

# **Written Supervisory Procedures**

## **Investment Planners, Inc.**

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# INTRODUCTION

The Firm, Investment Planners, Inc. will conduct its business consistent with high standards of commercial honor and just and equitable principles of trade. Keeping our customers' interest foremost is a key to the Firm's success. The trust of our customers and the Firm's reputation are of paramount importance. Effective supervision is an integral part of achieving our goals in serving our customers.

"Compliance" is not a static event; it is a process which evolves in tandem with regulations that govern our industry and the circumstances of each particular interaction. This manual includes the Firm's supervisory policies and procedures to provide guidance to RRs in their oversight of the Firm's business. It is a working document and reference for supervisors and will be updated when necessary. The compliance section of the website should also be incorporated where applicable.

It is recognized that supervision must be a flexible tool for use by those charged with managing the Firm's various activities. While it is generally expected these procedures will be followed, supervisors are encouraged to adapt these procedures to the needs of the Firm, their particular department, and the employees and customers of the Firm. These procedures are meant to be a basic framework upon which supervisors oversee the Firm's activities.

This manual does not attempt to set forth all of the rules and regulations with which employees must be familiar, nor does it attempt to deal with all situations involving unusual circumstances. When questions arise, refer them to Compliance for assistance.

Supervision may be delegated to others, where appropriate; however, designated supervisors are responsible for ultimate supervision of assigned areas. The term "employee" as used in this manual includes RRs (and others as identified by the Firm) who may be independent contractors for tax and compensation purposes.

This manual is the property of the Firm and may not be provided to anyone outside the Firm without the permission of Compliance or the Firm's counsel.

Any reference in this manual to "Registered Representative" or "RR" refers to our independent Financial Advisors. They are synonymous in this manual.



# **1.0 DESIGNATION OF SUPERVISORS**

The firm operates a system of supervision that is centralized in the main office as opposed to decentralized in the field offices.<sup>1</sup> Therefore, the main office in Decatur, IL is our only OSJ.

Regulatory supervision is diffused throughout the main office. The Operations department supervises the processing of business and sales practices. The Operations department acts as the "line supervisor" for each of our registered representatives. Issues identified by the Written Supervisory Procedures shall be brought to the attention of the designated supervisor if warranted.

The Compliance department on a limited basis engages in supervisory functions, as its primary function is monitoring the supervisory system employed by the firm and recommending modifications where necessary. This responsibility includes conducting (1) all office inspections involving field offices and (2) coordinating the various inspections of home office activities by independent third parties.

## **2.0 GENERAL EMPLOYEE AND RR POLICIES**

### **2.1 Standards Of Conduct (FINRA Rule 2010)**

It is the Firm's policy and mandate to its employees to conduct the Firm's business under the high standards and principles of the rules governing our industry. Employees are expected to deal with customers in a fair and honest way, with the customer's interest of primary concern.

Compliance will distribute compliance policies and procedures to all employees and from time to time will issue updates, as needed. Employees are expected to read all IPI communications, including Compliance Alerts and Regulatory Updates, in which guidance about rules, regulations, policies and procedures are communicated.

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<sup>1</sup> Given this framework and the characteristics of our RRs, the structure of our firm is not conducive to the operation of a field sales hierarchy. Therefore, we do not have branch office managers, sales managers, regional or district sales managers. Additionally, we have no other persons who perform a similar function as the personnel that are located in our main office who are responsible for providing sales support (which would be the closest function to sales management that we employ) are not compensated based on the overrides on production of the RRs to whom they offer such support. Additionally, such individuals perform no management function as it relates to the sales activity of our RRs.

## 2.2 Outside Business Activities (FINRA Rule 3270)

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests to engage in outside business activities</li><li>• Annual certifications</li><li>• Other potential indicators such as incoming or outgoing correspondence</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review requests for any potential conflict with the Firm's business or otherwise compromise the RR's responsibilities to the Firm and its customers</li><li>• Review requests to see if they may be viewed by customers or the public as part of the Firm's business based upon the nature of the proposed activity and the manner in which it will be offered</li><li>• Determine whether the activity is an outside business activity or if it would be considered a private securities transaction</li><li>• Question RR regarding potential unapproved outside business activities referenced in correspondence or other red flags such as apparent expenditures beyond the income level of the RR</li><li>• Approve or disapprove request and whether any limitations should be imposed prior to approval</li><li>• Notify RR of approval/disapproval and any limitations</li><li>• Update RR's U-4 as needed</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• OBA Disclosure Form in RR's file</li><li>• Retain for 3 years, 2 years in readily accessible location</li></ul>  |

Employees are required to disclose to the Firm, in writing, any outside business activities prior to engaging in such activity. Charitable activities are not included in this requirement unless the RR is being compensated or has access to the financial records (*i.e.*, checking, savings, and investments) of the organization for such activity. Outside business activities may include a wide range of activities including but not limited to the following:

- Employment with an outside entity other than those disclosed on your Form U-4.

- Acting as an independent contractor to an outside party. For example, receiving commission on the sale of a non-variable insurance product.
- Serving as an officer, director, or partner of your financial services firm or other organization.
- Referring someone and receiving a referral fee. For example, referring a client to a P&C agent for a fee.
- Receiving other compensation for services rendered outside the scope of employment with the Firm.

Compensation may include salary, stock options or warrants, referral fees or providing of services or products as remuneration. Generally, remuneration consisting of anything of present or future value for services rendered may be considered compensation.

The information to be disclosed should include the following:

- Name of the outside employer or association
- Nature of activity or association
- Time spent at this activity per week or month and whether the activity occurs during the Firm's normal business hours
- Type of compensation.

The Firm will consider if the proposed activity will interfere with the RRs responsibilities to the Firm or clients and how the activity will be viewed by the public. Based on the nature of the proposed activity and the manner in which it is offered, the Firm may impose specific conditions or limitations on the RRs outside business activity or prohibit the activity all together. The Firm will also evaluate the activity to determine if it should be characterized as a private securities transactions as covered in Section 2.3.

Employees requesting approval to engage in outside business activities must submit this request in writing to Compliance prior to engaging in the activity. Compliance will approve or disapprove the outside business activity in writing and amend the U-4 accordingly. A record of the approval or disapproval will be retained in the RR's file or a file established for outside business activities.

## 2.3 Private Securities Transactions (NASD Rule 3040)

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests to engage in private securities transactions</li> <li>• Annual certifications</li> <li>• Information gathered during audits or by reviewing correspondence</li> </ul> |

|                  |   |
|------------------|---|
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>As required</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>Review requests and certifications</li> <li>Notify RR by memo (with a copy to the RR's supervisor or file) that the PST is approved (not approved).</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>Memo in RR's file</li> </ul>   |

As a matter of course RRs are not permitted to engage in private securities transactions (as defined by FINRA), whether or not there is compensation paid for effecting the transaction, unless prior approval has been received in writing from Compliance. Private securities transactions are defined by FINRA as any securities transaction outside the regular course or scope of a business with the Firm (sometimes referred to as "selling away"). This does not include outside securities accounts approved by the Firm, transactions with immediate family members where the RR receives no selling compensation, and personal transactions in investment company and variable annuity securities.

RRs should note that promissory notes often are securities. Even if a promissory note is not deemed a security, the RR is obligated to obtain the Firm's permission before engaging in any outside business activity involving the offer of promissory notes.

RRs are expected to conduct all securities transactions through the Firm, unless approval has been granted in writing to do otherwise.

Exceptions may be authorized by either the Chief Compliance Officer or CEO (in writing) with full written disclosure. Notification of approval or disapproval will be kept in the RR's file.

## **2.4 Employee and Employee Related Accounts**

### **2.4.1 Employee and Employee Related Accounts Defined**

Employee accounts include any accounts where an employee (RRs or home office employees) has a personal financial interest; the employee is the named trustee or custodian; or otherwise has control over the account. "Accounts" include securities or commodities accounts at the Firm or other financial institutions including foreign or domestic broker-dealers, investment advisers, banks and other financial institutions.

Employee related accounts include accounts for relatives residing with the employee and accounts for any person who is supported, directly or indirectly, to a material extent by the employee.

## 2.4.2 Outside Accounts (NASD Rule 3050)

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests for outside accounts</li><li>• Annual certifications</li><li>• Information discovered during audits</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review requests and certifications</li><li>• Notify firm carrying the employee's outside account by letter regarding where duplicate confirmations and statements should be sent</li><li>• Review confirmations and statements as they are received. Review for:<ul style="list-style-type: none"><li>◦ Transactions in new issues by restricted person</li><li>◦ Large debit balances, very active trading, or other trading activity that may be of concern</li></ul></li><li>• For transactions in restricted securities, contact the employee/RR and take corrective action which may include cancellation of the transaction</li><li>• For trading activity that may be of concern, confer with the employee's supervisor or the employee directly regarding the nature of the activity and take appropriate corrective action, if necessary</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Letter to carrying firm in employee's file</li><li>• Confirmations/statements initialed and filed monthly (or a log showing same)</li><li>• Contact with employee and/or supervisor and corrective action, if appropriate, documented in a memo or note to the employee's file</li></ul>  |

It is the general preference of the Firm to require that employees maintain their personal securities accounts at RBC, Schwab Institutional or TD Ameritrade Institutional. Exceptions require the written approval of Compliance which will request duplicate confirmations and statements from the other dealer carrying the employee's account. This includes accounts with a commodities firm to trade security futures.

Under MSRB rules, this requirement extends to the accounts of an employee's spouse and the minor children of the employee.

Employees are required to request approval of outside accounts prior to opening an outside account. This requirement includes any employee account as defined in this section.

Review of confirmations and statements for outside accounts is the responsibility of Compliance or a designee. The Firm's Annual Certification includes a request for information regarding outside accounts.

These requirements do not apply to accounts limited exclusively to transactions in unit investment trusts and variable contracts or redeemable securities in mutual funds.

#### **2.4.3 Review Of Transactions (FINRA Rule 3110(d))**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Electronic record(s) of the order/order ticket(s)</li> <li>• Exception Reports</li> <li>• Daily Activity Reports</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review employee and related accounts for possible concerns regarding <ul style="list-style-type: none"> <li>○ Very active trading</li> <li>○ Sizeable debit balances</li> <li>○ Bounced checks</li> <li>○ Free-riding</li> <li>○ High risk trading patterns</li> <li>○ Transfers between accounts, particularly employee or related accounts and customer accounts</li> <li>○ Evidence or appearance of insider trading</li> <li>○ Joint accounts with non-family members</li> <li>○ Employees acting as fiduciaries</li> </ul> </li> <li>• Where items of concern are identified, action to be taken depends on the circumstances and may include: <ul style="list-style-type: none"> <li>○ Consult with the employee regarding trading in the account</li> <li>○ Confer with Compliance</li> </ul> </li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Electronic documentation of principal review</li> <li>• Memo to file.</li> </ul>   |

Transactions in employee and employee related accounts will be reviewed periodically by reviewing monthly statements or exception reports in a cycle determined by the designated supervisor. Transactions are also reviewed in the normal course of daily transaction reviews to determine whether a violation of the relevant laws or rules has occurred. Employees will be contacted about transactions that are potentially contrary to rules or Firm policy.

#### **2.4.4 Insider Trading ('34 Act, Section 10 & Rule 10b-5)**

Employees are prohibited from effecting transactions based on knowledge of material, non-public information. The Firm has established reasonable procedures to detect and prevent insider trading. The section "Insider Trading" includes the Firm's policy and all employees are expected to be familiar with the policy.

#### **2.4.5 Sharing In Accounts (FINRA Rule 2150(c))**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New Account Forms</li> <li>• Requests to open accounts jointly with customers</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Require written request from employee and written authorization from customer</li> <li>• Review and determine whether shared account is appropriate</li> <li>• Notify employee and supervisor of approval or disapproval</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Copies of employee request, customer's written authorization and notation of approval or disapproval is retained with the new account records for the account</li> </ul>  |

The Firm's registered employees may not share directly or indirectly in the profits or losses of a customer's account. As a general policy, registered employees may not participate in an account that includes customers who are not family members of the employee.

A registered employee may be a joint owner in an account with a customer only under the following conditions:

- the employee submits a written request to Compliance accompanied by signed authorization from the customer,
- the employee is a disclosed owner of the account,
- the employee shares in losses and gains only in proportion to the employee's monetary contribution to the account (not applicable to accounts shared with immediate family members)
- the employee receives written approval from Compliance.

This includes accounts like investment clubs or partnerships in which employees wish to participate.

#### **2.4.6 Prohibition On Purchases Of Initial Public Offerings (IPOs) (FINRA Rule 5130)**

Employees and their immediate families (parents, spouse, children, in-laws, siblings) are prohibited from purchasing IPOs unless one of three exemptions apply. The exemptions are:

##### **1. Issuer-Directed Securities**

Issuers of shares sold under an IPO often direct the underwriter to offer shares to certain persons. Such sales are exempt from restricted person prohibitions **only if** the restricted person, or a member of their immediate family, is an employee or director of the issuer.

IPO sales are also exempt if distributed as part of a program sponsored by the issuer, or an affiliate of the issuer, that meets four conditions:

- the opportunity to purchase a new issue under the program is offered to at least 10,000 participants;
- every participant is offered an opportunity to purchase an equivalent number of shares or will receive a specified number of shares under a predetermined formula applied uniformly across all participants;
- if not all participants receive shares under the program, the selection of the eligible participants is based on a random or other non-discretionary allocation method; and,
- the class of participants does not contain a disproportionate number of restricted persons.

Last, the issuer-directed exemption also applies to new issues directed to eligible purchasers as part of a conversion offering conducted in accordance with the standards of the governmental agency or instrumentality having authority to regulate the conversion offering.



## 2. Anti-Dilution

A restricted person that is an existing equity owner of an issuer may purchase shares in the IPO in order to maintain its equity ownership position. To qualify for this exemption, the restricted person must meet the following criteria:

- the account held shares for a period of at least 1 year prior to the offering;
- the sale of the new issue does not increase the account's percentage equity ownership in the issuer above the ownership level as of 3 months prior to the filing of the registration statement for the offering;
- the sale of the new issue to the account does not include any special terms; and,
- the new issue is held for at least 3 months following the effective date of the offering.

## 3. Stand-By Purchasers

Prohibitions on sales of IPOs do not apply if made pursuant to a stand-by agreement that meets four conditions:

1. the stand-by agreement is disclosed in the prospectus;
2. the stand-by agreement is subject to a formal written agreement;
3. the managing underwriter represents in writing that it is unable to find any other purchasers for the securities; and,
4. securities sold under a stand-by agreement are subject to a 3-month lock-up period.

## 2.5 Gifts and Gratuities (FINRA Rule 3220)

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests to give or receive gifts</li><li>• Annual certification</li></ul>                             |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review and approve or disapprove</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Maintained in a "Gifts and Gratuities" blotter reviewed during branch audits or upon request</li></ul> |

### **2.5.1 Gifts To Others**

Gifts of anything of value and gratuities to anyone relating to the Firm's business are limited to \$100 per person in total gifts during any calendar year. This limitation does not include usual business entertainment such as dinners or sporting events where the employee hosts the entertainment (not to exceed \$250 if for-profit sponsor). Gifts of tickets to sporting events or similar gifts (where the employee does not accompany the recipient) are subject to the limitations on gifts and gratuities. Amounts of gifts to non-profit organizations should be reasonable in nature (not to exceed \$1,000). Such gifts may not be so frequent or so expensive as to raise a suggestion of unethical conduct.

Employees of regulators are also subject to rule limitations regarding gifts to them from broker-dealers and their employees. Compliance should be contacted for guidance before giving gifts to employees of regulators.

Gifts and gratuities are not permitted when given for the purpose of influencing or rewarding the action of a person in connection with the publication of information which has or is intended to have an effect upon the market price of any security. This does not apply to paid advertising.

An NASD Interpretive Letter states FINRA's position that business entertainment, where the employee accompanies the guests, is not considered a gift or gratuity.

The policy does not apply to immediate family members who also happen to be customers and where the gift is unrelated to the Firm's business. The policy also does not apply to occasional personal gifts to others (wedding gifts, congratulatory gifts for births or sympathy gifts for a death).

The Foreign Corrupt Practices Act Policy prohibits employees from presenting an offer, gift, payment, promise of payment, authorization of payment or any item of value to a Foreign Official with the intent of assisting the Firm in obtaining, retaining or directing business to any person. The Firm prohibits employees from giving gifts to Foreign or Public Officials without prior approval from Compliance.

### **2.5.2 Accepting Gifts**

Employees may not solicit gifts or gratuities from customers or other persons with business dealings with the Firm. Employees are prohibited from accepting gifts with a value in excess of \$100. RRs are not permitted to accept gifts from outside vendors (wholesalers, promoters, *etc.*) currently doing business with the Firm or seeking future business without the written approval of Compliance. This policy does not include customary business lunches or entertainment; promotional items (caps, T-shirts, pens, *etc.*); or gifts of nominal (less than \$100.00) value.

Gifts are valued at the higher cost of market value excluding tax and delivery charges. For tickets, it is the higher cost or face value. If gifts are given to multiple recipients, the names of all recipients are recorded and the value of the gift is prorated among recipients.

## 2.6 Media Contact Is Limited To Certain Authorized Employees

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>Chief Executive Officer</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>Requests to communicate with the media</li> <li>Indications an unauthorized person has had media contact</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>For requests, determine nature of contact and whether the individual is or should be authorized to engage in the contact</li> <li>If necessary, notify the employee/RR whether contact will be permitted and provide guidelines</li> <li>For unauthorized contact, confer with the employee (and the employee's supervisor, if appropriate)</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>Maintain a list of authorized persons and limitations on their contact, if appropriate</li> </ul>  |

The Firm is sometimes contacted by media representatives (television, radio, newspapers, magazines, and other types of media). Employees who are contacted by media representatives are not permitted to comment but must refer the representative to one of the following individuals within the Firm:

- CEO/President
- Executive Vice President
- Chief Compliance Officer
- Others specifically authorized by the Firm

Individuals authorized to speak to the media are expected to make comments consistent with good taste and the Firm's opinion or position on matters discussed.

## 2.7 Requests For Information From Outside Sources

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Written or oral requests for information</li><li>• Subpoenas</li><li>• Other</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Provide response, as appropriate</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Retain record of response in legal, regulatory or other files</li></ul>                |

The Firm and its employees are sometimes contacted by outside parties such as regulators (SEC, FINRA, exchanges, state and other regulators), attorneys and governmental agencies (e.g., the IRS) that request information about customer accounts, Firm activities, or an individual employee's activities.

Information regarding customer accounts, the Firm and its employees is considered confidential and may be released only to those authorized to receive it. Any requests from outside parties (other than the principal or authorized person on behalf of an account requesting information on the account) should be immediately referred to Compliance for response. This includes requests received in any form whether written, by phone or in person. This also includes visits by regulators. Proof of identification should be requested and Compliance immediately notified.

## 2.8 Internal Reviews and Investigations

If necessary, the Firm may conduct an internal review or investigation. Employees may be requested to provide information that may include an employee's signed written statement. Failure to provide requested information may result in disciplinary action, including termination.

## 2.9 Internal Disciplinary Actions

The Firm will, when appropriate, take disciplinary action against employees who engage in improper activities. Action may include, but is not limited to, training or other enhanced education, written reminders or reprimands, limitations on certain types of business, monetary penalties, suspension or termination.

Managers should consult with Compliance when formal disciplinary action is considered. Compliance is responsible for reporting disciplinary action when the action is reportable under a regulator's requirements.

## **2.10 Obligation to Notify the Firm and Firm's Obligation to Report (FINRA Rule 4530)**

The Firm is obligated by rule to report certain events or information affecting the Firm and its employees (including independent contractors). **For this reason, Employees are obligated to notify Compliance immediately if they become subject to any of the following, if not previously reported to the Firm.** Some of these events require reporting to regulators:

- An investigation or finding of a violation by a securities regulator, government agency, or financial business or professional organization such as a bar association
- A temporary or permanent injunction issued by any court and involving securities, commodities, insurance or banking matters
- A customer complaint (securities or commodities) including a written or oral complaint, civil litigation or arbitration
- An arrest, indictment, arraignment, conviction, pleading guilty or no contest to any felony or misdemeanor (other than misdemeanor traffic offenses)
- Associated with a financial institution (broker dealer, insurance company, etc.) that is suspended or expelled by a regulatory agency or that has been convicted of or pleaded no contest to any felony or misdemeanor or is subject to a statutory disqualification (this includes association with individuals subject to statutory disqualification)
- A bankruptcy proceeding, judgment, lien or compromising with a creditor.

When it becomes aware of a reportable event, Compliance will promptly report this information to the appropriate regulator and will retain copies of reported information in a separate complaint or disclosure file for the event.

In addition, Compliance will file copies of the following with FINRA:

- any complaint where the Firm is named as defendant or respondent in any securities, commodities-related or financially-related insurance private civil litigation or arbitration claim (other than arbitrations filed for arbitration through FINRA).
- any private civil complaint or arbitration against a registered person and reportable under question 14 of Form U-4, regardless of dollar thresholds on Form U-4.
- any indictment, information or other criminal complaint or plea agreement against a registered person involving any felony or a misdemeanor that involves securities transactions, making false statements or reports,

bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or a conspiracy to commit any of these offenses, or substantially equivalent activity in any court.

Copies will be sent to:

FINRA  
Attn: Rule 4530(f)  
9509 Key West Avenue  
Rockville, MD 20850

The Compliance Department will analyze FINRA 4530 reports, Form U4 filings and other reports provided by FINRA such as the Sales Practice Complaint Report so that enhancements can continually be made to the examination module, the Firm's continuing education program and other application portions of the Firm's written supervisory procedures.

#### **2.10.13 External Findings (FINRA Rule 4530)**

The Firm will report to FINRA within 30 calendar days of being found by an external body to have violated any securities, insurance, commodities, financial or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body, SRO or business or professional organization.

*See Section 6.11.10.4 for internal conclusion reporting requirements.*

#### **2.11 Reports Of Crimes and Suspected Crimes**

All employees are obligated to report to Compliance any known or suspected crimes. This is an obligation imposed on **all** employees and all RRs.

**What to report:** Crimes or suspected crimes by individuals (whether or not associated with the Firm) are required to be reported. This includes suspicion that the Firm is being used as a conduit for criminal activity such as money laundering or structuring transactions to evade the Bank Secrecy Act reporting requirements. There is no clear definition of what constitutes a "crime." If you believe some improper or illegal activity is occurring, it is your obligation to report it.

Compliance is responsible for conducting an investigation and reporting to the proper authorities, if necessary.

## **2.12 Money Laundering (FINRA Rule 3310, Bank Secrecy Act)**

Money laundering is a serious crime potentially related to the funding or terrorist activities. It is the subject of extensive federal regulations that impose requirements on financial institutions, such as broker/dealers and their employees, to detect and prevent potential money laundering activities.

It is the policy of the Firm and its employees 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 the movement of criminally derived funds to conceal the true source, ownership or use of the funds. The funds are filtered through a maze or series of transactions, so the funds are "cleaned" to look like proceeds from legal activities.

In general, money laundering occurs in three stages. Cash first enters the financial system at the "placement" stage, where the cash profits from criminal activity are 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 separate further the proceeds from their criminal origin. At the "integration" stage, the funds are reintroduced into the economy and used to purchase legitimate assets or to fund further criminal or legitimate activities.

Engaging in money laundering is a federal crime with severe penalties for those engaged in criminal activities and those who facilitate, intentionally or inadvertently, money laundering. All employees are responsible for having a general understanding of money laundering and immediately reporting suspected money laundering activities to the AML (Anti-Money Laundering) Compliance Officer, as explained at the end of this section, or in the absence of the AML Compliance Officer to the Operations Department.

### **2.12.1 Background**

The Currency and Foreign Transactions Reporting Act, also known as the Bank Secrecy Act (BSA), and its accompanying regulation, is a tool the U.S. government uses to fight drug trafficking, money laundering, and other crimes. Congress enacted the BSA to prevent financial service providers (such as banks and broker-dealers) from being used as intermediaries for, or to hide the transfer or deposit of, money derived from criminal activity. Money laundering schemes may include the use of wire transfers, cash, bearer instruments, travelers' checks, money orders, cashier's checks and other negotiable instruments.

The Firm is required to comply with the reporting, recordkeeping and record retention requirements of the BSA. The requirements govern the payment, receipt or transfer of currency within and into and out of the U.S. and foreign financial transactions and accounts.

### **2.12.2 Penalties**

Participation in money laundering schemes or the knowing receipt of proceeds from criminal activities is a crime. The Firm and its employees are subject to severe criminal, civil and regulatory penalties if they facilitate or participate in money laundering activities. Violations by employees may result in internal disciplinary action including termination.

An employee may be deemed to be facilitating or participating in money laundering by engaging in a transaction with a customer (accept a deposit, arrange a withdrawal, effect a trade, *etc.*) when he or she is aware of, or willfully ignores, the fact that the customer is engaged in illegal activities.

### **2.12.3 Preventing Money Laundering**

There are a number of ways the Firm and its employees can avoid money laundering schemes.

#### **2.12.3.1 Knowing The Customer**

Being familiar with the customer's financial resources, business activities, and sources of funds are avenues for knowing the customer. Knowing the customer occurs at the time an account is opened as well as during the operation of a customer's account. The identity of customers must be verified when a new account is opened. Procedures for verifying customer ID are explained in the chapter *Accounts* in the section *New Accounts*.

#### **2.12.3.2 Risk Indicators**

The following are examples of risk indicators that may suggest potential money laundering.

- The customer exhibits unusual concern regarding the firm's compliance with government reporting requirements and the firm's AML policies, particularly with respect to his or her identity, type of business and assets, or is reluctant or refuses to reveal any information concerning business activities, or furnishes unusual or suspect identification or business documents.
- The customer wishes to engage in transactions that lack business sense or apparent investment strategy, or are inconsistent with the customer's stated business strategy.
- The information provided by the customer that identifies a legitimate source for funds is false, misleading or substantially incorrect.
- Upon request, the customer refuses to identify or fails to indicate any legitimate source for his or her funds and other assets.



- The customer (or a person publicly associated with the customer) has a questionable background or is the subject of news reports indicating possible criminal, civil or regulatory violations.
- The customer exhibits a lack of concern regarding risks, commissions or other transaction costs.
- The customer appears to be acting as an agent for an undisclosed principal, but declines or is reluctant, without legitimate commercial reasons, to provide information or is otherwise evasive regarding that person or entity.
- The customer has difficulty describing the nature of his or her business or lacks general knowledge of his or her industry.
- The customer engages in suspicious activity involving the practice of depositing penny stocks, liquidates them and wires proceeds. A request to liquidate shares may also represent engaging in an unregistered distribution of penny stocks which may also be a red flag.
- The customer attempts to make frequent or large deposits of currency, insists on dealing only in cash equivalents, or asks for exemptions from the Firm's policies relating to the deposit of cash and cash equivalents.
- The customer engages in transactions involving cash or cash equivalents or other monetary instruments that appear to be structured to avoid the \$10,000 government reporting requirements, especially if the cash or monetary instruments are in an amount just below reporting or recording thresholds.
- For no apparent reason, the customer has multiple accounts under a single name or multiple names, with a large number of inter-account or third-party transfers.
- The customer is from, or has accounts in, a country identified as a non-cooperative country or territory by the Financial Action Task Force (FATF).
- The customer's account has unexplained or sudden extensive wire activity, especially in accounts that had little or no previous activity.
- The customer's account shows numerous currency or cashier's check transactions aggregating to significant sums.
- The customer's account has a large number of wire transfers to unrelated third parties inconsistent with the customer's legitimate business purpose.
- The customer's account has wire transfers that have no apparent business purpose to or from a country identified as a money laundering risk or a bank secrecy haven.
- The customer's account indicates large or frequent wire transfers, immediately withdrawn by check or debit card without any apparent business purpose.
- The customer makes a funds deposit followed by an immediate request that the money be wired out or transferred to a third party, or to another firm, without any apparent business purpose.
- The customer makes a funds deposit for the purpose of purchasing a long-term investment followed shortly thereafter by a request to liquidate the position and transfer of the proceeds out of the account.

- The customer engages in excessive journal entries between unrelated accounts without any apparent business purpose.
- The customer requests that a transaction be processed in such a manner to avoid the firm's normal documentation requirements.
- The customer, for no apparent reason or in conjunction with other "red flags," engages in transactions involving certain types of securities, such as penny stocks, Regulation "S" (Reg S) stocks, and bearer bonds, which although legitimate, have been used in connection with fraudulent schemes and money laundering activity. (Such transactions may warrant further due diligence to ensure the legitimacy of the customer's activity.)
- The customer's account shows an unexplained high level of account activity with very low levels of securities transactions.
- The customer maintains multiple accounts, or maintains accounts in the names of family members or corporate entities, for no apparent business purpose or other purpose.
- The customer's account has inflows of funds or other assets well beyond the known income or resources of the customer.

#### **2.12.4 Cash Or Currency Deposits Not Accepted**

The Firm does not accept cash deposits or cash equivalents (money orders, travelers checks). Customers who attempt to deposit cash should be advised to submit a personal check to his or her account.

#### **2.12.5 Reporting Requirements**

##### **2.12.5.1 Currency Transaction Reporting**

The Bank Secrecy Act requires broker-dealers to report certain transactions relating to currency transactions, as follows:

- Report cash or currency deposits of more than \$10,000, including multiple deposits on the same day that would total more than \$10,000. A currency Transaction Report (CTR) is filed with the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department. Some state regulators also require reporting of currency transactions.
- Report currency or bearer instruments over \$10,000 transferred into or out of the U.S. The Currency and Monetary Instrument Transportation Report (CMIR) is filed with the U.S. Customs Service.

##### **2.12.5.2 Suspicious Activity Reports (SARs)**

The Firm is required to file a Suspicious Activity Report (SAR) for transactions that may be indicative of money laundering activity. A SAR is filed for a suspicious transaction involving \$5,000 or more in funds or other assets. The AML Compliance Officer is responsible for reviewing potential suspicious activity

and determining whether a report will be filed. It is important for employees/RRs to report suspicious activity to Compliance.

By law, the Firm and its employees cannot disclose to the customer or anyone other than authorized regulators that it has filed a SAR. Questions regarding SAR filings should be referred to Compliance.

#### **2.12.6 Prohibition Against Structuring Deposits To Avoid Reporting**

Cash or currency deposits or attempted deposits which appear to be part of a deposit structure to avoid IRS or Customs currency reporting requirements or Firm limitations, or are otherwise suspicious, may not be accepted and must be reported to Compliance. Employees/RRs are prohibited from:

- aiding or advising a customer in structuring a transaction to avoid reporting requirements
- holding instruments for deposit on succeeding days
- transporting cash or cash equivalents or bearer instruments to a bank on behalf of a customer.

#### **2.12.7 Recordkeeping Requirements**

In addition to reporting requirements, broker-dealers are subject to requirements to maintain records of transfers of funds (including wire fund transfers) of \$3,000 or more. This includes transfers between accounts that are not for the same owner and transfers to third parties including banks and other financial institutions. Records of transfers are available for inspection by regulators and other appropriate authorities, when requested.

#### **2.12.8 AML Compliance Officer**

The Firm has designated an AML Compliance Officer who is responsible for overseeing the Firm's anti-money laundering program. The AML Compliance Officer ("AML Officer") is the Chief Compliance Officer of the Firm. The AML Officer may be contacted whenever an employee has questions about the Firm's program, a current or prospective account, or activities or transactions that raise questions about potential money laundering activities. An employee may also provide information anonymously to the AML Officer. The AML Officer is responsible for investigating suspected money laundering activities and taking corrective action when necessary.

All employees are obligated to promptly report to the AML Officer any known or suspected violations of anti-money laundering policies as well as other suspected violations or crimes. If the potential violation implicates the AML Officer, it should be reported to a senior manager of the Firm. All reports are confidential and the employee will suffer no retaliation for making them.

Crimes or suspected crimes by individuals (whether associated with the Firm, a customer or prospective customer) are required to be reported. This includes suspicion that the Firm is being used as a conduit for criminal activity such as money laundering or structuring transactions to evade the BSA reporting requirements. There is no clear definition of what constitutes a "crime." If you believe some improper or illegal activity is occurring, it is your obligation to report it.

Broker/dealers are required to file Suspicious Activity Reports (SARs) for transactions that may be indicative of money laundering activities. By law the Firm and its employees cannot disclose to the customer or anyone other than authorized regulators that it has filed a SAR. Questions regarding SAR filings should be referred to Compliance.

Engaging in money laundering is a federal crime with severe penalties for those engaged in criminal activities and those who facilitate, intentionally or inadvertently, money laundering. It is important that the Firm, as well as all employees, remain diligent and active participants in the Firm's anti-money laundering program.

#### **2.12.9 Treasury Dept. OFAC List**

The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) is responsible for publishing sanctions against persons, corporations, and other entities including foreign governments that have been identified by the U.S. Government as engaging in criminal activities including drug trafficking and terrorist activities. The Firm is obligated to check its accounts against the lists of blockings to ensure it does not engage in prohibited transactions which include securities transactions and transfer of assets out of a blocked account or to a blocked person or entity.

The Firm has procedures to monitor the OFAC lists and comply with requirements to block property and notify OFAC when required. Questions regarding the Firm's program should be referred to the AML Compliance Officer. More information is also available at the OFAC web site at [www.treas.gov/ofac](http://www.treas.gov/ofac).

#### **2.12.10 Emergency Business Recovery Procedures**

The Firm has a *Business Continuity Plan* that assigns responsibilities and outlines procedures in the event of a disaster or emergency which impacts the Firm's ability to continue conducting business (also termed a "significant business disruption"). Examples of a major disruption include a regional power outage; disruption at another company that provides services critical to the Firm's business; pandemic; and destruction of an office or other facilities by natural causes or by other means. The Plan designates employees who are responsible

for employee safety and protection of firm property, records, and customer assets.

In the event of a disruption, employees will be given instructions by authorized personnel. Depending on the nature of the emergency, it may be necessary to use alternative communication systems; transfer personnel and/or business activities to alternative office space; or transfer the Firm's business to other brokerage firms or financial institutions until normal operations can be resumed.

The Firm has established procedures for contacting employees in the event of an emergency. If the Firm conducts a test of its emergency procedures, all employees are required to participate as if the emergency were real.

Past emergencies affecting the securities industry have shown that preparedness and cooperation are key to maximizing the safety of employees and minimizing business interruptions. It is important for all employees to follow instructions from senior management and other authorized key personnel during any drill or when an emergency occurs.

Questions regarding the Firm's Business Continuity Plan may be referred to Compliance.

#### **2.12.11 Shell Companies**

Shell companies may represent potential money laundering risks. "Shell company" refers to non-publicly traded corporations, limited liability corporations (LLCs) and trusts that typically have no physical presence (other than a mailing address) and generate little or no independent economic value. It is important for employees to be aware of the risks involved in dealing with shell companies.

Most shell companies are formed for legitimate business purposes such as to hold stock or intangible assets of another business entity or to facilitate domestic or cross-border currency and asset transfers and corporate mergers. Unfortunately, shell companies have become common tools for money laundering and other financial crimes, primarily because they are easy and inexpensive to form and operate, and ownership and transactional information can be concealed from regulatory and law enforcement authorities. Most states do not collect or require disclosure of ownership information at the information stage or after.

Agents, also known as intermediaries or nominee incorporation services (NIS), can play a central role in the information and maintenance of shell companies. Agents and NIS firms offer a wide range of services that may include offering an office address, mail-forwarding services, local telephone listings and other services that may give the appearance of a locally-established business. Some agents and NIS firms also provide nominee services which can preserve a

client's anonymity. Some risk indicators of shell companies potentially engaged in money laundering are:

- An inability to obtain (through Internet searches, commercial database searches or direct inquiries to the company's foreign correspondent bank) information necessary to identify originators or beneficiaries of wire transfers
- A foreign correspondent bank exceeds the anticipated volume projected in its client profile for wire transfers in a given period or an individual company exhibits a high amount of sporadic activity that is inconsistent with normal business patterns
- Payments have no stated purpose, do not reference goods or services or identify only a contract or service number
- Goods or services of the company do not match the company's profile based on information previously provided
- Transacting businesses share the same address, provide only a registered agent's address or raise other address-related inconsistencies
- An unusually large number and variety of beneficiaries receive wire transfers from one company
- Frequent involvement of beneficiaries located in high-risk, offshore financial centers
- Multiple high-level payments or transfers between shell companies with no apparent legitimate business purpose.

## 2.13 Prohibited Activities

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Various (referral of items, direct identification, review of transactions, <i>etc.</i> depending on the nature of the prohibited activity)</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Take corrective action which may include: <ul style="list-style-type: none"> <li>○ Conferring with the employee</li> <li>○ Monetary penalty</li> <li>○ Issuing a written admonition</li> <li>○ Restricting the activities of or transactions handled by the employee</li> <li>○ Suspending the employee</li> <li>○ Termination</li> </ul> </li> </ul> |

|               |   |
|---------------|---|
| <b>Record</b> | <ul style="list-style-type: none"> <li>• The record of action taken depends on the nature and seriousness of the prohibited activity. Records, if needed, may be in different forms, including the following: <ul style="list-style-type: none"> <li>◦ Designated supervisors may record action taken in supervisory logs, Daytimers, memos to employee's files, etc.</li> <li>◦ Compliance may record action by memo to the employee's file</li> </ul> </li> </ul> |
|---------------|---|

Employees who are concerned about potential rule violations should notify someone in a supervisory role, as listed below:

- Notify the supervisor unless the supervisor's actions are the subject of concern;
- A supervisor is obligated to investigate the issue and refer it to Compliance if it is more than a minor issue that cannot be reasonably resolved;
- If the supervisor is the subject of a potential rule violation, the employee should immediately contact Compliance who is responsible for investigating and resolving the issue;
- If Compliance determines there is a significant rule violation, regulators may be contacted regarding action being taken by the Firm;
- Compliance is responsible for making necessary regulatory filings, including amendments to or filings of U4 or U5s and other filings that may be required.

### **2.13.1 Use Of Firm Name**

No employee may use the Firm's name in any manner which could be reasonably misinterpreted to indicate a tie-in between the Firm and any outside activity of the employee.

### **2.13.2 High Pressure Sales Tactics (FINRA Rule 2111)**

The Firm and its RRs will not engage in high pressure sales tactics which may include excessive telephone calls, implying that a price may change on a security if the customer does not act immediately, or falsely representing that there is a limited supply of a security at a particular price.

### **2.13.3 Rebates Of Commission (FINRA Rule 2040)**

Employees are prohibited from rebating to anyone, directly or indirectly, any commission or compensation received.

#### **2.13.4 Sharing Commissions Or Fees With Unregistered Persons (FINRA Rule 2040)**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li><li>• Accounting/Commissions</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests to share commissions</li><li>• Branch audits</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required (requests)</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Refer all requests to Compliance for approval</li><li>• Discontinue any unapproved arrangements identified until they are approved</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Accounting/Commissions will retain a record of approval of commission sharing arrangements</li></ul>   |

Regulations prohibit the sharing of commissions or compensation with non-registered persons or entities. Any payment or sharing arrangement to a non-registered or inappropriately licensed person is not allowed. Any payment or sharing arrangement to a registered person must be facilitated through the home office.

#### **2.13.5 Settling Complaints or Errors Directly With Customers**

Employees may not make payments to customers of any kind to resolve an error or customer complaint. Errors and complaints must be brought to the attention of Operations (errors) or Compliance (complaints) immediately.

#### **2.13.6 Borrowing From and Lending to Customers (FINRA Rule 3240)**

Registered employees are generally not permitted to borrow from or lend to their own customers.

This restriction does NOT apply when an employee enters into a loan agreement with a customer who is:

- An immediate family member (defined as parents; grandparents; in-laws; spouse; siblings; children; grandchildren; cousins; aunts or uncles; nieces



- or nephews; and any other person whom the RR supports, directly or indirectly, to a material extent);
- A financial institution in the business of providing credit, financing or loans AND where the terms of the lending arrangement are those that would be available to the general public doing business with those institutions;
  - Another registered employee of the Firm;
  - Someone (or an entity who has a personal relationship with the RR and the lending arrangement arises from the personal relationship rather than an RR/customer relationship; or
  - Someone (or an entity) that has a business relationship outside an RR/customer relationship,

Any proposed loan with the RR's customer (other than with a family member or financial institution as stated above) requires the PRIOR review and approval by Compliance. RRs requesting exceptions must obtain a signed notarized letter of authorization from the customer and submit it to Compliance prior to effecting the loan arrangement.

### **2.13.7 Personal Funds Deposited In Customer Accounts**

In general, employees are not permitted to deposit personal funds or securities in customers' securities or bank accounts or deposit customers' personal funds or securities in an employee's securities or bank accounts. The same prohibitions apply to withdrawals.

An employee should not accept a check made payable to himself/herself or his/her business entity where the purpose of the check is for the purpose of purchasing an investment product.

Exceptions should be reviewed by Compliance.

### **2.13.8 Prohibition Against Guarantees (FINRA Rule 2150)**

The Firm and its employees are prohibited from guaranteeing a customer against loss in any securities transaction. This includes promises to buy-back securities (even if no price is mentioned). Designated supervisors are responsible for identifying prohibited guarantees in correspondence or other written communications with public customers. Options or written agreements that establish the future price of a transaction such as repurchase agreements are not included in this prohibition.

### **2.13.9 Fees and Other Charges**

Employees are not permitted to charge fees or assess other charges to customers or customers' accounts unless they are expressly permitted by the Firm.

### **2.13.10 Customer Signatures**

Employees are not permitted to sign documents on behalf of customers, even when doing so is meant to accommodate a customer's request. Customer signatures must be original and signed by the customer on all documents after they are completed in full. Prompt and severe disciplinary action will be taken if the client's signature is found to be fraudulent.

### **2.13.11 Rumors (FINRA Rule 6140(e))**

No employee may spread any rumors or misinformation that the employee knows to be false or misleading. This includes rumors of a sensational character that might reasonably be expected to affect market conditions. Discussion of unsubstantiated information published by a widely circulated public media is not prohibited providing the source and unsubstantiated nature are also disclosed.

### **2.13.12 Misrepresentations**

Employees may not disseminate any information that falsely states or implies guarantees or approval of securities by the government or other institution such as government guarantee of securities that carry no such guarantee. SIPC and E&O insurance may not be misrepresented as a guarantor of a customer's account against losses from transactions.

### **2.13.13 Bribes**

No employee may offer or solicit explicit inducements to or from employees or representatives of other institutions or foreign governmental or political officials to obtain business. Entertainment and gifts in reasonable amounts are not included in this prohibition and are discussed in the section titled "Gifts and Gratuities."

### **2.13.14 Acting Without Registration**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• New account forms</li><li>• Notices of registration status/exception report</li><li>• BrokerCheck</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review new account forms to identify any out-of-state accounts where the RR may not be registered</li></ul> |

|               |   |
|---------------|---|
|               | <ul style="list-style-type: none"> <li>• Do not process business</li> <li>• Immediately refer any RRs requiring state registration to Compliance</li> <li>• Ensure unlicensed or inappropriately licensed RRs do not engage in unauthorized activities</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Include a notation on the New Account form that the registration issue was referred to Compliance</li> <li>• Document in DST Compliance System for post review</li> </ul>  |

No employee may engage in activities that require registration (selling securities, soliciting accounts, trading, *etc.*) unless registered in the appropriate capacities. Questions regarding the need for registration should be referred to Compliance.

### **2.13.15 Conversion Or Misappropriation Of Customer Funds**

Conversion or misappropriation of customer funds is prohibited. The Firm will institute reasonable internal controls in an attempt to detect and prevent such an occurrence.

#### **2.13.15.1 Monitoring**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New Accounts procedures</li> <li>• Distribution of statements and confirmations</li> <li>• Customer payment for securities records</li> <li>• Review of advertising and sales literature</li> <li>• Visits to branch and non-branch locations</li> </ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Varies</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Varies as discussed within the applicable sections of the written supervisory procedures as listed in the resources portion of this section</li> </ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Varies as discussed within the applicable sections of the written supervisory procedures as listed in the resources portion of this section</li> </ul>   |

## 2.14 Computer Records, Equipment and Software

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Designated Supervisor</li><li>• Compliance</li><li>• Technology</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Disks and other computer records and equipment maintained by terminating employee</li><li>• Information Security Policy Manual</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• When an employee leaves the Firm's employment, all Firm equipment and software, including customer records are retained by the Firm. This is accomplished by asking the employee, at the time of notification of termination, to turn over any software and disks or other computer or electronic records that are the property of the Firm.</li><li>• Any disks including proprietary information, including customer information, are considered property of the Firm and must be left with the Firm at time of termination</li><li>• Ensure someone locks the office daily to secure Firm equipment overnight</li><li>• Do not permit removal of Firm equipment without approval</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Information Security Policy Manual Attestation</li></ul>  |

The Firm considers its computer records, systems, and software to be corporate assets. Employees are responsible for protecting these assets from unauthorized use, destruction or unauthorized modification. This includes a prohibition against violating copyright laws or licensing agreements applicable to computer software.

Physical equipment (PCs, printers, software, thumb drives, *etc.*) must be placed in a secure location to avoid theft, tampering, unauthorized use and environmental hazards (water, smoke, magnets, *etc.*). The use of personal computers for Firm business is subject to the same guidelines and restrictions as Firm computers.

Employees who use laptops, tablets or other electronic mediums to gain access to the Firm's records are responsible for the security of the Firm information contained therein. Serious security breaches can occur if the medium containing

confidential information is lost or stolen. Passwords should be changed frequently and should not be readily-identifiable words or sequences.

When an employee terminates, any disks or other storage medium that includes proprietary information, including information, are considered property of the Firm and must be left with the Firm.

The Firm implemented an Information Security Policy Manual to guide and assist its employees/RRs in protecting Firm and client information. Any questions related to these policies should be addressed to Compliance or Technology.

## **2.15 Electronic Communications Policy**

### **2.15.1 Introduction**

This policy governs the use of electronic communications by employees including part-time employees and independent contractors of the Firm. This policy also extends to off-hours usage of electronic communications systems.

### **2.15.2 Summary Of Policy**

The following summarizes key points of this policy. It is important that the policy be read in its entirety.

- All personnel and RRs of the Firm are subject to this policy.
- The Firm's electronic communications systems are to be used for business purposes only.
- Electronic communications should not be considered private.
- Electronic communications are subject to monitoring and audit by the Firm.
- E-mails are subject to federal law restricting the sending of unsolicited electronic mail.
- Posting information and participating in chat rooms or instant messaging systems for Firm-related communications is generally prohibited.
- Certain public communications require approval and retention.
- To avoid downloading a computer virus, do not open attached documents from unknown sources.
- Failure to comply with this policy may lead to disciplinary action.

### **2.15.3 Electronic Communications Defined**

Electronic communications include (but are not necessarily limited to) the following:

- Electronic mail (E-mail)
- Third-party E-mail systems

- Internet Telephone
- Facsimile transmissions
- News Groups
- File Transfer Protocol (FTP)
- World Wide Web browsing (WWW)
- Social Networking and Social Media, e.g. Twitter, LinkedIn, Facebook
- Intranet
- Electronic Bulletin Boards
- Internet Relay Chat (IRC) or similar "Chat Rooms"
- Instant Messaging Systems
- Remote Host Access (Telnet or TN3270)
- Other information transmissions via the Internet

#### **2.15.4 Instant Messaging**

Instant messaging is included in some internet services and provides the ability to conduct instant, online interactive "conversations." Employees must be aware that because instant messaging provides a method of recording and potentially keeping such conversations, they are treated as written communications subject to Retail Communications (advertising, sales literature, and correspondence) recordkeeping review and retention requirements. The use of instant messaging subjects those communications to review by the Firm, retention in its records, and potential delivery to regulators, legal authorities, or others in civil litigation or arbitrations. Instant messages are not appropriate for "confidential" communications.

Employees outside of the home office are not permitted to use instant messaging to conduct the Firm's business, unless the messages meet the standards above and prior Compliance approval was requested and received.

#### **2.15.5 Guidelines For Proper Use**

The Firm's electronic communications systems should be used primarily for business purposes. Personal use should be only incidental and occasional. Electronic communications with customers and/or the public are permitted only through company-sponsored or alternative approved facilities.

The following guidelines apply:

##### **2.15.5.1 Electronic Communications Are Not Private**

**Employees should not confuse phone conversations or face-to-face conversations with communications through electronic means.** Newspaper articles, regulatory actions and legal actions abound with the consequences of employees who do not take what they say in electronic communications seriously. The repercussions of casual or poorly worded communications have

potential adverse consequences for both the Firm and the employee. While electronic communications often seem like one-on-one conversations, and many people converse in electronic communications in a casual and non-business manner, it is important to understand that the use of the Firm's electronic communications systems or approved alternative systems are communications that may be seen by others either through the Firm's review system or outsiders who access this information through official and authorized means or sometimes through unauthorized means.

Electronic communications and residual or temporary files resulting from participation in electronic communications can be widely disseminated. It is possible that such communications be saved to disk, printed, forwarded to another party, subpoenaed in litigation, viewed by system administrators or regulatory agents and/or intercepted by anyone at a variety of points.

Electronic communications are not suitable for communications that must remain confidential or private, unless the Employee has arranged for encryption of confidential messages. There should be no expectations of privacy in electronic communications.

#### **2.15.5.2 Communications Must Conform To Appropriate Business Standards and the Law**

Users of our electronic communications systems are expected to follow appropriate business communication standards. Sending or receiving communications that are inappropriate, profane, obscene, discriminatory, threatening or otherwise offensive is prohibited. Sending or receiving jokes, puzzles, games, chain messages, pictures, video/sound files and frequent or long personal correspondence are some examples of inappropriate use. Use must comply with applicable local, state, federal and international laws.

#### **2.15.5.3 Electronic Communications Are Business Communications and Should Be Treated As Such**

- Electronic communications sent should contain the most recent, valid information available.
- Personnel are required to report threatening, harassing or otherwise inappropriate communications to their supervisor or Compliance.
- Communications received with inappropriate content must be deleted/discarded immediately without forwarding.
- Unauthorized dissemination of proprietary information is prohibited.
- Unauthorized copying or transmitting software or other materials protected by copyright is prohibited. Personnel must obtain Compliance approval before distributing copyrighted material.
- Newly developed, non-company-sponsored electronic communication technologies are inappropriate for Firm communications without prior company approval.

- Because of the nature of electronic communications systems in general, there is no guarantee that a message will reach its destination in a timely manner or that it will reach its destination at all.

#### **2.15.5.4 Encryption**

- The Firm may require encryption of certain confidential communications.
- Users are responsible for controlling access to their own computer and encrypted messages.
- Employees must use encryption when required by the Firm (i.e. protecting client privacy when sending documents or emails that contain a client's personally identifiable information).
- Passwords should be safeguarded.

#### **2.15.5.5 Record Retention Requirements**

Regulator's rules require that the Firm retain records of business communications. The Firm retains electronic communications in accordance with these rule requirements.

#### **2.15.5.6 Required Pre-Use Review and Approval**

Electronic communications sent to external recipients may need approval or pre-approval in accordance with the Firm policies and procedures established for written communications. Refer to the *Communications With The Public* chapter for further policies regarding correspondence and other communications with the public.

#### **2.15.5.7 Monitoring, Audit and Control**

Electronic communications through the Firm's systems are the property of the Firm. The Firm reserves the right to monitor and audit electronic communications at any time for appropriate business usage, standards and compliance with this policy and applicable procedures.

### **2.15.6 E-Mail**

Only Firm approved e-mail addresses may be used to correspond to the public for the purpose of conducting the business of the Firm, and must be linked to the Firm's electronic communications monitoring system (Smarsh).

#### **2.15.6.1 Standard Disclosures Included With Outgoing E-Mail Communications**

All outgoing E-mail communications transmitted through the Firm's system should automatically include standard disclosures regarding the Firm's identity and other necessary or required disclosures.



#### **2.15.6.2 System Maintenance**

As part of routine maintenance, E-mail messages that are of a certain age or file-size may be automatically deleted from the system.

#### **2.15.6.3 Attachments**

In order to avoid downloading a computer virus, do not open attachments unless you are familiar with the source.

#### **2.15.6.4 Restrictions On Unsolicited E-Mails (CAN-SPAM Act of 2003)**

Federal law imposes restrictions on commercial e-mail, particularly unsolicited "mass" e-mail messages. "Commercial electronic mail" includes any electronic mail message primarily for the purpose of sending a commercial advertisement or promotion of a commercial product or service. It does not include electronic mail relating to transactions or where there is a relationship between the sender and the recipient.

Recipients of commercial e-mail must be provided the opportunity to "opt-out" and not receive future e-mails.

Senders of commercial e-mail may not:

- Use false or misleading e-mail header information or deceptive subject headings or otherwise deceive the recipient regarding the sender's address.
- Without prior authorization, use computers owned by others to transmit messages.
- Register for an e-mail address or domain name using materially false information or falsely represent themselves to be the registrants for Internet protocol addresses.
- Use automated means to create multiple e-mail addresses from which to send commercial e-mail (e.g., using a computer program to create multiple "Yahoo" accounts).

Each commercial e-mail must include clear and conspicuous identification that the message is an advertisement or solicitation; a valid physical postal address of the sender; and a valid return address or other method for the recipient to "opt-out" from receiving further e-mails.

#### **2.15.7 Internet**

**Employees may not post any Firm advertising or any business-related information without Compliance authorization.**

The Firm maintains a corporate Web site as its official Internet presence. Without prior authorization, personnel may not post information to the Internet containing any of the following:

- References to the Firm or information about the Firm,
- Communications involving investment advice,
- References to investment-related issues, or
- Links to any of the above.

This includes posting such information to the Internet through such means including, but not limited to, the World Wide Web, Social Networking, Social Media, Electronic Bulletin Boards, File Transfer Protocol (FTP) sites or any other method to establish their own Internet presence.

#### **2.15.7.1 RR Web Sites**

Individual representative (or office) web sites need pre-approval in accordance with the Firm's policies and procedures established for written communications. Refer to the *Communications With The Public* chapter for further policies regarding web sites.

#### **2.15.7.2 Chat Rooms**

As interactive, extemporaneous conversations, chat rooms are considered a public forum. Participation in investment-related chat rooms is generally prohibited. If a person wishes to participate in a chat room for business purposes, they must obtain prior written authorization from Compliance. In addition, content guidelines must be acknowledged in writing by RRs and copies of the discussion must be printed by the RR and provided to Compliance for monitoring. Exceptions: Chat rooms that do not deal with investments or securities.

#### **2.15.8 Failure To Comply**

*Failure to comply with this policy or any policy in this manual may lead to disciplinary action.* Non-compliance may generate one or more of the following:

- Oral and/or written warning or notification of violation communicated to the Firm's personnel involved and their supervisor.
- Suspension of electronic communications privileges permanently or for a set period of time.
- Messages may be blocked or rejected if the message contains inappropriate content.
- Written warning to the employee's/RR's file.
- Suspension from work.
- Education course related to the infraction, and paid for by the employee.
- Monetary sanctions
- Regulatory discipline or censure.

- Possible termination of employment.

### 2.15.9 Consent to Policy

In using the Firm's electronic communications systems, personnel consent to the terms outlined in this policy, including consent for the Firm to monitor and audit content and/or usage.

### 2.16 Advertising and Publishing Activities

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests to advertise, publish newsletters, books, <i>etc.</i></li> </ul>            |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Refer requests to Compliance for approval</li> </ul>                                 |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Compliance retains copies of approved advertising and published materials</li> </ul> |

Prior to issuing any advertising or writing any books, articles, newsletters, or other materials to be published in public media (magazines, newspaper, computer bulletin boards, Internet, *etc.*) for public access, employees must contact Compliance for review and approval. Approval is not required for use of materials previously approved by the Firm and intended for public distribution, contingent on requirements listed on pre-approved materials.

### 2.17 Employees Acting As Trustees, Executors, Or Other Fiduciary Capacities

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests from employees and/or their supervisors</li> <li>• New Account forms</li> </ul>                                    |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review requests and determine if they are acceptable</li> <li>• Notify employee and/or supervisor of approval or</li> </ul> |

|               |   |
|---------------|---|
|               | disapproval   |
| <b>Record</b> | <ul style="list-style-type: none"> <li>If approved, file approval in the RR's file</li> </ul> |

Employees should not act in a fiduciary capacity (e.g., trustee, executor) for their customer's account unless the account is for a relative of the employee. Exceptions require the approval of Compliance who should be notified by written memo requesting the exception and the reasons for the exception.

## 2.18 Annual Certification/Questionnaire

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>Annual certification form(s)</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>Annual</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>Make forms available to RRs for completion</li> <li>Review completed forms or data gathered</li> <li>Take appropriate action which may include: <ul style="list-style-type: none"> <li>Inquire on reported outside business activities</li> <li>Inquire on reported outside securities accounts</li> <li>Conferring with the RR for any other reported information requiring follow-up</li> <li>File any update on Form U4s, if necessary</li> </ul> </li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>Annual certifications are retained in the RR file or via electronic means</li> </ul>   |

The Firm will, on an annual basis, ask employees to complete an Annual Certification form or various individual forms at the discretion of Compliance. The purpose of this form(s) is to ensure the Firm's records are current regarding items to be reported to the Firm (outside business activities, outside accounts, *etc.*). The forms will be reviewed by Compliance for follow-up action on items reported.

## 2.19 Sales Contests

### 2.19.1 Introduction

The firm does not engage in sales contests by product.

