supervisor is assured the analyst is aware of disclosure requirements. The supervisor or compliance will retain a written record identifying the analyst who are permitted to participate in public appearances without prior approval. The supervisor or compliance should provide the analyst with information required to be disclosed, as discussed in the next section.

37.24 Disclosures during Public Appearances

A research analyst must disclose (if applicable, and to the extent the analyst knows) the following in public appearances:

- The Firm or any affiliate received compensation from the subject company in the past 12 months.
- The research analyst received any compensation from the subject company in the past 12 months.
- The subject company currently is, or during the 12-month period preceding distribution of a report on the company, a client of the Firm (or its affiliates). The types of services provided to the subject company (investment banking, non-investment banking securities services, or non-securities services).
- The Firm or an affiliate owns 1% or more of any class of common equity securities of the subject company (as of last day of the month before the appearance or the end of the 2nd most recent month if the appearance is less than 10 calendar days after the end of the most recent month).
- The research analyst or a household member has a financial interest in the securities of the subject company, and the nature of the interest (including options, rights, warrants, futures contracts, long or short positions).
- The research analyst or a household member is an officer, director, or advisory board member of the subject company.
- Any other actual, material conflict of interest of the research analyst or the Firm, of which the analyst knows at the time the public appearance is made. The research analyst is not required to make a disclosure if the disclosure would reveal material non-public information regarding specific potential investment banking transactions of the subject company.

For extemporaneous radio or television interviews where the analyst does not have the required disclosure information, the analyst cannot make a recommendation or offer an

opinion. If the analyst is aware of a media outlet that previously edited out disclosures provided in a prior public appearance, the analyst must decline subsequent appearances if he or she cannot obtain assurance that disclosures will not be edited out.

Disclosures during television or other video appearances may appear in a graphics box or scroll across the screen in lieu of oral disclosures. The graphic or scrolling disclosures must be in a prominent and readable format during the time of the appearance. An analyst is NOT required to make disclosures for public appearances in a password protected web-cast, conference call or similar event with more than 15 **existing** customers (*e.g.,* individuals or entities) provided that:

- no representatives of the media attend;
- all of the call participants previously received the most current research report or other documentation that included the required disclosures; and · the research analyst making the public appearance corrects and updates any disclosures in the research report that are inaccurate, misleading, or are no longer applicable.

A record must be retained of all attendees at the public appearance and that all participants previously received the most current research report. The research analyst is required to record this information and provide it to the research supervisor who will retain the record.

37.25 Restrictions on Public Appearances

Refer to the section on *Quiet Periods Affecting Research Reports And Public Appearances* for a description of periods during which analyst public appearances are restricted.

37.26 Communications Regarding Investment Banking Services

Research analysts are prohibited from promoting the Firm's investment banking services and investment bankers are prohibited from directing analysts to do so. Specifically, research analysts are prohibited from:

- Participating in road shows relating to investment banking services transactions; and
- engaging in any communications regarding investment banking services transactions with current or prospective customers in the presence of investment banking personnel or company management.

- Regarding road shows involving investment banking service transactions, research analysts are permitted to listen to (in "listen-only" mode, not identified as being present) or view a live webcast of a road show or other widely attended presentation to investors or the sales force as long as access is from a remote location (not at the same address as investment banking, investors or the sales force). If the road show or presentation is conducted from the Firm's offices, research personnel may listen from the same address but not from the same room as investment banking, investors, or the sales force.

In addition, investment banking personnel are prohibited from directing research analysts to:

- engage in sales or marketing efforts relating to investment banking services transactions; and
- engage in communications with current or prospective customers about investment banking service transactions.

Analysts are subject to information barriers that separate communications between research and investment banking personnel. Compliance must be consulted before contact occurs or if an analyst is contacted by investment banking personnel.

37.27 Blue Sky of Securities Recommended

"Blue sky" refers to standards imposed by states on the securities sold to state residents. When a security is "blue skied" it is qualified for sale to state residents. Selling securities that are not blue skied is a violation of state law and has civil remedies such as rescission of the customer's transaction and refunding of money. Blue sky requirements apply to corporate securities; government and municipal securities are exempt from these requirements. Exchange-listed securities and NASDAQ National Market securities generally are automatically blue skied in most states. Purchases by certain institutional customers may also be exempt from blue sky requirements. Before issuing a research recommendation, it is necessary to determine that the subject security is blue skied in states where the recommendation will be distributed. The designated reviewer of research reports is responsible for determining blue sky status prior to distribution. If the security is not blue skied in some states, it may be necessary to restrict distribution, include a disclosure in the report's footnotes, or limit distribution to potential institutional purchasers.

37.28 Review of Research Reports

There are requirements and restrictions regarding the review and approval of research reports. The designated supervisor will review all research publications for required disclosures and language prior to distribution. This will be done on an "as needed" basis.

37.29 Small Firm Exemption

the Firm qualifies for the "small firm" exemption under SRO rules (participated in 10 or fewer investment banking transactions as manager or co-manager in the past 3 years AND generated $5 million or less in gross investment banking revenues from those transactions; "investment banking transactions" include underwriting corporate debt and equity securities but not municipal securities). The Firm is not subject to restrictions on who may supervise analysts and is not required to establish "gatekeeper" procedures for communications between analysts and non-research personnel and between analysts and subject companies.

37.30 Obligation to Notify Compliance of Communications with Non-Research Personnel

While the Firm qualifies for the small firm exemption which eliminates the requirement that Compliance act as the "gatekeeper" between research and non-research personnel, the Firm is required to maintain a record of research-related communications between research analysts and non-research personnel, excluding communications with compliance or legal personnel. Research analysts are required to notify Compliance when they have communications with non-research personnel about research, including the date of the communication and with whom they communicated.

37.31 Subject Company Communications

Research reports may not be submitted to the subject company for review other than under the following conditions and with the **prior approval** of Compliance. Sections of a report may be submitted for purposes of verifying the factual accuracy of information in those sections if:

- A complete draft of the report and sections for subject company review are provided to Compliance **before** sections are submitted to the company;
- the sections do not contain the research summary, the research rating or the price target; and,

- any changes resulting from submission to the company must be justified in writing and submitted to Compliance who will review and provide written authorization for the changes.

Changes in ratings may be communicated to the subject company NO EARLIER THAN the business day preceding the announcement of the rating change AND after the close of trading of the principal market of the subject company's securities.

37.32 Approval of Company Communications

The Designated Supervisor will review a draft of the research report when a report is to be issued. The Designated Principal will review the report for compliance with policy and rule requirements and will contact the analyst to make any changes. The Principal will review the revised research report and will approve or disapprove the report. Where changes are made pursuant to review by the subject company, then the Designated Principal will review those changes and approve or disapprove.

Where a change in rating or price target is to be made, the research must include written justification and compare it with comments from the subject company regarding sections of the draft submitted for factual verification. The Principal will conduct a follow-up inquiry if needed to establish a reasonable and casual basis for the change. A copy of the research report, with recommended changes and final approval will be kept in a research issued file**.**

37.33 Retention Requirements

Research reports (including drafts and final reports) and materials and references used to prepare the research report will be retained for three years in files by issuer in the Research Department.

37.34 Quiet Periods Affecting Research Reports and Public

It is the responsibility of the Designated Supervisor to review resources such as, draft research reports, proposed analyst public appearances, and records of analyst public appearances in which the Firm is participating during quiet periods. The Designated Supervisor will consider these resources when a research report will be issued or when an analyst is anticipated to make a public appearance. **The Designated Principal will confirm** the subject security is not included in a distribution where the Firm is a participant. If it is, the Principal will determine whether a safe harbor is available, If a safe harbor is not available, then the Principal will restrict the distribution of the

research report until the quiet period is over, If a quiet period is violated, contact Compliance to determine corrective action.

37.35 Quiet Periods

Research reports may not be issued (unless a "safe harbor" is available, as discussed in the next section) and research analysts may not make public appearances during the following timeframes, depending on the Firm's role in the public offering of securities:

- IPOs where the broker-dealer acts as manager or co-manager: 40 days
- IPOs where the broker-dealer acts as underwriter or selling dealer: 25 days
- Secondary's when acting as manager or co-manager: 10 days
- Issues subject to lock-up agreements: 15 days prior to or after the expiration, waiver or termination of the lock-up or other agreement that restricts or prohibits sales of the security.

There is no quiet period against issuing research reports or analyst public appearances under the following circumstances:

For secondaries and issues subject to lock-up agreements, if the security qualifies under

- Rule 139 regarding an "actively-traded" security under Rule 101(c)(1) of Regulation M.
- There is significant news or there are significant events affecting the company, **and** with the **prior written approval** of Compliance or Legal.

37.36 Safe Harbors for Issuing Research Reports Regarding Securities Subject To a Public Offering

Research reports are afforded safe harbors for publishing in the pre-filing, post-filing, and post-effective periods of an offering, without having the communication deemed to be an offering or prospectus in violation of Section 5 of the Securities Act. For purposes of these safe harbors, "research" is defined as a written communication that includes research, including information, opinions, recommendations or an analysis of securities of the issuer. The report does not have to contain information reasonably sufficient upon which to base an investment decision. The definition includes all types of research reports, whether issuer-specific or industry compendiums separately identifying the issuer. The following summarizes the safe harbors that permit the publication of research around the time of an offering. The rules should be consulted for details.

37.37 Regulation S and Rule 144A Offerings and Proxy Solicitations

Research reports meeting the conditions of Rules 138 and 139 will not be considered offers, general solicitations or general advertising in connection with offerings relying on Rule 144A, or constitute direct selling efforts for purposes of, or be otherwise inconsistent with, the offshore transaction requirements of Regulation S. This does not apply to private placements under Regulation D. It does apply to a registered securities offering that is subject to the proxy rules under the '34 Act.

37.38 Rule 137

Applies to securities under registration of any issuer, including non-reporting issuers (but not blank check, shell, or penny stock companies). The safe harbor allowing publication of research is available to a broker-dealer (or an affiliate) that:

- Is not participating, and does not propose to participate, in the registered offering;
- is not receiving, and has not received, consideration directly or indirectly from the issuer, a selling security holder, any offering participant, or any other person interested in the securities; and
- Publishes or distributes the research in the regular course of its business.

37.39 Rule 138 Safe Harbor

- Permits a broker-dealer, participating in an offering, to publish or distribute research that is confined to another type of security of the issuer (*i.e.,* the offering is for common stock, a research report on a debt issue may be distributed).
- Requires that the broker-dealer must have previously published or distributed research reports on the same types of securities that are the subject of the report in the regular course of its business.
- Applies to offerings of all reporting issuers that are current in their periodic reporting at the time of reliance on the exemption.
- Applies to broker-dealers publishing or distributing research reports regarding non-reporting foreign private issuers that have had equity securities traded on a designated offshore market for at least 12 months or have a $700 million worldwide common equity public float.

37.40 Rule 139 Safe Harbor

- Permits a broker-dealer, participating in an offering of securities by a seasoned issuer or
- by a large foreign private issuer (with conditions), to publish research concerning the issuer or any class of its securities, as long as that research is contained in a publication that is distributed with reasonable regularity in the normal course of the broker-dealer's business. This includes any foreign private issuers that have had equity securities traded on a designated offshore market for at least 12 months or have a $700 million worldwide common equity public float.
- Permits initiation of coverage on a new class of an issuer's securities, as long as research reports about the issuer or its securities have been published or distributed previously, or at least one such report has been distributed or published following any discontinuation of coverage.

37.41 One-Day Restriction

the Firm imposes a one-day (24-hour) restriction on employee, employee-related accounts, and discretionary accounts from the time a new or significantly revised recommendation is disseminated. These accounts may not enter transactions consistent with the new or revised research recommendation for the restricted period. The restriction also includes any derivative security consistent with the recommendation (options or securities convertible into the security the subject of the recommendation).

37.42 Watch or Restricted List Additions

The analyst is responsible for notifying the Research Principal when a new or changed recommendation is to be published. The Research Principal is responsible for adding the company to the appropriate list and the Designated Principal will monitor for transactions that may indicate front running of a research recommendation or violation of the one-day restriction.

37.43 Monitoring Restrictions

Daily transactions are reviewed by the Designated Principal to identify transactions by employees or employee related accounts within the one-day restricted period. Transactions in violation of this policy may be subject to cancellation. Transactions for all accounts will also be reviewed for a one-month period prior to issuance of the recommendation to identify transactions that are consistent with the recommendation.

These transactions will be reviewed on a case-by-case basis to determine whether the confidentiality of the recommendation has been breached. The Designated Principal will retain a record of transactions identified in this review and what action, if any, is taken.

37.44 Termination of Coverage

If research coverage of a subject company will be terminated, a final research report must be published and include notice that coverage is terminated. The final report should be of the same scope as prior reports on the subject company and include a final recommendation or rating unless impractical (the analyst has left the Firm, the Firm terminates coverage of the sector or industry, or other comparable reason).

37.45 Personal Trading Of Research Analysts

Each Research Analyst is responsible for sending any buy or sell transactions in which he/she wants to make to the Designated Principal for approval prior to entering the order. The Designated Principal will review the request against the firm's internal research list, and watch/restricted lists. Approval or disapproval of the request will be emailed back to the Associated Person. In addition to the review at the time of the order, a quarterly review of the research analyst account is done for all internal and outside brokerage accounts.

The personal trading in research analyst accounts is subject to rule restrictions. "Research analyst account" includes any account in which a research analyst or member of the research analyst's household has a financial interest, or over which the analyst has control, other than an investment company registered under the Investment Company Act of 1940. If a research analyst manages the investments of a registered investment company, the investment company is not a "research analyst account" and not subject to personal trading restrictions. The term also does not include a "blind trust" account controlled by someone other than the research analyst or a member of the research analyst's household where neither the analyst nor the household member knows the account's investments or investment transactions. Also, restrictions apply only to trades in the securities of subject companies covered by the particular research analyst. In addition, a research analyst's automatic reinvestments of dividends in securities of a subject company through a dividend reinvestment plan (DRIP) are not subject to research analyst personal trading restrictions. Any discretionary cash investments in the subject company's securities, or securities of an investment fund that is subject to the personal trading restrictions, that are made through a DRIP would be subject to the blackout periods.

37.46 Security Affected Type of Restriction or Permitted Activity Time Period

- Securities of an issuer principally engaged in the same types of business as companies the analyst follows (including private companies regardless of whether the company goes public)
- No purchases or receiving any securities. Before the IPO.
- Any security issued by a company the analyst follows as well as any derivative security (options, warrants, etc.) This includes "neutral" rating of a subject company. No purchases or sales. This restriction provides for two circumstances where transactions are permitted: · Securities held in an analyst account may be sold. Purchases or sales permitted provided the Designated Principal **pre-approves** the research report and any change in the rating or price target. Beginning 30 calendar days before and ending 5 calendar days after publication of a research reporting concerning the company or a change in a rating or price target of the company's securities. Within 30 calendar days after the research analyst begins following the company. · Within 30 calendar days before publication of a research report or rating or price target.
- Research analyst changes earnings estimate which does not coincide with issuance of a new research report and did not result in a change in the rating or price target. No trigger of personal trading blackout period.
- Any security or option on or derivative of a security the subject of the analyst's recommendation
- No purchases or sales inconsistent with the analyst's recommendation. Since the most recent report published by the Firm. Exceptions to the above restrictions (other than obtaining securities the subject of an IPO, where exceptions are not permitted) may be authorized by the Principal if there is an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, if the Principal approves the transaction **before** it is entered. Exceptions will comply with the Firm's policies and procedures designed to prevent conflicts of interest between the professional responsibilities of the research analyst and the personal trading of the research analyst account. The firm will retain records for three years of transactions considered for exceptions including the name of the research analyst account,

date, description of the proposed transaction, and the reasons for granting (or denying) an exception.

- Prohibitions do not apply to purchases or sales of registered investment companies or any other investment fund over which neither the research analyst nor member of the analyst's household has discretion or control **if:**
    - the research analyst accounts collectively own interests of less than 1% of the assets of the fund;
    - the fund invests no more than 20% of its assets in securities of companies principally engaged in the same types of business followed by the analyst; and,
    - if the investment fund distributes securities in kind to an analyst or analyst's household member before the issuer's IPO, the analyst or household member either must divest those securities immediately or the analyst must refrain from participating in preparation of research concerning the issuer.

37.47 Pre-Approval of Supervisor's Transactions

The firm's Designated Principal is sent an email when an Associated Person/Supervisor of the firm wants to enter a buy or sell transaction in a security. It is the Designated Principal's responsibility to review the request against the firm's current internal research list, the watch/restricted list to ensure the Associated Person is not acting on any insider information, and is not buying or selling against the firm's recommendation on a security in which the firm issues research. Any questions regarding the buy or sell transaction is sent to the Associated Person and may request further information. The Designated Principal will send an email back with his/her approval or disapproval. Additionally, the Supervisor's transactions are reviewed on a quarterly basis for all accounts held at the firm and outside the firm.

37.48 Prohibitions

Prohibition against Soliciting Investment Banking Business

Research analysts are not permitted to participate in efforts to solicit investment banking business. Analysts may not participate in "pitches" for investment banking business to prospective investment banking clients or have other communications with companies to solicit investment banking business.

