KCD Financial Inc.'s Written Supervisor Procedures

KCD Financial

Effective: February 12, 2024

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1 INTRODUCTION

1.1 Information Sharing Between Law Enforcement Agencies And Financial Institutions

[US Patriot Act Section 314(a); FinCEN's 314(a) Fact Sheet: https://www.fincen.gov/sites/default/files/shared/314afactsheet.pdf; FinCEN Secure Information Sharing System: https://www.fincen.gov/314a/Login]

Responsibility	• Designated Supervisor
Resources	• FinCEN website including 314(a) requests
Frequency	• Every two weeks
Action	• Identify to FinCEN a designated contact (registered user) to: ○ Access FinCEN's Secure Information Sharing System (SISS) ○ Query KCD's data for a match ○ Verify positive match ○ Forward positive match information by the designated due date which is usually within two weeks of a request ○ Notify the Chief Compliance Officer of the positive match information • Notify FinCEN promptly of any changes to the designation or contact information
Record	• Designated contact and notification to FinCEN of any changes • Record of confirmation and a FinCEN 314(a) Search Self-Verification from SISS accessing FinCEN's website (5 years) • Notification to CCO • Record of information forwarded to FinCEN (5 years)

FinCEN's regulations enable law agencies, through FinCEN, to request information from financial institutions. Requests are sent to designated contacts at the financial institutions; the contacts receive, every two weeks, notifications about new 314(a) information requests posted at a secure Internet web site. KCD will:

- Access SISS bi-weekly (whether or not FinCEN sends notification) to download current requests
- Query KCD's records for data matches, including accounts maintained by the named subject during the preceding 12 months and transactions conducted within the last 6 months; records that must be searched are included in the FinCEN request
- To determine whether a potential hit is a false positive or a positive match, consider relevant information including (but not necessarily limited to): name, address, city, state, country, and any unique identifiers such as social security number, employer ID number, tax ID number, passport number, *etc*.)
- Send positive matches to FinCEN using the SISS on or before the designated response date which is normally 14 calendar days after the request is transmitted

The information provided to FinCEN is confidential and may not be used for any purpose other than reporting to FinCEN; determining whether to establish or maintain an account or engage in transactions.

No response is required if there are no matching accounts or transactions.

1.2 Political Action Committees (PACs)

[MSRB Guidance on Dealer-Affiliated PACs Under Rule G-37, 10-21-10; MSRB Rule G-37 Q and A]

Responsibility	• Designated Supervisor
Resources	• Requests to establish PACs • Information regarding PACs established by affiliates
Frequency	• As required
Action	• Obtain information from affiliates about PACs related to municipal business • Determine whether a PAC is controlled by KCD • Determine whether Rule G-37 applies to the PAC • If controlled by KCD, notify persons responsible for the PAC of the applicability of Rule G-37 • Make necessary MSRB filings on behalf of a controlled PAC • Establish and monitor information barriers to mitigate conflicts and prevent abuses, notify affected persons, and require acknowledgement of notification from affected persons • For affiliate PACs not controlled by KCD or an MFP or MAP, establish information barriers and notify affected affiliate and firm personnel of the barriers, including acknowledgement by affected persons
Record	• Requests and reviews of requests • Information regarding affiliate PACs • Review of PACs to determine whether Rule G-37 applies • G-37 filings, as required • Notification of information barriers for affiliate PACs not under control of KCD or an MFP or MAP and acknowledgement by affected persons, monitoring of barriers

A PAC controlled by KCD or its municipal finance or advisory professionals (MFPs and MAPs) is subject to the political contribution requirements of Rule G-37. There are factors that may result in an affiliated PAC being viewed as controlled by KCD; the MSRB's interpretive guidance should be consulted for specifics. **Compliance should be consulted before a PAC is established related to municipal securities business.**

A summary of factors that indicate potential control of a PAC by KCD includes:

- If KCD or one of its MFPs or MAPs is involved in the creation of a PAC (whether solely or together with others), there is a presumption of control unless there is a complete disassociation in any direct or indirect manner.
- The ability to direct or cause the direction of the management or policies of a PAC are potential indicators.
- The level of funding provided by KCD or a Firm MFP may indicate control, including potential leveraging of the contribution activities of affiliated PACs.

To avoid conflicts of interest and to comply with G-37, the following information barriers have been established between KCD, its MFPs, its MAPs, and any PAC that is not controlled by KCD or an MFP or MAP, but is controlled by an affiliate of KCD.

- KCD and its MFPs and MAPs cannot recommend, nominate, appoint, or approve the management of affiliated PACs.
- The PAC's meeting agenda, meeting schedule, or meeting minutes cannot be shared with KCD or Firm MFPs and MAPs.
- There cannot be identification of prior affiliated PAC contributions, planned PAC contributions, or anticipated PAC contributions.
- There is a prohibition on directly providing or coordinating information about prior negotiated municipal securities business, solicited municipal securities business, and planned solicitations of municipal securities business.

Compliance will notify affected affiliate personnel and firm personnel, as necessary. Affected persons will be required to acknowledge in writing their understanding and compliance with the information barriers.

1.3 Credit Risk Management

[FINRA 2022 Report: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• Available reports • Credit extension to customers • New business lines/products • Clearing, prime brokerage, give up, sponsored access and other arrangements that represent potential credit risk
Frequency	• Periodic: reviews of credit risk • As required: review of new business or services that may represent credit risk • As required: review credit risk limit changes

Action	• Identify individuals (and/or establish a credit committee) for review of credit risks
	• Identify areas of potential credit risk, establish and adjust credit limits, and monitor which may include:
	    ○ Leveraged investments and overall extension of margin for investments and customers
	    ○ Monitor exposure to affiliated counterparties considering their creditworthiness; liquidity and net worth; track record of past performance; and internal risk controls
	• Assign credit limits and review existing limits, as appropriate
	• Consider the quality of collateral
	• Monitor for exposures with potential impact on capital
	• For margin accounts (which may be assumed by a clearing firm):
	    ○ Establish house margin requirements
	    ○ Identify and assess credit exposures in real-time environments
	    ○ Issue margin calls, margin extensions, and resolve unmet calls
	    ○ Establish frequency and manner of stress testing for collateral held for margin loans and secured financing transactions
	    ○ Approve new, material margin loans

Record	• Reviews and monitoring of credit issues (including credit committee minutes and actions, if applicable) • Credit limits and reviews of limits • Reviews including collateral quality, net capital exposure, margin reviews and limitations and related actions

	• Monitoring of exposure to counterparties

KCD conducts risk management reviews to identify its exposure to credit risk. Responsibility for oversight of credit risk includes the Chief Financial Officer, the credit committee (if one has been established), and the clearing firm (if applicable).

1.3.1 Liquidity Risk Management

[FINRA Regulatory Notice 21-31, 21-12, 15-33, 10-57 and 99-92; FINRA 2022 Report: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• Reports and other available data
Frequency	• Ongoing

Action	• Identify persons responsible for carrying out actions when events representing liquidity risk to the firm and/or its customers occur
	• Establish controls and review outcomes and actions which may include:
	  ○ Conducting stress tests including concentration limits within securities or sectors and holdings across accounts held at other financial institutions
	  ○ Reviewing and adjusting assumptions regarding clearing deposits
	  ○ Accessing liquidity during stress conditions
	  ○ Determining how funding will be used
	  ○ Using empirical data from recent stress events to increase the robustness of stress testing
	  ○ Having a contingency funding plan
	  ○ Setting and periodically re-evaluating the level of funding and liquidity risk the organization is willing to accept to meet its business goals with communications to management of various business lines
	  ○ Using staff that is independent of business lines to ensure KCD does not exceed the levels of risk tolerance set by management
	  ○ When shorter-term financing funds longer-term positions, regularly assessing the ability to continue operating under a variety of market conditions and firm-specific events
	  ○ Identify the true liquidation value of inventory holdings and plan for liquidation if necessary
	• Monitor pricing, profit/loss and adherence to position limits
	• Establish and document credit lines and monitor usage
	• Establish committed loan facilities and access to a committed liquidity pool
	• Perform a daily computation of customer reserve fund requirements
	• Establish reasonable assumptions regarding the haircuts that counterparties are likely to require in stress scenarios
	• Establish a plan for liquidating firm inventory
	• Identify early warning signs of potential funding and liquidity problems

Record	• Records of controls and reviews and actions taken • Pricing of inventory, position limits, actions taken • Credit lines • Loan facilities

	• Daily computation of customer reserve fund requirements • Plan for liquidation of inventory • Other actions regarding red flags and events affecting liquidity

The Chief Financial Officer, Credit Manager, Credit Committee or other designated person(s) is responsible for establishing a program to evaluate and monitor KCD's liquidity risk. Liquidity risk can contribute to a firm's failure and customer inability to have prompt access to their assets, even in times of stress. Broker-dealers have an obligation to develop and maintain robust funding and liquidity risk management practices to prepare for adverse circumstances including extraordinary credit events, at the broker-dealer level and also at the holding-company level. FINRA Regulatory Notice 10-57 provides liquidity management practices and red flags for identifying problems.

1.4 Market Access

[Exchange Act Rule 15c3-5; SEC FAQs concerning market access risk management: http://www.sec.gov/divisions/marketreg/faq-15c-5-risk-management-controls-bd.htm; SEC Small Entity Compliance Guide: http://www.sec.gov/rules/final/2010/34-63241-secg.htm; Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• Order entry systems • Order data • FINRA report cards
Frequency	• Ongoing: oversight of systems • Daily, weekly, or other depending on available reports • Annual: review of risk controls and CEO certification • Monthly: review report cards • Periodically: test market access controls

Action	• Establish pre- and post-order entry controls (such as order entry limits and kill switches) to monitor and respond to aberrant behavior by trading algorithms or other impactful market events
	• Establish and maintain credit risk controls including:
	    ○ Credit limits/capital thresholds for customers and principal accounts considering the customer's trading patterns and order entry and/or quote history
	    ○ Monitor for compliance with limits and take corrective action when exceeded
	    ○ Entry of orders/quotes that exceed aggregate credit/capital thresholds
	    ○ Review of sub-limits at each exchange/ATS accessed
	    ○ Review credit limits periodically
	• Notify the appropriate supervisor of exceptions/breaches for corrective action
	• Provide reports to supervisors
	• Review report cards to identify potential layering and spoofing and take corrective action, when necessary
	• Conduct review of risk controls
	• Obtain CEO certification
	• Provide training to traders including steps and requirements for requesting ad hoc credit limit adjustments

	• When third-party vendor systems are used (including those of an ATS or exchange):
	  ○ determine whether the vendor can meet the obligations of the rule and how KCD maintains direct and exclusive control of applicable thresholds
	  ○ review for independence from their customers and appropriate controls
	  ○ confirm vendor is able to independently adjust its controls
	  ○ maintain direct and exclusive control over controls set by the ATS, if applicable
	• Test market access controls
	• Where direct market access is provided via multiple systems, employ controls to confirm system records are aggregated and integrated in a timely manner and conduct post-trade and supervisory reviews for potentially manipulative trading patterns

Record	• Credit limit approvals and reviews • Reviews of third-party vendors • Reviews of reports and corrective action taken, if applicable • Annual review • Training of traders • Annual certification • Report cards and actions taken

SEC Rule 15c3-5 requires broker-dealers (BDs) with market access, including BDs that provide a customer or any other person with market access through use of the BD's market participant identifier or otherwise, to establish appropriate risk management controls and supervisory systems. These requirements are designed to limit the financial exposure of a BD that could arise as a result of market access, and to ensure compliance with all regulatory requirements that apply to providing market access.

The Rule applies to BDs with market access to trading securities by virtue of being an exchange member, an ATS subscriber, or an ATS operator with non-broker-dealer subscribers. It applies to security-based swaps if they become traded on an exchange and to BDs engaged in proprietary trading.

The Rule prohibits "naked" or "unfiltered" sponsored market access for third parties accessing markets through the BD.

1.5 Investment Analysis Tools And Digital Investment Advice

[FINRA Rule 2214; FINRA report Digital Investment Advice: http://www.finra.org/sites/default/files/digital-investment-advice-report.pdf]

Responsibility	• Designated Supervisor • New Products Committee or Investment Committee
Resources	• Internal or external tools • Resulting recommendations, investments, and portfolio outcomes • Exception reports, if available
Frequency	• As required: evaluate potential tools • Ongoing: monitor results of tools used • When new tools are introduced and periodically after: train RRs • Within 10 days of first use: make necessary filings with FINRA

Action	• Review proposed internal or external tools:
	  ○ Evaluate algorithms for consistency with KCD's investment and analytic approaches
	  ○ Conduct due diligence on third-party tools
	  ○ Determine how customers will be profiled to match with tools
	  ○ Determine RR obligations to and involvement with customers
	  ○ Identify those responsible for supervising tools
	  ○ Consider what exception reporting is necessary for identifying anomalies where a tool's output deviates from expectations
	  ○ Consider portfolios to be offered including portfolio investment profiles, securities to be included and appropriateness for different portfolios
	  ○ Monitor pre-packaged portfolios for consistency with types of investors to whom they will be offered
	  ○ Identify and mitigate conflicts of interest of investments offered
	  ○ Identify the parameters for investor profiling including whether investing is appropriate for the customer
	  ○ Evaluate whether the tool captures customer-specific suitability elements including how conflicting responses will be resolved; criteria for Reg BI-compliant recommendations; concentration levels; identifying risk tolerance
	  ○ Determine whether rebalancing will be included in the tool and necessary elements such as automatic rebalancing, disclosure of potential cost and tax implications; if drift thresholds are used and disclosures to customers; tool response to a major market movement; minimizing tax impact
	• Conduct periodic and ongoing reviews of appropriateness of models; testing of output; RR recommendations inconsistent with tool output; efficacy of customer profiling for use of tools and ability to modify
	  ○ Test output to ensure performance as intended
	• Consider third parties to conduct reviews
	• Determine training content and frequency of training
	• Make necessary filings with FINRA for tools made available to non-institutional customers

Record	• Initial reviews including approval of accepted tools • Disclosures required in certain communications • Filings with FINRA • Ongoing reviews including records of actions taken, if any • Training including date provided, who attended, and content

Customers are offered investment analysis tools and digital investment advice for use either independently or with assistance from an RR. An "investment analysis tool" is an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, serving as a resource to investors in evaluating the potential risks and return of investment choices. Tools may be available for independent use by customers or RRs may interface with customers using the tools.

FINRA includes the following definition in its *Report on Digital Investment Advice*:

Digital investment advice tools (also referred to as digital advice tools) support one or more of the following core activities in managing an investor's portfolio: customer profiling, asset allocation, portfolio selection, trade execution, portfolio rebalancing, tax-loss harvesting and portfolio analysis.

This section outlines requirements regarding investment analysis tools and digital advice.

KCD Financial, Inc., (KCD) will conduct its business consistent with the highest standards of commercial honor and just and equitable principles of trade. Keeping our customers' interest foremost is key to KCD's success. The trust of our customers and KCD'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 KCD's supervisory policies and procedures to provide guidance to designated supervisors in their oversight of the Firm's business. It is a working document and reference for supervisors and will be updated when necessary.

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 may suggest changes to fit the needs of KCD, their particular department, and the employees and customers of KCD. 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 KCD) who may be independent contractors for tax and compensation purposes.

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

1.6 General Guidelines

The following general guidelines apply to sales contests:

- If an entity other than KCD finances the contest or provides remuneration for the contest, disclosure will be made to customers where necessary.
- Guidelines will be established for determining the appropriateness of securities the subject of the contest for the customers to be solicited.
- Designated supervisors will be responsible for selling efforts and appropriateness of sales subject to a contest. Designated supervisors may also determine whether to restrict the types of accounts that may participate including employee or employee related accounts or discretionary accounts.
- Refer to the chapter *MUTUAL FUNDS* regarding specific guidelines that apply to contests for the sale of mutual funds and to the chapter *MUNICIPAL SECURITIES* for special requirements under MSRB rules.
- Under Regulation Best Interest (BI), sales contests may not be limited to only certain securities or types of accounts.

ATTESTATION

As a Registered Representative of KCD Financial, Inc., it is important to understand our procedures and policies. This is accomplished through:

Independent review of KCD's **Written Supervisory Procedures Manual (WSPs)** accessed through the secured Rep page of our website:

www.kcdfinancial.com

or this link will take you directly to the current version of our WSPs:

https://policies.complianceresourcenetwork.com/2U5L3J4W2F2M5H1Q/WSP/

To verify your review of KCD Financial's WSPs complete the following.

Acknowledgements:

I have access to KCD's Written Supervisory Procedures and am familiar with the contents. If I have questions regarding procedures I understand they can be found in KCD's WSPs. If I have additional questions, I will contact my supervisor.

I will check for periodic updates of compliance issues and regulations in KCD's WSP. The WSPs can be found on KCD's website or through the Compliance Resource Network link.

I have read, understood and agree to abide by the terms, conditions and requirements contained in the Firm's WSP manual. I further agree to abide by any and all federal and state laws and the rules and regulations of any and all regulators having jurisdiction over me and the Firm. I further agree to indemnify the Firm for any legal fees, costs, expenses or other damages to the Firm as a result of my non-compliance with the Firm's compliance program.

Date

Registered Rep's Signature

Print Registered Rep's Name

Supervisor/Principal's Signature

Print Supervisior's Name

Please sign and return to KCD Financial via mail or fax to: 920-347-3402

2 DESIGNATION OF SUPERVISORS AND OFFICES

2.1 Designation Of Supervisors

[FINRA Rule 3110(a)]

This section includes KCD's designated supervisors responsible for supervision of the areas of business indicated.

Date: ____________________

SEE FINRA CONTACT SYSTEM FOR ROLES AND RESPONSIBILITIES

Area/ Department Supervised	**Name/Title/ Location of Supervisor**	**Registration Status**	**Effective Date of Supervision**	**RRs Supervised**
Establish policies and procedures including supervisory controls and testing of those procedures				N/A
	Principal Financial Officer			
	Principal Operations Officer			
	Compliance Officer			
	Investment Banking Principal			
	Private Securities Offerings Principal			
	Financial and Operations Principal			
CRD Electronic Filings				

2.2 Designation Of Offices

[FINRA Rule 3110(f); MSRB Rule G-27(b)(iii) and G-27(g)]

KCD maintains the following office(s):

Office Location	Type of Office*	Designated Supervisor(s)	Designated Person To Explain Office Records	Type(s) of Business Conducted at Office

*OSJ = Office of Supervisory Jurisdiction
*OMSJ = Office of municipal supervisory jurisdiction
*BR = Branch Office
*MBR = Municipal branch office

Non-Branch locations:

*FLR = Exchange floor location (where KCD conducts a direct access business with public customers)
*NSA = Non-sales location (limited to customer service, back office functions, *etc.*)
*NSE = Non-securities location (associated person(s) primarily engaged in non-securities activities)
*PR = Primary residence (associated person's primary residence used for securities business)
*OPR = Locations other than primary residences (*e.g.,* other location used less than 30 business days/year for securities business)
*OC = Office of convenience (location used occasionally and exclusively by appointment to meet with customers)
*NON = Location used primarily to engage in non-securities transactions (no more than 25 securities transactions in a calendar year; retail communications (including business cards) must include location of supervising office)
*TEMP = Temporary office established because of implementation of business continuity plan

3 SUPERVISORY SYSTEM, PROCEDURES AND CONTROLS

3.1 Introduction

KCD 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 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. Most supervisory procedures are explained in "matrixes" that appear throughout this manual and include the following:

Responsibility	• Who is the responsible supervisor? *Supervisors are sometimes referenced by name, sometimes by title or as "designated supervisor" which is cross-referenced to the "Designation Of Supervisors" table that appears in this manual.*
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? *Generally supervisors are expected to initial and date reports or other records, note any action taken, and retain that information in their files.*

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.

3.2 Responsibility

Responsibility for KCD 's supervisory system, policies, and controls includes the following, if applicable:

- Designated supervisors are responsible for enforcing policies and procedures in their respective business areas.

- The Chief Compliance Officer (CCO) is responsible for establishing and maintaining the supervisory system, policies and procedures for all areas of the firm.
- 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 following are not applicable at this time, but in the future may be established.

- The Chief Operations Officer (COO) is responsible for establishing and maintaining systems, policies and controls regarding operations procedures.
- The Chief Information Officer (CIO) is responsible for maintenance and testing of computer programs and systems.
- The Internal Audit manager is responsible for developing audits and identifying business, financial, and operations areas to be reviewed.
- The Risk Manager is responsible for developing and evaluating risk management procedures.
- The Audit Committee is responsible for reviewing internal and external audits and initiating corrective action where appropriate.

3.2.1 Widespread Health Emergencies

[Federal government Business Pandemic Influenza Planning Checklist: http://www.pandemicflu.gov/plan/pdf/businesschecklist.pdf; FINRA Regulatory Notice 20-16, 20-08 and 09-59; FINRA Information Notice 3/26/20 Cybersecurity Alert]

A widespread pandemic or any biologically based threat could have significant impact on the ability of KCD to continue conducting business. This section outlines the steps KCD has taken and will take in the event of a widespread pandemic.

3.2.1.1 Preparatory Steps

- Document government resources for information about a pending pandemic
- Engage cybersecurity procedures (see the chapter: *CYBERSECURITY*)
- Identify and document an alternative firm or firms to handle KCD's business for extended periods of time
- Identify and document medical resources to assist employees, including administering vaccinations or other medications
- Stock antibacterial and other hygiene products for use by employees
- Identify alternative work sites
- Identify employees who can telecommute and establish a list of those employees and what computers and technology will be necessary
- Establish supervisory procedures to oversee employees who will telecommute or are relocated to an alternative site

3.2.1.2 Action If A Pandemic Occurs

The following procedures will be followed in the event of a threatened health emergency.

1. The Emergency Response Team will meet to determine the potential seriousness of the threat and what action to be taken as the threat escalates.
2. Notify employees of:
    - available vaccinations or other medication and whether they are mandated
    - necessary conduct such as avoiding personal contact such as handshaking

    - access to antibacterial or other hygiene products to reduce infections and transmission of communicable diseases
    - requirement to stay home and telecommute
    - transfer of business/functions to other firms
    - contact list of key personnel
3. Restrict access to KCD by outsiders (customers, vendors, *etc.*).
4. The Emergency Response Team will meet or communicate regularly to determine steps to be taken.

3.3 Controls

3.3.1 Verification and Testing

KCD 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
- 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

3.3.2 Outside Auditors

KCD '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 KCD'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.

3.4 Written Compliance and Supervisory Procedures

[SEC Securities Exchange Act of 1934 Rule 17a-4(e)(7); FINRA Rule 3110(b)(7) and 3110.11]

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 written procedures and incorporated where necessary. Changes are considered at least bi-monthly.
- Changes are incorporated in written procedures including the date of the revision.
- Prior versions of the manual are archived for books and records purposes.
- When policy and procedure changes affect personnel, Compliance will distribute new or revised policies as follows:
  - In written form, where practical
  - By email
- Compliance provides manuals to new employees and obtains receipts that are maintained in employee or other compliance files.
- If a new policy manual is distributed, receipts will be requested and maintained in employee or compliance files.
- Policies may be made available to employees in electronic format. Changes will be promptly posted to the electronic version of policies and procedures.
- Electronic versions are protected to prevent changes by unauthorized persons. Compliance maintains a record of those authorized to change and post policies and procedures.

3.5 Chief Compliance Officer (CCO)

[FINRA Rule 3130(a)]

KCD has designated a CCO who is listed on the *Designation Of Supervisors* chart and Schedule A of Form BD which is filed with regulators.

3.6 Internal Inspections

[FINRA Rule 3110(c)]

Responsibility	• Compliance
Resources	• Records, reports, policies and procedures
Frequency	• Annual (or more frequently for certain high-risk areas)
Action	• Identify business areas subject to review • Prepare schedule of inspections considering the risk profile of each business area • Assign inspection responsibility considering any potential conflicts of interest including economic, commercial, or financial interests in the associated persons or business being inspected and ensuring the person assigned does not work in the business unit and is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the unit or location. Where compliance is not possible due to KCD's size or business model, document in the report both the factors used to make this determination and how the inspection otherwise complies with the requirements of Rule 3110(c)(1) • Prepare draft report of review and provide to appropriate supervisory personnel for comment • Prepare final report and send to supervisor of the business area and senior management

	• Obtain response regarding corrective action from the supervisor • Follow up regarding deficiencies (at the latest at the next inspection)
Record	• Records of internal inspections including when conducted, who conducted them, and reports and responses

The Firm reviews, at least annually on a calendar-year basis, the businesses in which it engages to identify potential non-compliance with Firm policies and procedures and regulatory rules, laws, and regulations.

Reviews may be conducted through a number of resources including (but not necessarily limited to):

- Compliance
- Clearing firm (for those areas that are the clearing firm's responsibility)
- Internal audit
- Outside auditors
- Outside consultants
- Risk management

Reviews conducted internally may use different approaches:

- Review of a specific period of time
- Review based on a sampling of the activity
- Other reviews appropriate to the area of business

OSJ and branch office inspections are described in the chapter *OFFICES* in the section *Office Inspections*.

3.7 Review and Testing of Procedures and Controls

[FINRA Rule 3120(a)]

Responsibility	• Compliance
Resources	• Records, reports, policies and procedures
Frequency	• Annual - or as needed
Action	• Test procedures/controls • Identify gaps in procedures and document • Revise procedures where necessary
Record	• Documentation of reviews and testing • Revised policies and procedures, as appropriate • Update CRS as necessary

The Firm conducts reviews of its supervisory procedures and controls at least annually to confirm procedures are current and include all areas of business. Procedures and controls are also tested to determine they achieve the necessary levels of compliance. Findings from internal inspections are also considered in this review.

Reviews and testing may be conducted through a number of resources including (but not necessarily limited to):

- those responsible for conducting reviews and testing

3.7.1 Conducting Risk-Based Reviews and Testing

Reviews and testing will be documented on the *Supervisory Policies, Procedures, And Controls Review & Testing* form or through similar types of reports or forms. This includes identifying who is conducting the review/testing and assigning risk levels to different areas of business. Areas of higher risk will be subject to more frequent and/or more extensive reviews which may include look-backs, larger samples and/or longer time periods for review, certifications by supervisors, or other reviews determined by the reviewer(s). Review potential need to update CRS when performing due diligence on new products or if any material change in the way the firm conducts its business. These functions are conducted by compliance department.

3.7.2 Findings and Follow-Up

Findings from reviews and testing are included in the CEO report and annual certification discussed in the next section. Compliance is responsible for:

- Amending policies and procedures to address gaps
- Reporting deficiencies (found in testing) to supervisors of appropriate business areas
- Follow up to determine deficiencies have been addressed
- Assembling findings for inclusion with the CEO report and annual certification (next section)

3.8 Escalation of Issues

Employees (including supervisors) have an obligation to report issues that are potential problems involving wrongdoing. While each incident is unique, following is a general protocol for escalating such reporting when necessary.

1. The potential problem should initially be reported to the individual's direct supervisor.
2. If the problem involves the direct supervisor, or it appears there is inadequate response from the direct supervisor, report the issue to the direct supervisor's supervisor.
3. If the issue involves the supervisor's supervisor, or if it appears there is inadequate response, contact Compliance or internal counsel.
4. Compliance or internal counsel may:
    - contact outside counsel for further guidance
    - notify senior management
    - notify regulators

3.9 Annual Certification of Compliance and Supervisory Processes

[FINRA Rule 3120 and 3130]

Compliance prepares an annual compliance report for the CEO (or equivalent officer).

3.9.1 Meetings Between CEO and CCO

The CEO meets once or more annually with the CCO to review compliance matters the subject of the annual certification.

3.9.2 Annual Report to CEO

The CCO will prepare and provide the CEO (or equivalent officer) with an annual report that includes a review of the Firm's supervisory system and procedures and key compliance issues. The report will also include a summary of testing results including significant identified exceptions and any amended supervisory procedures adopted in response to the test results. 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. If the Firm has designated multiple CCOs, each CCO will meet with and prepare a report for the CEO annually.

The annual report will be provided to members of the board of directors (or equivalent senior management) and the audit committee, if one has been established. The report will be provided to these governing bodies at the earlier of their next scheduled meetings or within 45 days after execution of the certification.