## 2.20 Special Supervision

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li><li>• Designated Supervisor</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Form U-4 information</li><li>• Customer complaints</li><li>• Regulatory actions</li><li>• CRD</li><li>• Other activity that may warrant heightened supervision, at the discretion of Compliance</li></ul>                           |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Identify RRs subject to special supervision</li><li>• Determine the scope of special supervision</li><li>• Notify the RR's supervisor of required supervision</li><li>• Conduct and document required special supervision</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Reviews of RRs for potential special supervision are retained in a "Special Supervision" file in Compliance</li><li>• Memos and certifications pertaining to a specific RR are retained in Compliance's file for the RR</li></ul>   |

### 2.20.1 Introduction

The Firm will institute special supervision for RRs or others when appropriate. The following sections describe the Firm's procedures for identifying RRs subject to special supervision and the types of supervision that may be conducted.

### 2.20.2 Identifying RRs For Special Supervision

It is the responsibility of Compliance to identify RRs for potential special supervision. RRs will be identified at the time of hire or when an RR becomes subject to regulatory action and/or a pattern of customer complaints. Unregistered individuals who were previously registered and the subject of customer or regulatory complaints are also subject to consideration for special supervision.

### 2.20.3 Criteria For Identifying Candidates For Special Supervision

The following are criteria that will trigger a review by Compliance to determine whether an RR should be subject to special supervision. Pending as well as Investment Planners, Inc.

resolved matters will be considered. The criteria are subjective and the details of the complaints and/or regulatory actions must be considered in determining whether special supervision is necessary.

- Three or more customer complaints alleging sales practice abuse within the past two years (complaints include written complaints, arbitrations, other civil actions)
- Complaint filed by a regulator
- Injunction in connection with an investment-related activity
- Termination for cause or permitted to resign from a former employer where the termination appears to involve a significant sales practice or regulatory violation

#### **2.20.4 Special Supervision Memorandum**

When a candidate is identified for possible special supervision, Compliance in consultation with the RR's supervisor, will consider whether special supervision will be established. After the determination is made, Compliance will prepare a memorandum outlining action taken (or not taken).

Where it is determined that the Firm's existing supervision is adequate to address oversight of the candidate, Compliance will document in the memorandum the reasons why existing supervision is adequate. Where it is decided special supervision will be conducted, Compliance will outline the supervision to be conducted (including type, frequency, time period of special supervision and how supervision should be documented) and provide copies of the memorandum to the subject RR outlining the terms of the special supervision. The RR will sign and return copies of the memorandum to Compliance.

#### **2.20.5 Scope Of Potential Special Supervision**

Special supervision will be established after considering the specifics that apply to the subject RR. Special supervision may take many forms and may include some of the following, to be determined by Compliance. This list does not limit or prescribe how special supervision should be structured for any one RR, since each case must be reviewed individually.

- Limits on type of business (options, direct participation programs, *etc.*)
- Limits on types of accounts (discretionary, certain age groups or other demographics, *etc.*)
- Verification with customers of new account information when accounts are opened
- Pre-approval of some or all trades entered
- Pre-approval of certain types of accounts
- Contact with customers by the RR's supervisor or designee
- Pre-approval of all written public communications originated by the RR

- Extra training or continuing education in areas subject to special supervision
- Assignment of the RR to a "mentor" or partner

## 2.21 Taping Rule

If the Firm is notified by FINRA or otherwise acquires actual knowledge that it meets one of the criteria of FINRA Rule 3170, the Firm's Chief Compliance Officer shall within sixty (60) days of notification, assign personnel to implement a taping system and establish, maintain and enforce special written procedures for supervising the telemarketing activities of all of its registered persons.

The Firm currently is not subject to the requirements of this Rule.

## 2.22 Signature Guarantee

Signature Guarantee Stamps will only be assigned and provided to those individuals with a business need and who meet qualification standards. RRs must sign a Letter of Indemnity before a Stamp is received and complete the medallion certification course on-line. Upon an RR's termination, the Signature Guarantee Stamp is required to be returned to Compliance. Failure to return the Stamp will result in a \$250 fee. Monthly usage logs are required to be sent to Compliance or posted to Salesforce. Additionally, Compliance will conduct periodic audits of each Stamp.

# 3.0 TRAINING AND EDUCATION

## 3.1 Annual Compliance Meeting (FINRA Rule 3110(a)(7))

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• List of RRs by branch, department or for the Firm</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Annual</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Determine appropriate subjects to include in the meetings</li> <li>• Conduct compliance meetings or interviews with RRs</li> <li>• Ensure all subject RRs complete the required annual meeting or interview</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• A record of when and where meetings are conducted, subjects discussed and who attended is maintained by Compliance</li> </ul>  |

|  |   |
|--|---|
|  | <ul style="list-style-type: none"> <li>• A record of corrective action, if needed, is retained if RR fails to complete the requirement</li> </ul> |
|--|---|

As required by FINRA rules, all RRs will attend an annual compliance meeting or interview.

## 3.2 Continuing Education (FINRA Rule 1250)

Registered employees are subject to SRO continuing education requirements composed of two distinct elements. Registered employees are required to complete both elements at specified time intervals. The two elements are:

**Regulatory Element:** This element is a computer-based training program that focuses on compliance, regulatory, ethical and sales practice standards. Its contents is derived from rules and regulations as well as standards and practices widely accepted within the industry. This element is administered by regulators via computer at designated testing centers or online.

**Firm Element:** All registered employees dealing with public customers are required to complete continuing education administered by the Firm.

### 3.2.1 Regulatory Element

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• CRD continuing education notices</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Ongoing</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Notify affected persons of requirements</li> <li>• Notify Operations, Compliance and Commissions of restricted persons</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Notices maintained in RR's file</li> </ul>  |

#### 3.2.1.1 Who Is Subject To The Requirements

All registered persons are subject to the regulatory element. All fees are the responsibility of the RR.



### 3.2.1.2 When Requirements Must Be Completed

The regulatory element is to be completed within 120 days of the 2<sup>nd</sup> anniversary of the individual's original registration date and every three years thereafter. For registered persons who become subject to statutory disqualification or disciplinary action as defined under the rules, the regulatory element must be completed within 120 days of the posting date of the disciplinary action and every three years after that date.

### 3.2.1.3 CRD Notices and Appointments For Training Sessions

Compliance is responsible for: (1) disseminating CRD notices or information from the notices to notify employees of pending Regulatory Element requirements; and (2) reminding registered persons to schedule training sessions at designated training centers. Up to five (5) notices are sent to the registered person outlining the requirements. Notification begin approximately 30 days prior to the continuing education session window opening date and occur approximately every 30 days thereafter until completion. Each notification includes a summary of the requirement, steps needed to fulfill it and the penalty for non-compliance, inactivation of registration.

### 3.2.1.3 Regulatory Element Contact Person (FINRA Rule 1250(a)(7))

Compliance has identified an individual who will be the contact person to receive CRD notices. On an annual basis (within 17 business days after the end of the calendar year) and no later than 30 days following any change in such information, the contact person information will be reviewed and updated per FINRA Rule 4517, if necessary.

### 3.2.2 Firm Element

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• List of all Registered Persons and others</li><li>• Information regarding firm products, services, training needs</li><li>• Guidance from regulators</li><li>• Current regulatory concerns</li><li>• Disciplinary actions</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Annual and ongoing</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Develop needs analyses; training plans; and training materials or choose vendors with appropriate training materials</li></ul>  |

|               |   |
|---------------|---|
|               | <ul style="list-style-type: none"> <li>• Identify employees who are subject to the requirement</li> <li>• Monitor completion of requirements</li> <li>• Restrict covered persons who do not complete requirements</li> </ul>  |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Needs analyses; training plans; training materials</li> <li>• Dates of training; contents of training; list of attendees</li> <li>• Certifications</li> <li>• Evaluations</li> <li>• Records of actions restricting covered persons, if necessary</li> </ul> |

### **3.2.2.1 Who Is Subject To The Requirements**

All registered persons who do business with the public are subject to the firm element. Firm element continuing education is required regardless of the length of registration or employment in the securities industry. All fees are the responsibility of the RR.

### **3.2.2.2 Firm Requirements**

The Firm is required to:

- identify job functions and persons subject to the requirement
- prepare an annual needs analysis including gathering information about products and services and training topics
- determine training objectives
- develop a written training plan
- implement the training plan
- retain a record of participation
- develop a method of evaluating the effectiveness of the training
- consider the evaluations in developing the next year's needs analysis
- restrict covered persons who do not complete the requirement.

The Firm's internal program may include videos, computer training, in-person presentations, self-study and other methods of conveying training material including a combination of methods. Complete details of the Firm's Continuing Education Program are maintained by the Compliance Department.

### **3.2.2.3 Identifying New Registered Persons**

As new registered persons are hired, Compliance will establish a procedure in the training plan to determine if a cutoff date for new hires should be established depending on the new hire date.

#### **3.2.2.4 Annual Needs Analysis**

An annual needs analysis is prepared for covered persons.

In developing the needs analysis, the following methods may be used:

- Feedback from regulators, including recent audits, regulatory alerts, and continuing education feedback.
- Customer complaints, arbitrations and other litigation involving the firm
- New business lines or marketing strategies.
- Questionnaires will be provided to key managers in business and other areas including Compliance and those responses will be considered in determining topics to be included.
- Regulatory element scoring reports.

#### **3.2.2.5 Determining Training Objectives**

The questionnaires used in developing the annual needs analysis will be used to determine the following year's training objectives.

#### **3.2.2.6 Written Training Plan**

Compliance is responsible for preparing an annual written training plan to be used in various departments and with RRs. The plans for each may vary in content.

#### **3.2.2.7 Records Of Participation**

Records of participation include:

- lists of those who attended continuing education training, and/or forms signed by participants that may include evaluation of the training.

#### **3.2.2.8 Monitoring Participation**

Compliance is responsible for follow up to ensure required firm element continuing education is completed.

#### **3.2.2.9 Evaluating The Firm Element Program**

Participants are asked to complete an evaluation form to evaluate the effectiveness of the firm element continuing education program. These evaluations are considered by Compliance in designing the next year's continuing education program.

#### 3.2.2.10 Other Records

Compliance will retain a record of the annual needs analyses for three years, two years in a readily accessible location.

#### 3.2.3 Registered Persons Who Fail To Complete Requirements

Registered persons who fail to complete the requirements of continuing education cannot conduct any duties that require registration or earn commissions or other compensation related to such activities. Registrations are considered "inactive" until continuing education requirements are completed.

Compliance will notify affected persons and their supervisors by written memorandum/email when their registration becomes inactive and when the requirement is satisfied and inactive status is lifted.

Accounting/Commissions and Operations also will be specifically notified by memorandum or email. Accounting will prevent payment of any commissions generated during the inactive period.

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Notices of restricted status</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Monitor restricted persons for duration of inactive period</li><li>• Terminate registration of restricted person if duration of inactive period exceeds 30 days.</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Records, if needed, may be in different forms, including the following:<ul style="list-style-type: none"><li>○ Transaction blotters</li><li>○ Call records</li><li>○ Copies of memos or correspondence will be retained in the individual's registration file.</li></ul></li></ul> |

### 3.3 Trainees

When the Firm affiliates with individuals to serve as registered representatives, those individuals will complete a training program as designed by the designated supervisor usually through self-study courses provided by an outside vendor. Trainees are only permitted to conduct business with public customers for

investments in which they are properly registered. Trainees will not conduct business otherwise until all other required registrations are successfully completed.

## **4.0 REGISTRATION AND LICENSING**

Pursuant to FINRA Rule 1010, the Firm has designated an employee with authority over registration functions, as named in the Firm's *supervisory chart*.

### **4.1 Registration**

#### **4.1.1 Hiring Procedures**

##### **4.1.1.1 RR Interview Guidelines**

At the time an RR is being considered for hire, the following are areas which should be considered:

1. Discuss with the applicant the nature of the applicant's prior customers and the types of securities sold while associated with prior employers. Obtain copies of the applicant's commission statements if necessary. If customers' investments include investment company products (mutual funds, variable annuities), determine whether the Firm has dealer or servicing agreements in place or will need to put in place.
2. Obtain the applicant's explanations regarding any customer complaints and regulatory actions to determine the merit, to the extent practicable, of each before hiring.
3. Ask the applicant about the existence of and nature of any pending proceedings, customer complaints, regulatory investigations, or arbitrations not listed in the CRD.
4. Discuss the reasons for the applicant's frequent change of employers, if applicable.
5. Obtain the RR's prior year W-2 or 1099 (not required).
6. Ask the RR whether he or she signed an employment contract with the present employer and if so, advise them to read it carefully and discuss any potential question/issues with an attorney.

##### **4.1.1.2 Prospective RRs Require Pre-Clearance By Compliance**

Information regarding RRs who are being considered for hire should be referred to Compliance for review of the individual's CRD record. This review requires the written permission of the RR. The RR may sign page 4 of Form U-4 or a separate form which provides Authorization to Check CRD and to conduct a background check. Information regarding complaints, regulatory actions, and other

information determined by Compliance will be referred to Senior Management for consideration before extending an offer of registration.

#### **4.1.1.3 Qualification Of Supervisors**

The manager who hires or appoints a supervisor is responsible for determining that the individual is qualified for the supervisory position. Qualifications include:

- Proper registration to supervise the RRs and areas of business assigned to the individual
- Knowledge of Firm policies and procedures in the appropriate areas of business
- Experience (or training, if necessary) to supervise designated areas of business

Compliance is responsible for identifying registration requirements and determining the need for additional registrations. Supervision may be assumed only after the individual has met the necessary regulatory requirements.

#### **4.1.1.4 Background Investigation (FINRA Rule 3110(e))**

The Firm will conduct a background investigation for all new employees to determine the good character, business reputation, qualifications and experience of an applicant before the Firm applies to register that applicant with FINRA and before making a representation to that effect on the application for registration.

- Contact with at least the last three years' employers.
- For registered persons, obtain a copy of and review the RR's Form U-5 from the prior firm or inquire for the U-5 information through the Web CRD system within 60 days of the filing date of an application for registration or demonstrate that the Firm has a reasonable effort to do so.
- Any "Yes" answers or termination for cause on Form U-5 that were not previously known will be reviewed by Compliance.

A record of contacting prior employers will be included in the RR's personnel or registration file. A copy of Form U-5 or the Web CRD inquiry will be maintained in the RR's file and will include the date of review and the reviewer's information. Additionally, no later than 30 calendar days (unless the delay is documented) after an application is filed with FINRA, the Firm will verify the accuracy and completeness of the information in the applicant's Form U4 through various sources which include, but may not be limited, to the following:

- Credit Check through Business Information Group
- FBI Criminal Check results.

#### 4.1.1.5 Fingerprints

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Notifications regarding registration applicants</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Submit electronic filing to CRD</li><li>• Obtain fingerprint card and submit to CRD with barcode</li><li>• If fingerprints are not received by the CRD within 30 days of filing Form U-4, notify appropriate supervisor that activities requiring registration must cease</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Registration files for employees/RRs include records of CRD filings and submission of fingerprints</li></ul>  |

Compliance will obtain and submit fingerprints on all registered personnel and associated persons who are required to be fingerprinted pursuant to SEC Rule 17f-2 for receipt by the CRD within 30 days of filing Form U-4. If fingerprints are not received by the CRD within 30 days, the employee/RR must cease engaging in activities that require registration. 'Associated persons' includes all persons who sell securities, persons who have access to securities, money or original books and records (includes administrative staff).

#### 4.1.1.6 Policies and Procedures

At the time of licensing approval, Compliance will provide the RR with a current copy of the Firm's policies and procedures by notifying the RR of the location of policies and procedures in electronic form. On an annual basis, the RR will be asked to sign an acknowledgement that the policies were received and that he/she is responsible for compliance with the Firm's policies and procedures.

#### 4.1.1.7 New RR Questionnaire

New RRs will be asked to complete the Firm's Financial Advisor Application, outside business activity forms, forms concerning accounts at other brokerage firms and various other materials. Any answers that present concerns will be referred to Compliance for review.

#### 4.1.2 Termination Procedures

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul> |
|-----------------------|--|

|                  |  |
|------------------|--|
|                  | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Accounting</li> <li>• Technology</li> </ul>   |
| <b>Resources</b> | <ul style="list-style-type: none"> <li>• Notification from RR of termination or determination by Firm to terminate</li> </ul>  |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Immediately notify Compliance and Operations of terminating registered employee/RRs</li> <li>• Immediately notify Compliance of terminating non-registered employees where termination was caused by theft or fraud</li> <li>• Immediately notify appropriate departments of terminating registered and non-registered employees</li> <li>• Secure computers and computer files (if applicable)</li> <li>• Retrieve office keys, company credit cards, <i>etc.</i> from terminated employee (if applicable)</li> <li>• Reassign accounts</li> <li>• Notify customers of newly-assigned RR</li> <li>• Compliance will file Form U-5 for terminating RRs</li> <li>• Compliance will provide the terminated RR with a copy of the RR's Form U-5 within 30 days of termination</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Compliance retains copies of Form U-5 filed on behalf of terminated RRs</li> </ul>  |

#### 4.1.2.1 Notification To Compliance

Whenever an employee terminates employment from the Firm, the designated supervisor is responsible for immediately notifying Compliance. Notification to Compliance regarding registered employees/RRs should include:

- Name of terminated person and RR number(s)
- Type of termination (voluntary, permitted to resign, discharged, *etc.*)
- If the termination is not voluntary, an explanation of the reason for termination.
- Date of termination
- Any known compliance problems at the time of termination.



#### **4.1.2.2 Securing and Retrieving Firm Property**

Designated supervisors are responsible for retrieving firm property from terminated employees including office keys, company credit cards, computer files, customer files, and any other items which are the property of the Firm.

#### **4.1.2.3 Reassignment Of Accounts**

Operations is responsible for reassigning the accounts of terminated RRs.

#### **4.1.2.4 Responding To Customer Inquiries**

Designated supervisors should instruct branch employees, including RRs receiving reassigned accounts, to only indicate the employee is no longer with the Firm. No details or speculation regarding the departure should be given to customers or anyone else outside the Firm unless authorized by Compliance to do so.

#### **4.1.2.5 Form U-5**

Compliance is responsible for filing Form U-5 for any terminated employee. Compliance will also send, within 30 days of termination, a copy of Form U-5 to the former employee.

### **4.2 Registration Process**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• New hire notices</li><li>• Change of status notices</li><li>• Requests for registration</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Identify employees who require registration by reviewing new hire or change of status records</li><li>• Submit required filings to the CRD</li><li>• Acknowledge electronic filings are on behalf of the Firm and its employees</li><li>• Request examinations</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Registration records including CRD notices, approvals and other records are maintained in employee files</li></ul>   |

#### **4.2.1 Registration Requirement**

All individuals engaged in activities (including selling or trading products such as stocks, bonds, options, insurance, *etc.*) subject to registration requirements of SROs or other regulators must complete the necessary registration and licensing prior to engaging in such activities. Employees may not conduct business with public customers until required registrations or licenses are effective. All registration (initial and ongoing) fees will be the responsibility of the RR.

Employees who assume duties that require registration with FINRA as a principal have 90 calendar days to pass the appropriate principal's examination.

Regulators seldom grant waivers of training period requirements or examinations. In those very few instances when waivers are granted, the candidate must be able to demonstrate comparable work experience or other successfully completed examinations that could, in the view of the regulator, constitute satisfying their requirements. Any requests for waivers will be submitted by Compliance.

#### **4.2.2 State Registrations**

RRs must be registered in the state from which they conduct business and may be required to be registered in other states where customers are domiciled. Application must be made to Compliance to obtain each state registration.

RRs are responsible for identifying transactions in states where registration may be required. Operations may also identify states where RR is required to be registered. Requests for state registrations should be made to Compliance.

*See section 2.13.14 "Acting Without Registration."*

#### **4.2.3 Parking Registrations**

The Firm does not permit individuals to "park" licenses. Parking occurs when the Firm maintains a registration on behalf of an individual that does not work for the Firm or who does not need that registration for their job function. Registration status is retained only for those persons where it is required. The Firm may, however, maintain registration for legal, compliance or other non-sales employees as permitted under regulators' rules.

#### **4.2.4 Form U-4 (FINRA Rules 1010 and 2263)**

All applicants for registration are required to complete Form U-4. It is the RR's responsibility to include accurate information and promptly notify the Firm of any updates that may require amendment to Form U-4.

At the time a new U-4 is signed, the applicant will be provided the *Form U-4 Disclosure To Associated Persons*, which discloses information about the pre-dispute arbitration clause included in Form U-4.

#### **4.2.5 Amendments To Form U-4 Or Form U-5**

The Firm will submit amendments to Form U-4 when an RR advises of updates that require amendment. Compliance is responsible for determining whether disciplinary or complaint matters or matters reported on the Firm's Annual Certification require the filing of an amendment to an RR's Form U-4. Compliance is also responsible for identifying disciplinary or complaint matters to be reported on Form U-5 termination notices including amendments required after termination. Amendments in the CRD system incur a fee which is the sole responsibility of the RR.

Compliance will review the CRD Late Filing Fee Report on a Quarterly basis to identify late filings. Compliance will take corrective action where appropriate.

#### **4.2.6 Assignment Of RR Numbers**

RR numbers are assigned by Operations (clearing) and Accounting (direct). New numbers will not be assigned to individuals who are not yet registered with the Firm. An RR number may be assigned prior to registration approval when customer accounts are being transferred and the RR number is needed to transfer accounts. However, the number is not approved for conducting business until all registration approvals have been received.

#### **4.2.7 FINRA Risk Monitoring Report: Registered Representative Composition Report.**

Compliance will review FINRA Risk Monitoring Report: Registered Representative Composition Report. This report displays trends in the profile of registered representatives associated with the Firm.

### **4.3 Statutorily Disqualified Persons**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• N/A</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Compliance will:<ul style="list-style-type: none"><li>◦ Complete the Form MC-400 filing for FINRA</li></ul></li></ul> |

|               |   |
|---------------|---|
|               | <ul style="list-style-type: none"> <li>○ Establish procedures for conducting required supervision</li> <li>• The designated supervisor will: <ul style="list-style-type: none"> <li>○ Conduct required supervision</li> <li>○ Provide Compliance with certifications of supervision, if required</li> </ul> </li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• MC-400 and related documents are retained in the RR's file in Compliance</li> <li>• Certifications of supervision, if required, are retained in the RR's file in Compliance</li> </ul>   |

### 4.3.1 Introduction

Individuals may become subject to statutory disqualifications as a result of a suspension, revocation of registrations or injunctions. The definition of statutory disqualification is included in Sections 3(a)(39) and 19(b)(4) of the Securities Exchange Act of 1934. FINRA Regulatory Notice 09-19 includes a chart that outlines statutory disqualifications under the Rule.

### 4.3.2 Hiring A Statutorily Disqualified Person

As a matter of Firm policy, Statutorily Disqualified (SD) persons will not be hired. Should an exception to this be requested, the Chief Compliance Officer and the CEO should be consulted to review the nature of the statutory disqualification and potential special supervision that may be required upon hiring. Both must agree to the new hire.

### 4.3.3 Filing Form MC400

Compliance is responsible for completion and filing of FINRA Form MC400 which will be signed by a senior officer of the Firm. A hearing may be required prior to approval of the individual's association with the Firm. The individual may not conduct any activities requiring registration until approval is received from the appropriate regulatory authorities. All fees associated with the process will be the sole responsibility of the RR. This includes annual, ongoing fees.

### 4.3.4 Supervision

Compliance will establish procedures to carry out the supervision required under agreement with the SRO reviewing the disqualified person, including records of supervision to be conducted by the designated supervisor. The supervisor assigned to supervise the statutorily disqualified person will be provided a copy of the procedures and will be responsible for carrying them out.

### 4.3.5 Reporting Statutory Disqualifications

When an employee becomes subject to a statutory disqualification, Compliance will file the necessary registration updates and, in addition, the required notification on the 4530 report will be made to regulators consistent with those SRO's reporting requirements.

## 4.4 Broker-Dealer Registration

### 4.4.1 Form BD

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Information regarding reportable items including civil and regulatory actions</li><li>• Records regarding officers and directors to be included on Form BD</li><li>• Other information as required by Form BD</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required – updates</li><li>• Annual review</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Prepare updates as required; consult with in-house or outside legal counsel, as required</li><li>• File Form BD updates</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• File of BD amendments</li></ul>   |

Compliance is responsible for updating Form BD when necessary and filing with the required SROs and other regulatory agencies.

### 4.4.2 Change In Ownership, Control, Or Business Operations (NASD Rule 1017)

When the Firm anticipates a material change in its business, Compliance will file requests for approval by the appropriate SROs. Events that require approval include merger with or acquisition of another broker-dealer or acquisition of 25% or more of the assets of another dealer; a change in ownership or control; and a material change in business operations. If the Firm operates under a Restriction Letter, it will conduct business consistent with the Letter and Compliance will contact FINRA if a change is necessary.

#### **4.4.3 Executive Representative (FINRA Rule 4517)**

The firm has filed the required executive representative designation with FINRA. On an annual basis (by the 17th business day of the month following the end of the calendar year) Compliance will review the designation and update the designation and contact information for the Executive Representative and those listed on the FINRA/NASD Contact System, if necessary. Additionally, the firm will update the FINRA/NASD Contact System no later than 30 days following any change in such information.

#### **4.4.4 Regulatory Filings (NASD Rule 4517)**

The Firm will submit regulatory filings electronically where required. Filing procedures are included in appropriate sections of this manual.

### **5.0 COMMUNICATIONS WITH THE PUBLIC**

The Firm will maintain and interchange use of the previous terms, advertising and sales literature, to describe FINRA Rule 2210 relative to retail communications.

#### **5.1 Retail Communications (Advertising and Sales Literature)**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests regarding advertising or sales literature</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review proposed advertising or sales literature</li><li>• Make revisions as needed</li><li>• Provide requestor with approved copy or notify of disapproval</li><li>• File with FINRA if required</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Copies of reviewed advertising are retained in an Advertising file in Compliance</li></ul>   |

##### **5.1.1 Retail Communications (Advertising and Sales Literature) Defined**

Retail communications are written communications distributed or made available to twenty-five or more retail investors within any thirty (30) calendar-day period.

Retail investors are defined as any person other than an institutional investor, regardless of whether the person has an account with the firm. Retail communications generally encompass previous Communications with the Public categories of advertising, sales literature and independently prepared reprints to twenty-five or more retail investors within a thirty (30) calendar-day period, but it does not include correspondence.

Advertising generally includes material published or designed for use in newspapers, magazines or other periodicals, radio, television, telephone or tape recordings, telephone directory advertising (other than routine listings), computer bulletin boards or other electronic messages, videotape displays, signs or billboards, movies or other material published in public media.

Sales literature generally includes circulars, research reports, form letters sent to more than one person, market letters, newsletters, seminar texts and reprints or other material originated by the Firm or its employees/RRs and to be reproduced and provided to multiple customers or prospective customers. Sales literature also includes telemarketing scripts. The terms "advertising" and "sales literature" are interchangeable in this chapter.

### **5.1.2 General Guidelines**

All communications must meet the general standards of good taste and accuracy and should fairly represent the products or services included in the communication. Promissory, exaggerated or false statements as well as language inferring guarantees are not permitted.

Projections and predictions are not permitted. Past performance is not a guarantee of future performance and should be identified as such if included in communications. Portraying the performance of past recommendations or actual transactions must include an acceptable universe over a reasonable period of time.

### **5.1.3 Required Information**

All advertisements and sales literature will contain the name of the Firm. "Blind" ads are not permitted except for recruiting personnel. Exceptions to use of the Firm's name must comply with FINRA Rule 2210(d)(3) that deals with generic, derivative and other potential variations on the Firm's name.

Sales literature is also required to include the name of the person or firm preparing the material, if other than the Firm, and the date on which it is first published, circulated or distributed. If the information in the material is not current, this fact should be stated.

Inclusion of other names, such as an RR's separate corporation, or DBA, in advertising and sales literature regarding the Firm's services, is not permitted unless it is clear which services are provided by which entity. Compliance's review of advertising will consider such requests on a case-by-case basis. Refer to the chapter *Independent Contractors* for further information about use of the Firm's name.

Effective June 6, 2016, FINRA Rule 2210(d)(8) requires that Firm websites must include a readily apparent reference and hyperlink to BrokerCheck on:

- Initial webpage to be viewed by a client and
- Any other webpage that includes a professional profile of one or more RRs who conduct business with retail investors.

#### **5.1.4 Approval Prior To Publication**

All advertising or sales literature must be submitted to Compliance for approval prior to publication or use.

The Firm will not be required to approve prior to use any retail communication that does not make any financial or investment recommendation or otherwise promote a product or service of the firm. However, these materials will be supervised in the same manner as correspondence. For example, this exception would cover communications that are administrative or informational in nature, such as communications that inform investors that their account statement is available online or the date on which a security in an investor's portfolio is expected to pay a dividend.

#### **5.1.5 Legends and Footnotes (FINRA Rule 2210[d][1][C])**

When legends or footnotes are included in public communications, they cannot be placed or sized in a way that limits the investor's ability to read or understand the information. Small fonts may inhibit reading the information or may inappropriately diminish the importance of the information. Bold claims balanced by a footnote may also mislead the reader.

#### **5.1.6 Disclosure Of Prices For Recommended Corporate Securities**

In communications where corporate securities are recommended, the price of the security at the time of the recommendation must be disclosed. While this requirement does not extend to other securities, inclusion of the price would be required if price information is deemed "material" and necessary to make the communication not misleading.



### **5.1.7 Use Of Outside Retail Communications (Advertising Or Sales Literature)**

Advertising or sales literature provided by outside entities and intended for re-publication with the name of the Firm or a RR requires the prior approval of Compliance. A copy of the approved item including the approval and date of approval will be included in the Firm's central advertising file and should also be kept in the RR's advertising file.

### **5.1.8 SIPC Membership**

Advertising must include a notation that the Firm is a member of SIPC, *e.g.*, "Member, SIPC." If an explanatory statement will be included in advertising explaining what SIPC is, one of the following two standardized phrases must be included:

- 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](http://www.sipc.org).
- Member of SIPC. Securities in your account protected up to \$500,000. For details, please see [www.sipc.org](http://www.sipc.org).

The words "Member, SIPC" may be omitted if the official explanatory statement is used in conjunction with the official SIPC symbol.

"Advertising" is defined under SIPC rules as any 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.

### **5.1.9 Telemarketing Scripts**

All scripts used for telemarketing calls require the approval of the Compliance Department prior to use. The section titled "Cold Callers" includes further information regarding the use of scripts and callers.

### **5.1.10 Special Filing Or Approval Requirements**

There are special filing or approval requirements for certain products, as outlined below.

- Compliance will make the final determination of what needs to be filed with FINRA.
- Filings must be accompanied by FINRA's Advertising and Sales Literature Filing Cover Sheet as prepared by the Compliance Department.

- All advertising or sales literature to be submitted to FINRA must be approved by the Compliance prior to submission to FINRA.
- The actual or expected date of first use or publication must be included with FINRA filing.

FINRA rules should be consulted for specific requirements and some exclusions from the requirements.

| <b>Retail Communications to be filed</b>   | <b>When to file with FINRA</b>   |
|--|--|
| Bond mutual fund volatility ratings  | 10 business days prior to first use for approval   |
| Security futures   | 10 business days prior to first use for approval   |
| Investment company advertising or sales literature that contains a ranking category created by the Firm  | 10 business days prior to first use for approval   |
| Investment company (all other)   | Within 10 business days of first use   |
| Public direct participation program (DPP)  | Within 10 business days of first use   |
| Template for written reports – investment analysis tools   | Within 10 business days of first use   |
| CMOs registered under Securities Act   | Within 10 business days of first use   |
| Any security registered under Securities Act derived from or based on a single security, basket of securities, index, commodity, debt issuance or foreign currency | Within 10 business days of first use   |
| TV and video advertisements  | If a draft version is filed with FINRA, the final filmed version must be filed within 10 business days of first use or broadcast |
| Press releases   | No filing required if made available only to members of the media  |

It is not necessary to file with FINRA any retail communications which have previously been filed and is used without any changes. There are other requirements regarding advertising of certain products including CMOs, municipal securities and mutual funds. Refer to those specific sections for further information. All fees charged by FINRA for filing of required documents will be the responsibility of the RR.

### **5.1.11 Records Of Retail Communications (Advertising and Sales Literature)**

Compliance maintains a central file of all advertising and sales literature approved by the Firm. The file will include, for each item reviewed:

- the approval by Compliance
- any revisions, if necessary
- a record that the item was filed with FINRA and when (if required)
- feedback received from FINRA (if required)
- date of first use (if required) in what media the item appeared (if applicable).

### **5.1.12 Options**

No advertising of "options" is allowed by the Firm or its RRs.

### **5.1.13 Mutual Funds**

Refer to the chapter titled *Mutual Funds* regarding requirements for mutual funds advertising.

### **5.1.14 Municipal Securities**

Refer to the chapter titled *Municipal Securities* regarding requirements for municipal securities advertising.

### **5.1.15 Collateralized Mortgage Obligations (CMOs)**

Refer to the chapter titled *Collateralized Mortgage Obligations (CMOs)* regarding requirements for CMO advertising.

### **5.1.16 Advertisements Involving Non-Branch Locations**

FINRA rules specify that any non-branch location referenced in an advertisement or sales literature by its local telephone number and/or local post office box is permitted if the advertisement does NOT include the street address of the non-branch location and INCLUDES the address and telephone number of the branch office or OSJ directly supervising the non-branch location.

The Firm's central office address and telephone number may be substituted for the supervisory branch or OSJ. Refer to the chapter *Branch Offices* for further information.

### 5.1.17 Testimonials

There are specific requirements when using testimonials in communications with the public and limitations on their use in relation to advisory activities.

Compliance should be contacted before preparing any communications that include testimonials.

## 5.2 Outgoing Correspondence

### 5.2.1 Correspondence Defined

Correspondence includes any written or electronic communication prepared for delivery to a single current or prospective customer and not for dissemination to multiple customers or the general public. Correspondence also includes portfolio summaries and other types of information originated by the RR and provided to customers or prospective customers. Interactive electronic conversations (direct links or "chat rooms") generally are not regarded as correspondence, though they are subject to restrictions discussed in the section *Chat Rooms* in the Firm's Electronic Communications Policy. Retail Communications (advertising, sales literature, and market letters) are not included in this definition of correspondence and are subject to separate requirements described in other sections of this chapter.

### 5.2.2 Review and Approval - Outgoing Correspondence

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li><li>• Designated Supervisor</li><li>• RRs</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Outgoing customer correspondence</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Review correspondence for appropriateness of language</li><li>• Review correspondence for indications of outside business activities or private securities transactions</li><li>• Review correspondence for misleading or inappropriate sales practices</li><li>• Review 1% of emails and with 150+ message score</li></ul> <p>May "spot check" correspondence sent to the home office from branch offices. (target 50% review)</p> |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Initial correspondence may be reviewed and maintained in branch or department outgoing customer correspondence files or maintain log showing evidence of</li></ul>  |

|               |  |
|---------------|--|
|               | supervisory review.  |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Docupace</li> <li>• Smarsh</li> </ul> |

Outgoing customer correspondence is subject to post-review and feedback by Compliance. This review includes letters, facsimiles, courier deliveries and other forms of written communication. Electronic mail is subject to specific procedures for review; see the section titled *Electronic Mail* in this chapter and the section *Electronic Communications Policy* in the chapter titled *General Employee and Registered Rep Policies*.

#### **5.2.2.1 Independently Prepared Reprints**

Articles and other reprints are subject to outgoing correspondence reviews and copies should accompany correspondence submitted for review and approval. If the article or reprint was provided by the Firm to RRs, the letter or other correspondence may reference what was enclosed without including a copy of the reprint.

Articles and reprints that are issued by an independent publisher and not materially altered are not subject to FINRA filing requirements and most content standards. This exception does not apply to reprints published by an affiliate of the Firm.

Distribution of copyrighted material is subject to the copyright holder's approval.

#### **5.2.2.2 Communications Defined as “Research” (NASD Rule 2711(a)(9)(A))**

R Rs are **not** permitted to send communications that may be deemed “research” since there are complex requirements that apply to the issuance of research reports. Federal and SRO rule interpretations define “research” as any written communication (including electronic) that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to make an investment decision and that is distributed to 15 or more individuals. This applies even if the author does not hold the title of “research analyst” and does not work in a research department.

#### **5.2.3 Guidelines**

Items to consider when preparing and reviewing outgoing correspondence (and other forms of written or electronic communications) include:

- Truthfulness and good taste are required.

- Exaggerated, unwarranted or misleading statements or claims are prohibited.
- Promises or guarantees: past performance may not be used to promise, guarantee or imply future profits or income from securities.
- Projections and predictions are not permitted.
- Comparisons of personnel, facilities or charges with those of other broker-dealers should not be made unless supported by the facts and other firms' names should not be included.
- Correspondence or other written communications regarding securities subject to pending distributions (underwritings) are generally not permitted.
- Only Firm-approved hedge clauses may be used.
- Photocopying and distributing copyrighted material may violate copyright laws.
- Profit and loss or other portfolio analyses should include a disclaimer that the customer should rely on customer statements provided by the Firm and any analysis or calculation is provided for information purposes only.
- The use of Firm letterhead or letterhead containing disclosure of the Firm should be restricted to Firm-related matters.
- Legends or footnotes included in retail communications cannot be placed or sized in a way that limits the investor's ability to read or understand the information (i.e. small fonts may inhibit reading the information or may inappropriately diminish the importance of the information; bold claims balanced by a footnote may also mislead a reader).

Outgoing correspondence must be sent or transmitted only through Firm-sponsored facilities or systems. Written correspondence must be sent through channels that permit review by a supervisor. Correspondence may not be sent through third-party systems or facilities that circumvent Firm review.

#### **5.2.4 Form Letters**

Form letters are standard letters available for sending to multiple current or prospective customers. As per FINRA rules, form letters are a type of retail communication (sales literature), not correspondence.

Form letters (pre-approved by Compliance) may be sent to customers or prospective customers without additional approval if used without revision. The approved form letter and the names and addresses of addressees must be maintained in the branch/non-branch advertising file.

#### **5.2.5 Letters and Notes**

Copies of letters, notes and similar correspondence must be provided to Compliance on a monthly basis with the branch's outgoing correspondence.

### 5.2.6 Facsimiles

Facsimile transmission of customer correspondence is subject to review and approval procedures. All facsimile transmissions must be provided in hard copy to the Compliance Department on a monthly basis with the branch's outgoing correspondence.

All fax cover sheets should have the following disclosure:

Securities offered through Investment Planners, Inc. Member FINRA/SIPC, 226 W. Eldorado Street, Decatur, IL 62522. 217-425-6340.

## 5.3 Incoming Correspondence

### 5.3.1 Review Of Incoming Correspondence

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li><li>• Designated Supervisor</li><li>• RRs</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Incoming correspondence, including correspondence marked "personal and confidential"</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As needed</li><li>• During branch visits/audits</li><li>• Send to Compliance by RR at least 1 time per month</li><li>• Weekly email review</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Refer customer securities and checks directly to Operations or product sponsor when appropriate</li><li>• Refer customer complaints to Compliance</li><li>• Refer audit letters to Operations</li><li>• Review 1% of emails and with 150+ message score</li><li>• May "spot check" correspondence sent to the home office from branch offices. (target 50% review)</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initial each piece of correspondence or show evidence of review by "batch" and maintain in customer correspondence files.</li><li>• Docupace</li><li>• Smarsh</li></ul>  |

All incoming written correspondence will be reviewed by Compliance or Designated Supervisor. This review includes letters, facsimiles, courier deliveries, and other forms of written communication. Electronic mail is subject to specific procedures for review; see the section titled *Electronic Mail* in this chapter and the section *Electronic Communications Policy* in the chapter titled *General Employee and Registered Rep Policies*.

The following guidelines for review apply:

- Correspondence identified as "Confidential" will be opened and reviewed.
- Obvious non-customer correspondence (bank statements, advertising, etc.) will not be opened and will be forwarded directly to the addressee.
- Audit letters (requests from customers' auditors for verification of account positions) will be forwarded directly to Operations for response.
- Complaints will be immediately forwarded to Compliance.
- Checks or securities will be immediately deposited with the appropriate Operations personnel, the RR notified of receipt and if appropriate sent to the product sponsor.
- Original customer correspondence will be retained for the Firm's files; the addressee will receive a copy.
- Original customer correspondence will be forwarded to the designated supervisor for review, initialing and filing.

### 5.3.2 Personal Mail

Employees/RRs should direct all personal mail to their home address. Personal mail is subject to incoming correspondence and electronic mail review policies.

## 5.4 Consolidated Account Reports

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Consolidated Reports</li> <li>• Custodian Statements</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Quarter End</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Random spot check of approximately 5% of actively used reports for feed balance and date range accuracy</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Docupace</li> </ul>  |



|  |  |
|--|--|
|  | <ul style="list-style-type: none"> <li>• Sample documentation</li> <li>• Smarsh</li> </ul> |
|--|--|

IPI utilizes and recommends Envestnet, EMoney or MoneyGuidePro for consolidating reports for its clients. At quarter end, the Firm samples these reports for balance and date range accuracy of the reports versus the custodian statements from the clearing firm, advisory platforms and product sponsor statements for parallel reporting. Errors are then reported to the vendors for any appropriate corrections needed in the feeds and reporting.

If a RR creates a consolidated account report outside of Envestnet, Emoney or MoneyGuidePro with clients, the report must be submitted to Compliance for review and approval. The review consists of comparing the data with the custodian statements and reviewing disclosures on the reports for appropriateness. After this initial review and approval has been obtained for use of a client report, any subsequent consolidated reports given to that client will be reviewed post-review as correspondence, unless a RR makes material changes to the consolidated account report in which it would then be submitted to Compliance for review and approval.

## 5.5 Internal-Use Only Information

Information marked "internal use only" or "broker-dealer use only" may not be sent or otherwise provided to individuals outside the Firm.

Inter-office memos and other communications are subject to retention requirements. Copies of written inter-office communications must be retained for 3 years with the 2 most recent years in an accessible location.

## 5.6 Complaints

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Customers' written or oral complaints</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Operations: <ul style="list-style-type: none"> <li>◦ Resolve complaints of an operational nature such as late dividends, delayed delivery of stock, <i>etc.</i> If written, forward a copy to Compliance with description of resolution.</li> </ul> </li> </ul> |

|               |   |
|---------------|---|
|               | <ul style="list-style-type: none"> <li>○ Refer all other complaints (mishandling of account by RR, improper transactions, churning, etc.) to Compliance</li> <li>• Compliance: <ul style="list-style-type: none"> <li>○ Send initial acknowledgment of receipt of complaint</li> <li>○ Gather needed information and investigate the complaint</li> <li>○ Provide a response and resolution to the customer with a copy to the RR</li> <li>○ If necessary, amend the RR's U-4 (or, in the case of a terminated RR, amend Form U-5)</li> <li>○ Include the complaint in the quarterly report of complaints to the Firm's Designated Self Regulatory Organization under FINRA Rule 4530</li> <li>○ Refer the matter to the Firm's E&amp;O carrier for file to be opened. Policy is on a "claims-made" basis.</li> <li>○ Review FINRA Risk Monitoring Report: Sales Practice Complaint Report. This report displays trends in sales practice complaints as reported to FINRA's Rule 4530 Application.</li> </ul> </li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Copies of complaint and related correspondence are retained in: <ul style="list-style-type: none"> <li>○ Branch file for complaints</li> <li>○ Compliance central file of Firm's complaints</li> </ul> </li> <li>• Note: Options and municipal bond complaints are retained in separate files both by branches and by Compliance</li> <li>• Reviewed FINRA reports</li> </ul>  |

### 5.6.1 Complaint Defined

"Customer Complaint" is defined in FINRA Rule 4513 as any grievance by a customer or any person authorized to act on behalf of the customer involving the activities of a member or person under the broker-dealer's control "in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer."

### 5.6.2 Handling Of Customer Complaints

When a written complaint is received, a copy should be forwarded immediately to Compliance for follow-up.

Oral complaints may be resolved by Operations if the nature of the complaint is operational such as late check, late dividend, or another type of nominal problem. Oral complaints alleging mishandling of the customer's account (unauthorized trading, improper investments, *etc.*) should be brought to the attention of Compliance for review and resolution.

The RR is responsible for losses attributable to his/her own errors or omissions.

### **5.6.3 Oral Complaints**

Oral complaints should be reported immediately to Compliance for sales practice issues, or to Operations for operational issues. Examples of sales practice issues include complaints regarding losses, improper trades, and other complaints involving the quality of investments or wrongdoing by the RR or the Firm. Examples of operational issues include late dividend checks, errors on monthly statements, *etc.* RRs should not make independent decisions regarding whether to report complaints; all oral complaints should be reported either to Compliance or Operations.

### **5.6.4 Complaints Received By Clearing Firm**

As required under SRO rules, whenever the Firm's clearing firm receives a customer complaint, the clearing firm will:

- Provide a copy of the complaint to the Firm's Chief Compliance Officer.
- Provide a copy to the Firm's designated examining authority (DEA).
- Notify the customer directly that their complaint has been forwarded to the Firm for response and to the DEA.

When received by the Firm, the complaint will be handled in the same manner as other complaints received directly by the Firm.

### **5.6.5 Records Of Complaints**

Compliance will maintain a central record of all customer complaints including the following:

- Complainant's name and address
- Account number
- Date the complaint was received
- Name(s) of employee(s)/RR(s) identified in the complaint
- Description of the nature of the complaint
- Disposition of the complaint.

#### 5.6.5.1 Office Records Of Complaints

Each office that is the subject of the complaint is required to maintain a separate file of all written customer complaints in the office. Records of options and municipal bond complaints are separately identifiable in Compliance and the office.

Note: A complaint file is a requirement for all offices - even if empty.

#### 5.6.6 Notice To Customers

Each customer is provided with notification of the address and telephone number of the location to which complaints may be directed via the new account application.

#### 5.6.7 Reporting Of Customer Complaints

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Complaints received from customers or referred by RRs, supervisors, or others</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Statistical Complaint Report: Quarterly</li><li>• Form BD, U-4s, and U-5s (if applicable) within 30 days after receipt of complaint</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Identify reportable complaints and other reportable events</li><li>• Report to designated SRO the events specified in FINRA Rule 4530 within 30 calendar days of knowledge of the disclosure event.</li><li>• File electronically the quarterly statistical report by the 15th of the month following the calendar quarter for written complaints.</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Quarterly complaint reports are maintained in a file for the reports</li><li>• Copies of events reported within 30 calendar days are retained in the RR's file, as well as the complaint files, or, if no RR is involved, in a Firm file for reportable events</li></ul>   |

The Firm will file a quarterly statistical report of complaints with the designated SRO. Complaints reportable in the Firm's Form BD and/or an RR's Form U-4 (or an amendment to Form U-5, if the RR is terminated) will be filed on CRD.

## 5.7 Customer Privacy Policies and Procedures (SEC Regulation S-P)

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• The Firm's Privacy Policy</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• When accounts are opened - provide copy of Privacy Policy</li><li>• Annually - send notice of Privacy Policy to all customers</li><li>• As necessary - establish procedures for protecting customer information and ensuring information is only shared when it is allowed</li></ul> |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Send annual notice to customers</li><li>• Ensure agreements with third parties receiving customer information reflect the third party firm's privacy policies.</li><li>• Training as needed</li><li>• Review existing policy</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Current Privacy Policy</li><li>• Record of annually providing notice to all customers</li><li>• Copies of signed agreements with third parties receiving customer information</li></ul>  |

### 5.7.1 Introduction

The Firm has adopted a Privacy Policy which is provided to customers at the time a new account is opened. Notice is also sent to all customers on an annual basis. The Privacy Policy explains the Firm's policies regarding safeguarding of customer information and records and whether the Firm shares information with outside parties. The Firm also publishes its Privacy Policy on its website.

SEC Regulation S-P ("Privacy Of Consumer Financial Information") applies only to accounts for individuals (*i.e.*, institutional accounts are not affected) and differentiates between "customers," where the Firm has an established relationship with the individual, and "consumers," where there is no pre-established relationship. For purposes of this section, any individual from whom information is obtained (and their legal representative acting on their behalf) to open an account or to obtain services or products from the Firm is considered a "customer." The term "consumer" will be considered synonymous with "customer" for purposes of this section.

The Privacy Policy applies to all individual customers of the Firm, whether U.S. residents or foreign residents.

### **5.7.2 "Public" vs. "Nonpublic" Personal Information About Customers**

Generally, information provided to the Firm by a customer or potential customer in the normal course of the Firm offering a product or service is considered "nonpublic personal information." Identifying whether information is "public" or "nonpublic" is important as to the Firm's obligations if the Firm shares information with nonaffiliated third parties. Public information is information that the Firm reasonably believes may be obtained from three sources:

- federal state or local government records;
- widely distributed media; or,
- disclosures to the general public that are required to be made by federal, state, or local law.

Nonpublic personal information also includes any list, description, or other grouping of customers (and publicly available information about them) that is derived from financial information that is not publicly available.

### **5.7.3 Sharing Nonpublic Financial Information**

In the normal course of business, the Firm will share customer nonpublic financial information with service providers such as clearing firms or service bureaus. Agreements with such third parties include assurances regarding the protection of customer records and information. Information sharing with affiliated companies may also occur, and if applicable, is disclosed in the Firm's Privacy Policy.

### **5.7.4 Annual Notification**

On an annual basis, the Firm will provide all customers with notice regarding the Firm's Privacy Policy.

### **5.7.5 Protection Of Customer Information and Records**

The Firm has adopted procedures to protect customer information, including the following:

- Customers will be provided the Firm's Privacy Policy at the time an account is opened.
- Computerized customer information is accessed by password protection or other established controls within the Firm's (or clearing firm's) system to ensure only authorized persons gain access. For example, sales

personnel may access information regarding accounts assigned to them but not the accounts assigned to others.

- Employees and RRs are prohibited from sharing their logins or passwords for any financial services-related websites or systems, including, but not limited to, RBC, the IPI Advisor website, and the websites of product sponsors. This prohibition extends to the sharing of such information with anyone, regardless of their licensing status, affiliation with the Financial Advisor or IPI, or family relationship with the Financial Advisor.
- Requests for customer information from outside parties such as regulators, the IRS, and other government or civil agencies, are referred to Compliance for review and response.
- All agreements with clearing firms and other service providers include the third party's privacy policies.

## 5.8 Scripts

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Scripts to be used by RRs or non-registered cold callers</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review and revise scripts (as needed)</li><li>• Scripts for use by non-registered personnel are strictly limited; refer to the section "Cold Callers" for more details</li><li>• Ensure required elements (as described in the policy) are included in all scripts</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Maintain copies of approved scripts in a file</li></ul>  |

Scripts used for the purpose of contacting the public are subject to the requirements governing sales literature as outlined in the section "Retail Communications (Advertising and Sales Literature)." The general requirements include the following:

- Any scripts involving options are not permitted.
- Scripts for non-option products require the approval of Compliance prior to use.
- Cold callers are restricted to using scripts when making calls (see the section titled "Cold Callers"). Depending on the content of the script and

states where used, the cold caller may require registration and be subject to more stringent state requirements.

- Scripts must clearly include the following, at the beginning or in the introductory portion of the script:
  - the caller's identity
  - the Firm's name (*i.e.*, a reference to Investment Planners, Inc.)
  - the address or phone number of the office where the caller may be contacted
  - a statement that the purpose of the call is to solicit interest in a security - if this is the reason for the call

These disclosures are not required for a script used by an RR who calls existing customers.

## 5.9 Recorded Phone Solicitations

The Firm does not permit the use of recorded telephone solicitations.

### 5.10 Calling Restrictions

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests from the public not to be called or to be removed from mailing lists</li><li>• Complaint or litigation files</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Maintain list of persons who do not wish to be called or contacted by the Firm</li></ul>  |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Do Not Call List located for RRs on our Advisor Website</li></ul>   |

#### 5.10.1 Introduction

The Firm and its RRs are subject to restrictions that govern telephone solicitations and are prohibited from making unsolicited facsimile advertisements to residences or businesses. "Telephone solicitation" is defined as a telephone call initiated for the purposes of encouraging the purchase of or investment in property, goods, or services.

Phone solicitations may not be made to phone numbers that are included in federal, state, or the Firm's do not call list. **Because fines may be substantial**



**for each call that violates a restriction, it is important to comply with these requirements.**

It is permissible to contact someone with whom the Firm has an "established business relationship" which includes customers who have had a transaction with the Firm within the past 18 months and, for others, within three months after an inquiry or an application to do business. If someone has asked to be included on the Firm's do not call list, that person may not be called regardless of whether they are a current customer or have an established business relationship. Individual states may impose stricter requirements limiting contact with persons on that state's do not call list.

### **5.10.2 Requirements and Restrictions**

The general requirements include the following:

- The caller must provide the called party, at the beginning or in the introductory portion of the script, the name of the caller; the name of the person or entity on whose behalf the call is being made (Investment Planners, Inc.); a telephone number or address at which the caller may be contacted; and disclosure that the purpose of the call is to solicit the purchase of securities or related services.
- Telephone solicitations to residences may not be made before 8:00 a.m. or after 9:00 p.m. in the time zone of the called party's location.
- A "Do Not Call" list must be established that includes the names of individuals who have specifically requested they not be called for solicitations. Do Not Call lists must be retained for 10 years.
- Prerecorded calls to anyone are prohibited.
- The telephone number of the sender may not be a 900 number or other number where the called party will incur a charge for notifying the sender of a desire not to be called. Consumers may not be charged to protect their privacy.

The restrictions do not apply to calls to customers for whom the Firm carries accounts and where the account has had some activity in the last 12 months (trading, credit of interest earned, *etc.*). Calls to other broker-dealers also are not covered by these restrictions.

### **5.10.3 Prohibited Activities**

The following are prohibited when calling customers or prospective customers:

- threats, intimidation, and the use of profane or obscene language
- calling a person repeatedly with intent to annoy, abuse, or harass the called party
- using an alias

- blocking caller id information
- pre-recorded messages
- abandon any outbound telephone call
- disclose or receive unencrypted consumer account numbers to use in telemarketing.

#### **5.10.4 Federal Do Not Call List**

The Federal Trade Commission (FTC) maintains a registry of phone numbers that do not accept phone solicitations. The Firm and its RRs must avoid solicitation calls to any number on the list unless the person has an "established business relationship" with the Firm.

#### **5.10.5 State Restrictions**

Certain states have enacted restrictions on telephone solicitations to residences. Florida, for example, has a restrictive policy whereby individuals may ask to be included on a state-wide "do not call" list. It is the telephone solicitor's obligation to be aware of any individuals who are included on that list. Contact Compliance if you have questions regarding state restrictions.

#### **5.10.6 Internal Do Not Call List**

RRs are responsible for reporting to Compliance the names of individuals who do not wish to be called. Compliance maintains a Do Not Call List that is posted on the Advisor website. It is the RR's responsibility to ensure outgoing calls are not made to anyone appearing on the Firm's Do Not Call List.

### **5.11 Public Speaking**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests for public speaking</li> <li>• Outlines of subjects to be included</li> <li>• Charts or other visual aids to be used in conjunction with public speaking</li> <li>• Written materials to be provided to attendees</li> <li>• Invitations</li> </ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review outlines of information to be presented and revise, as needed</li> <li>• Review charts and written materials to be presented</li> </ul>   |

|               |   |
|---------------|---|
|               | <ul style="list-style-type: none"> <li>• Ensure presentations involving securities being offered by prospectus include provision of prospectuses to attendees</li> </ul>  |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Maintain approved outline, samples of visual aids, and written materials in a Seminar or Advertising file</li> <li>• Initial and date all approved materials</li> <li>• Obtain and maintain in the Seminar file a list of attendees who received prospectuses (if applicable)</li> </ul> |

### 5.11.1 General Guidelines

The general concepts of truthfulness, good taste, and a fair presentation apply to employees/RRs engaging in public speaking. Public speaking includes participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity.

### 5.11.2 Approval

Prior to engaging in public speaking, the RR should prepare an outline for approval by Compliance. The outline will be retained in the office's seminar or advertising file and should include the date and location of the event, name of sponsoring group, and speaker's name. RRs should use pre-approved materials and advertisements for sales seminars. Materials and advertising must be submitted to Compliance for approval prior to use if it has not been pre-approved.

### 5.11.3 Radio, TV, and Other Extemporaneous Presentations

The standards of communications with the public apply to all public appearances whether scripted or not. The following should be considered when participating in radio, TV, or other non-scripted public appearances. Also refer to the chapter *General Employee and Registered Rep Policies* and the section *Media Contact Is Limited To Certain Authorized Persons* that explains restrictions on dealing with the media. Most employees/RRs are restricted from such contact except with the specific approval of Compliance.

- Specific recommendations of securities must be avoided unless approved by Compliance or the speaker is authorized under the Firm's "Media Contact" policy. If a recommendation is made, the speaker is required to disclose material information. The current price and any special risks associated with the security also must be disclosed.
  - Speaker must have a reasonable basis for the recommendation.

- Disclose any financial interest in any of the securities of the issuer whose securities are recommended and nature of financial interest, unless it is nominal; and
  - Disclose any other material conflict of interest of which the speaker knows or has reason to know at the time of the public appearance.
- Investment Planners, Inc. must be clearly disclosed in conjunction with any securities or services offered.
- The speaker cannot assume a specific level of audience knowledge, experience or suitability. High risk securities may not be appropriate for discussion in a broadcast format available to any listener.
- Media presentations should be clear and understandable. Avoid overly complex messages and technical terminology which are not understood by the general audience.
- Include products only where the speaker is licensed to sell the product.
- Do provide a full and fair description of any security product types or services which you discuss including material information such as risks or costs.
- Do not reference any specific future returns or projections of investment performance.