Changing Inventory Positions In Anticipation Of A New Or Changed Research Recommendation

the Firm may not establish an inventory position or add to (for a bullish report) or decrease (for a bearish report) The Firm's inventory in a security because of its knowledge of the anticipated issuance of a research report or recommendation or change in rating or price target. This restriction also applies to derivative securities related to the underlying securities the subject of the research report. Normal trading activity may continue when the trading department is not aware of a pending research report or recommendation. If the trading department is aware of an upcoming report or recommendation on a specific security, trades in the subject security with customers or other broker-dealers are restricted to unsolicited orders only.

Front-running A Research Recommendation

Employees are prohibited from acting on information about an impending new research recommendation or a change in rating or price target prior to its public distribution (including passing on such information to others). Engaging in such activity is "front-running," a violation of regulatory rules, and subject to potential disciplinary action by the Firm or regulators.

Prohibition against Promise of Favorable Research

The Firm and its employees are prohibited from directly or indirectly offering favorable research, a specific rating or specific target price, or threaten to change research, a rating, or a price target to a company as consideration or inducement for the receipt of business or compensation.

Prohibition of Retaliation against Research Analyst

The Firm and its employees are prohibited from directly or indirectly retaliating against or threatening to retaliate against a research analyst employed by the Firm or an affiliate of the Firm because of any adverse, negative, or otherwise unfavorable research report or public appearance that may adversely affect an investment banking relationship with the subject company of the research report or appearance.

37.49 Annual Attestation of Research Supervisory Procedures

As required by rule, a senior officer of the Firm will provide an annual attestation to FINRA regulator that the Firm has adopted and implemented supervisory procedures in compliance with the rule governing research analysts and research reports. The attestation will include reference to the compensation committee's review of analyst

compensation including approval of compensation and documentation for the basis of compensation. Evidence of the research analyst compensation review will be maintained in the firm's files.

38. PROPRIETARY TRADING

The firm engages in proprietary trading activities; in which we may exceed the ten proprietary transactions in a one year period. We do not intend to actively trade our proprietary account, but may occasionally hold inventory positions overnight. The firm engages in proprietary trading on either a principal or riskless principal basis, in which all trading is done in a proprietary trading account held at our clearing firm. The firm does not engage in any market making activities.

We primarily engage in proprietary trading activities in the following products:

- Corporate debt and fixed income securities
- U.S. government securities
- Municipal securities
- Equities
- Mutual funds
- Options

If at any time the firm intends to engage in proprietary trading for any other additional products not noted above, the Chief Compliance Officer (CCO) must be contacted, in which the CCO will request approval from FINRA.

38.1 Trading Systems

The firm will utilize the internal trading systems used by our clearing firm for all proprietary orders. At no time will our firm act as the "executing" broker/dealer. All orders are entered into the clearing firm's order entry system in which clearing will execute and report all transactions on our behalf.

38.2 Pricing Proprietary Inventory

Typically, our clearing firm will price the firm's inventory; however, it is the responsibility of the FINOP to verify larger positions. In the event that pricing information is not available for certain products, the price shall be determined by recent bona fide transactions by other broker/dealers.

Evidence: Initials of Trading Supervisor on Proprietary Trading Blotter.

Frequency: Daily

38.3 Short-Selling Activities—Affirmative Determination

Prior to any short-selling activity, the trader will contact the Stock Loan Department at our clearing firm. Because the clearing firm is the executing broker/dealer, it will have responsibility with compliance with the "down-tick" Rule.

Supervision: The trader shall be responsible for documenting Affirmative Determination. Order Tickets will be maintained for all short sales and will detail the person at the clearing firm that provided Affirmative Determination.

Evidence: Signature on the Order Ticket.

Frequency: Prior to Execution

38.4 Payment for Order Flow

The firm will not receive any payment for order flow.

38.5 Insider Trading for Proprietary Trading Activities

The firm will not engage in any proprietary trading for any issuers that the firm has engaged any investment banking or research related activities.

38.6 TRACE & RTRS Reporting

Our clearing firm will handle all the firm's reporting requirements to TRACE and the RTRS system. Even though our clearing firm reports on our behalf, we realize that our firm is ultimately responsible for accurate and timely transaction reporting to TRACE and RTRS. A more detailed description of our firm's TRACE and RTRS reporting procedures can be found in the general written supervisory procedure manual.

38.7 Registrations

All Registered Person trading debt securities for the firm's proprietary accounts will be required to have the appropriate registrations.

Supervision: It shall be the responsible of the Trading Supervisor to ensure that the Registered Representatives are properly registered in light of their activities. The Proprietary Trading Blotter details the person who effected any proprietary trades. The Trading Supervisor will ensure that the person effecting any proprietary trades is properly registered.

Evidence: Initials of Trading Supervisor on Proprietary Trading Blotter.

Frequency: Daily

38.8 Inventory Sales

The firm does not intend to sell any inventory to retail accounts. In some cases the customer may wish to "work" the other side of the transaction. For example, if a customer wishes to buy or sell a large block of stock, then the firm may wish to purchase into the proprietary trading account and then "work" the other side of the order.

38.9 Commissions/Markup / Markdown Policies

The Designated Principal will be responsible for ensuring that all principal trades are fair and reasonable based on prevailing market conditions. The Designated Principal shall consider such criteria as discussed in the firm's procedures under markups/markdowns when determining if the markups/markdowns are fair and reasonable. The DP is also responsible for ensuring all commissions are within the firm's commission schedules and FINRA's 3% guideline.

Supervision: It shall be the responsibility of the Trading Supervisor to ensure that commissions, markups or markdowns are "fair and reasonable."

Evidence: Initials of Trading Supervisor on Proprietary Trading Blotter. The Proprietary Trading Blotter provides details to the commissions, markups/markdowns for the corresponding trades. In the event a trade does not detail the commission, markup/markdown, then the Trading Supervisor will make a note of the commission or markup/markdown directly on the blotter.

Frequency: Daily

38.10 Security of Terminals

All trading terminals are password protected and only authorized individuals will have access to the trading systems.

38.11 Market Making

Neither the firm nor any of its registered representatives will engage in any market making activities.

39. Investment Banking Activities

The Firm implements these procedures to govern the conduct of its associated persons, registered representatives, and principals who engage in investment banking activities ("Investment Bankers"). The Firm holds its Investment Bankers to the highest standards of ethical conduct and requires all Investment Bankers to perform their duties and functions in accordance with just and equitable principles of trade, federal and state laws, and industry regulations.

39.1 Licensing and Registration

An associated person engaged in any of the investment activities described below must pass the Series 79 and register as an Investment Banker with the Firm. Investment Bankers are further required to maintain appropriate state registrations. To register with a state, the Investment Banker must hold the Series 63 or Series 66, in addition to the Series 79.

The designated principal who supervises investment banking activities must hold the Series 24 license, as well as the Series 79 license and the appropriate state registrations. A general securities principal who does not have the Series 79 may not supervise investment banking activities.

Waivers of the Series 79 Exam

FINRA may grant an associated person a waiver of the Series 79 if the Firm can establish that such person is qualified based on experience. On a case-by-case basis, the Firm will consider whether it is appropriate to seek a waiver of the Series 79 on behalf of an associated person.

39.2 Investment Banking Activities Requiring Registration

Investment banking is broadly defined and includes a wide range of activities in the capital markets. The investment banking activities described below, if performed by an associated person, are likely to trigger a requirement to register as an Investment Banker with the Firm.

Mergers and Acquisitions ("M&A")

An associated person who performs the following M&A activities should be registered as an Investment Banker:

- In a sell-side or buy-side transaction, performing the relevant analyses, managing the bidding process, and executing the deal.
- Assisting the client with the determination of whether a fairness opinion is necessary, preparing the financial analysis for the fairness opinion, presenting the analysis to the firm's internal approval committees, the client, and the client's board of directors, or special committee of the board.
- Assisting in preparation of fairness opinion meeting and the drafting the fairness opinion letter.
- Assisting client in the preparation of proxy statement/prospectus disclosure regarding any fairness opinion that has been issued and complying with FINRA Rule 5150 concerning fairness opinions.
- With respect to the closing of a transaction, reviewing proxy statement/prospectus disclosure regarding the transaction and assisting the buyer in the close.
- Complying with the tender offer regulations including communications, timing and filing requirements, disclosure requirements, and equal treatment of shareholders.

Underwriting, Offerings, and Registration of Securities

An associated person engaged in the following underwriting and offering activities should be registered as an Investment Banker with the Firm:

- Participating in the drafting of the offering documents, internal commitment memos, internal sales memos, and road show presentations.
- Assisting in the distribution of the preliminary and final prospectuses.
- Understanding FINRA/NASD rules pertaining to securities distributions.
- Managing the execution of syndicate agreements, including agreement among underwriters, selected dealers agreement, and deal wires.
- Preparing and filing necessary regulatory wires (e.g., Regulation M filings).
- Assisting in the education of internal sales force and marketing of the offering.
- Building the book and ascertaining investor interest.
- Compiling the deal file, including correspondence with underwriting group members, selling groups and/or the issuer, archives of pitch and marketing

materials, information used for road shows, book building, prospectuses, and copies of underwriting materials.

- Keeping track of billing and finalizing the transaction after the close of financing deals.
- For private placements, performing tasks similar to those associated with public offerings (e.g., due diligence) in addition to the tasks unique to private placement (e.g., preparing private placement memorandum).
- Understanding regulations pertaining to the distribution of private placement offerings.

Collection, Analysis, and Evaluation of Data

An associated person performing the following activities with or in support of the aforementioned investment banking activities should be registered as Investment Banker with the Firm:

- Collecting financial, performance, issuance, and transaction data from various commercial and proprietary market databases, regulatory sources, internet sites of private and public companies, media and other resources for the purpose of analyzing trends in the market and specific industry sectors, analyzing individual companies, conducting an analysis of the capital structure and valuation metrics of comparable companies, performing relative valuation analysis regarding positioning (the company's relative position when comparing its valuation with other companies within the same industry), and tracking recent securities offerings and mergers and acquisitions (i.e., precedent transactions), as well as recent deals executed by competitors.
- Reviewing and understanding the information found in schedules, reports, statements, and forms filed pursuant to the Securities Exchange Act of 1934.
- Engaging in permissible communications with clients and other departments within the firm and coordinating when necessary with legal and compliance personnel.
- Conducting financial analysis of individual companies, comparable companies, and particular industry sectors using models involving basic financial accounting concepts and statistical analyses, as well as preparing spreadsheets, graphs, and other materials based on the collected data.

- Using valuation metrics, ratios and other types of data in the areas of equity and debt transactions, equity-linked transactions, mergers and acquisitions, restructurings, and general corporate or financial advisory services.
- Analyzing market and industry trends.
- Understanding the characteristics of various types of securities and financial instruments.
- Reviewing and analyzing precedent transactions for trends in capital raising and mergers and acquisitions (e.g., capital restructuring, use of derivatives, share repurchase programs, tender offers, rights offerings, and debt issuance).
- Analyzing investor and shareholder data to understand ownership and trading behavior.
- Analyzing the impact of various financing strategies for potential investors.
- Analyzing the various alternatives available to the company.
- Evaluating the impact of various alternatives for the company, making preliminary recommendations with respect to transactions based on the results of analysis, and understanding the benefits and risks associated with such recommendations.
- Conducting due diligence by identifying information that is required to be disclosed in public or private offering documents.
- Assisting in the due diligence process for both sell-side and buy-side transactions.
- Understanding due diligence-related regulatory requirements.

The activities described above do not constitute an exhaustive list of investment banking activities. Registered representatives should contact the Compliance Department if they are not sure whether their activities could be construed as investment banking.

39.3 Conducting Investment Banking Activities Away from the Firm

All associated persons—including registered representatives and Investment Bankers—are prohibited from engaging in investment banking activities away from the Firm without prior written approval of the designated principal. Although some investment banking activities do not directly involve securities and may be conducted by firms not

registered as broker-dealers, it is the Firm's general practice to require its Investment Bankers to conduct all investment banking activities under the direct supervision of the Firm. Under very limited circumstances, the designated principal may allow an investment banking activity to be conducted by an affiliate of the Firm if such activity neither involves securities nor is reasonably likely to evolve into a securities transaction.

40. Sell-Side Advisory

The Firm implements these procedures to cover the sell-side advisory component of its mergers and acquisitions ("M&A") business. These procedures pertain to the sale of a company, division, business, or collection of assets by one of the Firm's sell-side advisory clients (the "Target"). The Firm recognizes the expertise of its Investment Bankers and gives them broad discretion in crafting the sales process that will lead to the optimal mix of value maximization, speed of execution, and certainty of completion (among other deal-specific considerations) for the Target. Because every sales process is unique and must be tailored to the specific priorities of the Target, these procedures are general in nature and are meant to provide guidance on applicable rules and standards without limiting Investment Bankers to using certain sale processes that might not be in the Target's best interests. Despite the flexibility afforded to Investment Bankers in selecting an appropriate sales process, the Firm requires rigid adherence to all laws and regulations.

40.1 Sales Processes

Before determining a sales process, Investment Bankers must ascertain the objectives of the Target. Investment Bankers may use any one or combination of the following processes to achieve favorable results for a Target:

- **Broad Auction**—Investment Bankers should consider using this process if a Target is looking to reach as many interested parties as reasonably possible in an effort to maximize competitive dynamics and heighten the probability of finding the one buyer willing to offer the best value. Broad auctions might not be appropriate if the Target has concerns about confidentiality, business disruptions, and timing.
- **Targeted Auction**—This sales process might better than a broad auction if the Target is looking for speed, greater confidentiality, a particular transaction structure, or a cultural fit.
- **Negotiated Sale**—This sales process focuses on one particular buyer and is good if the Target is looking to reduce the upfront organization, marketing, and resources commonly needed for an auction.

Investment Bankers may choose any variation or combination of the aforementioned processes to achieve the Target's objectives.

40.2 Drawbacks of Auctions

Investment Bankers must consider the following drawbacks in electing to use a broad or targeted auction:

- Information leakage into the market from bidders;
- Negative impact on employee morale at the Target;
- Possible collusion among bidders;
- Reduced negotiating leverage once a winner is chosen that could lead to re-trading (the practice of replacing an initial bid with a lower one at a later date); and
- Tainted perception of the Target in the event of a failed auction.

When recommending the use of an auction, Investment Bankers are expected to disclose all risks and drawbacks to the Target.

40.3 Advantages and Disadvantages of Broad and Targeted Auctions

When deciding between a broad or targeted auction, Investment Bankers must consider and disclose the following advantages and disadvantages.

	Broad	Targeted
Advantages	• Heightens competitive dynamics • Maximizes probability of achieving maximum sale price • Helps to ensure that all likely bidders are approached • Limits potential buyers' negotiating leverage • Enhances board's comfort that it has satisfied its fiduciary duty to maximize value	• Higher likelihood of preserving confidentiality • Reduces business disruption • Reduces the potential of a failed auction by signaling desire to select a buyer • Maintains perception of competitive dynamics • Serves as a "market check" for board in discharge of its fiduciary duties

Disadvantages	• Difficult to preserve confidentiality • Greatest risk of business disruption • Some prospective buyers may decline participation in broad auctions • Unsuccessful outcome can create perception of an undesirable company or asset ("taint") • Risk that industry competitors may participate just to gain access to sensitive information or key executives	• Potentially excludes credible buyers that may not recognized as prospective bidders • Potential to leave money on the table if certain buyers are excluded • Lesser degree of competition • May afford buyers more leverage in negotiations • Provides less market data on which board can rely to satisfy itself that value has been maximized

40.4 Stages of an Auction Process

With some variation, a traditional auction should generally be structured using the following stages and approximate timeline. Investment Bankers are expected to manage each stage of the sale process for the Target and ensure that the following responsibilities (if applicable) are carried out by them, their deal team, management, or qualified professionals (*e.g.*, attorneys).

Stage	Responsibilities
Organization and Preparation **(2-4 weeks)**	1. Identify seller objectives and determine appropriate sale process 2. Perform sell-side due diligence and preliminary valuation analysis 3. Select buyer universe 4. Prepare marketing materials 5. Prepare confidentially agreement
First Round	1. Contact prospective buyers

(4-6 weeks)	2. Negotiate and execute confidentiality agreements with interest parties 3. Distribute Confidential Information Memorandum and initial bid procedures letter 4. Prepare management presentation 5. Set up data room 6. Prepared stapled financing package (if applicable) 7. Receive initial bids and select buyers to proceed to second round
Second Round **(6-8 weeks)**	1. Conduct management presentations 2. Facilitate site visits 3. Provide data room access 4. Distribute final bid procedures letter and draft definitive agreement 5. Receive final bids
Negotiations **(2-6 weeks, longer if a third round is needed)**	1. Evaluate final bids 2. Negotiate with preferred buyer(s) 3. Select winning bidder 4. Render fairness opinion (if required) 5. Receive board approval and execute definitive agreement
Closing **(4-8 weeks or longer)**	1. Obtain necessary approvals 2. Financing and closing

Organization and Preparation

Identifying Seller Objectives and Determining Appropriate Sale Process

Investment Bankers must have a reasonable basis to believe that a recommended sales process is suitable for the Target based on the information obtained through reasonable diligence to ascertain the Target's objectives and needs.