3.9.2.1 Certification

Annually (after receipt and review of the report), the Chief Executive Officer (or equivalent) will certify that KCD 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. If KCD has co-CEOs, each CEO will certify as if he/she were acting as sole CEO.

3.10 Supervision of Supervisors

[FINRA Rule 3110(b)(6)(c) and 3110.10]

Responsibility	• Compliance
Resources	• Designation of supervisors
Frequency	• Ongoing
Action	• Identify and designate supervision of supervisors and include in the "*Designation Of Supervisors*" chart, confirming supervision complies with the requirements of this section ensuring supervisors do not report to someone they supervise, or have compensation determined by such a person • Identify supervisors who handle customer accounts and establish supervision in accordance with established procedures for supervising accounts • Where compliance with these requirements is not possible because of the size of KCD or a supervisor's position in KCD, document the factors used in making such a determination and how an alternative arrangement complies with the requirements • Ensure designated supervisors are aware of the designation and their responsibilities • Include review of supervision in inspections of offices
Record	• Designation of supervisors confirmation that such designations do not conflict with requirements to exclude supervision by those reporting to the supervisor or who determines the supervisor's compensation • Documentation of exceptions • Reviews of supervisors' customer accounts

	• Review of supervision as part of inspection reports

Supervisors are subject to supervision of their activities by other designated supervisors. Supervisors are not permitted to:

- supervise their own activities; and
- report to, or have their compensation or continued employment determined by, a person or persons they are supervising.

Where it is not feasible to comply with these requirements, KCD's records will be documented justifying the exception and how supervisory requirements will be met. Rule exceptions include instances where:

- KCD is a sole proprietor in a single-person firm;
- a registered person is KCD's most senior executive officer (or similar position); or
- a registered person is one of several of KCD's most senior executive officers (or similar positions).

3.10.1 Supervision of Customer Account Activity

Responsibility	• Compliance • Designated supervisor of producing manager
Resources	• Various for supervision of producing managers (listed in supervisory matrixes in appropriate chapters, by subject)
Frequency	• Ongoing: Compliance maintain supervisory designations • Ongoing: Designated supervisors oversight and supervision
Action	• Compliance: Identify supervisors ensuring independence (supervised person does supervise his/her supervisor, determine manager's compensation or have his/her compensation determined by the supervisor with particular review if the proposed supervisor is located in the same physical office as the supervisor) • Identify reviews to be conducted • Identify supervisors subject to heightened supervision and notify designated supervisor • Designated supervisor: conduct supervision depending on the types of the supervised person's activities, including reviews of customer account activity
Record	• Compliance records of supervisors and who supervises them • Designated supervisor: records of reviews conducted

As required by rule, all supervisors will be assigned to a designated supervisor who is responsible for oversight of the supervisor's activities.

Day-to-day customer account activity conducted by office managers, sales managers, regional or district managers or other supervisors is subject to review and supervision by someone senior to or independent of the supervised person. This includes account activity in family accounts.

3.11 Conflicts of Interest

[FINRA Report on Conflicts of Interest October 2013]

The Firm has an obligation to mitigate potential conflicts of interest and put the customer's interest before its own. Potential conflicts are addressed in the following sections which also address supervision of these potential conflicts.

1. The Firm's Code of Ethics addresses the following issues:
    - Confidentiality of the Firm's business, its employees, customers, suppliers or consumers
    - Actions constituting acting in self-interest
    - Gifts and entertainment
    - Bequests
    - Privacy of customer information and requests for information from affiliates
    - Holding outside offices or appointments
    - Internal accounting controls
    - Reporting ethics violations and disciplinary action
    - Trading in the stock of Firm customers, suppliers, or vendors
    - Full and fair disclosure regarding documents filed on behalf of the Firm
    - Employee compliance with Firm policies and rule requirements, obligations to report
    - Contacts regarding ethics issues
    - Supervision vested in supervisors
    - Administration of the Code of Ethics
2. Insider trading *(see the chapter INSIDER TRADING)*
3. Policies regarding employee outside business activities, outside accounts *(see the chapter GENERAL EMPLOYEE POLICIES)*
4. Customer privacy policies and procedures *(see the chapter COMMUNICATIONS WITH THE PUBLIC)*
5. Identity theft *(see the chapter ACCOUNTS)*

3.12 Cross Reference To Other Supervisory Control Subjects

The purpose of this section is to identify SRO supervisory control rule subjects that do not appear in the chapter *SUPERVISORY SYSTEM, CONTROLS AND PROCEDURES* and that appear in other chapters of this manual.

Subject	CHAPTER	Section / Subsection(s)
Transmittals of customer funds and securities to: • Third parties • Outside entities (banks, investment companies, *etc.*) • Post office or c/o addresses • Customer by RRs	FINANCIAL AND OPERATIONS PROCEDURES	Transmittals Of Customer Funds And Securities
Customer changes of address	ACCOUNTS	• Addresses On Customer Accounts • New Accounts - Post Office Addresses
Customer changes of address	FINANCIAL AND OPERATIONS PROCEDURES	Customer Confirmations And Statements - Change Of Customer Addresses On Accounts

Confirming changes in customer investment objectives ['34 Act Rule 17a-3(17)(i)(A)]	ACCOUNTS	• New Accounts - Customer Account Information • Updating Account Information And Periodic Affirmation
Time and price discretion for orders [FINRA Rule 3260]	ORDERS	Time And Price Discretion
Account designation changes on orders [FINRA Rule 4515]	ORDERS	Account Designation And Cancels/Rebills
Holding customer mail	FINANCIAL AND OPERATIONS PROCEDURES	Customer Confirmations And Statements - Hold Mail Instructions
Office inspections	OFFICES	Office Inspections

3.13 Policies Not Included

[FINRA Rule 3120]

Policies and procedures are **not** included in this manual for the following activities:

- Transmitting funds or securities from customers: to third parties; to outside entities (banks, investment companies, *etc.*); to locations other than the customer's primary residence (post office box, "care-of" accounts, alternate address, *etc.*); and between customers and RRs, including hand-delivery of checks.

If KCD 's business changes, policies and procedures will be adopted to address these requirements.

3.14 Cross Reference to Other Supervisory Control Subjects

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Subject	CHAPTER	Section / Subsection(s)
Transmittals of customer funds and securities to: • Third parties • Outside entities (banks, investment companies, *etc.*) • Post office or c/o addresses • Customer by RRs	FINANCIAL AND OPERATIONS PROCEDURES	Transmittals Of Customer Funds And Securities
Customer changes of address	ACCOUNTS	• Addresses On Customer Accounts • New Accounts - Post Office Addresses
Customer changes of address	FINANCIAL AND OPERATIONS PROCEDURES	• Customer Confirmations And Statements • Change Of Customer

		Addresses On Accounts
Confirming changes in customer investment objectives ['34 Act Rule 17a-3(17)(i)(A)]	ACCOUNTS	• New Accounts - Customer Account Information • Updating Account Information And Periodic Affirmation
Time and price discretion for orders [NASD Rule 2510]	ORDERS	Time And Price Discretion
Account designation changes on orders [FINRA Rule 4515]	ORDERS	Account Designation And Cancels/Rebills
Holding customer mail	FINANCIAL AND OPERATIONS PROCEDURES	Customer Confirmations And Statements - Hold Mail Instructions
Office inspections	OFFICES	Office Inspections
Form CRS	Regulation Best Interest	

4 CYBERSECURITY

[SEC Regulation S-P Rule 30; Exchange Act Regulation SCI; SEC Release No. 34-50781; DOJ Cybersecurity Unit report on best practices re victim response and reporting: http://www.justice.gov/sites/default/files/opa/speeches/attachments/2015/04/29/criminal_division_guidance_on_best_practices_for_victim_response_and_reporting_cyber_incidents2.pdf; FINRA Notice to Members 05-49; FINRA web page: Customer Information Protection http://www.finra.org/industry/cybersecurity; Fair and Accurate Credit Transactions Act of 2003 Section 216; FTC Safeguards Rule; SIFMA cybersecurity web page: http://www.sifma.org/issues/operations-and-technology/cybersecurity/overview/; FINRA Cybersecurity topics page: https://www.finra.org/rules-guidance/key-topics/cybersecurity; Safeguards Rule 16 CFR Part 314; SIFMA cybersecurity guidance for small firms: https://www.sifma.org/resources/general/cybersecurity-guidance-for-small-firms/; FINRA Small Firm Cybersecurity Checklist: https://www.finra.org/compliance-tools/cybersecurity-checklist; Center for Internet Security: https://www.cisecurity.org/]

Responsibility	• Designated Supervisors
Resources	• Internal and external systems, electronic devices, programs, *etc.* • Customer and Firm data
Frequency	• Annual: Identify risks • Annual: Conduct asset inventory • As required: Develop and update cyber incident response program • Periodically: conduct risk assessments • Ongoing: notify business managers of risks in their business units and their responsibilities relating to mitigating risk • Ongoing: Assign responsible employees • Ongoing: review integrity of systems, monitoring of breaches • Ongoing: Control of electronic devices/systems (passwords, retrieving/disabling devices held by terminated employees, *etc.*) • Annual: review of internal controls and procedures • Annual: provide report to senior management • Periodic: Train personnel on cybersecurity policies
Action	• Identify risks as outlined in this chapter • Develop a risk assessment schedule and conduct reviews • Assign employees responsible for cybersecurity • Conduct asset inventory to identify critical assets and their vulnerability • Oversee monitoring of KCD's networks and devices • Maintain a "whitelist" of trusted software to be used on Firm systems • Test systems regularly and correct anomalies • Develop and update, as needed, a cybersecurity incident response program • Coordinate responses to intrusions and recovery • Prepare and deliver a report to senior management about KCD's cybersecurity risks and actions taken (may be part of the annual CEO report) • When necessary, confer with outside counsel, consultants, other experts • Develop and conduct employee training which may include meetings (electronic or otherwise) and policy reminders
Record	• Summary of annual identification of risk • Schedule of risk assessments and findings • Asset inventory • List of employees responsible • Control of Firm systems and devices including passwords, disabling devices, *etc.* • List of approved software to be used with Firm systems and devices

	• Records of intrusions and responses including reports to regulators, notification of customers, actions taken • Annual report to senior management • Business unit managers' responses regarding deficiencies and corrective action • Records of training including date of training, persons trained, subjects included

This chapter outlines KCD's program for addressing cybersecurity risks. These procedures are modeled after the NIST Framework for Improving Critical Infrastructure of Cybersecurity and are guidance for KCD. It also includes guidance and practices from SEC and FINRA exam priorities and cybersecurity reports. Procedures are subject to KCD's business model and technology infrastructure. Some of these procedures will be conducted by KCD's clearing firm, if applicable, and will be subject to the section on third party vendors. Procedures in this chapter also apply to branch offices, as appropriate. See the section *Cybersecurity* in the chapter *OFFICES* as well as the *Cybersecurity Policy* in the chapter *GENERAL EMPLOYEE POLICIES AND PROCEDURES*.

4.1 Assignment Of Responsibility

Cybersecurity oversight is the responsibility of the following:

- Chief Compliance Officer

Where appropriate, responsibilities will be segregated and/or supervised to prevent unauthorized activities.

4.2 Identification Of Risks

Risks in KCD's systems will be identified, reviewed annually, and updated when necessary, including the following.

- Identification of mission critical systems (email, data storage, etc.)
- Inventory of physical devices and systems, software applications and platforms (updated as necessary, particularly where new systems, software or devices are added)
- Mapping of network resources, connections, and data flows (including locations where customer data is housed)
- Cataloguing of connections to the firm's network from external sources
- Prioritization of resources (hardware, data, and software) for protection based on their sensitivity and business value
- Review of logging capabilities and practices for adequacy, appropriate retention, and secure maintenance
- Identification of third parties with access to the firm's systems and data

4.3 Risk Assessments

Risk assessments will be conducted periodically.

- Third party vendors (including clearing firms) will be evaluated for their cybersecurity procedures which may include written affirmation regarding their procedures.
- Assessments will review to identify cybersecurity threats, vulnerabilities, and potential business consequences.

- Assessments will review physical security threats and vulnerabilities bearing on cybersecurity (access to systems or equipment by unauthorized persons, etc.).
- Moderate or high risks identified in prior reviews are followed up to determine whether corrective action has been taken.

4.3.1 Asset Inventory

The risk assessment will include an asset inventory to identify critical assets and their vulnerability to attack. KCD will also identify sensitive customer and Firm information and the location(s) where such information is stored. KCD will provide secured asset disposal, such as destroying hard drives of computers no longer in use.

4.3.1.1 Branch Assets

Branch asset review procedures will include the following:

- Requiring branches to perform initial and recurring inventories of branch assets and update the firm regarding any changes
- Identifying sensitive customer and firm information and the location(s) where such information is stored
- Ensuring the physical security of branch assets
- Establishing processes by which branches manage and report lost or stolen assets
- Providing secured asset disposal, such as destroying hard drives of computers no longer in use

4.4 Insider Threat

[SIFMA Best Practices for Insider Threats: https://www.sifma.org/wp-content/uploads/2018/02/insider-threat-best-practices-guide.pdf]

Responsibility	• Designated Supervisor
Resources	• Insiders with access to critical systems and information
Frequency	• Annually
Action	• Identify insiders and update annually • Review potential malicious activity indicators
Record	• List of insiders

"Insiders" include individuals who currently have or previously had authorized access to Firm systems and data because of their function or role and include individuals such as full and part-time employees, contract or temporary employees, consultants and interns, and employees or contractors of third-party vendors and sub-contractors.

Insider's threats are addressed as follows:

- Identification of insiders and their access to firm systems and data
- Review technical controls including security information and event management (SIEM) and data loss prevention (DLP) tools, as appropriate for the scale and technological sophistication of the firm

- Measures to identify potentially abnormal user behavior in the firm's network

4.4.1 Identifying Potentially Malicious Activity

Malicious insider threats are challenging because these individuals know KCD and its systems and weaknesses. Indicators of potential risk, if known, may include notification or evidence of illegal activity; threats of retaliatory acts or violence; significant debt and recurring financial irresponsibility; time and attendance fraud; falsifying reports or records; unexcused or unauthorized absences; and other indicators of the employee's dissatisfaction that may lead to malicious activity.

To mitigate the potential for malicious activity, KCD has adopted the following practices:

- Cultivating a strong culture of compliance that encourages confidential reporting of potentially suspicious activity (e.g., "if you see something, say something")
- Performing regular reviews of individuals with higher risk combinations of privileges, especially in environments where it is difficult to maintain segregation of duties
- Demonstrating executive leadership by commitment to the firm's cybersecurity policy by personal compliance with its requirements
- Imposing consequences for all employees violating the policy, regardless of their position or status in the organization
- Providing timely notifications when access or privileges are changed or an employee resigns, moves to another department or is terminated

4.5 Third Party Vendors

[Statement on Standards for Attesting Engagements (SSAE) No. 16; System and Organization Controls (SOC): https://www.aicpa.org/soc, https://www.aicpa.org/interestareas/frc/assuranceadvisoryservices/socforserviceorganizations.html; Cybersecurity and Infrastructure Security Agency's (CISA) Risk Considerations for Managed Service Provider Customers: https://www.cisa.gov/sites/default/files/publications/cisa-insights_risk-considerations-for-msp-customers_508.pdf]

Responsibility	• Designated Supervisor
Resources	• Information about and provided by vendors • Vendor contracts • Services provided by vendors
Frequency	• At time of vendor hire and ongoing

Action	• Conduct due diligence regarding proposed vendors including evaluation of vendor's knowledge and controls for:
	  ○ Cyber risks
	  ○ Current attack techniques and tools to test
	• Obtain certification regarding ethical hacking such as Certified Ethical Hacker (CEH), Offensive Security Certified Professional (OSCP), or GIAC Penetration Tester GPEN prior to engaging
	• Obtain a written contract specifying penetration testing (pen testing) such as what will be tested; the degree of testing, when testing will occur; non-disclosure of KCD's confidential information or findings; what is to be reported to KCD
	• Review the security controls of critical vendors through SOC2/SSAE report findings or through other appropriate methods (questionnaire, onsite review, annual meeting, *etc.*)
	• Follow up on any vulnerabilities identified for each vendor

	• Communicate vendor-issued security patches on a timely basis to users
Record	• Due diligence of vendor • Written contract • Reviews of vendor controls • Actions taken regarding vendor vulnerabilities

Third party vendors that will have access to KCD's systems or devices will be reviewed, prior to engagement and periodically, to:

- Evaluate the vendor's cybersecurity safeguards prior to approving engagement with particular review of firewalls and other security systems
- Include cybersecurity assurances in KCD's contract with the third party including notifying KCD of a breach of customer data
- Notify RRs and supervisors of approved third party vendors and limitation of use to only approved vendors
- Periodically (at least annually) review security systems including cloud-based storage and protection of data

4.5.1 Vendor Selection and Due Diligence

Due diligence conducted to select vendors may include:

- Confirming vendors have a sound knowledge of cyber risks, current attack techniques and appropriate tools to emulate the actions of an attacker

4.6 Cloud Computing

[FINRA report Cloud Computing in the Securities Industry: https://www.finra.org/sites/default/files/2021-08/2021-cloud-computing-in-the-securities-industry.pdf; FINRA Information Notice 10/2/19 re cloud-based email account takeovers: https://www.finra.org/rules-guidance/notices/information-notice-100219; National Security Agency Mitigating Cloud Vulnerabilities 1-20-20: https://media.defense.gov/2020/Jan/22/2002237484/-1/-1/0/CSI-MITIGATING-CLOUD-VULNERABILITIES_20200121.PDF]

Responsibility	• Designated Supervisor
Resources	• Vendor contracts • Vendor data • Existing controls for account protections
Frequency	• Ongoing
Action	• Identify a cloud service provider with particular consideration of cybersecurity protections • Execute a contract with the cloud computing vendor including a clear delineation of the division of cloud security-related tasks including threat detection; incident response; and patching/updating • Establish controls for cybersecurity concerns including sharing of confidential information (including potential inside information) • Monitor cloud computing for:

	◦ Misconfigurations (improper setup leading to vulnerabilities) ◦ Poor access controls (weak authentication) • Cloud computing is subject to outsourcing requirements (see the related section in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*) • Consider cloud computing as part of KCD's business continuity practices, and consider testing of redundant configuration of its data • Ensure the cloud computing vendor provides recordkeeping consistent with books and records requirements
Record	• Contract with vendor • Monitoring and testing of cloud computing services

KCD may use cloud computing as part of its business model. FINRA's report "Cloud Computing in the Securities Industry" provides extensive information about cloud computing considerations.

4.7 Encryption Of Data

Data regarding private customer information transmitted to laptops or remote devices will be encrypted. Such data stored on laptops and other remote devices will also be encrypted.

4.8 Identity Access Management (IAM) and User Entitlements

[FINRA Information Notice: Cybersecurity Background - Authentification Methods: Information Notice 10/15/20 (finra.org)]

Responsibility	• Designated Supervisor
Resources	• Systems/data requiring access • Personnel allowed access
Frequency	• Semi-annual or quarterly: review and certification for sensitive information or elevated access • Annual: review for all other employees and identification of systems requiring access • As required: issue passwords and assign access • Ongoing: monitor access activity
Action	• Identify systems/data requiring access • Review and certify access for assigned personnel • Oversee identity access management including passwords, privileged users • Review available information (including activity logs) to monitor privileged users' activity
Record	• Assignment of access and entitlements and reviews

KCD has adopted the following practices to control access to KCD's systems and data:

- Conducting periodic review and certification of user entitlements (e.g., annually for all employees, and semi-annually or quarterly for individuals with access to particularly sensitive information or systems or with elevated privileges) and implementing appropriate segregation of duties
- Implementing comprehensive password policies and controls that require complex passwords, periodic password changes after a specified period of time (and old passwords cannot be re-used) and password locks after a certain number of unsuccessful login attempts

4.8.1 Privileged User Controls

The Firm has adopted the following practices to control access:

- Monitoring of privileged user system access activities

4.9 Security Information and Event Management (SIEM) and User and Entity Behavioral Analytic (UEBA) Tools

SIEM tools collect and aggregate and correlate log information from numerous sources, including but not limited to: firewalls, Intrusion Detection and Prevention systems, servers, and network devices. Firms use the aggregated log to monitor various user activities and events. A SIEM system may identify and generate alerts regarding risky activities and potential attacks so that the firm can respond to and prevent sensitive information from going outside the firm's network. In some advanced cybersecurity programs, firms use machine learning in conjunction with SIEM tools to learn and model baseline and irregular behavior, which improves the system's ability to identify potentially malicious behavior, including risky insider activities.

UEBA tools can also enhance a firm's capability to detect anomalous behaviors. Such tools focus on analyzing individual user and entity behaviors, and typically include a learning element that enables the tool, over time, to identify normal and abnormal behaviors and to flag the latter for further review.

The Firm has adopted the following practices regarding SIEM and UEBA:

- Establishing risk-based approaches to identify high risk events, provide timely alerts and escalate events according to agreed procedures

4.10 Data Loss Prevention (DLP)

A strong DLP program creates preventative controls that can help to detect and mitigate insider (and other) threats. DLP controls can prevent the inadvertent or malicious transmission of sensitive customer or firm information to unauthorized recipients. DLP controls typically identify sensitive customer and firm data based on rules and then block or quarantine the transmission of the data whether by email, data upload or download, file transfer or other method. KCD may maintain DLP software internally or use vendors to support these efforts.

KCD has adopted the following practices to prevent data loss:

- Establishing rules to control printing of sensitive data and documents
- Implementing robust controls for employees and contractors working from home using personal computers, for example by requiring individuals to use multi-factor authentication and a secure Virtual Private Network (VPN) channel for login, as well as blocking the printing, copying, pasting or saving of firm data to personally owned computers, smartphones or tablets
- Encrypting critical data, back it up frequently and storing copies of back-ups offline

4.11 Penetration Testing (PEN)

Responsibility	• Designated Supervisor
Resources	• Systems and data • Third party vendors including clearing firm, if applicable
Frequency	• Annually or more frequently for higher-risk systems or after key events such as a significant change to applications or systems infrastructure
Action	• Conduct pen testing or engage a third party to test KCD's systems • Evaluate results and take corrective action when weaknesses are identified
Record	• Pen testing • Corrective action, if any

Penetration testing (or a pen test) is an important element of KCD's cybersecurity program. A pen test simulates an attack on a firm's internally- or externally-facing computer network to determine the degree to which malicious actors may be able to exploit vulnerabilities in the network and evaluate the effectiveness of the firm's protective measures. Pen tests may take the perspective of an outside attacker attempting to infiltrate a firm's system or an insider attacker trying to gain access to assets to which they should not have access.

KCD has adopted practices for penetration testing (PEN) which may include:

- Thoroughly vetting third party vendor testing providers and establishing contractual provisions that carefully prescribe vendor responsibilities

4.12 Retirement Of Equipment Containing Data

Computers or other data-retaining equipment that will be disposed of will be subject to clearing of hard drives and other repositories of data prior to disposal. If a computer will be re-assigned to someone who is not authorized to view data stored on that computer, the hard drive will be cleared prior to reassignment. Flash drives and other portable data devices that will no longer be used or will be reassigned will be destroyed or cleared of all data prior to disposal or re-use.

4.13 Detection Of Unauthorized Activity

Procedures to detect unauthorized activity on networks and devices include the following:

- The firm's network and physical environment are monitored to detect potential cybersecurity events.
- Software is used to detect malicious code on the firm's networks and mobile devices and to prevent loss of data.
- Activity of third party service providers with access to the firm's networks is monitored.
- Remote requests for transfer of customer assets are evaluated to identify anomalous and potentially fraudulent requests.
- Use network access controls, such as firewalls, to block unnecessary connectivity between firm systems and outside systems; if feasible, incorporate an Intrusion Detection and Prevention capability.

4.13.1 Cloud-Based E-mail Account Takeovers (ATOs)

[FINRA Regulatory Notice 21-18; FINRA Information Notice 10/2/19: Cybersecurity Alert: Cloud-Based Email Account Takeovers: https://www.finra.org/rules-guidance/notices/information-notice-100219]

Attackers may use compromised e-mail accounts to take over e-mail to defraud firms by requesting fraudulent wire requests or stealing confidential firm information or non-public personally identifiable information. This includes attacks taking over administrative privileges which may result in a broader attack. The Notice should be referenced for an explanation of attack techniques.

4.13.1.1 Responding To An Attack

KCD's response will include the following:

- [response to ATO experience]

4.13.1.2 Preventing ATOs

KCD has procedures to prevent and respond to ATOs which may include the following:

- [Preventing ATOs]

4.13.2 Fraudulent Options Trading

[FINRA Regulatory Notice 20-32; FINRA Report Card: https://www.finra.org/compliance-tools/report-center/options]

Fraudulent options trading includes: (1) account takeover schemes (sometimes referred to as account intrusions) through which a bad actor gains unauthorized entry to a customer's brokerage account; and (2) the use of new account fraud by fraudulently establishing a brokerage account through identity theft. A bad actor may access an account using compromised information or records such as login credentials. A bad actor may also establish an account without the victim's knowledge through identity theft, often with funds stolen from the victim's bank account or through a synthetic identity (legitimate SSNs with false names, addresses and dates of birth).

4.14 Ransomware

[FINRA Regulatory Notice 22-29]

Responsibility	• Designated Supervisor
Resources	• Reports of ransomware attacks • Business Continuity Plan
Frequency	• As required
Action	• Notify senior management, affected customers, and clearing firm (if applicable) • Determine corrective action

	• Report the attack to regulatory and other agencies
Record	• Notifications to others • Corrective action

Ransomware typically involves a bad actor gaining unauthorized access to KCD's systems and encrypting or otherwise accessing sensitive Firm data or customer information, then holding that hijacked data for ransom. FINRA's Rule 4370 Business Continuity Plans and Emergency Contact Information applies to ransomware attacks that include denials of service and other interruptions of KCD's operations. FINRA Regulatory Notice 22-29 provides extensive information about approaches to preventing and responding to ransomware attacks. In particular, Appendix 1 of the Notice provides some controls to address ransomware and Appendix 2 provides additional resources.

Following is a summary of procedures adopted by KCD. If KCD introduces business to a clearing firm, it will rely on that firm to conduct its own cybersecurity controls on services offered to KCD and evaluate those controls as part of KCD's agreement with the clearing firm.

- Responsibilities for controls and breaches are outlined in this chapter.
- KCD maintains a comprehensive inventory of its hardware, software data and applications and evaluates hardware or software for potential risks.
- KCD uses multi-factor authentication, encryption, and tools to restrict or limit access to Firm systems.
- Employees are trained to avoid social engineering and phishing risks and incoming email is filtered to monitor and block phishing and spam communications.
- Controls review and approve system access requests.
- Third-party vendor contracts include access to sensitive information and the vendor's responsibilities. Vendors are required to notify KCD of cybersecurity events and remediation efforts. Vendors are reviewed for a history of cybersecurity events and the vendor's response.
- Branch cybersecurity controls have been established.
- Incident response procedures have been established.

In addition to making any required immediate notifications to law enforcement and SAR filings, KCD will consider whether the ransomware attack should be reported to:

- FINRA's Regulatory Tip Form found on FINRA.org;
- U.S. Securities and Exchange Commission's tips, complaints and referral system or by phone at (202) 551-4790;
- the Federal Bureau of Investigation's (FBI) tip line at (800) CALL-FBI (225-5324) or a local FBI office;
- the Internet Crime Complaint Center for cyber-crimes (particularly if a firm is trying to recall a wire transfer to a destination outside the United States);
- Office of Foreign Assets Control, if there is any reason to suspect the cyber actor demanding ransomware payment may be sanctioned or otherwise have a sanctions nexus;
- local state securities regulators; and
- local law enforcement.

KCD will also consider whether ransomware attacks may require reporting the event pursuant to FINRA Rule 4530 (Reporting Requirements).

4.15 Impostor Websites

[FINRA Regulatory Notice 20-30]

Bad actors establish impostor websites that resemble legitimate websites to engage customers in fraudulent activity. Employees must immediately notify Compliance of any suspected impostor websites.