For RRs who are approved to engage in radio, TV, or other extemporaneous public speaking, Compliance is responsible for periodically reviewing the presentations, either on tape or concurrent with broadcast, contacting the RR if unacceptable material is included, and making a record of the review and any action taken.

#### **5.11.4 Securities Sold By Prospectus**

When presentations include discussion of securities sold by prospectus (mutual funds, new issues, *etc.*), participants should receive a copy of the prospectus. A list of participants should be prepared and an indication included that prospectuses were provided. This record will be included in the office's seminar or advertising file.

#### **5.11.5 Collateralized Mortgage Obligations (CMOs)**

Because of the potential complexity of some CMO investments, review by the designated supervisor of the CMO area is required prior to public speaking on these investments. The section titled *Collateralized Mortgage Obligations (CMOs)* should be reviewed for further information.

#### **5.11.6 Mutual Funds**

Refer to the section *Seminars and Other Public Presentations* in the Mutual Funds chapter for specifics regarding mutual fund seminars.

## **5.12 Cold Callers**

The following guidelines apply to **unregistered** individuals who engage in cold calling. All cold callers will be subject to the usual background investigations for all new employees and required to attest to receipt and understanding of the WSP, especially this section.

### **5.12.1 Permissible Cold Caller Activities**

Unregistered cold callers are restricted to the following:

- Inviting prospects to Firm-sponsored events
- Asking whether a prospect would like to speak to an RR
- Asking whether a prospect would like to receive information about investments

When making a call, the cold caller must identify himself or herself as well as the Firm (Investment Planners, Inc.) and the purpose of the call.

Prior to making calls, the caller must check the Firm's Do Not Call List.

### **5.12.2 Prohibited Cold Caller Activities**

Unregistered individuals may NOT:

- Solicit prospects to open accounts
- Discuss general or specific products or services
- Pre-qualify prospects by inquiring about financial status or investment objectives
- Use an alias when identifying themselves
- Contact persons included on the Firm's Do Not Call List

### **5.12.3 Telemarketing Restrictions**

Cold caller activities are subject to the Telephone Consumer Protection Act of 1991 issued by the Federal Communications Commission, as outlined in the Calling Restrictions section of this manual. No cold calling may be done to any telephone or facsimile number outside the United States.

### **5.12.4 Scripts**

Cold callers will be restricted to Firm-approved scripts when making calls. Scripts are approved by Compliance prior to use.

### 5.13 Cold Calling and Advertising to Persons In Foreign Jurisdictions

No cold calling is allowed to any location outside the U.S. RRs are subject to certain limitations when dealing with investors in foreign jurisdictions. Violations may constitute criminal offenses liable for prosecution and/or result in civil action that may include rescission of transactions. RRs should not contact foreign companies or residents or open accounts for such entities or persons unless specifically permitted to do so under the rules of the foreign jurisdictions. Questions should be referred to Compliance before engaging in such activities.

As an example, the U.K. regulates investment business under the Financial Services and Markets Act of 2000 (Act). The Act requires that persons conducting business must be authorized (registered) or exempt under the Act and imposes limitations on the types of business that may be conducted. Persons who operate from outside the U.K. are "overseas persons" who may be exempt from registration if they conduct their business in a way that does not violate the Act.

Following is a brief summary of limitations on doing business with U.K. persons:

- Cold calling is prohibited. No person may make an unsolicited call (*i.e.*, any call without the express invitation of the person contacted) in an attempt to engage in investment business with a person in the U.K. This applies whether or not the person is registered with FINRA and complies with the domestic rules regarding cold calling.
- Unsolicited calls may be made only to existing customers (a person with whom the Firm had an existing customer relationship before the person resided in the U.K.).
- Unsolicited calls may be made to "non-private customers" or "business investors" whom we would more commonly term "institutional investors" (government or public authorities, corporations, or partnerships with substantial assets and trustees of trusts holding substantial assets). RRs should not make subjective judgments regarding what constitutes a non-private or business investor. Compliance should be contacted regarding whether an account meets this definition.

In addition, no advertising may be published or distributed to U.K. residents without the prior approval of Compliance. The Act generally prohibits an "overseas person" from issuing advertising regarding investments in the U.K. unless its contents have been approved by an authorized person under the Act. Advertising subject to this restriction includes advertising directed to persons in the U.K. or made available to them by means other than newspapers or other publications.

## 5.14 Electronic Communications

### 5.14.1 Electronic Mail

#### 5.14.1.1 Electronic Communications Policy

Refer to Section 2.15 *Electronic Communications Policy* for the Firm's policy for all employees/RRs on electronic communications.

#### 5.14.1.2 Review and Approval

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Incoming and outgoing E-mail</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As needed</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Compliance Department review for business and inappropriate communications and review with RR</li><li>• Compliance Department review outgoing customer E-mail; review incoming customer E-mail and take corrective action as required</li><li>• Perform keyword/phrase, branch level and random reviews of emails</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Customer incoming and outgoing E-mail is reviewed and retained in the electronic email supervisory system (SMARSH).</li></ul>   |

#### 5.14.1.3 Information Required On Outgoing Electronic Mail

The following information must be included on all outgoing E-mail:

- Name of the Firm
- Name of sender
- Office of Supervisory Jurisdiction or branch address (Decatur Home Office)
- Phone number
- E-mail address of sender

In addition, the Firm's standard disclosures are automatically added to the signature on outgoing e-mails. (See Section 2.15.6)

#### 5.14.1.4 Special Requirements/Restrictions

- Securities licensing requirements necessary for public communications apply to electronic communications.
- Recommendations or communications that require an accompanying prospectus may be sent by E-mail. RRs must attach a PDF version(s) of the most current prospectus.
- If a message is received from a party requesting that they not be contacted, Compliance should be notified to add that person to the Firm's Do Not Call List.
- E-mail to customers or prospective customers regarding the Firm's products, services, or other Firm-related business communications sent from a home computer and/or using non-company sponsored electronic communications are still treated the same under our supervision requirements.

#### 5.14.1.5 Compliance Department Review

The Compliance Department will review a sample of all electronic mail:

- All incoming and outgoing E-mail correspondence shall be forwarded to the email supervisory system (SMARSH).
- Compliance will sample and review 1% of the SMARSH incoming and outgoing communications weekly and will review all emails with a SMARSH lexicon message score over 150.

#### 5.14.1.6 Monitoring Procedures

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• E-mail referred by branches or departments</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Weekly</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review for inappropriate content or language</li><li>• Notify employee/RR who sent or received inappropriate E-mail of policy violation</li><li>• Take disciplinary action, as appropriate</li><li>• Include review of E-mail procedures in periodic office reviews</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Action taken on violations is recorded by memo or in other written form and filed in the employee's/RR's registration file (if registered) or personnel file (if not</li></ul>  |



|  |  |
|--|--|
|  | registered) or recorded in the email supervisory system <ul style="list-style-type: none"> <li>• Branch/department reviews are documented in Compliance files or recorded in the email supervisory system</li> </ul> |
|--|--|

Electronic mail supervisory procedures will be monitored by Compliance as follows:

- Inappropriate mail referred by branches or departments will be reviewed and disciplinary action, if appropriate, will be taken and recorded in the employee's/RR's file.
- Outgoing business correspondence that appears questionable will be referred to the designated supervisor for follow up with the sender.
- Customer complaints will be handled in accordance with the Firm's complaint procedures.
- Action regarding inappropriate communications may include referring the matter to the designated supervisor; direct contact with the employee/RR who sent or received the communication; and disciplinary action, as appropriate.
- Branch procedures will be audited as part of the Firm's periodic branch reviews.
- Compliance may, at its discretion, conduct an electronic audit of an employee's/RR's computer to determine the types of computer files retained.

#### **5.14.1.7 E-Mail Policy Violations**

When a message is discovered that violates the Firm's policy, Compliance will take the following action:

- Review the employee's/RR's file to determine if there have been other violations and whether the employee/RR has responded appropriately.
- Send notification to the employee/RR of the violation including sender's identification; receiver's identification; date/time of message; subject line; and size/name of attachment, if applicable. Any prior violations will also be noted for the employee's/RR's information.
- At Compliance's discretion, send a copy to senior management if a repeat problem occurs and it does not appear an appropriate response was received for prior violation(s).
- Determine disciplinary action, if any.
- Retain a record of notification to the employee/RR and any action taken in the employee's/RR's registration file (if registered) or personnel file (if not registered).

- Where there is a history of violations, Compliance may conduct an electronic audit of the individual's computer files to determine content of information being retained.

#### 5.14.1.8 Record Retention

Incoming and outgoing electronic communications are to be reviewed and evidence of review recorded in the email supervisory system. Actions taken by Compliance regarding inappropriate communications will be recorded in memo or other written format and retained in the employee's/RR's registration file (if registered) or personnel file (if not registered), or recorded in the email supervisory system.

#### 5.14.1.9 Education and Training

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Annual compliance meetings</li> <li>• Firm Element continuing education</li> <li>• Annual certifications</li> <li>• Periodic reminders distributed to employees/RRs</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• At time of hire of new RRs</li> <li>• Annually for: <ul style="list-style-type: none"> <li>◦ Compliance meetings</li> <li>◦ Continuing education</li> <li>◦ Certifications</li> </ul> </li> <li>• Periodically for reminders</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Conduct annual compliance meetings</li> <li>• Conduct continuing education</li> <li>• Distribute and obtain certifications</li> <li>• Send periodic reminders</li> </ul>  |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Annual compliance meetings are documented in registration and/or branch files</li> <li>• Records are retained of RRs completing continuing education</li> <li>• Compliance retains copies of reminders sent to RRs</li> <li>• Annual certifications are filed in registration and/or personnel files</li> </ul> |

The Firm uses a number of methods to educate its employees/RRs regarding the Firm's policies regarding electronic communications.

- RRs acknowledge their understanding and agreement with the Policy in the Firm's annual certification.
- The Firm Element continuing education program and/or annual compliance meeting for registered RRs will include training regarding the Firm's electronic communications policy.
- Periodically the Firm will distribute reminders to employees/RRs regarding the Policy.

#### **5.14.1.10 Special Reviews**

As part of the Firm's supervision of RRs, Compliance may impose different standards of review that may include review of all incoming and outgoing correspondence regardless of form, pre-approval, or other special reviews. Refer to the chapter *General Employee and Registered Rep Policies* and the section *Special Supervision* for further information.

#### **5.14.2 Retail Communications (Advertising and Sales Literature)**

Electronic advertising and sales literature are subject to pre-use review and approval.

There are specific requirements for electronic advertising and sales literature (including form e-mails). In addition to the information required by the section entitled *Information Required On Outgoing Electronic Mail*, the communication needs to include the following:

- The header or title line of the communication must clearly indicate its purpose
- The communication must clearly identify itself as an advertisement or solicitation
- The communication must include a clear and conspicuous opt-out link

For general content standards, refer to the section *Retail Communications (Advertising and Sales Literature)* in this chapter.

#### **5.14.3 Bulletin Boards, Web Sites, Social Networking, Social Media and Other Electronic Communication Systems**

The use of computer bulletin boards, web sites, Social Networking and Social Media (e.g. Twitter, LinkedIn, Facebook) or other electronic communication systems on the Internet for the purposes of advertising or soliciting business is subject to the same requirements for approval as other forms of written communications.

#### 5.14.3.1 Web Sites

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• The Firm's website</li><li>• RR's website</li><li>• Requests to include information</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Approvals - as required</li><li>• Periodic review (or verification of no changes from the RR) of the RR's website</li><li>• Periodic review of Firm's website</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review proposed materials to be included on the website and approve or disapprove</li><li>• Review the website to ensure only previously approved materials are included</li><li>• Contact supervisors of departments that have included unapproved materials and take corrective action</li><li>• Corrective action may include changing or deleting the material and/or reminding the supervisor of the pre-use approval requirement</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Compliance will maintain records of:<ul style="list-style-type: none"><li>◦ Approved materials</li><li>◦ Notations regarding periodic reviews and corrective action taken (if needed)</li></ul></li></ul>  |

The Firm has established a website. Any information to be included on the website requires the **prior approval** of Compliance. Compliance will maintain a record of approved material to be included on the Firm's website and will periodically review the website to ensure only approved materials are included. Compliance will maintain a record of periodic reviews and action taken when exceptions are noted.

All websites maintained by RRs must be pre-approved and a hardcopy of the site (all windows) must be kept in the RR's advertising file. No changes may be made to the site without prior approval from the Compliance Department. (Please send us the web address and hard copies for review.)

All guidelines for Communications with the Public as outlined in Section 2.15 must be followed.

The firm can only conduct business in registered states where registration is required or if business is exempt under state requirements.

The firm does not take responsibility for content contained on hyperlinked sites.

When using communications not prepared under the direct supervision of IPI, it is necessary to identify, on the communication, the person or entity that prepared the material. This includes research reports obtained from outside sources.

#### **5.14.3.2 Social Networking and Social Media (FINRA Regulatory Notice 10-06 and 11-39)**

The use of Social Networking and Social Media sites is considered a form of electronic communication and is subject to FINRA regulations. Postings on these sites fall into the categories of retail communications (formerly advertising, sales literature) or correspondence, and are subject to supervisory, monitoring and record retention rules of FINRA and the SEC. The static content published on these sites (e.g. home page, profile, bio) must be pre-approved prior to posting and a copy of the record must be maintained for at least three (3) years in an advisor's advertising file. Additionally, whenever an advisor or a person (client, prospective client or other) posts a comment, link or other information on a page of an advisor's social media site, this would be considered correspondence and have to be submitted to IPI once posted, retained for three (3) years and monitored periodically by IPI.

#### **Advisor Websites:**

All websites maintained by advisors must be pre-approved and a hardcopy of the approved site (all windows) must be kept in the advisor's own advertising file. No changes may be made to the site without prior approval from IPI.

#### **Financial Services Social Media Sites:**

Facebook, LinkedIn and Twitter are the only Social Networking and/or Social Media sites approved for financial services related communications and are approved only if the advisor signs up for Smarsh's social media capture and archiving platform. Smarsh's platform allows IPI to supervise, approve and archive all activity conducted through these sites in accordance with FINRA Regulatory Notice 10-06 and 11-39 requirements. Compliance will randomly review 20% of this activity through Smarsh's system. In addition to subscription to Smarsh monitoring, all Facebook, LinkedIn and Twitter profiles must remain static. If changes are requested to be made, the profiles must be submitted for Compliance review and approval. Additionally, at the end of an advisor's profile for IPI the following disclosure is required: *Securities offered through Investment Planners, Inc., Member FINRA/SIPC. Investment advisory services offered through IPI Wealth Management, Inc.* Recommendations, testimonials and endorsements on these sites are not permitted. These features should be disabled and any instances where someone indicated endorsing material on an advisor's site should be removed.

**Personal Social Media Sites:**

Personal Social Media sites should be limited to listing either Investment Planners or IPI Wealth Management for the Employer\* profile section and the title listed on the advisor's business card. No other references to financial services are allowed to be placed on a personal Social Media site other than in an advisor's profile. Advisors will attest that they will not place financial service related postings to personal Social Media sites and if third parties do so that the advisor is responsible for the immediate removal of any third party posting related to financial services for their personal Social Media site.

Facebook Chat, Google Talk, Blogs, You Tube, texting, Skype profiles/pages and other similar social media sites used for financial services purposes are not approved for use at this time, but are permitted for personal content only. The list of other social media sites is not all inclusive and is subject to change.

\*Any reference to employer as it relates to a profile section of a Social Media site does not indicate actual employment with IPI as IPI advisors are independent contractors of the firm and not employees of IPI.

**5.15 Investment Analysis Tools (FINRA Rule 2214)**

Prior to providing investment analysis tools to investors (whether via Internet or in other forms), RRs must verify that the material complies with Firm policies. Firm policy requires that

- required disclosures will be provided to the investor; and,
- material about a new investment tool will be filed with FINRA within 10 days of first use.

**5.16 Use of Professional Designation**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Annual Compliance Questionnaire</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Annual certification by RRs</li><li>• Annual verification by Compliance</li><li>• Other reviews/verifications as required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Certification by RRs that designations are validly held</li><li>• Verification by Compliance that designations are validly held by RRs</li><li>• Maintenance of record of verified designations held by RRs</li></ul> |

|               |   |
|---------------|---|
|               | <ul style="list-style-type: none"> <li>• Review of designations used in advertising/sales literature</li> <li>• Review of use of designations in the office inspection process</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Evidence of verifications conducted</li> <li>• Record of verified designations held by RRs</li> </ul>  |

### 5.16.1 Introduction

Securities regulatory agencies are concerned about the proliferation of professional designations, particularly those that suggest an expertise in retirement planning or financial services for seniors, such as “certified senior adviser,” “senior specialist,” “retirement specialist” or “certified financial gerontologist.” The criteria used by organizations that grant professional designations for investment professionals vary greatly. Some designations require formal certification, with procedures that include completion of a detailed and rigorous curriculum focused on financial issues, culminating with one or more examinations, as well as mandatory continuing professional education. On the other end of the spectrum, some designations can be obtained simply by paying membership dues.

### 5.16.2 Verification of Designations

The procedures for verification of designations shall include the following:

- On an annual basis, registered representatives will be required to provide a list of all designations that they hold.
- Registered representatives will also be required on an annual basis to attest that they are current with the educational, ethics, renewal fee, and other requirements of the issuing organization, and certify that they continue to validly hold the designation(s).
- On an annual basis, Compliance will randomly verify 10% of the previously verified financial services designations disclosed on the annual questionnaire. This review will be conducted within 60 days after that particular questionnaire.
- Compliance will conduct a review to determine whether the registered representative continues to be validly held for those newly disclosed financial designations from the most recent Compliance Questionnaire. This review shall be done annually, and done within 60 days after that particular questionnaire. Evidence of this verification, such as a printout from the issuing organization’s website, evidence of a verification call directly to the issuing organization, or a copy of the current designation certificate, will be maintained.

- Upon the receipt of the initial U-4 paperwork for individuals holding the CFP, CFA, PFS, ChFC and/or CIC, Compliance will obtain a copy of the certificate or other evidence that the holder is in good standing.
- In the review of advertising and sales literature, the firm will validate that any designations used in the materials have been previously verified by the firm. This will be accomplished by confirming that the designation being used is listed in the firm's registered representative designation records as a previously-verified designation.
- During office inspections, examiners will confirm that any designations used by the representatives at that branch have been previously verified by the firm. This will be accomplished by confirming that the designation being used is listed in the firm's registered representative designation records as a previously-verified designation. If any designations which have not been previously verified are being used, the examiner will verify that the designation is validly held and maintain evidence of that verification, and the firm's registered representative designation records will be updated.

## **5.17 Institutional Communications**

Institutional communications include written or electronic communications distributed or made available only to institutional investors. A firm's internal communications are not considered an institutional communication. Institutional investors have the same definition as FINRA Rule 2210(a)(4) and include multiple employee benefit plans and multiple qualified plans offered to employees of the same employer provided that the plans in aggregate have at least 100 participants.

Legends on institutional communications such as "Institutional Investors Use Only" are an acceptable warning to recipients that the communication is intended for institutional investors. The firm has no affirmative obligation to inquire of an institutional investor's status. However, if the firm has reason to believe institutional communications or any excerpts thereof may be forwarded to a retail investor then the firm must treat all future communications to that institutional investor as retail communications.

## **5.18 Prohibition Against Payments Involving Publications to Influence Market Prices (FINRA Rule 5230)**

Payments of anything of value, directly or indirectly, are prohibited for the purpose of influencing or rewarding someone in connection with the publication or circulation of information in any electronic or other public media for the purpose of influencing the market price of the subject security. This includes any investment service or similar publication; websites; newspapers, magazines or other periodicals; radio or television program. The prohibition does not apply to



clearly identified paid advertising; a communications that discloses the amount and receipt of compensation or a research report as defined under FINRA rules.

## **6.0 FINANCIAL AND OPERATIONS PROCEDURES**

This chapter provides policies and procedures affecting the financial and operations areas of the Firm. Detailed operations procedures are included in the clearing firm's operations procedures manuals.

The Firm has designated a Financial and Operations Principal who is responsible for general oversight of financial and operations areas of the Firm. Supervisors of specific financial or operations areas are responsible for day-to-day procedures.

### **6.1 Books and Records**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Financial Operations Principal/FINOP</li><li>• Operations</li><li>• Compliance</li></ul> |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Various records</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Retain records per the Firm's retention policy</li></ul>                                 |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Various records</li></ul>  |

#### **6.1.1 Introduction**

SEC Rule 17a-3 identifies the types of books and records to be retained by the Firm and 17a-4 identifies the period these records are to be retained. SROs also specify certain record requirements. Designated supervisors are responsible for retaining required records for areas under their supervision.

The Firm introduces its transactions on a fully-disclosed basis to its clearing firm. The Firm will rely on the clearing firm to retain certain records regarding the Firm's accounts and transactions.

#### **6.1.2 Availability Of Records In Offices**

Required records under Rules 17a-3 and 17a-4 are available in office locations. Compliance is responsible for establishing a method for producing required

records at office locations upon the request of a regulator. The section *Office Records* in the chapter *Offices* discusses this subject in more detail.

## 6.2 Calculation and Reporting Of Net Capital

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Financial Operations Principal/FINOP</li> <li>• Accounting</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Financial and transaction records</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Ongoing</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Maintain ongoing calculation of the Firm's net capital</li> <li>• Report net capital as required</li> <li>• Report net capital deficiencies as required, when necessary</li> <li>• All reports filed pursuant to FINRA Rule 4517 will be filed electronically</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Records retained by the FINOP include: <ul style="list-style-type: none"> <li>◦ FOCUS reports</li> <li>◦ Other net capital calculations</li> <li>◦ Supplemental FOCUS information as required</li> </ul> </li> </ul>   |

The calculation and monitoring of net capital is the responsibility of the FINOP who also is responsible for ensuring the accurate and timely reporting of periodic net capital reports. Some of the FINOP's specific responsibilities include:

- Review and filing of the Firm's financial reports and periodic review of accounting records
- Periodic consideration of whether the Firm's minimum net capital requirements have changed because of changes in the Firm's business
- Supervising additions to, and withdrawals from, the equity capital of the Firm
- Reporting borrowings and subordinated loans for capital purposes
- Establishing procedures for retention of required financial books and records

If the Firm becomes deficient in its net capital position, the FINOP is responsible for making the necessary reports to regulators and communicating any restrictions in business that may result.

## 6.3 Reconciliations and Bank Records

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• FINOP</li><li>• Accounting</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Bank records</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Monthly</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Reconcile bank accounts against the Firm's records</li></ul>                    |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Bank statements and other bank records, retained by FINOP or designee</li></ul> |

The FINOP is responsible for establishing procedures for the periodic reconciliation of bank statements, clearing and depository accounts, and other accounting and business records. Records of bank accounts and other reconciled accounts will be maintained in accordance with regulatory requirements.

## 6.4 Financial Reporting (SEC Rules 17a-5, 17a-11)

The FINOP is responsible for financial reporting and payment of fees and assessments and maintaining records of reporting and payment. Some of the requirements include:

- Filing net capital reports
- Reporting net capital deficiencies
- Reporting notice of books and records deficiencies
- Preparation and filing of unaudited financial statements
- Engaging outside accountants to conduct the Firm's annual audit and notifying regulators when there is a change of accountant
- Filing audited financial statements with regulators and providing to customers, as required
- Notifying regulators of any change in the Firm's fiscal year
- Payment of assessments and fees to regulators.

### 6.4.1 Preparation Of Financial Reports

The FINOP is responsible for preparing and reviewing financial reports. While the FINOP may delegate responsibility for gathering information and preparing the reports, the FINOP is ultimately responsible for reporting accurate information.

Preparation of reports will include the following procedures:

- Gathering information through the Firm's records and systems to compile financial information.
- Working with outside auditors, when appropriate.
- Drafting reports.
- Determining the accuracy of calculations and information included in the report.
- Providing information to senior management and others, as appropriate.
- Sending reports to designated regulators.
- Providing information for publication to customers, where required by rule.
- Filing all reports electronically pursuant to Rule 4517.

The FINOP will maintain files including calculations and other information utilized for preparing financial reports and records of internal, regulatory, and other external distribution of reports, as required.

#### **6.4.2 Disclosure of Financial Condition (FINRA Rule 2261)**

Upon request, information about the Firm's financial condition in its most recent balance sheet will be made available to customers and to any member firm that is party to an open transaction or has on deposit cash or securities with the Firm. The information may be provided in paper or electronic form (if for a customer, the customer must consent to electronic delivery).

#### **6.5 Regulation T and Extension Of Credit To Customers**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Clearing firm exception reports</li><li>• Requests for extension</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Monitor accounts for compliance with Regulation T requirements</li><li>• Request extensions, issue margin calls, <i>etc.</i></li><li>• Discontinue margin trading for accounts missing required signed margin agreements</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Various records maintained by Operations</li></ul>   |

### 6.5.1 Compliance With Regulation T

It is the responsibility of the Operations department to establish operating procedures to ensure compliance with Regulation T regarding the settlement of customer transactions. Significant assistance is provided by our clearing firm.

### 6.5.2 Pattern Day Traders

Accounts that are considered "pattern day traders" are subject to additional margin requirements. A pattern day trader is a customer who day trades four or more times in five business days. However, if day-trading activities do not exceed 6% of the customer's total trading for the five-day period, the account is **not** considered a pattern day trading account.

#### 6.5.2.1 Margin Requirements

Following are the additional margin requirements for pattern day traders:

- Minimum equity must equal \$25,000 on any day the customer day trades.
- Day-trading buying power is limited to four times the day trader's maintenance margin excess, based on the customer's account position at the close of the prior business day.
- A day-trading margin call will be issued to pattern day traders who exceed their day-trading buying power. Customers have 5 business days to deposit funds to meet this call. The account is limited to day-trading buying power of two times maintenance margin excess based on the customer's daily total trading commitment, beginning on the trading day after buying power is exceeded until the earlier of when the call is met or five business days. Accounts failing to meet calls by the 5th business day are restricted to trading on a cash-available basis for 90 days or until the call is met.
- Funds required to meet day-trading minimum equity or to meet a day-trading margin call are subject to a two-day holding period in the customer's account.
- Pattern day traders are required to meet their own margin requirements, i.e., their accounts may not be cross-guaranteed by another account.

### 6.6 Identity Theft Prevention Program (SEC Identity Theft “Red Flags” Rules – 17 CFR Part 248 Regulation S-ID)

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li><li>• RR</li></ul> |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Clearing firm exception reports</li></ul>              |

|                  |  |
|------------------|--|
|                  | <ul style="list-style-type: none"> <li>• Customer Identification Procedures</li> </ul>   |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• Ongoing</li> </ul>  |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Evaluate red flags to identify identity theft</li> <li>• Compliance should review issues referred by Operations and determine whether or not accounts should be closed or restricted</li> <li>• Conduct periodic review of program</li> <li>• Update the program as required</li> <li>• Notify customers as required</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Notes and other documented reviews are retained in a suspicious activity file by Compliance</li> </ul>  |

The Federal Trade Commission and the federal financial institution regulatory agencies amended the Fair and Accurate Credit Transactions Act of 2003 to include rules which require financial institutions/creditors covered under the rule to develop and implement an Identity Theft Prevention Program for combating identity theft in connection with new and existing accounts. The rules are commonly referred to as the Red Flags Rule. The Dodd-Frank Act transferred identity theft rule making responsibility and enforcement to the SEC with effective date for compliance of November 20, 2013. The FACT Act and the SEC Rules are similar and contain only non-material language changes.

The Red Flags Rule applies to a “financial institution” or “creditor” holding “covered accounts” as defined by the rule. The Firm considers itself a creditor for purposes of this rule as the Firm, through its clearing firm, extends credit to clients when margin accounts are approved by the Firm.

#### **6.6.1 Examples of Red Flags for Covered Accounts**

- A consumer reporting agency provides a notice of address discrepancy, as defined in 16 C.F.R. §681.1(b) of this part.
- Documents provided for identification appear to have been altered or forged.
- Other information on the identification is not consistent with information provided by the person opening a new covered account or customer presenting the identification.
- An application appears to have been altered or forged, or gives the appearance of having been destroyed and reassembled.
- Personal identifying information provided is inconsistent when compared against external information sources used by the financial institution or

creditor. For example, the address does not match any address in the consumer report or the Social Security Number (SSN) has not been issued, or is listed on the Social Security Administration's Death Master File.

- Personal identifying information provided by the customer is not consistent with other personal identifying information provided by the customer. For example, there is a lack of correlation between the SSN range and date of birth.
- Personal identifying information provided is associated with known fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example, the address on an application is the same as the address provided on a fraudulent application or the phone number on an application is the same as the number provided on a fraudulent application.
- Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example, the address on an application is fictitious, a mail drop, or a prison or the phone number is invalid, or is associated with a pager or answering service.
- The SSN provided is the same as that submitted by other persons opening an account or other customers.
- The person opening the covered account or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.
- Personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.
- The person opening the covered account or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.
- A covered account that has been inactive for a reasonably lengthy period of time is used (taking into consideration the type of account, the expected pattern of usage and other relevant factors).
- Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection with the customer's covered account.
- The Firm is notified that the customer is not receiving paper account statements.
- The Firm is notified of unauthorized charges or transactions in connection with a customer's covered account.
- The Firm is notified by a customer, a victim of identity theft, a law enforcement authority, or any other person that it has opened a fraudulent account for a person engaged in identity theft.

### **6.6.2 Obtaining Identifying Client Information**

The firm obtains identifying information about, and verifies the identity of, a person opening a covered account by using the policies and procedures regarding identification and verification set forth in the Firm's Customer Identification Program procedures ("CIP") in the Firm's Anti-money Laundering Program.

### **6.6.3 Authenticating Customers in Existing Covered Accounts**

If a Red Flag is found regarding an existing account, the firm will review existing identity information on file and determine whether the documentation is suspicious. If further information is required, the firm will contact the client or the registered representative for further information.

### **6.6.4 Address Change Validations**

Address changes are validated as described in Section 6.14.1 entitled Change of Customer Addresses on Accounts.

### **6.6.5 Monitoring Transactions**

Transactions are reviewed pursuant to Section 2.4.3 entitled Review of Transactions (FINRA Rule 3110(d)).

### **6.6.6 Responses to Identity Theft**

- Monitoring a covered account for evidence of identity theft;
- Notifying the customer;
- Changing any passwords, security codes, or other security devices that permit access to a covered account;
- Reopening a covered account with a new account number;
- Not opening a new covered account;
- Closing an existing covered account;
- Notifying law enforcement; or
- Determining that no response is warranted under the particular circumstances.

### **6.6.7 Lost or Stolen Brokerage Debit Cards**

If a card has not been received, is lost or stolen and needs to be reported, clients will be referred to RBC's Client Support Services at 1-800-933-9946.



### **6.6.8 Address Discrepancies From Consumer Reporting Agencies**

If an address discrepancy is received from a consumer reporting agency, the Firm will compare the information in the consumer report with the following sources to form a reasonable belief that the consumer report is about the correct individual:

- Information obtained pursuant to the firm's CIP procedures.
- Information maintained in the firm's files, such as applications, change-of-address notification, or other customer account records;
- Information from third-party sources.

Once a reasonable belief is established, the firm will confirm the address by verifying the address with the customer, reviewing its own records, verifying the address through a third-party, or using other reasonable means. If a reasonable belief cannot be established, the firm will not use that report.

## **6.7 Fees and Service Charges**

### **6.7.1 General Requirements**

Broker-dealers are obligated to disclose service charges to customers at the time an account is opened and to existing customers 30 days prior to an increase in charges or additions to existing service charges. These notifications are provided by RRs to their clients directly and by RBC. In general, fees and charges are required to be reasonable and not unfairly discriminatory between customers.

## **6.8 Fidelity Bonding (FINRA Rule 4360)**

The Firm will obtain and maintain fidelity bonding as required by rule and verify the adequacy of coverage on at least an annual basis when the bond is subject to renewal.

## **6.9 Anti-Money Laundering (AML) Program**

### **6.9.1 Introduction**

The Firm is required to comply with Bank Secrecy Act (BSA) requirements to prevent and detect money laundering. An explanation of money laundering and guidance for employees/RRs to detect money laundering is included in the chapter "General Employee and RR Policies."

This section outlines the Firm's anti-money laundering ("AML") program including report filing and recordkeeping requirements.

### 6.9.2 AML Compliance Officer

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Chief Compliance Officer</li><li>• Compliance</li><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Clearing firm computer reports</li><li>• Internal audits or outside audits of program</li><li>• Regulations and rules for broker-dealer anti money laundering programs</li><li>• OFAC website</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Annual - review policies and procedures</li><li>• Annual - schedule audit of program and review audit results and adjust program as necessary</li><li>• At a minimum annual – AML training; Contact Person</li><li>• As needed - update program and provide revisions to senior management for review and approval</li><li>• Ongoing - review new regulations and monitor activity</li></ul> |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Develop and update the Firm's anti-money laundering program</li><li>• Obtain senior management approval for the program</li><li>• File required reports</li><li>• Retain required records</li><li>• Provide detailed contact information to FINRA and update contact information as necessary (FINRA Rule 3310[d])</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Current and past copies of anti-money laundering program with senior management approval</li><li>• Reports filed and other records as listed in program</li></ul>  |

The Firm's Chief Compliance Officer is its AML Compliance Officer. The AML Compliance Officer is responsible for developing policies, procedures, and internal controls to achieve compliance with AML rules and regulations.

The AML Compliance Officer will review new rule changes as required by the USA Patriot Act regarding AML as published in the FINRA Rules, Regulatory Notices and other similar sources. Any changes will be evidenced by updating the AML procedures when a rule change occurs and placing a copy of the change in the files.

### 6.9.3 Independent Testing

The AML Compliance Officer will periodically (at least annually) arrange for review of the Firm's policies and procedures regarding money laundering and the effectiveness of the program by an independent qualified tester.

### 6.9.4 Education Of Employees/RRs

All employees/RRs are given access to various on-line resources covering anti-money laundering, including the Written Supervisory Procedures, when they are hired. The policy is included in the chapter "General Employee and RR Policies."

In addition, ongoing education may include inclusion of the subject in the firm element continuing education program, periodic circulation of the Firm's policy, and other educational programs directed at specific employees.

### 6.9.5 OFAC List and Blocked Property

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resource</b>       | <ul style="list-style-type: none"><li>• OFAC sanctions information</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• At time of account opening, check new accounts against sanction information</li><li>• Additions to the OFAC list of sanctions are checked against the Firm's accounts and securities positions at the time updates are identified</li><li>• Ongoing, check disbursements against list of sanctioned parties</li><li>• When necessary, request bank affirmations</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review new and existing accounts and securities positions to identify potential sanctioned persons or entities (Existing accounts are reviewed through DST Compliance Alerts)</li><li>• Block accounts or securities subject to sanctions</li><li>• Add "blocked" identification to the name of any blocked account</li><li>• Cancel open orders for blocked accounts</li><li>• Notify RR, as appropriate, when an account or security is blocked</li><li>• Notify OFAC by FAX within 10 days of blocking an account (clearing firm will make filings where appropriate)</li></ul> |

|               |  |
|---------------|--|
|               | <ul style="list-style-type: none"> <li>Identify any disbursements of funds or securities to sanctioned parties and block disbursement where appropriate</li> </ul>   |
| <b>Record</b> | <ul style="list-style-type: none"> <li>Copies of filings with OFAC are retained in an OFAC file including any subsequent action taken on a blocked account. The file includes information provided by the clearing firm.</li> <li>DST Compliance reviews.</li> </ul> |

The Firm is obligated to comply with the requirements to block the property of sanctioned persons or entities and prevent the transfer of assets to such persons or entities. In addition, the Firm must block securities issued by sanctioned countries and other sanctioned issuers.

OFAC (the Office of Foreign Assets Control of the U.S. Treasury Department) is responsible for enforcing the sanctions and publishes, on its website ([www.treas.gov/ofac](http://www.treas.gov/ofac)), information about sanctions. The information is divided into several categories including:

- Persons and entities subject to sanctions, *Special Designated Nationals and Blocked Persons* (SDN list)
- Persons and entities engaged in drug trafficking, *Specially Designated Narcotics Traffickers* (SDNTKs)
- Terrorists and terrorist organizations, *Specially Designated Terrorists* (SDTs)
- Countries, governments, and other entities subject to sanctions

OFAC requirements apply to all persons and entities under U.S. jurisdiction, including foreign branches of U.S. institutions. This also includes foreign institutions that operate in the U.S.

The term "OFAC list" in this section includes all sanctions published by OFAC even though the information may appear in multiple lists. The Firm will not permit prohibited transactions with sanctioned parties and will file reports with OFAC when necessary.

#### **6.9.5.1 Prohibited Transactions**

The Firm is prohibited from conducting transactions in any account on behalf of a sanctioned party or in certain blocked securities. Securities and funds may not be released and securities transactions may not be executed. Securities and funds may be deposited to a blocked account, but no securities or funds will be

released until the account is no longer subject to sanctions. Funds or securities may not be transferred to sanctioned parties.

Because transactions are prohibited, all open orders for a blocked account will be cancelled.

#### **6.9.5.2 Blocking Requirements**

Blocking requirements are generally triggered under the following circumstances:

- An account is opened for someone included on an OFAC list.
- The owner of an existing account is added to an OFAC list.
- A security is identified in a customer account where the issuer is the subject of sanctions.
- A request is made by a customer to pay or transfer funds or securities to a blocked person or entity.

While title to blocked property remains with the blocked person or entity, transactions affecting the property (including transfer of the assets) cannot be made without authorization from OFAC. Debits to blocked accounts are prohibited, but credits may be accepted. Cash balances in blocked accounts must earn interest at commercially reasonable rates. Blocked securities may not be paid, withdrawn, transferred (even in book transfer), endorsed, guaranteed, or otherwise dealt in.

It is not a violation to open an account for a blocked person. The violation occurs when the account is not frozen and assets are allowed to transfer out of the account. In addition, OFAC restrictions may vary depending on the blocked person or entity; details of blocking requirements are explained at the OFAC website.

#### **6.9.5.3 Monitoring Procedures**

Monitoring is to be conducted as follows:

- Operations personnel should be aware of the countries included on the OFAC list, to watch for new accounts to be opened for or requests to transfer funds or securities to residents of those countries.
- The Firm's clearing firm has procedures to monitor new accounts, existing accounts, security positions, and potential disbursements of funds or securities.

#### **6.9.5.4 Other Requests To Monitor Accounts**

Regulators or law enforcement agencies may ask the industry's cooperation in identifying accounts for individuals or entities under investigation or suspected of criminal activities.

The AML Compliance Officer is responsible for responding to such requests; providing the necessary information; and retaining records of requests, reviews conducted pursuant to requests, and information provided to authorities.

#### **6.9.5.5 Blocking Property**

Any account or security included on the OFAC list will be blocked immediately and will be identified, in the name of the account, as a blocked account. No transactions will be permitted in a blocked account with the exception of accepting deposits of funds or securities.

Open orders of blocked accounts will be cancelled.

#### **6.9.5.6 Reporting Blocked Property and Legal Actions**

When an account or disbursement is blocked or a blocked security is identified, the clearing firm will notify OFAC within 10 days of blocking. If the Firm blocks an account or security, it will be responsible for filing the necessary report with OFAC. Reports filed by the Firm will be retained in a file of blocked accounts or securities. Information to be reported includes:

- Owner or account party
- Property and property location
- Existing or new account number
- Actual or estimated value
- Date property was blocked
- Copy of the payment or transfer instructions
- Confirmation that funds have been deposited in a blocked account that is identified as blocked
- Name and phone number of contact person at the Firm

For rejected disbursements, the following information is to be filed:

- Name and address of the transferee financial institution
- Date and amount of the transfer
- Copy of the payment or transfer instructions
- Basis for rejection
- Name and phone number of contact person at the Firm

##### **6.9.5.6.1 Annual Report Of Blocked Property**

On an annual basis by September 30, the clearing firm will file Form TDF 90-22.50 with OFAC for any blocked property held as of June 30.

#### **6.9.5.6.2 Legal Actions Involving Blocked Property**

U.S. persons involved in litigation, arbitration, or other binding alternative dispute resolution proceedings regarding blocked property must provide notice to OFAC. Copies of all documents associated with the proceedings will be submitted by Compliance within 10 days of their filing to the OFAC Chief Counsel at the U.S. Treasury Department. In addition, information about the scheduling of any hearing or status conference will be faxed to the Chief Counsel.

#### **6.9.5.7 Blocking Disbursements**

Disbursements of funds or securities may not be made to sanctioned parties.

#### **6.9.5.8 Role of Operations**

Operations is an important first line of defense in preventing transactions with sanctioned parties. The following guidance is provided to assist Operations in identifying blocked parties. Any questioned accounts or transactions should be referred to Compliance.

- Be familiar with countries included on the OFAC list. These are countries considered potential havens for money laundering, drug trafficking, or terrorist activities. Information is included on the OFAC website at [www.treas.gov/ofac](http://www.treas.gov/ofac).
- When processing the opening of accounts, question accounts for residents of countries included on the OFAC list.
- Question requests to transfer funds or securities to residents or entities domiciled in any country included on the OFAC list.

#### **6.9.6 Cash Deposits Not Accepted**

The Firm does not accept cash or currency from customers. If a customer attempts to deposit cash or currency, the employee/RR receiving the deposit is responsible for refusing the deposit and advising the customer the Firm will only accept checks.

In the event cash is inadvertently accepted, the following steps must be followed:

- Immediately provide the cash to the cashier or other authorized Operations personnel.
- The cashier or Operations is responsible for counting the cash (2 people must be present to verify the amount) and entering the amount into the Firm's customer account system for credit to the customer's account.
- Immediately thereafter the cash must be walked to the Firm's bank for credit to the account maintained for the benefit of customers or, if no account exists, obtain a cashier's check or money order made payable to

- the clearing firm and then send the check/money order to the clearing firm the same day.
- The Director of Operations is responsible for filing Form 4789 (Currency Transaction Report) with the IRS by the 15<sup>th</sup> calendar day after receipt for cash in excess of \$10,000 for one person on any one day.
  - The Director of Operations is responsible for retaining a file of forms filed with the IRS.

### **6.9.7 Cash Equivalents**

The Firm generally does not accept deposits of certain cash equivalents such as money orders, credit card or convenience checks and cashier's checks or bank checks for amounts less than \$10,000. Customers attempting to deposit cash equivalents should be advised to instead provide a personal check for deposit to their account.

### **6.9.8 Reporting Requirements**

The following summarizes the reporting requirements under the Bank Secrecy Act. The Firm's Director of Operations is responsible for maintaining records of any reports required to be filed by the Firm.

#### **6.9.8.1 Transactions Involving Currency Over \$10,000**

The Firm does not accept currency. But Firm's that do accept a currency deposit exceeding \$10,000 are required to file a Currency Transaction Report (CTR) with the Financial Crimes Enforcement Network (FinCEN). Multiple transactions by the same person equaling over \$10,000 in any one day must also be reported. "Currency" is defined as the coin and paper money of the U.S. or legal tender of other countries. Currency also includes U.S. silver certificates, U.S. notes, Federal Reserve notes, and official foreign bank notes customarily used and accepted as a medium of exchange in a foreign country. CTRs must be filed by the 15<sup>th</sup> calendar day after the day of the transaction and kept for 5 years.

#### **6.9.8.2 Transactions Involving Currency Or Bearer Instruments Over \$10,000 Transferred Into Or Outside The U.S.**

Broker-dealers are required to file a Currency and Monetary Instrument Transportation Report (CMIR) with the U.S. Customs Service to report transactions in currency and/or bearer instruments which alone or in combination exceed \$10,000 and which are shipped or transported into or outside the U.S. This filing is not required for currency or other monetary instruments mailed or shipped through the postal service or by common carrier. The Firm's clearing firm is responsible for filing these reports and maintaining records of them. CMIRs must be filed within 15 days after the receipt of the currency or monetary instruments.



#### **6.9.8.3 State Reporting Requirements**

States have adopted various currency and suspicious activity reporting requirements. Most states have entered into an agreement with FinCEN to provide them with duplicate copies of forms filed by broker-dealers. Some states, however, require duplicate filing with the states themselves at the time the broker-dealer files with a federal agency. The Firm will file reports as required under state requirements.

#### **6.9.8.4 Foreign Financial Accounts**

Broker-dealers that maintain accounts in foreign jurisdictions and with aggregate balances exceeding \$10,000 are required to file a Report of Foreign Bank and Financial Accounts (FBAR) with FinCEN on or before June 30 of each calendar year for accounts maintained during the previous calendar year.

The Firm does not maintain foreign financial accounts. To be sure IPI does not open this type of account, it will detect correspondent accounts (any account that permits the foreign financial institution to engage in securities or futures transactions, funds transfers or other types of financial institutions) for unregulated foreign shell banks by reviewing all account forms and the other backup documents we have outlined that will be obtained as backup information. Upon finding or suspecting such accounts, firm employees/RRs will notify the AML Compliance Officer, who will terminate any verified correspondent account in the United States for an unregulated foreign shell bank. We will also terminate any correspondent account that we have determined is not maintained by an unregulated foreign shell bank but is being used to provide such services to such a shell bank. We will exercise caution regarding liquidating positions in such accounts and take reasonable steps to ensure that no new positions are established in these accounts during the termination period. We will terminate any correspondent account for which we have not obtained the information described in Appendix A of the regulations regarding shell banks within the time periods specified in those regulations.

#### **6.9.8.5 Private Banking Accounts/Foreign Officials**

The Firm does not open or maintain private banking accounts. To be sure IPI does not open this type of account, it will detect private banking accounts (an account or 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 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 who is a senior foreign political official). Upon finding or suspecting such accounts, firm employees/RRs will notify the AML Compliance Officer, who will terminate such account. We will exercise caution regarding liquidating positions in such accounts and take reasonable steps to

ensure that no new positions are established in these accounts during the termination period.

#### **6.9.8.6 Prohibition of Acceptance of Foreign Securities**

**The Firm does not accept foreign securities.**

### **6.9.9 Recordkeeping Requirements**

In addition to maintaining records of reports filed with the IRS or other authority, broker-dealers are obligated to maintain records of certain transactions, for potential inspection by regulators and other authorities. These records must be retained for five years.

#### **6.9.9.1 Funds Transfers**

Broker-dealers are required to collect information and maintain records for domestic and international funds transfers (including wire fund transfers) of \$3,000 or more, with certain exceptions. Specific information is also required to accompany the wire transfer of funds. The Firm's clearing firm is responsible for complying with the requirements to record information regarding fund transfers and, when required, verifying information regarding transmitters and recipients who are not established customers. Examples of verification information include:

- Name and address
- ID reviewed (type and number on ID)
- Taxpayer ID number (passport number)
- Copy or record of method of payment (credit card, check).

#### **6.9.9.2 Extension of Credit**

Neither the Firm nor its associated persons shall extend credit to customers for any reason. Additionally, the Firm will not assist customers in obtaining financing in any manner. Should any employee of the Firm receive a request from a customer to assist them in obtaining financing that appears to be beyond normal banking channels, the employee shall notify the AML Compliance Officer. The Firm's AML Compliance Officer shall document the customer's request and begin an investigation. Upon completion of the review, the AML Compliance Officer shall evidence that review by placing a signed memorandum of the results of the investigation in the appropriate file. Should the AML Compliance Officer suspect that money laundering activities are taking place, the AML Compliance Officer will file a Suspicious Activity Report. This does not apply to the normal credit extended by the Clearing Firm for margin and similar accounts.

#### **6.9.10 Detecting Potential Money Laundering**

The Firm has included an educational policy under "General Employee and RR Policies" to educate employees/RRs on money laundering and guidelines for detecting money laundering activities. Periodically money laundering may be included in continuing education and other educational programs for employees/RRs.

In addition, the Firm utilizes reports to detect questionable patterns of activity. These reports are reviewed and Compliance will refer suspicious activity to the proper authorities, if needed.

The Firm will work with the clearing firm to exchange information, records, data and reports as necessary to comply with AML laws. As a general rule, the clearing firm will monitor the Firm's customer activity on the Firm's behalf, and the clearing firm will be provided with proper customer identification information as required to successfully monitor customer transactions. The Firm's and the clearing firm's responsibilities are included in the clearing agreement and each firm is responsible for its own independent compliance with AML laws. The Firm and the clearing firm cannot disclaim their respective responsibilities to comply with AML requirements.

#### **6.9.11 Information Sharing**

##### **6.9.11.1 Between Financial Institutions**

Under an AML regulation, financial institutions are permitted to share information regarding those suspected of terrorist or money laundering activities. Information sharing is not required but is permitted solely for the purpose of facilitating identification and reporting. For example, the Firm may share information about suspicious activity with our clearing firm and/or other financial institutions for purposes of determining whether to jointly file a SAR-SF. The regulation provides immunity from other laws restricting information sharing if certification and confidentiality requirements of the regulation are satisfied.

Because we are affiliated, we may share SAR-SFs with IPI Wealth Management, Inc.

Institutions that share information are required to provide FinCEN with a certification that confirms, among other things, the name of the institution; that the institution will maintain adequate procedures to protect the security and confidentiality of the shared information; that the information will be used only for the authorized purpose; and the identity of a contact person at the institution. Certification may be made online at [www.treas.gov/fincen](http://www.treas.gov/fincen) and must be re-certified annually if information sharing is to continue.

If the Firm decides to share information, the AML Compliance Officer is responsible for developing confidentiality procedures and will file the initial and annual certifications. In addition, the AML Officer is required to verify that any financial institution with which the Firm shares information has itself filed the requisite certification. A written letter or attestation will be required from the other financial institution and maintained in the AML Officer's files.

#### **6.9.11.2 Providing Information To Federal Law Enforcement Agencies**

Requests for information from FinCEN will be forwarded to and answered by the AML Compliance Officer who will retain a file of requests and responses. Responses will be provided as soon as possible by E-mail to *patriot@fincen.treas.gov*; by calling the Financial Institutions Hotline at 866-556-3974; or by another means specified by FinCEN.

#### **6.9.12 Suspicious Activity Reports (SARs)**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• AML Compliance Officer</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Reports from employees/RRs</li> <li>• Suspicious activities detected through ongoing reviews</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review transactions and accounts identified for potential suspicious activity</li> <li>• Determine whether the activity constitutes suspicious activity requiring reporting</li> <li>• File Form SAR-SF with FinCEN</li> <li>• File copies of forms with state authorities, if required</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Notes and other documented reviews are retained in a suspicious activity file</li> <li>• Copies of SARs are retained in a SAR file with notation of when and to whom sent</li> </ul>   |

The Firm is required to file Suspicious Activity Reports (SARs) for transactions that may be indicative of money laundering activity. Examples of risk indicators that may suggest potential money laundering are included in the chapter *"General Employee and RR Policies"* in the section *"Money Laundering."*

#### **6.9.12.1 Identifying Potential Suspicious Activity**

The Firm uses a number of tools to identify potential suspicious activity including:

- Education of Firm personnel, particularly supervisors in Operations areas
- Review of wire transfers, particularly accounts with a high volume/velocity of transfers and accounts in certain countries or other geographic areas deemed "high risk"
- Employee/RR reports of potential suspicious activity forwarded to the AML Compliance Officer

IPI utilizes exception reports provided by its clearing firm to assist in the process of identifying suspicious activity relating to accounts introduced to the clearing firm. Operations and Compliance access reports that are available for review via the RBC online system. They will review the report, document any actions taken and initial and date the report to evidence such review. Copies of these reports will be maintained by Compliance. Operations or Compliance will investigate the information contained in the report and notify the AML Compliance Officer if the Operations Director cannot resolve the issues raised in the report. A SAR will be filed by the AML Compliance Officer if necessary.

#### **6.9.12.2 When A Report Must Be Filed**

A SAR must be filed for any transaction that, alone or in aggregate, involves at least \$5,000 in funds or other assets, if the Firm knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is part) falls into one of the following categories:

- Transactions involving funds derived from illegal activity or intended or conducted to hide or disguise funds or assets derived from illegal activity.
- Transactions designed, whether through structuring or other means, to evade the requirements of the Bank Secrecy Act (BSA).
- Transactions that appear to serve no business or apparent lawful purpose or are not the sort of transactions in which a particular customer would be expected to engage, and for which the Firm knows of no reasonable explanation after examining the available facts.
- Transactions that involve the use of the Firm to facilitate criminal activity.

Excluded from the filing requirement are violations otherwise reported to law enforcement authorities such as:

- a robbery or burglary that is reported to law enforcement authorities
- lost, missing, counterfeit, or stolen securities reported pursuant to 17f-1
- a violation of federal securities laws or SRO rules by the Firm, its officers, directors, employees, or RRs that are reported to the SEC or SRO, except for violations of Rule 17a-8 (filing of Currency and Transaction Reports) which must be reported on a SAR.

#### **6.9.12.3 Filing A Report**

The AML Compliance Officer will file a SAR with FinCEN:

- within 30 days of becoming aware of the suspicious transaction
- if no suspect has been identified within 30 calendar days of detection, reporting may be delayed an additional 30 calendar days or until a suspect has been identified, but no later than 60 days from date of initial detection.

In situations involving violations requiring immediate attention (such as terrorist financing or ongoing money laundering schemes), the AML Compliance Officer will immediately notify by telephone an appropriate law enforcement agency. Suspicious transactions that may relate to terrorist activity may also be reported to FinCen's Financial Institutions Hotline. In either event, a SAR will be filed.

#### **6.9.12.4 Retention Of Records**

The AML Compliance Officer maintains a file of copies of SARs filed with FinCEN and all related documents for a period of 5 years from the filing date.

#### **6.9.12.5 Prohibition Against Disclosure**

By statute and regulation, the Firm may not inform customers or third parties that a transaction has been reported as suspicious. U.S. Treasury and Federal Reserve Board regulations also require the Firm to decline to produce SARs in response to subpoenas and to report to FinCEN and the Federal Reserve Board the receipt of such requests and the Firm's response. Failure to maintain the confidentiality of SARs may subject an employee/RR to civil and criminal penalties under Federal law. Violations may be enforced through civil penalties of up to \$100,000 for each violation and criminal penalties up to \$250,000 and/or imprisonment not to exceed 5 years. The Firm may also be liable for civil money penalties from AML deficiencies that led to improper SAR disclosure up to \$25,000 per day for each day the violation continues.

Procedures to protect the confidentiality of SARs include:

- Access to SARs is limited to employees on a need to know basis
- SARs will be maintained in locked physical or electronic files
- SARs may not be left on desks or on open computer files and must be viewed without access by unauthorized persons
- SARs shared with others will be clearly marked Confidential.

Compliance is responsible for responding to subpoena requests and Compliance will notify FinCEN and the Federal Reserve Bank of any subpoenas for SARs.

#### **6.9.13 Requests and Written Notices From Enforcement Agencies**

Under the Bank Secrecy Act, financial institutions are required to respond to federal banking agency requests for information relating to anti-money laundering compliance. The Rule requires provision of information and account documentation for any account opened, maintained, administered or managed in the U.S.

#### **6.9.13.1 FinCEN Requests For Information Under Section 314(a)**

The Financial Crimes Enforcement Network (FinCEN) sends law enforcement requests to financial institutions under Section 314(a) of the USA PATRIOT Act.

Requests for information from FinCEN will be forwarded to Compliance for response if necessary. Upon receipt, Compliance will review the lists provided by FinCEN and check firm records for any matches on this list. These lists are maintained electronically showing review and findings by Compliance. If a match is identified with a named subject, within two weeks of receipt of the request, the Subject Information Form (included with FinCEN's request) will be forwarded to FinCEN by electronic mail to [sys314a@fincen.treas.gov](mailto:sys314a@fincen.treas.gov) or, if e-mail is not available, by fax at 703-905-3660. FinCEN requests are confidential and may not be disclosed to the subject of the request. Compliance maintains evidence of the above mentioned reviews and submissions.

#### **6.9.13.2 National Security Letters**

National Security Letters will be forwarded to the AML Compliance Officer. National Security Letters are highly confidential. None of our officers, employees or agents may directly or indirectly disclose to any person that a government authority or the FBI has sought or obtained access to records of the person who is subject of the subpoena, its existence, its contents or the information we used to respond to it. If we file a SAR-SF after receiving a National Security Letter, the SAR-SF will not contain any reference to the receipt or existence of the letter. The SAR-SF will only contain detailed information about the facts and circumstances of the detected activity.

#### **6.9.13.3 Grand Jury Subpoenas**

Grand jury subpoenas will be forwarded to the AML Compliance Officer. The receipt of a grand jury subpoena concerning a customer does not in itself require the Firm to 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 file a SAR-SF in accordance with the SAR-SF filing requirements. 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. 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 contact detailed information about the facts and circumstances of the detected suspicious activity.

#### **6.9.14 Customer Identification Program (CIP) (Treasury Dept., 31 CFR Part 103 - 103.122 Customer Identification Programs For Broker-Dealers)**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> <li>• Operations</li> <li>• AML Compliance Officer</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Firm's types of business and account base</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• At inception of CIP program and as part of annual AML program review</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Evaluate risk factors for the types of accounts opened by the Firm</li> <li>• Establish CIP standards based on risk evaluation</li> <li>• Include CIP in AML program approved by senior management</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• The AML Compliance Officer's evaluations and review of the CIP are retained in AML Program files.</li> </ul>  |

The opening of new accounts is subject to the Firm's Customer Identification Program (CIP). This section outlines supervisory procedures to conduct the CIP. Detailed identity verification procedures are included in the chapter *Accounts - New Accounts - Customer Identity Verification*.