Performing Sell-Side Advisor Due Diligence and Preliminary Valuation Analysis

Investment Bankers must perform sell-side due diligence and valuation analysis in the early stages of an auction. Due diligence and valuation analysis should be conducted by qualified Investment Bankers on the deal team. In other words, due diligence and valuation analysis should not be delegated to persons who are unqualified to perform such functions. Investment Bankers are expected to fully understand any numbers or assumptions used in a valuation methodology.

Selecting Buyer Universe

Investment Bankers should compile a list of prospective buyers and present such list to the Target before contacting any buyers. The Target should review the list of prospective buyers and remove any buyers it does not want the Investment Banker to contact. Investment Bankers should contact only those prospective buyers authorized by the Target.

Preparing Marketing Materials

Investment Bankers must obtain pre-approval of marketing materials used by the Target during the sale process. Marketing materials consist primarily of the teaser and a confidential information memorandum ("CIM").

The teaser is a form of sales literature and must be pre-approved by the Firm before its distribution. The "teaser" should be an initial introduction and brief overview of the Target and its business. It should be a short document, only one or two pages long, that describes the Target and the buying opportunity it presents. The teaser should provide just enough information to attract the attention of buyers without revealing any confidential information about the Target. If deemed appropriate to preserve confidentiality, Investment Bankers must conceal the name of the Target. If the Target is especially sensitive about disclosing the fact that it is for sale, Investment Bankers must exercise extreme caution to avoid revealing details about its business.

Investment Bankers should generally include the following information in the teaser:

- A summary of the proposed transaction;
- A basic description of the Target's business—what it does, who it sells to, and where it operates;
- A synopsis of the Target's financials without projecting performance;
- A description of the investment opportunity the Target presents;

- Contact details for the person (usually the Investment Banker) who can provide further information;
- Eye-catching graphs and charts (must not project performance or be deceptive).

Preparing Confidentiality Agreement

The confidentiality agreement ("CA") is a contract between the Target and a prospective buyer. The CA, also known as the non-disclosure agreement, limits the prospective buyer's ability to disclose or share the Target's confidential information. The scope of the CA should vary depending on what type of company the Target is and what trade secrets or specific confidentiality concerns it may have. Investment Bankers should recognize that the bare fact that the Target is up for sale could be confidential information.

Investment Bankers must make sure the CA is distributed to and signed by prospective buyers before disclosing any confidential information. Investment Bankers should keep in mind that a breach of the confidentiality agreement may be very difficult to prove. Thus, if the Target is uneasy about disclosing certain information to a specific prospective buyer (*e.g.,* an unscrupulous direct competitor), the Investment Banker must assess the risks to the Target before it enters into a CA with the prospective buyer. Investment Bankers may consider using a less detailed set of materials for competitors, at least initially.

The Target's legal counsel should draft the CA. Some prospective buyers (or their counsel) may request modifications to the CA. Regardless of the details, the CA must state that the recipient of confidential information will keep the information confidential, will not disclose it except to specified consultants and advisors who have also signed a confidentiality agreement, and will not use the information for any purpose other than to evaluate the proposed transaction.

The CA usually should define what information is to be treated as "confidential," and how it will be designated as such. (The Target is usually interested in an expansive definition, while the prospective buyer prefers a narrow definition.) The CA may also:

- require the return or destruction of documents containing confidential information;
- specify how long the recipient must maintain confidentiality; and
- prohibit the prospective buyer from hiring key employees or executives of the Target if the buyer fails to complete a purchase.

CAs for public companies may also contain a standstill clause, which prohibits a buyer who fails to complete an acquisition from attempting a hostile takeover or seeking to amass shares of the target in the open market.

First Round

Contacting Prospective Buyers

Based on the buyer analysis and the sale process decided upon, the Investment Banker should contact the most logical prospective buyers. In a targeted solicitation, the Investment Banker should approach a handful of likely prospective buyers; if a broad auction process is being used, the Investment Banker should solicit a larger number of potential buyers.

The Investment Banker should generally use the phone to contact prospective buyers. If the Investment Banker determines that the prospective buyer has a legitimate interest in learning more about a proposed deal, he may provide a copy of the teaser and the CA.

Negotiating and Executing Confidentiality Agreements with Interest Parties

Investment Bankers must ensure that prospective buyers sign the CA. Legal counsel should become involved if the terms of the CA require negotiation. Once the CA is signed, the Investment Banker may provide more detailed information about the Target and the proposed transaction.

Distributing Confidential Information Memorandum and Initial Bid Procedures Letters

Early in the sale process, the Investment Banker and his sell-side team must create a confidential information memorandum ("CIM") describing the Target and the proposed transaction. The CIM must be pre-approved by the Firm. Unlike the fairly generic and much shorter teaser, the CIM will contain detailed and confidential information about the Target. Investment Bankers must ensure that the CIM fairly presents the Target to potential buyers.

CIMs may vary substantially from one company and industry to another. Normally, the CIM should include a short overview of the proposed deal; information about the Target's operations, industry segment, products and services, customer base, distribution network, and management team; historical and projected financial results, with commentary; and often a pitch about the investment opportunity the Target offers. Investment Bankers should consider whether the sell-side team should create an abridged version of the CIM that omits the most sensitive information for distribution to

competitors or other potential buyers about which the Target or its advisors have concerns.

Investment Bankers are prohibited from sending out a copy of the CIM to any prospective buyer that has not signed the CA.

Preparing Management Presentation

The Investment Banker should assist the Target in crafting appropriate management presentations to potential buyers, keeping in mind the capabilities of company executives, the extent to which confidentiality is required, the goals and strategy of the seller, and the likely interests of potential buyers. The typical presentation is in the form of a PowerPoint presentation or other slideshow, followed by a question-and-answer session. Investment Bankers must ensure that materials used as part of the management presentation are fair and balanced. These materials must be pre-approved by the designated principal.

Setting up Data Room

With assistance from the Target, Investment Bankers are expected to set up the data room and organize its contents.

Preparing Stapled Financing Package

Stapled financing refers to pre-packaged financing arrangement offered to prospective bidders. The Firm does not have the underwriting capabilities to offer stapled financing but may work with other investment banks capable of providing staple financing. Investment Bankers must obtain prior approval of the Firm before offering a stapled financing package during the sales process.

Receiving Initial Bids and Select Buyers to Proceed to Second Round

Investment Bankers must thoroughly analyze any bids received in the first round. A list of bidders with their bid information should be presented to the Target for consideration. The Target, not the Investment Bankers, must make the ultimate decision as to which bidders will enter the second round.

Second Round

Conducting Management Presentations

Investment Bankers are expected to facilitate the management presentations. Any materials prepared by the Investment Banker for use in the management presentation must be pre-approved by the Firm.

Facilitating Site Visits

Investment Bankers are expected to facilitate site visits. Site visits should be conducted in a manner that would not cause the Target's employees to realize the Target is for sale. Ideally, only the site's managers should know that the persons touring the site are prospective buyers.

Providing Data Room Access

The data room should be made available only to serious bidders. Investment Bankers must control access to the data room and its contents by assigning appropriate permissions to prospective buyers. Buyers that compete directly with the Target should be denied access to sensitive competitive information (*e.g.,* contracts with customers and suppliers) until later stages.

Distributing Final Bid Procedures Letter and Draft Definitive Agreement

The final bid procedures letter provides guidelines for submitting a final bid that is legally binding. The definitive agreement is the contract that binds the buyer and seller to the terms and conditions of the transaction. Investment Bankers should have the Target's legal counsel prepare a draft of the definitive agreement. Investment Bankers are responsible for ensuring the final bid procedures letter and the draft definitive agreement are distributed to the preferred bidders remaining.

Receiving Final Bids

Investment Bankers are expected to gather the final bids by the date specified in the final bid procedures letter.

Negotiations

Evaluating Final Bids

Investment Bankers must work with the Target to assess final bids. Investment Bankers should not assume that the highest bid is best. A high bid subject to significant terms and conditions might be less favorable than a lower bid with fewer conditions. Investment Bankers are expected to have the expertise to assess the attractiveness of bids.

Negotiating with Preferred Buyer(s)

Investment Bankers are expected to skillfully negotiate with the preferred bidder(s) to obtain the best possible combination of price and terms for the Target.

Selecting Winning Bidder

The Investment Banker should work with legal counsel to prepare a final definitive agreement with the winning bidder. Since the Target usually reserves the right to reject any bidders and may elect to reject all of them, Investment Bankers must respect a Target's decision to reject all bidders.

Rendering Fairness Opinion

If the Target requires a fairness opinion, Investment Bankers should ensure that it is prepared by someone who does not have an interest in seeing the deal close. Due to the conflict of interest, Investment Bankers should not prepare fairness opinions for their own deals.

Receiving Board Approval and Executing Definitive Agreement

Following a board's approval of a deal, Investment Bankers should ensure that the parties execute the definitive agreement and begin working toward meeting the closing conditions.

Closing

Obtaining Necessary Approvals

Investment Bankers must make certain that the parties obtain the required regulatory approvals. The filings should be made promptly after execution of the definitive agreement. Investment Bankers should do whatever they can to facilitate these approvals and bring the deal to consummation.

Financing and Closing

After all conditions in the definitive agreement are met, Investment Bankers must ensure that the transaction is closed in a timely manner.

40.5 Negotiated Sales

When an auction is not appropriate for a Target, the Investment Banker should consider the advisability of pursuing a negotiated sale. In the case of a negotiated sale initiated by a buyer, the Investment Banker should consider whether it would better for the Target to use a broad or target auction. In deciding the appropriateness of using a negotiated sale, Investment Bankers should consider the following advantages and disadvantages.

Negotiated Sale	
Advantages	• Highest degree of confidentiality

	• Generally less disruptive to business than an auction; flexible deal timeline and deadlines • Typically fastest timing to signing • Minimizes “taint” perception if negotiations fail • May be the only basis on which a particular buyer will participate in a sale process
Disadvantages	• Limits seller negotiating leverage and competitive tension • Potential to leave money on the table if other buyers would have been willing to pay more • Still requires significant management time to satisfy buyer due diligence needs • Depending on buyer, may require sharing sensitive information with competitor without certainty of transaction close • Provides less market data on which the board of directors can rely to satisfy itself that value has been maximized

The negotiated sales process uses much of the same steps as a broad or targeted auction process. When conducting a negotiated sale, Investment Bankers should refer to the corresponding section of the procedures for an auction process.

41. Buy-Side Advisory

The Firm's buy-side advisors ("Investment Bankers") are responsible for following these procedures when representing a client that is buyer or bidder in a transaction. Because much of the Firm's procedures regarding sell-side transactions apply equally (if in reverse) to buy-side transactions, Investment Bankers must be familiar with the Firm's sell-side advisory procedures in addition to these buy-side advisory procedures.

41.1 Analysis before the Bid

The Investment Banker's preliminary analysis may vary depending on whether the client is simply looking around for a company to buy or is responding to a solicitation by a specific target. In either case, much of the work that goes into the transaction on the buy side should happen before a bid is ever submitted. The Investment Banker's preliminary analysis should focus on the buyer's objectives in general, on the types of transactions that would best meet those objectives, and on whether a specific transaction involving a particular target makes sense for the buyer.

41.2 Determining the Buyer's Strategy

As an initial matter, the Investment Banker must determine why the buyer is interested in an acquisition or merger. The answer typically has something to do with enhancing shareholder value, but the Investment Banker must fully understand the buyer's specific strategy or what the buyer believes its strategy to be, which is not always the same thing.

Potential buyers typically fall into two categories: (1) financial buyers or sponsors and (2) strategic buyers. Financial buyers, which are often private equity funds, generally adhere to a strategy of generating the greatest returns on investment, which may entail using leverage when possible. If a financial buyer does not find the projected returns attractive, it will not pursue the deal.

A strategic buyer may have different concerns, and it is the Investment Banker's duty to assess these concerns. The strategic buyer is often seeking to purchase a business that provides a strategic fit in the long-term, and it may be willing to pay more for that business than a financial buyer would pay. The nature of a strategic buyer's interests can vary, but often entails looking to expand into a new line of business or geographic region. The Investment Banker should consider conducting a "buy versus build" analysis with the buyer to determine whether an acquisition makes sense. The Investment Banker might find that the buyer can achieve the same goals on its own without the need to acquire a target company. If the Investment Banker and buyer decide that it is

best to pursue an acquisition, the Investment Banker should help the buyer develop a list of potential targets or respond to one or more specific solicitations.

41.3 Assessing the Buyer's Resources and Financial Capacity

Once the Investment Banker identifies the buyer's acquisition strategy, he must assess the buyer's realistic capacity to complete an acquisition. Investment Bankers should understand that strategic buyers often suffer from an unrealistic assessment of the costs and benefits of a proposed transaction. The Investment Banker should ensure that the buyer is not making unwarranted assumptions about potential synergies.

The buyer's financial capacity is a major consideration, but Investment Bankers must also consider non-financial resources. Investment Bankers should warn buyers that even a relatively simple acquisition can create a tremendous drain on management time and attention. Even if the buyer can afford a transaction, the Investment Banker should assess whether the buyer has the management depth to complete the deal successfully.

The Investment Banker should provide a reality check early on, if one is necessary. When a buyer goes bankrupt after making a bad acquisition, the bankruptcy trustee may allege that the investment bank is liable for advising to proceed with the acquisition. For this reason, Investment Bankers are prohibited from recommending an acquisition if the buyer's financial or non-financial resources are inadequate and make the deal too risky.

41.4 Evaluating the Rationale for the Acquisition

When a potential target presents itself, the Investment Banker should help the buyer evaluate the rationale for the acquisition by considering, among other things, these questions:

- Does the acquisition fit into the buyer's overall strategy?
- What is the value of the proposed acquisition—not merely in monetary terms, but in terms of advancing the buyer's goals?

If a quick analysis of the rationale for the proposed transaction suggests that the opportunity is worthy of further exploration, the Investment Banker should evaluate the target in much greater detail.

41.5 Identifying Potential Hurdles

In addition to looking for benefits to the transaction, the Investment Banker should also consider potential corporate, structural, or legal hurdles. Such hurdles could include regulatory issues or a mismatch of corporate cultures. One potential impediment that Investment Bankers should always try to identify is the existence of anti-takeover defenses.

It is the Investment Banker's duty to find out whether the target has any means to defend itself from a takeover. One common defense, for example, is a shareholder rights plan or "poison pill." These plans kick in when a hostile takeover is threatened, and gives non-hostile shareholders the right to purchase additional shares at a heavily discounted price. The percentage of hostile shares is thus progressively diluted, and the raider has to either call off the transaction or use a different takeover strategy. Another defensive tactic is the use of staggered boards, in which directors have staggered three-year terms; since only one-third of the directors are elected at each annual meeting, it is difficult to change the board makeup through a proxy contest. Certain state laws such as control share acquisition statutes, if not waived, can also delay or complicate an acquisition. Most anti-takeover defenses will not prove to be insurmountable hurdles in a negotiated sale or seller-initiated auction process. Nonetheless, Investment Bankers must identify and evaluate them.

41.6 Identifying Potential Tax Issues

Tax considerations should be an integral part of the buyer's early analysis. Tax advisors will assist in identifying and formulating strategies to address potential tax issues. Investment Bankers are prohibited from providing tax advice to clients.

41.7 Reviewing the Confidentiality Agreement and Confidential Information Memorandum

If the teaser or other communications are of initial interest to the buyer, the buyer or the Investment Banker should request additional information. The seller almost always requires prospective buyers to sign a confidentiality agreement ("CA") or non-disclosure agreement before it provides confidential details. The Investment Banker should review and comment on the CA. Matters of concern should be forwarded to the buyer's legal counsel for further review and possible negotiation.

Once a CA is in place, the sell-side banker will send the prospective buyer the confidential information memorandum ("CIM"). Investment Bankers are expected to

spend a great deal of time reviewing and digesting the information in the CIM on behalf of their clients.

41.8 Analyzing the Target

After reviewing the CIM, the Investment Banker should analyze whether, and to what extent, the proposed transaction would enhance shareholder value. In addition to the target's finances, the Investment Banker should also analyze the target's future prospects and market position, and dynamics within the target's industry. If the buyer is a financial buyer, the Investment Banker should focus on financial issues and on the target's potential place among any existing portfolio companies. If the buyer is a strategic buyer, the Investment Banker should spend time looking at non-financial strategic considerations based on the buyer's specific needs or wants.

The Investment Banker should be on the lookout for potential synergies—*e.g.*, reduced costs or increased revenues—that could result from the transaction. Generally, it is easier to achieve cost savings, through economies of scale, increased efficiencies, and elimination of redundant facilities and other assets, than to capture increased revenues. The Investment Banker should ensure that any projected synergies are realistic, especially to the extent the projections affect the valuation analysis. If the buyer proceeds, the Investment Banker must ultimately incorporate much more information into his analysis than the CIM provides or that is available from other sources.