If a website is identified that impersonates KCD, an affiliate, or another person or entity representing KCD, the following actions will apply, depending on the situation:

- A notice will be sent to affected personnel
- Notice will be sent to customers, as necessary
- KCD's parent company will be notified (if applicable)
- Regulators and other officials will be notified, as required
- Notify the website host to take down the site

4.16 Cybersecurity Incident Response Program

[FINRA Regulatory Notice 21-18]

Responsibility	• Designated Supervisor
Resources	• Evidence of intrusion, system anomalies
Frequency	• As required
Action	• Coordinate response and take actions included in this section • Notify regulators, customers as required
Record	• Records of intrusions and corrective action taken • Notices to regulators, customers as required

If an intrusion is identified, the designated cybersecurity supervisor will coordinate KCD's response which may include:

- Limiting access to affected systems or devices
- Diverting computer resources to a safe system
- Engaging a third party to process data until KCD's system is safe
- Engaging a third party to assess the intrusion
- Assessing data loss and reviewing potentially impacted customer accounts
- Notifying the AML Compliance Officer and/or Chief Compliance Officer
- Notifying regulators and customers including filing of SARs
- Evaluating potential financial losses
- Taking corrective action to prevent a future intrusion
- Reporting fraud, where appropriate, to authorities including FINRA, the SEC, the FBI, the Internet Crime Complaint Center, and local state securities regulators. [Contact information is included in Regulatory Notice 21-18.]

4.17 Recovery

KCD has procedures for data backup and recovery of data. Refer to the *Business Continuity Plan* for further information.

4.18 Business Continuity/Pandemic Responses

[FINRA Information Notice 3/26/20 Cybersecurity Alert]

This section includes guidelines from FINRA Information Notice dated 3/26/20.

4.18.1 Measures for Associated Persons

Office and Home Networks

- Use a secure network connection to access your Firm's work environment (*e.g.,* through a company-provided Virtual Private Network (VPN) or through a secure Firm or third-party website (which begin with "https")).
- Secure Wi-Fi connections using a stringent security protocol (*e.g.,* WPA2).
- Check for and apply software updates and patches to routers on a timely basis.
- Change the default user names and passwords on home networking equipment, such as Wi-Fi routers.

Computers and Mobile Devices

- Check for and apply updates and patches to the operating system and any applications on a timely basis.
- Install and operate anti-virus (AV) and anti-malware software.
- For any files on a personal device, check your Firm's policy about file storage and back-up, especially if the files contain customer personally identifiable information (PII).
- Lock your screen if you work in a shared space and plan to be away from your computer.

Common Attacks

- Be sensitive to the growing variety of scams and attacks that fraudsters are using to exploit the current situation, such as:
    - phishing scams that reference COVID-19, the coronavirus or related matters;
    - fake, unsolicited calls from a "Helpdesk" requesting passwords or wanting to walk you through your home preparedness; and
    - malicious links in e-mails, online sites and unofficial download sites, especially those offering "free software."

Incident Response

- Understand your role in KCD's incident response plan and whom to contact in the event of a cybersecurity incident (*e.g.,* data breach, loss or exposure of customer PII, successful e-mail attack, ransomware, lost or stolen mobile device).

4.18.2 Measures for Firms

Network Security Controls

- Provide staff with a secure connection to the work environment or sensitive applications (*e.g.*, VPN, secure sessions remote desktop with multi-factor authentication).
- Evaluate privileges to access sensitive systems and data.

Training and Awareness

- Provide staff with training on:

  - how to connect securely to the office environment or office applications from a remote location; and
  - potential scams and other attacks described above.
- Alert KCD's IT support staff, or others involved in managing or supporting staff using KCD's systems, to be diligent in vetting incoming calls because fraudsters may use the increase in remote work to engage in social engineering schemes, such as making bogus calls requesting password resets or reporting lost phones or equipment. FINRA is aware of successful social engineering attacks where fraudsters contacted a Help Desk, for example under the guise of requesting a password reset, and subsequently used information about critical technical or business operations gained during this conversation that could be used to steal funds from KCD.

4.19 Reports To Senior Management

On at least an annual basis, the designated cybersecurity supervisor will provide a report to designated senior management regarding risk assessments and unauthorized activities or intrusions and corrective action taken. This may be provided in conjunction with the annual compliance report to the CEO.

4.20 Training

Data breaches may occur because well-intentioned employees or other users make preventable mistakes. Developing a firm culture that focuses on cybersecurity awareness and providing regular cybersecurity training can help address this problem. KCD provides ongoing training on:

- Appropriate handling of customers' requests for user name and password changes, money transfers and identity verification, particularly those involving large amounts of money transferred to an overseas location or third parties
- Sound practices regarding the opening of email attachments and links, including using simulated phishing campaigns where the firm notes and re-tests the individuals who failed the exercise
- Identifying social engineering activities from hackers

4.21 Other Policies

The following other policies in this manual address issues involving cybersecurity:

- Privacy Policy (GENERAL EMPLOYEE POLICIES)
- Electronic Communications Policy (GENERAL EMPLOYEE POLICIES)
- Mobile Devices (GENERAL EMPLOYEE POLICIES)
- Computer Records, Equipment And Software (GENERAL EMPLOYEE POLICIES)
- Cybersecurity Policy (GENERAL EMPLOYEE POLICIES)
- Identity Theft Prevention Program (Red Flags Rule) (ANTI-MONEY LAUNDERING [AML] PROGRAM)
- Electronic Communications Systems And Devices (COMMUNICATIONS WITH THE PUBLIC)
- Protection Of Customer Information And Records (FINANCIAL AND OPERATIONS PROCEDURES)
- Business Continuity Plan (FINANCIAL AND OPERATIONS PROCEDURES)
- Cybersecurity (OFFICES)

5 REGULATION BEST INTEREST (BI)

[SEC Regulation Best Interest, Form CRS and related Interpretations: https://www.sec.gov/regulation-best-interest; SEC final rule: https://www.sec.gov/rules/final/2019/34-86031.pdf; SEC small entity compliance guides: https://www.sec.gov/info/smallbus/secg/regulation-best-interest and https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary; SEC release announcing adoption of Reg BI with a link to the entire regulation: https://www.sec.gov/news/press-release/2019-89?mod=article_inline; FINRA Reg BI and Form CRS Checklist: https://www.finra.org/sites/default/files/2019-10/reg-bi-checklist.pdf; FINRA Regulatory Notice 19-26; FINRA website re Reg BI: https://www.finra.org/rules-guidance/key-topics/regulation-best-interest]

Regulation BI is an SEC regulation that requires a broker-dealer (BD) and its associated persons (RRs in this chapter) to act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer or RR ahead of the interest of the retail customer. Definitions and cross references to other chapters appear at the end of this chapter.

5.1 Summary Of Key Requirements

1. Regulation BI applies only to recommendations to natural persons who are retail customers. Reg BI **also** applies to recommendations to natural persons who are considered "institutional accounts" under FINRA rules.
2. Recommendations include those for orders; types of accounts (*e.g.,* brokerage vs. advisory, whether or not tied to a securities transaction); and investment strategies. Also included are recommendations to prospects.
3. The "best interest" standard goes beyond suitability requirements for recommendations; it requires acting in the customer's best interest and not the RR's or BD's interest including consideration of available alternatives and cost/risk rewards.
4. Compliance with Reg BI requires meeting four obligations: disclosure, care, conflict of interest, and compliance.
5. If the BD agrees to monitor a customer's account, Reg BI applies to explicit and implicit recommendations to hold. Reg BI does not impose a duty to monitor customer accounts.
6. Form CRS must be provided to customers when an account is opened (including additional accounts for existing customers) and when a recommendation is made (as defined in this chapter). Form CRS is posted on the Firm's website and updates must be provided to customers within 60 days of material updates.
7. BDs and their professionals are not permitted to use the titles "advisor" or "adviser" unless KCD is dually registered as a broker- dealer and investment adviser and the RR is employed by a registered investment adviser and authorized by Compliance to use such a title.
8. Incentive programs (sales contests, non-cash compensation, *etc.*) may not be limited to certain securities or types of accounts over a period of time.
9. Communications for education purposes (listed below) that do not include a recommendation of a particular security or strategy involving securities are not considered recommendations:
    - General financial and investment information which encompasses basic investment concepts.
    - Descriptive information about an employer-sponsored retirement or benefit plan.
    - Certain asset allocation models based on generally accepted investment theory accompanied by necessary disclosures.

5.2 General Obligations

Compliance with each of the following four component obligations is necessary to comply with Regulation BI.

5.2.1 Disclosure

[SEC FAQs on Form CRS: https://www.sec.gov/investment/form-crs-faq]

Responsibility	• Designated Supervisor • New Product Review Committee • Risk Management Committee
Resources	• New product reviews and information • Form CRS • Other disclosures regarding securities and accounts

Frequency	• Form CRS: when a recommendation is made and when updated
	• When new products/services are proposed and at least annually:
	    ○ Review current disclosures for materially outdated, incomplete, or inaccurate information
	    ○ Review products and services to confirm necessary disclosures are provided to retail customers including possible standardized disclosures
	    ○ Consider the need for specific training
	• As soon as practicable but no later than 30 days after a material change - update disclosures
	• Other disclosures: as required

Action	• Identify necessary disclosures and other requirements for new securities or services (Also see *New Products* in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*) • Identify necessary disclosures as part of a review of current products and services • Update disclosures including CRS if there have been any material changes • Provide Form CRS and other necessary disclosures to retail investors at time of a recommendation/account opening and within 60 days of material changes • Include review of disclosures in annual review of firm's procedures
Record	• Reviews of current disclosures for updating • Reviews of products and services and actions taken for disclosure • Tracking of providing disclosures including version, date provided, to whom provided including Form CRS • Records of providing updated disclosures within 60 days of material change • Various other methods of disclosure (confirmations, monthly statements, account agreements, prospectuses, *etc.*)

The obligation to provide full and fair disclosure should give sufficient information to enable a retail investor to make an informed decision with regard to a recommendation.

The disclosure obligation requires a BD or RR, prior to or at the time of the recommendation, to provide the retail customer, in writing, full and fair disclosure of:

- All material facts relating to the scope and terms of the relationship with the retail customer, including:
    - That the BD or associated person is acting as a BD or an associated person with respect to the recommendation;

  - The material fees and costs that apply to the retail customer's transactions, holdings, and accounts;
  - The type and scope of services provided to the retail customer, including any material limitations on the securities or investment strategies involving securities that may be recommended to the retail customer; and
  - Material facts relating to conflicts of interest that are associated with the recommendation. "Material facts" are facts a retail customer would consider important in making an investment decision. For example, material facts relating to conflicts of interest including, but not limited to, how RRs are compensated and the benefits to a BD from recommending a proprietary product.
- Other material facts relating to the scope and terms of the relationship with the retail customer which include:
  - The general basis for a recommendation (*i.e.,* what might commonly be described as investment approach, philosophy, or strategy); and
  - Risks associated with recommendations in standardized terms.
- If necessary, other material facts relating to the scope and terms of the relationship.

Disclosures are provided in a variety of ways, including (but not necessarily limited to) the following:

- [how disclosures are provided]

While disclosures must be in writing, in certain circumstances oral disclosures (no later than the time of the transaction) to supplement facts not reasonably known at the time written disclosure is made (a record of oral disclosures) must be maintained with the order record.

5.2.2 Care

[SEC Bulletin: https://www.sec.gov/tm/standards-conduct-broker-dealers-and-investment-advisers]

Responsibility	• Designated Supervisor
Resources	• Customer account information • Information about securities • Available reports
Frequency	• When recommendations are made • Other: as required
Action	• Communicate risks, costs, and other necessary information to RRs • Provide guidance and information to RRs on reasonably available alternatives • Provide guidance to RRs on how to consider costs (what types of costs to consider, including direct and indirect costs, or what systems to use to analyze costs in formulating a recommendation) • Review recommendations of transactions and opening of accounts • Consider whether to use a risk-based approach to identify certain type of recommendations that should be documented, and the type of documentation (*e.g.,* categorizing recommendations as "high risk" or "complex")
Record	• Order records • Account records • Reviews of orders and accounts with supervisor's record of supervision and actions taken, if any • Records of risk-based recommendations and documentation of

	recommendations, if applicable

The care obligation is broader than the previous suitability standard because it: (1) explicitly requires that the recommendation be in the customer's best interest and that the BD and RRs do not place their interests ahead of the customer; (2) explicitly requires that cost be a consideration; (3) applies the quantitative suitability requirement (recommending a series of transactions, avoiding excessive activity); and (4) requires the BD and RRs to consider "reasonably available alternatives" as part of having a "reasonable basis to believe" that the recommendation is in the best interests of the customer.

The RR must exercise reasonable diligence, care, and skill to:

- understand the risks, rewards, and costs associated with the recommendation;
- have a reasonable basis to believe the recommendation is in the customer's best interest; and
- have a reasonable basis to believe that recommended transactions are in the customer's best interest based on the customer's investment profile and doesn't place the interests of the BD ahead of the customer. This includes avoiding transactions that are excessive.

In particular, the BD and RR must have an understanding of complex products, and recommendations of complex investments should be documented, particularly where a recommendation may seem inconsistent with a retail customer's objectives on its face. The care obligation applies to a series of recommended transactions (quantitative suitability) whether or not the BD exercises actual or *de facto* control over the account.

5.2.2.1 Factors To Consider

When making recommendations, the following non-exclusive list of factors (depending on the particular product or strategy recommended) may be considered:

- What are the characteristics (including any special or unusual features) of the security or strategy?
- What are the initial and subsequent costs (if any, *e.g.,* surrender or redemption costs) of the security or strategy?
- How liquid is the security?
- What are the risks, volatility, and likely performance in a variety of market conditions (normal or stressed)?
- What is the expected return of the security?
- What are the financial incentives to recommend the security or investment strategy?
- Are there alternative investments or strategies, at lower cost, that may meet the customer's needs? More costly products may be recommended provided there is a reasonable basis to believe they are in the best interest of the customer. There is no obligation to recommend the "best" of all possible alternatives.

5.2.2.2 Recommending Types Of Accounts

RRs must have a reasonable basis for recommending accounts (margin, brokerage or advisory, IRAs, *etc.*). This includes the following considerations:

- services and products provided in the account;
- projected cost of the account;
- alternative account types available;
- services the retail customer requests; and

- the retail customer's investment profile. Profile elements include age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information disclosed by the customer.

Additional considerations when recommending IRAs (including rollovers or transfers of assets in a workplace retirement plan account to an IRA) include:

- customer's current financial situation and liquidity needs;
- fees and expenses;
- level of services available;
- ability to take penalty-free withdrawals;
- application of required minimum distributions;
- protections from creditors and legal judgments;
- holdings of employer stock; and
- any special features of the existing account.

5.2.2.3 Costs

The RR should understand and consider the potential costs associated with the recommendation and have a reasonable basis to believe that the recommendation does not place the financial or other interest of KCD or RR ahead of the interest of the retail customer. While cost must be considered, it should never be the only consideration. Cost is only one of many important factors to be considered regarding the recommendation and that the standard does not necessarily require the "lowest cost option." RRs need to consider costs in light of other factors and the retail customer's investment profile.

5.2.2.4 Alternatives

Alternatives should be considered before making recommendations to a particular retail customer. This does not mean customers must be offered all alternatives or necessarily the lowest-cost alternative or the "single best" alternative. Reasonably available alternatives include considerations of, for example:

- An RR's customer base (including the general investment objectives and needs of the customer base)
- Investments and services available to the RR to recommend (including limitations due to the RR's licensing)
- Specific limitations on the available investments and services with respect to certain retail investors (*e.g.,* product or service income thresholds; product geographic limitations; or product limitations based on account type, such as those only eligible for IRA accounts)

5.2.2.5 Quantitative Suitability

Responsibility	• Designated Supervisor
Resources	• Records of transactions • Available reports • Customer account records
Frequency	• Ongoing
Action	• Identify active accounts and review which may include calculating:

	◦ turnover rate (dividing the aggregate amount of purchases by the average monthly investment) ◦ cost-to-equity ratio (percentage of return on the customer's average net equity needed to pay commissions and other expenses) ◦ in-and-out trading (sale of newly-acquired investments) • Take action which may include: ◦ Review of new account records ◦ Consult with RR ◦ Contact the customer
Record	• Review of active accounts including action taken • Contact with customers

RRs may not make recommendations that result in transactions excessive for the customer considering the customer's investment objectives (also known as "churning"). A series of recommended transactions must be in the customer's best interest. The customer may be contacted by KCD to confirm that active trading is appropriate.

5.2.2.6 Documentation

RRs should document the basis of a recommendation (including those not adopted by the customer) of the following:

- Hold recommendations
- Complex products
- Rollovers
- Choice of accounts

Recommendations may be documented on the order record, account records (for a recommended account), and in electronic records available from KCD. Documentation should include costs, alternatives, and reasons for recommendation.

5.2.2.7 Material Limitations

Responsibility	• Designated Supervisor
Resources	• Records of products offered by KCD
Frequency	• Periodically, at least annually
Action	• Reconcile the product offerings with market alternatives to ensure KCD has a competitive product mix • Identify customer segments or investments needs where KCD could potentially have difficulties in making recommendations in the customer's best interest due to the limited nature of product offerings

Record	• Records of reviews of products and customers

If KCD materially limits its product offerings to certain proprietary or other limited menus of products or third-party arrangements, its limited menu does not justify a product recommendation that is not in the customer's best interest.

5.2.3 Conflict Of Interest

[SEC Staff Bulletin: https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest; FINRA website on conflicts of interest: https://www.finra.org/rules-guidance/key-topics/conflicts-of-interest]

Responsibility	• Designated Supervisor • Compliance Committee • Risk Management Committee • Compensation Committee • New Product Review Committee
Resources	• Reviews of products and services • Review of incentive programs
Frequency	• As required when revised or adopted: review incentive programs • When new products or services are proposed • At least annually: review current products and services to review for potential conflicts of interest • Annual and as necessary: training

Action	• Assign responsibility for identifying and mitigating potential conflicts of interest
	• Determine whether to use a risk-based approach
	• Review products and services for potential conflicts regarding compensation including, but not limited to:
	  ○ New products and services at the time of new product review
	  ○ Proprietary products/services
	  ○ Third-party products/services where KCD receives payment from the third party
	  ○ Non-cash compensation where RRs are provided incentives to sell a product or service
	  ○ Differential or variable compensation, incentives tied to appraisals or performance reviews
	  ○ Compensation practices for new or existing RRs
	  ○ Generally: overarching firm-wide conflicts; associated person related conflicts; material limitations
	• Document conflicts reviews including whether to mitigate, disclose and/or eliminate
	• Develop written disclosures for providing to customers
	• Mitigation consideration for compensation issues include the following:
	  ○ avoiding compensation thresholds that disproportionately minimize compensation incentives for employees to favor one type of account over another, or to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis, for example, by establishing differential compensation based on neutral factors

	○ eliminating compensation incentives within comparable product lines ○ implementing supervisory procedures to monitor recommendations that are near a compensation threshold for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or involve the rollover or transfer of assets from one type of account to another ○ adjusting compensation for RRs who fail to adequately manage conflicts of interest ○ limiting the types of retail customer to whom a product, transaction or strategy may be recommended ○ eliminating sales contests, sales quotas, bonuses, and non-cash compensation based on the sales of specific securities or specific types of securities within a limited period of time ○ modifying or eliminating certain compensation practices • Include conflict reviews in annual audits/reviews • Include conflicts of interest training of RRs
Record	• Conflicts reviews and mitigation/disclosures • New product and service reviews • Records of training including when, who attended, and subjects

A conflict of interest is an interest that might incline a BD or an RR - consciously or unconsciously - to make a recommendation that is not disinterested. Conflicts may exist between the BD and the retail customer; between the RR and the retail customer; and between the BD and the RR. Additional conflicts may exist between customers (*e.g.,* IPO allocations or proprietary research or advice among different types of customers).

KCD has an obligation to avoid or mitigate conflicts of interest where possible and provide disclosure where conflicts may exist.

KCD will identify conflicts and, where appropriate, identify material limitations placed on the investment product or strategy and any conflicts associated with such limitations (*e.g.,* limited product menu, proprietary products only, *etc.*) and make necessary disclosures. In addition to website disclosures, customers will be provided with electronic or written disclosures.

Incentive programs (whether provided by KCD or a third party) such as sales contests, sales quotas, bonuses, non-cash compensation, *etc.,* within a limited period of time are prohibited if they are based on:

- a specific product; or
- types of securities.

RRs have an obligation to avoid conflicts of interest when dealing with retail customers; some examples are listed below.

1. Recommending proprietary products because they result in higher compensation without considering the customer's needs and alternative investments.
2. Recommending other products or services based on compensation/incentives from KCD or third parties.

5.2.3.1 RRs Acting In Multiple Roles

Where RRs are dually registered as registered representatives and investment adviser representatives:

- the RR must disclose in what capacity he or she is acting prior to or at the time of the recommendation.
- KCD will provide guidance regarding when and how related conflicts will be disclosed.

5.2.4 Compliance

Responsibility	• Designated Supervisor
Resources	• Sources of revenue • Training program
Frequency	• Annual: review conflicts of interest, compliance with Reg BI • Annual or as required: training
Action	• Conduct reviews of new product reviews, new types of accounts/services to confirm conflicts of interest have been identified and necessary actions taken (eliminate, mitigate, disclosure) and identify types of accounts and customers suitable for the investment or product • Confirm policies and procedures comply with Regulation BI as part of the annual review of procedures • Take corrective action which may include new disclosures, contact with RR and/or RR's supervisor, contact with customer, *etc.* • Confirm Form CRS is current and accurate and provided to customers and posted on KCD's website • Include Reg BI requirements in annual audits/reviews of KCD's business • Provide training to new RRs upon hire and all RRs annually regarding the obligations under Regulation BI
Record	• Record of policy/procedure reviews and action taken, if any • Records of training including when, who attended, subjects

KCD conducts ongoing and annual reviews and training to achieve compliance with Regulation BI. It is the responsibility of RRs to be familiar with these requirements and act in the customer's best interest at all times. Questions should be referred to Compliance.

5.3 Form CRS

[SEC Form CRS instructions: https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf; SEC FAQs on Form CRS: https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary; SEC Form CRS Relationship Summary Small Entity Compliance Guide: https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary]

Responsibility	• Designated Supervisor
Resources	• Information about securities and types of accounts and services offered by KCD • New product and services reviews
Frequency	• When recommendations are made (as defined in this chapter) • Update and file with CRD as required
Action	• Provide Form CRS to retail customers when a recommendation is made and within 60 days of a material change to the Form

	• Post Form CRS to KCD's website and update as necessary • File Form CRS with the CRD and update within 30 days when required • Include Form CRS in reviews/audits to confirm the form is being kept up to date; posted to the website; filed with the CRD; and sent to customers when there are material changes
Record	• Website postings • Providing Form CRS to customers including when delivered; version provided; consent to e-delivery if delivered electronically • Records of updates, changes provided to customers, updates to website • CRD filings • Records of reviews/audits

Form CRS is a relationship summary intended to clarify the relationship between the BD and the customer. Firms without retail customers (as defined under Regulation BI) are not required to provide the form to customers or submit it to regulators. Form CRS must be provided before or at the time of a recommendation. The form is required upon **the first event that triggers the requirement** which includes when:

- An order is placed for the retail customer
- A new account is opened for a new customer
- A new account is opened for an existing customer
- A securities transaction or investment strategy is recommended
- A rollover is recommended from a retirement account into a new or existing account or investment
- An RR recommends or provides a new advisory service or product that does not necessarily involve opening a new account or would not be held in an existing account, for example, the first-time purchase of a direct-sold mutual fund or insurance product that is a security through a "check and application" process, *i.e.,* not held directly within an account
- A retail investor requests a copy (provide within 30 days)

The Form will be updated and filed with the CRD within 30 days of material changes. Updated summaries will be provided to customers within 60 days after material updates with changes highlighted. Updates may be provided electronically to customers who have consented to electronic delivery.

Dual registrants (BD and IA) are required to deliver a relationship summary to retail investor customers of both the investment advisory and brokerage businesses.

5.4 Training

Responsibility	• Designated Supervisor
Resources	• In-house training materials • Outside vendors or materials
Frequency	• Annual; when new RRs are hired; and as appropriate
Action	• Provide training on KCD's Reg BI policy; the requirements of recommendations under Reg BI; KCD's process and tools available to comply; KCD's culture; the Code of Conduct; and conflicts of interest mitigation and management

Record	• Record of subjects included in training, who attended, and when administered

RRs will receive training on "best interest" requirements and communicating Firm culture, specific requirements of KCD's code of conduct and its conflicts management framework.

5.5 Monitoring Accounts

Responsibility	• Designated Supervisor
Resources	• Customer accounts that are monitored
Frequency	• Ongoing
Action	• Identify accounts to be monitored • Include review of monitoring in annual reviews
Record	• Monitored accounts • Annual reviews of KCD's business including monitoring

KCD may provide monitoring of retail customer accounts under the following circumstances:

- Voluntarily and without any agreement with the customer to review the account for purposes of deciding whether to make an investment recommendation.
- Agreed-upon limited monitoring on a periodic basis for purposes of providing buy, sell, or hold recommendations.

KCD does not charge a separate fee or separately contracts for this service or receive any special compensation. Such monitoring is solely incidental to KCD's securities business. Account monitoring is disclosed on Form CRS.

If KCD offers monitoring for compensation or under other circumstances not solely incidental to its securities business, it will register as an Investment Adviser and comply with those requirements.

5.6 Dual Registrants

Dual registrants and affiliates (as defined at the end of this chapter) are required to provide a Form CRS for both the broker-dealer and advisory relationships; the forms may be combined. Broker-dealers have an obligation to file Form CRS with FINRA's CRD and advisers are required to file with IARD.

If two separate relationship summaries are provided, they will reference and facilitate access to the other with equal prominence and at the same time, without regard to whether the particular retail investor qualifies for those retail services or accounts.

5.7 Recordkeeping

[Exchange Act Rule 17a-3(a)(35); SEC Use of Electronic Media: https://www.govinfo.gov/content/pkg/FR-1996-05-15/pdf/96-12176.pdf]

Responsibility	• Designated Supervisor
Resources	• Provision of Form CRS to prospects, customers
Frequency	• As required under Form CRS requirements, obtaining consent
Action	• Obtain recipient's informed consent for electronic delivery • Track delivery of Form CRS which may include electronic return-receipt or by confirmation that information was accessed, downloaded, or printed and/or disseminating information through facsimile methods • Include reviewing providing Form CRS in audit/review programs
Record	• Consents for e-delivery • Tracking records of delivery • Records of Form CRS and updates to the form • Record of filing with FINRA CRD • Record of audits/reviews of providing Form CRS

Records of all information collected from and provided to the retail customer are maintained in accordance with recordkeeping rules. Records are not required to evidence best interest determinations on a recommendation-by-recommendation basis. KCD also is not required to provide information regarding the basis for each particular recommendation. Records of Form CRS will be retained for six years after the earlier of the date that the account was closed or the date on which the information was collected, provided, replaced or updated.

5.8 Definitions

Affiliate: Any persons directly or indirectly controlling or controlled by KCD or under common control with KCD.

Best interest: The term "best interest" is explained through SEC guidance and interpretations and is not expressly defined. Whether a broker-dealer has acted in the retail customer's best interest in compliance with Regulation BI will turn on an objective assessment of the facts and circumstances of how the specific components of Regulation BI - including its Disclosure, Care, Conflict of Interest, and Compliance Obligations - are satisfied at the time that the recommendation is made (and not in hindsight).

Conflict of interest: A conflict of interest is an interest that might incline a BD or RR, consciously or unconsciously, to make a recommendation that is not disinterested.

Dually licensed financial professional: A natural person who is both an associated person of a broker-dealer registered under section 15 of the Exchange Act, as defined in section 3(a)(18) of the Exchange Act, and a supervised person of an investment adviser registered under section 203 of the Advisers Act, as defined in section 202(a)(25) of the Advisers Act.

Dual registrant: A firm that is dually registered as a broker-dealer under section 15 of the Exchange Act and an investment adviser under section 203 of the Advisers Act and offers services to retail investors as both a broker-dealer and an investment adviser. There are exceptions; for example, if a BD dually registered offers investment advisory services to retail investors, but offers brokerage services only to institutional investors, the BD is not a dual registrant for purposes of Form CRS.

Full and fair: Sufficient information to enable a retail customer to make an informed decision with regard to a recommendation.