The use of the term "customer" in this section is understood to include prospective customers.

##### **6.9.14.1 Responsibilities**

The following chart summarizes the responsibilities for conducting and complying with the Firm's CIP.

|                   |  |
|-------------------|--|
| <b>Compliance</b> | Review for approval specific accounts (i.e., numbered, etc.)<br>Request additional ID information if necessary<br>Consider filing SAR for suspicious accounts<br>Review discrepancies referred by Operations<br>Identify discrepancies in information received from consumer reporting agencies or other vendors used to verify identity |
|-------------------|--|



|                               |   |
|-------------------------------|---|
|                               | Determine required CIP information is obtained in referred accounts prior to approving and review for adequacy and discrepancies<br>Approve or disapprove the account.<br>Refer suspicious or questionable accounts to the AML Compliance Officer   |
| <b>AML Compliance Officer</b> | Develop CIP in conjunction with Operations<br>File SARs for suspicious accounts   |
| <b>RR</b>                     | Obtain required CIP information for new accounts  |
| <b>Operations</b>             | Confirm CIP information is included for accounts opened<br>Reject accounts with deficient customer ID information and flag as not in good order ("NIGO")<br>Refer accounts requiring additional approval to Compliance<br>Refer suspicious or questionable accounts to Compliance.<br>Note on account records if account is limited to certain transactions until ID information is received<br>Refer discrepancies to Compliance |

#### 6.9.14.2 Accounts Requiring Approval By The AML Compliance Officer

The following accounts require review and approval by the AML Compliance Officer at the time of opening. The AML Compliance Officer may require additional customer identification information for these accounts.

- **Numbered accounts** (accounts designating a number rather than a name as the account name)
- **Any account requesting confidential handling** of its name, mailing of confirmation and statements, *etc.*
- **Accounts domiciled in high risk countries.** Accounts domiciled in countries identified by OFAC or the Financial Action Task Force on Money Laundering (FATF) as having inadequate anti-money laundering standards or representing high risk for crime and corruption. The list includes countries such as, but not limited to, Balkans, Burma, Cuba, Iran, Iraq, Liberia, Libya, North Korea, Sudan, Syria, and Zimbabwe. The most updated country list may be found at: <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx>
- **Foreign public officials.** Includes individuals in high offices of foreign governments, political party officials and their families and close associates (if known and/or readily identifiable).

#### 6.9.14.3 Minimum Identifying Information

The minimum required identifying information is included in the Firm's new account application (name, date of birth, tax payer ID and address).

#### **6.9.14.4 Customer Identity Verification**

The requirements for verifying customers' identities are detailed in the chapter *Accounts - New Accounts - Customer Identity Verification*.

#### **6.9.14.5 CIP Records**

Customer identification verification records and new account application records are maintained in accordance with rule recordkeeping requirements including:

- information recorded on the new account application
- documentary verification including information from or copies of government-issued IDs or passports
- non-documentary verification
- account approval or disapproval
- resolution of discrepancies
- referral of the account to the AML Compliance Officer
- closing of an account that fails to meet CIP requirements
- other records as may be required

#### **6.9.14.6 Comparison With Government Lists**

As required by law, the Firm compares customer information against government lists. The section *OFAC List and Blocked Property* in the Anti-Money Laundering Program describes comparison of accounts with lists published by the Treasury Dept.

#### **6.9.14.7 Customer Notice**

Customers are notified prior to opening an account that, as required by law, their identities will be verified. Customer identification notices appear as follows:

- On the new account application or other new account documents provided to the customer.

#### **6.9.15 Correspondent Accounts**

AML regulations specify certain requirements when dealing with "correspondent accounts," a term that should not be confused with the common usage in the securities industry. In this context, "correspondent account" refers to "an account established to receive deposits from, make payments on behalf of a foreign bank, or handle other financial transactions related to such bank" (*definition from a Treasury Dept. rule*).

#### **6.9.15.1 Prohibition Against Correspondent Accounts For Foreign Shell Banks**

The Firm is prohibited from establishing, maintaining, administering, or managing a "correspondent account" in the United States for an unregulated foreign shell bank. A foreign shell bank is defined as a foreign bank without a physical presence in any country.

The limitations on the direct and indirect provision of correspondent accounts to foreign shell banks do not apply to a foreign shell bank that is a regulated affiliate. A regulated affiliate is a foreign shell bank that (1) is an affiliate of a depository institution, credit union, or foreign bank that maintains a physical presence in the United States or a foreign country, as applicable; and (2) is subject to supervision by a banking authority in the foreign country regulating such affiliated depository institution, credit union, or foreign bank. An affiliate is a foreign bank that is controlled by or is under common control with a depository institution, credit union, or foreign bank.

If an account is inadvertently opened for a foreign shell bank, the AML Compliance Officer should be notified and the account will be immediately closed. The AML Compliance Officer will maintain a record of the closed account and will notify the appropriate authorities, if necessary.

#### **6.9.15.2 Opening Accounts For Foreign Banks**

The Firm does not maintain accounts for foreign banks.

### **6.10 Customer Payments For Purchases**

When an order to purchase securities is accepted from a customer, payment from the customer's bank account or other depository must be authorized in writing by the customer. Payment is not acceptable based only on the customer's oral authorization to withdraw funds. Examples of acceptable payment include:

- a check signed by the customer
- written authorization by the customer to draft funds from the customer's bank checking or savings account

Questions regarding proper payments should be referred to Operations.

#### **6.10.1 Checks Payable To Clearing Firm**

##### **6.10.1.1 Inadvertent Receipt Of Customer Funds Or Securities**

The Firm does not hold funds or securities for, or owe money or securities to, its customers. Therefore, the Firm is exempt from customer protection requirements under Reg. Section 240.15c3-3(k)(2)(i). In the event that funds are inadvertently

received by the Firm, certain procedures will be followed to ensure the client is aware of the oversight. *See Section 6.13.3 for these procedures.*

## **6.11 Risk Management**

This section generally outlines Firm procedures designed to address "risk management." Because these procedures address various lines of business that operate in a constantly changing market environment, they are not static and should be adapted by the designated supervisor to meet the needs of the Firm on an ongoing basis. RBC performs some of these tasks on our behalf.

### **6.11.1 Risk Practices Regarding Employment and Employees/RRs**

The Firm has established procedures regarding the hiring of personnel; conduct and review of employee/RR accounts; granting of authority to act in various capacities on behalf of the Firm; and the integrity of the Firm's systems and financial reporting.

#### **6.11.2 Background Checks**

One of the Firm's first lines of defense is the hiring of qualified people who do not bring high-risk behavior to their positions. The Firm conducts background checks on all applicants for employment with the Firm. All offers of employment are considered conditional pending the outcome of the reference checks. These reference checks include contact with the applicant's prior employers for at least the past three years. Any adverse information is referred to the hiring manager for consideration prior to finalization of employment.

Also refer to the section "New RR Hiring Procedures" in the chapter "General Employee and Registered Rep Policies" for more information about hiring procedures.

#### **6.11.3 Employee/RR Accounts**

Employees/RRs are subject to policies governing the conduct of their personal securities accounts. Refer to the section "Employee and Employee Related Accounts" in the chapter "General Employee and Registered Rep Policies" as well as the chapter on "Insider Trading."

#### **6.11.4 Authority**

Employees/RRs may only act on behalf of the Firm within the boundaries of authority granted them by the Firm. The following generally outlines the authority of certain employees/RRs or committees and their respective responsibilities.

#### **6.11.4.1 FINOP**

The FINOP (or his/her designee) is responsible for the following on behalf of the Firm:

- Establishing accounting procedures in accordance with generally accepted accounting principles
- Ensuring the accurate and timely filing of Firm financial reports with regulators and others where financial reports are required
- Establishing bank accounts and designating employees/RRs authorized to sign checks and transfer funds on behalf of the Firm
- Interacting with the Firm's public accounting firm and coordinating the providing of information requested during the Firm's annual audit
- Follow up regarding exceptions or recommendations referred by the outside public accounting firm
- Review of the annual audited financial statements and recommendations from the Firm's public accounting firm
- Review of significant risk matters referred to it by Operations or Compliance, or other departments.
- The payment of assessments and fees to regulators.
- Filing notice of the designation of the Firm's accountant, if required.

#### **6.11.4.2 Department/Business Unit Managers**

Department and business unit managers are responsible for oversight of the activities within their respective department or business unit, with the interests of customers and the Firm as foremost considerations. The general scope of responsibility includes, among other responsibilities, the following:

- Hiring and termination of department/business unit personnel with appropriate direction from HR
- Supervision of department/business unit personnel including periodic reviews and salary administration
- Creating a safe and positive work environment for personnel
- Ensuring only authorized personnel act on behalf of the Firm (check signing, purchasing supplies, etc.)

#### **6.11.5 New Accounts**

In addition to review and approval by a Registered Principal, new brokerage accounts are subject to the Firm's Customer Identification Program (described in the Anti-Money Laundering Program) and verification against vendor databases, as described below.

All new accounts are run through a system administered by a third party, Remitpro, to verify customer identification via non-documentary means.

All new brokerage accounts custodied at our Clearing Firm are run through the Clearing Firm's account database as well. It is designed to find all adverse information concerning the Firm's customers. Adverse information includes prior losses caused by customers at other RBC firms, mail drops as reported by Postal Inspectors and the Secret Service, FINRA/SEC regulatory issues, OFAC items (including SDN lists), FATF countries, and fraudulent issues as reported by the media.

#### **6.11.6 Handling Customer Funds and Securities - Introducing Firms**

The Firm's clearing firm has established procedures for safeguarding customer funds and securities. The Firm follows those procedures for receipt and deposit of customer checks and for receipt and forwarding of customer securities. Refer to the section "Safekeeping Of Customer Funds and Securities" for more information.

#### **6.11.7 Firm Computers and Computerized Data**

The Firm's IT Department is responsible for establishing procedures regarding the Firm's computers and data maintained on computers, including the following:

- Limiting access to centralized physical data processing and computer sites to authorized personnel only
- Limiting data access to authorized personnel only
- Back-up of data files
- Disaster recovery plans related to systems.

#### **6.11.8 Extension Of Credit**

The Firm introduces its accounts to a clearing firm that is responsible for overseeing the extension of credit.

##### **6.11.8.1 Accounts In Deficit Positions and Accounts Using Margin**

Operations staff regularly reviews accounts in deficit positions on a weekly basis to determine corrective action and may be notified by the Clearing Firm regarding higher margin maintenance requirements for margin accounts with concentrated positions.

#### **6.11.9 New Products**

All new products require the review and approval of the New Products Committee prior to offering new products to customers. A "new product" may include a product that:

- is new to the marketplace or the Firm.

- was previously sold only to a limited segment of the Firm's customers, such as only to institutional customers and now will be offered to retail customers.
- will be offered by a category of RRs who did not previously offer the product, such as a product new to retail RRs.
- involves material modifications to an existing product including risk, product structure, or fees and costs.
- requires material operational or system changes.
- involves a new or significant change in sales practices.
- raises conflicts that have not been previously identified and addressed.

If there is a question whether a product may be a "new" product, it should be submitted for new product review.

#### **6.11.9.1 New Product Committee Members**

The New Product Committee is responsible for review of new products and consists of members representing a cross-section of departments which may include senior management, Operations and Compliance personnel.

#### **6.11.9.2 Requests For Review Of New Products**

RRs and departments wanting to offer new products are required to prepare information for the review of the New Product Committee. Information to be provided includes a description of the product, to whom the product would be offered, and economic justification of the product. The Committee will notify the requestor regarding approval/disapproval or the need for modifications or additional information. Records of requests and action taken will be retained in a Committee file.

#### **6.11.9.3 Training**

A determination will be made by the Committee regarding the need for training before the product is made available for sale. Considerations include:

- Whether RRs are already knowledgeable about the product (prior training/training with product sponsor)
- Sophistication of targeted investors
- Complexity of the product.

#### **6.11.10 Internal Audit**

The Firm, as a small firm, has established an internal audit process utilizing outside consultants to assist in the reviews and assessments of the Firm.

#### 6.11.10.1 Reports

Risk assessments and review documentation is maintained by Compliance and is utilized in preparing the Annual Compliance Report pursuant to FINRA Rule 3120.

#### 6.11.10.4 Internal Conclusions (FINRA Rule 4530)

The Firm will report to FINRA within 30 calendar days of concluding that an associated person of the Firm or the Firm itself has violated any securities regulation or standard of conduct that has widespread or potential widespread impact to the firm, its customers or the markets, or conduct that arises from a material failure of the firm's systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts.

### 6.12 Disbursements Of Funds

This section describes the Firm's procedures for handling disbursements from customer accounts.

#### 6.12.1 Checking Account Safeguards

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• N/A</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Ensure checking account safeguard procedures are followed.</li><li>• Maintain list of authorized check signers and request additional signers as necessary.</li><li>• Handle disbursements in accordance with the Firm's procedures</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Records of checks issued, including approvals, are retained in files in the Operations area; in addition, the clearing firm retains records of checks issued.</li></ul>   |

The clearing firm disburses funds to customers from customer accounts.



### 6.12.2 Issuing Checks To Customers

Checks to be paid to customers from their accounts will be paid to the order of the account as it is carried on the Firm's books and sent to the address appearing on the account. Exceptions require a Letter of Authorization (LOA) signed by the customer. A Registered Principal shall review exceptions.

### 6.12.3 Disbursements Of Funds To Third Parties

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests to send funds/issue checks to third parties</li></ul>                          |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Obtain required LOA</li><li>• Issue check/funds in accordance with procedures</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Retain LOA in Operations files</li></ul>  |

When a customer wishes funds or securities to be paid to a third party in the third party's name, the customer will be required to provide a signed LOA that specifies to whom the funds are to be paid, which is sent to Operations. A Registered Principal shall review all such disbursements.

The Firm's clearing firm will send a letter to the customer confirming all wire and check disbursements to third parties (FINRA Regulatory Notices 09-64 and 12-05).

#### 6.12.3.1 Third-Party Journal Transaction Confirmations

When a customer wishes to journal funds or securities to a third party or unlike account registration that will result in a change of beneficial ownership, the customer will be required to provide a signed LOA that specifies to whom the funds or securities are to be paid, which is sent to Operations. A Registered Principal shall review all such journals.

The Firm's clearing firm will send a letter to the customer confirming all journals to third parties.

### **6.12.3.2 Distributions From Customer Accounts to RRs**

Distributions from customer accounts to RRs, including the hand delivery of checks, require a letter of authorization (“LOA”) from the customer and principal review of the LOA and justification for such payment.

### **6.12.3.3 Transmittals to an Alternate Address**

Funds and securities will be sent to the customer’s address of record, unless the customer provides written instructions to use an alternative address.

### **6.12.4 Standing LOAs**

Customers who have a need for regular third party disbursements will be required to provide the Firm with a standing letter of authorization which will be reviewed and approved by a registered principal. These clients should be encouraged to apply for checking account privileges.

### **16.12.5 Suspicious or Questionable Activities**

Employees/RRs are responsible for referring suspicious or questionable activities to their designated supervisor. If the activity involves the designated supervisor, the employee/RR should bring the activity to the attention of the Compliance Officer. If the Compliance Officer is involved, the activity should be brought to the attention of the CEO. Such activities may include transfers without required authorizations; failure to obtain secondary approvals where required; a pattern of transfers that have no reasonable business basis or any other activity that may be considered suspicious.

### **6.12.6 Lost Security Holders and Unresponsive Payees (SEC Rule 17Ad-17)**

The Dodd-Frank Act included an amendment implemented in 2014 requiring the notification of customers of their outstanding dividend checks, retirement distributions and client requested checks. Additionally, the Rule requires for searches for updated addresses for undeliverable mail. The Firm’s clearing firm has set procedures requiring RRs to log into the clearing firm’s platform to review for both of these items monthly.

## **6.13 Safekeeping Of Customer Funds and Securities**

### **6.13.1 Introduction**

SEC Rule 15c3-3 specifies requirements for broker-dealers to properly protect customers' funds and securities. These rules include segregation of certain funds and securities. Broker-dealers that self-clear are responsible for complying with these rules. Broker-dealers that do not hold customer funds and securities may

qualify for exemptive provisions of the Rule. Two significant elements of the Rule are:

1. a formula for a cash reserve which restricts a broker-dealer from using customer funds and securities in their own business; and,
2. a requirement that brokers or dealers maintain and obtain physical possession or control, as defined in the Rule, of fully paid and excess margin securities.

### **6.13.2 Exemptions From 15c3-3**

Because of the nature of the Firm's business, the Firm operates under the following exemptions to 15c3-3(k)(2)(ii).

### **6.13.3 15c3-3 Procedures**

The Director of Operations is responsible for establishing procedures that are consistent with requirements for safekeeping and handling customer funds and securities. With regard to clearing firm accounts, customer funds and securities shall be promptly delivered to the clearing firm by noon of the next business day. When customer checks or securities are held at the Firm overnight, the checks and securities will be held in a safe in Operations.

All customer funds and securities received in branch office locations must be forwarded from the branch by noon of the next business day following receipt in the branch.

Checks improperly made payable or endorsed incorrectly must be handled in the following manner:

*Dear Valued Customer:*

**\_\_\_ 1) The enclosed check copy is being sent to you because your recent check deposit was not made payable to RBC. In this case your deposit was made, however, in the future, deposits made into your brokerage account must be made payable to RBC.**

**\_\_\_ 2) The enclosed check is being returned to you because we are prohibited from accepting checks for brokerage accounts that are not made payable to RBC. Please submit a check payable to RBC.**

**\_\_\_ 3) The enclosed check copy is being sent to you because your recent check deposit was not properly endorsed. In this case your deposit was made, however in the future, we must have the name of the account and the account number listed in the endorsement and it must be signed by the person(s) listed in the payee section on the front of the check. No one else**

***may endorse the check other than the person(s) listed on the front of the check. Checks not endorsed or simply marked "For Deposit Only" are not acceptable under our regulatory guidelines. For your protection, please note that a check endorsed "For Deposit Only" with no account number or name listed may be deposited into anyone's account - not just yours. Please ensure future check deposits are endorsed properly.***

***\_\_\_ 4) The enclosed check is being returned to you because it is not properly endorsed. We must have the name of the account and account number listed in the endorsement and it must be signed by the person(s) listed in the payee section on the front of the check. No one else may endorse the check other than the person(s) listed on the front of the check. Checks not endorsed or simply marked "For Deposit Only" are not acceptable under our regulatory guidelines. For your protection please note that a check endorsed "For Deposit Only" with no account number or name listed may be deposited into anyone's account - not just yours.***

*We apologize for any inconvenience this may cause, but hope you understand that this is for your protection as well as ours. Please feel free to contact your Financial Advisor if you have any questions or concerns.*

*Sincerely,*

*Operations Department*

*cc: Financial Advisor*

- After the second check is received from the client, use option 2 or 4 above but return the check and wait for a properly endorsed/completed check to deposit in the account.
- If a pattern (two or more checks from the same client) appears, notify Compliance so the RR may be contacted.
- Make notations for follow-up or explanations of exceptions, etc., where needed and keep for documentation.
- Copies of all checks (front and back if endorsed) must be kept by Operations. In addition, department handling checks needs to maintain a check received and delivered blotter.
- All checks received in Operations for deposit to RBC brokerage accounts must be payable to RBC and no other entity. Checks received that are written payable to another entity or not endorsed properly must follow the same procedures as those outlined above. (i.e., the first check may be endorsed properly with a letter sent to the client and the RR but the second check must be returned if still not correct.)
- Checks for deposit into a RBC brokerage account that is endorsed "For Deposit Only" with no account number or registration information are not to be accepted after the first time either. The check must be endorsed

properly with the client(s)' signature(s). If there is an opinion that the check was not signed by the client, it should immediately be brought to the attention of Compliance.

## **6.14 Customer Confirmations and Statements**

### **6.14.1 Change Of Customer Addresses On Accounts**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Request to change address on account from customer or RR</li><li>• Returned mail from Post Office</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Change address</li><li>• Send a confirming letter to the customer's old address, notifying that the address has been changed on the account and a listing of the new address</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Copies of confirming letters or list of letters are retained or by our clearing firm for brokerage accounts</li><li>• Direct accounts documented in DST Compliance</li></ul>           |

When a customer requests a change of address, a notification confirming the change of address will be sent to the customer's old address by our clearing firm or IPI for a non-clearing account. Customer inquiries responding to the change of address notification will be forwarded to Compliance for follow-up.

### **6.14.2 Holding of Customer Mail**

The firm may hold mail for a customer who request not to receive mail at his/her usual address under limited circumstances:

1. Client sends written instructions to Operations that include the time period of the mail hold request. If the period exceeds three months, a rationale must be included which must be reasonable (convenience is unacceptable). Reasonableness is determined at the discretion of Operations.
2. Operations must inform the customer in writing of alternate methods the customer may use to receive or monitor account

- activity and information (email/website access) and obtain the customer's confirmation of receipt of such information.
3. Operations must verify at reasonable intervals that the customer's instructions are still applicable and document the verification.

The firm must be able to communicate with the customer during the hold period in a timely manner to provide important account information. Additionally, the firm must ensure the customer's mail is not tampered with, held without consent or used by an associated person in a manner that would violate securities laws.

### **6.14.3 Confirmation Disclosure Of Non-Rated Taxable Debt Securities**

Our clearing firm is responsible for establishing procedures to disclose on confirmations for a taxable-debt security (other than a U.S. Government security) that the security is not rated by a Nationally Recognized Statistical Rating Organization (NRSRO).

The confirmation will include a statement that rating information is based upon good faith inquiry of selected sources.

### **6.15 Solicitation Of Proxies**

RRs are not permitted to solicit proxies from customers. Federal securities rules prohibit solicitation of proxies except in very limited situations. Questions should be referred to Compliance.

### **6.16 Customer Requests For References**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests from customers or prospective customers for reference letters</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review requests and determine what, if any, reference letter may be issued</li> <li>• If appropriate, write reference letter with a copy to the RR</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Letters retained in Docupace</li> </ul>   |

Customers or prospective customers sometimes request letters of reference from broker-dealers regarding their accounts or future business to be done. Some of

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these requests in the past have been scams by unscrupulous individuals seeking to capitalize on a broker-dealer's good name. Any such requests should be referred to Compliance for handling.

### **6.17 Requests for Account Verification**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Letters requesting verification of balances in customer accounts</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Forward requests to Operations for response</li></ul>                      |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Retained in Docupace</li></ul>   |

Third parties sometimes send letters asking the Firm to verify funds and securities on behalf of their customers who also have accounts with the Firm. All requests should be forwarded to Operations for response. In no instance should an RR or other branch personnel respond to these requests.

### **6.18 Expense-Sharing Agreements (SEC Letter July 11, 2003 To The NASD and NYSE Regarding "Recording Certain Broker-Dealer Expenses and Liabilities;" NASD Notice To Members 03-63)**

The SEC specifies requirements for incorporating an expense-sharing agreement into a broker-dealer's operations and how these agreements are recorded in the broker-dealer's financial records. The FINOP is responsible for ensuring the Firm complies with the SEC's guidelines if it enters into any such agreements.

In addition, the FINOP is responsible for notifying FINRA if it enters into an expense-sharing agreement and does not record each of the expenses it incurs relating to its business on the reports it is required to file with the SEC or with FINRA. The notice will include the date of the agreement and the names of the parties to the agreement; a copy of the agreement will be provided to FINRA upon request.

### **6.19 Clearing Agreement**

The Firm introduces its accounts and customer transactions to its clearing firm. The Firm has executed a clearing agreement consistent with regulators'

requirements and will amend its clearing agreement when necessary. Any new clearing agreement or amendment will be submitted to its designated SRO for review and approval.

## 6.20 Clearing Firm Exception Reports

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Clearing firm lists of reports available and currently received</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Annually, at or around July of each year</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review list of reports available from clearing firm and adjust list of reports received, if appropriate</li></ul>                              |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Notice from the clearing firm and request for change to reports received are retained in a file for clearing firm exception reports.</li></ul> |

In compliance with SRO rules, the Firm's clearing firm is required to provide annual notice, by July 31 of each year, as follows:

- Notice to the Firm of:
  - exception reports available, and,
  - exception reports currently supplied to the Firm.
- A copy of this notice is forwarded to the Firm's designated examining authority or other appropriate regulator by the clearing firm.

When the list of available reports is received, the Firm will review the list and contact the clearing firm regarding changes to the list of reports currently received.

## 6.21 Short Interest Report (FINRA Rule 4560)

The Firm's clearing firm is responsible for filing the required short interest report(s) with FINRA resulting from short sales that have settled or reached settlement date by the close of the FINRA-designated reporting settlement date.



## **6.22 Electronic Blue Sheets (SEC Rule 17a-25)**

Regulators may request information regarding customer or Firm transactions as part of their ongoing market surveillance activities. Information is transmitted electronically through the Electronic Blue Sheet (EBS) system.

The Firm's clearing firm is responsible for responding to EBS requests. Any request received directly by the Firm will be promptly forwarded to the clearing firm for response.

## **6.23 Annual Disclosure of FINRA BrokerCheck (FINRA Rule 2267)**

Annually our clearing firm will provide customers with the following information about FINRA BrokerCheck:

- The hotline number
- The website address
- A statement regarding the availability of an investor brochure regarding FINRA BrokerCheck.

## **6.24 Business Continuity Plan (FINRA Rule 4370)**

The Firm has developed a Business Continuity Plan to provide procedures for response and recovery in the event of a significant business disruption. The purpose of the Plan is to identify responsible personnel in the event of a disaster; safeguard employees' lives and firm property; evaluate the situation and initiate appropriate action; recover and resume operations to allow continuation of business; provide customers with access to their funds and securities; and protect books and records. The Plan was developed considering the types of business conducted, systems critical to support business, and geographic dispersion of offices and personnel. The firm will report emergency contact personnel information to FINRA pursuant to FINRA Rule 4370.

## **6.25 Outsourcing (NASD NTM 05-48)**

Some services may be outsourced to third parties (vendors). While third parties are responsible for providing agreed-upon services in an accurate manner, regulators have stated that firms remain responsible for ultimate compliance with rules governing the outsourced activity.

When choosing an outside vendor, a number of factors will be considered depending on the type of service provided. Factors that may be considered when engaging a third party include:

- Length of time in business

- Financial stability
- Prior knowledge of the vendor
- Other users of the vendor's services
- Technology and ability to deliver services
- Security of customer or other financial information, if applicable
- Who at the Firm is responsible for monitoring the vendor's services.

## **7.0 INSIDER TRADING**

### **7.1 Insider Trading Policies and Procedures**

Broker-dealers are required to establish, maintain, and enforce policies and procedures to prevent the misuse of material non-public information ("inside information"). These requirements are included in the Insider Trading and Securities Fraud Enforcement Act of 1988. The Firm has established policies and procedures reasonably designed to prevent the misuse of inside information considering the Firm's business, structure, size and other relevant factors. Since the Firm does not conduct investment banking activities or conduct proprietary research on securities, the opportunities for its employees/RRs to obtain inside information are limited to outside sources.

### **7.2 Prohibition Against Acting On Or Disclosing Inside Information**

Firm policy prohibits employees/RRs and associated persons from effecting securities transactions while in the possession of material, non-public information. Employees, Associated persons and Registered Reps 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 employees/RRs receive inside information, 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 a 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.

### **7.3 Annual Certification**

RRs are required to annually certify their knowledge of and compliance with the Firm's insider trading policy. This certification is included in the Annual Certification form.

## 7.4 Firm Policy Memorandum Regarding Insider Trading

This policy memorandum is intended to provide information and guidance concerning the restrictions on insider trading, which is an enforcement priority of the Securities and Exchange Commission and the Department of Justice. It also explains policies adopted by the Firm to prevent fraudulent or deceptive practices relating to trading on material, non-public information ("insider trading"). Trading in securities on the basis of material, non-public information ("inside information") is prohibited and contrary to Firm policy. The penalties for insider trading can be considerable, including loss of profits plus treble damages, criminal sanctions including incarceration, loss of employment and permanent bar from the securities industry. This policy applies to all associates of the Firm. Specific departments of the Firm may have insider trading policies that supplement this policy.

**READ THIS MEMORANDUM VERY CAREFULLY.** You will be asked to sign a statement affirming that you have read and understand the policies set forth herein and that you will abide by them.

### THE PROHIBITION

The prohibition against insider trading includes the following: if you are in possession of material non-public information about a company or the market for a company's securities, you must either publicly disclose the information to the marketplace or refrain from trading. Generally, disclosure is not an option and the effect is to require an individual to refrain from trading. You also may not communicate inside information to a second person who has no official need to know the information.

Information is considered material if there is a substantial likelihood that a reasonable investor would consider it important in deciding to buy or sell a security. In addition, information that, when disclosed, is likely to have a direct effect on a security's price should be treated as material. Examples include information concerning impending tender offers, leveraged buy-outs, mergers, sales of subsidiaries, significant earnings changes and other major corporate events.

Information is non-public when it has not been disseminated in a manner making it available to investors generally. Information is public once it has been publicly disseminated, such as when it is reported on the Dow Jones or other news services or in widely disseminated publications, and investors have had a reasonable time to react to the information. Once the information has become public or stale (*i.e.*, no longer material), it may be traded on or disclosed freely.

Generally, a person violates the insider trading prohibition when that person violates a duty owed either to the person on the other side of the transaction or to

a third party (such as a customer or employer) by trading on or disclosing the information. The insider trading prohibition applies to an issuer's directors, officers and employees/RRs, investment bankers, underwriters, accountants, lawyers and consultants, as well as other persons who have entered into special relationships of confidence with an issuer of securities.

Virtually anyone can become subject to the insider trading prohibition merely by obtaining material non-public information by unlawful means or by lawfully obtaining such information and improperly using it. This is known as misappropriation. If you receive material, non-public information as part of your legitimate business dealings on behalf of the Firm or its customers and you use that information to trade in securities or if you transmit that information to another person for purposes of trading in securities (so-called "tipping"), you would likely be guilty of insider trading. Insider trading liability may also be derivative. A person who has obtained inside information (so-called "tippee") from a person who has breached a duty or who has misappropriated information may also be held liable.

The foregoing is just a synopsis of the insider trading prohibition. Because the law in this area is complex, the Firm has adopted the following guidelines which are designed to prevent violations of the insider trading rules.

## **GUIDELINES**

**TREATMENT OF CUSTOMER INFORMATION.** The Firm considers confidential all information concerning its customers including, by way of example, their financial condition, prospects, plans and proposals. The fact that we have been engaged by a company as well as the details of that engagement are also confidential. The Firm's reputation is one of its most important assets. The misuse of customer information can damage that reputation as well as customer relationships.

**WHAT TO DO IF YOU LEARN INSIDE INFORMATION.** It is not illegal to learn inside information. The Firm learns material non-public information from its customers and is permitted to use that information in a lawful manner to advise and assist them. It is, however, illegal for you to trade on such information or to pass it on to others who have no legitimate business reason for receiving such information.

If you believe you have learned inside information, other than in the ordinary course of business (such as investment bankers who learn inside information when working on an engagement), contact Compliance immediately so that we may address the insider trading issues and preserve the integrity of the Firm's activities. Do not trade on the information or discuss the possible inside information with any other person at the Firm. If you become aware of a breach

of these policies or of a leak of inside information, advise Compliance immediately.

**INVESTIGATIONS OF TRADING ACTIVITIES.** From time to time, the Exchanges, FINRA and the SEC request information from the Firm concerning trading in specific securities. Requests for information should be referred directly to Compliance. You may be asked to sign a sworn affidavit that, at the time of such trading, you did not have any inside information about the securities in question. Your employment may be terminated if you refuse to sign such an affidavit. The Firm may submit these affidavits to the Exchanges, FINRA or SEC.

### **STEPS YOU CAN TAKE TO PRESERVE THE CONFIDENTIALITY OF MATERIAL NON-PUBLIC INFORMATION.**

The following are steps you must take 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 you believe needs to know, contact your designated supervisor or Compliance.
2. Do not discuss confidential matters in elevators, hallways, restaurants, airplanes, taxicabs or any place where you can be overheard.
3. Do not leave sensitive memoranda on your desk or in other places where they can be read by others. Do not leave a computer terminal without exiting the file in which you were working.
4. Do not read confidential documents in public places or discard them where they can be retrieved by others. 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. Do not discuss confidential business information with spouses, other relatives or friends.
7. Avoid even the appearance of impropriety. Serious repercussions may follow from insider trading and the law proscribing insider trading can change. Since it is often difficult to determine what constitutes insider trading, you should consult with Compliance whenever you have questions about this subject.

**YOUR OWN SECURITIES TRADING.** The Firm policy is to require all employees/RRs to maintain their securities accounts at the Firm except with the approval of Compliance. If you have an account outside of the Firm and have not already done so, please advise Compliance immediately. This includes outside accounts in which you have a financial interest or direct the trading.

## CONCLUSION

The Firm has a vital interest in its reputation, the reputation of its associates, and in the integrity of the securities markets. Insider trading destroys that reputation and integrity. The Firm is committed to preventing insider trading and to punishing any employee/RR who engages in this practice or fails to comply with the above steps designed to preserve confidentiality of inside information. These procedures are a vital part of the Firm's compliance efforts and must be adhered to.

### 7.5 Employee, RR and Related Accounts

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Exception Reports</li><li>• Confirmations/statements for employees'/RRs' outside accounts</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Investigate as needed with employee or RR</li></ul>   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Notations of identified transactions including details of each trade and action taken</li></ul>     |

Employee/RR trades are reviewed by Operations for trades contrary to restrictions because of potential insider trading. This review includes review of employees'/RRs' outside securities accounts to identify transactions in securities that may be in violation.

## 8.0 ACCOUNTS

### 8.1 New Accounts

Obtaining information about the customer is important when opening a new account, enabling the RR to "know the customer" and provide suitable recommendations and service to the account. FINRA Rule 2090 (Know Your Customer) requires a RR to perform reasonable diligence in opening and maintaining every account through knowing and retaining the essential facts concerning every customer. Essential facts to knowing the customer include the following:

- Effectively service the customer's account
- Act in accordance with any special handling instructions for the account
- Understand the authority of each person acting on behalf of the customer; and
- Comply with applicable laws, regulations and rules.

### 8.1.1 Customer Identity Verification

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New account application and other customer ID information</li> <li>• Remitpro</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• When accounts are opened</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Before approving an account, determine that customer identification (ID) verification information is included with the new account application and meets the Firm's requirements</li> <li>• For non-documentary verification, check the information included with the new account application for completeness and consistency with other customer-provided information (name, address, taxpayer ID number, etc.)</li> <li>• For unacceptable verification information (incomplete, inconsistent), establish a not in good order and notify the RR of the need for further information</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• New account records include customer ID verification information as well as the Principal's approval</li> </ul>   |

When opening new accounts, the customer's identity must be verified, as required by federal law. Customer identification (ID) information must be completed on the new account application.

Customer ID verification does NOT apply to accounts for:

- persons with an existing account at the Firm (unless the account requires approval by the AML Compliance Officer\*)
- banks
- governmental entities

- issuers of listed equity securities
- other financial institutions subject to regulation by the SEC, CFTC, Federal Reserve Board, OCC, FDIC, Office of Thrift Supervision, or the National Credit Union Administration
- persons opening accounts to participate in an ERISA plan
- Transactions initiated by financial intermediary and the beneficial owner has no direct control over omnibus or sub-accounts.

\*Accounts that require additional approval by the AML Compliance Officer, and that are subject to customer identity verification procedures; include numbered accounts; accounts demanding confidential handling of the account; accounts domiciled in Treasury Dept. high-risk countries; foreign public officials; and certain foreign banks.

IPI has contracted with Remitpro to supply the firm with information regarding new accounts from multiple databases. This system is utilized to meet the customer identity procedures required by FINRA rules. This system verifies social security numbers, addresses, date of birth, etc. including OFAC screening.

#### **8.1.1.1 Required Customer Information**

Basic information required by law **prior to opening the account** includes:

- **Name**
- **Date of birth**, for an individual
- **Address:**
  - for an individual, residential or business street address. If no street address exists or is available, an APO or FPO box number or the residential or business street address of a next of kin or another contact individual
  - for a non-individual (corporation, trust, *etc.*) a principal place of business, local office, or other physical location.
- **Taxpayer identification number** for a U.S. person (U.S. citizen or non-individual established or organized under U.S. or state laws).
- **Identification number for non-U.S. person** which may include a taxpayer ID number; passport number and country of issuance; alien identification card number; or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photo or similar safeguard.

**In the case of a customer who has applied for a taxpayer identification number but has not yet received it**, notation must be made on the new account application that the taxpayer ID has been applied for. The account will be restricted to liquidating transactions if the taxpayer ID number is not received within 30 days of opening the account.



#### 8.1.1.2 Non-Documentary Methods Of Verifying Customer Identification

Non-documentary methods of verifying customer ID are used for all accounts for which the Firm is required to verify customer ID. Records of performance of the Firm's non-documentary verification will be maintained by Operations.

#### 8.1.1.3 Additional Verification For Certain Customers

For third party accounts, Remitpro report should be ran for the person holding a power of attorney or trading authorization.

For non-individual accounts, Remitpro will be run for the individual(s) listed on the new account form. Additional documents such trust instruments, articles of incorporation, partnership agreements, etc. will also be requested to verify who has the authority to act on behalf of the account and to what limitation(s).

For the following types of customers, a minimum of TWO forms of customer ID are required in addition to review and approval by the AML Compliance Officer **prior to** opening the account:

- Numbered accounts
- Accounts domiciled in high-risk countries included on the Treasury Dept. OFAC list (check with Operations personnel for a list of those countries or go to <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx>)
- Accounts for foreign public officials (individuals in high office in other countries, their families and close associates, political party officials)

#### 8.1.1.4 Lack Of Customer ID Verification

For **accounts where non-documentary verification results in substantive, unresolved discrepancies** (information that is inconsistent such as name, address, taxpayer ID number, etc.), either the account will not be opened, restricted to only liquidating transactions and transfers out or will be immediately closed. Questions regarding accounts that do not comply with requirements to verify customer ID should be referred to the AML Compliance Officer.

#### 8.1.1.5 Customer Notice

Customers are provided notice, prior to opening an account, that their identification will be verified. Additionally, per FINRA Rule 2266, customers are provided information about SIPC. These notices are provided on the new account application.

### 8.1.2 Approval

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• New Account Form</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review new account form for:<ul style="list-style-type: none"><li>◦ Completeness</li><li>◦ Proper styling of account</li><li>◦ Unacceptable accounts (accounts in name of minor only, fictitious accounts, numbered accounts without disclosure of owner, <i>etc.</i>)</li><li>◦ Potential improper addresses (post office boxes, addressed to RR or Firm, <i>etc.</i>)</li><li>◦ Consistency of investment objectives with financial status, prior investment experience, <i>etc.</i></li><li>◦ Initial transaction consistent with investment objectives</li><li>◦ RR registration in state of customer's residency</li></ul></li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Registered Principal's signature or stamp on New Account Form.</li></ul>  |

A completed new account form, signed by the RR, is required for each new account opened. Operations is responsible for reviewing the new account form for the necessary information. Compliance will promptly approve each new account form in good order.

### 8.1.3 Customer Account Information

Within 30 days of opening an account, we will send the customer an Account Opening Confirmation for verification of pertinent information in the account record. Operations will review returned letters and customer responses that revise new account information and update the client profile.

### 8.1.4 Addresses On Customer Accounts

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul> |
|-----------------------|--|

|                  |   |
|------------------|---|
| <b>Resources</b> | <ul style="list-style-type: none"> <li>• New account forms</li> </ul>   |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• Daily</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Identify improper address on new account forms at time of approval</li> <li>• When approving new accounts, ensure beneficial owner of the account will receive confirmations consistent with the policy</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Principal's signature or stamp on New Account Form</li> </ul>  |

Confirmations and statements and other account information will be transmitted to the customer at the address requested by the customer. The Firm or a RR may not be the sole addressee for a customer's account unless the account is for the direct benefit of the Firm or RR. Acceptable addresses include:

- **for an individual:** residential or business street address. If no street address exists or is available, an APO or FPO box number or the residential or business street address of a next of kin or another contact individual
- **for a non-individual (corporation, trust, etc.):** a principal place of business, local office, or other physical location.
- **for a P.O. Box address:** a legal address for the customer must also be provided.

Where the account is opened by a fiduciary such as an investment adviser on behalf of the fiduciary's customer, the Firm will make a good faith effort to obtain the information necessary to send statements and confirmations directly to the beneficial owner; however, if this information is not provided by the fiduciary, the Firm will forward statements and confirmations to the owner's custodian or, if there is no custodian or the Firm is the custodian, the Firm will send the statements or confirmations directly to the fiduciary.

#### 8.1.5 Account Documents

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>              |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New Account Application</li> </ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>                   |

|               |   |
|---------------|---|
| <b>Action</b> | <ul style="list-style-type: none"> <li>Establish procedures to ensure required account documents are obtained for each new account</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>New account files in Operations include documents obtained</li> </ul>                                  |

Additional account documents may be required depending on the type of account opened. Operations is responsible for establishing procedures outlining the necessary account documents and follow-up regarding missing documents. A list of the required documents is included with this chapter.

Requests for missing documents (or missing client account information) will be sent via E-mail to the RR. Other supporting documents, such as Power of Attorney, may also be obtained, if applicable.

#### 8.1.6 New Account Documents List

##### NEW ACCOUNT DOCUMENTS

| Type of Account   | Document(s) Required   |
|---|--|
| <b>Corporation</b>  | New account form<br>Corporate resolution<br>W9 (if non-DVP and not exempt)             |
| <b>Custodian</b>  | New account form<br>W9   |
| <b>Estate</b>   | New account form<br>Estate papers<br>W9  |
| <b>Financial institution</b><br>(banks, trust companies, insurance companies, etc.) | New account form<br>Corporate trading authorization                                    |
| <b>Guardian/conservatorship</b>   | New account form<br>W9<br>Guardianship papers  |
| <b>Individual</b>   | New account form<br>W9   |
| <b>Investment adviser</b>   | New account form<br>Adviser's agreement with client or<br>adviser blanket letter<br>W9 |

|  |  |
|--|--|
| <b><i>Investment club</i></b>  | New account form<br>W9<br>Investment club agreement or other document indicating who is authorized to place orders |
| <b><i>IRA</i></b>  | New account form<br>Adoption agreement   |
| <b><i>Joint account</i></b>  | New account form<br>W9   |
| <b><i>Partnership</i></b>  | New account form<br>Partnership agreement  |
| <b><i>Pension or profit sharing plan</i></b>   | New account form<br>Trust agreement or trustee certification   |
| <b><i>Public funds</i></b> (government agencies, i.e., cities, counties, hospitals, universities/colleges, etc.) | New account form<br>Investment policy<br>Trading authorization   |
| <b><i>Sole proprietorship</i></b>  | New account form<br>Sole proprietorship agreement<br>W9  |
| <b><i>Third Party directs account</i></b>  | New account form<br>Full or limited trading authorization<br>W9 (if applicable)                                    |
| <b><i>Trust</i></b>  | New account form<br>Trust agreement or trust certification<br>W9   |

### 8.1.7 Copies of Agreements to Customers

RRs will provide customers with copies of any signed agreements that include a pre-dispute arbitration agreement, costs and privacy policy. The customer will acknowledge receipt on the agreement. In addition, within 10 days of request by a customer, the Firm will provide a copy of any pre-dispute arbitration agreement the customer has signed as well as relevant arbitration forum rules, if requested. The customer will be notified if the signed agreement cannot be located.

### 8.1.8 Revisions to Customer Agreements

Firm policy does not permit revisions to pre-printed language on customer agreements. Requests for changes should be referred to Compliance for review.

### 8.1.9 Accounts Requiring Notification or Consent Of Customer's Employer

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• New Account Form</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• For accounts requiring prior consent, obtain consent prior to approval</li><li>• Code account for duplicate confirmations and/or statements as requested</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• New Account Application; Employer Consent (407 Letter)</li></ul>   |

Per FINRA Rule 3050, when the Firm has notice that an account for a person employed by another broker/dealer was opened or an account in which the person has discretionary authority was opened, the other broker/dealer must be notified. A copy of the notification will also be sent to the customer. Our clearing firm will provide duplicate confirmations, statements or other information requested by the employing broker-dealer.

Per FINRA Rule 2070, upon notice that a FINRA employee has a financial interest in, or controls trading in an account, the Firm will obtain and implement instructions from the employee to provide duplicate statements to FINRA.

### 8.1.10 Post Office Addresses

If the customer opens an account using a post office address, the street address must also be provided on the new account form. The only exception is for customers who reside in rural areas where the post office address is the only address, and this should be noted on the new account application.

### 8.1.11 Initial Deposits

If the initial transaction is a sell order, receipt of the securities prior to entering the order is recommended, particularly where the RR is unfamiliar with the new account. Potential items of concern include certificates not registered in the seller's name, restricted or legend stock, expired warrants or rights, and other securities that would not constitute "good delivery."

### **8.1.12 Unacceptable Accounts**

The following are examples of accounts that are unacceptable. Questions regarding whether new accounts may be opened should be referred to Compliance.

Unacceptable accounts include:

- Fictitious accounts in a name other than the name of the legal owner
- Accounts in the name of a minor
- Margin accounts for minors
- Margin accounts for qualified plans.

### **8.1.13 Sanctioned Securities and Individuals**

#### **8.1.13.1 Introduction**

The Firm cannot deal in securities issued by certain sanctioned countries and governments and is required to block or freeze accounts, assets, and obligations of blocked entities and individuals in the Firm's possession and control. The Office of Foreign Assets Control (OFAC) maintains lists of sanctioned securities and individuals.

#### **8.1.13.2 Monitor Of Accounts and Securities**

The Firm has established procedures for identifying and monitoring accounts and securities included on OFAC's list, as follows:

- Director of Operations or a designee should verify with our clearing firm (at least annually) that this review is being performed.
- When a sanctioned security or individual is identified, the account will be immediately frozen and no funds or securities will be released from the account (credits are permitted) at the responsibility of our clearing firm.
- The freeze includes restrictions against endorsement or guarantee of assets in the account.

### **8.2 Updating Account Information and Periodic Affirmation (Exchange Act Rule 17a-3(a)(17))**

RRs should promptly update customer new account information whenever they are informed or become aware of changes. Updates may be recorded by making revisions to existing forms, completing new forms or communicating changes to Client Services.

Within 30 days of changes to a customer's investment objectives, including change of name or address, the Firm will notify the customer of the revised

information with an Account Opening Confirmation letter with a request for correction of any inaccurate information. Upon notification of a change in address, a notice will be sent to the customer's old and new address confirming that an address change has been made to the account from the clearing firm.

At least every 36 months customers will be provided with new account information on record for their accounts and will be asked to advise of any changes or updates. This notification is not required for accounts that have been inactive for 36 months or where no recommendations are made to the customer.

## **8.3 Margin Accounts (FINRA Rule 4210)**

### **8.3.1 Opening Margin Accounts**

Prior to engaging in margin transactions, the customer's account must have on deposit at least \$2,000 in cash or securities. Customers must sign the Firm's margin agreement which must be received prior to the first margin trade.

### **8.3.2 Employee Accounts**

Extensions and prepayments are not permitted in employee/RR accounts, except under extraordinary circumstances and with approval of the designated supervisor.

### **8.3.3 Truth-In-Lending Requirements**

Upon opening a margin account, the customer will be provided a written statement explaining the operation of a margin account and the calculation of interest charges on debit balances. Our clearing firm fulfills the responsibility for the Firm.

### **8.3.4 Equal Credit Opportunity Act Requirements**

The Firm will not discriminate in the extension of credit to customers. Where credit is denied, the Firm will provide information to the credit applicant in accordance with the provisions of the Equal Credit Opportunity Act.

### **8.3.5 Arranging Credit**

RRs are not permitted to assist a customer in making credit arrangements to purchase securities outside the Firm, other than on terms consistent with those permitted by Regulation T and other rule requirements.



### **8.3.6 Suitability**

Margin accounts may involve more risk than cash accounts, depending on a number of factors including leverage used and types of transactions. The RR is responsible for determining the suitability of margin trading in a customer's account including understanding the customer's investment objectives and financial profile.

### **8.3.7 Margin Requirements**

Initial and maintenance requirements are available by contacting Operations.

### **8.3.8 Fiduciary Accounts**

Margin accounts are permitted for an administrator, conservator, custodian, executor, and guardian or trustee as follows:

- when such person holds explicit power to engage in margin transactions
- after review of the appointment and applicable document (trust agreement, trust certification, will, *etc.*) explaining investment powers and approval by Operations.

RRs should submit the appropriate enabling document (trust agreement, *etc.*) to Operations prior to engaging in margin transactions.

### **8.3.9 Pattern Day Traders**

Accounts that are identified as "pattern day traders" are subject to additional margin requirements. These special requirements are described in the chapter "Financial and Operations Procedures" in the section "Regulation T and Extension Of Credit To Customers."

## **8.4 Third Party Accounts**

When a third party who is not the principal or named person on the account will give instructions regarding orders, disposition of funds, or other actions involving an account, the Firm must have a signed third-party trading authorization. The authorization is signed by the principal of the account and the third party, giving the third party authority to act on behalf of the principal. An example of a third party account is an account for a wife whose husband will give instructions regarding his wife's account. The signed trading authorization must be received BEFORE accepting instructions from the third party.

The Firm has two types of trading authorizations:

- Limited trading authorizations limit the third party to giving instructions regarding the purchase and sale of securities and does NOT give authority regarding the disposition of funds or securities.
- Full trading authorizations give the third party authority to give instructions regarding purchases and sales as well as the disposition of funds or securities in the account.

## 8.5 Discretionary Accounts (NASD Rule 2510)

### 8.5.1 General Requirements

Discretionary accounts are only permissible in a managed account program through a Registered Investment Adviser. For a discretionary account, an IAR is granted written authority to enter orders on behalf of a customer without contacting the customer prior to each transaction. The key elements of discretionary account requirements include:

- Discretionary accounts require specific written authorization from the customer.
- A registered principal must approve the account as discretionary prior to effecting discretionary transactions.
- Discretionary authority is NOT effective until the customer has provided authority in writing AND the account has been approved for discretion.

### 8.5.2 Approval

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Director of Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Limited Power of Attorney</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Consider whether discretion is appropriate, which may include: <ul style="list-style-type: none"> <li>◦ Knowledge and experience of RR</li> <li>◦ Fiduciary accounts (trust, <i>etc.</i>) require Compliance review to determine whether authority may be transferred to a third person</li> <li>◦ Types of transactions anticipated</li> <li>◦ Ensure only limited authority is granted, unless discretion is for the account of a family member of the RR</li> </ul> </li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Approval by designated supervisor for establishment of</li> </ul>  |

|  |                       |
|--|-----------------------|
|  | discretionary account |
|--|-----------------------|

At the time a discretionary account is established, the Operations Department shall approve or disapprove the discretionary status of the account. A record of the approval will be included in the account file for the customer's account.

### 8.5.3 Limited Authority Only Permitted

Discretionary authority is permitted only on a limited basis, and only in managed account programs, *i.e.*, IARs may have authority to purchase and sell securities only. Discretion is not allowed on option orders. Full authority, which also authorizes the withdrawal of money or securities, is not permitted.

For brokerage accounts, this prohibition does not include temporary or limited discretion in the following examples:

- Price and time discretion for an order.
- Isolated or infrequent discretion (customer is unavailable for limited period of time). The customer must sign a trading authorization in advance, an expiration date must be noted on the agreement and the limited discretion must be approved by Operations or Compliance.
- Transactions to satisfy margin requirements.
- RRs family or personal accounts in which he/she has written authority.

### 8.5.4 Indication Of Discretion Exercised Or Not Exercised

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Electronic record(s) of the order/order ticket(s)</li> </ul>                               |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Mark Order condition as discretionary if discretion was exercised on the order.</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Initials/approvals on electronic record(s) of the orders</li> </ul>                        |

Orders in discretionary accounts should indicate whether discretion is exercised or not exercised on each order. Such indication is made by marking discretionary as the order condition. Marking an order as solicited or unsolicited would indicate

the order was not discretionary. Discretion not exercised means the IAR discussed the order with the customer BEFORE entering it.

### **8.5.5 Trusts and Other Fiduciary Accounts**

Some trusts or other accounts governed by a legal instrument such as a trust agreement may not allow the trustee to re-assign authority to a third party. A copy of the trust agreement or other legal document should be provided to Compliance for review prior to approval of a trust or similar account as a discretionary account.

### **8.5.6 Principal Transactions Not Permitted**

Principal transactions are not permitted when discretion is exercised in a discretionary account. Specific approval for the order should be obtained from the customer and the order marked "discretion not exercised" to execute on a principal basis, or the order should be executed on an agency basis if discretion is exercised.

### **8.5.7 Approval Of Orders and Monthly Review Of Transactions**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Order ticket</li><li>• Ongoing account review</li><li>• Quarterly performance report review</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As appropriate</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Approve orders on the day of entry</li></ul>  |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the orders</li><li>• Electronic record(s) of the order/order ticket(s) are retained with the day's orders; monthly statements are retained in a file for each discretionary account customer</li></ul> |

### **8.5.8 Cancellation Of Discretionary Authority**

Customers should provide instructions to cancel discretionary authority in writing. All open orders will be cancelled, unless the customer specifically requests they remain open.

## 8.6 Accounts For Minors

There are a number of requirements and restrictions that affect minors' accounts:

- A custodian must be named in and handle the account
- Only one custodian is permitted for each account
- Custodians generally may not delegate authority to another person
- Only one minor may be named in each account
- Margin transactions are not permitted
- Gifts to minors are irrevocable, *i.e.*, the custodian may not direct distribution of assets from the account except for the benefit of the minor
- The minor's social security number must be used when opening the account
- Minors may not be a party to a joint account, investment club, or partnership

## 8.7 Incompetent Persons

Accounts for incompetent persons may only be opened with the appropriate authority from a court-appointed guardian. If an RR becomes aware that a customer has become incompetent, the RR should contact Compliance for further guidance.

If a customer becomes incompetent while a third party trading authorization is in effect for his or her account, the authority generally is considered invalid and requires a court order for reinstatement. "Durable" powers of attorney, recognized by some states, remain in effect after a person is declared incompetent. Questions should be referred to Compliance.

## 8.8 Trust Accounts

New accounts for trusts require a copy of the trust agreement or a trust certification signed by the authorized trustee. The following activities in trust accounts require prior approval as follows:

- Margin trading requires approval by Operations
- Option trading requires approval by the Registered Options Principal (ROP)
- Discretionary accounts require approval by Operations (discretionary approval is granted for managed account programs only)

Fiduciaries (executors, trustees, guardians, administrators, conservators, *etc.*) may not be able to delegate their duties to a third party (whether the RR or an outside person) to manage the account unless the trust or other authorizing instrument specifically permits delegation. Some states require the fiduciary to obtain a court order to delegate authority to a third party.

## **8.9 Accounts For Foreign Banks**

Under anti-money laundering (AML) rules, there are special requirements that apply to accounts for foreign banks. The Firm does not open accounts for foreign banks or foreign shell banks.

## **8.10 Collateral/Escrow Accounts**

Collateral accounts are defined as accounts for customers where the assets in the account are pledged to a third party. In some cases the Firm is asked to acknowledge it is responsible for holding the assets pending instructions from the third party. These accounts are opened at the discretion of the Firm; subject to a complete review and approval by Compliance.

## **8.11 ERISA Accounts**

### **8.11.1 Introduction**

The Employee Retirement Income Security Act of 1974 (ERISA) is a Federal act that includes standards for employee benefit plans regarding matters such as the role of fiduciaries, vesting of benefits, funding, and prudence of investments. It also includes requirements for persons having a business relationship with such plans.

ERISA applies to all Internal Revenue Service-qualified pension and profit sharing plans, and employee welfare benefit plans. Most IRA accounts, while not covered by ERISA, are subject to the prohibited transaction penalties. Limited exemptions apply to governmental (public employee) plans and certain offshore and church plans.

### **8.11.2 Legal Relationships**

A fiduciary is generally anyone with discretionary authority or control over the management of a plan, the administration or the disposition of plan assets. Fiduciaries must comply with certain statutory duties which include prudence and diversification of investments and the duty to act in accordance with the governing instruments of the plan.

A person or entity providing services to an ERISA plan is considered a party-in-interest to the plan. This status generally applies to broker-dealers providing investment services to ERISA plans. If a closer relationship exists, such as exercising discretionary authority over an ERISA plan account, a fiduciary relationship will develop.

### **8.11.3 Restrictions On Party-In-Interest Accounts**

ERISA accounts where the Firm is a party-in-interest are permitted to engage in the following types of transactions:

- agency transactions
- mutual fund purchases
- covered call writing (if options are permitted in the ERISA plan)
- purchase of puts against existing long positions (if options are permitted in the ERISA plan)

ERISA accounts are generally NOT permitted to engage in the following types of transactions:

- margin transactions
- commodity transactions, unless approved by the designated supervisor
- purchases of calls and sale of puts, unless approved by the ROP
- uncovered option writing.