41.9 Valuation

The Investment Banker must use the data provided in the confidential information memorandum, as well as documents made available later during the due diligence process, to produce valuations of the target company using appropriate metrics, ratios, and analyses. Although the sell-side banker may have already produced a valuation using these techniques, the Investment Banker is expected to check the seller's figures using his own, more conservative, assumptions.

41.10 Evaluating Credit Implications

A merger or acquisition may affect the parties' credit ratings. Investment Bankers must consider the credit rating impact to the buyer, since the buyer survives as an entity with a credit rating after the deal is done. Investment Bankers should carefully assess whether an adverse effect on the buyer's credit rating could manifest itself as a higher cost of capital in the future.

The Investment Banker should assist the buyer in evaluating the credit implications of a proposed transaction. Using cash to acquire a company often has a greater potential for

adversely affecting the buyer's credit rating than using shares. Investment Bankers may consult with credit rating agencies on a confidential basis to obtain guidance on the likely effect of a proposed transaction on the buyer's credit rating.

41.11 Assessing Other Buyers

The Investment Banker should be an excellent source of knowledge on other potential bidders for the target company. The Investment Banker should be able to assess the capabilities of other potential buyers (to the extent their identities are known) and advise the client accordingly. The Investment Banker should inform the client of recent developments among other buyers that could affect the competitive environment of the auction process. For example, a prospective buyer could announce a different acquisition that effectively takes it out of the bidding process.

41.12 Anticipating Market Reaction

The Investment Banker should be able to anticipate and evaluate potential market reaction to a merger or acquisition announcement. While the effect of a merger announcement on the target's share price will typical cause a rise, the effect on the buyer's share price is not always so easy to forecast. In general, in a hot merger market, where mergers and consolidations are well received by the market, the buyer's share price is likely to rise; in a cold market, its share price may fall in anticipation of the merger or acquisition.

In addition to the effect on share prices, the Investment Banker should consider the potential reaction of analysts and the financial press. A positive reaction is always preferable, since a negative market or analyst reaction may discourage shareholders from approving the transaction, if a shareholder vote is necessary.

41.13 Bidding Process

Once the pre-bid analysis is complete, the Investment Banker should consult with the client to determine whether or not to continue exploring a potential deal with the target. If the buyer wishes to proceed, the Investment Banker should assist in the bidding process.

41.14 Assistance with Preliminary Bid

The Investment Banker should work with the buyer to develop a preliminary indication of interest ("IOI") that is realistic for the buyer and likely to be competitive in terms of price range and strategic considerations. The Investment Banker should review and

finalize the IOI, making sure that it addresses all items required by the initial bidding procedures letter, and that it is submitted by the deadline in the prescribed manner.

41.15 Working with the Seller and Sell-Side Advisors

The Investment Banker should make the initial contact with the seller's investment bankers (or with the seller directly, if the buyer is the one proposing a deal). Once the bidding process is under way, both before and after the buyer submits its initial IOI, the Investment Banker should serve as the buyer's liaison with the seller's investment bankers and other advisors. Informal interaction between the advisors on both sides often proves an effective and efficient way of obtaining and communicating desired information and clarifications, and helps speed the bidding process along. Investment Bankers should maintain a log of their calls and interactions with the target company.

41.16 Arranging Financing

If the buyer requires financing to complete the acquisition, the Investment Banker may help arrange appropriate financing. If the target's investment bank offers a stapled financing package, it may be a desirable financing option and can streamline the purchase process. However, the buyer is not required to accept the staple, and the Investment Banker should consider whether the buyer may be able to obtain financing from alternative sources at more attractive terms.

41.17 Due Diligence

The Investment Banker should work with the buyer's legal counsel and other members of the buy-side team to review the due diligence materials provided by the seller. The Investment Banker must follow up with the sell-side advisor to request additional due diligence information and to seek clarification and explanation as necessary.

41.18 Final Bid

If the buyer decides to pursue the acquisition, the Investment Banker should work with the buyer to create, review, finalize, and submit a final round bid. Because the final bid is binding if accepted, this process can be quite intense and requires solid financial analysis, sound judgment, and strategic thinking by the Investment Banker. If the seller has distributed a form of purchase/sale agreement for review, the Investment Banker should work with the buyer and the buyer's legal counsel to comment on the terms of the draft agreement.

41.19 Fairness Opinions

The buyer's board of directors may request a fairness opinion. To avoid conflicts of interest, the fairness opinion should typically be prepared by a different investment bank that has no interest in the completion of the deal. The Investment Banker must obtain prior approval of the designated principal before undertaking to prepare a fairness opinion.

41.20 Communicating Material Agreement Terms

If the buyer is the successful bidder (or one of the successful bidders), the Investment Banker should help negotiate the final substantive financial terms of the transaction. Once the seller confirms that the buyer is the sole successful bidder, and both sides have agreed on all material terms, the parties may or may not sign a letter of intent before a definitive final agreement is drafted. Regardless, the Investment Banker should communicate the material financial terms of the transaction to the buyer's accountants and legal counsel. If all conditions are met, the Investment Banker should work with the buyer to sign the definitive agreement.

42. FAIRNESS OPINIONS

Fairness opinions are routinely used by directors of companies in connection with a change of control transaction, such as a merger or sale or purchase of assets, to satisfy their fiduciary duties to act with due care and in an informed manner. A fairness opinion or information about a fairness opinion is often provided to shareholders as a part of the proxy materials relating to a change of control transaction. Fairness opinions express a conclusion as to whether the consideration offered in a transaction is within the range of what would be considered "fair." Such opinions generally do not offer an opinion as to whether the consideration offered is the best price that could likely be attained.

42.1 FINRA Rule 5150 (formerly NASD Rule 2290)

FINRA 5150 is a complementary rule that requires broker-dealers that render fairness opinions to inform investor-shareholders about the potential conflicts of interest that may exist between the firm rendering the fairness opinion and the issuer. The rule also addresses specific procedures concerning the issuance of fairness opinions.

42.2 Disclosures

In accordance with FINRA Rule 5150(a), the Firm is required to provide certain disclosures in fairness opinions. If the Firm knows or has reason to know at the time a fairness opinion is issued to a company's board, that the opinion will be provided or described to the company's public shareholders, the Firm must make the following disclosures in the fairness opinion:

1. If the Firm will receive any compensation contingent on the successful completion of the transaction for acting as a financial advisor to any party to the transaction or otherwise.
2. Any contemplated or existing material relationships involving the payment or receipt of compensation between the Firm and any party to the transaction during the last two years.
3. If the Firm has independently verified any information supplied by the company requesting the fairness opinion, which is a substantial basis for the opinion and, if so, describe the information.
4. Whether the fairness opinion was approved or issued by a fairness committee.

5. Whether the fairness opinion expresses an opinion about the fairness of the compensation to any of the company's insiders, relative to the compensation to the company's public shareholders.

42.3 Fairness Committee

The rendering of fairness opinions are led by the designated principal. The Firm may form and use a fairness committee, consisting of qualified committee members, to assist in the preparation and review of fairness opinions. The use of a fairness committee in the approval of fairness opinions requires the Firm to establish written procedures identifying when the Firm will use a fairness committee. When a fairness committee is used, the Firm must specify (1) the process for selecting members of the fairness committee, (2) the necessary qualifications for committee members, and (3) the process to promote a balanced review by the fairness committee, including review and approval of persons who are not on the transaction deal team.

The Firm will not require that the fairness committee be composed entirely of persons not serving on or advising the deal team. Rather, the Firm will promote a balanced review by including on the fairness committee, whenever possible, persons who are not serving on the deal team.

42.4 Valuation Analysis

The designated principal is responsible for ensuring the valuation analyses used in fairness opinions are appropriate.

42.5 Supervisory Review

Prior to the Firm's issuance of a fairness opinion, the designated principal is responsible for reviewing the fairness opinion to ensure that it complies fully with Rule 5150. The designated principal must document his review and make a record that the fairness opinion was approved for issuance.

43. Requirements Applicable to Mergers and Acquisitions

43.1 Rule 145

Investment Bankers must ensure that any transactions deemed offers or sales of securities are registered. Under Rule 145, the following transactions are considered offers when submitted to shareholders of a corporation (or other entity) for a vote:

1. **Reclassifications**. A reclassification of securities of the corporation, other than a stock split, reverse stock split, or change in par value, which involves the substitution of a security for another security;
2. **Mergers of Consolidations**. A statutory merger or consolidation, or similar plan or acquisition in which securities of such corporation or held by such security holders will become or be exchanged for securities of any person, unless the sole purpose of the transaction is to change an issuer's domicile solely within the United States; or
3. **Transfers of assets.** A transfer of assets of such corporation, to another person in consideration of the issuance of securities of such other person or any of its affiliates, if:
    i. such plan or agreement provides for dissolution of the corporation or whose security holders are voting or consenting; or
    ii. such plan or agreement provides for a pro rata or similar distribution of such securities to the security holders voting or consenting; or
    iii. the board of directors or similar representatives of such corporation or other person, adopts resolutions relative to (i) or (ii) above within 1 year after the taking of such vote or consent; or
    iv. the transfer of assets is a part of a pre-existing plan for distribution of such securities, notwithstanding (i), (ii), or (iii) above.

43.2 Form S-4

Investment Bankers must ensure that Form S-4 is filed for any transaction requiring registration.

43.3 Rule 165

Investment Bankers must ensure that parties to a transaction that requires registration comply with SEC Rule 165 by filing with the SEC any written communications to be distributed in connection with the transaction.

43.4 Rule 425

Investment Bankers must ensure that all written communications made in reliance on Rule 165 are filed with the SEC on the date of first use.

43.5 Proxy Statement Rules

Investment Bankers must ensure compliance with any proxy statement rules. Investment Bankers should refer to Rule 14A for the proxy statement requirements. An initial proxy statement must be filed with the SEC at least 10 days before the final version of the proxy statement is sent to shareholders.

43.6 Regulation M-A

Investment Bankers should refer to Regulation M-A for instructions on completing the SEC filings applicable to M&A transactions.

44. Due Diligence Activities

The Firm's Investment Bankers are required to conduct thorough due diligence with respect to any investment banking engagement. The level of due diligence should be risk-based and reasonable in light of the risks. Investment Bankers will need to conduct due diligence most commonly when the Firm is participating in a securities offering or representing companies contemplating a merger or acquisition. Investment Bankers are responsible for conducting due diligence and fully understanding the companies involved in the transaction or offering. The following procedures and guidelines are general in nature and apply to most investment banking deals. The designated principal may implement additional due diligence procedures for specific deals, especially in light of the risk the deal poses to investors and the Firm.

44.1 Conducting Due Diligence

At a minimum, Investment Bankers are responsible for conducting the following categories of due diligence as part of an investment banking engagement.

Business and Operational Due Diligence

In conducting business due diligence, Investment Bankers must identify, verify, and evaluate the company's operations, facilities, business strategy, and growth potential. Investment bankers are expected to take the lead role in this process. Investment Bankers should endeavor to conduct interviews not only with management (preferably the CEO and CFO) but also with any other personnel who can provide meaningful information. Investment Banker should ask questions about business operations, management structure, business plans, financial matters, and other relevant issues. Investment Bankers should consider conducting site visits to the company's facilities.

Investment Bankers should not rely solely on management assurances. They should contact employees, suppliers, distributors, and key customers to question them about their relationship with the company and to independently verify information provided by management. In addition to scrutinizing the company itself, Investment Bankers should conduct detailed analyses of the company's competitive position and consider what industry or general macroeconomic trends might affect the business.

Financial and Accounting Due Diligence

In conducting financial due diligence, Investment Bankers must examine the company's capital structure and historical financial results and attempt to predict its future financial performance. An issuer's accountant may provide "comfort letters" confirming

that financial information is accurate. Investment Bankers should not rely exclusively on the representations made by the issuer's accountant.

Legal Due Diligence

Investment Bankers must ensure that legal due diligence is being performed by qualified persons, typically attorneys. The attorneys should thoroughly examine a company's legal records and verify, at a minimum, the following:

- Management has observed corporate formalities,
- The company has complied with all applicable laws and regulations; and
- Critical contracts and documents are in order.

Investment Bankers should instruct the attorneys to assess any actual or pending litigation and identify any potential liabilities. Investment Bankers should request that the attorneys provide comfort letters or written representations concerning important issues.

Bring-Down Due Diligence

Due to the length of time it takes to conduct the due diligence process, Investment Bankers must confirm that information has not changed over the course of the process. Before finalizing a deal or a registration statement, the Investment Banker must confirm the validity of previously obtained information.

44.2 Due Diligence in Mergers and Acquisitions

The Firm requires Investment Bankers engaged in M&A activities to conduct or assist in the following due diligence for sell-side and buy-side engagements.

Sell-Side Transactions

In a sell-side engagement, the Investment Banker must fully understand the business for purposes of valuing, positioning, and marketing the company. By conducting adequate due diligence, Investment Bankers will be able to anticipate and address the concerns of potential bidders.

Performing Business and Financial Due Diligence on the Seller

Investment Bankers are expected to interview management and appropriate third parties, visit and inspect sites, and review financial and operational information. Attorneys may be utilized to conduct a legal due diligence review. Investment Bankers must have a deep understanding of the company's business and finances before proceeding to contact potential buyers.

Assisting in Compiling Due Diligence Material for Potential Buyers

The Investment Banker must work with the seller to gather relevant due diligence materials for potential bidders. The majority of the due diligence materials will be presented to buyers in the data room.

Setting Up the Data Room

The Investment Banker must work with the seller to identify and organize the documents presented in the data room. The contents of the data room may vary from one deal to the next.

Assisting Buyers with Due Diligence

The Investment Banker must maintain contact with potential buyers and assist with the due diligence process. In addition to managing the data room, the Investment Banker should facilitate meetings between prospective buyers and the seller's management and sets up site visits. If the buyer needs additional information that is not available from the data room, the Investment Banker should help to identify who in the seller's organization can provide that information.

Assisting in Performing Due Diligence of Potential Buyers

Investment Bankers should assist the seller with the due diligence of potential buyers. The Investment Banker should try to determine whether a potential bidder is serious about the deal. The Investment Banker should investigate the bidder's previous acquisitions (if any), as well as its general reputation. Investment Bankers should warn the client about any buyers that have a reputation of backing out of deals. Additionally, Investment Bankers should caution the seller about buyers that have a reputation for demanding concessions toward the close of the deal when it is hard for the seller to back out of the sale.

Investment Bankers should be especially careful when dealing with a buyer that is also a competitor. Investment Bankers are expected to evaluate the potential buyer's reputation and use good sense derived from experience to help detect whether a competitor is acting in good faith or trying to gain a competitive advantage by gathering information about the company. When allowing a competitor into the bidding process, Investment Banker must verify the following:

- The confidentiality agreements are well drafted to protect the seller;
- The data room is being managed in a way to limit a competitor's ability to view sensitive documents;
- Trade secrets and other information are disclosed to the competitor only after it seems very probable that the competitor is a legitimate bidder.

The Investment Banker should conduct due diligence into the buyer's financial ability to consummate the transaction. For public companies, Investment Bankers should conduct an analysis of the reported financial statements to assess the bidder's finances and to estimate the maximum price the buyer is likely to pay. If the purchase will be financed, the Investment Banker should determine whether the buyer has obtained or is likely to obtain financing. Performing due diligence on the buyer is especially important if the seller's shareholders plan to hold a minority interest in the acquiring company after the acquisition.

44.2.1 Buy-Side Transactions

The Investment Banker should focus much of his initial efforts on reviewing the information provided by the sell-side advisor. The Investment Banker should work with the sell-side advisors to coordinate management presentations, site visits, data room access, and other due diligence activities. The Investment Banker should perform financial modeling and valuation analysis, as well as investigate information uncovered in due diligence.

Due Diligence from Third-Party Sources and Evaluation of the Target's Leadership

The Investment Banker should collect information from third parties. State public records should be searched to identify any ongoing litigation, judgments against the company, or liens filed on the target's assets. Public records should be examined to determine whether the company is current in its state filings and whether it has the required business licenses. Investment Bankers should search media databases for information about the target's business practices or management.

The Investment Banker should carry out an investigation in an attempt to identify information that could affect the proposed transaction. Typically, this investigation should include an evaluation of and background checks on the target's management. Even if the bidder intends to replace the management team, the Investment Banker must identify any past issues that might adversely affect the company's reputation or value.

If allowed by the terms of any confidentiality agreement, the Investment Banker may interview customers, employees, vendors, or suppliers to confirm information provided by the target. The Investment Banker's primary objective should be identifying any risks that may not be apparent from inspecting the target's financials.

Identifying Strategic Positions for Negotiating

Investment Bankers are expected to recognize when potential problems or liabilities discovered in due diligence afford the bidder greater negotiating leverage. Investment

Bankers should consider using any potential problems to demand concessions from the target. However, Investment Bankers must use discretion in requesting concessions. By being overly demanding, the Investment Banker may cause his client to be rejected as a potential bidder.

Evaluation of Specific Aspects of the Proposed Deal

In performing due diligence, the Investment Banker should look for potential issues between the two entities in areas such as corporate culture or governance. The Investment Banker must bring these issues to the attention of the bidder so it can assess how to deal with them.