Implicit or explicit recommendations: For accounts where there is agreed-upon account monitoring, if the BD makes no recommendation in a periodic review, it is an implicit "hold" recommendation subject to Regulation BI just as would an explicit "hold" recommendation. Absent an agreement to monitor an account, Regulation BI does not apply to implicit hold recommendations.

Legal Representative: includes the non-professional legal representatives of a natural person, *e.g.,* a non-professional trustee that represents the assets of a natural person. Regulation BI would not apply when the legal representative is acting in a legal capacity as a regulated financial services industry professional retained to exercise independent professional judgment. Therefore, recommendations to registered IAs and BDs or corporate fiduciaries would not trigger Regulation BI. On the other hand, recommendations to non-professional trustees, executors, conservators and persons holding power of attorney that represent natural persons are covered. The definition does not apply to financial industry professionals.

Material facts (under Regulation BI): Information is material if there is a substantial likelihood that a reasonable shareholder would consider it important.

Monitoring accounts: An agreement between the BD and the customer to provide account monitoring services. Monitoring may be incidental reviews of accounts to make recommendations and does not require IA registration. Through Form CRS firms are required to advise customers if they provide account monitoring services. BDs do not have a duty to provide account monitoring.

Non-cash compensation: Non-cash compensation includes any form of compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

Personal, family, or household purposes: The phrase "primarily for personal, family or household purposes" covers any recommendation to a natural person for his or her account, other than recommendations to a natural person seeking these services for commercial or business purposes. Regulation BI would not cover, for example, an employee seeking services for an employer or an individual seeking services for a small business or on behalf of another non-natural person entity, such as a charitable trust.

Receives and Uses: The SEC has stated that "use" means when, as a result of the recommendation: (a) the retail customer opens a brokerage account with the BD regardless of whether the BD receives compensation; (b) the retail customer has an existing account with the BD and receives a recommendation from the BD, regardless of whether the BD receives or will receive compensation, directly or indirectly, as a result of the recommendation; or (c) the BD receives or will receive compensation, directly or indirectly, as a result of that recommendation even if that retail customer does not have an account at the firm.

Recommendation: Interpreted in a manner consistent with current BD regulation under federal securities laws and FINRA rules.

Relationship summary: A written disclosure statement (Form CRS) that must be provided to retail investors when a recommendation is made (as defined in Reg BI).

Retail customer: A natural person (regardless of their financial status, including those previously qualifying as "institutional accounts" under FINRA's suitability rule) or the legal representative of such person who: (a) receives a recommendation for any securities transaction or investment strategy from a broker-dealer or associated person (whether or not the recommendation results in a securities transaction); and (b) uses the recommendation primarily for personal, family, or household purposes.

5.9 Cross References To Sections In This Manual

Subject	CHAPTER/Section
Suitability	Sections in the following chapt ORDERS CORPORATE FIXED INCOME CORPORATE SECURITIES U MUTUAL FUND AND OTHER OPTIONS MUNICIPAL SECURITIES DIRECT PARTICIPATION PR BANK BROKER DEALERS INSURANCE PRODUCTS PRIVATE PLACEMENTS AND
Cash and Non-cash compensation	ORDERS: • Cash And Non-Cash C CORPORATE SECURITIES U • Non-Cash Compensat MUTUAL FUNDS • Non-Cash Compensat INSURANCE PRODUCTS • Sales Guidelines
New Accounts	ACCOUNTS
Form CRS	SUPERVISORY SYSTEM, TE

6 OFFICES

This chapter describes the types of offices defined by regulators and requirements for inspections and supervision of offices. **Compliance must be notified:**

- Before a new branch office or other business office is opened (including all types of offices defined in this chapter)
- When an office address changes
- Prior to a change in the types of business conducted in an office
- When an RR changes offices
- Prior to an RR commencing work from a second location, such as a primary residence
- Prior to establishing an office-sharing arrangement with an outside person or entity

6.1 Office Designations

[FINRA Rule 3110]

Responsibility	• Compliance
Resources	• Information regarding offices including new offices, address changes, office sharing arrangements
Frequency	• As required

Action	• Identify each office as to type to determine regulatory requirements, maintain list of offices and types
	• Establish and document supervision for non-branch locations
	• Make required regulatory filings
	• Review requests for a principal to supervise more than one OSJ considering the following:
	  ○ whether the on-site principal is qualified by virtue of experience and training to supervise the activities and associated persons in each location;
	  ○ whether the on-site principal has the capacity and time to supervise the activities and associated persons in each location;
	  ○ whether the on-site principal is a producing registered representative;
	  ○ whether the OSJ locations are in sufficiently close proximity to ensure that the on-site principal is physically present at each location on a regular and routine basis; and
	  ○ the nature of activities at each location, including size and number of associated persons, scope of business activities, nature and complexity of products and services offered, volume of business done, the disciplinary history of persons assigned to such locations, and any other indicators of irregularities or misconduct.

Record	• List of offices including types of offices • Regulatory filings • Approval for one principal to supervise more than one OSJ and document why

	such a supervisory structure is reasonable

This section describes different types of offices and related requirements.

6.1.1 Branch Office

[FINRA Rule 3110(a)(3), 3110(a)(4) and 3110(f)(2)]

A branch office is any location where one or more associated persons (*e.g.,* employees, independent contractors) regularly conduct the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any security or any location held out as such. Branch offices are required to be registered, and if the "main office" meets the definition of "branch office" (or OSJ) it is required to be registered.

Any office that is responsible for supervising associated persons at one or more non-branch locations is considered to be a branch office.

6.1.2 Non-Branch Locations

[FINRA Rule 3110(f)(2)]

There are seven exceptions from the branch office registration requirement. To qualify for an exception, all conditions must be met for the office location. All non-branch offices and their associated persons are assigned to a designated branch office for supervision.

Non-sales locations: Locations established solely for customer service and/or back office functions, not to be held out to the public as a branch office, and no sales activities are conducted from the location.

Primary residences: Any location that is the associated person's primary residence. Requirements for primary residence offices include:

- Only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;
- The location is not held out to the public as an office and the associated person does not meet with customers at the location;
- Neither customer funds nor securities are handled at that location;
- The associated person is assigned to a designated branch office, and such designated branch office is reflected on all business cards, stationery, retail communications and other communications to the public by such associated person;
- The associated person's correspondence and communications with the public are subject to the Firm's supervision in accordance with this Rule;
- Electronic communications (*e.g.,* e-mail) are made through the Firm's electronic system;
- All orders are entered through the designated branch office or an electronic system established by the member that is reviewable at the branch office;
- Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the Firm; and
- A list of the residence locations is maintained by Compliance.

Locations other than primary residences: Other locations used for securities-related activities less than 30 business days in any calendar year that meets the requirements of a primary residence office, above. This would generally include vacation or second homes and other non-primary residences. An RR operating from this type of location will be required to maintain a record of the dates when business is conducted from such a location and submit this information monthly to Compliance. When the "30-business day" exemption is exhausted, the RR is required to cease conducting business from that location or immediately submitting a request to Compliance to register the location as a branch office.

Offices of convenience: This is a location where an associated person occasionally and exclusively by appointment meets with customers, provided the location is not held out to the public as a branch office. An associated person may not establish business hours at the location or hold out the location in any way (except for signage required at bank locations). Final approval and execution of transactions must be done through the designated supervisory branch office.

Location used primarily to engage in non-securities transactions: Locations where associated persons are primarily engaged in non-securities activities (*e.g.,* insurance sales) and where the associated person effects no more than 25 securities transactions in a calendar year. Retail communications identifying the non-securities location must include the location of the supervising branch office. Compliance is responsible for monitoring the 25-transaction limit.

Floor of a registered national securities exchange: Any location on the floor of a registered national securities exchange where the Firm conducts a direct access business with public customers is exempt from the definition of "branch office."

Temporary location: Any temporary location established in response to the implementation of a business continuity plan is exempt from branch office registration.

Regardless of the above exceptions to the definition of "branch office," any location that is responsible for supervising activities of RRs at one or more non-branch locations is considered to be a branch office.

6.1.3 Offices Of Supervisory Jurisdiction (OSJ)

[FINRA Rule 3110(a)(3), 3110(a)(4), 3110(f), 3110.02 and 3110.03]

An office that includes any of the following activities will be designated as an Office of Supervisory Jurisdiction (OSJ) with a resident principal responsible for supervision:

- Order execution and/or market making
- Structuring of public offerings or private placements
- Maintaining custody of customers' funds and/or securities
- Final acceptance (approval) of new accounts
- Review and approval of customer orders
- Final approval of retail communications
- Supervision of RRs at one or more other branch offices

In addition, the following factors will be considered on determining whether an office is an OSJ:

- whether registered persons at the location engage in retail sales or other activities involving regular contact with public customers;
- whether a substantial number of registered persons conduct securities activities at, or are otherwise supervised from, such location;
- whether the location is geographically distant from another OSJ of the Firm;
- whether the member's registered persons are geographically dispersed; and
- whether the securities activities at such location are diverse or complex.

Excluded from the definition of OSJ is an office that solely provides final approval of research reports.

An OSJ principal will supervise only one OSJ; exceptions must be approved by Compliance.

6.1.4 Branch Offices Assigned To OSJs

Each branch office that is not an OSJ will be assigned to the supervision of an OSJ. The designated supervisor is required to visit non-OSJ branch offices on a periodic basis and record the visit in a memorandum or other record to be retained by the designated supervisor for the branch location. All business transacted by non-OSJ branch offices must be processed through the supervising OSJ. The designated supervisor is responsible for supervision of the branch office's activities and maintaining files for complaints, communications, new accounts, option accounts, advertising, and transactions originating from the branch office.

A branch office may be a "supervisory branch office" that has responsibility to supervise one or more other offices or a "non-supervisory branch office" that has no supervision over other offices.

6.2 Approval Of Persons To Operate In Non-Branch Locations

Responsibility	• Designated Supervisor or designee
Resources	• Requests for RRs to conduct business at non-branch locations
Frequency	• As required

Action	• Review the request considering:
	  ○ Business to be conducted
	  ○ RR disciplinary or complaint history
	  ○ Requirements to supervise, including the need for heightened supervision
	  ○ RR engagement in outside activities that may conflict with Firm business
	  ○ Technology requirements
	• Approve or disapprove request and notify RR's supervisor

Record	• Records of request reviews, action taken, notices to RR and supervisor

Because of the remote nature of some non-branch locations, approval is required **prior to** allowing an RR to operate from a non-branch location.

6.2.1 Primary Residence Offices

[FINRA Rule 3110(f)]

A RR may conduct business from their primary residence provided that, at a minimum, the RR is currently employed by KCD and is in good standing with both KCD and supervising regulatory authorities. Compliance must approve any such arrangement.

RRs approved for working from their primary residences may do so as long as the residence is not held out to the public as a branch office, and that they adhere to all relevant policies and procedures of KCD. The following requirements must also be met:

- only one Firm RR may conduct business from the location (unless otherwise approved by Compliance)
- the RR does not meet with customers at the location
- customer funds and securities are not handled at the location
- the RR is assigned to a designated branch office, and such office is reflected on all business cards, stationery, advertisements, and other communications to the public

- the RR's outgoing customer correspondence and other communications with the public sent from the primary residence are **pre-approved** by his/her designated supervisor
- all electronic business communications (*i.e.,* e-mails, faxes) are transmitted through Firm systems
- all customer orders are entered through the designated branch office or, if approved, via a Firm-approved system
- all required branch records are maintained at the designated branch office location

Other requirements:

- the RR may not use his/her personal e-mail accounts (*i.e.,* yahoo, gmail, *etc.*) to communicate with existing or potential clients; only Firm electronic systems may be used for customer communications

6.3 Supervision Of Non-Branch Locations

Each non-registered location will be assigned for supervision to a designated supervisor in a registered branch office. Compliance will determine the scope of supervision and notify the designated supervisor considering factors including the number of RRs, types of business conducted, volume of business, qualification and history of on-site personnel (*e.g.,* whether there is a registered supervisor at the location, whether RRs have disciplinary or complaint histories), and the nature and extent of RRs' outside business activities.

The designated supervisor will conduct ongoing reviews and retain records of the reviews at the designated branch location, which is subject to inspection, including records of non-branch office supervision.

6.4 Supervision Of Producing Managers

[FINRA Rule 3110(b)(6)(c) and 3110.10]

The customer account activities of managers and other supervisors are subject to supervision. Procedures are included in the chapter *SUPERVISORY SYSTEM, PROCEDURES, AND CONTROLS* in the section *Supervision Of Producing Managers' Customer Account Activity*.

6.5 Office Records

[SEC Securities Exchange Act of 1934 Rule 17a-3 and Rule 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 a 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.

There are two aspects to records requirements: *retention* and *access*. Documents (paper or electronic) regarding KCD's business ("books and records") must be retained for periods of time specified by regulators. Where KCD's required books and records (such as order tickets, correspondence, *etc.*) are not retained at the office that created the records, there is a requirement that the records must be produced within a reasonable period of time upon request from a regulator that visits the office.

This section describes both types of requirements. All questions regarding books and records should be referred to Compliance.

6.5.1 Retention Of Records At The Office

Office (OSJ and Branch) are required to retain copies of the following records:

- Order records (3 years, 2 recent years in an accessible location)
- New account records (6 years after account closing, in an accessible location)
- Correspondence, incoming and outgoing (3 years, 2 recent years in an accessible location)
- Advertising (3 years, 2 recent years in an accessible location)
- Operations records including records of receipt/delivery of securities or funds (3 years, 2 recent years in an accessible location)
- Complaints (3 years, 2 recent years in an accessible location)

LENGTH OF TIME TO MAINTAIN RECORDS

RECORD	Life Time	Six Years	Three Years
Blotters containing itemized daily records of securities purchases and sales, securities receipts and deliveries, cash receipts and disbursements, and other debits and credits.		X - 2	
Ledgers reflecting assets, liabilities, income, expense and capital accounts.		X - 2	
Ledgers itemizing for each customer and firm account all purchases, sales, receipts, deliveries of securitites and commodities, and other debits and credits.		X - 2	
Blotters – Records of Original entry including purchases and sales, checks received		X – 2	
Order tickets for brokerage orders or dealer transactions.			X - 2
Copies of confirmations			X – 2
Records of beneficial ownership of cash and margin accounts.			X – 2
Records of puts, calls, spreads, straddles and other options in which firm has a direct or indirect interest.			X – 2
Trial balances, and computation of aggregate indebtedness and net capital.			X - 2
Records pertaining to each "associated person."			X - 3 post termination
Fingerprint Records			X - 3 post termination
Fingerprint exemption notices.	X		
Account record information		6 yrs after account	

		closing or after date information replaced or updated	
			X – 2
Customer complaint records.			X – 2
Associated person compensation records.			X - 2
Records of approvals for public communications.			X -2
Records identifying persons capable of explaining the firm's records and identifying principals.		X - 2	
Checkbooks, bank statements, cancelled checks, cash reconciliations.			X - 2
Bills receivable or payable, paid or unpaid.			X - 2
Trial balances, computations of aggregate indebtedness and net capital, financial statements, branch office reconciliations, internal audit working papers.			X - 2
All agreements relating to the firm's business			X - 2
Certain records supporting the firm's annual financial statements.			X - 2
Communications sent or received by the firm, including inter-office and e-mail communications.			X - 2
"Approvals" of communications the firm sends.			X - 2
Communciations that must be kept under SRO rules on "communications with the public," including any advertising actually published or otherwise distributed to the public.			X - 2
Sales scripts used in communicating with the public (even though the scripts themselves are typically not delivered to the public).			X - 2
Account guarantees, powers of attorney, other documents granting discretionary authority, resolutions allowing agent to act for corporation.			X - 2

All agreements concerning any account.			X - 2
Notices to customers concerning any internal broker-dealer system (for example, notices concerning hours of operation, access instructions)			x - 2
Customer account cards and records concerning terms and conditions of account opening and maintenance.		6 yrs after account closing	
All firm partnership articles, articles of incorporation or charter, minute books and stock certificate books.	X		
Similar organizational records for firms organized as other forms of entities, for example, limited liability partnerships.	X		
Forms BD and BDW and amendments to these forms.	X		
Registration documents and licenses with all securities regulators.	X		
Reports requested or required from the firm by any securities regulator under any order or settlement with the regulator.			X
Examination reports by any securities regulator.			X
Reports of unusual activity in customer accounts (or the ability to regenerate these reports from a computer system).			18 months easily accessible
Compliance, Supervisory and procedural manuals; along with updates, modifications and revisions.			X

6.5.2 Forwarding Records To Home Office

Non-Branch Office must forward the following records to the home office for retention if not processed through the home office:

- Order records
- New account records
- Correspondence, incoming and outgoing
- Advertising
- Operations records including records of receipt/delivery of securities or funds
- Copies of complaints
- Wire requests

- ACATs
- Address changes

Copies should be kept in the non-branch or home office for the RR's use.

6.5.3 Access To Records

For records that are **not** maintained at the office location, the following records for the most recent two-year period will be produced at the office location promptly upon request of a regulator. **Regulators' requests should immediately be referred to Compliance for response.** "Promptly" is generally understood to mean within 24 hours of the request.

- Order records (daily trade blotters, order tickets/memoranda, including for the firm account)
- Receipts/deliveries of securities, receipts/disbursements of cash, all other debits/credits
- Employee records (U4, 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, retail communications, and (if applicable) institutional communications
- Record naming the person in the office who can explain records
- Record listing the person responsible for policies and procedures
- Compliance and supervisory manuals, including updates and revisions, until three years after termination of use of the manual

6.6 Changes In Branch Office Registrations

[FINRA By-Laws Article IV Section 8]

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, Compliance will verify state requirements before an office is opened and will file any necessary application or documents with state authorities which may include the secretary of state, taxing authorities, and/or broker-dealer licensing authorities.

6.7 Closing Offices

When an office is closed (and not just moved to another location), the designated supervisor is responsible for the following:

- Obtain all access cards or keys from branch personnel and change locks until the office is completely closed.
- Secure computers and other office equipment and arrange for removal and preservation of data.
- Secure branch files and transfer to Compliance or another department for record preservation.
- Secure and transfer operations records to appropriate operations area.
- Notify customers affected by the closing and maintain a record of notice.
- Finalize real estate issues such as leases.

When an office is relocated, the supervisor must secure all property and records and oversee transfer to the new location. Keys/access cards for the closed office will be collected from employees and new keys/access cards issued for the new office location.

6.8 Use Of Office Space By Others

[Form BR]

Responsibility	• Compliance
Resources	• Requests for office-sharing arrangements involving outsiders
Frequency	• As required

Action	• Review the potential arrangement to determine that it will be clear to the public which entity they are dealing with, considering the following:
	  ○ Amount of customer traffic in the office
	  ○ Physical separation
	  ○ Clearance with the fidelity insurance carrier
	  ○ Posting the name of each entity on the door to their working place
	  ○ The entities' names are not listed under the same telephone number
	  ○ The Firm's phone number is not used on the letterhead, business cards, or on any advertising of the outside entity
	  ○ Employees of each organization will wear a badge identifying their employer
	  ○ Any other considerations
	• When space-sharing involves the dual employment of KCD personnel, include policies and procedures that clearly identify the duties/functions to be performed for the Firm and the supervisory reporting lines
	• File an amendment to Form BR for approved arrangements

Record	• Record of review and considerations that allow or disallow the arrangement • Approval/disapproval of the arrangement • If dual employment is involved, policies and procedures to address duties and supervisory structure • Form BRs filed

Persons not affiliated with KCD are generally not permitted to conduct business or maintain offices on firm premises. Office-sharing arrangements require the prior approval of Compliance.

6.9 Cybersecurity

[SEC Risk Alert 4-26-23: https://www.sec.gov/files/risk-alert-safeguarding-info-branch-offices-042623.pdf]

Responsibility	• Designated Supervisor
Resources	• Branch computers and other devices

	• Software used in branches • Vendors used by branches
Frequency	• Ongoing: test and update devices • As required: train RRs when hired and prior to using new programs and software available in branches, as appropriate • As scheduled: branch reviews

Action	• Designated supervisor:
	    o Use Firm-approved vendors for email or other technology requirements of branches
	    o Provide branch personnel with a list of required and recommended hardware and software options and settings; approved vendors; and required controls
	    o Develop an inventory of branch-level data, software, and assets
	    o Provide instructions regarding installation of required firewalls, virus protections, update patches, and other cybersecurity defenses
	    o Include Firm-wide controls for technology such as multi-factor authentication, password complexity requirements, and other controls for remote access to Firm systems to prevent breaches
	    o Approve devices to be used
	    o Notify branch of approved cloud services if applicable
	    o Distribute alerts and notifications on emerging cybersecurity issues
	    o Confirm that desktops, laptops, and servers are using current software systems with secure settings and implement timely application of systems security patches
	    o Maintain records in accordance with Firm requirements for electronic records
	• Branch supervisor:
	    o Oversee branch's compliance with cybersecurity controls
	    o Allow only Firm-approved software, devices, and vendors
	    o Confirm updates to virus, malware, and other protection software are made to branch devices
	    o Notify Compliance immediately of violations of Firm cybersecurity standards or material cybersecurity incidents
	• Include cybersecurity in RR training
	• Include cybersecurity in branch reviews
	• Take corrective action (which may include fines, sanctions, or termination) for repeat violations of Firm requirements

Record	• Records of approved software, devices, required malware/virus protection, cloud services and notifications to branches • Records of ongoing testing and updating • Records of violations of requirements or material incidents • Training including when conducted, subjects covered, those who attended • Branch reviews

Branch offices are required to comply with KCD's requirements to protect customer and Firm information including the following. Refer to the chapter *CYBERSECURITY* and contact Compliance for further information. Branch office cybersecurity practices are subject to branch reviews. Computers and other devices that access or maintain confidential customer or Firm information must:

- be password-protected and use encryption of data where required

- be secured to prevent stealing
- be authorized Firm devices, software and cloud services
- have current required firewall, virus, malware, and other protection software

Branch personnel must immediately notify the branch supervisor of violations of Firm cybersecurity standards or material cybersecurity incidents involving loss of confidentiality, availability, or integrity of customer personally identifiable information or sensitive Firm data. Firm personnel are annually required to attest to their knowledge of and compliance with KCD's cybersecurity policy.

KCD has adopted the following procedures:

- Requiring branches to perform initial and recurring inventories of branch assets and update the firm regarding any changes
- Identifying sensitive customer and firm information and the location(s) where such information is stored
- Ensuring the physical security of branch assets
- Establishing processes by which branches manage and report lost or stolen assets
- Providing secured asset disposal, such as destroying hard drives of computers no longer in use
- Ensuring branch operating systems are properly supported and maintained either by KCD or by vendors

6.9.1 Branch Technical Controls

Risk assessments include technical controls at the branch level, including the following:

- Windows 10 Pro with BitLocker is required
- Devices are to be password protected
- computers employ core isolation
- computers employ secure boot
- Security processer activated

6.10 Office Inspections

[FINRA Rule 3110(c)(1), 3110(c)(2), 3110(c)(3), 3110.13 and 3110.14]

Responsibility	• Compliance
Resources	• Various reports/information regarding office activities
Frequency	• Annual: inspect OSJs and any branch office supervising one or more non-branch locations • Annual: conduct risk-based review to determine inspection cycle of other offices (no less than every 3 years for branch offices) • Annual or more often as required: review compliance with cybersecurity requirements • Annual: prepare inspection schedule • Annual: assign responsibility for conducting inspections • Per inspection schedule: conduct inspections
Action	• Conduct risk-based review to determine inspection cycle for non-supervisory offices • Prepare schedule including an explanation of the factors used in determining inspection cycles for non-supervisory offices

	• Assign inspection responsibility considering any potential conflicts of interest including economic, commercial, or financial interests in the associated persons or business being inspected and ensuring the person assigned is not assigned to the business unit and is not directly or indirectly supervised by, or otherwise reporting to, an associated person assigned to the unit or location. Where compliance is not possible due to KCD's size or business model (only one office; business model where small or single-person offices report directly to an OSJ-manager who is also considered the office's branch office manager), document in the report both the factors used to make this determination and how the inspection otherwise complies with the requirements of Rule 3110(c)(1)
	• Review compliance with cybersecurity standards which may include:
	  ○ Confirming branch examiners have sufficient cybersecurity expertise to perform reviews
	  ○ Developing a framework to capture cybersecurity risks, risk levels and related controls at each branch
	  ○ Implementing periodic exam visits or risk-based audits depending on branch risk profile
	  ○ Implementing automated ways to verify and monitor branch controls, such as verifying patching, virus and malware protection, encryption and password protection
	  ○ Confirming branch meets Firm cybersecurity standards and use Firm-recommended vendors or other vendors meeting Firm standards
	  ○ Re-evaluating branches where reviews identified material deficiencies or reported material cybersecurity incidents to ensure the branch has implemented corrective action
	• Conduct inspections
	• Prepare draft and final reports and provide final report to office supervisor and senior management
	• Obtain response from office supervisor and follow up regarding corrective action (no later than next inspection)
	• For an office with significant risk profile changes or regulatory/complaint issues, review the need for an immediate "for cause" inspection or acceleration of the inspection cycle
	• Maintain inspection program (and revise, as needed)

Record	• The inspection program, schedule of inspections, reports, review of those conducting inspections, reports • Determinations of whether a branch's inspection cycle should be accelerated or a "for cause" inspection should be conducted

All OSJs, branch offices, and non-branch offices are inspected in accordance with FINRA Rule 3110(c). "Non-supervisory office" in this section refers to branch offices that do not supervise other offices and non-branch offices.

6.10.1 Risk-Based Inspection Cycle

The Firm will inspect non-supervisory offices based on a risk-based inspection cycle. The frequency of inspections will be determined as follows.

- Consistent with FINRA rules, any office designated as an Office of Supervisory Jurisdiction will be inspected annually.
- Some offices will be inspected on an unannounced basis.

6.10.1.1 "For Cause" Inspections

At any time, a branch office may be identified for an immediate "for cause" inspection, as determined by Compliance. A "for cause" inspection may be initiated considering serious regulatory or disciplinary actions against branch personnel; serious or a pattern of complaints; thefts; fraud; suspected money laundering activities; or other malfeasance by branch personnel.

6.10.1.2 Change Of Risk Profile For Offices Inspected Less Frequently Than Annually

Compliance will consider whether a significant change to an office's risk profile triggers a review of the inspection schedule for that branch. Events that may trigger this review include:

- A branch RR comes under SRO/state/Firm heightened supervision requirements.
- A branch that previously did not supervise other offices now supervises another office (requiring annual inspection).
- A branch or branch employee becomes the subject of a pattern of complaints.
- A branch's level of errors or changes in accounts on orders becomes high compared to other branches.
- Branch personnel become the subject of regulatory action.
- The branch is assigned a new branch manager.
- An existing or newly-hired RR becomes or is subject to a statutory disqualification.

6.10.2 Conducting Inspections

[FINRA Rule 3110(c)(3)(B) and 3110.14]

Inspections generally include the following:

- Assignment of inspection responsibilities to a qualified person
- Pre-inspection document/information review including review of prior report(s) for the office
- Scheduling a visit on either an announced or unannounced basis
- For branch offices, scheduling reviews at the supervising office to examine records of supervision
- During a physical inspection, reviewing records and interviewing personnel in accordance with the inspection program
- Preparing a draft report of findings
- Submitting the draft to the appropriate supervisor for comment and response
- Preparing a final report incorporating the supervisor's responses
- Submission of the final report to management

Compliance, at its discretion, initiates unscheduled inspections (when potential significant problems are identified, a change in office management warrants a special review, at the request of senior management, *etc.*).

6.10.3 Temporary Relief For Remote Inspections

[FINRA Rule 3110.17; MSRB Rule G-27.01; MSRB Notice 2020-18]

Responsibility	• Designated Supervisor
Resources	• List of offices

	• Available records (accounts, *etc.*) and reports
Frequency	• Annual for OSJs, as determined for other branches

Action	• Design remote inspections to reasonably detect and prevent violations including:
	  ○ Methodology (including technologies) used
	  ○ Use of other risk-based systems used to identify and prioritize reviews for areas posing the greatest risk of potential violations
	• Identify offices for remote inspections
	• Identify records for review prior to inspection
	• Conduct remote inspection
	• Identify whether enhanced supervision or more frequent monitoring, including a physical inspection, is necessary and take necessary action
	• Prepare and send report to branch supervisor, review responses from supervisor and review for corrective action

Record	• Separate identification of offices or locations inspected remotely and a record of inspections • Office or locations where additional supervisory procedures are imposed or more frequent monitoring is necessary, and follow-up review of these actions • Records of inspections and follow-up regarding deficiencies

KCD may conduct office inspections remotely for the calendar years 2020, 2021, 2022, and 2023 as part of COVID relief.