### **8.11.4 Restrictions On Fiduciary Accounts**

ERISA accounts where the Firm is a fiduciary are only permitted to engage in the following types of transactions:

- agency transactions
- mutual fund purchases
- covered call writing (if options are permitted in the ERISA plan)
- purchase of puts against existing long positions (if options are permitted in the ERISA plan)

### **8.11.5 Prudent Man Rule and Diversification**

Trading in ERISA accounts is subject to the "prudent man" rule which is a standard that is generally understood to mean that individuals involved with investment decision-making act with the same care, skill, prudence and diligence as a prudent man in the same capacity. This measure is not judged on the risk of a single investment but by the investment's relationship to the overall portfolio.

ERISA also requires that investments in a covered plan be diversified to minimize the risk of large losses unless it is clearly prudent not to do so.

### **8.11.6 Prohibited Transactions**

Federal laws prohibit plan assets from being used by a fiduciary for certain transactions (known as prohibited transactions). Fiduciaries are prohibited from dealing in plan assets for their own benefit or for the benefit of a third party with

the fiduciary is affiliated. The Department of Labor (and other government agencies) have issued exemptions from the prohibited transaction rules which allow plans and broker/dealers to engage in some but not all types of securities transactions. The range of permissible transactions varies depending on whether the broker/dealer is a fiduciary to the plan.

#### **8.11.7 General Requirements When Dealing With ERISA Plans**

Because of substantial legal liability, RRs are not permitted to become fiduciaries when dealing with ERISA accounts (unless the Firm has a specific program designed to meet legal requirements in offering those services). The following summarizes the requirements and limitations:

- RRs may not accept responsibilities regarding administration of a plan (other than following instructions for contributions, distributions and investments for authorized persons acting on behalf of the plan).
- RRs may not be named trustees to plans (unless specifically authorized by Operations or Compliance).
- Recommendations to ERISA plans must be consistent with investment policies of the plans.
- Trading on margin does not generally occur in ERISA accounts; Operations approval is required prior to engaging in margin transactions in ERISA accounts.

#### **8.11.8 General Guidelines When Offering Retirement Plans**

Plans differ depending on the law under which they are established. Differences include limits on contributions, tax deductibility, costs, types of plan sponsors (employer or otherwise) and who may participate. The following sections provide general explanations of various types of common retirement accounts. Some of the general guidelines that apply to retirement plan sales including the following. Specific plans should be consulted for limitations and requirements

- Avoid tax-sheltered investments such as annuities and municipal securities, which generally are not suitable for retirement plans since plans already provide tax benefits;
- Consider the cost of investments recommended for retirement plans vs. the benefits;
- Consider the customer's risk profile and investment objectives when considering securities for recommendation for a retirement plan;
- Understand the type of plans being discussed or recommended;
- Encourage investors to contact their tax counsel to resolve any tax-related questions.



### **8.11.9 Individual Retirement Accounts (IRAs)**

IRAs are established by individuals through a plan sponsor, following are key features:

- Annual contributions are limited by law
- Older investors have higher contribution limits under a catch up provision
- Contributions may or may not be tax deductible, depending on the IRA owner's income level
- Contributions are from earned income (other than contributions to a non-working spouse's IRA)
- Early withdrawals (prior to age 59 ½) may result in tax penalties
- Owners of traditional IRAs are required to begin withdrawing by the year following the year the owner turns 70 ½.

There are multiple types of IRAs including:

- Traditional IRAs – contributions may or may not be tax deductible depending on the IRA owner's income
- Roth IRA
  - All contributions are in after-tax dollars
  - Withdrawals are not taxed at the time of withdrawal if the IRA owners is at least 59 ½ years old and the Roth IRA has been open 5 years or longer
  - Some high wage earners are not eligible to open Roth IRAs
  - No mandatory withdrawals after age 70 ½.
- Individual retirement annuity – a traditional or Roth IRA set up with a life insurance company through the purchase of a special annuity contract
- Simplified Employee Pension (SEP-IRA) – a traditional IRA set up by an employer for employees; limitations on contributions apply
- Spousal IRA – traditional or Roth IRA funded by a married taxpayer in the name of a spouse who earns less than \$2,000 annually
- Rollover IRA – funded with money that is already in a qualified retirement plan; allows moving the money without owing any tax at the time of the rollover (assuming the requirements for a rollover are met).

### **8.11.10 Employer Sponsored Plans**

Employers may offer different types of plans including traditional pension and profit sharing plans that are funded entirely by the employer. All eligible employees participate and employer contributions are above and beyond the employee's salary. This section describes other types of employer-sponsored plans that give eligible employees the opportunity to put a portion of current income into a tax-deferred investment account. Participation may be voluntary or mandatory and employers may make matching contributions.

The following sections provide a general explanation of these various plans.

#### **8.11.10.1 401(k) Plans**

- Established by corporations
- Permit their employees to make contributions through payroll deductions from pre-tax income (traditional 401(k) plan); tax is applied when withdrawals are taken
- Roth 401(k) plans permit employees to make contributions through payroll after tax dollars; there is not tax on withdrawals made after age 59 ½ and if the Roth 401(k) has been open 5 years or longer
- Both traditional and Roth 401(k) plans can be rolled over to an IRA (or a new employer's plan, if the plan permits) if the investor leaves the company
- No mandatory withdrawals for Roth 401(k) plans; mandatory scheduled withdrawals apply to traditional 401(k) plans

#### **8.11.10.1.2 Limitations on Advice**

Providing investment advice to 401(k) plan sponsors and participants is subject to strict limitations and requirements. Providing investment advice places the RR in the role of a fiduciary which creates the legal liabilities associated with fiduciaries.

RRs are limited to offering advice through advisory/financial plans offered through IPI Wealth Management.

#### **8.11.10.2 403(b) Plans**

A 403(b) plan is a salary reduction plan offered by non-profit, tax exempt employers such as schools and colleges, hospitals and foundations. Individual accounts in a 403(b) plan invest in two categories of investments:

- An annuity contract provided through an insurance company (fixed or variable)
- Mutual funds.

Features include:

- Individuals cannot establish 403(b) accounts; only employers may set up accounts
- For non-Roth plans:
  - Employees make pre-tax contributions and employers sometimes match contributions
  - Tax on contributions and earnings and gains on investments are paid when the investor begins withdrawing funds

- Mandatory withdrawals after age 70 ½.
- If the plan is a Roth contribution plan, tax is paid on contributions to the plan but withdrawals are not taxed; no mandatory withdrawals
- Some 403(b) plans impose steep surrender charges.

#### **8.11.10.3 457 Plans**

These plans are offered by a state or local government or a non-profit organization. A 457 plan is a deferred compensation plan similar to 401(k) or 403(b) plans.

- Pre-tax income is contributed
- No tax on contributions; withdrawals are subject to tax
- Technically, the portion of salary contributed to the plan is not owned by the employee; the plan sponsor owns all of the 457 plan assets which are held for the employee in an account set up in the employee's name
- Mandatory withdrawals after age 70 ½
- No early withdrawal tax penalties if funds are paid to the employee when leaving the job prior to reaching age 59 ½; withdrawal is subject to normal income tax
- May be rolled over to an IRA or a new employer's plan to retain tax deferred status.

#### **8.11.10.4 SIMPLEs (Savings Incentive Match Plans for Employees)**

- Offered by small companies with 100 or fewer employees who earn at least \$5,00 each during the year
- Less complicated to set up and administer than 401(k) or 403(b) plans
- Two types: SIMPLE IRA or SIMPLE 401(k), both with same contribution limits and catch up contributions for people 50 or older
- Employer must contribute to the plan in one of two ways, a fixed contribution or a matching contribution
- Account must be open for 2 years before the employee can move the money or tax it out; early withdrawal is subject to significant tax penalties.

## **8.12 Foreign Accounts**

Accounts for residents of foreign countries may be subject to special requirements under securities laws of the foreign country. Before opening an account for a person or entity residing in a foreign country, contact Compliance for further information regarding any special restrictions or requirements. IPI does not allow any solicitation of residents of foreign countries.

## 8.13 Day Trading Accounts

**IPI does not promote a day-trading strategy, directly or indirectly, with any clients.**

### 8.13.1 Special Margin Requirements

Accounts that are considered "pattern day traders" are subject to additional margin requirements. A pattern day trader is a client that buys and sells the same security four or more times in a five day period. Example - bought and sold IBM on Monday; bought and sold NCR on Tuesday; bought and sold DCT on Wednesday and bought and sold ATL on Thursday. However, if day-trading activities do not exceed 6% of the customer's total trading for the five-day period, the account is **not** considered a pattern day trading account.

Refer to the subsection "Pattern Day Traders" in the chapter "Financial and Operations Procedures," under the section "Regulation T and Extension Of Credit To Customers" for more information.

## 8.14 Death Of A Customer

When a customer dies, the account assets owned by the deceased person may become subject to a will, estate laws, and other governing laws or documents. The assets are, therefore, frozen in the account until necessary documents are received and legal distribution has been determined. Joint accounts and other accounts where the deceased person is a joint owner with others may be subject to certain distribution requirements depending on the styling of the account.

When a customer dies, the RR should:

- immediately notify Operations
- consider assets in the deceased person's account as "frozen" until distribution of assets has been determined, *i.e.*, accept no orders and do not authorize sending of securities or funds from the account
- cancel all open orders.

## 8.15 Active Accounts

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul> |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Exception Reports</li></ul>               |

|                  |  |
|------------------|--|
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• Monthly</li> </ul>  |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review reports to identify accounts for further review. Accounts requiring further review may include: <ul style="list-style-type: none"> <li>◦ Fiduciary accounts (trust, pension plans, <i>etc.</i>)</li> <li>◦ Minor's accounts</li> <li>◦ Accounts engaged in higher-risk transactions</li> <li>◦ Accounts with high volume of trading</li> </ul> </li> <li>• Further review includes: <ul style="list-style-type: none"> <li>◦ New account documentation for completeness</li> <li>◦ Investment objectives for consistency with trading activity</li> <li>◦ Consulting with the RR regarding account activity</li> </ul> </li> <li>• Further action may include contact with the customer in writing or by phone or in person. A record should be made of any such contact.</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Initial and date reports to record review or online review</li> <li>• Active account letters and/or customer contact forms are filed in a customer account file</li> </ul>  |

Operations will, on an as-needed basis, review accounts that are identified as "active." Items to be reviewed include, depending on the type of account and type of trading activity:

- Review of new account documentation to determine necessary documents are on file and to identify the customer's investment objectives and financial profile
- Review of trading activity in the account including types and size of trades and frequency of trades
- Contact with the RR to determine additional information regarding the customer and trading activity.

Reviews of active accounts may include these items or other items at the discretion of Compliance and/or Operations.

Compliance will determine whether contact will be made with the customer and whether that contact will be in the form of a letter or telephone call to confirm investment objectives and the customer's knowledge regarding the trading activity in the account. All records of customer contact in conjunction with active account reviews are to be maintained in a file for the customer or an active accounts file.

## **8.16 Concentrations**

### **8.16.1 Introduction**

While our clearing firm has established procedures to address aggregate positions of all its correspondent firms, we have established procedures to detect, monitor and evaluate the risks of potential accumulation of large positions in accounts of our Firm.

### **8.16.2 Extension Of Credit**

The Director of Operations is responsible for establishing procedures for monitoring large positions in margin accounts. The clearing firm may establish higher margin requirements for accounts with concentrated positions.

### **8.16.3 Review Of Firm-Wide Positions**

On a regular basis, the Director of Operations will review firm-wide concentrated positions. Items reviewed may include:

- Price and trading characteristics of the security
- Blue sky status of the concentrated position
- Size of the position on margin
- Consideration of possible restrictions on future purchases.

## **8.17 Account Transfers**

### **8.17.1 Accounts Transferring In**

When new accounts are transferred from another broker/dealer a transfer form must be completed by the customer authorizing the transfer and provide to the receiving firm. Most accounts transfer via ACATS which expedites validation and transfer from the other broker/dealer.

Orders to sell securities to be transferred from the other firm may not be entered until validation is received. RRs should contact Operations to confirm whether the transfer has been validated.

### **8.17.2 Accounts Transferring Out**

When validated instruction has been received to transfer a customer's securities account assets to another firm, the account will be frozen, all open orders must be canceled and no new orders taken (with exception of options orders that expire within 7 business days).

The Firm and its RRs may not interfere with a customer's request to transfer his/her accounts unless there is a bona fide reason for doing so, such as a lien for money owed.

### **8.17.3 Brokerage Accounts Transferring to Investment Advisory Accounts**

RRs that are dually registered with the Firm's RIA may have clients who choose to transfer their brokerage account to an advisory account with the RIA. RRs must ensure that the transfer would be in the best interest of the client based on the RRs fiduciary duty as an IAR.

Clients will be required to complete and return with their advisory paperwork, a disclosure form which describes the potential advantages and disadvantages of the account transfer. Additionally, the form provides a brokerage commission versus potential advisory fee review for the client's account.

Operations will review and validate the information on the form with the client's brokerage account activity to ensure the suitability of advisory fees to be charged within the advisory account as part of its establishment. Operations and Compliance will monitor ongoing advisory fees within the RIA for the clients.

## **8.18 Accounts for Senior Investors**

Suitability considerations are a concern for all types of accounts. While suitability requirements do not specifically refer to age or life stage, these factors should be considered when making recommendations to older investors. Considerations when dealing with senior investors include:

- Current and future prospects for employment
- Primary expenses including whether the customer still has a mortgage
- Sources of income and whether it is fixed or will be in the future
- Income needed to meet fixed or anticipated expenses
- Savings for retirement and how they are invested
- Liquidity needs
- Financial and investment goals (income needs, preservation of capital, accumulation of assets for heirs)
- Health care insurance and future needs to fund health costs.

### **8.18.1 Use of Title Inferring Expertise**

Regulators have expressed concerns regarding RRs using titles that infer expertise in dealing with seniors. RRs titles are reviewed and approved by Compliance upon registration and when requests for business cards are made. Review look for consistency and that inference/improprieties would not be derived from the RR's title.

### 8.18.2 Reverse Mortgages

A reverse mortgage is an interest bearing loan secured by the equity in a home. Generally, the borrower and any other co-borrowers must own the home and be 62 or older. Home equity may be converted to cash that can be used for any purpose. RRs are not permitted to recommend customer use reverse mortgages to fund investments. If a customer indicates he/she has funds available for investments from the proceeds of a reverse mortgage, contact Compliance before proceeding with the purchase of the investments.

## 9.0 ORDERS

This chapter provides policies and guidelines for the entry and handling of customer orders. References to "order records" in this chapter includes manual electronic record(s) of the order/order ticket(s) and electronic order tickets, where appropriate.

Orders should be accepted only from the beneficial owner of an account or their authorized agent. Authorized agents would include anyone holding third-party power to act on the customer's behalf such as a trustee, court appointed guardian, etc. Orders accepted from an unauthorized third party may result in rescission of the transaction and assigning the loss to the RR. For example, orders should not be accepted from a husband, on behalf of a wife's account, unless the wife has signed a trading authorization giving her husband authority to act on her behalf.

If an RR receives a telephone order from someone they do not recognize or know to be the owner of the account or person authorized to act on behalf of the account, identity should be requested before accepting the order.

### 9.1 Orders Requiring Approval

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Order records</li><li>• Daily Blotter</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Instruct order entry person of orders requiring approval</li><li>• Review and approve or disapprove orders</li><li>• Remind RRs and order entry person of requirement for order approval when exceptions are noted</li></ul> |



|               |  |
|---------------|--|
|               | <ul style="list-style-type: none"> <li>• If problem persists, take additional corrective action</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approvals on order records/blotter</li> </ul>            |

Certain orders require approval by Operations prior to execution because of rule requirements of the clearing firm. Operations should be consulted further for a determination of the types of orders that may require Operations' approval before being executed by the clearing firm.

## 9.2 Solicited and Unsolicited Orders

### 9.2.1 Definition Of Solicited Order

When a transaction is recommended to a customer and the customer enters an order as a result of that recommendation, the resulting order is considered to be solicited. Other actions that may result in an order being deemed solicited include the mailing of a research report or other written communication for the purpose of encouraging the customer to act on the information provided or sending a prospectus on a new issue. A good rule of thumb to follow: If the RR brings the security to the attention of the client, it is solicited.

### 9.2.2 Solicited Orders Should Be Indicated

Customer orders that are solicited should be so marked on the order ticket for the transaction.

### 9.2.3 Prohibited Solicitations

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Order records</li> <li>• Daily Blotter</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Watch for prohibited solicited orders</li> <li>• Identify orders contrary to solicitation limitations</li> <li>• If prohibited solicitations are identified, take corrective action: <ul style="list-style-type: none"> <li>◦ Other exceptions may require different actions including cancellation of the transactions, removal</li> </ul> </li> </ul> |

|               |  |
|---------------|--|
|               | of commissions, reminder to RRs, <i>etc.</i>   |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on order records/blotter</li> </ul> |

RRs may NOT solicit transactions listed below:

- When securities are being sold under Rule 144, purchasers may not be solicited
- Securities that are by definition "penny stocks" - non-listed and <\$5/share.

### 9.3 Suitability Of Recommendations

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New account forms</li> <li>• Order records</li> <li>• Daily Blotter</li> <li>• Customer Monthly Statements</li> <li>• Exception Reports</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Ongoing</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review customer orders for suitability</li> <li>• Refer to new account applications when necessary to identify investment objectives and other customer information</li> <li>• Confer with RR regarding suitability questions</li> <li>• Confer with Compliance when necessary</li> <li>• Contact customer when necessary to confirm customer's understanding of an agreement with transactions</li> <li>• Modify or restrict future transactions, as appropriate</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Initials/approval on order records and Daily Blotter</li> <li>• Documentation of review for questionable transactions either in client file or on Daily Blotter</li> </ul>   |

### **9.3.1 General Requirements**

RRs must perform reasonable diligence to understand the nature of the recommended security or investment strategy involving a security or securities, as well as the potential risks and rewards.

Additionally, RRs must 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 RR to ascertain the customer's investment profile and any updates to new account information.

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 RR in connection with such recommendation.

Operations or Compliance is responsible for reviewing customer transactions for suitability, where appropriate. There are a number of considerations that may assist the designated supervisor when reviewing the suitability of recommendations or determining suitability requirements. One or more of the following may be appropriate:

- Information included on the customer new account forms
- Other securities held in the customer's account
- The RR's record of the customer's transactions
- Other information regarding the account such as whether the account is managed by an investment adviser or uses other advisers or consultants in making investment decisions
- Transaction information from daily blotters and monthly statements
- Information obtained from the RR
- Information obtained by contacting the customer.

### **9.3.2 Institutional Accounts**

In addition, factors to consider when determining the scope of the Firm's suitability obligation when making recommendations to institutional customers include: (1) the customer's capability to evaluate investment risk independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the extent to which the institutional customer affirmatively acknowledges its intent to exercise independent judgment in evaluating the recommendation. The following may be relevant in determining the customer's capability to evaluate risk:

- the use of one or more consultants, investment advisers, or bank trust departments
- the general level of experience of the institutional customer in financial markets and specific experience with the type of instruments under consideration
- the customer's ability to understand the economic features of the security involved
- the customer's ability to independently evaluate how market developments would affect the security
- the complexity of the security or securities involved.

In determining whether the customer is making an independent investment decision, the following may be relevant:

- any written or oral understanding that exists between the Firm and the customer and the services to be rendered by the Firm
- the presence or absence of a pattern of acceptance of the Firm's recommendations
- the use by the customer of ideas, suggestions, market views and information obtained from other broker-dealers or market professionals, particularly those relating to the same type of securities
- the extent to which the member has received from the customer current comprehensive portfolio information in connection with discussing recommended transactions or has not been provided important information regarding its portfolio or investment objectives.

### **9.3.3 Investment Strategies**

RR recommendations must be consistent with their customer's best interests. The Firm believes every account utilizes an investment strategy and employs a risk-based approach to supervising such investment strategies. Hold strategies are implicit and are generally not subject to a suitability review, unless by their nature or due to particular circumstances could be viewed as:

- a shorter-term investment component;
- a periodic reset or similar mechanism that could alter a product's character over time;
- are particularly susceptible to changes in market conditions;
- are otherwise potentially risky or problematic to hold at the time the recommendations are made; or
- until such time as an explicit event occurs, such as a transaction.

RRs are encouraged for explicit hold recommendations (i.e. a RR recommend directly to a client to hold a particular investment), per FINRA Rule

2111, to document the hold recommendation in writing through contemporaneous notes maintained for the specific client.

#### **9.3.4 Investing Liquefied Home Equity (NASD NTM 04-89)**

Increasing home prices and re-financings have provided homeowners with access to funds, some going into investments. Recommending or facilitating liquefying of home equity to purchase securities is not suitable for all investors. RRs are obligated to consider whether investing these funds is suitable including the following factors:

- How much equity does the investor have in the home?
- What is the level of equity being liquefied for investments?
- How will the investor meet increased mortgage obligations?
- Is the mortgage or home equity loan at a fixed or variable rate?
- What is the investor's risk tolerance with respect to the funds being invested?
- What is the investor's overall debt burden?
- What is the sustainability of the value of the investor's home?

#### **9.4 Orders In Volatile Stocks**

Some securities are characterized by volatility of price and volume. This has, in particular, been a characteristic of some Internet stocks. The RR should know the potential effect of volatility on recommended stocks and discuss these risks when recommending such investments with customers unfamiliar with transactions in these types of securities. Following are some of the conditions potentially affecting volatile stocks:

- High volume in volatile stocks may result in delays in execution at the opening or during the trading day.
- Market orders may be executed at a price significantly different from the current quote. The benefits and risks of market vs. limit orders should be discussed.
- Orders for IPOs in the secondary market may be executed at prices significantly away from the current quote, and, because of "fast market" conditions, the current quote may not be up to date.
- No RR may accept a market order for the purchase of shares of a new issue in the secondary market prior to the commencement of trading of such shares in the secondary market.
- Volatile stocks may be subject to higher margin requirements or not available for purchase on margin.
- Margin requirements, as determined by our clearing firm, may change daily (or more frequently) as markets fluctuate.

## **9.5 Order Records**

### **9.5.1 Account Designation (FINRA Rule 4515)**

Each order, prior to execution, must include the account name or designation on the order/blotter.

Whenever an order is cancelled and re-billed to another account (including changes between related or same-owner accounts), it needs to be approved by the designated supervisor and a record of such approval needs to be retained with the account. The record of the approval shall contain the essential facts related to the transaction, and the record shall be initialed by the designated supervisor. Reports available from the clearing firm will be reviewed to ensure that all such transactions have been so documented.

### **9.5.2 Time and Price Discretion (NASD Rule 2510[d][1])**

With the customer's consent, time and price discretion may be used for orders for a definite amount of a specific security without written authorization from the customer. The duration of this authority is limited to the end of the business day on which the order was received. Discretion beyond the same day requires establishment of discretionary authority and signed and dated authorization from the customer. Refer to the chapter *ACCOUNTS* and the section *Discretionary Accounts* for procedures for establishing and handling discretionary accounts.

Exercise of time and price discretion should be noted on the order/blotter record.

This limitation does not apply to time and price discretion exercised in institutional accounts pursuant to valid good 'til cancelled instructions issued on a "not held" basis.

### **9.5.3 Other Required Information**

Certain information must be recorded for orders accepted by the Firm. Information to be recorded includes:

- Identification of the account
- Buy or sell
- If sell, long or short
  - Stock should be in brokerage account prior to entering sell order. If not: Submit a copy of the certificate to Operations for verification.
- If a short sale, an indication the security can be borrowed
- If an option, put or call and open or close
- Name of security
- Quantity
- Price (if a limit order)

- Day or GTC (if not a market order)
- Other terms of the order (fill or kill, stop limit, *etc.*)
- If a discretionary account, notation whether discretion is exercised or not exercised
- Identity of RR responsible for the account, if any
- Identity of other person(s) who entered or accepted the order
- Date and time order is received and entered
- At this time, the Firm will not allow an event other than a transaction at the stop price as a trigger for stop or stop limit orders as described in FINRA Rule 5350.

Other information to be recorded for the order includes:

- If the customer's order is granted a stop (*i.e.*, price protection on an order as negotiated by the Firm and the customer), the stop is to be noted on the order
- Any modification to/cancellation of order or instructions
- Execution price
- Date and time of execution or cancellation
- If the customer enters the order on an electronic system, a notation regarding electronic entry.

## 9.6 Conflicts Of Interest

### 9.6.1 Adverse Interest

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Order records</li> <li>• Daily Blotter</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Identify transactions where an RR is on the other side of the trade from the customer</li> <li>• Cancel RR's trade</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Copy of trade correction to RR</li> </ul>   |

When an RR is on the opposite side of a transaction from a customer (customer sells a security and the RR is the purchaser, or customer buys a security and the RR is the seller), the RR may be considered to have an "adverse interest" in the transaction.

### 9.6.2 Precedence Of Customer Orders

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Order records</li><li>• Daily Blotters</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Identify orders where the RR has received a better price for a transaction in the same security, on the same day, and on the same side of the market (buy or sell) as the RR's customer</li><li>• Adjust the customer's order to the better price, if appropriate</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Order adjustments are included in order records</li></ul>   |

The customer's interest has precedence over any RR's personal interest. While there is no standard that applies in every case, in general, RRs will solicit customer orders before entering orders for personal accounts in the same security. When an RR receives a better price in a security the same day the RR's customer executes an order in the same security on the same side of the market (buy or sell), the customer will generally receive the better price unless there are circumstances that justify the RR's better price (time of order entry, inability to reach customer, *etc.*). Operations will determine when a price adjustment is required.

## 9.7 Review Of Customer Transactions

### 9.7.1 Review Of Daily Transactions

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Order records</li><li>• Daily Blotter</li><li>• Surveillance/Exception Reports</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |



|               |   |
|---------------|---|
| <b>Action</b> | <ul style="list-style-type: none"> <li>• Review orders for, among other possible items: <ul style="list-style-type: none"> <li>◦ Completeness of order records</li> <li>◦ Suitability of transactions</li> <li>◦ Discretionary account orders</li> <li>◦ Orders requiring approval</li> <li>◦ Prohibited orders</li> <li>◦ Excessive commissions</li> <li>◦ Unauthorized transactions</li> </ul> </li> <li>• Take corrective action, where warranted</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on order records</li> </ul>  |

On a daily basis, Operations and/or Compliance will review electronic record(s) of the order/order ticket(s) of transactions and will record the review by initialing the report.

### 9.7.2 Unauthorized Transactions

Reviews of transactions should include identification, where possible, of unauthorized transactions. Potential indicators of unauthorized transactions may include patterns of:

- Cancellations of transactions
- Cancels and rebills between accounts
- Sellouts for failure to pay for purchases
- Buy-ins for failure to deliver securities
- Numerous extensions.

Operations is expected to take corrective action regarding potential unauthorized transactions. Corrective action may include, depending on the circumstances:

- Confer with the RR
- Contact customers directly to confirm authorization of transactions
- Cancellation of unauthorized transactions.

### 9.7.3 Review Of New Account Activity

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New account applications</li> <li>• New account purchases (check and app. business)</li> </ul> |

|                  |   |
|------------------|---|
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• As needed basis</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review customer transactions records for suitability of transactions</li> <li>• Refer to new account applications when necessary to identify investment objectives and other customer information</li> <li>• Confer with RR regarding suitability questions</li> <li>• Contact customer when necessary to confirm customer's understanding of an agreement with transactions</li> <li>• Modify or restrict future transactions as appropriate</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Initials/approval on records reviewed</li> </ul>   |

Designated Supervisors are expected to periodically review customer account activity. This may be accomplished by reviewing the New Account Application, and other cumulative transaction information.

#### **9.7.4 Review Of Transactions For Excessive Commissions (NASD IM-2440)**

The Firm has an obligation to charge fair commissions or markups/markdowns on customer transactions. Charges should comply with the Firm's established commission schedule. Operations or Compliance is responsible for reviewing daily reports of commission and markups/markdowns on customer transactions to determine compliance with Firm guidelines. The following factors are considered when determining the fairness of charges:

- type of security
- availability of the security in the market
- price of the security
- amount of money involved in the transaction
- disclosure to the customer of the markup or markdown
- pattern of markups or markdowns
- nature of the Firm's business.

In addition, the markup/markdown on "proceeds transactions" must conform to FINRA's Mark-Up Policy which includes a 5% guideline. Proceeds transactions are transactions where the customer sells a security and uses the proceeds to buy another security at or about the same time. Fairness of the markup/markdown is determined by combining the charges for both transactions. For example, if a 2% markup is added to the buy order, no more than 3% could be charged as a markdown on the sell order.

### 9.7.5 Review of Account Activity By Compliance

Accounts are referred from Operations to Compliance if questions arise from applicable exception reports.

### 9.8 Cancels and Rebills

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Cancel/Rebills</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily review of reports presented</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Frequent cancellations and cancel/rebills may be an indicator of unauthorized trades. It is important to identify patterns that require corrective action.<ul style="list-style-type: none"><li>◦ Review and approve or disapprove cancels and rebills.</li><li>◦ For cancels from one account to another, particularly review reason for cancel and rebill prior to approval.</li><li>◦ Review Cancel/Rebill Report for patterns by customer and/or by RR.</li><li>◦ Where patterns appear, confer with RR.</li><li>◦ Where patterns continue to appear, contact customers whose orders were cancelled to confirm orders were originally authorized.</li><li>◦ If customers advise transactions are unauthorized, contact Compliance.</li><li>◦ Review FINRA Risk Monitoring Report: Canceled and as-of Trades Report. This report displays a summary of as-of-trades and cancels in equity trading activity provided to FINRA by the Firm's clearing firm.</li></ul></li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on Cancel/Rebill Report</li><li>• For patterns of cancellations, notes of review and action taken on Cancel/Rebill Report, if appropriate.</li></ul>   |

Cancels and rebills between accounts require the approval of the designated supervisor.

## 9.9 Trade Errors

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Trade Error Form/Ticket</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Frequent errors by RRs may indicate poor work habits, insufficient manpower to properly enter orders, deficiencies in understanding proper order entry procedures, or unauthorized trading. It is the designated supervisor's responsibility to minimize trade errors; take immediate corrective action when an error is identified; and take follow up corrective action as necessary.<ul style="list-style-type: none"><li>○ Instruct the wire operator or other order entry person regarding action to correct the error</li><li>○ Approve Trade Error Forms/Tickets</li><li>○ Identify patterns of errors by individual RRs</li><li>○ Where patterns are identified, confer with the RR regarding any order entry problems and the reasons for frequent errors</li><li>○ Take correction action as appropriate</li></ul></li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on Trade Error Forms and Cancel/Rebill</li><li>• Notes regarding corrective action in the RR's file or the Forms, as appropriate</li></ul>   |

Trade errors are to be immediately reported to Operations for correction. RRs are not permitted to correct errors themselves.

The Firm may not cover losses for investors by treating transactions as errors when, in fact, they are not errors. Some customers may request such an accommodation in exchange for future business. Absorbing losses is a violation of SRO rules and is not permitted.

The RR is responsible for 100% of the error unless it can be proven that the error was the fault of the Firm. Failure to give complete and accurate information regarding a trade will *always* result in 100% of the error being charged to the RR. Don't guess on CUSIPs, symbols, amount of money or shares in an account, *etc.*

### 9.9.1 Error Account

The Firm maintains an error account through its clearing firm which is used exclusively to process erroneous transactions where the Firm assumes or acquires the position resulting from the error. This includes errors where there is an erroneous transaction.

- If the error is corrected at a better price, the better price must be offered to the customer. If the customer refuses the better price, a record must be made of the refusal on the error record.
- If the error is corrected at an inferior price, it may be resolved by the use of a "difference check" at the discretion of the customer, representing the difference between the execution price and the price the customer should have received. Record of difference checks exceeding \$500 must be maintained by the Firm but it is not necessary to record it in the error account.
- A customer may accept the error, in which case the transaction takes place in the customer's account. The Firm is required to maintain a record that the customer accepted the erroneous transaction.

#### 9.9.1.1 Recordkeeping

The required records are retained with other order records in the trading or order area where the error originated. Records to be retained include:

- Nature and amount of error
- How the error was resolved
- The amount of loss from the error.

### 9.10 Sellouts/Buy-ins

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Notices from Operations regarding sellouts or buy-ins</li></ul>    |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Sell out/Buy in customer securities</li></ul>                      |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Sellouts/buy-ins are included in the day's order records</li></ul> |

Customers who fail to pay for transactions will be subject to sellouts to close out the unpaid security position. RRs will be charged for any unpaid balance

remaining after the sellout. Customers who fail to deliver securities will be subject to buy-ins of the securities or contracts per FINRA Rule 11810.

A pattern of sellouts/buy-ins may indicate problems with customers or potential unauthorized transactions. Operations is responsible for directly contacting customers where there is a pattern of sellouts/buy-ins to determine the cause of the sellout and whether the customer authorized the transaction. If unauthorized transactions or other wrongdoing are identified, it is the designated supervisor's responsibility to take corrective action including disciplinary action against the RR. Compliance should be contacted for guidance, if needed.

### 9.11 Time Clock Synchronization

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• IT Administrator</li><li>• Director of Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Clock Synchronization System</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Take corrective action for failure to synchronize clocks which may include: repair or replacement of clocks (for mechanical failure); additional training of personnel; or other appropriate action in consultation with Compliance.</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• All errors will be documented and retained in an error file.</li></ul>   |

Under FINRA rules, all time clocks (computer system or mechanical) used for recording date and time of orders must be synchronized to ensure the accuracy of recorded time. The following procedures are to be followed to synchronize time clocks used to record order entry and execution times:

- All clocks must reflect Eastern Time (Daylight or Standard, depending on time of year).
- Clocks that have not been checked according to these procedures must **not** be used for recording order information.
- All clocks must be synchronized **each business day**, at the following times by the IT Administrator or a designee:
  - prior to the opening; and
  - at least once during the trading day (target time: 12:00 p.m. Eastern Time).
- The Director of Operations will periodically review the synchronization records.

If a RR immediately transmits orders to Operations or the clearing firm either electronically or manually, the independent contractor is not required to maintain a separate synchronized clock. If there is any delay in transmitting the order, however, the contractor must maintain a synchronized clock.

## **9.12 Cash and Non-Cash Compensation Policy (FINRA Rules 5110, 2310, 2320; NASD Rule 2830)**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests from RRs or outside firms regarding sponsorship of cash or non-cash compensation relating to the sale of securities</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review request and ensure compensation is consistent with rule requirements and limitations</li> <li>• Approve or disapprove compensation in writing</li> <li>• Establish and maintain required records of approved compensation programs</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Records are maintained in a Cash/Non-Cash Compensation file</li> </ul>   |

FINRA regulations include restrictions on compensation relating to the sale and distribution of debt, equity, municipal, investment company, variable product, direct participation program (DPP), and REIT securities. RRs may not accept (directly or indirectly) cash or non-cash compensation from outside firms or persons. The only exception includes compensation arrangements specifically approved by the Firm.

### **9.12.1 Definitions**

**Cash compensation** is defined as follows:

Any discount, concession, fee, service fee, commission, asset based sales charge, loan or override, or cash benefit received in connection with the sale and distribution of securities.

**Non-cash compensation** is defined as follows:

Any form of compensation received in connection with the sale and distribution of securities, other than cash compensation, which includes, but is not limited to, merchandise, gifts and prizes, travel expenses, meals and lodging.

### **9.12.2 Approval**

Any compensation as defined in this section and paid directly to the RR requires Compliance approval. The following section outlines types of non-cash compensation permitted without specific approval, unless otherwise noted.

### **9.12.3 Types Of Permissible Non-Cash Compensation**

The following types of non-cash compensation are allowed provided they are *not preconditioned on achieving a sales goal*:

- Gifts amounting in aggregate value not exceeding \$100 annually, per person.
- An occasional meal, ticket to a sporting event or show, or comparable entertainment that is not so frequent nor so extensive as to raise any question of propriety.
- Payment or reimbursement in connection with training or educational meetings, subject to several conditions. *Note:* Prior approval must be obtained from Compliance before participating in such meetings.
- The location of the meeting is appropriate for its purpose, e.g., at or near the sponsoring company's home office; an office of the Firm or facility near an office; or a regional location for a regional meeting.
- Only expenses incurred by the Firm or its Employees/RRs are eligible for payment. Expenses for guests of employees (spouse, etc.) will not be reimbursed.

Non-cash sales incentive programs ***may be preconditioned on achieving a sales goal*** provided they are pre-approved in-house incentive programs sponsored by the Firm and meet the following criteria:

- The program must be based on the RR's total production with respect to all of that type of security sold by the Firm (investment company, DPP, etc.).
- Credit received for each security is equally weighted.
- Only Firm employees/RRs may participate.
- Other firms may make contributions to the program, provided they do not participate, directly or indirectly, in the organization of the program. However, the outside entity may provide a speaker for the meeting.



### 9.13 Prohibited Transactions

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Order records</li> <li>• Daily Blotter</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily review of order records and Daily Blotter</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Reviews of transactions should include consideration of prohibited transactions prescribed in these policies. Action on identified prohibited transactions could include consultation with Compliance to confirm whether transactions in question are prohibited and to identify corrective action.</li> <li>• Some specific guidelines for review include the following. Contact Compliance for guidance regarding corrective action: <ul style="list-style-type: none"> <li>◦ Wash transactions result from cross transactions between two accounts with the same beneficial owner and at no market risk, <i>i.e.</i>, the buy and sell are pre-arranged at a set price. Wash transactions should be cancelled and securities sold at the risk of the market.</li> <li>◦ Cross transactions on a frequent basis particularly in thinly-traded securities may be an indicator of supporting the market.</li> <li>◦ Orders by the same RR frequently marked for "at the opening" or "at the close" may be an indication of an attempt to influence the market.</li> <li>◦ A pattern of purchasing securities in one account and transferring to another account at a later date may indicate parking.</li> <li>◦ Excessive trading may be an indicator of churning. See "Active Accounts" section for guidance regarding action on actively traded accounts.</li> <li>◦ RRs trading ahead of customer block orders that may affect the market price of a security may indicate front running.</li> </ul> </li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Initials/approval on order records/blotters</li> <li>• Notes/memos to RR's file, if appropriate</li> </ul>   |

### **9.13.1 Introduction**

Generally, the designated principal responsible for reviewing transactions should review transactions in an effort to identify these types of prohibited transactions. Specific reviews by Compliance or areas other than the designated principal are indicated in the appropriate sections.

### **9.13.2 Unauthorized Trading**

No RR may enter a transaction before contacting the owner of the account (or the authorized agent for the owner) unless the RR has specific written authorization to act on the customer's behalf. Failure to contact the customer or the customer's agent can result in the customer later rescinding the transaction because it was not authorized. Engaging in unauthorized transactions subjects the RR to regulatory and Firm discipline which may include fines and/or termination depending on the seriousness of the violation. If the Firm determines an RR engaged in unauthorized trading, any related losses will be charged directly to the RR.

RRs must also avoid "inadvertent" unauthorized transactions such as accepting an order from a husband for a wife's account where the wife has not signed a trading authorization giving her husband authority to trade on her behalf. Doing a customer a "favor" by entering an order when he or she cannot be reached may be construed as good customer service by the RR but in reality is a rule violation and subjects the RR and the Firm to potential liability for losses from unauthorized transactions.

Using time and price discretion, as permitted under FINRA/NASD rules, does not constitute unauthorized trading.

### **9.13.3 Prearranged Trading**

An offer to sell coupled with an offer to buy back at the same or a higher price, or the reverse, is a prearranged trade and is prohibited. Options or written agreements such as repurchase agreements are not included in this prohibition.

### **9.13.4 Adjusted Trading**

Adjusted trading is a prohibited practice that involves the sale by a customer of a security to a broker-dealer at a price above the prevailing market price and the simultaneous purchase of a different security at a price greater than its market value. This may be requested in instances where a bank or other fiduciary does not want to realize a loss on their books and engages in a scheme to avoid, disguise, or postpone losses. Federal banking regulators have stated that adjusted trading by federal financial institutions is an unacceptable and unsuitable investment practice.

### **9.13.5 Overtrading Or Undertrading**

These are transactions at prices in excess of or below the prevailing market. Customer transactions must be executed at a price reasonably related to the market; overtrading and undertrading is not permitted.

### **9.13.6 Wash Transactions**

Transactions between two accounts with no market risk and where there is no beneficial change in ownership may be considered a "wash sale." Customers sometimes request cross transactions for tax purposes between accounts with the same owner. Such transactions may violate rules and tax losses may be disallowed by the IRS.

There should be no pre-arrangement or guarantee of execution price for both sides of the transaction where there is no change in beneficial ownership. All such transactions should be executed at the risk of the market.

### **9.13.7 Cross Transactions**

Firms and their RRs may not engage in a practice of effecting cross transactions for the purpose of supporting or maintaining the market price of a security. Operations will review daily transactions to identify patterns of cross transactions that may represent rule violations.

### **9.13.8 Orders At The Opening Or Close**

Orders entered at the opening or close of the market for purposes of influencing the price of a security are prohibited.

### **9.13.9 Parking Securities**

"Parking" is a prohibited practice where a trade or series of trades are affected for a person or entity and held in another person's or entity's account to disguise the investment activities of the original person or entity.

### **9.13.10 Churning**

Churning of a customer's account is prohibited. The term "churning" has a number of elements including:

- Control of the account by the RR
- Excessive transactions
- Intent to defraud which may be defined as the RR acting in the RR's own interest contrary to the customer's interest.

An account that is "active" does not necessarily denote churning. An account's activity must be reviewed individually when reviewing for churning including the customer's objectives and the customer's control of the account.

#### **9.13.11 Prohibition Against Acting On Knowledge Of Other Orders**

The Firm and its RRs may not enter orders for their own account to benefit from their knowledge of customers' orders in a particular security ("front running"). This includes orders in securities that are derivatives (options, warrants, *etc.*) of the security being purchased or sold by the customer.

#### **9.13.12 Market Manipulation (FINRA Rule 6140)**

The Firm and its RRs may not engage in manipulative activity to artificially affect the price of a security including entering orders at successively higher prices; creating or inducing a false or misleading appearance with respect to the market in a security; trading at the close to influence the price of a security; or participate (directly or indirectly) in the profits of a manipulative operation or knowingly manage or finance a manipulative operation.

#### **9.13.13 Trade Shredding (FINRA Rule 5290)**

"Trade Shredding" (also known as tape shredding) is the practice of breaking orders into multiple smaller orders for the primary purpose of maximizing commissions or other revenue. For example, a firm may receive a rebate from a particular market center for directing a certain number of transactions to that market center. The Firm and its RRs are prohibited from engaging in breaking up orders for the purpose of maximizing the Firm's revenues or for any other prohibited purpose.

### **9.14 Blue Sky Of Securities**

#### **9.14.1 General Requirements**

"Blue sky" refers to state laws that govern the sale of securities and those who sell securities to residents of individual states. Registration of agents is discussed in the chapter "Registration and Licensing." This section discusses blue sky requirements of securities sold by the Firm.

The Firm will comply with blue sky requirements affecting the sale of securities in the state where the customer resides. Securities may achieve blue sky status by registration of the issue directly with a state. A transaction or security may also be subject to an exemption under a state's blue sky laws. Generally, securities issued by the federal government and by municipalities are exempt from state blue sky laws. Because blue sky laws vary from state to state, Compliance should be consulted to determine specific requirements.

## 9.15 Short Sales (Regulation SHO; FINRA Rule 4560)

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Order records</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As needed</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review for:<ul style="list-style-type: none"><li>◦ sell orders marked "long" or "short"</li></ul></li><li>• Locate information (affirmative determination) on short sells including who was contacted and the date advised the stock could be borrowed</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on order records</li><li>• Locate information in order records</li></ul>   |

A "short sale" is defined as the sale of a security that the seller does not own or any sale that is completed by the delivery of a security borrowed by or on behalf of the account of the seller. Determination of whether a sale is long or short also requires that the seller must net all positions in the security. This includes netting positions held in accounts that are related or under common control.

For example, a customer is long 1,000 shares of Security A in an account. The customer also cross guarantees, for Regulation T and margin purposes, a "short account" for the benefit of a family member who is short 1,000 shares of Security A. The net position would be zero; if the customer sells shares of Security A, the sale would be deemed a short sale.

Accounts are considered related or controlled if the customer:

- exercises discretion over the account;
- cross guarantees the account for Regulation T or margin purposes; or,
- has been granted a power of attorney to execute transactions in the account.

### 9.15.1 Marking Orders (Regulation SHO, Rule 200[g])

All sell orders are required to be identified on the order records as "long," "short," or "short exempt" at the time of entry.

A sell order may be marked "long" when the seller owns the security being sold and the security either is in the physical possession or control of the

Firm or it is reasonably expected that the security will be in the physical possession or control of the Firm by settlement date.

A sell order should be marked "short" when the security being sold is not owned by the seller and will require it to be borrowed to make delivery by settlement date. See the section on *Locate and Delivery Requirements* regarding the requirement to borrow securities.

A sell order should be marked "short exempt" if the seller is entitled to rely on an exception to the short sale rule.

### **9.15.2 Locate and Delivery Requirements (Regulation SHO, Rule 203)**

Prior to affecting a short sale in an equity security, there is an obligation to "locate" securities available for borrowing and delivery by settlement date. The "locate" must be determined prior to order entry. Exceptions to this requirement are listed below.

It is the RR's responsibility to contact Operations to confirm whether the security being sold short may be borrowed. This confirmation must be obtained prior to entering any short sell order and recorded on the order.

The borrow list relied upon must be less than 24 hours old. The following locate information must be recorded in the order records:

- if obtained from a person, the name of the person and the number of shares to be borrowed and the date
- if obtained from an authorized "borrow list," notation that the list was consulted and the date.

If affirmation is obtained from someone outside the Firm, the order record must also include the name of the person's employer.

### **9.15.3 SEC Requirements for Reporting Securities (Regulation SHO, Rule 204)**

To prevent naked short selling (when seller does not intend to deliver securities in time for settlement), the SEC has imposed requirements that securities must be delivered for short sales of all equity securities by settlement date (T+3). If not delivered, the firm is obligated to close out the position by borrowing or purchasing securities by the beginning of regular trading hours on the following day (T+4). For long sales and bona fide market making activity, the firm must close out the position no later than T+6.

When a firm fails to close out a position as required, the firm may not accept a short sale order in that security from another person or effect an order in its own account until the fail to deliver is closed out.

## 9.16 Sale Of Control Or Restricted Stock

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Proposed 144 sales</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Determine the seller's status (affiliate or non-affiliate)</li><li>• Determine eligibility for selling the amount and timing of sale</li><li>• Assist the customer in preparation of required forms</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Records of forms filed and determinations are included in the client file</li></ul>   |

### 9.16.1 Introduction

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 sellers.

Operations should be consulted directly for assistance regarding the processing of Rule 144 and Rule 145 sales. This section is provided for quick reference only.

### 9.16.2 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.

### **9.16.3 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.

### **9.16.4 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.

### **9.16.5 Holding Period**

Under Rule 144, the seller of restricted securities is subject to a one-year holding period prior to sale. In addition, 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.

### **9.16.6 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 re-sales of restricted securities after a holding period of one year. However, if the issuer is subject to the Exchange Act reporting requirements and you have held the securities for at least six months but less than one year, you may sell the securities as long as you satisfy the current public information condition. Refer to <http://www.sec.gov/investor/pubs/rule144.htm> for additional information.



### **9.16.7 Filing Requirements**

The seller is required to file Form 144 concurrent with placing the order or executing the transaction. Operations should be consulted regarding the necessary filing requirements.

### **9.16.8 Lending and Option Writing On Control and Restricted Securities**

The lending of money, extension of loan value, or use as collateral of restricted securities are subject to specific limitations. Operations 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. Operations should be contacted to determine the salability of the underlying securities prior to writing covered options.

### **9.16.9 Reporting Of Insider Transactions - Section 16(a)**

Under Section 16(a) of the Exchange Act, an issuer's directors, officers, and >10% holders of equity securities are required to report their purchases and sales of the issuer's securities to the SEC by the end of the second business day following the transaction.

Alternate 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
- 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 3rd 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.

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. Customers should be encouraged to contact their counsel if they have questions, and Section 16 should be referenced for specifics regarding filing requirements.

## 9.17 Certificates Of Deposit

The Firm offers certificates of deposit (CDs) as one of the products available to customers. Because CDs offered by the Firm may be different from traditional bank-issued CDs that carry a fixed interest rate over a fixed duration of time and are insured by FDIC, it is important that RRs understand the features of these CDs before offering them to customers.

### 9.17.1 General Sales Guidelines

The following guidelines apply to the sale of CDs:

- Only Firm-approved advertising/sales material may be provided to clients.
- RRs should be familiar with the features of the CD prior to discussing it with the client. In particular, it is important to understand FDIC insurance coverage, interest rates, maturity dates, fees or markups, and other terms of CDs.
- RRs must consider suitability when recommending CDs. For example, a 30-year zero coupon CD is not likely to be appropriate for an elderly client.

### 9.17.2 Special Characteristics Of CDs

Some CDs have unique characteristics which should be understood by the RR and communicated to the potential purchaser. Some of those special characteristics are explained below.

**CDs may be securities.** Some CDs may be considered securities and must be registered. Whether or not a CD is a security depends on a number of factors and requires individual analysis. For this reason, the brokering of CDs may only be accomplished through the Firm.

#### **"Brokered" CDs may be significantly different from traditional CDs.**

Brokered CDs are CDs issued by banks via a "master CD" to deposit brokers (which include broker-dealers) which sell interests to individual investors. The master CD is an aggregation of individual CDs with the same denomination.

- Brokered CDs may have longer maturity dates (in some cases 20 years) than traditional CDs.
- Interest rate terms may differ significantly from simple rates paid by traditional CDs.
- There may be a penalty for withdrawing funds before maturity.
- If a secondary market exists for the CD, the customer may lose principal because of prevailing interest rates at the time of sale.
- FDIC insurance protection may or may not be available to the customer, depending on whether the customer has exceeded the \$100,000 limit at a particular bank, thrift or credit union.

- Brokered CDs may have a call feature.

### 9.17.3 Disclosures When Selling Brokered CDs

Disclosures must be made to customers in the following areas:

- Potential for loss of principal
- Limitations on secondary markets
- Call features
- Step-up or Step-down features

**Loss of Principal:** Long-term CDs are subject to market price fluctuations primarily affected by prevailing interest rates. If a customer chooses to sell a CD prior to maturity, the pre-maturity sales price of the brokered CD may be less than its original purchase price. Using the term "no penalty for early withdrawal" is misleading unless the issuer guarantees redemption at full face value for a sale prior to maturity.

**Secondary market:** The secondary market for long-term CDs may be limited. The Firm will make the appropriate disclosure to purchasers of CDs during an initial distribution.

**Call features:** Callable CDs give the issuer the right to redeem the CD. This typically happens when a long-term CD is trading at a premium to its call price in the secondary market. Purchasers should understand it is the issuer that has the right to call the CD, and it may be redeemed at a time when less favorable interest rates are available for reinvesting the funds. RRs must not predict the likelihood that the CDs will or will not be called.

**Discount or zero CDs:** Purchasers should understand the maturity date of the CD and that interest and principal are not payable until maturity. Early sales may result in a substantial loss of value.

**"Step rate" CDs:** A "step-down" CD generally pays an above-market interest rate for a period of time after which it will then "step down" to a lower, predetermined rate that will be paid until maturity. A "step-up" CD generally pays a below-market interest rate for a period of time after which it will then "step up" to a higher predetermined rate that will be paid until maturity. The "step rate" may be below or above then-prevailing market rates. The initial rate cannot be used to calculate yield to maturity.

In addition to the point of sale disclosures required above, RBC mails a "Certificate of Deposit Disclosure Statement" to each account which has affected a CD purchase upon the direction of Operations.

#### **9.17.4 Account Statements**

When brokered CDs are held in the customer's account, they may be priced at an estimated value. It may be difficult to accurately price brokered CDs and the Firm's statements will include appropriate disclosures regarding pricing.

#### **9.18 Callable Common Stock**

Callable common stock is common stock that includes a feature where the issuer or a third party may call the stock away from the shareholder. The price at which the stock is called away may be at a premium to the prevailing market price at the time of the call or at a price or schedule of prices established at the time the stock is issued. Customer confirmations for transactions in callable common stock include a disclosure that the security is callable and that the customer may contact the Firm for further information.

Because callable common stock may be called away from a shareholder, RRs should consider this factor when making a suitability determination before recommending the purchase of the stock.

##### **9.18.1 Callable Securities (FINRA Rule 4340)**

Our clearing firm ensures that the order allocation for favorable redemptions for callable securities is to the clients first and then to associated persons. Additionally, our clearing firm does not exclude associated persons from unfavorable redemptions of callable securities.

#### **9.19 Promissory Notes**

Promissory notes are a form of debt similar to a loan. Companies sometimes issue them to raise money for a variety of business needs. The company promises to return the buyer's funds (principal) and make interest payments during the life of the note.

Promissory notes often are deemed securities and must be registered with the SEC and/or the state they are sold in, or they must qualify for an exemption from registration.

When sold through the Firm, RRs are required to make suitability determinations before recommending purchase. Considerations include the safety of the note and length of the term of the note. Transactions in promissory notes offered by the Firm are subject to review by the designated supervisor.

Individuals or entities outside the Firm may attempt to sell unregistered promissory notes through licensed RRs. RRs are reminded that they may only sell securities offered by the Firm. In addition, sales of promissory notes not

executed through the Firm are not covered by our Errors and Omissions insurance policy.

## 9.20 Penny Stocks

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• New Account Form</li> <li>• Order Records</li> <li>• Exception Report</li> <li>• Daily Blotter</li> <li>• Risk Disclosure Documents</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Transactions in penny stocks impose requirements on the Firm and the RR to obtain a signed risk disclosure document prior to effecting penny stock purchases, as described in the policy. The Operations Department is responsible for: <ul style="list-style-type: none"> <li>◦ reviewing the customer's new account form for completeness and investment objectives consistent with penny stock transactions;</li> <li>◦ ensuring risk disclosure documents are received prior to penny stock transactions;</li> <li>◦ reviewing and initialing the customer's signed risk disclosure document</li> <li>◦ Confer with Compliance if necessary</li> </ul> </li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Initials/approvals on the Risk Disclosure Document</li> <li>• Risk Disclosure Documents retained in customer file</li> </ul>   |

### 9.20.1 General Requirements

Solicited penny stock orders are prohibited transactions at the Firm. Under Rule 15g-1 through 15g-6 and 15g-9 of the Securities Exchange Act of 1934, securities that are identified as "designated securities" (penny stocks) are subject to certain requirements including:

- risk disclosure to a customer other than an "established customer"
- a two day cooling off period after risk disclosure is sent before a penny stock may be purchased
- disclosure of certain price information relating to the customer's purchase

- disclosure of compensation received by the broker or dealer
- inclusion of prices of penny stock positions on the customer's monthly statement and a legend regarding the value assigned to the penny stock.

There are five primary exemptions from these requirements:

1. The price of the security is \$5.00 or more per share.
2. The purchaser is either an accredited investor or established customer or is a principal affiliated with the issuer (as defined in the rule).
3. The transactions are not recommended.
4. The broker-dealer's commissions, mark-ups and mark-downs from penny stock transactions did not exceed 5% of total commissions or mark-ups and mark-downs during the 3 months immediately preceding the transaction, AND, the broker-dealer has not been a market maker in the penny stock to be purchased by the customer for the immediate 12 months preceding the transaction.
5. Any other transaction exempted by the SEC.

The following sections outline the Firm's requirements for penny stock transactions subject to the rules.

### **9.20.2 Penny Stock Defined (Reg 240.3a51-1)**

Penny stocks are equity securities identified as "designated securities" under the SEC's Penny Stock Rule. Penny stocks are low-priced securities (less than \$5.00 per share) with the Rule listing securities that are **not** included in the definition, as follows.

The following are **not** considered penny stocks subject to the requirements outlined in the following sections:

- A reported security as defined in Rule 11Aa3-1(a).
- The stock is priced at \$5.00 or more per share.
- Shares of investment companies.
- The stock is listed on an-exchange or with NASDAQ.
- The issuer has net tangible assets in excess of \$2 million, if the issuer has been in continuous operation for at least 3 years, or \$5,000,000 if in continuous operation for less than 3 years; or average revenue of at least \$6,000,000 for the last 3 years.

RRs should assume that any unlisted securities priced less than \$5.00 per share may be subject to the penny stock requirements.

### **9.20.3 Suitability Information**

RRs are required to obtain information from the customer including prior investment experience, investment objectives, and financial situation. This information is recorded on the Firm's new account form which must be completed prior to effecting a transaction in a penny stock. With this information, the RR is required to reasonably determine whether transactions in penny stocks are suitable for the customer.

Prior to effecting a transaction in a penny stock, the new account form must be completed and submitted to the designated supervisor for approval. The designated supervisor should review the information included on the form to confirm the suitability of penny stocks for the customer's account.

### **9.20.4 Risk Disclosure Document**

Prior to effecting a penny stock transaction for a customer, the RR must furnish the customer with a copy of the Firm's penny stock disclosure document titled "Important Information On Penny Stocks" and obtain the customer's signature on the disclosure document acknowledging receipt. The disclosure document may NOT be copied on Firm letterhead but must be reproduced on plain paper.

Furnishing this disclosure and obtaining the customer's signature evidencing receipt is required annually for penny stock transactions. Operations is responsible for ensuring required disclosure documents are obtained.