45. Regulatory Requirements

45.1 Recordkeeping

The deal file is essentially an archive of relevant information and documentation for a specific transaction. Investment Bankers are expected to compile a deal file to preserve documents created as part of an investment banking engagement. The deal file serves as a useful reference for future deals, and it is an invaluable record in case an investigation is launched or litigation occurs. To ensure that the information in the deal file is easily accessible, Investment Bankers must index the documents so that they can be easily found at a later date. Investment Bankers must adhere to other recordkeeping requirements that apply to all registered representatives.

45.2 Selling Restricted and Control Securities

SEC Rule 144 provides a method for the resale of restricted or control securities. Rule 144 provides a safe harbor for the resale of restricted and control securities. It includes conditions which, if satisfied, permit holders of such securities to sell them publicly without registration and without being deemed underwriters. Rule 145 governs the offer or sale of securities received in connection with reclassifications, mergers, consolidations and asset transfers. Sellers under Rule 145 are afforded similar safe harbor to Rule 144 seller. The Compliance Department should be consulted directly for assistance regarding the processing of Rule 144 and Rule 145 sales. This section is provided for quick reference only.

Restricted Securities Defined

Restricted securities generally are securities which were:

- Acquired directly or indirectly from the issuer or from an affiliate of the issuer (as defined below) in a transaction or series of transactions not involving a public offering.
- Acquired from the issuer and are subject to the resale limitations of Regulation D under the Securities Act of 1933 or acquired in a transaction or series of transactions not involving a public offering subject to the resale limitations of Regulation D.

Affiliate Defined

An "affiliate" of an issuer is a person who directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer. An affiliate can be an individual, certain relatives, trusts, estates, corporations or

other entities in which the seller is a 10% beneficial owner, trustee, executor, or one in a similar capacity.

Control Person and Control Securities

A "control" person is regarded as one who has the power to direct or cause the direction of the management and policies of an issuer of securities through significant stock ownership (generally 10% or more) or by virtue of holding a board or management position with that issuer. Whether or not a customer has a control relationship with the issuer or is a "statutory underwriter" or holds "restricted securities" are legal questions. "Control securities" are those owned by an affiliate of an issuer of the securities.

Holding Period

Under Rule 144, the seller of restricted securities is subject to a one-year holding period prior to sale. If the securities were purchased, they cannot be sold until the full purchase price has been paid. If restricted securities are acquired as a gift, the one-year holding period is assumed to begin the date the donor acquired the shares. The donee's sales are subject to aggregation with sales made by the donor, for purposes of calculating limitations on amount sold.

Limitations on Amount Sold

Rule 144 limits the amount of restricted securities that may be sold during any three-month period. The seller's sales are also subject to aggregation with sales of restricted stock by others connected with the seller. The limitations relate to a percentage of the outstanding shares and the average trading volume in the security. Non-affiliates of the issuer may make unlimited resales of restricted securities after a holding period of two years.

Filing Requirements

The seller is required to file Form 144 concurrent with placing the order or executing the transaction. The Compliance Department should be consulted regarding the necessary filing requirements.

New Account Information Regarding Affiliates

The Firm's new account form includes an inquiry whether the customer is an affiliate of an issuer. Registered representatives are responsible for obtaining this information and, if the customer is an affiliate and places an order to sell shares of the issuer, contacting the Compliance Department for instructions on executing the order under Rule 144.

Lending and Option Writing on Control and Restricted Securities

The lending of money, extension of loan value, or use as collateral of restricted securities is subject to specific limitations. The Compliance Department should be contacted prior to any such arrangement. Covered listed options may be written on underlying control or restricted stock if the stock is saleable when the option is written. The Compliance Department should be contacted to determine the salability of the underlying securities prior to writing covered options.

Reporting of Insider Transactions

Under Section 16(a) of the Exchange Act, directors, officers, and 10% or greater holders of equity securities of a publicly-traded company are required to report their purchases and sales of the issuer's securities to the SEC (and, if the security is listed on a national exchange, with the exchange where listed) as follows:

- at the time the security is registered on a national securities exchange or by the effective date of the registration statement;
- within 10 days of becoming a 10% beneficial owner, director, or officer; and
- by the end of the second business day following a purchase or sale transaction.

Alternative reporting period requirements apply to two categories of transactions in which the insider does not control and may not be able to predict when the transaction will occur:

- Transactions pursuant to a contract, instruction, or written plan; and
- Discretionary transactions pursuant to employee benefit plans such as fund switching transactions.

In these instances, the date the executing broker-dealer or plan administrator notifies the insider of the transaction is deemed the date of execution for reporting purposes, as long as the notification is not later than the third business day following trade date. The SEC may also provide different due dates for limited types of transactions where two-day reporting is not feasible.

If the issuer maintains a corporate website, the issuer is required to post the filing on the site no later than the end of the business day following the filing. Transactions by directors or officers that result in "short-swing" profits but that are exempt from Section 16(b) are also subject to the two-day reporting requirement.

The obligation to report is the responsibility of the insider. Registered representatives should encourage customers to contact their legal counsel if they have questions, and Section 16 should be referenced for specifics regarding filing requirements.

45.3 SEC Rule 144A—Private Resales of Securities to Institutions

SEC Rule 144A must not be confused with SEC Rule 144 (described above). SEC Rule 144A allows for the private resales of restricted securities to qualified institutional buyers ("QIBs").

Registered representatives transacting business in restricted securities in reliance on SEC Rule 144A are prohibited from offering or selling restricted securities to entities that are not verified as QIBs. The term "qualified institutional buyer" is defined in SEC Rule 144A and means:

i. Any of the following entities, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity:

   A. Any insurance company as defined in section 2(a)(13) of the Act ; Note: A purchase by an insurance company for one or more of its separate accounts, as defined by section 2(a)(37) of the Investment Company Act of 1940 (the "Investment Company Act"), which are neither registered under section 8 of the Investment Company Act nor required to be so registered, is deemed to be a purchase for the account of such insurance company.

   B. Any investment company registered under the Investment Company Act or any business development company as defined in section 2(a)(48) of that Act;

   C. Any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958;

   D. Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees;

   E. Any employee benefit plan within the meaning of title I of the Employee Retirement Income Security Act of 1974;

   F. Any trust fund whose trustee is a bank or trust company and whose participants are exclusively plans of the types identified in paragraph (a)(1)(i)(D) or (E) of SEC Rule 144A, except trust funds that include as participants individual retirement accounts or H.R. 10 plans.

G. Any business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

H. Any organization described in section 501(c) (3) of the Internal Revenue Code, corporation (other than a bank as defined in section 3(a)(2) of the Act or a savings and loan association or other institution referenced in section 3(a)(5)(A) of the Act or a foreign bank or savings and loan association or equivalent institution), partnership, or Massachusetts or similar business trust; and

I. Any investment adviser registered under the Investment Advisers Act.

ii. Any dealer registered pursuant to section 15 of the Exchange Act, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $10 million of securities of issuers that are not affiliated with the dealer. (**Important:** Securities constituting the whole or a part of an unsold allotment to or subscription by a dealer as a participant in a public offering are not deemed to be owned by such dealer.);

iii. Any dealer registered pursuant to section 15 of the Exchange Act acting in a riskless principal transaction on behalf of a qualified institutional buyer;
Note: A registered dealer may act as agent, on a non-discretionary basis, in a transaction with a qualified institutional buyer without itself having to be a qualified institutional buyer.

iv. Any investment company registered under the Investment Company Act, acting for its own account or for the accounts of other qualified institutional buyers, that is part of a family of investment companies which own in the aggregate at least $100 million in securities of issuers, other than issuers that are affiliated with the investment company or are part of such family of investment companies. Family of investment companies means any two or more investment companies registered under the Investment Company Act, except for a unit investment trust whose assets consist solely of shares of one or more registered investment companies, that have the same investment adviser (or, in the case of unit investment trusts, the same depositor). For purposes of this section:

A. Each series of a series company (as defined in Rule 18f-2 under the Investment Company Act) is deemed to be a separate investment company; and

B. Investment companies are deemed to have the same adviser (or depositor) if their advisers (or depositors) are majority-owned

subsidiaries of the same parent, or if one investment company's adviser (or depositor) is a majority-owned subsidiary of the other investment company's adviser (or depositor);

v. Any entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers; and

vi. Any bank as defined in section 3(a)(2) of the Act, any savings and loan association or other institution as referenced in section 3(a)(5)(A) of the Act, or any foreign bank or savings and loan association or equivalent institution, acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with it and that has an audited net worth of at least $25 million as demonstrated in its latest annual financial statements, as of a date not more than 16 months preceding the date of sale under the Rule in the case of a U.S. bank or savings and loan association, and not more than 18 months preceding such date of sale for a foreign bank or savings and loan association or equivalent institution.

Determining the Aggregate Amount of Securities

When determining the amount of securities owned and invested on a discretionary basis, the entity wishing to qualify as a QIB must exclude the following: bank deposit notes and certificates of deposit; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency, interest rate, and commodity swaps. It is important to note that any securities owned by subsidiaries of the entity that are consolidated with the entity in its financial statements prepared in accordance with generally accepted accounting principles may be included if the investments of such subsidiaries are managed under the direction of the entity, except that, unless the entity is a reporting company under section 13 or 15(d) of the Exchange Act, securities owned by such subsidiaries may not be included if the entity itself is a majority-owned subsidiary that would be included in the consolidated financial statements of another enterprise.

Valuing Securities

The aggregate value of securities owned and invested on a discretionary basis by an entity is the cost of such securities, except where the entity reports its securities holdings in its financial statements on the basis of their market value, and no current information with respect to the cost of those securities has been published. In the latter event, the securities may be valued at market.

Qualifying Conditions for Resales

In order for the Firm to offer or sell restricted securities to a QIB, the Firm must have a reasonable belief that the buyer is in fact a QIB. The Firm will typically rely on one of the following methods of establishing the purchaser's ownership and discretionary investments of securities:

i. The prospective purchaser's most recent publicly available financial statements. (**Important:** Such statements must present the information as of a date within 16 months preceding the date of sale of securities in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser.);

ii. The most recent publicly available information appearing in documents filed by the prospective purchaser with the SEC or another United States federal, state, or local governmental agency or self-regulatory organization, or with a foreign governmental agency or self-regulatory organization. (**Important:** Such information must be as of a date within 16 months preceding the date of sale of securities in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser.);

iii. The most recent publicly available information appearing in a recognized securities manual. (**Important:** Such information must be as of a date within 16 months preceding the date of sale of securities in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser.); or

iv. A certification by the chief financial officer, a person fulfilling an equivalent function, or other executive officer of the purchaser, specifying the amount of securities owned and invested on a discretionary basis by the purchaser as of a specific date on or since the close of the purchaser's most recent fiscal year, or, in the case of a purchaser that is a member of a family of investment companies, a certification by an executive officer of the investment adviser specifying the amount of securities owned by the family of investment companies as of a specific date on or since the close of the purchaser's most recent fiscal year.

Qualifying Securities for Private Resales

The securities offered or sold by the Firm in reliance on Rule 144A must not have been, when issued, of the same class as securities listed on a national securities exchange registered under section 6 of the Exchange Act or quoted in a U.S. automated inter-dealer quotation system. Securities that are convertible or exchangeable into securities so listed or quoted at the time of issuance and that had an effective conversion

premium[6] of less than 10 percent are treated as securities of the class into which they are convertible or exchangeable. Warrants that may be exercised for securities so listed or quoted at the time of issuance, for a period of less than 3 years from the date of issuance, or that had an effective exercise premium[7] of less than 10 percent, will be treated as securities of the class to be issued upon exercise. The SEC may from time to time, taking into account then-existing market practices, designate additional securities and classes of securities that will not be deemed of the same class as securities listed on a national securities exchange or quoted in a U.S. automated inter-dealer quotation system.

Additionally, the Firm must ensure that the resales are not securities of an open-end investment company, unit investment trust, or face-amount certificate company that is or is required to be registered under section 8 of the Investment Company Act.

Proprietary Trading

Until such time that the Firm becomes a QIB, the Firm is strictly prohibited from purchasing restricted securities offered pursuant to SEC Rule 144A for its own account.

[6] "*Effective conversion premium"* means the amount, expressed as a percentage of the security's conversion value, by which the price at issuance of a convertible security exceeds its conversion value.

[7] "*Effective exercise premium"* means the amount, expressed as a percentage of the warrant's exercise value, by which the sum of the price at issuance and the exercise price of a warrant exceeds its exercise value.

46. Financing Activities and Transactions

In addition to the Firm's traditional investment banking activities, the Firm may engage in or advise on these more specialized financing activities and transactions.

46.1 Reverse Mergers

A recommendation to pursue a reverse merger may be suitable for a private company that wants to get publicly-listed in a relatively short time period. Reverse mergers tend to raise less funding than traditional public offerings. Without an initial public offering, companies might find it hard to obtain market support and analyst coverage for their publicly traded stock. Therefore, Investment Bankers should recommend reverse mergers only when the disadvantages are outweighed by any combination of the following advantages of pursuing a reverse merger:

- Lower cost
- Speedier process
- Not dependent on IPO market for success
- Not susceptible to changes from underwriters regarding initial stock price
- Less time-consuming for company executives
- Less dilution
- Underwriters are unnecessary

46.2 Private Investment in Public Equity (PIPE)

A PIPE is a private placement of securities of an already-public company that is made to selected accredited investors (usually institutional investors). The investors typically enter into a purchase agreement committing them to purchase securities. The agreement usually requires the issuer to file a resale registration statement to allow the investors to sell their securities in the future.

Use of PIPE Transactions

Investment Bankers may advise clients to pursue a PIPE transaction as a source of financing. From time to time, the Firm may participate in a PIPE transaction involving shares of common stock held by selling stockholders or a combination of primary and secondary shares of an already-public company that is made through a placement agent to accredited investors.

Purchasers of PIPEs

The Firm's institutional clients and accredited investors may purchase securities in a PIPE transaction. The Firm must prepare a customer account profile and suitability questionnaire for each accredited investor offered securities through a PIPE transaction. The Firm's designated principal will review and approve the customer profile and suitability questionnaire.

Disclosure

The registered representative is responsible for delivering a private placement memorandum (if one was prepared for the specific transaction). The registered representative must disclose all risks to the investor or his representative. Each registered representative is responsible for disclosing to the investor that the PIPE is a private offering and that certain information shared with the investor is not known to the market. Registered representatives should obtain an acknowledgement from the investor that he understands the transaction is private.

Due Diligence

In a traditional PIPE transaction, the process is controlled by the placement agent. If the Firm acts as an underwriter or placement agent in a PIPE transaction, it will perform extensive due diligence on the issuer's management team and financial statements. The Firm will review, among other things, risk disclosures, material terms of the offering, agreements, background checks, and any other relevant information regarding the issuer.

Payment

The Firm will not accept any customer checks or wires made payable to it or its registered representatives. All checks must be payable to the issuer or, for contingent offerings, the escrow account. All checks must be promptly forwarded to the designated principal. The designated principal will be responsible for promptly forwarding and handling all customer funds. In the event of a contingent offering, the designated principal will ensure that all funds are deposited in an escrow account in accordance with SEC Rule 15c2-4. A "checks received and forwarded" blotter must be maintained to evidence that funds are promptly forwarded (defined as noon the next business day).

SEC Rule 15c2-4

The CCO is responsible for compliance with SEC Rules 15c2-4. In contingent offerings, all customer funds must be deposited in an escrow account in accordance with SEC Rule 15c2-4, until such time as the contingencies of the offerings are met or the offering is

terminated. In the event that the contingency is not met prior to the offering termination date, all customer funds must be returned to the respective parties.

Form D Filings

The Firm is responsible for ensuring that Form D filings are made with the SEC within 15 days of the first sale.

Communications with the Public

The Designated Principal is responsible for approving all marketing materials. The Firm will not engage in any cold-calling or telemarketing activities. The CCO is responsible for establishing training programs and for ensuring that the Firm does not engage in general solicitation for any PIPE offering. General solicitation is strictly prohibited.

Registration of Securities

The Firm may act as dealer manager for selected private offerings. The designated principal must ensure that all marketing materials, including fund materials, are approved by the CCO and filed with FINRA 10-days prior to use (if required pursuant to the regulations). All marketing is to be documented and approved with a signature and date.

Non-Cash Compensation

All employees are strictly prohibited from receiving non-cash compensation. The Chief Compliance Officer is responsible for enforcing this policy and requiring associated persons to attest annually that they have not received non-cash compensation.

Regulation M

The Firm does not engage in market making activities; therefore, it will not make a market in the securities in which it offers through a PIPE transaction.

Research Activities

If the Firm issues research reports, it will suspend the issuance of any and all research reports for any issuer offering securities through a PIPE transaction by the Firm. The issuer will be put on the Firm's watch/restricted lists.

Underwriting Engagement Letter

When underwriting a PIPE, the Firm must maintain an underwriting engagement letter with the issuer, which discloses its responsibility as the placement agent and the underwriting concessions and agency fee. The designated principal is responsible for reviewing and approving the underwriting engagement letter and keeping a copy in the underwriting file.