6.10.4 Reports

[FINRA Rule 3110(c)(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 which will include, at minimum (depending on types of business conducted in the office)
    - safeguarding customer funds and securities;
    - maintaining books and records;
    - supervision of supervisory personnel;
    - transmittals of funds (*e.g.,* wires or checks, *etc.*) or securities from customers to third party accounts; from customer accounts to outside entities (*e.g.,* banks, investment companies, *etc.*); from customer accounts to locations other than a customer's primary residence (*e.g.,* post office box, "in care of" accounts, alternate address, *etc.*); and between customers and registered representatives, including the hand-delivery of checks; and
    - changes of customer account information, including address and investment objectives 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.*) and a statement that the office may not engage in these activities until policies and procedures for these activities are in place at that location
- observations and exceptions regarding compliance with policies and procedures
- the office supervisor's response regarding exceptions and corrective action

Final reports will be distributed to senior management and the audit committee, if a committee has been appointed.

6.11 Branch Manager's Checklist

Responsibility	• Designated Supervisor
Resources	• Order Records • Daily Transaction Report • Customer Monthly Statements • Communications • Reg T records including margin calls, prepayment requests, *etc.* • Other various records reviewed by the Branch Manager
Frequency	• Monthly
Action	• Complete the checklist and forward to Compliance, retaining one copy in a branch file
Record	• Branch file to retain at least three years' Checklists • Compliance file to retain at least three years' Checklists

Branch managers will complete a monthly checklist to be submitted to Compliance by the 15th of the month following the month reported. The checklist summarizes many of the reviews conducted by the branch manager.

6.12 Display Of Certificates

[SIPC By-Laws Article 10 Section 3]

Branch offices are required to display certificates on their premises, including:

- SIPC symbol

6.13 Availability Of Rules

Each office that deals with public customers will maintain copies of rules for regulators where KCD is a member. Where Internet access is available, this requirement is satisfied by providing access to the rules published on the regulators' web sites.

6.14 Networking Arrangements With Other Financial Institutions

[SEC Securities Exchange Act of 1934 Section 3(a)(4)(B)(i); SEC Regulation R; FINRA Rule 3160; Interagency Statement on Retail Sales on Bank Premises]

<table>
<tr><td>Responsibility</td><td>Designated Supervisor</td></tr>
<tr><td>Resources</td><td>Networking agreement
Customer acknowledgments
Advertising and sales literature referring to services on financial institution premises
New accounts
Customer communications (incoming and outgoing)
Daily transaction report
Information regarding associated persons terminated for cause</td></tr>
<tr><td>Frequency</td><td>Networking agreement - as required
Advertising and sales literature - as required
New accounts - as required
Communications - daily or as required
Transaction review - daily
Audits - as scheduled</td></tr>
<tr><td>Action</td><td>Establish the initial networking agreement and amend as needed
Satisfy Regulation R Rule 701 requirements for referrals by bank employees included in the networking agreement which may include:
Confirming a bank employee is not subject to a statutory disqualification (Compliance)
Confirming that customers meet definitions of "high net worth" or institutional customers
Review accounts opened to confirm customer disclosure was provided
Review and revise, approve, or disapprove advertising and sales literature
Review communications and customer transactions
Audits: Review for physical separation; disclosures provided; other sales practice areas reviewed as part of branch reviews
Notify financial institution of associated persons employed by them terminated for cause</td></tr>
<tr><td>Record</td><td>Networking agreement and amendments retained by Compliance
Records of reviews of bank employees for statutory disqualifications, if applicable (Rule 701, Regulation R)
Records of reviews for compliance with "high net worth" or institutional customer definitions, if applicable (Rule 701, Regulation R)
Advertising and sales literature and notation of date and action taken retained by Compliance
Approval of new accounts retained in Operations
Copies of communications retained by Designated Supervisor
Daily transaction report initialed and dated including notes of action taken, retained by Designated Supervisor
Audits: records of audits conducted are retained by Compliance
Record of termination notifications</td></tr>
</table>

KCD is not currently engaged in a networking arrangement with a financial institution and provides broker-dealer services on the institution's premises. This section explains requirements for conducting firm business on the institution's premises.

6.15 Networking Agreement

A networking arrangement is a contractual or other written agreement between a FINRA member and a financial institution (federal and state-chartered banks, savings and loan associations/banks, credit unions, or service corporation of such institution)s. under which the member offers broker-dealer services on or off the premises of the financial institution.

If KCD enters into a networking agreement with a financial institution, the agreement will stipulate the respective responsibilities of KCD and the financial institution; the compensation arrangements; KCD's obligations (as applicable under Regulation R Rule 701); and that supervisory personnel of KCD and representatives of the SEC and FINRA will be permitted access to the financial institution's premises where Firm business is conducted in order to inspect KCD's books and records and other relevant information.

Banks that engage in securities activities may be required to register as broker-dealers. Rule 701 under Regulation R provides an exemption for banks that are engaged in contractual arrangements with broker-dealers and where referral fees are paid to bank employees. Banks must meet the criteria of Rule 701 to avoid broker-dealer requirements and may include these criteria in the networking agreement placing the responsibility on KCD to comply.

This includes an obligation to:

1. determine that a bank employee is not subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act, have a reasonable basis to believe that the customer is a "high net worth customer" or an "institutional customer" and conduct a suitability or sophistication analysis for customers and securities transactions by customers;
2. promptly inform the bank if KCD determines that the customer referred to KCD is not a "high net worth customer" or an "institutional customer," as applicable, or the bank employee receiving the referral fee is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act; and
3. inform the customer if the customer or the securities transaction(s) to be conducted by the customer does not meet the applicable standard set forth in the suitability or sophistication determination in Rule 701.

6.15.1 Setting

When CD conducts broker-dealer services on the premises of a financial institution, all of the following requirements apply:

- KCD and anyone associated with KCD will be clearly identified as providing broker-dealer services that distinguish its services from those of the financial institution.
- The Firm's name will be clearly displayed where its business is conducted.
- To the extent practicable, KCD's business will be conducted in a location physically separate from the routine retail deposit-taking activities of the financial institution.

6.15.2 Customer Disclosure

RRs operating on financial institution premises are, at or prior to the time a customer account is opened subject to the networking agreement, required to provide **oral and written** disclosure that the broker-dealer services are being provided by KCD and not by the financial institution, and that the securities products purchased or sold in a transaction are:

- Not insured by the FDIC;

- Not deposits or other obligations of the financial institution and are not guaranteed by the financial institution; and
- Subject to investment risks, including possible loss of the principal invested.

6.15.3 Communications With The Public

This section outlines public communication requirements (including confirmations/statements and advertising) that apply when conducting business under a networking agreement.

6.15.3.1 Confirmations And Statements

All confirmations and statements indicate that broker-dealer services are provided by KCD (or its clearing firm).

6.15.3.2 Retail Communications

Disclosure requirements apply to retail communications (including material published, or designed for use, in radio or TV broadcasts; ATM screens; billboards; signs; posters; and brochures) that announce the location of a financial institution where firm services are provided or promote the name or services of the financial institution or that are distributed by the Firm on the financial institution's premises (or another location where the financial institution is present or represented). The following disclosures must be conspicuously displayed:

- Not FDIC insured
- No bank guarantee
- May lose value

As long as omission of the disclosures would not be misleading, disclosures are not required for:

- Radio broadcasts of 30 seconds or less;
- Electronic signs, including billboard-type signs that are electronic, time and temperature signs and ticker tape signs, but excluding messages contained in such media as television, online services, or ATMs; and
- Signs such as banners and posters, when used only as location indicators.

6.15.4 Compensation To Financial Institution Personnel

RRs working on bank premises are strictly prohibited from providing compensation to financial institution personnel. Permissible compensation is governed by the networking agreement and is subject to limitations imposed by regulators. Financial institutions may pay unregistered personnel nominal one-time cash fees of a fixed dollar amount not contingent upon a successful transaction and may pay other fees for referrals of institutional and high net worth customers. Compensation is regulated by Regulation R; questions should be referred to Compliance.

6.15.5 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.

6.15.6 Notifications Of Terminations

KCD will notify the financial institution if any associated person employed by the financial institution is terminated for cause by KCD.

7 GENERAL EMPLOYEE POLICIES

7.1 Standards Of Conduct

[FINRA Rule 2010]

It is KCD's policy and mandate to its employees to conduct KCD'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 policies and procedures will be provided to all employees and from time to time updates will be issued if needed.

7.2 Outside Business Activities

[FINRA Rule 3270]

Responsibility	• Designated Supervisor
Resources	• Requests to engage in outside business activities • Annual certifications • Other potential indicators such as incoming or outgoing correspondence
Frequency	• As required

Action	• Employee's supervisor:
	    ○ Question employee regarding potential unapproved outside business activities referenced in correspondence or other indicators of outside business activity
	    ○ Refer requests to Compliance
	• Compliance:
	    ○ Consider whether the proposed activity will:
	        ▪ Interfere with or otherwise compromise the employee's responsibilities to KCD and its customers
	        ▪ Be viewed by customers or the public as part of KCD's business based upon the nature of the proposed activity and the manner in which it will be offered
	        ▪ Involve digital asset activities (including activities performed through affiliates) which may be considered securities transactions
	    ○ Conduct reviews which may include:
	        ▪ RR interview
	        ▪ Social media, professional networking and other publicly available websites, and other sources (such as legal research databases and court records)
	        ▪ E-mail and other communications
	        ▪ Documentation supporting the activity (such as organizational documents)
	        ▪ Capital raising or directing securities transactions with investment advisers or fund companies to identify private securities transactions

	○ Determine whether the activity is an outside business activity or if it would be considered a private securities transaction subject to the requirements of the next section ○ Determine any limitations to be imposed prior to approval ○ Notify employee of approval/disapproval and any limitations, in writing ○ When violations are detected, take corrective action which may include heightened supervision, fines, or termination ○ For outside business activities that involve digital assets, confirm whether securities are involved including reviewing private placement memoranda or other materials analyzing the underlying products and investment vehicle structures • Include outside business activities in training
Record	• Retention for 3 years, 2 years in a readily accessible location: ○ Outside Business Activity Request forms including approval/disapproval and any limitations on the activity ○ Written notification to the employee and his/her supervisor • Records of training

Employees are required to disclose to KCD, in writing, any outside business activities and obtain approval prior to engaging in such activity. Charitable activities are not included in this requirement unless the employee is being compensated. This policy applies to all employees (or other relationships such as RRs acting as independent contractors registered with KCD); it does not apply to private securities transactions which are discussed in the next section.

Outside business activities may include a wide range of activities including but not limited to the following:

- Employment with an outside entity
- Acting as an independent contractor to an outside party
- Serving as an officer, director, or partner
- Acting as a finder
- Referring someone and receiving a referral fee
- Receiving compensation or having the reasonable expectation of compensation from any other person as a result of a business activity outside the scope of employment or other relationship with KCD

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.

Employees requesting approval to engage in outside business activities must complete the Outside Business Activity Request form and submit it to Compliance **prior to** engaging in the activity. Compliance will approve or disapprove the outside business activity in writing and notify the employee and the employee's supervisor.

7.3 Private Securities Transactions

[FINRA Rule 3280]

Responsibility	• Designated Supervisor
Resources	• Requests to engage in "buying away" private securities transactions • Annual certifications

<table>
<tr><td></td><td>Indications of potential "buying away" such as in correspondence</td></tr>
<tr><td>Frequency</td><td>As required</td></tr>
<tr><td>Action</td><td>Employee's supervisor:
Refer requests or indications of private securities transactions to Compliance
Compliance:
Review requests and certifications
Follow up with RR and supervisor regarding indicators of buying away
Notify employee by memo (with a copy to the employee's supervisor) whether the private securities transaction is approved
If approved:
Obtain information regarding private securities transaction
Require immediate notification of any transaction as it occurs
Establish required supervision of the outside transactions
For unapproved transactions, take corrective action which may include:
Disciplinary action against the RR (letter of reprimand; fine, suspension; termination)
Notification to private securities investors that KCD is not associated with the investment</td></tr>
<tr><td>Record</td><td>Record of approval or disapproval
Records of transactions and review/action taken
Records of action taken for unapproved transactions</td></tr>
</table>

Private securities transactions are defined by FINRA as any securities transaction outside the regular course or scope of an employee's employment with KCD (sometimes referred to as "selling away"). This does not include outside securities accounts approved by KCD, transactions with immediate family members where the employee receives no selling compensation, and personal transactions in investment company and variable annuity securities.

Registered representatives who wish to engage in a private securities transaction for their own account (buying away" must submit their request in writing for approval by Compliance in advance. Information is required about the private security and the transaction cannot proceed prior to receiving written approval from Compliance. Compliance or the designated supervisor will supervise and review all private securities transactions

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

7.4 Employee and Employee Related Accounts

7.4.1 Employee and Employee Related Accounts Defined

[FINRA Rule 3110(d)(4)]

Employee and employee related accounts ("covered accounts") are subject to review by KCD. Covered accounts include:

- the spouse of a person associated with the member;
- a child of the person associated with the member or such person's spouse, provided that the child resides in the same household as or is financially dependent upon the person associated with the member;
- any other related individual over whose account the person associated with the member has control; or
- any other individual over whose account the associated person of the member has control and to whose financial support such person materially contributes.

In addition, accounts subject to review include any account where an employee has a beneficial interest or the authority to make investment decisions (for example, trust accounts, accounts for minors, *etc.*).

7.4.2 Outside Accounts

[FINRA Rule 3210; FINRA FAQs on Rule 3210: http://www.finra.org/industry/faq-responses-frequently-asked-questions-concerning-new-finra-rule-3210; NYSE Rule 407]

Responsibility	• Designated Supervisor
Resources	• Requests for outside accounts • Annual certifications • Other
Frequency	• As required

Action	• Employee's supervisor:
	    ○ Refer requests to Compliance
	• Compliance:
	    ○ Review requests and certifications
	    ○ Notify employee by memo of approval or disapproval
	    ○ Notify firm carrying the employee's outside account by letter regarding to whom duplicate confirmations and statements should be sent. If the carrying firm is a non-member and the ability to receive confirmations and statements is limited, consider whether the account should be approved.
	    ○ Review confirmations and statements as they are received. Review for:
	        ▪ Transactions in securities restricted by KCD
	        ▪ Transactions in new issues
	        ▪ Transactions potentially involving insider trading or other rule/law violation
	        ▪ Large debit balances, very active trading, or other trading activity that may be of concern
	    ○ For transactions in restricted securities, contact the employee and take corrective action which may include cancellation of the transaction
	• For trading activity that may be indicative of law or rule violations, conduct an internal investigation

Record	• Approval/disapproval of outside account in employee's file • Confirmations/statements initialed and filed in employee's file • Record of internal investigation, if applicable • Quarterly report to FINRA of internal investigations, if KCD engages in investment banking activities

It is the general policy of KCD to require that employees maintain their securities accounts at KCD. Exceptions require written approval by Compliance prior to opening the account. Compliance 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 and any accounts where the employee has a beneficial interest.

Accounts for the following where the employee is presumed to have a beneficial interest include:

- a spouse
- a child of the employee or the employee's spouse, provided the child resides in the same household or is financially dependent upon the employee
- any other related individual over whose account the employee has control
- any other individual over whose account the employee has control and to whose financial support the employee materially contributes

There may be exceptions to the presumption if the employee can demonstrate to Compliance that the employee derives no economic benefit from, and exercises no control over, the account.

The employee is also obligated to notify in writing the broker-dealer or other institution prior to opening the account that the employee is associated with KCD. Accounts opened prior to association with KCD are subject to the same approval requirement by Compliance and notification to the carrying institution within 30 days of employment with KCD.

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

7.4.3 Review of Transactions

[FINRA Rule 3110(d)]

Responsibility	• Designated Supervisor
Resources	• Order records • Customer monthly statements
Frequency	• Daily (order records) • Monthly (customer monthly statements)
Action	• Review employee and employee related accounts for possible concerns regarding: ○ Very active trading ○ Sizeable debit balances ○ Bounced checks ○ High risk trading patterns ○ Transfers between accounts, particularly employee or related accounts and customer accounts ○ Insider trading • Where items of concern are identified, action to be taken depends on the circumstances and may include conducting an internal investigation to identify potential rule/law violations
Record	• Record of review of orders and actions taken, if applicable • Record of internal investigation, if applicable • Record of review of accounts and actions taken, if applicable • Quarterly report to FINRA of internal investigations, if the Firm engages in investment banking activities

Transactions in employee and employee related accounts are reviewed daily. Employees will be contacted about transactions that are potentially contrary to rules or Firm policy.

7.4.4 Sharing in Accounts

[FINRA Rule 2150]

Responsibility	• Designated Supervisor or Designee
Resources	• New account forms • Requests to open accounts jointly with customers
Frequency	• As required
Action	• RR's supervisor: ○ When approving new accounts, identify accounts where an RR is potentially sharing in the account ○ Confer with employee as to the nature of the shared account (what is the relationship between the employee and the other account owner, allocation of profits and losses) If necessary contact client ○ Refer shared accounts or requests to share in an account to Compliance • Compliance: ○ Require written request from employee and written authorization from customer ○ Review and determine whether shared account is appropriate ○ Approve or disapprove the request ○ Notify employee and supervisor of approval or disapproval
Record	• Copies of employee request, customer's written authorization, and notation of approval or disapproval is retained with the new account records for the account

KCD and its registered employees may not share directly or indirectly in the profits or losses of a customer's account (with the exception of performance-based fees specifically permitted under rules governing investment adviser and other permitted arrangements). As a general policy, registered employees may not participate in an account that includes customers who are not family members of the employee.

Under limited conditions 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 which explains in detail the purpose of the account and reason for joint ownership prior to opening the account
- 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
- client will receive written notification of account opening

7.4.5 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. Details regarding this prohibition are in the chapter *CORPORATE SECURITIES UNDERWRITING* in the section *Restrictions On Purchases Of Initial Public Offerings (IPOs)*.

7.5 Private Securities Transactions

[FINRA Rule 3280]

Responsibility	• Designated Supervisor
Resources	• Requests to engage in private securities transactions • Annual certifications • Other indications of potential "selling away" such as in correspondence
Frequency	• As required

Action	• Employee's supervisor:
	  ○ Refer requests or indications of private securities transactions to Compliance
	• Compliance:
	  ○ Review requests and certifications
	  ○ Follow up with RR and supervisor regarding indicators of selling away
	  ○ Notify employee by memo (with a copy to the employee's supervisor) that private securities transactions are not permitted
	  ○ Take corrective action which may include:
	    ▪ Disciplinary action against the RR (letter of reprimand; fine, suspension; termination)
	    ▪ Notification to private securities investors that the Firm is not associated with the investment

Record	• Memo in employee's file • Records of transactions and review/action taken

Employees are not permitted to engage in private securities transactions (as defined by FINRA), whether or not there is compensation paid for effecting the transaction. Private securities transactions are defined by FINRA as any securities transaction outside the regular course or scope of an employee's employment 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 employee 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 has the obligation to obtain the Firm's permission **before** engaging in any outside business activity involving the offer of promissory notes.

RRs are required to conduct their selling activities through the Firm.

7.6 Outside Business Activities (OBA)

Registered persons of KCD are obligated to notify the Firm of any business activity outside conducted prior to conducting any such business activity. Upon hire or when changes occur the Registered person will complete a OBA form, providing enough detail to complete their U4 as required and to satisfy the Firm's questions with respect to those activities. The RR will be required to provide annual affirmation regarding any OBA activity.

The Firm will keep a written record of this notice and will indicate whether the activity is approved and the reasons approved or not. When considering the activity for approval, the Firm will evaluate the nature of the activity, the manner in which it will be offered, and whether it should be treated as an outside securites activity.

7.7 Gifts, Gratuities And Entertainment

[FINRA Rule 2310(c)(2)(A), 2320(g)(4)(A), 2341(l)(5) and 3220; FINRA FAQs: https://link.edgepilot.com/s/55d23a57/gIVpBJJgE06xkTj8tIhDnQ?u=https://www.finra.org/rules-guidance/key-topics/gifts-gratuities-and-non-cash-compensation/faqs; FINRA guidance: https://link.edgepilot.com/s/1c493ce2/Rx7c69-n8Eu6Z8tJ9RH6sQ?u=https://www.finra.org/rules-guidance/key-topics/gifts-gratuities-and-non-cash-compensation]

Responsibility	• Designated Supervisor or Designee
Resources	• Requests to give or receive gifts • Expense reports • Annual certification
Frequency	• As required

Action	• RR's supervisor:
	  ○ Refer requests regarding gifts and gratuities to Compliance
	  ○ Review expense reports for reasonableness and compliance with expense policies and approve or disapprove
	• Compliance:
	  ○ Review and approve or disapprove gifts and gratuities to be given, aggregated on a calendar year basis to determine compliance with the $100 annual limit
	• FINOP:
	  ○ File Form LM-10 with Dept. of Labor if necessary

Record	• Gift Approval Forms are maintained in a branch/department file • Expense reports are maintained in Accounting

Gifts, gratuities, and entertainment are subject to regulators' limitations. Failure to comply may result in fines or other regulatory actions against the employee and KCD. **It is important for all employees to know and comply with this policy.** Questions regarding this policy on gifts and entertainment should be referred to Compliance. Key requirements include:

- **Gifts to others are limited to $100 per year per person** (other than "personal gifts" defined in the policy).
    - Multiple gifts to the same person are aggregated, *i.e.,* the total of all gifts in any year firm-wide cannot exceed $100 to one person.
    - "Personal gifts" are excluded (as discussed below).
- **Receiving** gifts is limited.
- An **employee must host entertainment** to avoid entertainment being considered a "gift" subject to limitations.

- **Records of entertainment** must include details of who was entertained and the nature of entertainment.
- **Gifts to labor union employees require prior Compliance approval.**
- **Gifts to public officials require prior Compliance approval.**
- **Your supervisor must be notified** of gifts to others prior to the transmittal.
- **Your supervisor must be notified** of gifts received (other than personal gifts).
- Gift requirements (whether the gift is given or received) **do not apply to personal gifts** to immediate family members (parents, children, grandparents, siblings, spouse, in-laws) who also happen to be customers and where the gift is unrelated to KCD's business. The policy also does not apply to occasional personal gifts to others (such as a wedding gift or a congratulatory gift for the birth of a child).
- **If KCD pays for the gift** or reimburses the employee for the cost of the gift, the gift is subject to the requirements of this policy.
- **Gifts incidental to entertainment** (*e.g.,* a golf shirt given during a golf outing, *etc.*) are considered gifts subject to reporting to Compliance and the gift limitations.

7.7.1 Gifts To Others

Employees are required to submit the Gift Approval Form to their supervisor prior to giving a gift (other than a *de minimis* gift described below). Gifts relating to KCD's business are limited to $100 per year per person. 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. 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.

De Minimis And Promotional Items

The policy does not apply to gifts of *de minimis* value (such as pens, notepads, or modest desk ornaments) or to promotional items of nominal value with KCD's logo (*e.g.,* umbrellas, tote bags or shirts). Promotional items must be valued substantially below the $100 limit to be excluded from the gift policy. Items of higher value (near $100 or more), even if they include KCD's logo, are considered "gifts" subject to this policy.

FINRA excludes customary lucite tombstones, plaques or other decorative items commemorating a business transaction. This exemption is very limited; other items are considered gifts subject to the policy, even if they commemorate a business transaction.

Aggregation Of Gifts

The annual gift limitation is the aggregate of all gifts given to any one individual. For example, a gift of a $75.00 ticket to a football game in November (as a gift and not as entertainment discussed below) and then a holiday gift of a $50.00 bottle of wine to the same person in the same year would be in violation of the $100 limitation.

Each recipient is limited to $100 in **total** gifts during any calendar year.

Valuation Of Gifts

Gifts are valued at the higher of cost or market value excluding tax and delivery charges. For tickets, it is the higher of 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. For example, a $250 fruit basket given to an office of three individuals is permitted since the value of the gift prorated is less than the $100 limitation per person.

7.7.2 Accepting Gifts

Employees may not solicit gifts or gratuities from customers or other persons with business dealings with KCD. Employees are not permitted to accept gifts from outside vendors currently doing business with KCD 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. When accepting gifts from customers or other business-related persons, the employee is required to submit the Gift Approval Form to his or her supervisor.

7.7.3 Entertainment

Entertainment of customers or prospective customers must be reasonable and not so expensive it raises a suggestion of unethical conduct. All entertainment and related expenses must be detailed on an expense form with receipts attached for expenses over $25.00. Expense forms should be submitted to the appropriate supervisor within 30 days of incurring the expenses.

The limitation on gifts and gratuities does not apply to usual business entertainment such as dinners or sporting events where the employee hosts the entertainment, though such expenses should be reasonable. "Entertainment" includes a broad range of activities such as trips, parties, and other activities where an employee hosts someone related to KCD's business. Questions regarding the reasonableness of proposed entertainment and related expenses should be referred to Compliance.

Items given in conjunction with entertainment (a golf shirt at a golf outing; a fruit basket delivered to a customer's room during a firm outing) are considered gifts subject to the $100 limitation.

7.7.4 Gifts, Loans, And Entertainment Involving Unions And Union-Affiliated Individuals

Responsibility	• Designated Supervisor or Designee
Resources	• Expense reports • Annual Employee Certification
Frequency	• Annual
Action	• Include reportable gifts, loans, entertainment, *etc.* excluding de minimis amounts of $250 or less • Review Annual Employee Certifications to identify union-related gifts, loans, *etc.* and follow up to include item in annual reporting on Form LM-10 within 90 days of

	fiscal year end
Record	• Vouchers, worksheets, receipts, and other records including Form LM-10 • Gift Approval Forms • Annual Employee Certifications with notes of action taken, if any

The Department of Labor (DOL), under a federal act, requires KCD to report any payment or loan, direct or indirect, of money or other things of value (including reimbursed expenses), or any promise or agreement to make such payments, to any labor organization or officer, agent, shop steward or other representative or employee of a labor organization. This includes entertainment (cost of meals, *etc.*), expenses, or giving gifts or other things that exceed $250.00 in value where the recipient or beneficiary involves a union or union-affiliated individual.

When reporting gifts, entertainment, loans, and other payments, employees must identify when a union or union-affiliated individual is involved. Employees are obligated to report such items to KCD regardless of the dollar amount involved.

7.7.5 Gifts Or Payments To Public Officials Under State Laws

[Various state laws]

A "public official" is anyone who is elected or appointed to an office or is an employee of a "public entity" including any teacher or professor employed by a public entity. A "public entity" is broadly defined and includes political bodies, municipalities and their governing bodies (school district, school board, *etc.*), public universities and colleges as well as any other municipal entity. This policy also includes honorarium payments (payments for any speech given, article published, or attendance at any public or private conference, convention, meeting, social event, or similar gathering).

Some public entities are statutorily authorized to charge the cost of inspections of regulated entities. A public official may, therefore, receive payment for statutorily-authorized expenses. For example, if a state securities official appears at an office to conduct an inspection, the state may, if authorized in state statutes, charge KCD for expenses related to conducting the inspection.

Prior approval from Compliance is required for gifts or entertainment involving public officials.