RRs should check with Operations prior to placing a penny stock purchase to determine whether a new acknowledgement form is required, regardless of whether the client has previously purchased that security or another penny stock through the Firm. A copy of the Risk Disclosure is on the Advisor's website under the Broker/Dealer Documents link. Print on plain paper only. DO NOT EDIT.

### **9.20.5 Disclosure Of Compensation**

The Firm's compensation for penny stock transactions will be disclosed on customer confirmations as follows:

- For agency transactions, the amount of the compensation.
- For riskless principal transactions where the Firm is NOT a market maker, the difference between the price to the customer and the contemporaneous purchase or sale price.
- For other principal transactions, the difference between the price to the customer and the prevailing market price.

"Active and competitive" market, for purposes of calculating mark-ups or mark-downs, is defined in the penny stock rules to include a market where the market maker, in the five business days preceding the transaction, executes less than 20% of the aggregate number of all transactions in the penny stock reported to an automated interdealer quotation system.

Operations is responsible for recording the required information on electronic record(s) of the order/order ticket(s). This information is to be transmitted for inclusion on customer confirmations. The designated supervisor is responsible for establishing procedures for ensuring that required compensation disclosures are included on customer confirmations.

## 9.21 Payment For Order Flow

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Agreements to receive payment for order flow</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Ongoing (confirmation and new account disclosures)</li> <li>• Annual (disclosures to customers)</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Ensure confirmations include required disclosures</li> <li>• Ensure new accounts receive disclosure of payment for order flow arrangements as required</li> <li>• Clearing firm sends annual disclosure to customers</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Confirmations, new account records include required disclosures</li> <li>• Retain a record of the annual disclosure sent to customers</li> </ul>  |

### 9.21.1 Payment For Order Flow Defined

Payment for order flow is an arrangement between two broker-dealers whereby retail orders are directed to a particular market maker for execution. Under the agreement between the two, the market maker will pay the retail broker-dealer a fee for directing retail order flow to the market maker. The definition also includes payment for order flow received from a national securities exchange, registered securities association, or exchange member. In addition to monetary (cash) payments for order flow, non-monetary compensation may constitute payment for order flow. Types of non-monetary compensation could include reciprocal order routing arrangements and clearing services and a discount, rebate, or credit of execution fees, to the extent payments exceed the amount of the fee.



### 9.21.2 Disclosures

If the Firm receives payment for order flow, the Firm will provide customers with the following information as required by the rule:

- Confirmation disclosures required under Rule 10b-10.
- Disclosures required at account opening and annually thereafter describing the Firm's policies on receipt of payment for order flow and description of the nature of compensation received. The policy disclosure includes the Firm's procedures regarding where to route customer orders that are subject to payment for order flow including a description of the extent to which such orders have the opportunity to be executed at prices superior to the national best bid or offer.

The disclosure obligations relate to customer orders that do not specify a price or a particular firm or market to which they should be routed and involve payment for order flow arrangements.

### 9.21.3 Best Execution Of Orders (FINRA Rule 5310; (MSRB G-18 - 3/21/16))

Customer orders associated with the Firm's receipt of payment for order flow will be subject to the same best execution requirements applicable to all customers' orders. The Firm directs all order flow to our clearing firm which is responsible for ensuring that all measures are taken to obtain best execution for customers.

### 9.22 Best Execution Reviews

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Clearing firm</li><li>• Rule 11Ac1-5 order execution reports</li></ul>                                       |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Quarterly</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Request best execution information from clearing firm or obtain such information via their website</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Reports are maintained in Operation's files</li></ul>  |

In order to confirm that the Firm is achieving the best execution for its customers, the Firm requests documentation from its clearing firm regarding its procedures for evaluating the routing of customer orders and providing best execution. This documentation is reviewed and maintained by the Director of Operations.

## 9.23 Order Audit Trail System (OATS) FINRA Rule 7400 Series

All firms that enter orders in NASDAQ, OTC domestic equity and certain transactions in foreign equity securities have an obligation to record the time of the order and are subject to OATS reporting requirements. This section describes the key requirements of FINRA Order Audit Trail System (OATS), a mechanism for tracking orders in certain securities. Detailed information about OATS is available on the FINRA website.

### 9.23.1 Who and What Orders Are Subject to OATS Requirements

All market makers and order-entry firms that handle and/or effect orders in the following securities must comply with rules regarding OATS reporting: NASDAQ securities, OTC domestic equity securities and certain transactions in foreign equity securities.

OATS reporting requirements apply to all executed and unexecuted orders other than those specifically excluded and listed in the next section. OATS applies to open orders, orders that have been modified, orders that have been partially executed, and cancelled orders.

#### 9.23.1.1 Orders NOT Covered By OATS Rules

The following types of orders are not required to be reported:

- The orders a market maker places for its proprietary market making account
- Proprietary orders executed through NASDAQ National Market Center in the normal course of market making activities
- Proprietary orders placed on an ECN during the normal course of market making activities
- Orders received from another market maker in the same security as the Firm makes a market.

### 9.23.2 Registering With OATS

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• N/A</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Registration when Firm initially will become subject to OATS requirements</li><li>• Update contact person and registration information with FINRA as needed</li></ul> |

|               |   |
|---------------|---|
| <b>Action</b> | <ul style="list-style-type: none"> <li>• Register the Firm with OATS</li> <li>• Update contact person and other registration information</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Copies of registration and subsequent filings are retained</li> </ul>                                      |

Firms subject to OATS requirements are required to register with OATS. The OATS Subscriber Initiation and Registration Form is available at:  
<http://www.finra.org/Industry/Compliance/MarketTransparency/OATS/Registration/p085462>

An individual at the Firm is named as FINRA contact (the OSO Administrator) for OATS purposes. The Administrator oversees user accounts and passwords.

### 9.23.3 List Of Contact Persons

The OSO Administrator is responsible for maintaining a current list of contacts with whom OATS technical and regulatory staff may communicate, including e-mail addresses.

### 9.23.4 Capture Of Required OATS Information (FINRA Rule 7440)

The Firm is required to capture specific information relating to the handling or execution of orders including recording all times of these events in hours, minutes, and seconds.

### 9.23.5 Reporting Of OATS Information

The Firm's clearing firm will transmit information to FINRA in compliance with OATS requirements.

Details of requirements for OATS transmissions are included in FINRA publication *OATS Reporting Technical Specifications*.

#### 9.23.5.1 Clearing Firm Transmission

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• OATS web-based information regarding rejections and reporting statistics</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Monthly - review OATS information regarding rejections and reporting statistics to evaluate the Clearing Firm's compliance with OATS</li> </ul> |

|               |  |
|---------------|--|
|               | <ul style="list-style-type: none"> <li>• Update of contract(s) - as needed</li> </ul>  |
| <b>Action</b> | <ul style="list-style-type: none"> <li>• Review available OATS data to evaluate compliance with OATS requirements</li> <li>• Contact the Clearing Firm to discuss exceptions or variances from OATS requirements</li> <li>• Request corrective action from the Clearing Firm, if necessary</li> <li>• Update contract(s) when necessary</li> </ul>           |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• OATS records of rejections and reporting statistics are maintained in an OATS review file, including the date reviewed as well as written comments about any corrective action or follow-up taken with the third party.</li> <li>• Third party agreements are maintained in the Clearing Firm agreement.</li> </ul> |

The Firm has contracted with its Clearing Firm to transmit OATS information to FINRA. The Firm's contract with the Clearing Firm includes assurances regarding compliance with OATS requirements. The Firm also will periodically review data available to evaluate the Clearing Firm's compliance with OATS requirements.

#### **9.23.5.2 Manual Orders**

Manual orders must be reported to OATS including the time the order was received or originated, even if the order is later entered into the Firm's electronic order routing or trading system. (It is not necessary to record the time the order is entered into the electronic system.)

This includes orders received by an Employee/RR and recorded on a paper ticket and then later transmitted to the main office.

#### **9.23.5.3 Limit Orders**

Transmission of information about a limit order must always include an indicator whether or not the customer has given specific instructions about whether or not an order should be displayed. Y indicates the customer has given instructions, and N indicates the customer has NOT given instructions.

#### **9.23.5.4 When To Report OATS Information**

Order information must be sent electronically to OATS on the same day that the order, or specific information about the order, is received, originated, transmitted, modified, cancelled, or executed. Where information about an order is not

complete or changes (for example, an order is cancelled), the additional information must be transmitted on the day the information becomes available.

OATS order data may be collected during the day and transmitted to OATS in one or more files during the day or after the market close. Reports for events that occur during a particular Oats Business Day must be reported by 4:00:00 a.m. ET the following calendar day or they are marked late by FINRA. For example, an order received at 2:00:00 p.m. ET on Thursday must be reported to OATS by Friday at 4:00:00 a.m. ET. An order received at 10:00:00 p.m. ET on Friday must be reported by Tuesday at 4:00:00 a.m. ET.

Corrections or deletions must be reported within five days of the original submission (except for GTC or GTC New Order Reports corrections or deletions, which must be reported within one year).

OATS accepts file transmissions 24 hours a day, 5 days a week, from 8:00 a.m. ET Monday to 8:00 a.m. ET Saturday. The *Technical Specifications* provide additional information regarding how and when data can be transmitted to OATS.

#### 9.23.6 Reviews and Repairs

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• OATS Web interface</li> <li>• OATS rejections</li> <li>• ACT Matching Statistics</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily - review OATS Web interface</li> <li>• Monthly - review Order Trade Matching Statistics</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Repair rejected ROEs</li> <li>• Review Order Trade Matching Statistics to determine how well Execution Reports match with ACT trade reports</li> <li>• Take corrective action if there appears to be a pattern of OATS data errors, including further education of those assigned with responsibility to input, evaluation of electronic data capture and subsequent corrections to programming</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Corrections/reconciliations are retained with daily OATS data files.</li> <li>• Review of Order Trade Matching Statistics, including note of corrective action, if any, are retained in an OATS</li> </ul>   |

|  |              |
|--|--------------|
|  | review file. |
|--|--------------|

The Firm will review rejections and make corrections, as necessary. A review of OATS order statistics will also be compared periodically with ACT trade reports to determine consistency of data reporting.

## 9.24 Disclosure Of Order Routing (Rule 11Ac1-6)

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Customer agency order trade data</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Publish reports - quarterly</li> <li>• Provide individual customer order routing information - as requested</li> <li>• Notify customers of availability of information - annually via brokerage statement</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Collect necessary data for 11Ac1-6 report from clearing firm</li> <li>• Publish report on the internet by the end of the month following each calendar quarter</li> <li>• Respond to requests from customers for order routing information</li> <li>• Send annual notification to customers</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Copies of quarterly reports</li> <li>• Records of customer requests and fulfillment of requests</li> <li>• Copies of annual customer notification</li> </ul>   |

Under Exchange Act Rule 11Ac1-6, the Firm is required to publish quarterly statistics regarding its customer agency order routing practices. The purpose of the report is to provide the public with information on how broker-dealers route their customers' orders, to enable customers (and others) to evaluate order routing practices. The Rule was adopted by the SEC to enhance market transparency and foster competition among market participants.

This information is available on the internet at [www.investment-planners.com](http://www.investment-planners.com) and in hard copy for those who do not have access to the internet. The report is published by the end of the month following the calendar quarter reported. In addition to quarterly reports, information about the routing of individual customer

orders is available to customers, upon request, for the prior six months' trading activity.

In addition, the Firm will send an annual notification to customers via their statement that the above information is available, as required by the Rule.

#### **9.24.1 Orders Covered By The Rule**

The report includes customer orders in exchange-listed securities, NASDAQ securities, and listed options. It does not include the following orders:

- equity orders with a market value of \$200,000 or more
- option orders with a market value of \$50,000 or more
- firm trading account orders (proprietary orders)
- orders for OTC Bulletin Board securities.

#### **9.24.2 Customer Requests For Order Routing Information**

Customers may request information on how their individual orders were routed for the past six months. This information may be obtained by making a request to Operations.

#### **9.25 Trading Halts (FINRA Rule 5260)**

The Firm's clearing broker, RBC, facilitates routing of equity and option orders. The Firm does not route orders or publish quotations to "other markets" which may not prohibit or close trading in securities pursuant to a halt under FINRA Rule 6120(a)(3).

#### **9.26 Non-Conventional Investments (NCI)**

Certain investments may have features and complexities not as easily understood by investors as traditional investments such as stocks or bonds. Non-conventional investments (NCIs) such as derivative products may warrant closer scrutiny to determine suitability of the security for the specific potential investor.

The RR recommending a NC is responsible for understanding the features of the NCI and making a suitability determination considering the potential investor's investment objectives and financial background. The RR is also responsible for providing information to the prospective investor, including balanced disclosure of the risks and rewards, so the investor may make an informed decision about the potential investment. Where prospectuses or other disclosure documents are available, it is the RR's responsibility to provide the written disclosure to the prospective purchaser. RRs must

obtain signed subscription or other agreements from NCI investors, where required.

### **9.26.1 Hybrids**

Hybrids have the characteristics of both debt and equity. Hybrids may offer higher yields, which are attractive to investors. However, since hybrids may be complex, investors must be familiarized with the risks and features of the particular hybrid being considered. The investor's ability to understand the risks is a factor in determining suitability.

### **9.27 Structured Products**

Structured products generally are securities that are derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance and/or a foreign security. There are many variations of structured products and different features such as principal protection; payment of interest above market rates; and capping upside participation. Structured products have a fixed maturity and some may be listed while others are thinly traded.

Structured products typically have two components, a note and a derivative (often an option). The note pays interest at a specified rate and interval while the derivative establishes the payment at maturity. Structured products are generally subject to the requirements for public offerings of securities under the '33 Act and are usually offered from a shelf registration.

#### **9.27.1 Suitability**

Only accounts approved for option trading will be eligible to purchase structured products. Additionally, because of the potential complexity of the structured products, RRs must determine the suitability of potential purchasers, including the customer's:

- Financial situation including income and net worth
- Age
- Investment experience
- Ability to bear the risks involved with the product
- Knowledge and experience in financial matters that the customer can be reasonably expected to be capable of evaluating the risks of the recommended transaction.



### **9.27.2 Risk Disclosures**

RRs should inform the customer of the features of the structured product being recommended. If a prospectus or risk disclosure statement is available for the product being offered, it must be provided prior to any purchase. RRs must discuss the following risks with potential individual investors:

- General types of risks associated with structured products
- Any risk not usually associated with a given product, such as risk of loss due to any sale of the product before maturity
- Any material product-specific risk such as risks arising from the underlying asset, liquidity and market risks in relation to the product itself, or specific tax considerations
- Acknowledgment of limitations on available data
- The distinction between the underlying asset and the structured product based on the asset
- For principal-protected products, that the principal protection applies only at maturity and the costs of unwinding the product mean an earlier redemption value which may differ significantly from maturity value
- Availability or lack of availability of a secondary market to liquidate the investment
- Sales in the secondary market may be at significantly discounted value to the original investment
- The potential need to consult with the investor's accountant, tax attorney or other tax professional due to possible tax implications, if applicable.

### **9.27.3 Credit Ratings**

Credit ratings of issuers (or guarantors) may not represent a rating of the structured product. If credit ratings are disclosed to potential investors, disclosure must make clear the significance of the rating in relation to the investment.

### **9.27.4 Features and Risks of Structured Products**

Each structured product will have different features and it is the RR's responsibility to understand those features before making a recommendation. The following are some features that must be communicated to the customer (depending on the product) before a structured product is purchased:

- Principal protection: Some products offer full upside protection or have a cap; no dividends are paid. Principal protection may mature

within one to seven years and investors must hold them until maturity to guarantee the principal's return. Maturities shorter than 5 years usually cap returns.

- **Buffered return-enhanced notes:** Usually linked to the performance of a market index and issued as senior unsecured debt obligations that mature within one to five years and trade in \$1,000 increments. There is no dividend or interest income and gains are taxed as long-term capital gains if the investment is held un-hedged for more than one year. Buffered notes provide partial principal protection with the buffer ranging from 10-15%.
- **Return-enhanced notes:** The investor gives up the right to participate in market gains over a period in exchange for a payout at maturity that may be 2 or 3 times the return of a benchmark index. Maturities generally range from 1 to 3 years and trade in \$1,000 increments. They have a cap and provide no protection against market declines, and there is no dividend income.
- **Reverse convertibles:** This product is linked to a particular stock, basket of stocks or index and pay a fixed coupon that provides some protection from loss. The registered notes mature within one year or less and trade in \$1,000 increments. They typically carry a coupon of between 10-20% and the upside is limited to the coupon amount. If the underlying stock falls below a set barrier level, the investor may be significantly lower-valued stock instead of cash upon maturity. If the underlying stock is volatile, risk is significantly increased. Investors who try to sell a reverse convertible before maturity may lose money since there may not be much demand for the notes, especially in a down market.

### **9.27.5 Training**

The Firm requires its RRs to complete online Continued Education training on structured products offered through Incapital's website. Upon completion of the training, RRs must provide the completed certificates to Operations before placing structured products trades for customers. If a RR places a structured products trade for a client without following this process, the customer's transactions will be cancelled. RRs should contact Operations with any questions on this process.

# 10.0 SUPERVISORY SYSTEM, PROCEDURES, AND CONTROLS (Exchange Act Sec. 15[f]; FINRA Rules 3110, 3120, 3130; NASD Notice to Members 88-84, 89-34, 99-45, 04-71)

## 10.1 Introduction

The Firm has established a supervisory system, procedures and controls reasonably designed to comply with regulators' rules.

*Supervisory system:* The internal system to oversee business includes the designation of supervisors and allocation of responsibilities; assignment of RRs to appropriate supervisors; identification of areas of business and rules that govern those businesses; and development of procedures.

*Supervisory procedures:* Procedures in this manual (and in other policies or manuals, if referenced in specific chapters) include:

- compliance procedures for RRs/employees and others that explain rule requirements and prohibitions as well as internal policies when conducting sales and other activities; and,
- supervisory procedures that explain how supervisors are to conduct their ongoing responsibilities. Many supervisory procedures are explained in "matrixes" that appear throughout this manual and include the following:

|                |  |
|----------------|--|
| Responsibility | Who is the responsible supervisor? <i>Supervisors are referenced by department or as "designated supervisor" which is cross-referenced to the supervisory chart and/or list that appears in the Exhibits.</i>  |
| Resources      | The information / reports / documents that supervisors use to conduct supervision.   |
| Frequency      | How often are supervisory reviews to be conducted (daily, weekly, etc.)?   |
| Action         | How supervision is to be conducted (i.e., review a report, read correspondence, interview RR or customer, etc.).   |
| Record         | What record is made that supervision was conducted? <i>Generally supervisors are expected to initial and date reports or other records, note any action taken, and retain that information in their files.</i> |

*Supervisory Controls:* Controls refer to testing and evaluation of systems and procedures to measure and maintain their effectiveness. Internal controls typically involve sampling of functions to test effectiveness and identify shortcomings, gaps, or other inefficiencies in supervisory systems and

procedures. Internal controls also involve the ongoing reassessment of these functions to determine whether they are serving their intended purpose.

## **10.2 Responsibility**

Responsibility for the Firm's supervisory system, policies, and controls includes the following:

The Chief Compliance Officer (CCO) is responsible for establishing and maintaining the supervisory system, policies and procedures other than financial and operations procedures.

The Financial and Operations Principal (FINOP) is responsible for establishing and maintaining systems, policies and controls regarding financial and accounting procedures and reporting.

The Director of Operations is responsible for establishing and maintaining systems, policies and controls regarding operations procedures.

Designated supervisors are responsible for enforcing policies and procedures in their respective business areas and for the RRs they supervise.

## **10.3 Controls**

### **10.3.1 Verification and Testing**

The Firm periodically conducts reviews to test and verify its supervisory system and controls.

Testing and verification generally include:

- Identifying areas to be reviewed at least annually
- Developing reviews and a schedule for conducting the reviews
- Assigning responsibility for conducting reviews
- Preparing reports of reviews
- Providing reports to management and other appropriate personnel for potential corrective action
- Following up regarding deficiencies in subsequent reviews

Records of testing are maintained by the department responsible for conducting testing and include:

- areas to be reviewed
- schedule of reviews

- reports of findings including a record of distribution of the report and responses from the supervisor of the area examined
- follow-up or corrective action taken

Testing and verification is the responsibility of:

- Compliance for operational and supervisory systems and procedures
- Accounting for financial and operations systems and procedures

*Also See Section 6.11.10 - Internal Audit*

### **10.3.2 Outside Auditors**

The Firm's outside auditors conduct an annual review of internal financial and operational controls as well as compliance with selected rules and regulations. The FINOP (and other personnel, as required) is responsible for working with the outside auditors and providing them with requested information. The auditors' report is provided to senior management and the Firm's audit committee (if an audit committee has been established) who are responsible for delegating responsibility for taking corrective action on exceptions noted in the report.

The FINOP retains records of outside audits and reports.

## **10.4 Written Compliance and Supervisory Procedures (WSP)**

Compliance is responsible for maintaining and updating the Firm's compliance and supervisory procedures which are included in this manual.

This manual is updated and policies distributed as follows:

- New and amended rules and releases from regulators are reviewed on an ongoing basis and changes considered for the WSP and incorporated where necessary.
- Applicable changes are incorporated in the WSP at least annually.
- Notice is provided to all employees/RRs when a new manual is posted.
- Prior versions of the manual are archived for books and records purposes.

Policies are made available to employees/RRs in electronic format. Certifications of receipt and understanding are obtained annually.

## **10.5 Chief Compliance Officer (CCO) FINRA Rule 3130**

The Firm has designated a CCO who is listed on its Form BD.

## **10.6 Annual Compliance Report To CEO FINRA Rule 3130**

The CCO will arrange for the preparation of and provision to the CEO of an annual report that includes a review of the Firm's supervisory system and procedures and key compliance issues. The CCO will meet with the CEO to discuss and review the report and will meet at other times, as needed, to discuss other compliance matters.

The annual report will be provided to members of senior management.

### **10.6.1 Certification**

Annually (after receipt and review of the report), by December 31, the Chief Executive Officer (or equivalent) will certify that the Firm has in place processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to comply with regulators' rules. Certification does not, by itself, establish line supervisory responsibility for those involved in the certification process.

## **10.7 Supervision Of Supervisory Personnel (FINRA Rule 3110(b)(6))**

The firm's supervisors are prohibited from supervising their own activities and reporting to, or having their compensation or continued employment determined by, a person or persons they are supervising. However, if it is unavoidable to have a supervisor's compensation or continued employment determined by a person they are supervising, the firm will document the factors used to reach such determination and how the supervisory arrangement will comply with FINRA Rule 3110(a).

## **11.0 OFFICES**

### **11.1 Office Designations**

#### **11.1.1 Offices Of Supervisory Jurisdiction (OSJ) (FINRA Rule 3110(e)(1))**

Certain offices that meet the OSJ criteria will be established as such. Currently, the firm's only OSJ is the Decatur home office.

#### **11.1.2 Branch Offices (FINRA Rule 3110(e)(2))**

Each branch office is assigned to the supervision of an OSJ. Currently, all branch offices are assigned to the Decatur home office. The Compliance department or their chosen representative(s) is required to visit branch offices on a periodic basis (not to exceed three years) and record the visit in a

memorandum or other record to be retained for the branch location. All business transacted by branch offices must be processed through the supervising OSJ.

### **11.1.3 Non-Branch (“Unregistered”) Business Locations**

Locations used occasionally and exclusively for appointments from time to time between RRs and customers ("locations of convenience") and where the Firm has no other tangible presence are not deemed "branch offices." RRs conducting business at such locations are required to provide each customer with the address and telephone number of the branch office or office of supervisory jurisdiction that supervises the RR.

Each non-branch business location will be assigned to a branch office or OSJ for supervision. This includes RRs who are assigned to a branch office but transact business at a separate location. These RRs are referred to as off-site RRs. Compliance visits non-branch business locations and off-site RRs on a periodic basis and records the visit in a memorandum or other record to be retained by Compliance in a file for the location. Off-site RRs are required to process all business through the assigned OSJ.

NASD Notice To Members 98-38 and 04-71 should be considered part of this manual and consulted regarding supervisory obligations.

Compliance will maintain a record of all offices.

## **11.2 Use Of Office Space By Outsiders**

Registered persons not affiliated with the Firm are generally not permitted to conduct business or maintain offices on premises with RRs of the Firm. Office-sharing arrangements require the prior approval of Compliance.

## **11.3 Office Records (SEC Rules 17a-3 & 17a-4)**

Each office is required to maintain or have access to certain records relating to the business conducted in the office. "Office," for records purposes, means any location where an associated person conducts business (not including a home office or the office of a customer that an RR visits regularly). "Conducting business" includes handling funds or securities or soliciting/accepting orders. Each office is required to designate someone who can explain the office records to regulators.

Following is a list of office records for the most recent two-year period that must be produced in office locations, upon request by regulators. It is not necessary to maintain physical records in office locations if they can be retrieved and reproduced promptly at the office where they are being

requested. "Promptly" is generally understood to mean within 24 hours of the request.

- Order records and receipts/deliveries of securities (transaction blotters, applications, etc.)
- Employee/RR records (U-4, employment application, compensation agreements, CRD numbers, internal identifying numbers, offices where RR conducts business)
- Customer account records
- Complaints
- Transactions, by RR, including compensation earned, commission schedules, method by which compensation is determined
- Communications with the public (originals of communications received, copies of communications sent; approval of outgoing communications including correspondence, advertising and sales literature, sales scripts, and other outgoing communications requiring the supervisor's approval)
- Record naming the person in the office who can explain records
- Compliance and supervisory manuals

#### **11.4 Regulatory Requests For Records**

If a regulator (SEC, SRO, state regulator, or other) requests office records (in person or by another means), Compliance should be contacted immediately. The Firm is obligated to provide prompt response to regulators' requests for information; therefore it is important the record retrieval process begin immediately or as soon as possible after receipt of the request.

#### **11.5 Changes In Branch Offices**

Compliance is responsible for filing the uniform branch office registration form (Form BR) with the CRD to reflect changes to existing offices or to register new offices. Compliance retains records of branch registration filings. In addition, state requirements will be verified and any necessary application or documents will be filed with state licensing authorities before the office is opened.

#### **11.6 Office Inspections (FINRA Rule 3110(c)(1))**

##### **11.6.1 Inspection Cycle**

Offices will be inspected according to the following schedule:

- OSJs - annually



- Branch offices - periodically as established by Compliance (at minimum every 3 years) based on factors which may include:
  - Types of business conducted in the office
  - Volume of business conducted
  - Number of RRs and other personnel
  - Customer complaints and/or regulatory actions filed against office personnel
  - Prior year's inspection report findings
  - Other factors determined by Compliance
- Non-branch offices - periodically as established by Compliance based on factors which may include:
  - Types of business conducted in the office
  - Volume of business conducted
  - Number of RRs and other personnel
  - Customer complaints and/or regulatory actions filed against office personnel
  - Prior year's inspection report findings
  - Other factors determined by Compliance

Compliance, at its discretion, initiates unscheduled inspections (when potential significant problems are identified, at the request of senior management, etc.). RRs who are wholesalers will have their offices inspected as needed as they do not hold customer accounts.

### **11.6.2 Conducting Inspections**

Inspections are conducted by Compliance department staff (or their designee).

### **11.6.3 Reports (FINRA Rule 3110)(2))**

Written reports of inspections will include:

- the name of the person who conducted the inspection and prepared the report
- the date(s) of the inspection
- areas reviewed (depending on types of business conducted in the office) may include:
  - safeguarding customer funds and securities;
  - maintaining books and records;
  - supervision of supervisory personnel;
  - transmitting funds between customers and RRs and between customers and third parties; and
  - customer account information changes, including address and investment objective changes and validation of such changes.

- for any of the above areas not included in the report, an explanation of why they were not included (i.e., the office does not accept funds or securities, the office does not have a producing manager, etc.).
- observations and exceptions regarding compliance with policies and procedures
- the RR's response regarding exceptions and corrective action.

#### **11.6.4 Branch Office Inspection Procedures**

Compliance reviews the Firm's branch office inspection procedures on an ongoing basis. The branch office inspection procedures shall be modified if necessary, including but not limited to revisions due to new rules, regulations, and changes in the firm's Written Supervisory Procedures.

#### **11.6.5 Analysis of Branch Office Inspection Results**

Those conducting branch office inspections provide feedback to appropriate management personnel related to the perceptions of needed topics pertaining to continuing education, training, modifications to the examination module and particular patterns of deficiencies so that enhancements can continually be made to the examination module and the Firm's continuing education program.

### **11.7 Availability Of Rules**

Each office will maintain copies of FINRA/NASD and MSRB rules that are available to customers for examination upon request. In offices where Internet access is available, this requirement is satisfied by providing access to the rules published on the MSRB and FINRA web sites. These web sites are [www.msrb.org](http://www.msrb.org) and [www.finra.org](http://www.finra.org). These sites should be bookmarked on an office computer for quick, easy reference.

### **11.8 Display Of SIPC Symbol**

In authorized branch locations, the SIPC symbol will be displayed. Compliance is responsible for identifying the office locations that require the necessary SIPC display.

### **11.9 Offices On Bank and Other Financial Institution Premises**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> <li>• Operations</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Networking Agreement</li> <li>• Customer acknowledgments</li> <li>• Advertising and sales literature referring to services on</li> </ul> |

|                  |   |
|------------------|---|
|                  | <ul style="list-style-type: none"> <li>bank premises</li> <li>New accounts</li> <li>Customer correspondence (incoming and outgoing)</li> <li>Daily transaction report</li> </ul>  |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>Networking Agreement - as required</li> <li>Customer acknowledgments - spot-check by supervisor quarterly</li> <li>Advertising and sales literature - as required</li> <li>New accounts - as required</li> <li>Correspondence - daily or as required</li> <li>Transaction review - daily</li> <li>Audits - as scheduled</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>Establish the initial Networking Agreement and amend as needed</li> <li>Review accounts opened to confirm customer acknowledgment was provided</li> <li>Review and revise, approve, or disapprove advertising and sales literature</li> <li>Review correspondence and customer transactions</li> <li>Audits: Review for physical separation; acknowledgments provided; other sales practice areas reviewed as part of branch reviews</li> </ul>                                      |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>Networking Agreement and amendments retained by Compliance</li> <li>Advertising and sales literature and notation of date and action taken retained by Compliance</li> <li>Approval of new accounts retained in Operations</li> <li>Copies of correspondence retained by Compliance</li> <li>Daily transaction report initialed and dated including notes of action taken, retained by Operations</li> <li>Audits: records of audits conducted are retained by Compliance</li> </ul> |

The Firm is engaged in a networking arrangement with an unaffiliated depository institution (referred to as "bank" in these procedures) and provides broker-dealer services on the bank's premises. This section explains procedures for conducting Firm business on the bank's premises.

### **11.9.1 Networking Agreement**

The Firm has entered into a Networking Agreement with the bank. The Agreement stipulates the responsibilities of the Firm and the bank, the conditions of the arrangement, and the compensation to be received by the bank.

### **11.9.2 Physical Separation**

The Firm's brokerage activities must be conducted in a location on the bank's premises that is physically separate from the bank's regular business activities and clearly distinguishes the brokerage services from the bank's services.

### **11.9.3 Customer Acknowledgments**

RRs operating on bank premises are required to:

- inform all securities customers orally that purchases and sales through the Firm are not guaranteed by the bank or the FDIC or any other federal or state deposit guarantee fund; and,
- obtain a written acknowledgment from the customer of the above which is included in new account form application disclosures.

### **11.9.4 Retail Communications (Advertising and Sales Literature)**

All advertising and sales literature used to promote the availability of brokerage services through the bank must be approved by Compliance in advance of use. References to the bank in these materials are limited to identifying the location where brokerage services are available, and the references may not appear prominently in the materials.

### **11.9.5 Customer Correspondence**

Copies of all incoming and outgoing customer correspondence (including faxes) must be provided to Compliance for past use review and retention. Electronic correspondence is reviewed in accordance with the Firm's electronic communications policy.

### **11.9.6 Compensation To Bank Personnel**

RRs working on bank premises are strictly prohibited from providing compensation to bank personnel. Permissible compensation is governed by the Firm's Networking Agreement with the bank and is subject to limitations imposed by regulators.

### 11.9.7 Bank and Other Financial Institution Regulators

RRs operating on bank premises and their supervisors should be aware that bank regulators have taken the position that they may require access to the broker-dealer's records as part of their regulatory reviews. Requests from regulators or other outside parties for Firm records or information should always be referred to Compliance for response.

### 11.10 Customer Account Access

All offices, including branch and non-branch locations, must implement reasonable measures to protect and restrict access to private client information and order entry systems. All employees and RRs must follow the procedures in Section 5.7.5 Protection of Customer Information and Records.

Onsite inspections performed in accordance with Section 11.6 Office Inspections will incorporate reviews to ensure that all offices protect and Secure User IDs and passwords ensure that access to physical and digital customer information is limited to licensed and fingerprinted individuals and deter password sharing.

## 12.0 CORPORATE FIXED INCOME SALES AND TRADING

### 12.1 Fair Prices

RRs and Operations (if placing the trade) are responsible for making a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.

### 12.2 Mark-Ups and Mark-Downs

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li><li>• RRs</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Orders</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• RRs:<ul style="list-style-type: none"><li>◦ Ensure mark-ups and mark-downs are within Firm guidelines</li><li>◦ For mark-ups and mark-downs that are outside</li></ul></li></ul> |

|               |  |
|---------------|--|
|               | <p>guidelines, include a written justification on the order record</p> <ul style="list-style-type: none"> <li>• The Operations or Compliance reviews mark-ups and mark-downs that exceed Firm guidelines: <ul style="list-style-type: none"> <li>◦ Review order records for written justification</li> <li>◦ Notify Operations Director of missing justifications and request correction of the deficiency</li> <li>◦ Confer with Director of Operations regarding orders where justification does not seem warranted</li> </ul> </li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Order records maintained by Operations</li> <li>• Trading reports including initials/approval of reviewer</li> </ul>  |

The designated supervisor is responsible for reviewing the reasonableness of mark-ups and mark-downs on customer trades. In determining fair and equitable mark-ups or mark-downs, relevant factors may include:

- 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
- total dollar amount of the transaction
- availability of the security
- the price or yield of the security
- the maturity of the security
- resulting yield to the customer, as compared to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market
- the nature of the Firm's business
- any other relevant facts at time of execution.

### 12.3 Errors

All errors in customer orders must be resolved immediately when discovered. No overnight positions should be maintained in the error account. Errors in customer accounts are documented on the Cancel & Rebill/Error Report form which requires a designated principal's approval.

### 12.4 Cancells and Rebills

Cancellations and rebills in customer accounts are documented on the Cancel & Rebill/Error Report form which requires a designated supervisor's approval.

## 12.5 Prohibited Activities

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Trading reports</li><li>• Observation of trading activities</li></ul>               |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Take corrective action depending on the nature of the prohibited activity</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Operations files</li></ul>  |

### 12.5.1 Inside Information

RRs are prohibited from acting on, passing on, or discussing any inside information regarding and fixed income security issues, including any material non-public information such as credit rating changes, defaults or advance refunding. Any knowledge of such information must be brought to the attention of the designated supervisor and Compliance. No Firm proprietary account or RR account may enter a transaction in a security based on material non-public information about that security.

### 12.5.2 Financial Arrangements

RRs are prohibited from entering into financial arrangements with customers or issuers (*i.e.*, sharing in profits or losses, sharing in commissions, rebating commissions, *etc.*).

### 12.5.3 Market Manipulation

No purchase or sales order shall be entered 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. No purchase or sale order shall be entered or executed with the intent to “corner” a market or create a “squeeze” in a security.

### 12.5.4 Front running

No Firm proprietary or RR account may trade a security while in possession of material information about an imminent block-sized transaction in that security or a derivative security.

### **12.5.5 Self-Preferencing**

No firm may trade for its own account ahead of a customer's limit order at the same or better price.

### **12.5.6 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 a financing transaction, are not included in this prohibition if they are not entered for a manipulative purpose.

### **12.5.7 Inter-positioning**

A RR may not interpose the Firm or any account between a customer order and the best available market.

### **12.5.8 Secret Profits**

A RR may not permit the charging of a mark-up or mark-down in addition to a commission on any transaction.

### **12.5.9 Marking The Opening or Close**

Entering orders at the opening or close of the market for the purpose of affecting the price of securities is prohibited.

### **12.5.10 Adjusted Trading**

Adjusted trading or "overtrading" is a prohibited practice that 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. The purpose of an adjusted trade usually is to assist a customer in avoiding, disguising, or postponing losses.

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
- inter-positioning 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



All transactions must be executed at prices reasonably related to current market prices and all books and records of the Firm must show an accurate price for securities purchased or sold.

## **12.6 Review Of Transactions**

The designated supervisor is responsible for daily review of transactions executed in the fixed income trading area(s) to identify transactions or patterns that may violate regulatory requirements or Firm policies. Particular attention should be given to cancellations and rebills, error accounts, extended settlements and any transaction that would constitute a prohibited activity. The supervisor should investigate any questionable transaction and inform Compliance as appropriate.

## **12.7 Mark-Up Policy**

It shall be deemed a violation of FINRA Rule 2010 and NASD Rule 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable. The Firm bases its mark-up policy on the NASD's Conduct rules and Interpretive Memo "IM-2440."

Excerpts of IM-2440 follow:

"The question of fair mark-ups or spreads is one that has been raised from the earliest days of the NASD. No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the Association's Board adopted what has become known as the "5% Policy" to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were effected at a mark-up of 5% or less. The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in 1943.

1. The "5% Policy" is a guide, not a rule.
2. A member may not justify mark-ups on the basis of expenses which are excessive.
3. 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, a member's own contemporaneous cost is the best indication of the prevailing market price of a security.
4. A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy."

5. 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."

According to the Interpretive Memorandum, other factors to be considered when determining the appropriate level of mark-up are to include:

- The type of security involved
- The availability of the security in the marketplace
- The price of the security
- The amount of money involved in the transaction
- Disclosure.

Any disclosure to the customer, before the transaction is effected, of information that would indicate

- A. the amount of commission charged in an agency transaction
- B. Mark-up made in a principal transaction is a factor to be considered.

Disclosure itself, however, does not justify a commission or mark-up that is unfair or excessive in light of all other relevant circumstances.

- The pattern of mark-ups
- The nature of the firm's business.

Consistent with industry interpretations, it is the position of the Firm that the 5% mark-up should be considered to be the sum of the mark-up on the buy and the sell of any given position, or half of the 5% on any given transaction. To ensure appropriate pricing, the Firm endeavors to price transactions at 2.0% or lower. Exceptions may be made on the basis of the conditions noted above, including price, type, and maturity. The Firm will publish its mark-up guidelines for RRs on the Advisor's site.

The specific Mark-up Guidelines for the firm will be monitored and maintained by Operations, and may from time to time be amended to reflect any of the conditions noted above.

## 12.8 TRACE FINRA Rule 6700 Series

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• TRACE-eligible transactions</li><li>• TRACE Report Cards</li></ul> |

|                  |  |
|------------------|--|
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• Daily</li> </ul>  |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Conduct a spot-check to determine whether trades are properly reported</li> <li>• Review Report Cards and take corrective action</li> </ul>                         |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Review documented in daytimer or other notations to the designated principal's files including date of review, evidence of review, and any action taken.</li> </ul> |

FINRA requires the reporting of OTC transactions in eligible corporate debt securities to its Trade Reporting and Compliance Engine (TRACE). This section summarizes TRACE reporting requirements, FINRA rules should be consulted for more detailed information, including the information to be reported.

### **12.8.1 TRACE Eligible Securities (FINRA Rule 6710, NTM 04-90, 04-65, 04-39 07-18)**

Securities required to be reported to the TRACE system include corporate debt securities as follows. The rule itself should be referenced for specific definitions of “investment grade,” “non-investment grade,” and “split –rated” securities.

- U.S. dollar denominated and depository eligible;
- FDIC guaranteed debt securities under the federal Temporary Liquidity Guarantee Program;
- Agency debt securities;
- Issued by U.S. and/or foreign private corporations; and, registered under the '33 Act; or, issued under Section 4(2) of the '33 Act and bought or sold under Rule 144A.

TRACE eligible securities include unlisted convertible debt, unlisted equity-linked notes and similar securities (those that are listed on a national securities exchange must be reported to the appropriate equity trade reporting facility). A “foreign private issuer” is a foreign issuer that is not eligible to use the SEC’s Schedule B for registering a debt offering in the U.S.

Reporting obligations include primary market transactions in TRACE eligible securities.

#### **12.8.1.1 Securities Excluded From TRACE Requirements**

Securities excluded from TRACE reporting requirements are:

- debt securities that are not depository eligible

- sovereign debt
- development bank debt
- money market instruments (debt securities with a maturity of one year or less).

### **12.8.2 Reportable Transactions**

Any secondary market transaction in a TRACE-eligible security must be reported to TRACE **unless** the security is executed on and reported to a national exchange. Transactions in convertible debt securities reported to NASDAQ also are excluded as well as securities that are part of a primary distribution.

### **12.8.3 Transaction Reporting FINRA Rule 6730**

The Firm is obligated to report to TRACE as soon as practicable, but no later than within 15 minutes of the time of execution, any transactions in the securities subject to TRACE requirements, for transactions executed within the timeframes listed below (all times are Eastern Time).

1. During TRACE system hours (between 8:00 a.m. through 6:29:59 p.m.): within 15 minutes of time of execution, except for transactions executed less than 15 minutes before 6:30 p.m., the trade may be reported the next business day within 15 minutes of TRACE opening, indicating "as/of" and the actual transaction date.
2. After 6:30 p.m. through 11:59:59 p.m.: next business day within 15 minutes of TRACE opening, indicating "as/of" and the actual transaction date.
3. After 12:00 a.m. through 7:59:59 a.m.: the same day within 15 minutes after TRACE opening.
4. Executions on a non-business day: the next business day within 15 minutes after TRACE opening and indicating date of execution; execution time; and the modifier "special price." May not be reported "as/of."
5. For certain primary market transactions (List or Fixed Offering Price Transactions or Takedown Transactions), the reporting period is extended to the close of business of the day following the day of execution (i.e., to 6:30 p.m. E.T. on T+1). Transaction information is not disseminated.
6. The TRACE system also accepts reports of transactions in TRACE-eligible securities where the execution date is more than T+365 days old.

#### **12.8.3.1 Who Reports**

When the buyer and seller are both FINRA members, both members must report to TRACE. For transactions between a member and a non-member, including a customer, the member must report. Reporting will be completed through our clearing firm.

## 12.9 High Yield Debt Securities

### 12.9.1 Suitability

Since high yield debt securities generally involve a higher degree of risk, it is important that the RR recommend such securities only to customers willing to risk loss of principal. Supervisors reviewing daily transactions should consider the suitability of recommended purchases of high yield debt securities in relation to the customer's investment objectives and other investments.

## 13.0 MUTUAL FUNDS

### 13.1 Introduction

Mutual funds, for purposes of these policies and procedures, refer to open-end investment companies. RRs are responsible for recommending mutual fund transactions in compliance with these policies.

In addition to mutual funds, this chapter includes sections on closed-end funds and unit investment trusts (UITs), which also are investment company securities but are not considered "mutual funds."

Key points for consideration when offering mutual funds include the following:

- RRs must consider sales charges when recommending mutual funds and determine the most advantageous cost structure for the customer including class types.
- Customer suitability determination includes consideration of investment objectives, other investments held, financial and tax status and risk tolerance.
- Fund characteristics to consider include investment objectives, risk, cost structure and underlying investments and strategies.
- Switching from one fund to another requires the customer's signed acknowledgement.
- RRs cannot sell dividends or facilitate customer late trading or market timing.
- Required disclosure are included in prospectuses or summary prospectuses (open-end funds only) which must be provided to purchasers.

### 13.2 Mutual Funds Offered By The Firm

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|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Product Review Committee</li></ul> |
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| <b>Resources</b> | <ul style="list-style-type: none"> <li>• Prospectuses and other information provided by mutual fund companies or other distributors</li> <li>• Selling agreements</li> </ul>  |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review information on mutual funds</li> <li>• Determine which fund companies' products to offer</li> <li>• Execute selling agreements with mutual fund companies</li> <li>• Review special sales programs and promotions outside the standard commission schedule to determine compliance with the anti-reciprocal rule</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Information used to determine which funds to sell</li> <li>• Signed selling agreements</li> </ul>  |

Mutual funds with a range of investments and objectives will be available for investment by customers.

### **13.2.1 Anti-Reciprocal Rule (NASD Rule 2830[k], NTM 05-04)**

The selection and offer of mutual funds will comply with anti-reciprocal prohibitions. If an employee or RR becomes aware of a prohibited activity, it should be reported immediately to Compliance. Specifically, the Firm will not:

- Favor or disfavor sales of investment companies based on commissions received or expected and tied to sales
- Sell shares of, or act as underwriter for, any investment company where the Firm is aware that the investment company or its investment adviser or underwriter have directed brokerage arrangements in place that are intended to promote the sale of investment company products
- Require such commissions to sell the funds or offer commission to another broker/dealer relating to their sale of funds
- Circulate information about commissions received from an investment company, other than to senior managers for purposes of managing the Firm's business
- Provide incentive or special compensation based on the amount of commissions expected to be received from the fund or another source
- Establish recommended, selected, or similar preferred lists of investment companies if based on brokerage commissions
- Allow RRs and other sales personnel to participate in commissions received from investment company portfolio transactions

- Use the sale of investment company shares to negotiate the price or amount of brokerage commissions paid on investment company portfolio transactions.

These prohibitions do not prevent execution of investment company portfolio transactions that are not tied to sales of the investment company's shares. Employees/RRs may also be compensated for sales attributable to them including the use of overrides, accounting credits, or other compensation, provided the extra compensation does not violate anti-reciprocal prohibitions.

### 13.3 Sales Charges

Mutual funds (other than no-load funds) generally charge a sales charge that is a cost to the investor. Sales charges may be a front-end load, deducted from the amount invested when the fund is purchased; a back-end load, deducted from sales proceeds when the fund is sold depending on how long the investor holds the fund; or a combination of sales charges. The fund prospectus explains sales charges and other costs to the investor.

Mutual funds sold with a front-end load often offer investors the opportunity to pay reduced sales loads 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.

**RRs are responsible for understanding the availability of such options provide the customer the opportunity to purchase the fund under the most favorable terms available.** The availability of reduced sales charges are explained in the fund prospectus.

#### 13.3.1 Breakpoints

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|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Electronic record(s) of the order/order ticket(s)</li> <li>• Applications</li> <li>• Daily Blotter</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review mutual fund purchase transactions for potential breakpoint sales. Items to look for include: <ul style="list-style-type: none"> <li>◦ Purchases near but below common breakpoint levels (\$50,000, \$100,000, <i>etc.</i>)</li> <li>◦ Multiple purchases of mutual funds that, if</li> </ul> </li> </ul> |

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|---------------|--|
|               | <p>aggregated, would have qualified the customer for a breakpoint if one or fewer funds were purchased</p> <ul style="list-style-type: none"> <li>• For purchases where it appears the customer would have been better served by purchasing an additional amount or where purchasing fewer funds would have qualified for the breakpoint: <ul style="list-style-type: none"> <li>○ Confer with the RR to determine the basis for the less than breakpoint purchases</li> <li>○ Correct transactions accordingly and take corrective action with the RR if necessary</li> </ul> </li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on electronic record(s) of the order/blotter</li> </ul>   |

For some 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 RR has the point of sale obligation to disclose the existence of breakpoints to enable the customer to evaluate the desirability of making a qualifying purchase. The RR also must also notify the product sponsor or, if applicable, note on the electronic order or application if the customer qualifies for a breakpoint because of linked accounts, transactions, or share classes or other basis for meeting a breakpoint by linking the customer's transaction with another.

"Improper breakpoint sales" (FINRA Rule 2342) is a term that denotes selling mutual funds to maximize commissions earned, i.e., selling an amount close to but below a breakpoint. The customer will, therefore, pay a higher sales charge. This practice is prohibited.

Recommending diversification among several funds with similar investment objectives, particularly if sales occur in amounts just below the breakpoints of one or more funds sold, may not be in the best interests of the customer. If multiple purchases of different mutual funds is appropriate but will preclude the customer from qualifying for a breakpoint, the RR should have the customer acknowledge in writing his or her understanding that a breakpoint is being given up by purchasing the applicable multiple funds.

It is recommended that RRs should utilize FINRA's breakpoint search tool, which is available at the following web address:  
<http://apps.finra.org/fundanalyzer/1/fa.aspx>. The tool provides breakpoint schedules and linkage rules for mutual funds, ETFs and ETNs with sales charges. It estimates the value of the funds and impact of fees and expenses on



the client's investment and also allows the ability to look up applicable fees and available discounts for funds.

### 13.3.2 Rights Of Accumulation

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| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• RRs</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Daily electronic record(s) of the order/order ticket(s)</li><li>• Applications</li><li>• Daily Blotter</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review orders for indication whether customer will qualify for rights of accumulation</li></ul>                  |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the order/blotter</li></ul>   |

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 RR should ask the customer whether the customer has other holdings in the fund or fund family, to determine whether rights of accumulation may be available to the customer.

Mutual funds follow different rules to determine the value of existing holdings and when a customer qualifies for a breakpoint discount. Most funds use current net asset value (NAV) of existing holdings and a small number of funds use historical cost (cost of the initial purchase). If historical cost is used, it may be necessary for the investor to provide account records to qualify for the breakpoint discount.

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.

### 13.3.3 Reinstatement Privilege

Some funds offer shareholders a "reinstatement privilege" allowing the shareholder to reinvest some or all of the proceeds from a prior liquidation of the fund within a specified period of time (for example, 180 days) at a reduced sales load or no sales load. The RR should determine whether the customer qualifies for a reinvestment privilege and, if he or she qualifies, note this on the order at time of entry.

### 13.3.4 Deferred Sales Charges

If a customer purchases shares of a mutual fund that imposes a deferred sales charge on redemption, the confirmation will include the following legend: "On selling your shares, you may pay a sales charge. For the charge and other fees, see the prospectus."

### 13.3.5 Letters of Intent

A letter of intent (LOI) 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 group over a specific period of time. The aggregate investment over time may qualify for a breakpoint and a lower percentage sales charge.

The mutual fund purchase should indicate if the customer will execute a LOI so the lower sales charge will apply. Some funds allow investors to use an LOI retroactively to include the value of past purchases in the LOI period. The RR should determine whether the customer made a prior purchase within the allowable period and whether the funds allows backdated LOIs.

## 13.4 Switching

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| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li><li>• RRs</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Electronic record(s) of the order/order ticket(s)</li><li>• Applications</li><li>• Exception Report</li><li>• Daily Blotter</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review mutual fund orders for transactions where the customer sells one mutual fund to buy another mutual fund</li><li>• When switching is identified, ensure the customer provides a signed switch letter</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the order/blotter</li><li>• Switch Letter</li></ul>   |

Switching is the selling or redemption of one mutual fund with a sales charge to buy another mutual fund with a sales charge. Recommended switches may not be based on the compensation to be received by the RR or the Firm as a result of affecting the switch. As for all recommendations, the RR must have a reasonable basis for believing the switch is suitable for the customer.

The customer may incur multiple sales charges by changing from one fund to another or may be subject to an extended holding period, and there may also be tax consequences because of the switch. The concern is whether the switch is justified and whether the customer understands the consequences of the switch.

Switches between mutual funds that result in potential additional sales charges for the customer (whether front-end or back-end load) require that a letter be obtained from the customer acknowledging an understanding of the consequences of the switch. It is the RR's responsibility to ensure switch letters are obtained for switch transactions. The letter will be retained with the record of the order and/or in a branch file for the customer or for switch letters. FINRA prohibits the use of "negative consent letters," which are used to advise a client that there will be a switch from one fund to another unless the customer responds before a specified date.

### **13.5 Market Timing Transactions**

FINRA has stated that recommendations to fund investors to engage in market timing transactions should be made, if at all, within a single family of funds or where there are no transaction costs associated with the trades. Transactions that do not adhere to this standard may raise suitability questions.

### **13.6 Selling Dividends**

Selling dividends is a 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. In fact, there may be increased tax liability for the investor. A related concern is representing 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.

### **13.7 Misrepresenting "No-Load" Funds**

Certain funds impose a sales charge when the customer redeems or liquidates an investment ("back-end load" or contingent deferred sales charge). These charges are generally on a decreasing basis the longer the mutual fund is held.

For example, a mutual fund may charge 5% if the shares are sold prior to being held 5 years, 4% if after 5 but before 6 years, *etc.* Other funds have a combined asset-based sales charge and/or service fee exceeding .25 of 1% of average annual assets.

Mutual funds with back-end loads or asset-based sales or service fees may not be sold as "no-load" funds.

### 13.8 Reinvestment Of Maturing Certificates Of Deposit In Mutual Funds

When funds from maturing certificates of deposit (CDs) are used for the purchase of mutual funds, including money market funds, customers must be advised of the material differences between the two products, particularly the greater risk to the customer's capital and the absence of any federal insurance or guarantee for assets placed into mutual funds.

### 13.9 Suitability

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| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Electronic record(s) of the order/order ticket(s)</li> <li>• Applications</li> <li>• Daily Blotter</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review mutual fund transactions for suitability with particular attention to the following: <ul style="list-style-type: none"> <li>◦ Funds with high risk objectives: is the investment consistent with the customer's investment objectives?</li> <li>◦ Purchasing multiple funds in different families that may result in higher sales charges: is diversifying funds justifiable and does the customer understand the higher cost, if applicable?</li> <li>◦ Confer with RRs regarding any transactions that raise questions</li> <li>◦ Share Class</li> <li>◦ All other determinants discussed in this section</li> </ul> </li> <li>• Follow up action may include: <ul style="list-style-type: none"> <li>◦ Requesting written acknowledgement from the customer that the higher costs are understood</li> <li>◦ Canceling transactions that appear to be</li> </ul> </li> </ul> |

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|               | inappropriate  |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on electronic record(s) of the order/blotter</li> <li>• Customer's signed acknowledgement filed in the customer file, if appropriate</li> </ul> |

When determining whether or not an investment is suitable for a client, RRs must take the necessary steps to "know their client." This includes gathering all pertinent financial information as well as discussing other personal issues that may impact the financial information at a future time. Once the client has provided all of this information, RRs are charged with assisting the client in determining what investment vehicle best meets their needs and objectives. When recommending mutual funds, at a minimum, RRs should keep the following things in mind:

- **Objective of the Fund** - The investment objective of the fund should match the investment objective of the client. A discussion of risk factors should also be undertaken. For example, sector and small-cap funds have special degrees of risk that need to be covered with the client.
- **Investment Time Horizon** - Mutual funds are generally considered long-term investments. Any client who does not have a long-term investment horizon may not be suitable for this investment type. Discuss this with the client and determine their needs and goals for the monies invested. Shorter time horizons may preclude certain investment types and also dictate that more attention be paid to the various charges that accompany the different classes of shares.
- **Charges Associated with the Funds** - Depending on the amount of the investment, the time horizon of the client, and the goals of the client, you need to discuss all applicable material aspects of the mutual fund investment with the client. These material aspects include the breakpoints available for each level of investment; the contingent deferred sales charge, and the expense ratio of the fund (including 12b-1 fees). All of these must be considered before deeming a fund as suitable for a client.

Mutual fund families offer investors many different funds and share classes that are designed to meet virtually all investment objectives and risk tolerance levels. See *Mutual Fund Share Class Distinctions* section.

### 13.10 Late Trading and Market Timing

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| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul> |
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| <b>Resources</b> | <ul style="list-style-type: none"> <li>• Records of mutual fund transactions</li> <li>• Reports available to track mutual fund transactions</li> </ul>  |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• Daily</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review transactions for patterns of late trading</li> <li>• Identify patterns of "as-of" trades in mutual funds that may indicate late trading</li> <li>• Review transactions for indications of market timing (frequent in-and-out transactions in a mutual fund)</li> <li>• Determine whether market timing is permitted for the fund</li> <li>• Consult with Compliance when potential violations of late trading or market timing are identified</li> <li>• Take corrective action which may include contact with the fund, fund sponsor, or other person potentially engaging in the prohibited activities; limiting trading activity; closing the account; or other corrective action appropriate to the situation.</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Records reviewed for trading (whether order records or reports)</li> </ul>   |

There are two mutual fund trading activities that may violate SRO rules whether initiated by the RR or the RR facilitates the prohibited activity by assisting a fund manager, an investment adviser, a fund sponsor, a customer, or someone else in engaging in these activities.

**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 p.m. E.T., 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 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.**

**Market timing** is rapid and repetitive in-and-out trading to take advantage of market movements such as buying an international mutual fund one day and selling it the next day because of movements in foreign markets that impact the fund's value. While trading a mutual fund is not, in itself, illegal or violates a rule, it often violates restrictions established by the fund on short-term market timing

trades. **Engaging in market timing or knowingly aiding someone in activity that violates a mutual fund's internal trading guidelines is prohibited.**

There are valid reasons why an occasional mutual fund trade may be entered late and should be processed at the current day's NAV. There may also be funds that do not prohibit market timing. However, RRs must not engage in or assist someone else in engaging in prohibited late trading and market timing. Compliance should be contacted if someone proposes to engage in either activity.