Books and Records

The designated principal is responsible for keeping a file for each PIPE offering in which the Firm participates, which will include all due diligence files, the PPM (if prepared for the offering), a list of investors, subscription documents, the checks received and forward blotter, sales/marketing materials, and any other records regarding the offering.

46.3 Bank Financing

Investment Bankers may work with clients to develop bank financing relationships or to obtain financing through programs offered by the Small Business Administration (SBA). At all times, Investment Bankers must act in the client's best interest and avoid conflicts of interest. For example, it would be inappropriate for an Investment Banker who has an association with a bank to steer the client toward the bank if such bank cannot offer the best terms of financing.

46.4 Liquidation and Restructuring

For Chapter 7 proceedings, Investment Bankers may advise on and assist with the sale of assets that are being liquidated. For Chapter 11 proceedings, Investment Bankers should generally work with attorneys in a restructuring. Bankruptcy law is very complex, and Investment Bankers should take great precautions to avoid giving any advice that could be construed as legal advice. Investment Bankers are strictly prohibited from giving any legal advice.

46.5 Angel Investing

Investment Bankers may advise clients on obtaining rounds of financing from angel investors. Angel investors tend to be very sophisticated, so Investment Bankers should protect the client's best interest and ensure that the angel investors do not take advantage of the client.

46.6 Venture Capital

Investment Bankers may advise clients on obtaining financing from private equity groups and venture capitalists. As with angel investors, private equity groups and venture capitalists are very sophisticated. It is the duty of the Investment Banker to protect his client's best interests.

46.7 Rights Offerings

Investment Bankers may advise clients on raising money through a rights offering.

46.8 Leveraged Buyouts

Leverage buyouts are transactions in which a public company (or part of it) is taken private by investors through the use of borrowed capital. Investment Bankers must notify the designated principal prior to participating in or recommending a leverage buyout strategy.

46.9 Takeover and Tender Offers

A tender offer is an open solicitation to purchase a significant percentage of a company's outstanding shares from existing shareholders. It is an alternative to acquiring a company through a negotiated merger. Investment Bankers must obtain approval of the Firm prior to participating in or recommending a tender offer or takeover strategy.

46.10 Interests in Mortgages or Other Receivables

With prior approval of the Designated Principal, Investment Bankers may advise on or participate in transactions involving the sale or purchase of interests in mortgages or other receivables. It is important to note that interests in mortgages or other receivables may be deemed securities under federal or state securities laws. The Designated Principal will review the terms of any sale or purchase and make sure the interests, if deemed securities, are either properly registered or qualify for an exemption from registration. The Firm will implement additional procedures if its Investment Bankers become involved in a public offering of interests in mortgages or other receivables.

47. UNDERWRITING ACTIVITIES

47.1 Best Efforts Offerings

The Firm's underwriting activities will be restricted to best efforts offerings. The Firm is prohibited from participating in a firm commitment offering.

47.2 Firm Commitment Offerings

The Firm has not been approved by FINRA to participate in a firm commitment offering. The Firm and it Registered Representatives are strictly prohibited from having any involvement in a firm commitment offering.

47.3 Agreements

The Designated Principal will ensure that all underwriting agreements, selling group agreements, syndicate agreements, and commitment letters are executed and maintained in the files pursuant to SEC Rule 17a-4. In no case will these agreements be permitted to bind the Firm to a participation that would cause a capital deficiency.

47.4 Due Diligence

The Designated Principal will review and maintain all appropriate documents necessary to demonstrate the fulfillment of the Firm's due diligence responsibilities pertaining to each security underwritten. Such documents may include:

- Final and preliminary prospectuses
- Copies of regulatory filings
- Registration statements
- Blue sky memorandum
- Correspondence
- Any research or analysis (gathered during the structuring of the deal)
- Financial statements or filings of the issuer
- Free-riding questionnaires

The above noted information will be maintained in a specified underwriting file. A cover note or checklist will be included which will evidence that the Designated Principal has reviewed the documents.

47.5 Sales Practices

The Designated Principal will ensure that:

1. Final prospectuses are delivered to each customer that purchases an initial public offering. Each offering document will be numbered and a record will be prepared indicating the offering document provided to the client. Each offering will be reviewed by the Designated Principal who will initial that record as evidence of review.
2. All securities are placed in accordance with FINRA's free-riding rules. If requested by FINRA through a free-riding questionnaire, the Designated Principal will ensure that a response is promptly made through the FINRA COBRA system. The response will be made by the Designated Principal and a copy will be maintained on file.
3. The Firm's insider trading policies are adhered to.
4. No selling concessions have been improperly granted and that the offering price has been maintained.
5. Designated credits paid to another member are documented and filed with FINRA within 30 days of each quarter end.
6. Designated credits received are documented including customer's name, security name, manager of the offering, and the date of the commencement of the offering.

47.6 Regulatory Filing Requirements with the FINRA Corporate Finance Department

The Designated Principal will ensure that all regulatory filing requirements are met. In addition, the Designated Principal will maintain a file of all correspondence with the FINRA Corporate Finance Department. All correspondence is reviewed and initialed by the Designated Principal.

All public offerings must be filed with the FINRA Corporate Finance Department where the terms and arrangements of the proposed offering are reviewed to ensure the offering is fair and reasonable. This is typically done by the managing underwriter, but can be done by another syndicate member. While there is no specific compensation amount allowed by the rule, anything under 10% is generally acceptable.

Documents to be filed:

- Three copies of the registration statement, offering circular, offering memorandum, notification of filing, notice of intention, application for conversion and/or any other document used to offer securities to the public;
- Three copies of any proposed underwriting agreement, agreement among underwriters, selected dealer agreements, agency agreement, purchase agreement, letter of intent, consulting agreement, partnership agreement, underwriter's warrant agreement, escrow agreement, and any other document that describes the underwriting or other arrangements in connection with or related to the distribution.
- Three copies of each pre- and post-effective amendment to the registration statement or other offering document, one copy marked to show changes and three copies of any other amended document previously filed and one copy to show marked changes;
- Three copies of the final registration statement declared effective by the Commission or equivalent final offering document and a list of the members of the underwriting syndicate, if not indicated therein, and one copy of the executed form of the final underwriting documents and any other document submitted to FINRA for review.

All documents that are filed with the Commission through the EDGAR system shall be treated as filed with FINRA.

47.7 Offerings Not Required To Be Filed (with the FINRA Corporate Finance Department)

- Exempt securities (exempt from registration under sections 4(1), 4(2) and 4(6) of the '33 Act. Rule 505 and 506 of Regulation D)
- Securities defined as exempt by section 3(a)(12) of the 1934 Exchange Act
- Open-end investment companies
- Variable contracts
- Municipal securities
- Rated non-convertible debt securities
- Securities registered with the SEC on Form S-3 or F-3, pursuant to SEC Rule 415 of the Securities Act of 1933.

Note: Rule 504 offerings are considered by FINRA as public offerings and must be filed with the FINRA Corporate Finance Department (Notice to Members 00-12). If the Firm participates in such offerings, the Designated Principal will ensure that the offering is filed with FINRA and a file of the information will be maintained with evidence of review.

47.8 Best Efforts Underwriting

The Designated Principal will review all best efforts underwriting agreements, prospectuses, and/or private placement memorandums for securities sold by the Firm. This review will encompass an examination of the following:

1. Registration exemptions
2. Disclosures to investors
3. Compensation to underwriters
4. Contingencies of the offering
5. Escrow requirements
6. Due diligence materials

Evidence of review will be maintained in a file designated for the offering.

47.9 Sales Practices

The Designated Principal will ensure that all sales to customers are executed in accordance with the provisions of the offering memorandum. Sales persons will ensure that customers receive the appropriate offering document. Such provisions may include:

- Suitability profile (accredited vs. non-accredited)
- Use of an escrow agent pursuant to SEC Rule 15c2-4
- Meeting contingencies required by the offering through bona fide sales only (min-max/all or none)

The Designated principal will review the above noted documents and evidence his review.

47.10 Contingent Offerings

Best efforts offerings which include contingencies such as all or none, or minimum-maximum subscription amounts, require the prompt deposit of investor funds into a separate bank escrow account pursuant to SEC Rule 15c2-4. The rule allows certain broker-dealers to act as agent for investors; however, most firms must appoint a bank

as escrow agent. This is determined by the amount of capital a firm is required to maintain under SEC Rule 15c3-1. Funds deposited in either type of escrow account are held until the contingency outlined in the offering document is met and then distributed to the issuer. In the event that the contingency is not met within the time frames allowed, the funds are returned directly to the investors. Sales used to meet any contingencies must be bona fide sales for investment purposes; therefore, it may be a violation of SEC Rule 10b-9 if an underwriter or its affiliates purchase securities for the purposes of meeting a contingency.

47.11 Procedures

The Firm will open an escrow account as required by SEC Rule 15c2-4 for contingent best efforts offerings. An independent bank escrow agent will act as trustee for the separate bank account pursuant to paragraph (b) of SEC Rule 15c-2-4. All checks will be made out to the escrow account and those received by the broker/dealer will be promptly transmitted, by noon of the next business day, to that escrow account. The receipt of checks will be recorded on the Firm's checks received and forwarded blotter. An escrow agreement will be in force at the time that the account is open. The Designated Principal will establish and monitor the escrow account, and will review the bank statements on a monthly basis. Initialing and dating the statements will evidence all reviews. The Designated Principal will determine when contingencies have been met pursuant to the offering memorandum and subsequently authorize the escrow account trustee to release funds to the issuer. This will be documented by memo from the Designated Principal to be maintained in the escrow account file. In cases in which the Firm is not managing the offering, it will request a letter from the issuer or managing broker-dealer confirming that the contingency was met.

Under no circumstances will the Firm "force-close" a deal through the purchase of the security for its own account or that of related parties for the purpose of resale subsequent to the closing. The Firm will ensure compliance with the provisions of SEC Rule 10b-9 and 15c2-4, and will maintain copies of the escrow account statements for at least three (3) years.

47.12 Underwriting Securities of an Affiliate

The Designated Principal will ensure that when participating in a public offering of the securities of an affiliate, the Firm will act in accordance with the provisions of FINRA Rule 5121.

An affiliate is defined as a company that controls, is controlled by or is under common control with the FINRA member underwriting its securities (10% ownership generally establishes an affiliation).

Any director, officer, general partner, controlling shareholder or a member of the immediate family of such person that beneficially owns securities of an issuer subject to the rule is precluded from the sale, transfer, or hypothecation of such securities for a period of 90 days from the effective date of the offering unless:

- The sales price is no higher than that established for the IPO by a qualified independent underwriter who has participated in the preparation of the registration statement and prospectus; or
- The amount sold is less than or equal to 1% of the securities being offered.

A broker-dealer offering the securities of an affiliate must disclose this relationship to all customers.

- Principals of the firm (majority of board members for corporations, majority of general partners or the sole proprietor) underwriting the securities of an affiliate must have been actively engaged in investment banking or securities business for the five year period preceding the filing of the registration statement.
- The issue price must be recommended by a qualified independent underwriter who has participated in the preparation of the registration statement and offering memorandum and has performed due diligence.

47.13 Sale of Affiliate, Insider and Restricted Stock - Rule 144

Orders to sell "control" or restricted stock may not be accepted without the prior approval of the Designated Principal. Evidence of principal approval will be noted on the order memorandum. Registered Representatives are required to work closely with the Designated Principal, who in turn will coordinate with the clearing firm, and when necessary the transfer agent, to ensure the proper clearance of the transaction.

47.14 Definitions of Sales Subject to SEC Rule 144

"***Control Stock***" - Control stock refers to stock held by an affiliate or insider of a publicly held company in their company's stock. This rule applies regardless of whether or not the certificates bear a restrictive legend and regardless of how the shares were originally acquired.

"***Restricted Stock***" - Restrictive stock refers to certificates bearing a legend stating that the shares were not registered under the Securities Act of 1933, or indicating that

transfer of the certificate is restricted in any manner. Any certificate bearing any legend whatsoever should be closely examined and reviewed by the Designated Principal if there is any question as to its meaning.

Sales pursuant to SEC Rule 144 may not be executed until all supporting documentation is complete and the transaction is approved by a principal. The Registered Representative should obtain and submit to the principal, at a minimum, the following documents prior to a 144 sale:

1. Three prepared copies of form 144 signed by the seller(s),
2. Three prepared copies of the "seller's rule 144 letter", and
3. Three executed copies of the "broker's representation letter".

47.15 Sections 4(3) and 4(4)

Sections 4(3) and 4(4) of the Securities Act of 1933 exempt transactions by a dealer and "brokers" transactions executed upon customers orders on any exchange or in the over-the-counter market, but not the solicitation of such orders. The term "brokers' transaction" is interpreted by the SEC in Rule 144(g).

47.16 Section 4(1) and Rule 144

Section 4(1) of the Securities Act of 1933 ('33 Act) exempts transactions from registration for any person other than an issuer, underwriter, or dealer. This exemption commonly applies to sale of securities between individuals who have no relationship to the issuer, or by a broker/dealer. A broker/dealer acting in a fiduciary capacity, or as finder with respect to such a transaction, could jeopardize the availability of the exemption. An agent or employee of a broker/dealer would also fall subject to the purview of Rule 3010 of the NASD Conduct Rules.

The term "underwriter" causes the most problems with the availability of the Section 4(1) exemption. The '33 Act defines an underwriter as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security…. '[I]ssuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer." One of the most troublesome aspects of this definition occurs with respect to sales of securities by persons who have purchased the securities from the issuer in a private placement, and sales by persons who are in a control position with the issuer. To provide a level of safety to persons selling their securities, the SEC adopted Rule 144, which provides a safe-harbor by defining circumstances in which a person is deemed not to be engaged in a distribution, and therefore, is deemed not to be an underwriter.

Rule 144 defines conditions under which "restricted" securities may be sold and the circumstances under which affiliates of the issuer can sell securities of the issuer. All of the provisions of the Rule must be complied with in order to receive protection.

The problems of control stock and non-registered stock are not to be dealt with lightly because violations may be criminal as well as civil and may result in both prison terms and monetary judgments. The problems with control and non-registered stock are most apt to occur when you are dealing with a customer who could be an officer or director of a public company and/or an individual who is selling a sizable amount of stock in relationship to the total outstanding shares of the firm. Additionally, it could simply be a sizable amount of stock.

While sales under Rule 144 are considered to be the seller's responsibility, the Registered Representative is expected to use due diligence in learning the essential facts relative to his customer. The Registered Representative should be able to recognize the warning signals and by doing so, protect himself, the firm and his customer.

47.17 Definitions of the Rule

1. A "person" is defined in Rule 144 as the seller, including relatives; trusts and estates in which the seller and such relatives collectively own a 10% or greater beneficial interest or where any of them serve as trustee or executor; and corporations or other entities in which the seller, such relatives, such trustees and estates together have a 10% equity interest or own 10% of a class of equity securities.
2. The terms "control person" and "affiliates" apply to any person that directly, or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with an issuer of securities. All directors and executive officers, as well as stockholders who own a sufficient number of shares to be able to influence corporate affairs, are generally considered by the SEC to be in a control relationship to an issuer.
3. "Restricted securities" are defined as those securities acquired from an issuer or an affiliate in a non-public transaction.
4. "Control Stock" is defined as securities acquired by persons in a control relationship to the issuer in a public transaction, including public distributions, transactions on a stock exchange or in the over-the-counter market. The sale of "control stock" must be made in accordance with certain provisions of Rule 144.
5. "Aggregation" is a provision of Rule 144 that requires certain persons, (see definitions 1 and 2 of this section), to add together their stock to determine the

number of shares that may be sold under the Rule. It also refers to aggregation of sales of pledgors with sales of pledgees; sales of donees with those of settlers and sales of an estate or its beneficiary with those of the deceased.

6. Sales by persons "acting in concert" are aggregated. The mere fact that several affiliated persons sell at the same time will not in and of itself be considered "acting in concert" but it does give rise to a situation which must be considered carefully. Where investors have agreed not to sell more than a specified percentage of their securities during a specified period, the SEC staff has taken the position that this constitutes an agreement to "act in concert".

47.18 Availability of the Rule

The holder of the restricted securities may avail himself/herself of Rule 144 in the following instances:

1. He/she has contractual registration rights;
2. He/she is discussing with the issuer registration of his restricted securities;
3. He/she has restricted securities which were included in a pending registration statement but which were withdrawn voluntarily from registration before the registration statement became effective; or,
4. He/she has restricted securities which were effectively registered, but were withdrawn from registration after the registration statement ceased to be current because of a lapse of time or material changes in the condition of the issuer, whether or not the registration statement included an undertaking to file a post effective amendment to update the prospectus prior to any offering during the "stale" period.

Rule 144 is not available for shares which are covered by an effective registration statement or which are withdrawn from a current effective registration statement. The Rule is also not available for underwriter's compensation securities; securities issued to finders in connection with an underwriting; sales by an issuer of its own securities and securities of an issuer held by a subsidiary of that issuer.