7.8 The Foreign Corrupt Practices Act (FCPA)

[United States Code Title 15 Chapter 2B; FINRA Regulatory Notice 11-12; SEC/DOJ/FCPA resource guide: http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf]

Responsibility	• Compliance or Designee
Resources	• Proposed contracts • Entertainment, expense, and/or other information regarding expenditures
Frequency	• As required: Proposed contracts • Ongoing: Maintain list of employees required to provide certification • As required: Review reports of potential violations • Annual: Review of expenditures relating to gifts, travel, etc. in conjunction with

<table>
<tr><td></td><td>business area reviews</td></tr>
<tr><td>Action</td><td>Review entertainment, gifts, travel expenses, other expenditures relating to Foreign Officials for approval and compliance with firm policy
Review/approve contracts with foreign agents, representatives, etc.
Review reports from employees of potential violations
Investigate the reported issue
Engage outside counsel if necessary
Determine course of action which may include consultation with counsel to determine whether there was a violation; decide on corrective action, if necessary, to be taken involving the employee and KCD; make necessary regulatory or other filings
Notify the employee of the outcome
Conduct employee training regarding the FCPA and employee obligations to report, including KCD's anti-retaliation policy
Maintain list of employees required to provide annual certification
Obtain certifications</td></tr>
<tr><td>Record</td><td>Reviews for compliance with policy and any action taken
Contracts reviewed and approved/disapproved
Employee training including employees trained, subject, when it occurred</td></tr>
</table>

KCD has a commitment to comply with all Federal and regulatory requirements; part of that is compliance with the Foreign Corrupt Practices Act (FCPA). The FCPA is a U.S. act that applies to all employees, affiliates and subsidiaries involved in potential payments to foreign officials and provides standards of conduct and practices under the anti-bribery and accounting provisions of the FCPA. For purposes of this policy, a "Foreign Official" includes any officer or employee of a foreign government, agency, or instrumentality of the agency; public international organization; any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality; or for or on behalf of any such public international organization; or a foreign political party or official or person acting on behalf of a foreign political party. Foreign Official also includes an employee of an entity that is 100% owned by a government. Foreign Officials may also include employees of an entity where a government holds a controlling interest. The U.S. Government has not specified what level of control creates a state-owned entity. Questions about whether someone is a Foreign Official should be referred to Compliance.

Violations of the FCPA can result in severe civil and criminal penalties for KCD as well as individual employees. Failure to adhere to this policy may result in disciplinary action up to and including termination of employment.

7.8.1 FCPA Prohibitions

In general, the FCPA violations of the anti-bribery prohibitions involve making use of the mails or any means or instrumentality of interstate commerce:

- Corruptly;
- In furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give or authorization of the giving of anything of value to any:
  - Foreign official;
  - Foreign political party or party official;
  - Candidate for foreign political office; or
  - Person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to any foreign official, political party, party official or candidate;
- For the purpose of:

  - Influencing any act or decision of the foreign official, political party, party official or candidate in his or its official capacity;
  - Inducing the foreign official, political party, party official or candidate to do or omit to do an act in violation of his or its lawful duty;
  - Securing any improper advantage;
  - Inducing the foreign official, political party, party official or candidate to use his or its influence with a foreign government or instrumentality to affect or influence any act or decision of such government or instrumentality; or
  - In order to assist in obtaining or retaining business for or with, or directing business to, any person.

The FCPA 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 KCD in obtaining, retaining or directing business to any person. Intent can include those gifts, payments, *etc.* made with a conscious disregard or deliberate ignorance of their purpose.

The FCPA also prohibits any such payments to third parties or intermediaries while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to any Foreign Official. Intermediaries can include, but are not limited to, joint venture partners or other agents such as consultants, independent service providers and vendors.

Cash payments and political contributions made on behalf of KCD to Foreign Officials, either directly or via a third party, are prohibited.

FINRA Regulatory Notice 11-12 includes a summary of affirmative defenses and exception for facilitating payments for "routine governmental actions."

7.8.2 Required Approvals

An expenditure of any size for courtesies, gifts, entertainment, travel, lodging or other payment of any kind to or on behalf of any Foreign Official must be approved in accordance with KCD's gifts policy. All questions about the application of this policy, or concerns regarding potential violations of the policy, should be directed to Compliance.

7.8.3 Contracts With Third Parties

KCD must exercise reasonable due diligence in the selection of any third party to be used in connection with a foreign government, its officials or anyone meeting this policy's definition of "Foreign Official." No agent, representative, or consultant may be retained for such purpose without the written approval of Compliance after the satisfactory completion of appropriate due diligence procedures. Contracts with such third parties will be in writing, and specifically bind the individual or entity to comply with the FCPA. Payment to such third parties will be permitted only if it is reasonable in relation to the services performed.

7.8.4 Business Entertainment, Gifts And Travel Expenses

Entertainment, gifts and travel expenses may not be paid to, or on behalf of, Foreign Officials unless they meet all of the guidelines below. For further guidance, employees should contact Compliance.

- The expenditures should not be lavish or excessive, on either a per capita or event basis, as determined by the economic standards of the country in which the benefit is being given.
- A valid business purpose should be associated with all KCD-funded activities.
- The event or provision of gifts should be infrequent.

- The event or activity should be legal under both U.S. and local law, within accepted industry norms, and consistent with company policy.
- The expenditures should be accurately and adequately documented in KCD's books and records, including their business purpose, value and record of approval.
- Travel and hotel expenses for government officials should be made directly to the vendor by KCD rather than allowing the officials to pay their own way and to seek reimbursement.
- Entertainment and gifts must comply with KCD's policies.
- All expenditures must be permitted under the local law where the Foreign Official is employed, which may be more restrictive than U.S. law. For further guidance on complying with this requirement, employees are encouraged to confer with Compliance.

7.8.5 Promotional/Educational Expenses

Reasonable promotional expenditures are permitted under the FCPA; however, they must not be designed to improperly influence a Foreign Official in a decision-making capacity. If KCD intends to cover any of the attendee's expenses at a promotional/educational event, and one or more attendees is a Foreign Official, approval by Compliance is required.

7.8.6 Facilitating Payments

The FCPA's general anti-bribery prohibition does not apply to small payments to facilitate and expedite performance of a "routine governmental activity" (*i.e.,* ministerial actions to which KCD is legally entitled), such as obtaining permits, licenses and official documents, processing governmental papers, or providing postal or utility services. "Routine governmental action" does not include any discretionary decision by a foreign official to award new business or to continue business with KCD.

In as much as the FCPA does not prohibit these types of facilitation payments to be made outside of the United States, local law may prohibit them. In such cases, local law will prevail. If such payments are permitted, they may be made only after written pre-approval has been obtained from Compliance.

7.8.7 No Cash Payments To Foreign Officials

Payments to a Foreign Official, third-party service provider, or anyone else pursuant to an available and approved exemption from the FCPA must not be made in cash. Checks may not be made payable to "cash," "bearer," or other designees of the party entitled to payment. Payments may not be made outside the country of residence of the recipient without prior consultation and approval of Compliance.

7.8.8 Political Contributions

Neither KCD nor any employee should make any political contribution on behalf of KCD to a foreign government, official, or political party or candidate in a foreign country without prior approval by Compliance. Private political contributions are not under any circumstances reimbursable by KCD.

7.8.9 Financial And Accounting Controls

If KCD is deemed an "issuer" under FCPA, the CFO is responsible for establishing appropriate accounting and financial policies, procedures and other internal controls to fulfill the accounting provisions of the FCPA.

7.8.10 Certifications

Some employees who deal with foreign entities, persons, and/or accounts may be required to submit annual certification regarding their knowledge of and compliance with KCD's FCPA policy. Compliance will maintain a list of affected employees and obtain certifications where required by KCD.

7.9 Solicitation Of Charitable Contributions

[FINRA Notice to Members 06-21]

When an employee or an agent of a customer such as a mutual fund, pension plan, or investment manager solicits a substantial charitable contribution from KCD or an RR, there may be a conflict of interest. There can be no quid pro quo between contributions and business conducted with KCD.

To avoid potential conflicts of interest, KCD has established the following guidelines for handling such requests.

1. Charitable giving by KCD is subject to review as needed.
2. Contributions cannot be based on the actual or anticipated level of business done by the customer.
3. These requirements do not apply to a retail customer who solicits a charitable contribution when acting in his or her individual capacity.

7.10 Media Contact Is Limited To Certain Authorized Employees

Responsibility	• Compliance Officer or designated Officer
Resources	• Requests to communicate with the media • Indications an unauthorized person has had media contact
Frequency	• As required
Action	• For requests, determine nature of contact and whether the individual is or should be authorized to engage in the contact • If necessary, notify the employee whether contact will be permitted and provide guidelines • For unauthorized contact, confer with the employee (and the employee's supervisor, if appropriate)
Record	• Maintain a list of authorized persons and limitations on their contact, if appropriate

KCD 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 KCD:

- CEO
- President
- Compliance Officer

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

7.11 Requests For Information From Outside Sources

Responsibility	• Designated Supervisor or Designee
Resources	• Written or oral requests for information • Subpoenas • Other
Frequency	• As required
Action	• Compliance: Provide response, as appropriate
Record	• Retain record of response in legal, regulatory, or other files

KCD 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, KCD activities, or an individual employee's activities.

Information regarding customer accounts, KCD 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.

7.12 Internal Reviews And Investigations

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

7.13 Internal Disciplinary Actions

KCD's goal in administering discipline is to take measures to maintain the quality of service provided to our customers by encouraging appropriate behavior. The expected result of these measures is the deterrence of inappropriate behavior and, when improper activity occurs, to take corrective action commensurate with the activity.

7.13.1 When Disciplinary Action Is Considered

Although it is impossible to list all circumstances in which discipline may be imposed, disciplinary action will be considered when there is:

- An admitted violation of company policy, regulatory rules or regulations, or federal/state laws.
- A determination of an actual or probable violation of company policy, regulatory rules or regulations, or federal/state laws.

7.13.2 Who Determines Disciplinary Action

Typically, the supervisory is the individual responsible for administering and deciding upon appropriate discipline methods. Compliance is to be notified in advance of all disciplinary actions in order to analyze such actions for regulatory reporting purposes and for adequate recordkeeping of disciplinary information. Compliance may also modify the terms of discipline outlined in the policy depending on the facts and circumstances of the situation.

7.13.3 Types Of Discipline

There is a range of possible disciplinary action; the level of discipline will be determined by Compliance. Compliance will collaborate with the individual's supervisor who will be copied on any communications to the individual regarding the disciplinary action. This list is not all inclusive.

Letter of Caution (LOC): An LOC is a memorandum that specifies a possible violation and/or serves as a warning of inappropriate behavior. The LOC outlines the expected behavior and the possible consequences of future violations similar in nature. The LOC requests the recipient's signature certifying his/her receipt of the memorandum and understanding of the matter. The LOC will be sent by mail or other such means (FedEx) that is trackable for receipt to the address of record. In the event the recipient does not respond the trackable receipt will be used in place of the recipient's signature as acknowledgement and understanding of the matter.

Admonishment: An Admonishment is a memorandum that formally reprimands an individual based on admitted or determined violations. The Admonishment specifies the admitted or determined violation and the expected behavior. It specifies the possible consequences of future violations similar in nature and may be administered with a ***Non-reportable*** or ***Reportable Fine*** (see below). The Admonishment requires the recipient's signature certifying his/her receipt of the memorandum and understanding of the matter.

Non-reportable Fine: A Non-reportable Fine is a monetary sanction that is less in amount than that which is required to be reported to a self-regulatory organization (SRO). Non-reportable fines will usually be attached to an ***Admonishment*** (see above) and/or ***Suspension of Employment***. In any event, the admitted or determined violation will be specified along with the expected behavior and possible consequences of future violations similar in nature.

Non-reportable fines will be withheld from a producing-employee's commissions. In the case of a non-producing employee, the fine will be collected in the form of personal or certified check or money order.

Reportable Fine: A Reportable Fine is a monetary sanction that is greater than or equal to the amount that is required to be reported to an SRO. Reportable fines will usually be attached to an ***Admonishment*** (see above) and/or ***Suspension of Employment***. In any event, the admitted or determined violation will be specified along with the expected behavior and possible considequences of future violations similar in nature.

Reportable fines will be withheld from a producing-employee's commissions. In the case of a non-producing employee, the fine will be collected in the form of personal or certified check or money order.

Suspension of Employment: An employee may be suspended for violations of applicable company policy, regulatory rules or regulations, or federal/state laws. Prior to Suspension of Employment, the employee will be informed of the violation, the expected behavior, and the terms of the suspension.

While under suspension, employees may not:

- Have direct or indirect contact with customers
- Act as a registered representative
- Represent oneself as a registered representative
- Give investment advice or counsel
- Receive compensation
- Transact business in any securities account (other than a personal account)
- Have contact with company employees except the employee's supervisor or Compliance
- Enter into any company premises

A Suspension of Employment memorandum will be delivered to the employee. This document will specify the admitted or determined violation and the expected behavior. It will also specify the possible consequences of future violations similar in nature. The Suspension of Employment memorandum may require the recipient's signature certifying his/her receipt of the memorandum and understanding of the matter. Suspensions will be reported by Compliance to the appropriate SRO(s).

Termination of Employment: Violations of company policy, regulatory rules or regulations, or federal/state laws may result in the termination of the employee or RR. The employee will be informed of the violation and termination of employment.

Special Supervison: The employee may be subject to Special Supervision as outlined in the chapter *EMPLOYMENT, REGISTRATION AND LICENSING*. The employee may also be subject to added education, re-testing for licensing, title downgrading, or other remedial actions deemed appropriate by Compliance.

Other Types of Discipline: Other types of discipline that the Firm may utilize are: letter of instruction, letter of reprimand, required training, or additional continuing education.

Termination will be reported by Compliance to the appropriate SRO(s).

7.13.4 Considerations In Determining Type Of Discipline

The nature of the inappropriate conduct is important in determining the type of discipline to be imposed. The more serious the conduct, the more severe the discipline. An employee's prior complaint and disciplinary history will be considered in determining the appropriate level of discipline. The activity's risk to KCD, injury to customers, and the employee's cooperation may all be factors (among others) in determining the discipline.

7.14 Employee Obligation To Notify The Firm And The Firm's Obligation To Report

[FINRA Rule 4530]

Responsibility	• Designated Supervisor
Resources	• Information provided by employees including information from Annual Employee Certifications • Lawsuits and arbitrations

	• Regulatory actions • Criminal actions • FINRA compliance reports
Frequency	• As required
Action	• Determine whether information or events are reportable including updating the RR's Form U4 or U5 • File information electronically with FINRA
Record	• Record of electronic filings • Records of updates to Form U4 or U5

Regulators require reporting of certain events and updating of Forms U4 and U5 when previously-filed information changes. **Employees are obligated to notify Compliance if there are changes to Form U4 responses and report other information required by rule or by KCD.**

The following is an excerpt from FINRA Rule 4530 that outlines events that require reporting:

1. the member or an associated person of the member:
    - has been found 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, self-regulatory organization or business or professional organization;
    - is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery;
    - is named as a defendant or respondent in any proceeding brought by a domestic or foreign regulatory body or self-regulatory organization alleging the violation of any provision of the Exchange Act, or of any other federal, state or foreign securities, insurance or commodities statute, or of any rule or regulation thereunder, or of any provision of the by-laws, rules or similar governing instruments of any securities, insurance or commodities domestic or foreign regulatory body or self-regulatory organization;
    - is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities, insurance or commodities industry domestic or foreign regulatory body or self-regulatory organization or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member of any such self-regulatory organization;
    - is indicted, or convicted of, or pleads guilty to, or pleads no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or a conspiracy to commit any of these offenses, or substantially equivalent activity in a domestic, military or foreign court;
    - is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, underwriter or insurance company that was suspended, expelled or had its registration denied or revoked by any domestic or foreign regulatory body, jurisdiction or organization or is associated in such a capacity with a bank, trust company or other financial institution that was convicted of or pleaded no contest to, any felony or misdemeanor in a domestic or foreign court;
    - is a defendant or respondent in any securities- or commodities-related civil litigation or arbitration, is a defendant or respondent in any financial-related insurance civil litigation or arbitration, or is the subject of any claim for damages by a customer, broker or dealer that relates to the provision of financial services or relates to a financial transaction, and such civil litigation, arbitration or claim for damages has been disposed of by judgment, award or settlement for an amount exceeding $15,000. However, when the member is the defendant or

respondent or is the subject of any claim for damages by a customer, broker or dealer, then the reporting to FINRA shall be required only when such judgment, award or settlement is for an amount exceeding $25,000; or
    - is, or is involved in the sale of any financial instrument, the provision of any investment advice or the financing of any such activities with any person who is, subject to a "statutory disqualification" as that term is defined in the Exchange Act. The report shall include the name of the person subject to the statutory disqualification and details concerning the disqualification; or
2. an associated person of the member is the subject of any disciplinary action taken by the member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of $2,500, the imposition of fines in excess of $2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual's activities on a temporary or permanent basis.

In addition, employees are required to promptly report any of the following to Compliance:

- A temporary or permanent injunction issued by any court and involving securities, commodities, insurance, or banking matters
- Any customer complaint (securities or commodities) including a written 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)
- A bankruptcy proceeding or unsatisfied liens or judgments

7.14.1 Reporting Requirements

KCD will report specified events involving the firm or an associated person to FINRA via the Regulatory Filings Application on the FINRA Firm Gateway no later than 30 calendar days after KCD knows of the event. This is in addition to any obligation to update an associated person's U4 or U5 or KCD's Form BD.

KCD will promptly report to FINRA (not later than 30 calendar days after KCD has concluded or reasonably should have concluded) that an associated person of KCD or KCD itself has violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any domestic or foreign regulatory body or self-regulatory organization. Conduct reported will be conduct that has a significant monetary result with respect to KCD, customers, or markets, or multiple instances of any violative conduct.

Relating to reported events, KCD will file with FINRA copies of the following. Events already reported on Form U4 with an affirmative request to satisfy Rule 4530 reporting requirements and FINRA findings and actions will not be reported separately.

1. any indictment, information or other criminal complaint or plea agreement for conduct reportable under paragraph (a)(1)(E) of this Rule;
2. any complaint in which a member is named as a defendant or respondent in any securities- or commodities-related private civil litigation, or is named as a defendant or respondent in any financial-related insurance private civil litigation;
3. any securities- or commodities-related arbitration claim, or financial-related insurance arbitration claim, filed against a member in any forum other than the FINRA Dispute Resolution forum;
4. any indictment, information or other criminal complaint, any plea agreement, or any private civil complaint or arbitration claim against a person associated with a member that is reportable under question 14 on Form U4, irrespective of any dollar thresholds Form U4 imposes for notification, unless, in the case of an arbitration claim, the claim has been filed in the FINRA Dispute Resolution forum.

7.15 Money Laundering

[FINRA Rule 3310; Bank Secrecy Act]

Money laundering is a serious crime potentially related to the funding of 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. This is an obligation of each employee of KCD.

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. It is important that KCD, as well as all employees, remain diligent and active participants in KCD's anti-money laundering (AML) program.

7.15.1 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, cashiers' checks, and other negotiable instruments.

KCD 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.

7.15.2 Penalties

Participation in a money laundering scheme or the knowing receipt of proceeds from criminal activities is a crime. KCD 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.

7.15.3 Preventing Money Laundering

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

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.*

7.15.3.1 Risk Indicators

[NASD Notice to Members 02-21; FINRA Small Firm AML Template]

The following are examples of risk indicators (red flags) that may suggest potential money laundering.

Customer accounts (opening, other activities related to establishing accounts)
The customer exhibits unusual concern regarding KCD's compliance with government reporting requirements and KCD'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 is reluctant to provide complete information about nature and purpose of business, prior banking relationships, anticipated account activity, officers and directors or business location.
The customer's background is questionable or differs from expectations based on business activities.
The information provided by the customer that identifies a legitimate source for funds is false, misleading, or substantially incorrect or refuses to provide information.
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 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 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 has no discernible reason for using the Firm's service.
Customer account transactions
The customer exhibits a lack of concern regarding risks, commissions, or other transaction costs.
The customer wishes to engage in transactions that lack business sense or apparent investment strategy or that are inconsistent with the customer's stated business strategy.
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. [FINRA Regulatory Notice 09-05]
The customer attempts to make frequent or large deposits of currency, insists on dealing only in cash equivalents, or asks for exemptions from KCD'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 business purpose or other reason, the customer has multiple accounts under a single name or

multiple names (including family members or corporate entities); there may be a large number of inter-account or third-party transfers.
The customer's account shows numerous currency or cashiers check transactions aggregating to significant sums.
The customer requests that a transaction be processed in such a manner to avoid KCD's normal documentation requirements.
The customer's account shows an unexplained high level of account activity with very low levels of securities transactions.
Transactions patterns show a sudden change inconsistent with normal activities.
The customer engages in prearranged or other non-competitive trading, including wash or cross trades of illiquid securities.
Two or more accounts trade an illiquid stock suddenly and simultaneously.
The customer has opened multiple accounts with the same beneficial owners or controlling parties for no apparent business reason.
Customer transactions include a pattern of receiving stock in physical form or the incoming transfer of shares, selling the position and wiring out proceeds.
Customer's trading patterns suggest that he or she may have inside information.
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.)
Large numbers of securities transactions across a number of jurisdictions.
Buying and selling securities with no purpose or in unusual circumstances (e.g., churning at customer's request).
Penny Stock Company Related Transactions
Company has no business, no revenues and no product.
Company has experienced frequent or continuous changes in its business structure.
Officers or insiders of the issuer are associated with multiple penny stock issuers.
Company undergoes frequent material changes in business strategy or its line of business.
Officers or insiders of the issuer have a history of securities violations.
Company has not made disclosures in SEC or other regulatory filings.
Company has been the subject of a prior trading suspension.
Customer avoidance of reporting and recordkeeping
Reluctant to provide information needed to file reports or fails to proceed with transaction.
Tries to persuade an employee not to file required reports or not to maintain required records.
"Structures" deposits, withdrawals or purchase of monetary instruments below a certain amount to avoid reporting or recordkeeping requirements.
Transactions involving insurance products
Cancels an insurance contract and directs funds to a third party.
Structures withdrawals of funds following deposits of insurance annuity checks signaling an effort to avoid BSA reporting requirements.

Rapidly withdraws funds shortly after a deposit of a large insurance check when the purpose of the fund withdrawal cannot be determined.
Cancels annuity products within the free look period which, although could be legitimate, may signal a method of laundering funds if accompanied with other suspicious indicia.
Opens and closes accounts with one insurance company then reopens a new account shortly thereafter with the same insurance company, each time with new ownership information.
Purchases an insurance product with no concern for investment objective or performance.
Purchases an insurance product with unknown or unverifiable sources of funds, such as cash, official checks or sequentially numbered money orders.
Customer wire and other transfers or deposits
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 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's account has inflows of funds or other assets well beyond the known income or resources of the customer.
Many small, incoming wire transfers or deposits made using checks and money orders almost immediately withdrawn or wired out in manner inconsistent with customer's business or history. May indicate a Ponzi scheme.
Physical certificate is titled differently than the account.
Physical certificate does not bear a restrictive legend, but based on history of the stock and/or volume of shares trading, it should have such a legend.
Customer's explanation of how he or she acquired the certificate does not make sense or changes.
Customer deposits the certificate with a request to journal the shares to multiple accounts, or to sell or otherwise transfer ownership of the shares.
Other indicators
Law enforcement subpoenas.
Payment by third-party check or money transfer without an apparent connection to the customer.
Payments to third-party without apparent connection to customer.
No concern regarding the cost of transactions or fees (*i.e.,* surrender fees, higher than necessary commissions, *etc.*).

7.15.4 Cash Deposits Not Accepted

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

7.15.5 Reports Of AML Non-Compliance And Other Potential Crimes

All employees are obligated to promptly report to the AML Compliance 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 officer of KCD. All reports are confidential and the employee will suffer no retaliation for making them.

What to report: Crimes or suspected crimes by individuals (whether associated with KCD, a customer, or prospective customer) are required to be reported. This includes suspicion that KCD is being used as a conduit for criminal activity such as money laundering or structuring transactions (discussed below) 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.

SAR reports: Broker-dealers are required to file Suspicious Activity Reports (SARs) for transactions that may be indicative of money laundering activity.

By law, KCD 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.

7.15.6 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.

7.15.7 Identity Theft

Identity thieves use someone's personal identifying information to open new accounts and misuse existing accounts. KCD has established an Identity Theft Prevention Program (ITPP) to help detect and prevent identity theft. Many elements of detecting or preventing identity theft are similar to anti-money laundering (AML) requirements that are included in these policies.

The ITPP is based on identifying "red flags" that indicate identity theft may have occurred. ***It is the responsibility of all employees to be alert and report to the AML Compliance Officer any new or existing customers who may be engaged in violations of anti-money laundering regulations or identity theft or who have reported identity theft.***

It is recommended that the RR install and update virus protection annually to protect their computers. The RR is responsible for any identity theft because their virus protection is out of date.

Please see our ITPP program for a list of potential identity theft red flags.

7.16 Cybersecurity

Cybersecurity is generally defined as maintaining the security of cyber systems. Cybercrimes are broadly defined as any illegal activity that involves a computer, another digital device, or a computer network. Cybercrime includes common cybersecurity threats like social engineering, software, vulnerability exploits, and network attacks. The U.S. financial system makes institutions attractive targets to criminals, including terrorists and state actors targeting websites, systems, and employees to steal customer and commercial credentials and proprietary information.

Employees should immediately report to Compliance any perceived cybersecurity threat. The chapter *CYBERSECURITY* in this manual addresses details of KCD's efforts to ensure the integrity of its systems.

7.17 Emergency Business Recovery Procedures

[FINRA Rule 4370]

KCD has a *Business Continuity Plan* that assigns responsibilities and outlines procedures in the event of a disaster or emergency which impacts KCD'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 KCD's business; 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 KCD's business to other brokerage firms or financial institutions until normal operations can be resumed.

KCD has established procedures for contacting employees in the event of an emergency. If KCD 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 KCD's Business Continuity Plan may be referred to Compliance.

7.18 Prohibited Activities

Responsibility	• Designated Supervisor or Designee
Resources	• Various (referral of items, direct identification, review of transactions, correspondence, *etc.* depending on the nature of the prohibited activity)
Frequency	• As required
Action	• Take corrective action which may include: ○ Conferring with the employee

	○ Referring the matter to Compliance ○ Issuing a written admonition ○ Restricting the activities of or transactions handled by the employee ○ Suspending the employee ○ Termination
Record	• 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: ○ Designated supervisors may record action taken in supervisory logs, Daytimers, memos to employees' files, *etc.* ○ Compliance may record action by memo to the employee's file

7.18.1 Private Communications Regarding Firm Business Are Prohibited

Communications relating to KCD's business MUST be communicated through Firm-provided or Firm-approved systems, devices, and channels. Important federal and SRO regulations require the retention of copies of ALL business communications, and failure to comply has resulted in multi-million dollar fines against firms and individuals. KCD has established procedures for retaining records of communications through its systems, devices, and channels.

This requirement is very important and taken very seriously by KCD and regulators. This means:

1. Personal phones or other personal devices may NOT be used for business communications.
2. Outside channels such as Facebook, Twitter, and others may NOT be used for communicating with customers, prospects, broker-dealers, or anyone else regarding Firm-related business matters.
3. Violation of these requirements may result in termination.

Questions regarding allowable communications should be referred to Compliance.

7.18.2 Use Of Firm Name

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

7.18.3 High Pressure Sales Tactics

KCD 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 doesn't act immediately, or falsely representing that there is a limited supply of a security at a particular price.

7.18.4 Providing Tax Advice Not Permitted

Employees may not give tax advice to customers or potential customers through KCD since KCD is not engaged in the business of providing tax advice. Employees that are pre-approved to engage in an Outside Business Activity which includes providing tax advice may engage in this activity provided that it is not done so through KCD.

Customers requiring specific tax guidance should be referred to their personal tax advisers.

7.18.5 Rebates Of Commission

[FINRA Rule 2040]

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

7.18.6 Sharing Commissions Or Fees With Non-Registered Persons

[FINRA Rule 2040]

With few exceptions, regulations generally prohibit the sharing of commissions or compensation with non-registered persons. Any payment, finder's fee, or sharing arrangement involving a non-registered person must be referred to Compliance for review.

7.18.7 Accepting Compensation From Others

RRs are prohibited from accepting direct or indirect compensation (finders' fees, commissions, *etc.*) for Firm-related business other than through Firm-approved products or programs or with the prior approval of Compliance.

7.18.8 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 immediate attention of the employee's designated supervisor.

7.18.9 Borrowing From And Lending To Customers

[FINRA Rule 3240; FINRA Notice to Members 04-14]

Registered employees are generally not permitted to borrow from or lend to their own customers. "RR" as used in this policy refers to **any** registered employee of KCD.