### 13.11 Correspondence

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|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Outgoing correspondence</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Correspondence regarding mutual funds is subject to specific restrictions limiting what may be included since they are offered by prospectus<ul style="list-style-type: none"><li>◦ Review RR-generated correspondence to ensure language only indicates a prospectus is enclosed and the RR will call the customer to discuss the investment further</li><li>◦ Ensure sending of only Firm-approved correspondence other than the limited language described above</li></ul></li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on correspondence</li><li>• Compliance retains correspondence it reviews</li></ul>  |

When reviewing correspondence regarding mutual funds, the designated supervisor should watch for the following in addition to the usual considerations when reviewing correspondence:

- Selling dividends (not permitted)
- Representing a back-end load fund as "no-load" (not permitted)
- Representing a fund with an asset-based sales or service fee exceeding .25 of 1% as "no-load" (not permitted)
- Representations regarding yield (there are specific requirements regarding quotation of yields; RRs 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
- Letters that include excerpts from the prospectus that would be misleading when taken out of context
- Disclosures, as applicable (see explanation in the section titled "Disclosure of Material Facts")
- Performance is represented accurately and consistent with rule requirements regarding yield and return

RRs should use letters pre-approved by the Firm and include a prospectus or limit correspondence to stating that a prospectus is enclosed and the RR will be in contact with the customer. Questions should be referred to Compliance.

### **13.12 Disclosure Of Material Facts**

FINRA has stated that there are material facts that should be disclosed to a customer when recommending a mutual fund. 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, i.e., share class
- 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.

#### **13.12.1 Mutual Fund Share Class Distinctions**

Generally speaking, mutual funds offer three classes of shares. The differences between the classes usually lie in the sales charges and internal expense structure. RR's are obligated to know the specifics regarding any mutual fund that you sell to a client. All of these differences will be described in detail in the prospectus. A generic, brief description of the three classes follows.



## **Class A Shares**

Class A shares typically charge a front-end sales charge (or a "front-end load"). In exchange for having the investor pay the sales charge up-front, the expenses of the fund (as measured by the "expense ratio") usually include little or no extraneous fees for sales and marketing fees (these extra fees are referred to as 12b-1 fees). Higher amounts invested result in even lower sales charges as investment breakpoints are reached, and investors can meet these breakpoints by rights of accumulation (to take advantage of past purchases) or by signing a letter of intent (to take advantage of future purchases).

## **Class B Shares**

Class B shares generally do not charge a front-end sales charge but the expense ratio is usually higher than that of Class A shares. No sales charges are imposed at the time of purchase; hence, the client's total investment will be invested immediately. The fund companies usually will charge the client a contingent deferred sales charge (CDSC) that is paid if the shares are sold within a certain timeframe. The CDSC usually decreases the longer the investment is held. However, the expense ratio associated with B shares are traditionally higher. Once the investment is held for a certain length of time, the CDSC to the client to liquidate is eliminated. With some funds, the B shares are automatically converted to A shares at the end of the CDSC period (and thus lower the expense ratio after conversion).

The combination of the expense ratio of the fund and the CDSC may not be in the best interest of the investor if his/her time horizon is not in line with the fee structure of the fund.

## **Class C Shares**

Class C shares normally do not have a front-end sales charge and may charge a small CDSC if the shares are sold within a short period of time, usually one year. Class C shares generally impose a higher asset-based expense ratio than A shares. Because C shares do not convert to A shares, you (and investor) need to be aware that these charges are not reduced for the life of the investment.

Ensure that the different share classes are discussed in detail with the client and that they read the prospectus carefully, particularly the sections on sales charges and expenses.

## **13.13 Performance Information**

IPI prefers that all written discussion of a fund's performance simply refer clients to the prospectus. When presenting performance information, an explanation of total return should explain that total return measures overall performance while

current yield represents only the interest or dividend paid by the fund. Where appropriate, RRs should explain the difference between return of principal and return on principal. When providing information regarding distribution rates, the RR is responsible for explaining the difference between distribution rate and current yield.

Any communication with the public that discusses performance or rates of return must be pre-approved by Compliance.

### **13.14 Prospectuses**

RRs should provide a copy of the prospectus when recommending or discussing a mutual fund purchase with a customer. A summary prospectus may also be provided for open-end funds, if available. The summary prospectus includes reference to an internet site where the complete statutory prospectus is available along with other required information. A prospectus must be provided prior to completion of an application or dissemination of retail communications (sales literature or advertising).

### **13.15 Retail Communications (Advertising and Sales Literature)**

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| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Firm-approved advertising and sales literature</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Ensure only Firm-approved advertising and sales literature is used in conjunction with sales of mutual funds</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Compliance retains records of Firm-approved advertising and sales literature.</li></ul>                                |

There are specific requirements for advertising and sales literature regarding mutual funds. Advertising must be filed with FINRA within prescribed periods (see the chapter titled "Communications With The Public" and the section titled "Retail Communications (Advertising and Sales Literature)" for details). There also are mandated guidelines on representations regarding performance and yield. RRs may use materials provided by the fund or Firm-approved materials. Any other advertising or sales literature must be approved by Compliance prior to use.

### 13.16 Dealer-Use-Only Material

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| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Outgoing correspondence</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Ensure the branch does not distribute dealer-use-only materials to the public</li><li>• Review correspondence to identify inclusion of restricted materials</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on correspondence</li></ul>   |

Materials provided by fund distributors for dealer-use only may not be provided to customers and must not be displayed in a public area such as a reception area where customers obtain written information regarding investments. Dealer-use-only material is often provided as educational material for dealers and their RRs. There is no requirement to file this material with FINRA because it is for internal use only.

All dealer-use-only material will be marked as such with limited distribution.

### 13.17 Seminars and Other Public Presentations

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Outlines of proposed seminars and other public presentations that include mutual funds</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review outlines for appropriateness of presentation</li><li>• Make necessary changes and approve (or disapprove, if appropriate)</li><li>• Remind the RR of the requirement to provide prospectuses and compile a list of attendees who received prospectuses if specific mutual funds will be offered</li><li>• If wholesaler sales materials will be included, ensure</li></ul> |

|               |   |
|---------------|---|
|               | Compliance approves prior to use  |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on outlines which are retained in the branch Advertising or Seminar file</li> <li>• List of attendees who received prospectuses (if appropriate) retained in the branch Advertising or Seminar file</li> </ul> |

The following guidelines apply when an RR or the Firm sponsors a seminar for customers or prospective customers and where mutual funds are the subject of the seminar:

- An outline of the seminar must be provided to the designated supervisor prior to conducting the seminar.
- If specific mutual funds are discussed, prospectuses must be provided to those who attend and a list retained of to whom prospectuses were provided. A copy of the list is to be provided to the designated supervisor after the seminar.
- If a wholesaler makes a presentation at the seminar, the sales materials used (*i.e.*, story boards, scripts, handouts, *etc.*) must be approved by Compliance prior to the seminar.

The designated principal is responsible for approving and filing the outline of the seminar and the copy of the prospectus list, if applicable. Compliance is responsible for approving any wholesaler sales materials and filing it with FINRA's Advertising Department within 10 days of first use.

### 13.18 Redemption Of Outside Funds

If the customer requests liquidation of an outside open-end mutual fund held by the fund, the RR should obtain the customer's authorization if the customer does not handle the request on their own. Be sure to follow the fund's procedures. No redemption checks should be made payable to the RR, the RR's business, or mailed to the RR's address.

### 13.19 Cash and Non-Cash Compensation Policy - Investment Company Securities

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests from RRs or outside firms regarding sponsorship of cash or non-cash compensation relating to the sale of investment company or variable contract</li> </ul> |

|                  |   |
|------------------|---|
|                  | securities  |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review request and ensure compensation is consistent with rule requirements and limitations</li> <li>• Approve or disapprove compensation in writing</li> <li>• Establish and maintain required records of approved compensation programs</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Records are maintained in a Cash/Non-Cash Compensation file.</li> </ul>  |

FINRA regulations include restrictions on compensation relating to the sale and distribution of investment company securities and variable annuity and variable life products. RRs may not accept (directly or indirectly) cash or non-cash compensation from outside firms or persons. The only exception includes compensation arrangements specifically approved by the Firm.

### 13.19.1 Definitions

**Cash compensation** is defined as follows:

Any discount, concession, fee, service fee, commission, asset based sales charge, loan or override, or cash benefit received in connection with the sale and distribution of investment company and variable contract securities.

Cash compensation relating to investment company securities must be disclosed in the prospectus for the securities with only few exceptions permitted under the rule.

**Non-cash compensation** is defined as follows:

Any form of compensation received in connection with the sale and distribution of investment company and variable contract securities, other than cash compensation, which includes, but is not limited to, merchandise, gifts and prizes, travel expenses, meals and lodging.

### 13.19.2 Approval

Any compensation as defined in this section and paid directly to the RR requires the written approval of the Compliance Department. The following section

outlines types of non-cash compensation permitted without specific approval, unless otherwise noted.

### **13.19.3 Types Of Permissible Non-Cash Compensation**

The following types of non-cash compensation are allowed provided they are not preconditioned on achieving a sales goal:

- Gifts amounting in aggregate value not exceeding \$100 annually, per person.
- An occasional meal, ticket to a sporting event or show, or comparable entertainment that is not so frequent nor so extensive as to raise any question of propriety.
- Payment or reimbursement in connection with training or educational meetings, subject to several conditions. Note: Prior approval must be obtained from the Compliance Department before participating in such meetings.
- The location of the meeting is appropriate for its purpose, e.g., at or near the sponsoring company's home office; an office of the Firm or facility near an office; or a regional location for a regional meeting. The designated supervisor will determine the appropriateness of the meeting.
- Only expenses incurred by the Firm or its employees/RRs are eligible for payment. Expenses for guests of employees/RRs (spouse, etc.) will not be reimbursed.
- Expenses for outside activities such as golf, theater tickets, etc. are not reimbursable when in conjunction with training or educational meetings.

Non-cash sales incentive programs may be preconditioned on achieving a sales goal provided they are pre-approved in-house incentive programs sponsored by the Firm and meet the following criteria:

- The program must be based on the RR's total production with respect to all investment fund or variable contract securities sold by the Firm.
- Credit received for each investment company or variable contract security is equally weighted.
- Only Firm employees/RRs may participate.
- Other firms may make contributions to the program, provided they do not participate, directly or indirectly, in the organization of the program. However, the outside entity may provide a speaker for the meeting.

### **13.19.4 Recordkeeping**

The Compliance Department will retain the following records, in a file for Cash/Non-cash Compensation arrangements:

- names of participating companies

- amount of cash and the nature and value, if known, of any non-cash compensation including whether the non-cash compensation was received in connection with a sales incentive program or a training and education meeting
- for training and education meetings:
  - date and location of meeting
  - names of employees/RRs approved to attend meetings
  - the fact that attendance at the meeting is not preconditioned on achieving a previously-specified sales goal
  - the fact that payment is not applied to expenses of guests of employees/RRs.

## **13.20 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 they trade like other stocks, requirements that apply to open-end mutual funds such as switch letters and prospectuses provided to all purchasers generally do not apply to closed-end funds. Certain features of mutual funds such as breakpoints, letters of intent, and rights of accumulation are not features of closed-end funds.

As for all security recommendations, however, RR's are responsible for making suitability determinations prior to making a recommendation to a customer.

A Series 7 registration is required in order to be able to offer closed-end funds to clients.

## **13.21 Unit Investment Trusts (UITs)**

UITs are investment company securities that invest in a fixed portfolio of securities such as corporate, municipal, or government bonds, mortgage-backed securities, common or preferred stock, or other investment company shares. 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 all securities in the portfolio have matured or are liquidated per the terms of the trust.

### **13.21.1 Suitability**

As for other securities, the RR is responsible to 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

may not be assured and prices available in the secondary market may vary considerably from the liquidation value of the trust.

### **13.21.2 Primary Offerings**

While UITs are not "mutual funds," they have some features similar to mutual funds, particularly in the initial offering of a UIT. The purchaser of a new UIT pays a load or other charges as described in the prospectus. Purchasers are provided a prospectus describing the UIT.

### **13.21.3 Secondary Market Transactions**

A secondary market exists for many UITs. Investors may liquidate or purchase a UIT by placing an order to sell or buy it in the secondary market, if one exists. 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.

Prospective UIT investors must not be 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.

Secondary market purchasers are provided a copy of the UIT prospectus at time of purchase.

A Series 7 registration is required in order to be able offer secondary market trading in UITs to clients.

### **13.21.4 Other Sales Practice Considerations**

Since UITs are similar in many aspects to mutual funds, the other sections in this chapter also apply to UITs. RRs are required to consider breakpoints, letters of intent, and rights of accumulation when recommending purchases to investors.

### **13.21.5 Sales Charges**

UITs impose sales charges including front-end and back-end loads and management fees. Like mutual funds, discounts may be available through breakpoints, LOIs and rights of accumulation. Some UIT sponsors offer rollover and exchange discounts for purchases made with the proceeds from a UIT originally purchased from the same sponsor as well as UITs purchased from a different sponsor.

RRs are required to consider charges and discounts available to determine that the customer will receive the best available price.



## **13.22 Funds Of Hedge Funds**

A fund of hedge funds is an investment company that invests in multiple hedge funds and provides some 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) are generally unregistered, high-risk securities, RRs must consider the risk of the underlying hedge funds prior to recommending the fund to customers.

### **13.22.1 Characteristics and Risks Of Hedge Funds**

When recommending a fund of hedge funds, it is important to understand the general characteristics and risks of hedge funds. While a fund of hedge funds provides diversification, the underlying funds represent a higher level of risk that should be considered when making a recommendation to a customer.

Hedge funds have the following general characteristics and risks:

- not registered under the Investment Company Act and exempt from registration under the '33 Act
- high minimum investments, often \$1,000,000 or more
- wide differences in the fees for investments in registered vs. unregistered hedge funds. Managers of unregistered hedge funds may receive both a management fee and a direct percentage in the profits earned
- often engage in leveraging and other speculative investment practices that may increase the risk of investment loss
- can be highly illiquid
- are not required to provide periodic pricing or valuation information to investors
- may involve complex tax structures and delays in distributing important tax information
- are not subject to the same regulatory requirements as mutual funds
- often charge high fees to their direct investors.

## **13.23 Exchange-Traded Funds (ETFs)**

ETFs are open-ended investment companies or unit investment trusts listed on stock exchanges; they can be bought and sold throughout the trading day at the current market price. A typical ETF is based on specific domestic and foreign market indexes. An index-based ETF tracks the performance of an index by holding in its portfolio either securities replicating the index or a representative sample of the securities in the index. ETFs also track non-traditional investments such as commodities and currencies. Some ETFs track indexes inversely (i.e., the ETF rises when the index falls) and new ETFs are continually evolving.

Following are considerations when recommending ETFs:

- Purchasers must be provided with a prospectus or product description. Some ETFs have obtained exemptive relief from the SEC allowing provision of a description instead of a prospectus.
- Recommendations must consider what the ETF tracks to determine suitability for the proposed investor.
  - Where a commodity such as oil underlies the fund, it is important that the customer understands how the ETF is impacted by changes in price of the underlying commodity.
  - ETFs that track narrow sector or foreign market indexes can be highly concentrated and highly volatile or might fail to track their indexes properly. They also may have higher fees than ETFs based on broader indexes.
  - An ETF that invests in a sampling of the tracked index may not perform consistent with the index.
- Some ETFs sell short, others use leverage, and others use a combination of the two. Leveraged ETFs amplify daily index moves; short selling provides the inverse daily return of market indexes. Targeted leverage levels do not necessarily meet targets over long periods due to compounding returns. Investors in these types of ETFs must be willing to assume higher risk.
- ETFs are not suitable for a customer who wants to make regular periodic investments since each transaction will generate a commission cost. ETFs are more appropriate for larger lump sum investments.
- Some ETFs allow investors to cash out their investment with the issuer.
- ETF shares can be sold short and bought on margin.
- For most ETFs, holdings are transparent, i.e., an investor will know what is being held by the ETF by the makeup of the tracked index. However, in the case of an actively managed ETF, knowledge of investments may not be available to investors.
- ETFs may have lower annual expenses than traditional funds; however, investors incur commission costs for each purchase and sale in the market.
- ETFs may be more tax efficient than regular mutual funds. Since shares are traded in the secondary market, the ETF is not required to liquidate its portfolio to satisfy fund sales and therefore reduces generation of capital gains distributions to investors that result in tax liabilities each year.
- ETFs do not offer dividend reinvestment plans which are available from regular mutual funds.
- Funds of ETFs (complete portfolios of multiple ETFs) may be considerably more expensive than buying the underlying ETFs directly.

## 14.0 OPTIONS

### 14.1 Registered Options Principal

The Firm has one person designated as the Registered Options and Securities Futures Principal (ROP). The ROP is responsible for the following:

- Supervision of all customer options transactions
- Review and approval of option accounts
- Review of daily options transactions
- Review of selected option accounts on a periodic basis
- Develop training programs for RRs as needed
- Review and propose appropriate action for the Firm's compliance with securities laws and regulations with respect to the Firm's option business
- Furnish reports directly to the Firm's compliance officer (unless the ROP is also the compliance officer) and to other senior management of the Firm
- Establish recordkeeping requirements for required records of options accounts and transactions including approval of accounts and customers' verification of background and financial information
- Review of accounts without required approval and placing restrictions on accounts until deficiencies are cleared (missing option agreements or trading outside approved levels)
- Maintain the Firm's central option complaint file
- Supervise the preparation of option-related forms including account approval forms and agreements, standard options worksheets, and periodic account statements
- Establish procedures to ensure only qualified Registered Options Representatives are permitted to solicit or sell options
- Review and approval of any option programs involving the systematic use of one or more option strategies
- Review trusts, pension plans, and other types of fiduciary accounts for authority to engage in options transactions.

### 14.2 Registered Options Representatives

Only persons who are qualified to engage in the solicitation and/or sale of options contracts are permitted to do so. Generally, anyone who has successfully completed the Series 7 General Securities Representative examination is qualified to solicit and sell options. Questions regarding qualification should be referred to Compliance.

### 14.3 Approval Of Option Accounts

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Registered Options Principal</li></ul> |
|-----------------------|--|

|                  |   |
|------------------|---|
| <b>Resources</b> | <ul style="list-style-type: none"> <li>• Customer Option Agreement</li> <li>• Electronic record(s) of the order/order ticket(s)</li> </ul>  |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• Daily</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review option agreements and approve for appropriate trading level</li> <li>• Ensure option agreements are submitted for approval prior to the customer's first option transaction</li> </ul>                                      |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Customer's signed Option Agreement signed and dated by RR and client</li> <li>• Copy of approved option agreement retained in Firm's new accounts file</li> <li>• Notes regarding restricting accounts on Daily Blotter</li> </ul> |

Prior to the first option trade, a completed option agreement must be approved by a ROP.

RRs are responsible for obtaining the required information on the Firm's customer option agreement. The customer must sign the option agreement confirming the information included on the form and agreeing to abide by the requirements included on the Firm's agreement.

The customer's signed option agreement must be submitted to the Firm before the account will be opened. Each office will retain a copy of customer option agreements for customers of that office.

#### 14.4 Approved Levels Of Option Trading

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Registered Options Principal</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Customer Option Agreement</li> <li>• Electronic record(s) of the order/order ticket(s)</li> <li>• Daily Blotter</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• If a customer is trading outside the approved level on the customer's option agreement:</li> <li>• Confer with the RR regarding whether the customer's</li> </ul> |

|               |  |
|---------------|--|
|               | trading level should be amended <ul style="list-style-type: none"> <li>• If yes, require a new option agreement from the customer and review for higher level of trading</li> <li>• If no, immediately inform the RR trading outside approved levels must cease</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on electronic record(s) of the order/blotter</li> <li>• Notes of action taken on blotter</li> </ul>   |

The following guidelines apply to accounts requesting approval to trade at various levels:

- Level 1 - Covered Call Writing and Buying Puts and Calls on Individual Equities
  - No minimum requirements - Only permissible level for IRA accounts.
- Level 2 - Level 1 plus Put Writing on Cash-Backed Individual Equities
  - Clients must hold in the account 100% of cash needed to pay for underlying stock at the strike price during the life of the option.
- Level 3 - Level 2 plus Buying Uncovered Puts and Calls on Individual Equities

Accounts approved for these trading levels that do not meet the minimum criteria require the written notation of the ROP to explain why the account was approved for that level.

The ROP is responsible for identifying accounts trading beyond an approved level and taking corrective action to restrict trading or upgrade the approval level.

## 14.5 Requalification Of Accounts

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Registered Options Principal</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Customer Option Agreement</li> </ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review and approve (or disapprove) new option agreements that revise a customer's approved level of trading</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Customer's Option Agreement signed and dated by ROP</li> </ul>   |

|  |  |
|--|--|
|  | <ul style="list-style-type: none"> <li>• Copy of Customer Option Agreement retained in Firm's new accounts file</li> </ul> |
|--|--|

When a previously-approved option account is to be approved for a higher level of option, a new option agreement is required. The new agreement is to be approved by a ROP and sent to the customer for verification of account information on the form.

## 14.6 Option Disclosure Document

All customers will be provided the required disclosure document(s) either before or at the time the account is approved for option transactions. Prior to the first option transaction, RRs are responsible for providing the customer with a copy of the appropriate disclosure document.

Operations is responsible for providing each existing options customer with a copy of each amendment to the required disclosure document(s). The document(s) will be provided no later than the time a confirmation of a transaction in the category of options to which the amendment pertains is delivered to such customer.

## 14.7 Suitability Of Options Transactions

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Registered Options Principal</li> <li>• RRs</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Electronic record(s) of the order/order ticket(s)</li> <li>• Daily Blotter</li> <li>• Electronic Records</li> <li>• Option Agreements</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• Daily (electronic record(s) of the order/order ticket(s), Daily Blotter)</li> <li>• Periodically</li> <li>• Upon Settlement following each monthly expiration cycle.</li> </ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review daily transactions and electronic records for suitability of option transactions, including the following: <ul style="list-style-type: none"> <li>○ Large transactions [&gt;25 contracts]</li> <li>○ Options expiring within 30 days of purchase</li> <li>○ Uncovered short options</li> </ul> </li> </ul> |

|               |  |
|---------------|--|
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Initials/approval on blotter</li> </ul> |
|---------------|--|

When recommending opening option transactions, RRs should have a reasonable basis for believing the customer has the knowledge and experience in financial matters that he/she may be reasonably expected to be capable of evaluating the risks of the recommended transaction, and financially able to bear the risks of the recommended position. Suitability determinations are based on the information provided by the customer including the RR's understanding of the customer's ability to evaluate the risk and financial ability to bear the risk.

The ROP should consider these factors when reviewing options transactions.

## 14.8 Adjustments In Terms Of Options

The number of shares underlying an option contract and/or the exercise price is subject to adjustments by the Options Clearing Corporation when the underlying shares are subject to dividends (other than cash dividends), distributions, stock splits, recapitalization, or reorganization. Reports are made available to RRs who will advise customers who hold option positions in the affected security.

## 14.9 Complaints

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• ROP</li> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Incoming correspondence</li> <li>• Oral or written complaints</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Immediately provide the original of any written complaint to Compliance</li> <li>• Retain a copy of the complaint for office files</li> <li>• Contact Compliance regarding oral complaints, if needed</li> <li>• Compliance (<i>in consultation with the RR</i>) will respond to the complaint</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Copy filed in branch Option Complaints file</li> <li>• Compliance retains the Firm's central complaint files</li> </ul>   |

All written option complaints are to be forwarded to the Compliance immediately upon receipt. A copy is to be retained in the office's option complaint file, which is to be maintained separate from other branch complaints.

The Firm's central option complaint file will include the following:

- identification of complainant
- date complaint received
- identification of RR servicing the account
- general description of the matter complained of; and,
- a record of what action, if any, was taken with respect to the complaint.

Compliance will maintain a central option complaint file on behalf of the Firm.

#### **14.10 Option Orders**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations/ROP</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Electronic record(s) of the order/order ticket(s)</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Ensure electronic record(s) of the order/order ticket(s) include all required details for option orders</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the order</li></ul>  |

All option orders will include the following:

- description of option
- put or call
- open or close
- covered or uncovered
- spread, straddle, or combination, if applicable

#### **14.11 Option Retail Communications (Advertising and Sales Literature)**

No option advertising or sales literature is allowed. This also means no seminars on investing in options.



## 14.12 Communications With The Public Regarding Options

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Outgoing correspondence</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review to ensure appropriate language and options disclosure document is provided</li></ul>  |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on outgoing correspondence</li><li>• Retained in office correspondence files</li><li>• Retained in Home Office correspondence file</li></ul> |

All written communications are subject to the general requirements of truthfulness and avoidance of language that includes promises of specific results, exaggerated or unwarranted claims. Written communications should avoid hedge clauses which disclaim responsibility for the content of such literature or for opinions included or which are inconsistent with the communication. Statements suggesting the certain availability of a secondary market for options may not be made.

Written communications regarding options should include the following:

- special risks of options and the complexities of certain strategies
- a statement that options are not suitable for all investors
- statements referring to potential opportunities should be balanced by a statement of corresponding risks.

Written communications regarding options, other than advertising that meets the requirements of Rule 134 of the Securities Act, must be preceded or accompanied by the options disclosure document.

## 14.13 Fiduciary Accounts

The ROP will review trusts, pension plans, and other fiduciary accounts to determine whether options transactions are permitted in the document (trust agreement, *etc.*) governing the account.

## 14.14 Prohibited Transactions

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Registered Options Principal</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Electronic record(s) of the order/order ticket(s)</li><li>• Daily Blotter</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review orders for potential prohibited transactions</li><li>• Contact Compliance if any potential prohibited transactions are identified</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the order/blotter</li></ul>   |

The following transaction(s) is/are not permitted:

- Option rules prohibit the entering of a transaction for the sale (writing) of a call option contract for the account of any corporation which is the issuer of the underlying security.
- An opening covered short position in a call option contract may not be established if the underlying stock is restricted and not free to sell.

## 14.15 OTC Options (Non-Standardized Options)

ROP approval is required prior to writing OTC non-standardized options. Margin requirements may vary from standardized options.

## 14.16 Discretionary Options Accounts

Discretionary options accounts are prohibited by the Firm.

## 14.17 Disclosure Of Option Order Routing (Rule 11Ac1-6)

The requirements of Rule 11Ac1-6 include publishing statistics regarding customer agency orders in options. The Firm's procedures for publishing the required information are detailed in the chapter "Orders" under "Disclosure of Order Routing (Rule 11Ac1-6)."

## **14.18 Tendering Procedures for Exercise of Options**

Per the Options Clearing Corporation (OCC) Rule 805, unless contrary instructions are given, standardized equity option contracts in-the-money by specific amounts shall be automatically exercised.

Option holders have until 5:30 pm ET on the business day immediately prior to the expiration date to make a final decision to exercise or not exercise an expiring option. Options holders requesting to exercise or not exercise expiring standardized equity options must either:

1. Take no action and allow exercise determinations to be made in accordance to OCC's Ex-by-Ex procedure where applicable; or
2. Submit a "Contrary Exercise Advice" by the deadline of 7:30 pm ET on the business day immediately prior to the expiration date for customer accounts.

## **14.19 Option Margin Requirements**

Accounts approved for both margin and an appropriate level of option trading are subject to the margin requirement and strategy limitations itemized in FINRA Rule 4210. Option spread and combination strategies not approved by FINRA will not be permitted; in which case the margin requirement will be calculated on each individual option chain. Margin requirements, as determined by our clearing firm, are subject to change. All option optimization and margin requirements are calculated by the clearing firm. Option margin strategy requirements are available by contacting Operations.

# **15.0 MUNICIPAL SECURITIES**

## **15.1 Administration and Operations**

### **15.1.1 Fees and Assessments**

The designated supervisor is responsible for reporting required information to the MSRB. The FINOP is responsible for paying the annual fee to the MSRB in a timely manner.

### **15.1.2 Municipal Securities Representatives**

All RRs who solicit orders or sell municipal securities will be qualified as municipal securities representatives. Generally, individuals who successfully complete the Series 7 General Securities Sales examination will satisfy this requirement. Those RRs, at the discretion of Compliance, who regularly engage

in municipal securities activities will be required to annually complete at least one Firm Element course on municipal securities per MSRB Rule G-3.

### **15.1.3 Municipal Securities Principals**

The Series 53 examination qualifies individuals for the registration status of municipal securities principal which permits the individual to supervise all aspects of the Firm's municipal business. Qualified municipal principals and any designees will be designated to supervise the areas of trading and pricing. Per MSRB Rule G-3, the Firm's Municipal Principal and any applicable designee will be required to annually complete at least one Firm Element course on municipal securities.

### **15.1.4 Financial and Operations Principal**

The Firm will designate a financial and operations principal as required under MSRB rules.

### **15.1.5 Non-Registered Employees**

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• MSRB Designated Principal</li><li>• Compliance</li></ul>                        |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• N/A</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Ensure non-registered employees engage in only permissible activities</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• N/A</li></ul>   |

Employees who are not appropriately registered are limited to clerical and ministerial functions when contacting public customers in regard to municipal securities including:

- the recording and transmission of orders through normal channels;
- the reading of approved quotations; and,
- the giving of reports of transactions.

Non-registered employees, including apprentices, are not permitted to solicit new accounts on behalf of the Firm. The RR to whom the non-registered employee

reports is responsible for reasonably ensuring the employee does not exceed the limitations listed above.

#### **15.1.6 Anti-Money Laundering Program (Rule G-41)**

The Firm has established an anti-money laundering program which is described in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*.

#### **15.1.7 Fidelity Bonding Requirements**

The designated supervisor is responsible for arranging, maintaining and verifying the adequacy of appropriate fidelity bond coverage.

#### **15.1.8 Recordkeeping**

Refer to the section titled "Books and Records" regarding the Firm's recordkeeping policies.

#### **15.1.9 Confirmations**

These are prepared and sent to customers by the Clearing Firm.

#### **15.1.10 Control Relationships**

A "control relationship" exists when the Firm controls, or is controlled by, or is under common control with the issuer of a municipal security or a person (other than the issuer) who is obligated, directly or indirectly, with respect to debt service on the municipal security.

Where a control relationship exists, the Firm will provide disclosure to any customer who effects a transaction in the subject municipal security prior to effecting the transaction. Written disclosure will be provided before or at the time the transaction is confirmed to the customer. In the case of a new issue of municipal securities, disclosure will be made in the official statement. In the case of other transactions, disclosure will be included on the customer confirmation or by separate written disclosure included with the confirmation.

In addition, for discretionary accounts, discretion may not be exercised for a transaction in a security subject to a control relationship. The customer must specifically authorize the transaction before it is entered.

#### **15.1.11 Disclosure Of Interest In Distribution**

Rule 15c1-6 of the Securities Exchange Act of 1934 specifies requirements for disclosures when the Firm is involved in a primary or secondary distribution of

municipal securities. The Firm will provide the required disclosure on or with the customer's confirmation of a transaction in the subject securities.

#### **15.1.12 Reciprocal Dealings**

The Firm and its employees/RRs are prohibited from soliciting municipal transactions from accounts for investment companies in return for sales of shares in the investment company.

#### **15.1.13 Use Of Ownership Information**

The Firm is prohibited from using information regarding the owners of municipal securities obtained in a fiduciary or agency capacity (*i.e.*, as paying agent, correspondent of another municipal dealer, *etc.*) for the purpose of soliciting purchases, sales or exchanges of municipal securities. The Firm is also prohibited from using the information for financial gain except with the consent of the issuer or other broker or dealer or the person on whose behalf the information was given.

#### **15.1.14 Electronic Mail Contact (G-40)**

The Firm has filed Form G-40 with the MSRB and maintains an Internet mail account to permit communication with the MSRB. A Primary Electronic Mail Contact who is a registered municipal securities principal has been designated. The Firm may also designate an "Optional Contact" as a secondary electronic contact person who is not required to be registered as a municipal securities principal.

Compliance will retain a record of Form G-40 filed with the MSRB and any subsequent amendments and will review electronic mail contact information quarterly and update electronically as necessary.

#### **15.1.15 Transactions For Employees Of Other Municipal Dealers (Rule G-28)**

When an account is opened for the employee of another municipal dealer, the Firm is obligated to notify the other dealer, in writing, and send confirmations and statements to the other dealer. The RR is responsible for identifying on new account documentation that the customer is employed by another broker-dealer. Operations is responsible for sending written notice to the other firm and coding the account for duplicate confirmations and statements to the other firm.

This requirement does not apply if the account for the employee of the other municipal dealer is limited to transactions in municipal fund securities.

### **15.1.16 Written Supervisory Procedures**

The Firm has established and maintains written supervisory procedures including regular review for changes and updates. Procedures regarding the review, maintenance, and updating of written procedures are included in the chapter SUPERVISORY SYSTEM, CONTROLS AND PROCEDURES.

### **15.1.17 Receipt of Material Events Concerning Municipal Issuer**

Rule 15c2-12(c) of the Securities Exchange Act of 1934 prohibits the recommendation of the purchase or sale of a municipal security unless the selling firm has procedures in place that provide reasonable assurance that it will receive prompt notice any material event concerning the municipal issuer of that municipal security.

While the Firm does not act as an underwriter in the primary offering of municipal securities, we nonetheless subscribe to and utilize a service which provides us with material event information about municipal issuers.

## **15.2 Sales Of Municipal Securities**

### **15.2.1 Conduct Of Municipal Securities Business**

It is the Firm's policy to deal fairly with all persons. Deceptive, dishonest, or unfair practices are prohibited.

### **15.2.2 Suitability**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• MSRB Designated Principal - Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Electronic record(s) of the order/order ticket(s)</li><li>• Daily Blotter</li></ul>  |
| <b>Frequency</b>      | Daily (electronic record(s) of the order/order ticket(s) and Daily Blotter)  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review municipal transactions for suitability with particular consideration of:<ul style="list-style-type: none"><li>○ Non-rated issues</li><li>○ Long-term bonds [&gt;10 years to maturity]</li></ul></li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the order/blotter</li></ul>   |

RRs are required to obtain pertinent information about customers regarding financial background, tax status, investment objectives, and other information to assist in the evaluation of suitability of recommendations. If the customer refuses to provide the requested information, the new account form should be so marked. Changes to customer suitability information should be made by amending existing new account information or submitting a new account form.

RRs are required to have a reasonable basis to believe recommendations are suitable based both on information available from the issuer and on the facts disclosed or otherwise known about the customer.

### **15.2.3 Customer Disclosures**

The Firm and RRs must fully understand the municipal securities they sell and disclose to their customer all material information about the transaction and security that is known or available through established industry sources at the time of trade. Material information includes official statements, continuing disclosures and trade data, which is available through EMMA.

RRs are obligated to disclose information for secondary market transactions including:

- A complete description of the security including features that likely would be considered significant by a reasonable investor and facts that are material to assessing the potential risks of the investment (call features, non-standard features that may affect price or yield calculations complex structures, infrequent trading, unusual features, when interest is paid, tax status, etc.)
- Credit risk and rating information, including the rating or lack of rating; change of rating; identity of any credit enhancer or liquidity provider; credit rating of the credit provider or liquidity provider; material terms of the credit facility or liquidity facility such as any circumstances under which a standby bond purchase agreement would terminate without a mandatory tender
- Disclosures must be made at the time of trade (at or before the point at which the investor and the dealer agree to make the trade).

If an RR becomes aware of non-public material information, the RR should contact Compliance immediately and maintain the confidentiality of the information.

The Firm's clearing firm provides information on the trade confirmation as to how a customer may obtain the Official Statement following a primary offering transaction to satisfy MSRB Rule G-32. The customer's trade confirmation contains the following language:



**“ACCESS THE OFFICIAL STATEMENT FOR THIS SECURITY BY CUSIP# AT [HTTP://EMMA.MSRB.ORG/](http://EMMA.MSRB.ORG/) OR CALL YOUR FA FOR A PRINTED COPY”**

### **15.2.4 Minimum Denominations (G-15 & G-17)**

The Firm may not sell municipal securities to customers below the minimum denomination for securities issued with two limited exceptions to this rule:

- The Firm may purchase a below-minimum denomination position from the customer provided the customer liquidates his or her entire position.
- The Firm may sell such a liquidated position to another customer but the purchasing customer must be provided with written disclosure.

#### **15.2.4.2 Written Disclosure**

Written disclosure about the potential effect on liquidity will be included on confirmations where a customer buys an amount below the minimum denomination.

If the Firm determines to provide a separate written disclosure, records of providing the disclosure will be retained by Operations for a minimum of three years.

### **15.2.5 Customer Accounts**

Customer accounts may be reviewed on a regular basis at the discretion of the Firm. Operations and/or Compliance is responsible for reviewing daily transactions as well as patterns of account activity by reviewing reports or electronic records that show cumulative activity. Refer to the chapter "Accounts" for details of the Firm's policies regarding supervision of accounts.

The frequency and scope of the account reviews depend on a number of factors which may include the number of transactions in the account; profitability of the account; types of municipal products being purchased or sold; and the experience of the RR handling the account. The review of cumulative account activity should take into consideration suitability of overall recommendations compared to the customer's investment objectives, the volume of activity; patterns of cancelled transactions; and other factors such as complaints.

### **15.2.6 Complaints**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• MSRB Designated Principal – Compliance</li></ul> |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Incoming correspondence</li></ul>                |

|                  |  |
|------------------|--|
|                  | <ul style="list-style-type: none"> <li>• Oral or written complaints</li> </ul>   |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• As required.</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Immediately refer original copy of complaint to Compliance.</li> <li>• Retain copy for branch files.</li> <li>• Contact Compliance regarding oral complaints, if needed.</li> <li>• Compliance will respond to the complaint, in consultation with the RR.</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Compliance retains all written complaints in a central complaint file.</li> <li>• Copy of written complaint in branch complaint file.</li> </ul>  |

The handling of customer complaints is described in the section "Complaints" in this manual.

Upon receipt of a complaint involving a municipal security, Compliance will send to the customer a copy of the investor brochure designated by the MSRB, and will record the date when the investor brochure was provided.

### **15.2.7 MSRB Rules**

The Firm will maintain a copy of the MSRB rules in each office where municipal securities business is conducted. It is considered maintained in the office, if available via internet access at *www.msrb.org*.

### **15.2.8 529 College Savings Plans (Municipal Fund Securities)**

529 College Savings Plans are higher education savings plans named for Section 529(b) of the Internal Revenue Service Code. Through a 529 Plan, an individual may contribute cash to be invested for the purpose of accumulating savings for qualifying education costs of beneficiaries. Plan investments include pooled investment funds and have features similar to mutual funds or variable annuities.

529 plans established by states or local governmental entities are deemed municipal fund securities subject to MSRB rules. This section addresses requirements for 529 plans that are considered municipal securities.

#### **15.2.8.1 Registration Requirements**

The following registrations are required to sell municipal fund securities:

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- RRs qualify through a Series 6 or Series 7 examination (Series 6 qualification is limited to municipal fund securities only and not other types of municipal securities).
- To supervise the sale of municipal fund securities, supervisors must have the following principal qualifications:
  - Municipal Securities Principal (Series 53); **or**
  - General Securities Principal (Series 24) prerequisite **and** Municipal Fund Securities Limited Principal (Series 51); **or**
  - Investment Company/Annuity Principal (Series 26) prerequisite **and** Municipal Fund Securities Limited Principal (Series 51).

#### **15.2.8.2 Features Of 529 Plans**

General features include the following; specific programs must be reviewed to determine actual features.

- Plan programs are offered by states or other governmental bodies that either oversee plan investments themselves or, more often, hire an outside entity such as a mutual fund company to handle underlying investments.
- The person who establishes a plan for a beneficiary retains control, a form of revocable gift. Plans may also allow a change of beneficiary.
- While plans have cumulative maximum contributions, the limits are usually very high.
- There are no federal taxes on earnings if used for qualifying education expenses.
- Withdrawals that are not used for qualifying educational expenses are subject to Federal taxes as well as a 10% penalty. There may also be state tax implications.
- There is no time limit in many states on when the 529 money must be used.
- Other features vary depending on the state's plan and may include limitations on investment options and ability to change investments and limits on aggregate contributions for all beneficiaries.
- For most state plans, the customer does not have to reside in the state to establish a plan.

#### **15.2.8.3 Disclosure Document**

Issuers of 529 plans provide a document to be used in connection with sales of municipal fund securities. This may be an official statement, program disclosure document, information statement, prospectus, or other document provided by the issuer.

R Rs are obligated to provide the appropriate disclosure document to prospective customers when offering 529 plans.

When marketing out of state 529 college savings plans, disclosure will be provided to the customer prior to or at the time of the trade as follows:

- Depending on the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by such home state may be available only if the customer invests in the home state's 529 college savings plan.
- State based benefits should be one of many appropriately weighted factors to be considered in making an investment decision.
- The customer should consult with his/her financial tax or other advisor about how such state based benefits would apply to the customer's specific circumstances and may wish to contact his/her home state or any other 529 plan to learn more about their features.

#### **15.2.8.4 Selling Considerations**

When recommending 529 plans, the RR has the obligation to determine the suitability of the recommendation, with particular consideration of the plan's underlying investments. RRs should consider the following when discussing 529 plans with prospective purchasers:

- The customer's investment objectives and the types of underlying investments available.
- Tax implications including Federal and state tax benefits as well as penalties on withdrawals not used for qualifying higher education costs.
- Limitations in the plan being considered including changing investments; changing beneficiaries; limits on aggregate contributions; time limits for using plan money; or other limitations.
- Associated costs including expenses, enrollment fees, mutual fund load expenses, and maintenance fees. A detailed discussion regarding sales charges, breakpoints, rights of accumulation and share class suitability is found in Section 13 entitled "Mutual Funds."
- Whether out-of-state customers qualify for a particular plan.

Correspondence that includes performance data is subject to advertising requirements and requires the approval of Compliance prior to sending.

#### **15.2.8.5 Sales Material For 529 Plans**

Special requirements apply to sales material for 529 Plans. In addition to MSRB rule requirements, any municipal fund securities sales material that includes the following information about underlying investment company investments must comply with SEC advertising rules and FINRA Rule 2210:

- performance
- investment objectives or investment strategies

- experience or capabilities of the investment adviser or portfolio manager
- potential benefits or risks
- fees and expenses.

#### **15.2.8.6 529 Plan Transaction Documentation Integration**

In order to increase transparency with respect to the determination of client suitability, IPI maintains a record retention structure which allows for prompt access to client transaction documentation on a consolidated basis. The firm maintains the IPI Account Application, any notes from reviewing principals, a copy of FINRA 529 Expense Analyzer (if required) and any notes related to the analysis completed by a reviewing principal with the respect to the recommendation and suitability determination for any specific 529 transaction.

#### **15.2.8.7 Supervisory Review of 529 Plan Recommendation and Sales**

Reviewing principals shall review all documents specified in section 15.2.8.6 529 Plan Transaction Documentation Integration.

During the review process, the reviewing supervisor should ensure the completeness and accuracy of the forms that were submitted, and generally the review should include:

- If the investments were not dictated by the plan (some plans have age based selections and the investment selection is not made by the client), the reviewing principal must review the stated risk preference and time horizon to determine share class suitability;
- The reviewing principal shall search for related account holdings if the plan offers rights-of-accumulation to ensure the client receives the appropriate sales charge on A share purchases;
- The reviewing principal shall review to determine the suitability of the replacement by comparing the fees, expenses, benefits (tax or otherwise) of the product being redeemed and the product being purchased paying close attention to the presence of any applicable surrender charges.
- For any initial transaction for a beneficiary with an initial cumulative investment amount of \$10,000 or more, the reviewing principal conducting the supervisory review of the transaction shall utilize FINRA 529 Plan Expense Analyzer for each transaction associated to the application to analyze the costs and fees associated with the 529 Plans available share classes. This analysis will become part of the reviewing principal's notes files, electronically stored in conjunction with the new account application transaction documentation.
- The reviewing principal (and RRs) shall use the following assumptions when utilizing FINRA 529 Plan Expense Analyzer:

- Investment Return Rate used shall be 5%
- Time frame: the reviewing principal will use age 18 of the beneficiary as the assumption when calculating the number of years until the funds will be needed by the beneficiary.

If the client desires another return rate or time frame used, any deviation from either of these factors will be discussed with the client and noted within the RRs client file.

In situations in which the analyzer indicates the mutual fund share class purchased may not be the most cost effective share class available within the same 529 Plan the reviewing principal will:

- Follow up with the RR and/or the client to discuss the transaction;
- Review the transactions with direct supervisor and/or Compliance
- If appropriate, offer an adjustment to the client.

### 15.3 Telemarketing (Rule G-39)

The sale of municipal securities is subject to telemarketing restrictions including prohibitions against contacting individuals on the National Do-Not-Call Registry.

Refer to the chapter *COMMUNICATIONS WITH THE PUBLIC* and the section *Calling Restrictions* for policies affecting telemarketing.

### 15.4 Advertising and Sales Literature (Rule G-21)

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• MSRB Designated Principal - Compliance</li> </ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Requests to advertise</li> <li>• Requests to distribute sales literature</li> <li>• Unapproved advertising/sales literature brought to the Firm's attention</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Refer all requests and unapproved items to Compliance</li> <li>• Compliance will review and approve/disapprove</li> <li>• Compliance will make required FINRA filings for municipal fund securities advertising/sales literature</li> </ul> |

|               |  |
|---------------|--|
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Compliance retains records of advertising and sales literature</li> </ul> |
|---------------|--|

All advertising involving municipal securities must be approved by a designated municipal securities principal or general securities principal. General requirements included in the section of this manual titled "Retail Communications (Advertising and Sales Literature)" apply to municipal advertising.

MSRB Rule G-21 includes specific requirements that apply to the advertising of municipal securities. Some specific requirements under this Rule include the following:

- Advertising that includes yield is subject to certain requirements regarding disclosing the basis of the yield.
- Advertising regarding new issues are subject to certain disclosures regarding price or yield and must include an indication, if applicable, that securities shown may no longer be available at the time of publication or may be available from the syndicate at a price or yield different from that shown in the advertisement.
- If bonds are subject to the alternative minimum tax, a statement is to be included in the advertisement to that effect.
- Sales material about municipal fund securities may be subject to additional requirements, including filing advertising with FINRA, if it discusses underlying investment company securities.

MSRB Rule G-28 includes special requirements which also apply to advertising and sales literature. General disclosures in advertising will include:

- investor consideration of investment objectives, risks, charges and expenses;
- more information available in the issuer's official statement (OS);
- disclosure that the Firm is the underwriter if an OS is offered in the ad; and
- a statement that the OS should be read carefully before investing.

If the advertisement or sales literature refers to a specific security, issuer, sponsor, or securities held as assets, additional disclosure will include:

- source from which an OS may be obtained;
- considerations of benefits of the investor's state of residence plans vs. an out-of-state plan; and
- for securities with money market characteristics, that there is no FDIC or other governmental guarantee and net asset value may decline resulting in a loss to the investor.

Ads will comply with MSRB requirements and interpretive guidance regarding disclosures, representations, and historical performance data.

Compliance should be consulted regarding questions about advertisements and sales material that include municipal securities.

## 15.5 Trading

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• MSRB Designated Principal - Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Electronic record(s) of the order/order ticket(s)</li><li>• Account Review</li><li>• Daily Blotter/Reports</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review customer orders for suitability</li><li>• Confer with RR regarding suitability questions</li></ul>            |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approvals on electronic record(s) of the order</li></ul>  |

### 15.5.1 Quotations

All quotations must be bona fide quotations other than a nominal quotation which is an indication of the price given solely for information purposes. Quotations must represent the trader's best judgment of the fair market value taking into account factors such as the Firm's position and anticipated market movement.

On joint accounts, quotations must not indicate more than one market in the same security.

If quotations are distributed outside the Firm in writing, a record of the written quotations will be retained by the designated supervisor including the quotation, the date of the quotation, and the person giving the quotation and to whom the quotation was provided. If quotations are included in Firm advertising, records will be retained in accordance with the Firm's advertising policy.

### 15.5.2 Fair Prices

RRs are responsible for making a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.



### **15.5.3 Minimum Denominations (G-15 & G-17)**

The Firm may not sell municipal securities issued after June 1, 2002 to customers in amounts below the minimum denomination as explained in the section "Sales Of Municipal Securities," with limited exceptions. In addition, where municipal securities issued on or before June 1, 2002 are sold to customer below minimum denominations, the Firm has an obligation to make written disclosure to the customer regarding the potential effect on liquidity.

RRs and Operations (if executing on behalf of a RR) executing orders for municipal securities are responsible for:

- identifying potential sales to customers in amounts below the minimum denomination
- determining whether the security was issued after June 1, 2002
- if the security was issued after June 1, 2002, refusing the order or inquiring whether the sale represents the customer's entire position in the security, in which instance the order may be accepted and the order must be marked to ensure inclusion of the required disclosure on the customer confirmation
- if the security was issued on or before June 1, 2002, marking the order to ensure inclusion of the required disclosure on the customer confirmation.

### **15.5.4 Records of Orders**

Operations will maintain a record of orders in municipal securities consistent with the requirements of MSRB Rule G-8 and will maintain and preserve records according to MSRB Rule G-9. The designated supervisor is responsible for daily review of transactions in municipal securities.

### **15.5.5 Mark-Ups and Mark-Downs**

The designated principal is responsible for reviewing the reasonableness of mark-ups and mark-downs on customer trades. In determining fair and equitable mark-ups or mark-downs, relevant factors may include:

- 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
- total dollar amount of the transaction
- availability of the security
- the price or yield of the security
- the maturity of the security

- resulting yield to the customer, as compared to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market
- the nature of the Firm's business
- any other relevant facts at time of execution.

MSRB Rule G-30 also includes the factor that the Firm is entitled to a profit on the transaction.

Operations and/or Compliance will review mark-ups and mark-downs on at least a spot-check basis. Transactions deemed excessive will be canceled and rebilled to reflect an acceptable mark-up or mark-down.

### **15.5.6 Mark-Up Policy**

It shall be deemed a violation of FINRA Rules 2010 and 2121 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable. The Firm bases its mark-up policy on the NASD's Conduct rules and Interpretive Memo "IM-2440."

Excerpts of IM-2440 follow:

"The question of fair mark-ups or spreads is one that has been raised from the earliest days of the NASD. No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the Association's Board adopted what has become known as the "5% Policy" to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were affected at a mark-up of 5% or less. The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in 1943.

1. The "5% Policy" is a guide, not a rule.
2. A member may not justify mark-ups on the basis of expenses which are excessive.
3. 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, a member's own contemporaneous cost is the best indication of the prevailing market price of a security.
4. A mark-up pattern of 5% or even less may be considered unfair or unreasonable under the "5% Policy."

5. 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."

According to the Interpretive Memorandum, other factors to be considered when determining the appropriate level of mark-up are to include:

- The type of security involved
- The availability of the security in the marketplace
- The price of the security
- The amount of money involved in the transaction
- Disclosure.

Any disclosure to the customer, before the transaction is effected, of information that would indicate:

- A. the amount of commission charged in an agency transaction
- B. Mark-up made in a principal transaction is a factor to be considered.

Disclosure itself, however, does not justify a commission or mark-up that is unfair or excessive in light of all other relevant circumstances.

- The pattern of mark-ups
- The nature of the firm's business.

Consistent with industry interpretations, it is the position of the Firm that the 5% mark-up should be considered to be the sum of the mark-up on the buy and the sale of any given position, or half of the 5% on any given transaction. To ensure appropriate pricing, the Firm endeavors to price transactions at 2.0% or lower. Exceptions may be made on the basis of the conditions noted above, including price, type, and maturity. The Firm will publish its mark-up guidelines for the internal use of RRs on the Advisor's site.

RRs and Operations (if executing for a RR) are provided access to written guidelines for determining mark-up by product and quantity. The specific Mark-up Guidelines for the firm will be monitored and may from time to time be amended to reflect any of the conditions noted above.

#### **15.5.7 Commissions On Agency Transactions**

Operations and/or Compliance is responsible for reviewing the reasonableness of commissions on agency transactions. Relevant factors in determining the reasonableness of commissions may include:

- the expense of executing and filling the customer's order
- the value of the services rendered by the Firm

- the amount of any other compensation received by the Firm in connection with the transaction
- factors considered in principal transactions
- any other relevant factors at the time of execution.

### **15.5.8 Reports Of Transactions (Rule G-14)**

Reports of purchases or sales of municipal securities are to be entered into the Firm's clearing firm trading system as soon as practicable to facilitate reporting the transactions to the MSRB's Real-Time Transaction Reporting System (RTRS) within 15 minutes of the time of trade execution. Such reports should be made only if the trader knows or has reason to believe the transaction actually occurred.

Transactions that are not subject to this reporting requirement include:

- an inter-dealer transaction that is not eligible for comparison in an automated comparison system operated by NSCC (because of the lack of a CUSIP number or for other reasons)
- a customer transaction in a municipal security that is ineligible for a CUSIP number
- a transaction in a municipal fund security

If reports of purchases or sales are distributed outside the Firm in writing (other than to customers for whom orders are executed), the designated supervisor will retain a record of the reports including a copy of the reports, date of the report, and the persons giving and receiving the report. If reports of transactions are included in Firm advertising, records will be retained in accordance with the Firm's advertising policy.

Our clearing firm is responsible for reporting transactions to the MSRB or its designee per MSRB Rule G-14.

On a daily basis Operations monitors e-mail confirmations from the MSRB. Any discrepancies will be brought to the attention of our clearing firm for resolution or resolved internally if applicable.

Items that cannot be resolved will be brought to the attention of Compliance. Compliance will maintain documentation of all such items.

### **15.5.9 Errors**

All errors in customer orders must be resolved immediately when discovered. No overnight positions should be maintained in the error account. Errors in customer accounts are documented on the Cancel & Re-bill/Error Report form which requires a designated principal's approval.

### 15.5.10 Cancels and Rebills

Cancellations and re-bills in customer accounts are documented on the Cancel and Re-bill/Error Report form which requires a designated supervisor's signature.

## 15.6 Gifts

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• MSRB Designated Principal - Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests to give gifts</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review and approve or disapprove gift requests</li><li>• Maintain record of gifts given from requests</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Compliance maintains a file of gift requests and gifts given</li></ul>  |

### 15.6.1 Introduction

MSRB Rule G-20 prohibits the giving of gifts or gratuities, directly or indirectly, in excess of \$100 per year per person. These are gifts related to municipal securities business conducted by the Firm and as defined in the Rule.

Employees/RRs are required to notify Compliance of gifts relating to customers or prospective customers. Compliance is responsible for maintaining a record of gifts; the record is subject to review by regulators.

Also refer to "Gifts and Gratuities" in the General Employee and Registered Rep Policies chapter of this manual.

## 15.7 Prohibited Activities

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• MSRB Designated Principal - Operations</li></ul>                       |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Trading reports</li><li>• Observation of traders' activities</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Ongoing</li></ul>  |

|               |   |
|---------------|---|
| <b>Action</b> | <ul style="list-style-type: none"> <li>• Take corrective action depending on the nature of the prohibited activity</li> </ul> |
| <b>Record</b> | <ul style="list-style-type: none"> <li>• Operations files</li> </ul>  |

### **15.7.1 Inside Information**

RRs are prohibited from acting on, passing on, or discussing any inside information regarding municipal issues, including confidential information regarding advance refundings. Any knowledge of such information must be brought to the attention of the designated supervisor and Compliance. No Firm proprietary account or employee/RR account may enter a transaction based on material non-public information about the issuer of that security.

### **15.7.2 Financial Arrangements**

RRs are prohibited from entering into financial arrangements with customers or issuers (*i.e.*, sharing in profits or losses, sharing in commissions, rebating commissions, *etc.*).

### **15.7.3 Market Manipulation**

No purchase or sales order shall be entered 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.

### **15.7.4 Parking Securities**

No arrangement may be used to conceal the true ownership of securities through a fictitious sale or transfer to an accommodator 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.

### **15.7.5 Secret Profits**

A RR may not permit the charging of a mark-up or mark-down in addition to a commission on any transaction.

### **15.7.6 Adjusted Trading**

Adjusted trading is a prohibited practice where a broker-dealer is involved in a swap transaction with a customer at prices not reasonably related to the current market value of the securities. An example is a customer sale to a broker-dealer at a price below market value and the simultaneous purchase and booking of a

different security at a price above the current market value. The purpose of an adjusted trade is to assist one party in avoiding, disguising, or postponing losses.

### **15.7.7 Fraud or Misrepresentation**

The Firm and its RRs are prohibited from engaging in any activity that may be deemed fraudulent or engaging in misrepresentation. Additionally, RRs may not make improper use of municipal securities or funds held on behalf of someone else; provide guarantees against loss; or share in the profits or losses of a customer's account (unless family member, limited exception).

## **15.8 Political Contributions**

### **15.8.1 No Business Exemption**

The Firm does not file Form G-37 or record political contributions because it is exempt under the No Business Exemption of MSRB Rule G-37.

## **16.0 GOVERNMENT SECURITIES**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Daily blotters</li><li>• Order log</li></ul>                           |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review orders for suitability</li></ul>                                |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval electronic record(s) of the order/ blotter</li></ul> |

### **16.1 Sales**

The general sales practice procedures included in the sections titled "Accounts" and "Orders" apply to the sales of government securities. Also refer to the section titled "Collateralized Mortgage Obligations (CMOs)" for specific policies affecting CMOs.

## **16.2 Trading**

### **16.2.1 Fair Prices**

RRs are responsible for making a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.

### **16.2.2 Mark-Ups and Mark-Downs**

The designated supervisor is responsible for reviewing the reasonableness of mark-ups and mark-downs on customer trades. In determining fair and equitable mark-ups or mark-downs, relevant factors may include:

- 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
- total dollar amount of the transaction
- availability of the security
- the price or yield of the security
- the maturity of the security
- resulting yield to the customer, as compared to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market
- the nature of the Firm's business
- any other relevant factors at time of execution.