47.19 Basic Conditions of the Rule

Current Public Information

Adequate current information with respect to the issuer must be available to the public. The information requirement is met if the issuer has:

1. Securities registered under either the ’33 Act or the Securities Exchange Act of 1934 (the “ ’34 Act”);
2. Been subject to the periodic reporting requirements of the ’34 Act of at least 90 days prior to the sale; and,
3. Filed all ‘34 Act reports required to be filed during the 12 months preceding the sale. As part of the procedures, the Compliance Department requests written evidence from the issuer that they are current in all financial reporting to the SEC as required by subparagraph (c)(1) of Rule 144 as amended.
4. Is not required to file reports under the ’34 Act, and there is information publicly available about the issuer as required by Rule 15c2-11 under the ’34 Act.

Holding Period

A one-year holding period must be satisfied by the seller and the acquirer of the restricted securities must take full economic risk of such one-year holding period. Thus, restricted securities must be fully paid for and the holding period requirements met before the stock can be sold under Rule 144. Securities purchased with notes or other obligations are not considered fully paid for unless (i) the notes or other obligations are with full recourse; (ii) there is adequate collateral, other than the purchased securities; and (iii) the note or obligation is paid in full before the sale.

1. The acquisition of restricted securities will not restart the holding period on previously acquired restricted securities. Where a seller has made more than one purchase of restricted securities, only the specific securities sold must satisfy the holding period.
2. Securities acquired as stock dividends, stock splits in recapitalizations, upon conversion of convertible securities, and as contingent pay-outs in business combinations are deemed to be acquired at the same time as the restricted securities.
3. The holding period for restricted securities issued under employee stock bonus plans commences when the employee has the right to such securities without possibility of forfeiture.
4. The one-year holding period is suspended for any period that the holder of the restricted securities has a short position (including short sales against the box) or an option to sell securities of the same class (or convertible into the same class).
5. Restricted securities sold by bona fide pledgees or donees acquired by gift, or acquired through trusts, are deemed to be acquired by gift, or acquired through trusts, when they were acquired by the pledgor, donor, or settler. In these instances, the two parties to the transaction must aggregate the amount of securities they can sell.

6. Securities in estates and restricted securities acquired from an estate are deemed to be acquired at the time they were acquired by the decedent. No holding period is required, however, if neither the estate nor the beneficiary is an affiliate.

7. There is no holding period where a control person or affiliate is selling registered shares purchased on the open market. However, the stock must be sold in an agency brokerage transaction and the stock sold would have to be aggregated with any 144 stock within a six-month period, if the seller is deemed to be a control person or an affiliate of the issuer.

8. If the seller has owned the securities for two (2) years or more, and the seller is not an affiliate of the issuer at the time of sale (and has not been an affiliate during the preceding three (3) months) the provisions of subsections 3 and 4 do not apply; and the seller is not required to file Form 144.

Volume Limitation

A) The amount of shares sold in each three-month period cannot exceed the greater of 1% of the outstanding securities of that class or the average weekly reported exchange volume of trading during the four-week period prior to the date of the 144 Form.

- In the case of securities which are dually listed and traded, the average weekly reported volume or trading for both exchanges may be computed.
- Where a stock is traded on National Stock Exchange and NASDAQ, the latter volume may be used in lieu of the National Exchange volume, but the two may not be combined.
- Both restricted and unrestricted securities are aggregated for determining the volume limitation for sales to affiliates.
- Only restricted securities are considered in determining the limitation on sales by non-affiliates.
- Sales pursuant to registered offerings and in private placements are not aggregated with 144 sales in determining the amount of stock which may be sold.

B) If the amount of securities to be sold during any three-month period does not exceed 500 shares or units and the total sale price will not exceed $10,000, it is not necessary to file Form 144 with the SEC.

C) Where the customer owns more than the small order limit but is only selling a small portion, it is best to file the Form 144. In any case, a completed and signed Form 144 is necessary in order to induce the corporate counsel to remove the legend.

D) Form 144 cannot specify an amount of listed securities to be sold in excess of the volume limitation determined as of the date of filing Form 144. If thereafter the average trading increases, the volume may be recomputed (excluding sales made by the seller during the new period) and an amended Form 144 filed. The seller can then sell up to the new volume limitation.

E) If the number of outstanding shares of an over-the-counter security increases subsequent to the filing of a Form 144, an amended Form 144 may be filed to permit sales based on the increase in the number of outstanding shares, provided the information regarding the increase has been published by the issuer.

- Where an over-the-counter stock subsequently lists on an exchange, the listed security volume limitation becomes applicable four weeks after listing, and all sales in the preceding three months are considered in determining the volume limitation.
- The number of shares to be sold under Rule 144 may be adjusted for stock splits or major stock dividends paid after the Form 144 has been filed.

Manner of Sale

- Sales of 144 stock can only be made in an agency brokerage transaction or directly to a market-maker.
- The seller cannot solicit or arrange for the solicitation of buy orders, or make any payment in connection with the sale other than usual commissions to the broker who executes the order.
- Brokerage transactions are defined as those in which the broker does no more than execute a sell order as agent for the usual commission, and does not solicit any buy orders.
- The broker-dealer may inquire of other broker-dealers who have indicated an interest in the security within the preceding 60 days.
- The Registered Representative may inquire of his customers who have indicated an unsolicited bona fide interest in the security within the preceding 10 business days prior to the anticipation of the 144 transaction. The SEC has cautioned brokers to maintain written records of such indications in order to substantiate the bona fide nature thereof. It also must be remembered that such inquiries cannot be part of a plan to evade the provisions of the Rule.
- Where a broker affects a sale of securities sold in a 144 transaction, he may collect commissions as usual and customary. Where negotiated commissions are applicable, they are permitted under Rule 144 if “negotiated in the usual and customary manner.”

- Market-making activity may continue by a broker-dealer provided that prior to anticipation or receipt of the Rule 144 order, they have been making an inter-dealer market for the security for the broker's own account and have published quotes (bid and ask) 12 out of the preceding 30 calendar days. There can be no more than four business days in succession without such two-way quotations.

47.20 Company Policy - Restricted Securities

In order to simplify the above standards of the Rule, the following will be the policy of the firm with respect to Rule 144 sales of restricted securities.

- A Registered Representative, upon being notified that a client that wishes to dispose of restricted securities, will notify the Branch Office Manager (Designated Principal) of the name of the customer, his state of residence and the security which is proposed to be sold.
- If the firm and the Registered Representative are registered in the customer's state and if the stock can be traded in the customer's state, the Designated Principal will give initial approval to pursue the completion of the trade and prepare a "144 Control Form."
- The Registered Representative will obtain the following documents:
  - Form 144, completed and signed by client;
  - Seller's representation letter;
  - Transmittal letter to SEC and endorsed stock certificate;
  - Letter from company that it is current in its filings (if it is a reporting company), or that information is publicly available about the firm , and;
  - If required by the Designated Principal or Compliance Department, an opinion of counsel.
- The Registered Representative will submit all documents to the Designated Principal who will review them; if additional documentation is needed, the Designated Principal will contact the Registered Representative. The Designated Principal will contact the transfer agent to assure that there will be no problem with the transfer; then sends copies of all documents to the issuer or its attorney; and copies of all of the documents (with the original certificate) to the firm's clearing agent. The Designated Principal will also give the Registered Representative the approval to sell.
- The clearing agent will handle the transfer and accounting in accordance with its standard procedures.
- The 144 Control Form will be considered complete when the Designated Principal lists all information related to the execution of the sale of the

securities. This information must include the date(s) of the sale, number of shares, prices, commission, and contra-party.

- The documentation can be done in one or two days depending upon the adequacy of the information supplied by the Registered Representative and the seller, excluding other requirements of the corporate counsel and the transfer agent. Generally, the process takes three to four weeks.
- Only shares actually sold are sent for transfer. There is a 90-day period from the date of the Form 144 filing with the SEC in which the stock is to be sold. If all the stock is not sold within the 90 days, the remaining shares will retain the restrictive legend. While the Rule provides for a 90-day extension, the SEC has issued interpretations under paragraph (1) of Rule 144 regarding "bona fide intent to sell" and its relationship to "shelf registration." If all of the shares are not sold within 90 days determination as to extension will be made by the Compliance Officer. In any case, an amended Form 144 must be filed to establish the shares to be sold.
- Restricted stock may not be transferred merely to have legends removed. A customer must have bona fide intent to sell before a Rule 144 procedure will be started. Stock that has been cleared under Rule 144 is restricted in street name. If a customer decides not to sell stock that has been cleared, the stock must be re-registered in customer's name with a restrictive legend, then delivered to the customer.
- The Compliance Department should review the trading activities in these accounts on a quarterly basis to ensure that the customer did not exceed their volume limitation during a 90 day period.

47.21 Company Policy - Control Stock

Should the Registered Representative have a seller of control stock, he should furnish to the Designated Principal, the following:

1. 144 Control Form information sheet completed in full;
2. Form 144 signed by the customer;
3. Assuming the information is complete, the Form 144 can be mailed and the sale can take place concurrently with the mailing of the Form 144;
4. While control stock sales must be made in compliance with Rule 144, there is no two-year holding period and opinion of the issuer's corporate counsel is not necessary since the shares were purchased in a public transaction and the certificates will not carry the restrictive legend;

5. Control stock is still subject to current public information, non-solicitation of buyers by both seller and broker, and volume limitation requirements of affiliates.

47.22 Underwriting Review Checklist

1. Due diligence of the issuer must be conducted. This may include, among other things: visiting issuing company and principals, verification of all financials, background check on all principals, research into the economic viability of all issuer business activity.
2. A thorough review of the proposed underwriting agreement, agreement among underwriters, dealer agreements, agency agreements, letters of intent and any other documents related to the underwriting will be reviewed.
3. A review of the preliminary and final prospectuses (verification of all financials based upon auditor's review and counsel opinions, review of any projections for reasonableness, dates, addresses, etc.) including an assessment that disclosure is suitable to make an informed decision.
4. Prior to dissemination to investors, a principal, as part of the due diligence process, shall review the agreements/sales literature to verify that there is sufficient information required to determine the accreditation and suitability of investors (individuals, partnerships and entities).
5. Maintain copies of executed agreements and verify that they are completed properly.
6. A review of the checks receipt and disbursement log to verify that all checks have been forwarded to the issuer or escrow agent if received by the Firm or a verification of receipt by issuer if sent directly to the insurer.
7. If an escrow account is used there should be a review of the agreement to verify accuracy (addresses, wiring instructions, etc.). A copy of the authorizations for all disbursements from the escrow account along with authorization to close the account.
8. After the closing of the offering reconciliation of the shares (units, etc.) that have been subscribed with the funds received by the issuer or deposited into the escrow account.
9. A verification that there have been proper blue sky filings in all states where the offering was subscribed.
10. A verification that the issuer has filed all required documents with regulators, or if not, that the lead or co-managers of the underwriting have filed all documents with regulatory authorities.

48. Managed Futures Funds

The futures markets have played a pivotal role in the world's economies, and tremendous market expansion has created new categories of markets and industry growth. Managed futures funds have been used by individual investors for more than 25 years. More recently, institutional investors such as pension funds, endowments, trusts and family offices have incorporated managed futures as part of a well-diversified portfolio. Managed futures are increasingly being recognized as an important investment alternative that may potentially enhance the returns and lower the overall volatility of a diversified investment portfolio.

Managed Futures Funds can offer the potential opportunity to a client to profit in both rising and falling markets, while providing a client with significant growth potential along with commensurate risk. However, managed futures also maintain a high degree of risk, are considered speculative investments and may not be suitable for everyone.

Managed Futures Funds are comprised of professional money managers who manage assets on behalf of their clients by directing investments in the global currency, interest rate, equity, metal, energy and agricultural markets. They do this through the use of futures, forwards, and options. There are two types of Managed Futures Funds. Public Funds are appropriate for qualified retail investors and the minimum investment requirements typically being at $5,000 ($2,000 for IRA's). Private funds are open to investments by high net worth accredited investors. The minimum investments typically range from $100,000 to $500,000.

Managed Future funds are for qualified investors with a diversified investment strategy and a long-term financial plan/investment objective. Our firm offers both public and private funds to our clients; which are purchased directly in their brokerage account held at our clearing firm.

48.1 Suitability

Managed futures involve a high degree of risk and are not suitable for everyone. It is important to understand that the high degree of leverage often obtainable in commodity trading, can work against an investor as well as benefit an investor. The use of leverage can lead to large losses as well as gains. In some cases, managed futures accounts are also subject to substantial charges for management and advisory fees. There are many other risks to consider with trading in the commodity markets. Investors should carefully study the disclosure document before making any investment in a managed futures product.

A determination must be made as to a particular investor's suitability, at which point the investor will be provided with all of the necessary information to make sure he or she understands both the risks and possible rewards of this type of investing. Generally, in addition to having the required risk capital, an investor needs to have realistic expectations about returns on investment and tolerance to temporary market fluctuations that inevitably will occur with managed futures products. Only investors who are financially eligible and willing to accept managed futures' inherent fluctuations should consider managed futures investments. Because these investments can be volatile, they are appropriate only for the risk capital portion of an investment portfolio, and they should be positioned for the long-term. Investors are cautioned that they could lose all or substantially all of their managed futures investments.

It is the responsibility of the Registered Representative to ensure the client's investment objectives, risk tolerance and time horizon are suitable to purchase managed futures. The Registered Representative should disclose all risk considerations to the customer prior to purchasing a managed future to ensure it is an appropriate investment for the client. The following are some risk considerations which should be discussed with client prior to sale:

- An investor could lose all or a substantial part of his or her investment.
- There is no guarantee that an investment of this type will achieve its objectives.
- Managed futures funds' high fees and expenses offset trading profits and reduce returns.
- Managed futures investments involve the use of significant leverage that may increase the risk of investment loss.
- Managed futures are not subject to the same regulatory requirements as mutual funds.
- An investment in managed futures funds is illiquid.
- There is no secondary market for managed futures funds, and there are restrictions on transfer of managed futures funds.
- Investors via IRA accounts should be aware that managed futures investments may endure extended periods of losses, which should be of particular concern if such an investor maintains a high concentration of managed futures investments within such IRA accounts.

48.2 Prospectus/Offering Documents

At the time of sale or prior, the Registered Person is responsible for giving an investor a copy of the prospectus and/or offering documents for each managed futures investment offered or purchased by the client. The Representative is responsible for having a comprehensive discussion with the investor regarding the product's features and risks, and ensures the client has reviewed the prospectus and/or offering documents carefully before making an investment decision.

48.3 Supervisory Review

The Designated Principal is responsible for reviewing and approving all managed future fund sales on the daily trade blotter. The Principal is responsible for ensuring the managed future is suitable for the customer by evaluating their overall suitability information which is disclosed on the new account form or customer update form. The Principal will also conduct a periodic review of all accounts that have purchased a managed future fund in which the Principal will maintain evidence of supervisory account review on a supervisory log.

48.4 Registration

The Firm does not intend to maintain registration with the National Futures Association ("NFA"). The CCO is responsible for ensuring that neither the Firm nor its Associated Persons engage in activities requiring registration with the NFA or the Commodities and Futures Trading Commission ("CFTC"). The determination as to whether a broker-dealer can rely on an exemption to NFA and CFTC registration can be quite complex. Consequently, the CCO should consult a qualified futures industry expert if there is any doubt as to whether the Firm may avail itself of an exemption.

49. Referral Activities

From time to time, the Firm may refer securities business to other broker-dealers. Under certain circumstances, the Firm may be compensated by broker-dealers for these referrals.

49.1 Responsibilities of the Firm to Referred Customers

The Firm's acceptance of referral fees creates no responsibility for the Firm to monitor a customer's account activity at another broker-dealer. The referred customer becomes a customer of the other broker-dealer, and the other broker-dealer is solely responsible for, among other things, making suitable recommendations to the customer. The Firm will provide all referred customers with a referral disclosure form. The form will disclose that the Firm assumes no responsibility for the actions of other broker-dealers. The form will also be used to disclose the Firm's possible receipt of referral fees.

49.2 Disclosure of Referral Fees

When referring securities business elsewhere, the Firm will disclose to the referred customer that it has a referral arrangement with the other broker-dealer. This disclosure stems from no specific rule but from the Firm's commitment to adhere to just and equitable principles of trade. Fairness dictates that the Firm's customers should be made aware that the Firm might have a financial incentive in making referrals. Such disclosure gives the customer the ability to evaluate for himself the factors that might influence the Firm in its referral recommendations. Ultimately, with all facts known, the customer can decide for himself whether he wants to accept the Firm's recommendation or seek an unbiased referral from another source.

49.3 Approved Products

The Firm may refer securities business to other broker-dealers when it cannot accommodate the business of a customer, such as when the customer wishes to purchase an investment not offered by the Firm. The Firm may receive compensation for referrals involving a broad range of securities products. The following non-exhaustive list identifies some of the products for which the Firm is approved to receive referral compensation:

- Equity securities, including closed-end funds, exchange-traded funds, and exchange-traded limited partnerships.
- Debt securities, including collateralized mortgage obligations and structured products

- Government securities
- Municipal securities
- Investment companies, including closed-end funds, mutual funds, and unit investment trusts
- Certificates of deposit
- Options and other derivatives
- Limited partnerships and other types of direct participation programs
- Hedge funds and funds of hedge funds
- Real estate investment trusts
- Insurance products, include variable annuities
- Managed futures funds – The Designated Principal is responsible for determining whether the sharing of commissions subjects the Firm or any of its Associated Persons to additional registration requirements applicable to participants in the futures business. Certain managed futures funds will pay commissions only to firms and individuals registered with the National Futures Association (NFA).