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

1. 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);
2. a financial institution in the business of providing credit, financing, or loans AND where the terms of the lending arrangement are those that would also be available to the general public doing business with those institutions;
3. another registered employee of KCD;
4. 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,
5. someone (or an entity) that has a business relationship outside the RR/customer relationship.

Any proposed loan with the RR's customer (other than a loan with a family member or financial institution in item numbers 1 and 2 above) requires the PRIOR review and approval by Compliance. RRs requesting exceptions must complete the RR/Customer Lending Arrangement Request form and submit it to Compliance prior to effecting the loan arrangement. Compliance will retain written approvals for at least 3 years after the date that the borrowing or lending arrangement has terminated or for at least 3 years after the RR has terminated employment with KCD.

7.18.10 Personal Funds Deposited In Customer Accounts

In general, employees are not permitted to deposit personal funds or securities in customers' accounts or deposit customers' personal funds or securities in employee accounts, except family accounts. The same prohibitions apply to withdrawals. Exceptions should be reviewed by Compliance.

7.18.11 Prohibition Against Guarantees

[FINRA Rule 2150]

KCD and its employees are prohibited from guaranteeing a customer against loss in any securities transaction. 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.

7.18.12 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 KCD.

7.18.13 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 by the customer on all documents. Original documents signed by customers may be scanned or faxed when submitting for approval.

7.18.14 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.

7.18.15 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 may not be misrepresented as a guarantor of a customer's account against losses from transactions.

7.18.16 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 *Gifts, Gratuities And Entertainment*.

7.18.17 Acting Without Registration

No employee may engage in activities that require registration (selling securities, soliciting accounts, trading, *etc.*) unless registered in the appropriate capacities. Acting without proper registration will result in the forfeiture of commissions and may result in additonal disciplinary action. Questions regarding the need for registration should be referred to Compliance.

7.19 Cybersecurity Policy

Cybersecurity is everyone's responsibility. Loss of data or systems can have a serious effect on the conduct of business and KCD and its employees. Some aspects of cybersecurity are included in the Electronic Communications Policy. This policy summarizes key issues to maintain cybersecurity.

1. Employees must protect passwords assigned to them and not share them with anyone not authorized to receive the information.
2. Employees may not access data, files, or systems where they are not authorized to have access.
3. Electronic devices used for Firm business must be authorized by KCD. Personal devices may not be used for Firm business unless specifically authorized.
4. All devices must include virus, spyware, and other intrusion protections required by KCD. All mobile personal devices must maintain a separate, secure, encrypted mobile device management application for all Firm activities including e-mail, calendar, and other activities.
5. Only software approved by KCD may be used for Firm business. Software must be updated promptly when updates are provided.
6. Devices must have a locking mechanism to prevent others from accessing data.
7. All access to Firm systems or transmission of data must be conducted through secure systems and networks.
8. Devices must be physically secured at all times to prevent the risk of theft or loss.
9. Your supervisor and Compliance must be notified immediately if devices with customer information are lost or stolen.
10. Do not open e-mails and particularly attachments from unknown sources and sources that appear to be genuine but ask for confidential information (potential phishing).
11. Software, services and applications that violate Firm policy will be removed.
12. Failure to comply may result in additional training, written notices, fines, suspension, or termination of employment.

7.20 Computer Records, Equipment And Software

Responsibility	• Designated Supervisor • Compliance - lost devices
Resources	• Records of employees with company-issued laptops or other devices

	• Disks and other computer records maintained by a terminating employee • Reports of lost devices
Frequency	• As required
Action	• Issue firm laptops or other mobile devices to employees and maintain a record of laptops • Provide employees with education and policy information about proper use of computer and other electronic equipment including appropriate security measures and accessing customer information • Instruct offices to secure equipment and information • Secure disks, computers, software, and other firm property when an employee terminates • Do not permit removal of firm equipment without approval • Take action regarding lost devices including remote deactivation, if available, and assessment of whether a breach of customer information has or may occur
Record	• Records of laptops or other devices and to whom they are provided • Records of lost devices and actions taken

KCD 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, diskettes, *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 KCD business is subject to the same guidelines and restrictions as KCD computers. Employees and independent RRs are required to install and maintain adequate anti-virus protection software on computers, whether the computer is personally owned or provided by KCD.

When an employee terminates, any disks or other storage medium that includes proprietary information, including customer information, are considered property of KCD and must be left with KCD. Employees are prohibited from copying such information unless provided written authorization by his/her supervisor prior to copying.

7.20.1 Laptop Computers And Other Mobile Devices

Employees who use laptops or other mobile devices for Firm business are responsible for the security of the device and the information contained on it. Serious security breaches can occur if a device containing or capable of accessing confidential information is lost or stolen.

Employees who use laptops for company business are required to comply with the following requirements:

- All laptops are to be password protected
- All laptops must be utilizing the most up-to-date version of Windows 10 PRO
- All laptops must be running Bitlocker Drive Encryption
    - Go to Control Panel
    - Click on Bitlocker Drive Encryption
    - Verify that it is turned on

7.20.2 Reporting Lost Devices

- The loss of a mobile device **must be immediately reported to Compliance**.

7.20.3 Identifying And Reporting Data Breaches

- All employees are required to immediately report an identified potential intrusion into a mobile device or into the Firm's systems.

7.20.4 Software

Software installed and used on electronic devices is limited to software approved by The Firm. KCD will install or provide authorized software for business use including anti-virus and anti-malware protection for Home Office devices.

Employees are strictly prohibited from installing software other than what is authorized by The Firm.

7.20.5 Prohibited Downloading

Employees are prohibited from:

- Downloading customer and other confidential firm information from KCD's mainframe or other central records, unless specifically authorized by Compliance or supervisor
- Using portable devices such as USB key drives, MP3 players, mobile phones, and other devices for downloading information
- Downloading programs from the Web to KCD computers unless specifically authorized by supervisor or Compliance.

7.21 Electronic Communications Policy

[FINRA Rule 3110(b)(4), 3110.07, 3110.08 and 3110.09]

This policy governs the use of electronic communications by employees including part-time employees and independent contractors. It applies during business hours and after-business hours. ***This is an important policy; employees will be required to certify annually that they are familiar with and will comply with the policy.***

1. Firm electronic systems or communications devices are for firm business purposes and business communications must conform to accepted business standards and regulatory requirements.

- Inappropriate communications (profanity, obscenity, threats, otherwise offensive content) are prohibited. Report threatening or harassing communications to Compliance.
- Communications must include current and valid information.
- Copyrighted material cannot be sent unless authorized; contact Compliance for assistance.
- Copyrighted software cannot be copied or transmitted to others unless authorized.
- References and/or links to web sites are a form of communications requiring Compliance approval prior to use.

- Communications that must be accompanied by a prospectus may not be sent electronically unless the prospectus is available as an electronic attachment or an electronic link is provided to access the prospectus.
- KCD and its employees are prohibited from sponsoring a social media site or using a communication device that includes technology which automatically erases or deletes content.
- Employees must not open e-mails from unknown sources or open attachments from unknown sources. "Phishing" occurs when an e-mail fraudulently represents itself as originating from a recognized sender; opening attachments may compromise the device receiving the e-mail and attachment and may infect computers throughout KCD.

2. Electronic business communications must be accessed and transmitted only through firm-sponsored systems.

- Regulators require retention of business communications and firm systems are designed to comply with retention requirements.
- Approved firm-sponsored systems include:
  - KCD issued e-mail
  - LinkedIn - only with KCD pre-approval
  - Business Websites - only with KCD pre-approval.
  - All NEW rep websites must be provided through Broadridge unless specifically approved by Compliance.
- The use of personal e-mail accounts for business communications is prohibited.
- Encryption of information may be required by KCD; employees may not independently encrypt communications on firm systems.
- Home computers or other personal devices and external systems may not be used for business purposes (unless specifically approved by Compliance).

3. Consider electronic communications as public communications; protect confidential information.

- Do not confuse phone conversations or face-to-face communications with electronic communications. Your electronic conversation is subject to review and retention and may be the subject of subpoena in a civil or regulatory action.
- Confidential communications must not be sent on portable devices in public places unless encrypted.
- Do not view confidential information where unauthorized persons may have access (elevators, other public places).
- Safeguard portable devices to avoid unauthorized access to firm business.
- Safeguard passwords.
- Close open pages and sign out when the device is not in use.

4. There are restrictions on unsolicited e-mails under the CAN-SPAM Act of 2003.

- Unsolicited "mass" commercial e-mails are prohibited.
- "Commercial" e-mail includes any electronic messages that send a commercial advertisement or promote a commercial product or service. It does not include e-mail where there is an existing business relationship.
- Recipients may "opt-out" of receiving future e-mails. Forward such requests to Compliance.
- "Address harvesting" or "dictionary attacks" may not be used to obtain e-mail addresses off the Internet.
- E-mails sent from firm systems will include required identification of KCD and disclosures or disclaimers.

5. Participation in social media sites, blogs, and other electronic forums or communication systems is permitted with certain requirements and restrictions.

- Participants must receive prior approval from the designated supervisor and complete required training.
- Approved participants will be required to certify, upon completion of training and annually thereafter, their understanding of and compliance with KCD's policies and procedures.
- Postings may require the prior approval of the designated supervisor depending on the type of participation.

- Media and systems used must be able to provide a permanent record of communications for retention by KCD.
- KCD will monitor and review such communications.

Refer to the section *Social Media, Blogs, Web Sites And Other Electronic Communication Systems* in the chapter *COMMUNICATIONS WITH THE PUBLIC* for KCD's policy on social media.

6. Electronic communications will be reviewed, monitored and audited by KCD.

- All electronic communications are subject to review and retention.
- Communications that require pre-use approval may not be transmitted prior to review by the designated supervisor. This includes:
  - Retail communications.
  - Communications that must be accompanied by a prospectus (Compliance approval required).
  - Advertising (Compliance approval required).

7. Use of the Internet related to KCD's business is subject to restrictions.

- Employees are prohibited from posting information to the Internet without prior firm approval.
- Accessing offensive sites is prohibited. KCD may block sites that are offensive or contrary to the conduct of business.

7.21.1 Failure To Comply

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

- Oral and/or written warning or notification
- Education/training
- Suspension of electronic communications privileges permanently or for a set period of time
- Regulatory discipline
- Suspension or termination of employment

7.21.2 Consent To Policy

Use of KCD's electronic communications systems represents the employee's consent to the terms outlined in this Policy, including consent for KCD to monitor and audit content and/or usage.

7.22 Advertising And Publishing Activities

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 KCD-issued research or other materials approved by KCD and intended for public distribution.

7.23 Employees Acting As Trustees, Executors, Or Other Fiduciary Capacities

Employees usually will not act in a fiduciary capacity (*e.g.,* trustee, executor) for a 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.

7.24 Use Of Titles

Employees may not use titles unrelated to their activities with KCD. The use of any other title requires the prior approval of Compliance. Examples of the types of titles not specifically related to KCD's activities include (but are not limited to) C.P.A., J.D., M.B.A., or Attorney at Law.

7.25 Annual Certification

Responsibility	• Designated Supervisor or Designee
Resources	• Annual certification form
Frequency	• Annual

Action	• Send forms to employees for completion
	• Review completed forms
	• Take appropriate action which may include:
	    ○ Inquiring regarding reported outside business activities
	    ○ Inquiring regarding reported outside securities accounts
	    ○ Conferring with the employee and/or employee's supervisor for any other reported information requiring follow up
	    ○ Filing updates to the employee's Form U4, if necessary

Record	• Annual certifications are retained in an annual file for employee certifications

KCD will, on an annual basis, ask employees to complete an Annual Certification form. The purpose of this form is to ensure KCD's records are current regarding items to be reported to KCD (outside business activities, outside accounts, *etc.*).

8 TRAINING AND EDUCATION

8.1 Annual Compliance Meeting

[FINRA Rule 3110(a)(7) and 3110.04]

Responsibility	• Designated Supervisor or Designee
Resources	• List of RRs and registered principals by branch, department, or for KCD
Frequency	• Annual
Action	• Determine appropriate subjects to include in meetings, depending on RRs and principals who are participants • Conduct compliance meetings or interviews with RRs and principals • If electronic media is used to conduct meetings, designate a local supervisor to complete an attendance record to ensure RRs and principals arrive on time and attend the entire meeting • If on-demand webcasts are used: ○ Users are assigned a unique user ID and password ○ Records of attendance are maintained electronically in "read-only" format ○ Each user will be advised he or she has the opportunity to e-mail or telephone questions to the presenter and receive answers in a timely manner ○ Each user will be advised of Q&As available on KCD's intranet and Q&As will be updated when questions are received ○ The number of minutes the webcast stays on is tracked ○ The webcast is configured as click-as-you-go ○ At the end of the webcast a pop-up box requires the user to attest that the entire webcast was viewed (or a separate attestation will be required) • Ensure all subject RRs and principals complete the required annual meeting or interview • For RRs and principals who do not complete the requirement, take corrective action which may include contact with the RR's or principal's supervisor; limitation on business activities until the requirement is completed; other corrective action determined as appropriate for the circumstances
Record	• A record of when and where meetings are conducted, subjects discussed, and who attended is retained by Compliance • A record of corrective action is retained in the RR's or principal's file

As required by FINRA rules, RRs and registered principals are required to attend an annual compliance meeting or interview.

KCD may employ the use of electronic media in conducting the annual compliance meeting. The use of this media will permit the attendees to interact with the presenters to ask and have questions answered in real-time or otherwise engage the presenters in dialogue.

8.2 Continuing Education

[FINRA Rule 1240; FINRA Regulatory Notice 21-41; FINRA CE web site: http://www.finra.org/industry/continuing-education; FINRA FAQs: https://www.finra.org/registration-exams-ce/continuing-education/ce-transformation-faq?utm_source=MM&utm_medium=email&utm_campaign=O%5FWeekly%5FUpdate%5F111721%5FFINAL]

Registered employees are subject to SRO continuing education requirements composed of two distinct elements. Registered employees are required to complete both elements by December 31 annually. Failure to complete CE requirements by December 31 will result in suspension of registration. 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 content is derived from rules and regulations as well as standards and practices widely accepted within the industry. This element is administered by FINRA through a web-based delivery system or a Firm-administered AML compliance program or other required training.

Firm Element: All registered employees are required to complete continuing education administered by KCD.

8.2.1 Two-Year Qualification Period And Partial Terminations

Effective January 1, 2023, the two-year qualification period will apply to all partial terminations, with the exception of a partial termination of a registration category that is a subset of a broader registration category for which an individual remains registered or otherwise qualified under the two-year qualification period.

8.2.2 Regulatory Element

Responsibility	• Designated Supervisor
Resources	• CRD Firm Queues and related reports • CRD notifications of inactive registrations
Frequency	• Ongoing: monitor requirements and completion of requirements • Annual: schedule FINRA-based or FIRM-based training
Action	• Develop a Firm-based AML compliance program or other required training, as applicable • Review CRD Firm queue reports • Request queue reports • Notify affected persons of requirements • Schedule web-based training • Review CRD notifications of inactive registrations • Notify designated supervisors of restricted persons • Review activity of restricted persons during restricted period 1. Impose disciplinary action if appropriate including cancellation of commissions, letters of admonition, other appropriate action
Record	• Records of programs and attendance • Queue reports, FINRA notices, and records of notifying employees are maintained in registration files

	• Reviews of restricted person activities and action taken

8.2.2.1 Who Is Subject To The Requirements

All registered persons are subject to the regulatory element.

8.2.2.2 When Requirements Must Be Completed

Individuals must complete their annual Regulatory Element by December 31 each year. Registered persons who fail to complete required CE by December 31 will have their registration status changed to "CE inactive" by FINRA and are prohibited from engaging in activities requiring registration until the required CE is successfully completed.

Regulatory Element Contact Person

[FINRA Rule 1250(a)(7)]

Compliance or a designated person responsible for registration will notify FINRA of the name and email address of the contact person to receive CRD notices. Changes will be reported within 30 days of the change. Annually, by the 17th business day following the end of the calendar year, the contact person information will be reviewed and updated, if necessary.

8.2.3 Firm Element

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

KCD 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

KCD's internal program may include videos, computer training, in-person presentations, and other methods of conveying training material including a combination of methods. KCD may not solely rely on teleconferences or other remote training methods.

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.

The designated supervisor will notify affected persons and their supervisors by phone and written memorandum when their registration becomes inactive and when the requirement is satisfied and inactive status is lifted. Accounting/Commissions also will be notified by memorandum. Copies of memos will be retained in the individual's registration file.

8.2.3.1 Who Is Subject To The Requirements

All registered persons are subject to the firm element. Firm element continuing education is required regardless of the length of registration or employment in the securities industry. KCD may consider other required training toward satisfying an individual's annual Firm Element.

Annual Needs Analysis

An annual needs analysis is prepared for covered persons.

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

- Feedback form regulators including recent audits and regulatory alerts will be evaluated.
- Customer complaints, arbitrations, and other litigation involving the firm will be evaluated
- New business lines or marketing strategies will be evaluated

Needs analysis will be completed by December 31 (or shortly thereafter) each year for the upcoming calendar year.

Evaluating The Firm Element Program

Participants are asked to provide feedback to evaluate the effectiveness of the firm element continuing education program. These evaluations are considered when designing the next year's continuing education program.

8.2.4 Maintaining Terminated Persons' Registration

[FINRA Rule 1240(c); FINRA Regulatory Notice 21-31]

Individuals who terminate their RR or principal registration categories may maintain their qualification(s) for five years following termination of terminated registration categories subject to the following conditions:

- The person was registered for at least one year immediately preceding termination of the registration category, and the person was not subject to a statutory disqualification and is not during the term of the Maintaining Qualifications Program (MQP).
- The person must satisfy CE requirements as outlined in FINRA Rule 1240(c).

8.3 Trainees

Responsibility	• Designated Supervisor or Designee
Resources	• New trainees • Internal or external training material • Rules and regulations
Frequency	• As required when new trainees are hired
Action	• Develop training program that addresses the business areas of trainees and includes key regulatory requirements such as anti-money laundering, insider trading, and other key issues
Record	• Record of training program content, who attended, dates attended

When KCD hires individuals to train to serve as registered representatives, those individuals will complete an orientation meeting. Trainees are not permitted to conduct business with public customers until all required registrations are effective and training is accomplished.

9 EMPLOYMENT, REGISTRATION AND LICENSING

9.1 Employment and Hiring Procedures

[FINRA Regulatory Notice 07-55]

This section outlines hiring requirements.

9.1.1 RR Interview Guidelines

[FINRA Notice to Members 07-06]

At the time an RR is being considered for hire, the following are areas the hiring manager should consider:

1. Discuss with the applicant the nature of the applicant's prior customers and the types of securities sold while associated with prior employers. If customers' investments include investment company products (mutual funds, variable annuities), determine whether KCD has dealer or servicing agreements in place and, if not and the RR is hired, plan for suitability reviews and notification to customers of investment options and costs of switching investments.
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. Ask the RR whether he or she signed an employment contract with the present employer and if so, obtain a copy from the RR.

9.1.2 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 U4 or a separate form. Information regarding complaints, regulatory actions, and other information determined by Compliance will be referred to the hiring manager for consideration in extending an offer of employment.

9.1.3 Qualification Of Supervisors

[FINRA Rule 3110(a)(6)]

Responsibility	• Hiring Supervisor - confirm qualifications • Compliance - determine registration requirements
Resources	• Individuals identified as potential supervisors • Background information on candidate including registration status

Frequency	• As required when a supervisory position is to be filled

Action	• Hiring supervisor:
	  ○ Evaluate candidate's qualifications including experience and knowledge
	  ○ Arrange for training, if necessary
	• Compliance:
	  ○ Confirm individual has required registration qualifications and, if not, arrange for the individual to complete the required exams
	  ○ Notify the hiring supervisor of added qualifications required and remind him/her the individual may not act as a supervisor until necessary registrations are obtained (unless a regulator allows for a grace period to act as a supervisor before registration is completed)
	  ○ Provide supervisory policies/procedures to the candidate if not already available to him/her

Record	• Hiring manager's consent to appoint the candidate to a supervisory position • Background and registration information in candidate's file • Record of training (if necessary) including a description of training and when completed • Record of providing supervisory policies/procedures

The manager who hires or appoints a supervisor is responsible for determining that the individual is qualified for the supervisory position. Individuals included in KCD's business plan filed with FINRA are required to have at least one year of direct experience or two years of related experience in the area to be supervised.

9.1.4 Multiple CCO Designations

[FINRA Rule 3130.02]

Responsibility	• Designated Supervisor or Designee
Resources	• Proposed multiple CCOs
Frequency	• As required
Action	• Confirm principal status of candidate • Document areas of responsibility and provide to each CCO and his/her supervisor • Confirm each CCO meets the requirements of Rule 3130 • Coordinate multiple annual compliance reports to the CEO
Record	• Records of qualification review • Documentation of areas of responsibility and provision to CCO and supervisor

If KCD designates multiple chief compliance officers (CCOs), it will meet the following requirements:

- CCOs will be designated on Schedule A of Form BD.
- Each designated CCO is a principal.
- Each CCO's areas of compliance responsibility are defined and documented with identification of primary responsibility in areas that overlap.
- Each CCO meets the requirements of Rule 3130 regarding the defined area of primary compliance responsibility.
- The designated CCOs have the responsibilities and expertise enabling them to consult with the CEO on the totality of subject matters included in certification requirements.

9.1.4.1 Background Investigation

[FINRA Rule 3110(e)]

Responsibility	• Designated Supervisor
Resources	• Employment application • Form U4 • Form U5 filed by prior employer • Public records • Outside background check services
Frequency	• When new employees are hired

Action	• Identify outside services, if any, to conduct background investigations
	    ○ Where an outside service is used, review capabilities and references
	• Obtain records for review
	• Within 30 calendar days of filing the initial or transfer Form U4, verify the accuracy and completeness of information:
	    ○ Contact prior employers for 3 years
	    ○ Obtain additional information from employee, if necessary, and verify
	    ○ Review notification from FINRA regarding public records information missing or contrary to filed U4
	    ○ Submit revised U4 within 30 days to reflect information received from FINRA public records search
	• Within 60 days of filing an application for a transferring RR, review the most recent U5 (including any amendments) and take follow up action, if necessary
	• Review CFTC Form 8-T if applicable
	• Conduct further investigation where reviews reveal patterns of negative information such as customer complaints, bankruptcies, liens, criminal activity, litigation, or other negative information
	• Where discrepancies or incomplete information are identified, contact the employee for further information and investigate further, if needed
	• Evaluate negative information and its impact on the employment of the individual, consulting with the employee's supervisor

Record	• Review of outside services to conduct background investigations • Review of public records • Form U5 and results of review • Form U4 with related reviews and results of reviews including public records • CFTC Form 8-T and results of review • Contact with prior employers for 3 years including contact person and date contacted • Reviews of discrepancies or missing information and action taken including

	consultation with employee and supervisor • Action taken, if any, after reviews conducted

Background investigations are conducted on all new employees. New employees must be accurate and complete in the information provided to KCD at time of hire. Failure to do so may result in termination.

Records to be provided by a new employee include:

- Driver's license or passport to verify identity
- Completed Form U4 (required for all registered persons)
- Prior firm's Form U5 filed on behalf of a registered person
- CFTC Form 8-T for registered persons previously employed with an FCM (Futures Commission Merchant) or IB (Introducing Broker)
- Other information requested by KCD

Reviews conducted will include:

- Contact with at least the last three years' employers
- Form U5 from prior employer
- Form U4 filed with KCD
- CFTC Form 8-T
- Review of public records by FINRA for information regarding criminal and bankruptcy records, civil litigation, judgements and liens
- Other reviews which may include a review of credit records

New employees will be required to reconcile discrepancies or missing information which may affect the employee's eligibility for hire. U4s will be updated within 30 days of notice from FINRA regarding public record discrepancies.

9.1.5 Fingerprints

[SEC Securities Exchange Act of 1934 Rule 17f-2; FINRA Rule 1010(d)]

Responsibility	• Designated Supervisor or Designee
Resources	• Notifications regarding registration and other applicants
Frequency	• As required
Action	• If necessary, identify third parties (local law enforcement officials, *etc.*) to take fingerprints and: ○ Notify the third parties of securities industry fingerprinting requirements including identification verification procedures ○ Provide applicants with a list of acceptable third-party vendors • Submit electronic filing to CRD • Obtain Fingerprint Attestation and fingerprints, compare signatures of applicant and note on Attestation • Submit fingerprints to CRD with barcode • If fingerprints are not received by the CRD within 30 days of filing Form U4, notify

	appropriate supervisor that activities requiring registration must cease
Record	• Registration files for employees include records of CRD filings and submission of fingerprints including Fingerprinting Attestation form

Compliance will obtain and submit fingerprints on all registered personnel for receipt by the CRD within 30 days of filing Form U4. Fingerprints for other personnel will be obtained and kept in employee file. If fingerprints are not received by the CRD within 30 days, the employee must cease engaging in activities that require registration. Compliance will notify the appropriate supervisor of deficiencies, and the supervisor is responsible for restricting the applicant's activities until fingerprints have been received by the CRD.

9.1.5.1 Policies And Procedures

At the time of hire, Compliance will provide the RR with a current copy of KCD's policies and procedures either in hard copy or by notifying the RR of the location of policies and procedures in electronic form. The RR will be asked to acknowledge, in writing or electronically, that the policies were received and that the RR is responsible for complying.

9.1.6 New Employee Questionnaire

New employees will be asked to complete KCD's New Employee Questionnaire. Any "Yes" answers will be referred to Compliance for review.

9.1.6.1 Recruitment Practices And Account Transfers

[FINRA FAQs: https://www.finra.org/rules-guidance/guidance/faqs/frequently-asked-questions-regarding-finra-rule-2273]

Responsibility	• Designated Supervisor
Resources	• Newly-hired RRs
Frequency	• As required
Action	• Instruct responsible persons to provide the required communication to former customers transferring to the Firm • Monitor accounts transferred within 3 months of the RR's hire to confirm communications are provided
Record	• New RRs including date of hire • Communications provided to former customers

When an RR is hired by the Firm, each former customer transferring to the Firm will be provided, in paper or electronic form, an educational communication prepared by FINRA. The requirement applies for 3 months following the date the RR begins employment with the Firm.

The communication will be provided when:

- The former customer of the RR is contacted by the Firm or through a representative to transfer assets; or
- A former customer, without individual contact, transfers assets to an account assigned, or to be assigned, to the RR.

Events that trigger the requirement include oral or written communications by the newly-hired RR:

- informing the former customer that he or she is now associated with the recruiting firm;
- suggesting that the former customer consider transferring his or her assets or account to the recruiting firm;
- informing the former customer that the recruiting firm may offer better or different products or services; or
- discussing with the former customer the fee or pricing structure of the recruiting firm.

Communication with a group of customers via a mass mailing, e-mail, or automated phone calls or voicemails also triggers the requirement to provide the disclosure to the customers.

The educational communication must be provided as follows:

- at the time of first individualized contact regarding transferring assets to the Firm.
  - If first contact is in writing, the disclosure must accompany the written communication.
  - If by electronic communication, a hyperlink to the disclosure may be included.
  - If oral, the RR must notify the customer that an educational communication that includes important considerations about transferring assets will be provided no later than 3 business days after the contact.
- If the customer seeks to transfer assets but there has been no individualized contact with the customer, the communication must be sent to the customer with the transfer approval documentation.

If the former customer states he or she will not transfer assets, the educational communication requirement does not apply. Should the former customer decide to transfer assets within 3 months of the RR's employment, the communication must be provided with the account transfer approval documentation.

9.1.6.1.1 Exceptions

"Former customer" includes any customer that had a securities account assigned to a registered person at the representative's previous firm. The term "former customer" does not include a customer account that meets the definition of an "institutional account" as defined in FINRA Rule 4512(c); accounts held by a natural person do not qualify for the institutional account exception.

The Rule does not apply to circumstances where a customer's account is proposed to be transferred to the Firm via a bulk transfer or due to a change of broker-dealer of record.