### **16.2.3 Commissions on Agency Transactions**

The designated supervisor is responsible for reviewing the reasonableness of commissions on agency transactions. Relevant factors in determining the reasonableness of commissions may include:

- the expense of executing and filling the customer's order
- the value of the services rendered by the Firm
- the amount of any other compensation received by the Firm in connection with the transaction
- factors considered in principal transactions
- any other relevant factors at the time of execution.

### **16.2.4 Errors**

All errors in customer orders must be resolved immediately when discovered. Errors in customer accounts are documented on the Cancel & Rebill/Error Report form which requires a designated principal's approval.



Cancellations and re-bills in customer accounts are documented on the Cancel and Re-bill/Error Report form which requires a designated supervisor's signature.

### **16.2.5 Review Of Transactions**

Operations is responsible for daily review of transactions executed in government securities trading area(s).

## **16.3 Prohibited Activities**

### **16.3.1 Inside Information**

RRs are prohibited from acting on, passing on, or discussing any inside information. Any knowledge of such information must be brought to the attention of the designated supervisor and Compliance. No Firm proprietary account or employee/RR account effect a transaction based on material non-public information about the issuer of that security.

### **16.3.2 Financial Arrangements**

RRs are prohibited from entering into financial arrangements with customers or issuers (*i.e.*, sharing in profits or losses, sharing in commissions, rebating commissions, *etc.*).

### **16.3.3 Market Manipulation**

No purchase or sales order shall be entered 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.

### **16.3.4 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. An example would be a person engaged in an attempted takeover of a public company, and, to avoid reporting requirements, arranges for another party to purchase securities on their behalf. The second party agrees to later transfer or re-sell the securities to the person attempting the takeover.

### **16.3.5 Secret Profits**

RRs may not permit the charging of a mark-up or mark-down in addition to a commission on any transaction.

### 16.3.6 Adjusted Trading

Adjusted trading is a prohibited practice where a broker-dealer is involved in a swap transaction with a customer at prices not reasonably related to the current market value of the securities. An example is a customer sale to a broker-dealer at a price below market value and the simultaneous purchase and booking of a different security at a price above the current market value. The purpose of an adjusted trade is to assist one party in avoiding, disguising or postponing losses.

The designated supervisor should review transactions to identify dual transactions for the same customer or other entity where execution prices are not reasonably related to the current market value.

## 17.0 COLLATERALIZED MORTGAGE OBLIGATIONS (CMOs)

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Electronic record(s) of the order/order ticket(s)</li><li>• Daily blotters</li><li>• Logs</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review for suitability</li></ul>  |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approval on electronic record(s) of the orders</li></ul>                                   |

### 17.1 Introduction

CMOs are identified in this separate section because of certain special requirements under the rules. CMOs may be government, municipal or corporate securities.

### 17.2 Suitability

As for all recommendations, RRs have an obligation to determine suitability when recommending CMOs to individuals. The RR has an obligation to understand the features of CMOs before recommending them. Because of the wide range of features and potential complexity of some CMOs, the following must be considered:

- Customer's financial status including liquid net worth and income
- Customer's experience in investing in CMOs and his/her ability to understand the features including prepayment risk
- Customer's risk profile
- Customer's investment objectives, particularly the need for cash flow
- Features of the CMO and how they fit the customer's needs
- Disclosures of risks.

Operations and/or Compliance is responsible for reviewing CMO transactions for suitability. The supervisor should, in particular, identify customers purchasing more risky types of CMOs (inverse floaters, IOs, POs) and more risky tranches. Purchases of the more risky CMOs by retail customers, in particular, should be reviewed for suitability.

### **17.3 REMICs – Real Estate Mortgage Investment Conduits**

Ginnie Mae REMICs may be sold to retail investors with the exception of classes Ginnie Mae designates as "Increased Minimum Denomination" classes, which are subject to a \$100,000 minimum purchase denomination. Suitability must be considered when recommending Ginnie Mae REMICs to customers. REMICs are also offered by Fannie Mae and Freddie Mac with varying minimum purchase denominations depending on the class.

### **17.4 Required Education Material (FINRA Rule 2216)**

Prior to the sale of a CMO to a customer other than an institutional investor, the customer must be provided with education material about CMOs. FINRA has stated that the Bond Market Association (BMA) publication *"An Investor's Guide To Collateralized Mortgage Obligations"* (the "BMA brochure") satisfies those disclosure requirements.

RRs must provide a client with the BMA brochure prior to the purchaser's first purchase of a CMO. Additionally, Operations will mail the BMA brochure to each purchaser prior to or contemporaneously with the confirmation of the transaction.

### **17.5 Inverse Floaters, IOs, POs**

Because of special risks associated with the purchase of inverse floaters, interest-only (IO), and principal-only (PO) securities, purchasers will be required to sign a special disclosure document explaining the risks associated with these investments and affirming the customer's willingness to assume higher risk. Operations is responsible for identifying accounts purchasing these types of securities and requesting the required disclosure. Copies of the signed disclosures will be maintained in customer files or in a file established for the disclosure forms.

## **17.6 Communications With The Public (FINRA Rule 2216)**

### **17.6.1 Bids**

When bids are provided to customers in written form, the following disclosure should be included on the bid sheet or list:

"Prices on bonds are obtained from various sources including pricing services which may use mathematical matrixes and other methods of estimating value. These prices are estimates only, are subject to change, and do not represent prices at which these bonds may actually be purchased or sold."

### **17.6.2 Disclosures**

Communications (including advertising, sales literature, and correspondence) regarding CMOs must include the following disclosures and may not include certain statements. Because the requirements are extensive, all written communications about CMOs must be approved by Compliance prior to sending.

- Communications must include, within the name of the product, the term "Collateralized Mortgage Obligation;"
- CMOs must not be compared to CDs, treasury bonds, or other securities with fixed interest rates and stated maturities;
- Communications 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,
- Communications 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.
- There should be no assurance that the CMO will prepay principal at the current assumed rate; timing may vary significantly.

In addition to the above, FINRA has established standards for communications that promote a specific security or contains yield information. These requirements are complex and Compliance should be consulted when preparing this type of communication.

### **17.6.3 Radio/Television Advertisements**

FINRA Rule 2216 specifies oral disclaimers that must be included in any radio or television advertisements about CMOs. Compliance should be consulted prior to creating or committing air time for such advertisements.

#### **17.6.4 Bloomberg and Other Financial Services**

When providing Bloomberg or other comparable reports to customers regarding CMOs, the report should show, at a minimum, PSAs at 200 basis points above and below current interest rate levels. Copies of Bloomberg prints or comparable reports provided to customers should be reviewed and retained by the designated supervisor.

### **17.7 Trading**

#### **17.7.1 Fair Prices**

RRs are responsible for making a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. Mark-ups, mark-downs and agency transaction commissions are the same as those stated in Chapter 18, Government Securities.

#### **17.7.2 Errors**

All errors in customer orders must be resolved immediately when discovered. No overnight positions should be maintained in the error account. Errors in customer accounts are documented on the Cancel & Re-bill/Error Report form which requires a designated principal's approval.

Cancellations and re-bills in customer accounts are documented on the Cancel and Re-bill/Error Report form which requires a designated supervisor's signature.

#### **17.8.1 Inside Information**

RRs are prohibited from acting on, passing on, or discussing any inside information. Any knowledge of such information must be brought to the attention of the designated supervisor and Compliance. No Firm proprietary account or employee/RR account may effect a transaction based on material non-public information about the issuer of that security.

#### **17.8.2 Financial Arrangements**

RRs are prohibited from entering into financial arrangements with customers or issuers (*i.e.*, sharing in profits or losses, sharing in commissions, rebating commissions, *etc.*).

#### **17.8.3 Market Manipulation**

No purchase or sales order shall be entered 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.

#### **17.8.4 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. An example would be a person engaged in an attempted takeover of a public company, and, to avoid reporting requirements, arranges for another party to purchase securities on their behalf. The second party agrees to later transfer or re-sell the securities to the person attempting the takeover.

#### **17.8.5 Secret Profits**

A RR may not permit the charging of a mark-up or mark-down in addition to a commission on any transaction.

#### **17.8.6 Adjusted Trading**

Adjusted trading is a prohibited practice where a broker-dealer is involved in a swap transaction with a customer at prices not reasonably related to the current market value of the securities. An example is a customer sale to a broker-dealer at a price below market value and the simultaneous purchase and booking of a different security at a price above the current market value. The purpose of an adjusted trade is to assist one party in avoiding, disguising, or postponing losses.

The designated supervisor should review transactions to identify dual transactions for the same customer or other entity where execution prices are not reasonably related to the current market value.

### **17.9 Review Of Transactions**

The designated supervisor is responsible for daily review of transactions in CMOs.

#### **17.10 Confirmations**

Our clearing firm will place disclosures on CMO confirmations. Rule 10b-10 requires that the confirmation include a statement that actual yield of the CMO may vary according to the rate at which the underlying receivables or other financial assets are prepaid, and a statement of the fact that information concerning the factors that affect yield (including, at a minimum, estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon the written request of the customer. MSRB Rule G-15(a)(i)(D)(2) includes a similar provision for municipal CMOs.

## 18.0 DIRECT PARTICIPATION PROGRAMS

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Operations</li><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Applications</li><li>• Alternative Investment Disclosure Form</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As needed</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review each application for completeness and suitability</li><li>• Review Alternative Investment Disclosure Form for suitability</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Alternative Investment Disclosure Form</li></ul>   |

### 18.1 Introduction

FINRA defines Direct Participation Programs as any "program which provides for flow-through tax consequences regardless of the legal entity or vehicle for distribution including, but not limited to, oil and gas programs, condominium securities, Subchapter S corporate offerings and all other programs of a similar nature, regardless of the industry represented by the program, or any combination thereof." Direct participation programs are also often called "limited partnership" investments.

This chapter outlines the Firm's procedures regarding the underwriting and sale of Direct Participation Programs (DPPs).

#### 18.1.1 Real Estate Investment Trusts (REITs)

REITs invest in different types of real estate or real estate related assets such as shopping centers, apartment buildings, office buildings, hotels, mortgages, etc. secured by real estate. The three types of REITs include:

- Equity REITs that invest in or own real estate with income primarily from rents collected
- Mortgage REITs that lend money to owners and developers or invest in financial instruments secured by mortgages on real estate
- Hybrid REITs that combine the investment strategies of equity and mortgage REITs.

REITs trade on national exchanges or in the OTC market; some mutual funds specialize in public real estate. Some REITs invest specifically in one area of the real estate or in one specific geographic region. REITs generally provide ongoing (but not guaranteed) income along with the potential for long-term capital gains.

#### **18.1.1.1 General Sales Guidelines**

- When determining the suitability of recommending a REIT, consider the investor's investment objectives and need for income and the risks of the REIT including the use of leverage
- Apply a volume discount, if available
- For unlisted REITs, consider liquidity and marketability and advise the investor of such risks
- Customer account statements may include valuations and disclosures regarding certain REITs
- Requirements regarding sales contests and cash/non-cash compensation apply to REITs.

#### **18.1.1.2 Guidelines for New Issue REITs**

- Follow new issue requirements for limiting written communications to the offering document
- When discussing the REIT, base information on the offering document including features and risks of the REIT
- Provide the offering document to the prospective investor.

#### **18.1.1.3 Private and Non-Traded REITs**

Private and non-traded REITs are companies whose shares do not trade on a national stock exchange. They generally operate like UITs by purchasing assets that are held for a fixed amount of time, often 7 -10 years, and will either sell off the properties or do an IPO at the end to exit the fund and deliver returns to shareholders.

There are features and risks which RRs must be familiar with prior to recommending a private or non-traded REIT:

- The investment is generally illiquid during the term of investment, which may be 7-10 years. Trying to liquidate the investment earlier is often difficult or costly or may be impossible.
- Many companies offer some form of redemption plan but these are very limited, often limited to 3% of the shares outstanding in a year and involve a significant penalty.
- The fixed portfolio and long-term horizon provide a level of stability since the REIT is not required to sell properties to meet investor liquidation requirements.



- Non-traded REITs pay monthly or quarterly dividends which may be higher than publicly-traded REITs; however, dividends are not guaranteed.
- Private REITs are not required to provide the same level of quarterly disclosure as publicly-traded REITs.
- They impose minimum income and/or net worth requirements; RRs are obligated to determine the investor meets the requirements and completes any necessary subscription agreements along with the Firm's Alternative Disclosure Form to ensure suitability relative to this criteria.

## **18.2 New Issues**

### **18.2.1 Due Diligence**

The Products Review Committee has established due diligence procedures for reviewing potential DPP offerings. The procedures include utilizing internal staff as well as an external due diligence service providers to conduct due diligence on Direct Participation Programs. Internal staff manages the entire process.

The due diligence process for any product begins with determining if a need for a particular product exists. This initial step is the more subjective portion in which we determine whether we believe the sponsor is a viable sponsor (i.e., do they meet minimum requirements pertaining to size, longevity and ability to produce consistent results) and whether the program is viable or not (i.e., do we believe the investment objectives are reasonably attainable). There is no formal documentation that is the end product of this portion of the process. The fact that the sponsor moves into the more formal level of review documents that we believe they have met our initial subjective requirements. The more objective process is the more formal analysis and focuses on two levels: a sponsor review and a product review.

The sponsor level due diligence is focused on validating documentation which relates to the size, longevity and ability to produce consistent results. The product level due diligence process is focused on affirmatively discharging our responsibilities to ensure that all material facts pertaining to a program or REIT are adequately and accurately disclosed in the offering document. Additionally, we perform a reasonable-basis suitability analysis which is an affirmative determination that the investment is suitable for some investors. The RR is responsible for performing customer-specific suitability analysis in connection with any recommended transactions. The scope of the review by our external third party due diligence providers is to assess the adequacy of the disclosure in the offering materials, i.e., Prospectus, Private Placement Memorandum, etc. More specifically, it is conducted to ensure and document compliance with FINRA Rule 2310(b)(3)(A).

In addition to the extensive documentary analysis which occurs, both the internal and external reviews may involve site visits and personal interviews with Senior

Management of the sponsor. The Firm also reviews under FINRA Rule 2310(b)(4) a product's organization and offering expenses for fairness and reasonableness in consideration of all relevant factors.

No due diligence process guarantees the success of the underlying investment. RRs need to educate themselves fully on the products available.

### **18.2.2 Suitability**

Each DPP will have specified suitability standards including information such as the purchaser's income and net worth. Offerings that require a subscription agreement that is signed by the purchaser will include an affirmation that the customer meets the minimum suitability standards.

The RR will comply with the Firm's Alternative Disclosure Guidelines to ensure the customer meets the standards of the Firm's suitability procedures for all DPP products.

### **18.2.3 Subscription Agreements**

The designated supervisor is responsible for the following:

- Determining when subscription agreements signed by purchasers are suitable for a DPP offering.
- Ensuring completed and signed subscription agreements are on file, when required, prior to confirming purchases.

### **18.2.4 Prospectuses**

Prospectuses or offering memorandums will be provided to all purchasers of DPP offerings. The sponsor will maintain a record of to whom prospectuses were sent and the date sent, unless "prospectus enclosed" or a similar notation appears on the confirmation (also sent by the sponsor).

### **18.2.5 Sales Practices**

IPI's personnel who are involved in the private placement process are expected to have a sound working knowledge of Regulation D and complete awareness of the firm's policy and procedure requirements relating to such offerings.

In order to ensure conformance with the Regulation D requirement that prohibits general solicitation, the firm has adopted the following policies and procedures:

1. Offers are not made to persons until after the RR has information sufficient to evaluate the prospective offeree's sophistication and financial circumstances, qualifies the person as an offeree and documents their files accordingly;

2. Cold Calling is not permitted;
3. Advertisements, articles, notices or any other communication cannot be published in any newspaper, magazine, newsletter or similar media or broadcast on TV, radio or cable.

Offerees, having received private placement offering documents, frequently request oral explanations or supplements to the information presented. Great care should be taken in making oral disclosures regarding a private placement. Deviation from the printed material is prohibited.

#### **18.2.6 1031 Tax-Deferred Exchanges [Section 1031 of the Internal Revenue Code, IRS Revenue Procedure 2002-22 and 2004-86; NASD Notice to Members 05-18]**

This section describes considerations when recommending and effecting a 1031 exchange for tenants-in-common (TIC) or Delaware Statutory Trust (DST).

Section 1031 of the Internal Revenue Code allows an investor in income-producing or rental real estate to exchange the investment for another like investment of equal or greater value and defer payment of capital gains tax on the original investment. To qualify for the deferral, the investor must acquire an interest in real estate in exchange, and not an interest in a partnership.

TIC and DST exchanges receive favorable tax treatment. A 1031 exchange by TIC would qualify for deferral only if the TIC and the transaction meets 15 IRS conditions outlined in Revenue Procedure 2002-22. A 1031 exchange through a DST would qualify for deferral only if the DST follows the requirements of Revenue Procedure 2004-86.

TIC and DST interests offered and sold together with other arrangements generally constitute securities under federal securities laws. FINRA considers TIC interests to be a type of non-conventional investment (NCI) subject to due diligence, suitability, training, and internal control requirements.

NASD Notice to Members 05-18 should be referenced for a detailed discussion of "Private Placements of Tenants-in-Common Interests."

#### **18.2.7 Private Placements**

Per FINRA Rule 5123, the Firm will submit to FINRA or have submitted on its behalf a copy of any private placement memorandum, term sheet or other offering document, along with any materially amended versions within 15 calendar days of the date of first sale or indicate to FINRA that no such offering

documents were used, unless the private placement meets one of the exceptions as cited in the Rule.

## **18.3 Secondary Market Transactions**

### **18.3.1 Trade Tickets**

Each secondary market transaction in a Direct Participation Program will be recorded on a trade ticket that will include the time of execution, which is defined as the time the parties have agreed to the essential terms of the transaction.

### **18.3.2 Reporting Transactions**

Secondary market transaction in non-exchange listed DPP securities must be reported to FINRA within 30 seconds of execution. The date of execution and time of execution are defined as the date and time when the parties to a transaction in a DPP have agree to all of the essential terms of the transaction, including the price and number of units to be traded.

Those required to report are as follows:

- Between two members, the seller reports
- Between a member and a customer, the member reports.

Operations is responsible for reporting secondary DPP transactions.

### **18.3.3 Standard Transfer Forms**

The Firm will use the standard transfer forms prescribed by FINRA when limited partnerships are sold in the secondary market. This requirement does not apply to limited partnership securities which are traded on NASDAQ or a registered national securities exchange. These will be provided by the secondary market maker who arranges the buy or sell.

## **19.0 VARIABLE INSURANCE PRODUCTS**

This chapter describes policies and procedures that apply to the sale of variable insurance products. RRs are permitted to sell only those products approved by the Firm.

### **19.1 Licenses and Appointments**

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Licensing</li><li>• Operations</li></ul> |
|-----------------------|--|

|                  |   |
|------------------|---|
|                  | <ul style="list-style-type: none"> <li>• RRs</li> </ul>   |
| <b>Resources</b> | <ul style="list-style-type: none"> <li>• Requests from RRs</li> <li>• Insurance applications</li> <li>• Inquiries from insurance companies whose products are sold</li> </ul>                                       |
| <b>Frequency</b> | <ul style="list-style-type: none"> <li>• As required</li> </ul>   |
| <b>Action</b>    | <ul style="list-style-type: none"> <li>• Review insurance applications prior to submission to determine whether RR is licensed and appointed</li> <li>• Obtain licenses and appointments where necessary</li> </ul> |
| <b>Record</b>    | <ul style="list-style-type: none"> <li>• Records of insurance licenses, appointments, and required continuing education are retained in the RR's licensing file.</li> </ul>   |

To offer insurance products, the RR must have a state license for the type of insurance product. The RR must also have a non-resident license for the customer's state of residence, if different from the RR's resident state. In addition, the RR must be "appointed" with the insurance company whose product is being sold.

A RR engaged in the sale of variable insurance products requires the following:

- Licensing with the state insurance regulator as an insurance agent for the type of insurance business (ordinary life, variable annuity, *etc.*). Some states require successful completion of an examination for the type of license requested.
- Licensing in the state where the RR resides as well as the state of domicile of the client.
- Appointment with the insurance company whose product is being sold. Insurance business cannot be dated prior to the RR's insurance company appointment in certain states.
- Continuing education, depending on the state where licensed.
- Registration as securities representative with FINRA and with the appropriate state (customer's state of residence).

RRs may not engage in the sale of variable insurance products or receive commissions from such sales unless properly registered, licensed and appointed.

### **19.1.1 Requests For Licenses**

RRs should contact Compliance to request insurance licensing and appointment. The RR will be notified when insurance licenses are effective. Licenses are sent to the RR's home by the state licensing agency; a copy should be forwarded to the Compliance as soon as possible after receipt.

### **19.1.2 Non-Resident Licenses**

RRs may obtain non-resident licenses. Compliance should be contacted to clarify requirements before offering insurance products to out-of-state clients.

### **19.1.3 Unsolicited Insurance Transactions**

If a non-insurance licensed RR receives an unsolicited order to purchase an insurance product, the transaction must be referred to a properly licensed insurance agent. Commissions will not be paid to an unlicensed RR.

### **19.1.4 Additions To Existing Variable Annuity Policies**

If a client wishes to make an additional contribution to an existing variable annuity policy, the RR must be registered in the state **where the customer currently resides**.

## **19.2 Sales Guidelines**

There are differences between insurance and securities products; it is important that the RR understand these differences when discussing variable insurance products with customers. The following sections discuss sales guidelines for offering variable insurance products.

### **19.2.1 General Guidelines**

- All insurance product purchases and sales (including group variable annuities) **MUST** be conducted through the Firm, *i.e.*, RRs are not permitted to accept any direct commission payments from insurance companies unless previously approved in writing.
- RRs are permitted to sell only those products approved by the Firm. The Product Review Committee is responsible for evaluating and selecting products which may include, among other considerations:
  - the insurance company's rating by a nationally recognized rating service
  - when available, the number and substance of material complaints against the company and existence of criminal judgments against the company or its senior management.
  - availability of similar products from other insurance companies

- pricing of the product, including premium rates, compared with competitor's product
  - sales support provided by the insurance company.
- Discussion of benefits of an insurance product should include disclosure of fees and charges.
- Focus on tax advantages must be balanced with disclosure of tax consequences.
- Avoid excessive focus on gross interest rate or investment performance rate without disclosure of product expense charges that serve to effectively reduce the return rate. Life insurance products may have significant front-end and/or back-end load structures; they are designed as long-term vehicles.
- Encourage customers to review their periodic statements received from the insurance company.
- Make a prior determination that a recommended purchase or sale of an insurance product is appropriate for the customer depending on the customer's financial circumstances and reasons for considering the insurance product.

### **19.2.2 Variable Life Insurance and Other Non-Annuity Products**

- Do not refer to life insurance as an investment or investment product
- One primary need satisfied by life insurance is providing death benefit protection (including income to heirs directly for day to day living expenses or providing funds to pay estate taxes).
- Another use of life insurance is to accumulate cash value on a tax-advantaged basis.
- Positioning life insurance as a way to get tax-free income through policy cash value should be carefully evaluated. Other financial products may be a better source of tax-advantaged cash flow.
- Replacing an existing policy (or reducing its value to raise funds) to purchase a new policy must be considered carefully for its suitability and the costs that will be incurred by the customer. Refer to the section "Replacements" for the policies and procedures that apply to such transactions.
- RRs should ensure the customer fully understands the difference between guaranteed and non-guaranteed elements of life insurance.
- Illustrations of returns are projections only and not guaranteed.
- Life insurance purchased for pension or educational funding planning purposes must be disclosed as life insurance.

#### **19.2.2.1 Suitability**

Before recommending any product to a client it is the RRs responsibility to ascertain what that client's needs are now, and what he/she anticipates those needs to be in the future. It is only after such familiarity with the client's current financial condition and future plans that an RR should begin to consider specific

product recommendations to help the client reach these goals. With the multitude of investment products available, there is no one product that is right for every client. Each product has its own benefits and drawbacks that need to be analyzed to determine whether that particular product will be able to help the client reach his/her long-term goals.

FINRA rules mandate that RRs have a reasonable basis when recommending securities products to clients. This reasonableness must be based on the client's:

- investment objectives,
- age,
- other investments,
- financial situation and needs
- tax status,
- investment experience,
- time horizon,
- risk tolerance and
- any other information the customer may disclose to the RR.

A variable life insurance policy is a hybrid investment and insurance product that offers many unique features that are not found in any other investment product. These features include a tax advantaged death benefit. The hybrid nature of a variable life insurance policy makes determining suitability unique in that each portion of the product has to be suitable for the client. If one portion is not suitable, then the product as a whole is not suitable. If your client expresses a wish for a non-insurance product (just wants a mutual fund) then a variable life policy is not going to be the best product for that client. Conversely, if your client is looking for a way to provide a death benefit, then a mutual fund will not serve that client's needs.

The following is a detailed description of some of the key issues that should be used by the Firm as well as the RR in determining suitability of a variable annuity transaction.

## **1. Age**

Special attention needs to be focused on quantifying with certainty an older client's income stream to ensure that such a client has the financial means to sustain the likely amount of policy premium payments. Additionally, variable life insurance may not be suitable for an older individual who is primarily seeking an investment rather than an insurance product due to the unavailability of an extended cash build-up or deferral period and the relatively high costs of insurance.



## **2. Funding**

Ongoing premiums will often be required to keep a variable life policy in force. The client must be able to afford the premiums likely needed to keep the policy in force. As a rule of thumb you should avoid a scenario where the client is going to need to commit more than 10% of their annual net income to fund the anticipated premium. Over-funding or under-funding a policy has consequences. Ensure that the client understands the possible consequences of minimum funding as well as over-funding of the policy. The main adverse consequence of minimum funding is the potential for lapse of the policy due to inadequate cash value. Adverse tax consequences like recognition of any gain will follow. Similarly, over-funding may lead to the unavailability of certain tax advantages that are otherwise normally inherent in life insurance

## **3. The client's life insurance needs**

Life insurance is a substantial component of a variable life product and so is the attendant cost for that feature. A client must understand and commit to the cost of funding the desired benefit.

## **4. The client's ability to understand all the features of the variable life insurance policy.**

The client should have the ability to understand all the fees and costs associated with the policy including, but not limited to, surrender charges, mortality and expense risk charges, administrative charges and investment fees. Additionally, the client should be able to appreciate and have the risk tolerance to withstand adverse market conditions. The client should also understand that market risk could result in the investment being worth more or less at the time of redemption as well as depleting the cash value to the point where additional premium payments are necessary to avoid the policy lapsing.

## **5. Policy illustrations**

The illustration is NO guarantee of returns. The sole purpose of the illustration is to demonstrate the mechanics of the policy. Extreme care should be taken when determining the rate at which to illustrate a policy. In no event should the rate of illustration exceed the long-term historical average return of the sub-account allocation being recommended and by regulation it cannot exceed 12%.

## **6. Replacements**

Replacing one variable life insurance policy with another variable life insurance policy may at times be suitable. Prior to recommending a replacement, be sure to analyze the transaction from the client's perspective taking into account any decrease in available cash value, the imposition of new fees, extended surrender

charge periods, possible higher insurance risk rating due to ill health and older age and new suicide and incontestability periods. The only replacement that should be recommended is the one that is in the best interests of the client. A registered principal at IPI reviews each replacement to ensure all documentation has been obtained (be sure to include any required state replacement forms) and that the transaction is suitable for the client.

## **7. Financing arrangements**

Occasionally, the cash value of one insurance policy can be used to finance the purchase of another insurance policy underwritten by the same insurer. FINRA often views such arrangements with skepticism. If you recommended such a course of action, you must disclose the potential consequences to both the existing policy and new policy to your client. The main consequence is that at some point premium payments will be required to maintain both policies and in such an event a lapse on one or both of the policies will occur without payment. A lapse will result in loss of coverage as well as a likely taxable event.

### **19.2.3 Variable Annuities**

- Some primary needs satisfied by annuities include tax deferral; providing income that cannot be outlived; and enhanced death benefit features.
- Annuities are designed for customers with long-term investment objectives; typically, as a source of retirement income.
- Some annuity companies have designed products for customers with short term time horizon. These annuities have shorter surrender periods and some may have no surrender charges.
- Surrender charges and tax penalties generally make annuities unsuitable for short-term investors. Customers should have adequate sources of liquidity apart from the money paid into the contract.
- While it may seem that most customers have a need for tax deferral, taxable investments may be more appropriate for customers in higher tax brackets, depending on the contract's mortality/expense fees and other charges.
- Guarantees on death benefits cannot be represented as applying to investment return or principal value of the account.
- Discussion of investment features and insurance features should be balanced, i.e., do not neglect either feature.
- Illustrations of return are projections only and not guaranteed.
- Once a contract is annuitized, it is generally irreversible. Accordingly, there should be an income objective and no need for access to principal.
- Be alert to the investment experience of customers purchasing variable annuities. Customers should be comfortable with the risks of the sub-accounts in which they invest.
- Variable annuities cannot be described as "mutual funds."

- Purchasers must receive a prospectus. The RR should provide a prospectus when a variable annuity is recommended. Many applications include a box to check to indicate a prospectus has been provided or whether the customer would like one to be sent.
- Replacing an existing policy (or reducing its value to raise funds) to purchase a new policy must be considered carefully for its suitability and the costs that will be incurred by the customer. Refer to the section "Replacements" for the policies and procedures that apply to such transactions.

#### **19.2.3.1 Suitability (NTM 99-35,07-53, 09-32 and IPI's Variable Annuity Suitability Guidelines)**

Before recommending any product to a client it is the RRs responsibility to ascertain what that client's needs are now, and what he/she anticipates those needs to be in the future. It is only after such familiarity with the client's current financial condition and future plans that an RR should begin to consider specific product recommendations to help the client reach these goals. With the multitude of investment products available, there is no one product that is right for every client. Each product has its own benefits and drawbacks that need to be analyzed to determine whether that particular product will be able to help the client reach his/her long-term goals.

FINRA Rules 2330 and 2111 mandates that RRs have a reasonable basis when recommending securities products to clients. This reasonableness must be based on the client's:

- Investment objectives
- Financial situation and needs
- Risk tolerance
- Age
- Annual Income
- Investment Experience
- Intended use of the deferred variable annuity
- Time horizon
- Existing assets
- Liquidity needs
- Liquid net worth
- Tax Status
- Other investments
- Other information the customer may disclose.

A variable annuity is a hybrid investment and insurance product that offers many unique features that are not found in any other investment product. These features include lifetime income and a death benefit. In addition, many variable annuities offer enhancements of these and other features through the purchase of riders. The hybrid nature of a variable annuity makes determining suitability

unique in that each portion of the product has to be suitable for the client. If one portion is not suitable, then the product as a whole is not suitable. If your client expresses a wish for a non-insurance product (just wants a mutual fund) then a variable annuity is not going to be the best product for that client. Conversely, if your client expresses a wish for a product that has the ability to provide lifetime income or is looking for a way to provide a death benefit, then a mutual fund will not serve that client's needs.

The following is a detailed description of some of the key issues that should be used by the Firm as well as the RR in determining suitability of a variable annuity transaction.

### **1. Age**

Variable annuities are considered long-term investments, and may not be suitable for those approaching retirement that want to use the variable annuity as an accumulation tool. A variable annuity is also not the most efficient way to pass assets to heirs because of double taxation.

There may also be required minimum distribution with which to deal. In addition to estate taxes, the gains are taxed as ordinary income to the beneficiary. Most other products may be passed on to heirs at an increase in tax basis to the date of the owner's death so the gain is not taxed to the beneficiary. Please note that a rider has been developed by many insurance carriers to help offset the effect of taxes through an additional benefit amount tied to any gain in the contract. Check for availability of such a rider where ordinary income treatment is a concern.

### **2. Time Horizon**

Variable annuities are considered long-term investments. The compounding and deferral features on the variable annuity may not be realized if the client does not have 7-10 years until the money invested is needed. If the client does not have a long time horizon, then he/she may be better served by using another investment product.

### **3. Liquidity**

Variable annuities are rather illiquid investments. You should ensure that your client does not have a short-term need such as paying for a child's education or purchasing a new home.

### **4. Investments in tax-qualified accounts**

There are situations where using qualified funds to purchase a variable annuity are appropriate. However, when considering recommending a variable annuity that is bought with qualified funds, there are certain things that must be taken into

consideration. Is the client able to contribute to a qualified plan and is not doing so? Because of the potential for employer matches in many qualified plans, it may be better for the client to maximize his/her contributions to the company-sponsored retirement plan before purchasing a variable annuity. In a rollover situation, you must ensure that you discuss each option available to the client: (a) roll over into a qualified plan at his/her new place of employment or (b) roll over into a regular IRA? Additionally, a regular IRA can be funded with many different types of investments. Each should be discussed with the client. In either of these scenarios you have an absolute obligation to disclosure that there are no added tax benefits when using qualified funds to purchase a variable annuity. Additionally, a variable annuity should only be the funding vehicle where the client understands the costs associated with using the variable annuity and the variable annuity fulfills the objectives of the client to a greater extent than alternate funding vehicles. For example, the additional benefits of the variable annuity, i.e. death benefit, income rider etc., must be of enough importance to the client to make the recommendation appropriate. If not, then the product may not be suitable.

## **5. Tax consequences**

Clients who withdraw money from their variable annuity before age 59½ may be charged the IRS early withdraw penalty of 10% as well as have the money withdrawn taxed as income in the year it was withdrawn. This also ties in to the liquidity issue. It is imperative for clients to understand the consequences of early withdrawals, and their effect on the death benefit feature of the product.

## **6. The client's life insurance needs**

If the client directly expresses that his/her protection needs have been met, a variable annuity may not be suitable. Likewise, if the client has expressed a preference for a product other than an insurance-based product, a variable annuity may not be suitable.

## **7. The client's ability to understand all the features of the variable annuity.**

The client should have the ability to understand all the fees and costs associated the variable annuity including, but not limited to, surrender charges, riders, mortality and expense risk charges, administrative charges and investment management fees. The client should also understand the various distribution options and the tax consequences of those options.

## **8. The client's ability to monitor and understand the market risk of the investments in the sub-accounts.**

The client should be able to appreciate and have the risk tolerance to withstand adverse market conditions. The client should also understand that market risk

could result in the investment being worth more or less at the time of redemption. The allocation of the sub-account selection is also an important factor to consider when determining the suitability of a variable annuity. As with other investments in a client's portfolio, the allocation of sub-accounts must be in line with the client's stated investment objectives and risk tolerance.

In summary, variable annuities are very complex products that can help RRs help their clients. However, there is no one right product for every client. In general, when considering which investment product to recommend to a client, please consider that a variable annuity may not be suitable for a client who meets one or more of the following criteria:

- The client expresses a desire for a non-insurance based product
- The client is eligible to contribute to a qualified plan, but is not doing so
- The client has no need for tax deferral or a death benefit
- The client desires a short-term, liquid investment
- The client will need the funds before attaining age 59½
- The client is elderly and in a higher estate tax bracket.

## **19.3 Disclosure Of Material Facts**

### **19.3.1 Variable Life**

FINRA and various states have stated that there are material facts that should be affirmatively disclosed to a customer when recommending a variable life -- insurance product. Items to be disclosed, if applicable or appropriate, include:

- Do not refer to life insurance as an "investment" or "investment product."
- One primary need satisfied by life insurance is providing death benefit protection (including income to heirs directly for day-to-day living expenses or providing funds to pay estate taxes).
- The RR should ensure the customer fully understands the difference between guaranteed and non-guaranteed elements of life insurance.
- Illustrations of return are hypotheticals only and not guaranteed.
- Life insurance purchased for pension or educational funding planning purposes must be disclosed as life insurance.

Firms and RRs have an obligation to affirmatively disclose these material facts. Where applicable, such disclosure shall be assisted and documented through the completion of a Variable Life Insurance Disclosure Form.

### **19.3.2 Variable Annuities**

FINRA has stated that there are material facts that should be affirmatively disclosed to a customer when recommending a variable annuity product. Items to be disclosed, if applicable or appropriate, include:

- Some primary needs satisfied by annuities include tax deferral; providing income that cannot be outlived; and enhanced death benefit features.
- Annuities are designed for customers with long-term investment objectives, typically as a source of retirement income.
- Variable annuities cannot be represented as short-term or liquid investments. References to liquidity must disclose the effect of liquidating (e.g., tax consequences; surrender charges).
- Illustrations of return are **projections only** and not guaranteed.
- Once a contract is annuitized, it is generally irreversible. Accordingly, there should be an income objective and no need for access to principal.
- Guarantees on death benefits cannot be represented as applying to investment return or principal value of the account.
- Discussion of investment features and insurance features should be balanced, *i.e.*, do not neglect either feature.

Firms and RRs have an obligation to affirmatively disclose these material facts. Where applicable, such disclosure shall be assisted and documented through the completion of a Variable Annuity Disclosure Form.

## **19.4 Purchases**

The following is a summary of how variable insurance contracts are purchased and processed. Refer to the section "Replacements" for further policies and procedures if the value of one policy is used to purchase a new policy.

### **19.4.1 Variable Life Insurance and Other Non-Annuity Products**

RRs may offer insurance products available from designated wholesalers. The Firm must have a sales agreement with the insurance carrier prior to effecting sales. The RR may call approved wholesalers directly for the following:

- Quote on the requested product
- Appointment of the RR with the insurance company
- Applications and forms to purchase the policy
- Brochures on products available.

### **19.4.2 Variable Annuities**

The Firm must have a signed selling agreement with the insurance company to permit sales of products of that company. Operations should be contacted to obtain a list of approved insurance companies or verify whether a particular company has an agreement with the Firm. All variable annuities (group and individual) must be sold through the Firm.

The following are steps for purchasing annuities:

- Both the customer and the RR must sign the application and the RR sends the application to Operations or uploads it to Docupace.
- Compliance will review for funding and required licensing and appointment of the RR.

### **19.4.3 Group Variable Annuities**

Group Variable Annuities are exempt securities under Federal Securities Law. However, FINRA rules require that all activity regarding such products conducted by RRs be supervised by the Firm. For this reason, all procedures regarding individual variable annuities are hereby deemed applicable to Group Variable Annuities as well.

### **19.4.4 Bonus Products**

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. While bonus products are not necessarily a bad idea, there are certain factors that need to be considered before the investment is made.

- The internal fees and expenses are generally higher than on a non-bonus product. Before recommending a bonus product, careful analysis of these higher expenses needs to be done in order to determine if these higher costs will end up costing the client more over the life of the contract than he/she would have paid if a non-bonus product had been purchased.
- The surrender charges on a bonus product are generally 1-2% higher than on a non-bonus product. If the client needs to liquidate the contract in the early years, he/she will pay a higher percentage of the contract in surrender charges. The surrender period on a bonus product is often 1 to 3 years longer than on its non-bonus counterpart. The client's funds will be inaccessible for a longer period of time before withdrawals are penalty free.

R Rs must be aware there may be disadvantages and added costs may more than offset the benefit to the customer. The RR is responsible for understanding the benefits and disadvantages of a bonus product before making a recommendation to a customer.

### **19.4.5 Charitable Gift Annuities**

A Charitable Gift Annuity (CGA) enables an individual to transfer cash or marketable securities to charitable organizations that, in turn issue gift annuities in exchange for a current income tax deduction and the organization's promise to make fixed annual payments for life. At the death of the annuitant, the funds remaining are disbursed to the charity. The Philanthropy Protection Act of 1995



exempted Charitable Gift Annuities from securities registration provided that no commissions be paid to solicitors of these gifts. The underlying reason for the exemption is that the primary purpose for a CGA is to make a charitable donation and not an investment.

RRs are prohibited from selling these products if the Charitable Gift Annuity has built-in variable or investment component which would necessitate securities registration absent the exemption.

#### 19.4.6 Customer Applications and Payments

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"> <li>• Operations</li> <li>• Compliance</li> </ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"> <li>• Variable annuity and variable life applications</li> <li>• Customer payments</li> </ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"> <li>• As required when applications and payments are received for processing</li> </ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"> <li>• Review application for completeness</li> <li>• Contact RR to obtain missing information, retaining the customer's check in a pending file (return application to RR if incomplete)</li> <li>• Confirm payment is correct for product being purchased</li> <li>• After approval, promptly transmit complete application and customer's payment to the issuer</li> <li>• <b>Principal review and approval (or rejection) of a customer's deferred variable annuity application</b> must be completed within 7 days of receipt of a complete and correct application package at IPI's home office.</li> </ul> |
| <b>Record</b>         | <ul style="list-style-type: none"> <li>• Maintain record of any applications returned to the RR or requests for additional information forwarded to the RR</li> <li>• Retain copy of application and payment with notation of when forwarded to the issuer</li> </ul>   |

The designated person is responsible for reviewing variable annuity applications for completeness and returning incomplete applications to RRs or contacting the RR for the missing information. Approved applications and customer payment will be promptly forwarded to the issuer.

#### 19.4.7 Suitability

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Applications</li><li>• Variable Annuity Disclosure Form</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review variable product transactions for suitability with particular attention to the following:<ul style="list-style-type: none"><li>◦ Insurance need</li><li>◦ All other determinants discussed in the previous section regarding suitability and sales guidelines</li></ul></li><li>• Follow up action may include:<ul style="list-style-type: none"><li>◦ Canceling transactions that appear to be inappropriate</li></ul></li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Initials/approvals on applications and disclosure forms</li><li>• Customer's signed Disclosure Form filed in the customer file, if appropriate</li></ul>   |

##### 19.4.7.1 Recommendation Requirements for Deferred Variable Annuities

Pursuant to FINRA Rule 2330, no RR shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has a reasonable basis to believe the transaction is suitable in accordance with Rule 2111 and, in particular, that there is a reasonable basis to believe:

- The customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59 ½ ; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities and market risk;
- The customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and;
- The particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product

enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by FINRA rules.

When an RR recommends the liquidation of an insurance product in order to use the proceeds of such liquidation to fund the purchase of a deferred variable annuity, this is called an exchange. When an RR recommends an exchange of a deferred variable annuity, the RR must consider whether:

- The customer would incur a surrender charge;
- Be subject to the commencement of a new surrender period;
- Lose existing benefits such as death, living, or other contractual benefits;
- Be subject to increased fees or charges such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements;
- The customer would benefit from product enhancements and improvements; and
- The customer has had another deferred variable annuity exchange within the preceding 36 months.

#### **19.4.8 Contract Delivery**

RRs must comply with the administrative procedures of the issuing insurance company with regard to delivery of the insurance contract and documentation of that delivery through a delivery receipt. Obtaining a delivery receipt (even when not required by an issuing insurance company) is recommended, though not required by IPI.

### **19.5 Communication With The Public Regarding Variable Insurance**

Written communications regarding variable annuities are subject to limitations that apply to investment companies.

#### **19.5.1 Retail Communications (Advertising and Sales Literature)**

Only Firm-approved vendor material may be provided to customers. Compliance is responsible for reviewing vendor materials and confirming FINRA approval has been obtained, where necessary, by the vendor. Copies are retained by the Compliance Department.

Firm-developed advertising or sales literature regarding insurance products requires the approval of Compliance prior to issuance. Compliance is responsible for filing such material with FINRA and retaining a record of filings.

Depending on the content, some material may require providing a prospectus prior to or with the advertising or sales literature.

### 19.5.2 Correspondence

RRs should use letters pre-approved by the Firm and include a prospectus or limit correspondence to stating that a prospectus is enclosed and the RR will be in contact with the customer. Questions should be referred to Compliance.

### 19.5.3 Sales Seminars and Public Presentations

Seminars and presentations including variable products require the prior approval of Compliance. An outline of subjects to be covered and any handouts or copies of slides or other presentation materials must be provided for review. Compliance will retain records of materials reviewed and any changes to be made.

## 19.6 Replacements

|                       |  |
|-----------------------|--|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>   |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Variable applications and order records</li><li>• Variable Annuity Disclosure Form</li></ul>   |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Daily and as required</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review insurance transactions to identify potential replacements</li><li>• Review Disclosure forms where required</li><li>• Review proposed replacement and, if appropriate, sign form indicating approval</li><li>• Notify RR the replacement was not approved and cancel purchase and sale, if necessary.</li><li>• Customer inquiry regarding previous replacements, if deemed appropriate.</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Replacement documentation is retained by Operations with records of the transaction.</li><li>• Compliance maintains a spreadsheet to track advisors performing 1035 exchanges/replacements to review for sales practice concerns.</li></ul>  |

The term "replacement" refers to using the value of an existing annuity or life insurance policy to fund the purchase of a new annuity or life insurance policy. If the RR is aware of a replacement, certain procedures must be followed, as explained in the following sections.

### **19.6.1 Definition**

Replacement occurs when an existing life insurance or annuity has been or is to be:

- Terminated;
- Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of non-forfeiture benefits or other policy values;
- Amended to effect either a reduction in benefits or in the term for which coverage would otherwise remain in force or for which benefits would be paid;
- Reissued with any reduction in cash value; or,
- Pledged as collateral or subjected to borrowing, whether in a single loan or under a schedule of borrowing over a period of time for amounts in the aggregate exceeding 25% of the loan value of the policy.

Common transactions that constitute replacements include Internal Revenue Code section 1035 exchanges; loans on existing life insurance policies used to fund new purchases; and note transactions involving the same insurer (commonly known as internal replacements), depending on state law.

### **19.6.2 Suitability Of Replacements**

Replacing a variable annuity contract just to generate a commission is a violation of FINRA rules concerning fair dealings with the public. With that being said, there is absolutely nothing wrong with being compensated for serving your clients with products that are appropriate for their situation.

The RR must have a reasonable basis for determining the suitability of recommending a replacement. A replacement may not be in the customer's best interest. For example, a customer may incur new fees, extended surrender charge periods, lose existing benefits, increased fees, a possible higher insurance risk rating due to ill health and new suicide and incontestability periods. There may also be unfavorable tax consequences. RRs should carefully consider whether a replacement is suitable for the customer and take into consideration the following:

Notice to Members 99-35, 00-44 and 07-53 should be reviewed in order to become familiar with the suitability standards placed on replacements by regulators.

For a change in investment objective/risk tolerance (e.g., existing fixed rate annuity replaced by variable annuity), consider the following:

- Has surrender charge period in the old annuity expired?

- What is the composition of the customer's overall portfolio? Will a new variable annuity represent a significant asset in the portfolio?
- 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?
- 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 need.
- What existing benefits would the customer lose?

If new life insurance provides a higher death benefit for truly the same or lower premium cost than under old life insurance policy consider:

- Surrender charges, if any, under old policy;
- Surrender charges, and duration, in new policy;
- Imposition of new contestability/suicide period (Has there been a change in the customer's health?);
- Premium payment period of new policy compared to old policy;
- Possible variability of future premium payments.

### **19.6.3 Replacement Procedures**

If a replacement is to be effected, the RR 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 original application.
- Check with Operations to determine whether the insurance carrier requires its own surrender form or state replacement form.
- Complete a state replacement form where required (check with the Insurance Dept. regarding states requiring their own replacement form).
- Obtain the surrendering carrier's original policy or complete a lost policy statement, signed by the customer.
- Take into consideration whether or not the customer would incur additional charges, be subject to increased fees or charges (such as those relating to mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements).
- Take into consideration prior exchanges made by the customer within the previous 36 months.
- Ensure customer would benefit from product enhancements and improvements.
- Complete the replacement section of appropriate Disclosure Form including signatures of the customer, the RR and a designated supervisor.
- Send all original paperwork to Operations for processing.

#### 19.6.4 1035 Exchanges

A 1035 Exchange refers to a section of the IRS Code that allows for the non-taxable exchange of non-qualified funds from one insurance carrier to another. The tax code states that the old insurance contract must be exchanged for a new contract; the policyholder cannot receive a check and apply the proceeds to the purchase of a new insurance or annuity contract. The tax code also states that the policyholder may make a tax-free exchange from: 1) a life insurance contract to another life insurance contract or an annuity contract, or 2) from one annuity contract to another annuity contract. 1035 exchanges are **not allowed** for liquidations **from** annuity contracts **to purchase** life insurance contracts.

When a customer exchanges an annuity or life insurance contract to purchase an annuity contract, in addition to the requirements listed in the prior section, a specific 1035 exchange form will be required.

#### 19.6.5 Rates of Exchange - Deferred Variable Annuities

Compliance is responsible for monitoring exchanges and determining if a RR has a rate of effecting deferred variable annuity exchanges that may evidence conduct that is inconsistent applicable securities regulations. Compliance will utilize exception reports which are designed to assist in this supervisory responsibility.

Compliance is also responsible for the implementation of corrective measures to address inappropriate exchanges. The following may occur if Compliance identifies an exchange that may be unsuitable or otherwise inconsistent with FINRA rules:

- Contact the RR to gather all relevant client data.
- Initiate communications with the client if necessary.
- Identify and facilitate the appropriate corrective measures.

#### 19.6.6 Twisting

Twisting is defined as the movement of customer funds from one annuity to another in order to generate commissions. Twisting is not an acceptable practice. All variable exchanges will be reviewed for twisting in addition to suitability and appropriateness of the transaction.

#### 19.6.7 Multiple Contract Sales

A series of multiple contract sales may be deemed unsuitable based on activity type, surrender fees, among other reasons. Compliance will review contract sales previously purchased prior to approving the current transaction.

## 19.7 Cash and Non-Cash Compensation Policy - Variable Insurance Securities

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Compliance</li></ul>  |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Requests from RRs, or outside firms regarding sponsorship of cash or non-cash compensation relating to the sale of investment company or variable insurance securities</li></ul>  |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• As required</li></ul>   |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review request and ensure compensation is consistent with rule requirements and limitations</li><li>• Approve or disapprove compensation in writing</li><li>• Establish and maintain required records of approved compensation programs</li></ul> |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• Records are maintained in a Cash/Non-Cash Compensation file.</li></ul>  |

FINRA regulations include restrictions on compensation relating to the sale and distribution of investment company securities and variable annuity and variable life products. RRs may not accept (directly or indirectly) cash or non-cash compensation from outside firms or persons. The only exception includes compensation arrangements specifically approved by the Firm.

### 19.7.1 Definitions

**Cash compensation** is defined as follows:

Any discount, concession, fee, service fee, commission, asset based sales charge, loan or override, or cash the RR received in connection with the sale and distribution of investment company and variable insurance securities.

Cash compensation relating to investment company securities must be disclosed in the prospectus for the securities with only few exceptions permitted under the rule.

**Non-cash compensation** is defined as follows:

Any form of compensation received in connection with the sale and distribution of investment company and variable contract securities, other than cash



compensation, which includes, but is not limited to, merchandise, gifts and prizes, travel expenses, meals and lodging.

### **19.7.2 Approval**

Any compensation as defined in this section and paid directly to the RR requires the approval of the designated supervisor. The following section outlines types of non-cash compensation permitted without specific approval, unless otherwise noted.

### **19.7.3 Types of Permissible Non-Cash Compensation**

The following types of non-cash compensation are allowed provided they are not preconditioned on achieving a sales goal:

- Gifts amounting in aggregate value not exceeding \$100 annually, per person.
- An occasional meal, ticket to a sporting event or show, or comparable entertainment that is not so frequent nor so extensive as to raise any question of propriety.
- Payment or reimbursement in connection with training or educational meetings, subject to several conditions. Note: Prior approval must be obtained from the designated supervisor before participating in such meetings.
- The location of the meeting is appropriate for its purpose, e.g., at or near the sponsoring company's home office; an office of the Firm or facility near an office; or a regional location for a regional meeting. The designated supervisor will determine the appropriateness of the meeting.
- Only expenses incurred by the Firm or its employees/RRs are eligible for payment. Expenses for guests of employees/RRs (spouse, etc.) will not be reimbursed.

Non-cash sales incentive programs may be preconditioned on achieving a sales goal provided they are pre-approved in-house incentive programs sponsored by the Firm and meet the following criteria:

- The program must be based on the RR's total production with respect to all investment fund or variable contract securities sold by the Firm.
- Credit received for each investment company or variable contract security is equally weighted.
- Only Firm employees/RRs may participate.
- Other firms may make contributions to the program, provided they do not participate, directly or indirectly, in the organization of the program. However, the outside entity may provide a speaker for the meeting.

#### 19.7.4 Recordkeeping

The designated supervisor will retain the following records, in a file for Cash/Non-cash Compensation arrangements:

- names of participating companies
- amount of cash and the nature and value, if known, of any non-cash compensation including whether the non-cash compensation was received in connection with a sales incentive program or a training and education meeting
- for training and education meetings:
  - date and location of meeting
  - names of employees/RRs approved to attend meetings
  - the fact that attendance at the meeting is not preconditioned on achieving a previously-specified sales goal
  - the fact that payment is not applied to expenses of guests of employees/RRs.

#### 19.8 Training

The Firm provides training for RR's and for registered employees who review transactions in deferred variable annuities to ensure compliance with FINRA Rule 2330. This training is incorporated in the programs outlined in Section 3, Training.

### 20.0 INDEPENDENT CONTRACTORS

|                       |   |
|-----------------------|---|
| <b>Responsibility</b> | <ul style="list-style-type: none"><li>• Designated Supervisors</li><li>• Senior Management</li></ul>                |
| <b>Resources</b>      | <ul style="list-style-type: none"><li>• Compliance Questionnaire</li><li>• U4 Review</li><li>• OBA Review</li></ul> |
| <b>Frequency</b>      | <ul style="list-style-type: none"><li>• Annual and as needed</li></ul>  |
| <b>Action</b>         | <ul style="list-style-type: none"><li>• Review for compliance with WSPs</li></ul>                                   |
| <b>Record</b>         | <ul style="list-style-type: none"><li>• See Resources</li></ul>   |

## **20.1 Independent Contractor Defined**

Most individuals are associated with the Firm as "independent contractors" as defined under current IRS guidelines. Independent contractors are not "employees" of the Firm for purposes of compensation and other considerations under IRS guidelines.

## **20.2 Supervision**

Independent contractors who are RRs are subject to the supervision of the Firm and are responsible for complying with the Firm's policies and procedures and the rules and regulations governing the activities of the Firm and its associated persons.

## **20.3 Agreements**

RRs who are independent contractors (ICs) will, at the time of association with the Firm, sign the Firm's agreement outlining the conditions under which the IC provides services to the Firm.

## **20.4 Use and Display Of The Firm's Name**

The Firm's name may be used only in conjunction with the products or services provided by the Firm. The Firm's letterhead or letterhead bearing the Firm's name may be used only for correspondence related to the Firm's business.

The Firm's name may be displayed only in authorized locations and in a manner approved by the Firm.

## **20.5 Display Of SIPC Symbol**

In authorized branch locations, the SIPC symbol will be displayed. Compliance is responsible for identifying the office locations that require the necessary SIPC display.

## **20.6 Use Of Other Names**

ICs are permitted to establish business entities (sole proprietorship, partnership, corporation, *etc.*) under which they conduct business. The use of other business entities must be disclosed to the Firm prior to use and receive Compliance approval. Disclosure is to be directed to Compliance and include:

- the name of the business entity
- description of the type of entity (partnership, corporation, *etc.*)

- description of what types of business will be conducted under the business entity.

Compliance is responsible for reviewing requests to establish or conduct business through the ICs business entity and approving or disapproving the request. Compliance will retain a record of the requests and approval or disapproval.

## **20.7 ICs As Investment Advisers**

### **20.7.1 ICs Who Are Investment Advisor Representatives Of The Firm's Affiliated Registered Investment Adviser, IPI Wealth Management, Inc.**

In addition to their responsibility to comply with the written supervisory procedures contained herein, such individuals must also comply with the IPI Wealth Management, Inc. Policies and Procedures Manual.

### **20.7.2 ICs Who Are Affiliated With Independently Registered Investment Advisers.**

ICs or their business entities may be independently registered as investment advisers, however, under FINRA regulations, the investment adviser activities may be subject to the supervision of the Firm. Therefore, independent registration as an investment adviser requires the approval of the Firm prior to engaging in investment adviser activities. Requests for approval should be submitted to Compliance for review and approval and include the following:

- the name under which the investment adviser activity will be conducted
- a copy of Form ADV for the adviser.

Based upon this information as well as ensuing discussion, the activity will be designated as either (a) an outside business activity or (b) private securities transactions.

Compliance may request other information, as necessary, to complete its review of the request. Compliance will retain a copy of the request and the approval or disapproval.

If approved as an outside business activity under FINRA Rule 3270, the IC is required to provide copies of the following information to the designated supervisor on an ongoing basis:

- updates to the ADV.

If approved as a private securities transaction under NASD Rule 3040, the IC will be required to provide copies of the following information:

- all investment adviser agreements and account applications with adviser customers, within 10 days of receipt by the adviser
- correspondence regarding investment adviser activities
- reports to adviser customers
- proposed allocation.

In addition, the IC will maintain copies of or provide electronic access to all trading activity (confirmations and statements) in investment adviser accounts for review by the Firm. As required by NASD Rule 3040, the Firm will maintain evidence that it has reviewed and approved all information detailed above.

## **20.8 Outside Business Activities and Outside Accounts**

As stated previously, ICs are subject to all provisions of the Firm's policies and procedures. Independent contractor status does not relieve the individual from complying with the requirements to disclose and obtain approval of all outside business activities and outside securities accounts. The section titled "General Policies" includes the policies in these and other areas affecting all individuals associated with the Firm.