If the Firm wishes to receive referral compensation with respect to any product that is not identified above, the Designated Principal will make a determination as to whether the Firm's membership agreement would permit the compensation arrangement.

In addition to the above-mentioned products, the Firm may receive referral compensation for any other product or business area specifically approved on its membership agreement.

49.4 Calculation of Referral Fees

The calculation of referral fees will be dictated by the referral agreement entered into with the broker-dealer. The other broker-dealer will be responsible for ensuring that the referral fees paid to the Firm are based solely on revenue from products for which the Firm may receive referral compensation. The Firm is able to accept referral fees for any product areas described above in the section "Approved Products." Referral fees may also be collected for any other product and business areas specifically approved on the membership agreement.

50. Business on the Premises of a Financial Institution

These policies and procedures apply to retail sales of mutual fund shares and other securities ("non-deposit investment products") through or on the premises of banks, savings associations and credit unions (collectively, "banks"). Registered representatives and principals must comply with these policies and procedures with respect to all non-deposit investment products sold on bank premises or to bank customers referred by the bank, pursuant to a license or networking arrangement between the Firm and a bank.

Sales of non-deposit investment products by banks or by unaffiliated broker-dealers through banks are subject to various federal and state regulatory requirements. The nature and extent of the regulation may be affected by the regulatory structure of the bank (e.g., national bank, state-chartered bank, savings and loan association, credit union) or by other restrictions applicable to that particular institution. The designated principal should verify the nature of the bank's regulatory oversight and consult with the Compliance Department to verify that additional procedures or compliance measures are not required.

The Firm will market non-deposit investment products in a manner that does not mislead or confuse customers as to the nature of the products or their risks. Specifically, the Firm will conduct its broker-dealer activity in a physical location that is distinct from the area where retail deposits are accepted. At a minimum, the Firm will post a sign that clearly distinguishes the investment area from the retail deposit area of the bank.

50.1 Effecting Transactions in Bank Securities

Equity Securities. Registered representatives are prohibited from soliciting transactions in the bank's equity securities or the equity securities of any bank affiliates (including required service corporations). However, registered representatives may accept non-solicited transactions for the bank's and any affiliate's securities (including those of a required service corporation).

Debt Securities. Registered representatives are prohibited from selling the debt securities of the bank or its affiliates (including required service corporations), on an unsolicited basis or otherwise.

50.2 Disclosures and Advertising

1. Registered representatives must make complete and accurate disclosure to customers in order to make it clear that non-deposit investment products are not bank deposits and are not insured by the Federal Deposit Insurance Corporation ("FDIC").
2. At a minimum, registered representatives must provide conspicuous disclosure to retail customers (the "minimum disclosures") that the non-deposit investment products offered:
   - are not FDIC insured
   - are not deposits or other obligations or guarantees of the bank
   - involve investment risk, including possible loss of principal amount invested
3. Written disclosure must be conspicuous and presented in a clear and concise manner.
4. The minimum disclosures should be provided to the customer:
   - Orally, during any sales presentation.
   - Orally when investment advice concerning non-deposit investment products is provided.
   - Orally and in writing prior to or at the time an investment account is opened to purchase these products.
   - In advertisements and other promotional materials (described below).
5. Except as described below, all advertising and other promotional material used to describe or promote the availability of the Firm's broker-dealer services on the bank's premises must contain the disclosures described above.
6. With respect to billboards, signs, posters, written advertisements and brochures, a "logo" format may be used, provided the item contains the following disclosure:
   - Not FDIC Insured.
   - No Bank Guarantee
   - May Lose Value
   - Not a deposit
   - Not insured by any federal agency

   The disclosures **must** be conspicuous and easy to read. The print must be as large as the surrounding text.

7. All advertising and promotional material must be approved by the Compliance Department.
8. Any reference to the bank in advertisements or other promotional material must be limited to the purpose of identifying only the location where brokerage services are available, and must not appear prominently in the materials. In addition, all advertisements must indicate that (1) brokerage services are being provided by the Firm and (2) accounts are carried with the clearing firm.
9. All advertising and other promotional material used to promote the availability of broker-dealer services of the Firm on the bank's premises must otherwise comply with applicable securities laws and with NASD Rule 2210 and, where required, must be filed with the FINRA Advertising Regulation Department.
10. Confirmations and account statements must not contain the name or logo of the bank and must contain the minimum disclosures.
11. If sales activities include any disclosures made with respect to any insurance entity ***other*** than the FDIC, (e.g., SIPC), then the registered representative must provide clear and accurate written or oral explanations of the insurance coverage, in order to minimize confusion with FDIC insurance.

50.3 Use of Confidential Information

The Firm may use confidential financial information provided by the bank to solicit customers for broker-dealer services provided the bank presents evidence of the customer's written consent to use the confidential financial information for that purpose. Furthermore, the Firm and the bank must comply with Regulation S-P or any other applicable privacy regulations and adhere to adopted privacy policies.

50.4 Dual Employees

If the Securities Activities and Services Agreement between the Firm and a bank contemplates employees of the bank also serving as registered representatives of the Firm ("Dual Employees"):

1. The Firm will exclusively control, supervise and be responsible for the securities activities of each Dual Employee to the extent that such Dual Employee acts in the capacity of a registered representative. Each Dual Employee will be supervised by the Firm's supervisory personnel who are registered securities principals.
2. The Firm will determine the transaction-related compensation of Dual Employees under its customary compensation program, independent of any compensation that the bank may pay the Dual Employee.

3. The Firm will train each Dual Employee to comply with all of the policies and procedures applicable to all its registered representatives as well as the policies and procedures applicable to securities activities through banks. The Firm will provide each Dual Employee with a copy of its Procedures Manual and will monitor the Dual Employee's compliance with the manual.
4. If the Securities Activities and Services Agreement does not contemplate that bank employees will also serve as registered representatives of the Firm, all bank employees will be subject to the restrictions set forth below for non-registered employees.

50.5 Non-Registered Employees of Bank

Bank employees who are not registered representatives of the Firm ("Non-Registered Bank Employees") are limited to purely clerical and ministerial functions, with respect to sales of non-deposit investment products. Non-Registered Bank Employees must:

1. Not engage in any securities-related or investment-related activities on behalf of the Firm.
2. Not recommend any security, give any form of advice, describe investment vehicles, discuss the merits of any security with a customer, or handle any questions that might require familiarity with the securities industry or require the exercise of judgment regarding securities.
3. Not accept or transmit orders or handle customer funds and securities.
4. Refer all securities-related questions to properly licensed registered representatives.
5. The Firm may not pay to any Non-Registered Bank Employee a transaction-related compensation or referral fee. The bank may, however, pay Non-Registered Bank Employees a one-time fee of a nominal, fixed-dollar amount for the referral of a customer, which is wholly unrelated to whether the referral results in a transaction or the volume of securities traded by the customer, to the extent this is permitted by law and the contractual arrangement between the bank and the Firm.
6. The Firm will provide the bank with written procedures to make available to its Non-Registered Bank Employees. The written procedures will specify the limits of the activities of Non-Registered Bank Employees.

50.6 Securities Activities and Services Agreement with Bank

The Firm will enter into a Securities Activities and Services Agreement with each bank that will enable the Firm to sell to bank customers and must comply with the provisions of the Interagency Statement on Retail Sales of Non-deposit Investment Products, which has been adopted by the four primary banking regulatory agencies, including the FDIC. At a minimum, the Securities Activities and Services Agreement must:

1. Describe the duties and responsibilities of each party, including a description of permissible activities by the Firm on the bank's premises, terms as to the use of the bank's space, personnel, and equipment, and compensation arrangements for personnel of the bank and the Firm.
2. Specify that the Firm must comply with all applicable laws and regulations, and will act consistently with the provisions of the Interagency Statement and, in particular, with the provisions relating to customer disclosures.
3. Authorize the bank to monitor the Firm and periodically review and verify that the broker-dealer and its sales representatives are complying with its agreement with the bank.
4. Authorize the bank and the appropriate banking agency to have access to the records of the Firm as are necessary or appropriate to evaluate compliance.
5. Require the Firm to indemnify the bank for potential liability resulting from the Firm's actions with regard to the investment product sales program.
6. Stipulate that that Firm's supervisory personnel, as well as representatives of the SEC and FINRA, shall be permitted access to the bank's premises where the Firm conducts broker-dealer services in order to inspect the books and records and other relevant information maintained by the Firm with respect to the broker-dealer services.
7. Stipulate that unregistered employees of the bank shall not receive any compensation, cash or noncash, that is conditioned upon whether a referral results in a transaction.
8. Stipulate that the Firm shall notify the bank if the Firm terminates any registered representative who is also employed by the bank, for cause.

50.7 Compliance

1. The Compliance Department will periodically review the securities activities conducted pursuant to Securities Activities and Services Agreements for compliance with these procedures.

2. The Firm will comply with reasonable requests by the bank in connection with its internal compliance programs.

3. The Firm shall allow the bank and banking regulators access to its books and records in connection with any compliance or regulatory examination.

4. The designated principal will be responsible for supervising the registered representative serving on bank premises in the following manner. At least every three years, the designated principal will visit each branch location on bank premises to ensure compliance with the policies and procedures. The designated principal will utilize a checklist to evidence supervision of the bank branch and forward a copy of the completed checklist to the Compliance Department. The designated principal will ensure compliance with, among other things:

5. Setting and Circumstances. The designated principal will:

   - Determine whether there are effective controls to distinguish retail deposit-taking activities from retail non-deposit investment sales.

   - Ensure that the signage in the bank clearly delineates the different locations on the premises where brokerage and bank services are provided.

   - Ensure that the brokerage location clearly (i) displays the minimum disclosures as described above, (ii) identifies the Firm as the provider of brokerage services, and not the bank and (iii) discloses that the Firm clears all transactions through the clearing firm (member FINRA/SIPC). Such disclosures must be clearly displayed on the registered representative's desktop in full view of the public.

   - Where the deposit-taking and securities sale functions are performed by the same personnel, determine if the registered representative uses appropriate written and oral disclosures to guard against customer confusion. The designated principal will observe the extent to which such disclosures are made in these circumstances.

6. Promotional material. The designated principal will:

   - Ensure that promotional literature for brokerage services is appropriately placed and is not located at teller stations.

   - Review promotional material at the brokerage location and ensure that all such literature is current and contains (i) the minimum disclosures; (ii) identifies the Firm as the provider of brokerage services; and (iii) discloses that the Firm clears all transactions through the clearing firm (member FINRA/SIPC).

- Ensure that all promotional materials have been approved by the Compliance Department.
- Discard any promotional materials that (i) fail to contain the appropriate disclosures, (ii) contain stale performance figures, or (iii) that have not been approved by the Compliance Department for use with the public. A list of these materials will be sent to the Compliance Department.

7. Customer and Correspondence Files

8. Teller Stations. The designated principal will observe the non-registered bank employees to ensure that they do not engage in impermissible activities. Specifically, the designated principal will observe how referrals are made and whether they are in compliance with the policies adopted by the bank.

9. Customer Disclosures. The designated principal will:

- Observe the registered representative during sales presentations to potential customers to ensure that the minimum disclosures are made in an appropriate and timely manner.
- Ensure that the registered representative requires the customer to sign all applicable forms including, but not limited to, the account agreement and customer agreement.
- Determine whether all of the required disclosures are featured conspicuously in: all written or oral sales presentations; advertising and promotional materials; and confirmations and account statements;
- Determine whether disclosures are made with respect to early withdrawal penalties, sales charges, commissions, mark-ups/downs and CDSCs.
- If representations about non-FDIC insurance coverage are made, determine whether the explanation is appropriate and is given to all customers.

10. Use of Confidential Information. The designated principal will ensure that the Firm's and the clearing firm's privacy notices are provided in a timely manner and made available to all potential customers upon request.

50.8 Branch Based Sales Administrative Assistants

All Branch Based Sales Administrative Assistants report directly to the designated principal for that area and not to the Rep. This is done to ensure that a Sales Administrative Assistant (who is not a registered person) does not participate in any sales activities. The responsibilities of the Sales Administrative Assistant are purely clerical and administrative. These responsibilities include, but are not limited to: filing, answering telephones, copying documents, ordering sales information, and opening

mail. An unregistered Sales Administrative Assistant may contact a prospective customer only for the following reasons:

- to extend an invitation to firm-sponsored events at which any substantive presentations and account or order solicitation will be conducted by appropriately registered personnel
- to inquire whether the prospective customer wishes to discuss investments with a registered person
- to determine whether the prospective customer wishes to receive investment literature from the Firm

Sales Administrative Assistants may not:

- discuss investments or make recommendations to customers
- solicit, take or accept orders; distribute sales literature or prospectuses; answer customer questions related specifically to investments
- open new accounts; or discuss the financial market or specific securities

Sales Administrative Assistants must be:

- Fingerprinted and the Compliance Department will either:
    1. Enter an U-4 into the FINRA Web CRD system opening a Series 7 for testing purposes; or
    2. Enter the person as a NRF (non-registered fingerprint)

51. Broker of Record for ERISA Plans

The designated principal is responsible for compliance with ERISA Section 408(b)(2) and ERISA Section 404(a)(5). This is the rule directly related to Service Provider Disclosures. It addresses disclosure of services and fees required to be furnished to plan fiduciaries (the plan administrator of a covered plan) by covered service providers ("CSP").

50.1 Definition of Covered Service Provider

The rule defines covered service providers ("CSP") as:

a. ERISA fiduciary service providers to a covered plan or to a "plan asset" vehicle in which such plan invests;

b. Investment advisers registered under Federal or State law;

c. Record-keepers or brokers who make designated investment alternatives available to the covered plan (e.g., a "platform provider");

d. Providers of one or more of the following services to the covered plan who also receive "indirect compensation" in connection with such services: accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administration, or valuation services.

50.2 ERISA Requirements

The rule requires an aggregated plan fee disclosure ("plan-level") that specifies the fees paid to each service provider of the plan, the services rendered and the fiduciary status of that provider. Each provider is required to deliver a 408(b)(2) disclosure to each plan that pays compensation to that provider of more than $1,000, directly or indirectly. The rule applies to ERISA-covered defined benefit and defined contribution pension plans. It does not apply to simplified employee pension plans (SEPs), SIMPLE retirement accounts, IRAs, and certain annuity contracts and custodial accounts described in Internal Revenue Code section 403(b). The final rule does not apply to employee welfare benefit plans. EBSA intends to separately publish proposed disclosure requirements for welfare benefit plans in the future. There are no participant-level disclosures required under 408(b)(2). This rule is effective July 1, 2012 and applies to existing and new contracts or arrangements between covered plans and CSPs as of July 1, 2012. Service providers not in compliance as of July 1, 2012, will be subject to the prohibited transaction rules of ERISA section 406 and Internal Revenue Code section 4975 penalties.

EBSA strongly encourages CSPs to offer responsible plan fiduciaries a "guide," summary, or similar tool to assist fiduciaries in identifying all of the disclosures required under the final rule, particularly when service arrangements and related compensation are complex and information is disclosed in multiple documents. Please refer to the attached final rule, which includes a Sample Guide as an appendix that can be used on a voluntary basis as a model for such a guide. Although use of such a “guide” is not currently required under the rule, EBSA intends to pass future legislation making a guide, or similar tool, a requirement.

Service providers may use electronic means to disclose information under the 408(b)(2) regulation to plan fiduciaries provided that the covered service provider's disclosures on a website or other electronic medium are readily accessible to the responsible plan fiduciary, and the fiduciary has clear notification on how to access the information.

ERISA Section 404(a)(5) is the new rule that addresses fee disclosures required to be provided to participants in participant-directed individual account plans. It only applies to defined contribution plans with participant-directed investments. The effective date for this rule is August 30, 2012.

For calendar year plans, the initial annual disclosure of “plan-level” and “investment-level” information (including associated fees and expenses) must be furnished no later than August 30, 2012 (i.e., 60 days after the 408(b)(2) regulation’s July 1 effective date). The first quarterly statement must then be furnished no later than November 14, 2012 (i.e., 45 days after the end of the third quarter (July through September), during which initial disclosures were first required). This quarterly statement need only reflect the fees and expenses actually deducted from the participant or beneficiary’s account during the July through September quarter to which the statement relates.

This rule requires that investment-related information must be furnished to participants or beneficiaries on or before the date they can first direct their investments, and then again annually thereafter. It also must be furnished in a comparative format, a chart or similar format designed to facilitate a comparison of each investment option available under the plan. Please refer to the attached final rule, which includes a model comparative chart as an appendix. When correctly completed, the model chart may be used by the plan administrator to satisfy the rule’s requirement that a plan’s investment option information be provided in a comparative format.