9.1.7 Termination Procedures

[FINRA Corporation By-Laws Article V Section 3; FINRA Rule 3110(f); FINRA Regulatory Notice 19-10]

Responsibility	• Designated Supervisor
Resources	• Notification from RR or supervisor of termination
Frequency	• As required
Action	• Immediately notify Compliance of terminating registered employees

	• Immediately notify Compliance of terminating non-registered employees where termination was caused by theft or fraud
	• Immediately notify Human Resources of terminating registered and non-registered employees
	• Secure computers and computer files
	• Retrieve office keys, company credit cards, *etc.* from terminated employee
	• Regarding customers of the departing RR:
	    ○ Promptly reassign accounts
	    ○ Promptly and clearly communicate to customers how accounts will continue to be serviced
	    ○ Provide timely and complete answers, if known, when customers ask questions about the RR including, when asked, the choice of the newly assigned RR or an alternative RR or the availability of transferring the account to another firm
	    ○ If the departing RR has consented and the customer asks, provide reasonable contact information (phone number, e-mail or mailing address)
	• Compliance will file Form U5 for terminating RRs
	• Compliance will provide the terminated RR with a copy of the RR's Form U5 within 30 days of termination

Record	• The CRD retains copies of Form U5

Notification To Compliance

Whenever an employee terminates employment from KCD, the designated supervisor is responsible for immediately notifying Compliance. Notification to Compliance regarding registered employees 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

Securing And Retrieving Firm Property

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

9.1.7.1 Responding To Customer Inquiries

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

If asked by a customer, the customer may be advised he/she may be serviced by the newly assigned RR or an alternative RR or may transfer the account to another firm. If the departing RR consents, reasonable contact information may be provided in response to inquiries (phone number, e-mail or mailing address).

Form U5

Compliance is responsible for filing Form U5 for any terminated registered employee. Compliance will also send, within 30 days of termination, a copy of Form U5 to the former employee.

9.2 Registration And Licensing

[FINRA Corporation By-Laws Article V; FINRA Rule 1200 series; FINRA Regulatory Notice 17-30; FINRA FAQs: https://www.finra.org/registration-exams-ce/qualification-exams/faq; FINRA Information Notice 3/15/23; NASDAQ General 9 Section 20]

Responsibility	• Designated Supervisor or Designee
Resources	• New hire notices • Change of status notices • Requests for registration • CRD Late Filing Fee Report
Frequency	• Quarterly - review CRD Late Filing Fee Report • As required for new hires and requests for registration • Periodically - confirm personnel are registered as required and those with "permissive registration" do not act outside the scope of their assigned functions
Action	• Identify employees who require registration by reviewing new hire or change of status records • Submit required filings to the CRD • Acknowledge electronic filings are on behalf of KCD and its employees • Request and schedule examinations • Ensure employees who require registrations obtain them • Amend U4s or U5s when there are reportable events • Review the CRD Late Filing Fee Report to identify late filings and to take corrective action • Affirm that employees are registered as required for their responsibilities • For those with "permissive registration:" ○ Assign persons with permissive qualification to a registered supervisor (representative or principal to supervise a representative; principal to supervise a principal); the assigned registered person is responsible for periodically contacting the person's direct supervisor to confirm the person is not acting outside his/her assigned responsibilities
Record	• Registration records including CRD notices, approvals, amendments, and other registration records are maintained in employee files ○ Where the registered person's signature is not required on U4 amendments, KCD may rely on the CRD for recordkeeping • The CRD Late Filing Fee Report is retained in a file with notes indicating why the form was filed late • Affirmation regarding appropriate registrations or activities

This section outlines the requirements for registration. All individuals engaged in activities (including selling or trading products such as stocks, bonds, options, insurance, *etc.*) or supervising such activities subject to registration requirements must complete the necessary registration and licensing prior to engaging in such activities (with the 120-day exception explained below). Employees may not conduct business with public customers or engage in other activities requiring registration until required registrations are effective.

Changes in registration requirements became effective October 1, 2018.

9.2.1 Persons Registered Prior To October 1, 2018

- Individuals registered prior to October 1, 2018 who maintain their registration on or after that date may continue conducting business requiring their registration status without further requirements.
- Individuals whose registration terminated between October 1, 2014, and September 30, 2018 are not required to take the Securities Industry Essentials (SIE) examination provided they re-register within four years from the date of their last registration.

9.2.2 Registered Representatives

Individuals registering as representatives after October 1, 2018 must satisfy the following requirements:

- Pass the SIE examination; and
- Pass a representative-level qualification examination (such as the Series 7 exam).

Accepting customer orders requires registration as a representative.

As of October 1, 2018, FINRA has eliminated the registration categories of Order Processing Assistant Representative, United Kingdom Securities Representative, Canada Securities Representative, Options Representative, Corporate Securities Representative, Government Securities Representative and Foreign Associate. These registrations may be maintained but will not be reinstated if registration is terminated.

9.2.3 Registered Principals

Firms are required to have at least two officers or partners who are registered as General Securities Principals; however, a firm limited in its activities may instead have two officers or partners who are registered in a principal category corresponding to the scope of the firm's activities.

Principals are required to pass the SIE, representative level, and principal-level qualification examinations.

Representatives who assume duties that require principal registration have 120 calendar days to pass the appropriate principal examination, provided that such person has at least 18 months of experience functioning as a registered representative within the five-year period immediately preceding the designation and has fulfilled all applicable prerequisite registration, fee and examination requirements prior to designation as a principal.

9.2.3.1 Financial And Operations Principal (FINOP) And Introducing Broker-Dealer Financial And Operations Principal

Every firm is required to designate a FINOP (which includes a FINOP for an introducing BD) unless exempt from the requirement. The FINOP is responsible for the BD's financial reports including approval and preparation; compliance with financial responsibility rules; supervision of those preparing reports, maintaining books and records, and engaged in back office operations; and any other matter involving the financial and operational management of the member.

9.2.3.2 Principal Financial Officer And Principal Operations Officer

KCD will appoint a Principal Financial Officer and Principal Operations Officer subject to the following:

- The Principal Financial Officer is responsible for financial filings and related books and records.
- The Principal Operations Officer has primary responsibility for the day-to-day operations of the business, including overseeing the receipt and delivery of securities and funds, safeguarding customer and firm assets, calculation and collection of margin from customers and processing dividend receivables and payables and reorganization redemptions and those books and records related to such activities.
- Both must qualify through registration as a Financial and Operations Principal or Introducing Broker Financial and Operations Principal as well as an Operations Professional. No exam is required for these principals to qualify as an Operations Professional. The FINOP exam does not apply to BDs exempt from the FINOP requirement.
- Introducing vs. clearing firms:
  - If the firm neither self-clears nor clears for others, the same person may act in both roles as well as Financial and Operations Principal or introducing Broker-Dealer Financial and Operations Principal.
  - Firms that are clearing and self-clearing must designate separate persons to function as Principal Financial Officer and Principal Operations Officer, though such individuals may also carry out the responsibilities of a Financial and Operations Principal.
  - A clearing or self-clearing firm that is limited in size and resources may request a waiver of the requirement to designate separate persons to function as Principal Financial Officer and Principal Operations Officer.
- Firms may appoint multiple Principal Operations Officers (but not Principal Financial Officers), provided that the firm precisely defines and documents the areas of primary responsibility and makes specific provision for which of the officers has primary responsibility in areas that can reasonably be expected to overlap.
- A Principal Financial Officer or a Principal Operations Officer is permitted to delegate his or her day-to-day duties to other principals at the firm with the understanding that ultimate responsibility for the function rests with the Principal Financial Officer and the Principal Operations Officer.

9.2.3.3 Compliance Officer

KCD will designate a Compliance Officer (unless it is engaged in limited investment banking or securities business). An individual designated as Chief Compliance Officer on Schedule A of Form BD may register in a principal category that corresponds to the limited scope of business. Individuals who have the prerequisite qualifications prior to October 1, 2018 may be designated as Compliance Officer without taking further examinations. Those qualifying on or after October 1 must qualify as a General Securities Representative including the SIE; General Securities Principal (Series 24); and Compliance Official (Series 14).

9.2.3.4 BDs Exempt From FINOP Requirement

BDs exempt under FINRA Rule 1220(a)(4) are not required to designate a FINOP. In addition, they may name the same person as Principal Financial Officer and Principal Operations Officer.

9.2.4 Expiration Of Registrations

When a registration is terminated, there are grace periods for re-registering before an individual must re-take examinations. These periods are:

- SIE registration: four years
- Representative or principal: two years

9.2.5 Persons Exempt From Registration

[FINRA Rule 1230]

The following persons are not required to be registered with FINRA:

- persons whose functions are solely and exclusively clerical or ministerial; and
- persons whose functions are related solely and exclusively to:
    - effecting transactions on the floor of a national securities exchange and who are appropriately registered with such exchange;
    - transactions in municipal securities;
    - transactions in commodities; or
    - transactions in security futures provided that any such person is registered with a registered futures association.

9.2.6 FSAWP Waivers

[FINRA Rule 9600]

Individuals who go to work for a foreign or domestic financial services industry affiliate of KCD and have previously received the Financial Services Affiliate Waiver Program (FSAWP) waiver have the option of continuing in the FSAWP. This waiver program is not available to new applicants. Participants are subject to annual Regulatory Element Continuing Education.

9.2.7 Other Registrations

- KCD may permit any employee to become registered as a representative or a principal, including individuals working in a clerical or ministerial capacity ("permissive qualification"). If not required for the person's responsibilities, approval by the supervisor and Compliance is required. These individuals are subject to regulatory conduct rules such as outside business activities, private securities transactions, *etc.* All registered persons, including those who solely maintain a permissive qualification, are required to satisfy the annual Regulatory Element of continuing education. Permissively qualified persons will be assigned to a registered supervisor who is responsible for confirming that individual does not act outside the scope of his/her responsibilities or registration status.
- Anyone (whether employed by a member firm or not) may ask to take the SIE exam. That person cannot be registered with FINRA unless employed by a member firm and has completed an RR qualification examination.

9.2.8 Qualified Persons Serving In The Armed Forces

[FINRA Rule 1210.10]

FINRA provides exceptions for qualified persons who volunteer for or are called into active U.S. military service. The supplementary material should be consulted for details of the requirements.

9.2.9 CRD Electronic Filings

[FINRA Rule 1010]

KCD has designated one or more employees with authority over registration functions, as named in KCD's *Designation Of Supervisors* chart. Any supervisor of electronic filings is a registered principal or a corporate officer and is responsible for review and approval of electronic filings and acknowledging electronically that the forms are filed on behalf of KCD and its associated persons.

KCD has appointed a Super Account Administrator (SAA). Annually the SAA will review KCD's user accounts to determine that: 1) each user has a continuing need to access FINRA applications; 2) each user is entitled only to the applications and privileges needed to perform job responsibilities; and 3) only users who require access to sensitive data are entitled to access this type of data.

9.2.10 Dual Registration

RRs may be registered with another broker-dealer resulting in dual registration. For those with dual registration, the following procedures will apply:

- Dual registration must be approved by Compliance.

9.2.11 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. Failure to do so will resilt in forteiture of any commissions earned and may result in additional discipline.

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

9.2.12 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. Most states require successful completion of the Series 63 Uniform State Agent Securities Law Examination. Successful completion of the exam does not automatically confer registered status on the examinee. Application must be made to the CRD to obtain each state registration.

The designated supervisor is responsible for identifying transactions in states where registration may be required.

9.2.13 Parking Registrations

[FINRA Rule 1210.11]

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

9.2.14 Form U4

[FINRA Rule 1010 and 2263]

All applicants for registration are required to complete Form U4. It is the RR's responsibility to include accurate information and promptly notify KCD of any updates that may require amendment to Form U4.

At the time a new or amended U4 is signed, the applicant will be provided the *Form U4 Disclosure To Associated Persons,* which discloses information about the predispute arbitration clause included in Form U4.

9.2.15 Amendments To Form U4 Or Form U5

KCD will submit amendments to Form U4 when an RR advises of updates that require amendment. Compliance is responsible for determining whether reportable events or other matters require the filing of an amendment to an RR's Form U4. Compliance is also responsible for identifying disciplinary or complaint matters to be reported on Form U5 termination notices including amendments required after termination. Required reportable events include the receipt of an SEC Wells notice.

9.2.16 Assignment Of RR Numbers

RR numbers are assigned by Compliance. New numbers will not be assigned to individuals who are not yet registered with KCD. 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.

9.2.17 Maintaining Terminated Persons' Registration

[FINRA Rule 1240(c); FINRA Regulatory Notice 21-31]

Individuals who terminate their RR or principal registration categories may maintain their qualification(s) for five years without having to requalify by examination following termination of registration categories. Rule 1240(c) should be consulted for conditions which are summarized below:

- The person was registered for at least one year immediately preceding termination of the registration category, and the person was not subject to a statutory disqualification and is not during the term of the Maintaining Qualifications Program (MQP);
- Participation must be commenced at the time of Form U5 submission or at a later date within 2 years from termination of registration; and
- All CE is completed annually by December 31 during participation in the program.

9.3 Statutorily Disqualified Persons

[FINRA Rule 9285; FINRA Regulatory Notice 21-09 and 09-19; SEC Securities Exchange Act of 1934 Rule 19h-1 and Section 3(a)(39); FINRA By-Laws Article III Section 3 and Section 4; FINRA FAQs for MCDC firms: https://www.finra.org/rules-guidance/guidance/faqs/faq-eligibility-proceedings-firms-participating-mcdc-initiative]

Responsibility	• Designated Supervisor

Resources	• N/A
Frequency	• As required
Action	• Compliance will: ○ Complete the required regulatory forms ○ Establish an interim plan of heightened supervision that would be in effect throughout the application review process ○ Establish procedures for conducting heightened supervision: ▪ during the pendency of an appeal from, or NAC review of, a disciplinary decision ▪ including specific supervisory policies or procedures to address violations ▪ considering the conditions or restrictions imposed by the Hearing Officer or Review Subcommittee, and ▪ designate the responsible principal, who must sign the heightened procedures and carry out supervision • The designated supervisor will: ○ Sign a copy of the heightened supervision plan ○ Conduct required supervision ○ Provide Compliance with certifications of supervision, if required
Record	• Regulatory applications/forms and related documents are retained in the RR's file in Compliance • Copy of the heightened supervision plan and records of supervision • Certification of supervision, if required

9.3.1 Introduction

Individuals may become subject to statutory disqualifications as a result of a felony conviction or regulatory suspension, revocation of registrations or injunctions (including actions by domestic regulators including the CFTC and actions by foreign regulators). The definition of statutory disqualification is included in Section 3(a)(39) of the Securities Exchange Act of 1934. FINRA Regulatory Notice 09-19 includes a chart, in Attachment B, that outlines statutory disqualifications under the Rule.

9.3.2 Hiring Or Retaining Employment Of A Statutorily Disqualified Person

All prospective employees (including those engaged solely in clerical and/or ministerial activities) are subject to background investigations that include identification of potential statutory disqualification. Prior to hiring an individual subject to a statutory disqualification, Compliance should be consulted to review the nature of the statutory disqualification and potential heightened supervision that may be required. When an existing employee becomes subject to a statutory disqualification, KCD is required to submit an application to continue associating with a disqualified person and establish an interim plan of heightened supervision in effect throughout the application review process.

9.3.3 Regulatory Filings

[FINRA Rule 4517]

Compliance is responsible for completion and filing of the appropriate regulatory form or application, which will be signed by a senior officer or partner of KCD. A hearing may be required prior to approval of a new employee or existing employee's continued association with KCD.

9.3.4 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 which must be signed by the supervisor who is then responsible for carrying them out.

9.3.5 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 quarterly complaint report will be made to regulators consistent with those SRO's reporting requirements.

9.4 Retiring Representatives

[FINRA Rule 2040(b)]

Responsibility	• Designated Supervisor
Resources	• Requests from retirees to continue commissions
Frequency	• As required
Action	• Obtain signed continuing commissions agreement from retiree • Notify designated supervisor and Accounting of agreement
Record	• Signed agreement retained in retiring employee's file

RRs who retire may be eligible to participate in the Firm's continuing commissions policy program. This program provides for the transfer of accounts from the retiring RR to another RR and gives the retiring RR the opportunity to provide support to the receiving RR as well as deal with customer transition issues. Retirees under the program sign a continuing commissions agreement whereby the retiring RR is prohibited from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments. Requests to receive continuing commissions should be referred to Compliance.

The retiring RR continues to be subject to all the rules and regulations governing RRs and is subject to ongoing supervision by the RR's designated supervisor.

"Retiring registered representative" is an individual who retires from the Firm (including as a result of a total disability) and leaves the securities industry. In the case of death of the retiring registered representative, the retiring registered representative's beneficiary designated in the written contract or the retiring registered representative's estate if no beneficiary is so designated may be the beneficiary of the Firm's agreement with the deceased representative.

9.5 Broker-Dealer Registration

9.5.1 Form BD

Responsibility	• Designated Supervisor or Designee
Resources	• Information regarding reportable items including civil and regulatory actions • Records regarding officers and directors to be included on Form BD • Other information as required by Form BD
Frequency	• As required - updates • Quarterly - review for potential updates
Action	• Prepare updates as required; consult with in-house or outside counsel, as required • File Form BD updates • At least quarterly review Form BD for potential updates
Record	• File of BD amendments

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

9.5.2 Member Application And Associated Person Registration (MAP Rules)

[FINRA Rule 1000 series; FINRA Regulatory Notice 21-09; FINRA web site re mergers, acquisitions, and business transfers: http://www.finra.org/industry/checklist-organizational-change-important-steps-related-merger-acquisition-or-succession; NASDAQ General 3]

When KCD anticipates a material change in its business, Compliance will file requests for approval by the appropriate SROs.

9.5.2.1 Events Requiring Approval

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. In addition, material changes include removing or modifying a membership agreement restriction; market making for the first time; adding business activities that require a higher level of minimum net capital; and engaging in activities beyond proprietary trading as defined in NASDAQ rules.

Certain types of expansions are presumed to not be a "material change in business operations" and do not require FINRA approval. However, this safe harbor is not available to firms that, among other things, have a "disciplinary history" as defined in IM-1011-1 or that seek to add a natural person who has, in the prior five years, one or more final criminal matters or two or more specified risk events and seeks to become an owner, control person, principal, or registered person of KCD. The interpretation must be consulted to determine what changes are not material and what constitutes disciplinary history precluding use of the safe harbor.

If KCD operates under a Restriction Letter, it will conduct business consistent with the Letter and Compliance will contact FINRA if a change is necessary.

9.5.2.2 Employment (New Or Continuing) Of A Natural Person Subject To Criminal Matters Or Risk Events

[FINRA Regulatory Notice 21-09]

KCD must file a Continuing Membership Application (CMA) when a person who, during the past five years, becomes subject to one or more "final criminal matters" or two or more "specified risk events" and seeks to become an owner, control person, principal or registered person of KCD. As an alternative, KCD may submit a written request to FINRA for a materiality consultation for the contemplated activity. This does not apply to an existing RR or principal of KCD who seeks to add an additional RR- or Principal-level registration, respectively.

9.5.3 Regulatory Contact Information

KCD is obligated to maintain current contact information with regulators.

9.5.3.1 FINRA and NASDAQ Contact Information

[FINRA Rule 4517; FINRA Contact System web page:http://www.finra.org/Industry/Compliance/RegulatoryFilings/FCS/]

Updates to contact information will be made within 30 days following any change. In addition, by the 17th business day after the end of each calendar year, KCD is required to verify contact information through the FINRA Contact System.

Compliance will update the following information through FINRA's Contact System when necessary and will conduct the mandatory annual verification:

- Executive Representative [FINRA By-Laws Article IV, Section 3, FINRA Rule 4517; NASDAQ Rule 1150]
- Regulatory Element Continuing Education Contact Person [FINRA Rule 1250]
- Emergency contact persons [FINRA Rule 4370]
- AML contact person(s) [FINRA Rule 3310.02]
- Other contacts mandated by FINRA rules

Contact information will be provided promptly to FINRA upon request, but no later than 15 days after the request.

9.5.4 FINRA Entitlement Program

[FINRA FAQs: http://www.finra.org/industry/saa-faq]

FINRA's Entitlement Program provides authorized Firm personnel with access to FINRA Web Applications. KCD has designated a Super Account Administrator (SAA) who is responsible for creating, editing, or deleting accounts for Account Administrators and users at KCD. The designating criteria for the SAA are as follows:

- Must be formally delegated the authority by KCD and as authorized in the New Organization Super Account Administrator (SAA) Form (or Update/Replace Super Account Administrator (SAA) Form) to perform the SAA responsibilities on its behalf.
- The designation must be executed on the current version of FINRA's New Organization SAA Form (or Update/Replace SAA Form), as instructed, and be executed by an Authorized Signatory, as defined by

FINRA. An SAA may serve in this role for multiple organizations (affiliated or non-affiliated); however, a separate user name and password is required for each organization. The individual does not need to have an existing FINRA Entitlement Account.

The SAA is responsible for the following:

- Designate Account Administrators and users
- Update authorized persons as required
- Certify annually to FINRA
- Retain information about authorized users, updates, and certifications

9.5.5 Regulatory Filings

[FINRA Rule 4517]

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

9.5.6 Restricted Firms

[FINRA Rule 4111; FINRA Regulatory Notice 21-34; FINRA mapping of disclosure categories: https://www.finra.org/compliance-tools/mapping-disclosure-categories-finra-rule-4111; FINRA FAQs on Rule 4111: https://www.finra.org/rules-guidance/key-topics/protecting-investors-from-misconduct/faq?utm_source=MM&utm_medium=email&utm_campaign=O%5FWeekly%5FUpdate%5F041322%5FFINAL]

Responsibility	• Designated Supervisor
Resources	• Firm and RR regulatory history • FINRA notifications
Frequency	• As required

Action	• When notified by FINRA of Restricted Firm status:
	  ○ Confer with FINRA about designation and requirements
	  ○ Establish a Deposit Account with required funds or securities
	  ○ Comply with FINRA requirements per FINRA's annual Preliminary Identification Metrics

Record	• FINRA notifications • Deposit Account records • Books and records signifying compliance with Restricted Firm compliance

FINRA has identified KCD as a potential or actual Restricted Firm. Rule 4111 provides for the following:

- Engagement in a consultation between KCD and FINRA regarding why the designation should not be made.
- Potential firm reduction of staff to avoid the designation and related obligations.
- Requirement to create an account to deposit cash or qualified securities in a segregated, restricted account.
- Limitations on business or imposition of specific requirements.
- Failure to comply resulting in partial or full closure of business.

9.6 Special Supervision

[FINRA Regulatory Notice 18-15]

Responsibility	• Designated Supervisor or Designee
Resources	• Form U4 information • CRD • Customer complaints • Regulatory actions • Other activity that may warrant special supervision, at the discretion of Compliance
Frequency	• As required
Action	• Compliance: ○ Identify employees subject to special supervision ○ Determine the scope of special supervision ○ Notify the employee's supervisor of required supervision ○ Collect certifications from supervisor • Designated supervisor: ○ Conduct required special supervision ○ Prepare and send certifications to Compliance
Record	• Reviews of employees for potential special supervision are retained in a "Special Supervision" file in Compliance • Memos and certifications pertaining to a specific employee are retained in Compliance's file for the employee

9.6.1 Introduction

KCD Financial will institute heightened supervision for RRs or other employees when appropriate. The following sections describe KCD's procedures for identifying those subject to heightened supervision and the types of supervision that may be conducted. Reference to "employees" also includes independent contractors affiliated with KCD.

9.6.2 Identifying Employees For Heightened Supervision

It is the responsibility of Compliance to identify employees for potential heightened supervision. Employees will be identified at the time of hire or when an employee 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 heightened supervision.

9.6.3 Criteria For Identifying Candidates For Heightened Supervision

The following are criteria that will trigger a review by Compliance to determine whether an employee should be subject to heightened supervision. Pending as well as resolved matters will be considered. The criteria are subjective and the details of complaints and/or regulatory actions must be considered in determining whether heightened 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
- Employment with three or more broker-dealers in the past five years
- Direct or indirect outside business activities associated with microcap and OTC companies (see the section *Low-Priced And Microcap Securities* in the chapter *ORDERS*)
- Traders involved in trading microcap and low-priced OTC securities (determined by Trading Supervisor)

9.6.4 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 KCD'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 and the RR's supervisor outlining the terms of the special supervision. The RR and the supervisor will sign and return copies of the memorandum to Compliance.

9.6.5 Scope Of Potential Special Supervision

Special supervision will be established after considering the specifics that apply to the 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 (option, futures, *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 designated supervisor
- 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

9.6.6 Certification By RR's Supervisor

During the term of special supervision, the RR's supervisor will certify to Compliance, in writing, that the special supervision has been conducted. The form and frequency of certification will be determined by Compliance and will be explained in the Special Supervision Memorandum provided to the supervisor.

9.7 Considerations For Newly-Hired RRs

[FINRA Regulatory Notice 07-36; FINRA Notice to Members 07-06]

There are considerations when a newly-hired RR transfers customers who hold variable company products (mutual funds, variable annuities). If KCD cannot or will not service the customer's existing investment (inability to transfer products, KCD does not have a dealer or servicing agreement), the appropriateness and suitability of recommending a new investment company product must be determined by the RR and KCD. Before liquidating existing investments and reinvestment in new products, disclosure must be made to the customer regarding the costs and benefits of any proposed change in investments and proposed replacement investments must be suitable. A change of employment is not by itself a suitable basis for recommending a switch from one product to another.

10 INDEPENDENT CONTRACTORS

[FINRA Notice to Members 01-80, 99-45, 98-38 and 86-65]

Responsibility	• Designated Supervisor or Designee
Resources	• Order records or transaction reports for review of sales activities
Frequency	• At time of hire - obtain contracts • Daily - supervise sales activities
Action	• Obtain necessary IC contract • Review daily transactions and take corrective action where necessary
Record	• IC contracts retained in files by IC • Initials and date of review on order records or transaction reports reviewed

10.1 Independent Contractor Defined

Certain individuals are associated with KCD as "independent contractors" as defined under current IRS guidelines. Independent contractors are not "employees" of KCD for purposes of compensation and other considerations under IRS guidelines.

10.2 Supervision

Independent contractors are subject to the supervision of KCD and are responsible for complying with KCD's policies and procedures and the rules and regulations governing the activities of KCD and its associated persons.

10.3 Agreements

RRs who are independent contractors (ICs) will, at the time of association with KCD, sign KCD's agreement outlining the conditions under which the IC provides services to KCD. No commission or other payments will be made to the IC until a signed agreement is on file. The designated supervisor is responsible for ensuring signed agreements are submitted to KCD prior to any payments to the IC.

10.4 Use And Display Of The Firm's Name

KCD's name may be used only in conjunction with the products or services provided by KCD. KCD's letterhead may be used only for correspondence related to KCD's business.

KCD's name may be displayed only in authorized locations and in a manner approved by KCD.

10.5 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.

10.6 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 names or entities must be approved by KCD prior to use. Requests for approval are 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.

10.7 ICs As Investment Advisers

[FINRA Notice to Members 96-33, 94-44 and 91-32]

ICs or their business entities may be independently registered as investment advisers, however, the investment adviser activities are subject to the supervision of KCD. Independent registration as an investment adviser also requires the approval of KCD 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

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, the IC is required to provide copies of the following information to the designated supervisor on an ongoing basis:

- all investment adviser agreements with adviser customers, within 10 days of receipt by the adviser
- correspondence regarding investment adviser activities
- reports to adviser customers

In addition, the IC will maintain copies of all trading activity (confirmations and statements) in investment adviser accounts for review by KCD when the IC's activities are inspected by KCD.

10.8 Outside Business Activities And Outside Accounts

[FINRA Rule 3210 and 3270; NYSE Rule 407]

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 chapter *GENERAL EMPLOYEE POLICIES* includes the policies in these and other areas affecting all individuals associated with KCD.

11 COMMUNICATIONS WITH THE PUBLIC

[FINRA Rule 2200 Series, 3110(b)(4), 3110.06, 3110.07, 3110.08 and 3110.09; FINRA Regulatory Notice 19-31; FINRA Rule 2210 Q & A: https://www.finra.org/industry/finra-rule-2210-questions-and-answers]

11.1 Introduction

[FINRA Rule 2200 Series; FINRA Regulatory Notice 12-29]

This chapter explains regulatory and policy requirements when dealing with the public through a wide range of media including electronic media. "Communications" consist of correspondence, retail communications and institutional communications.

In general,

- All communications must be truthful and balanced.
- Communications (incoming and outgoing) are subject to review by KCD. Do not expect confidentiality for any communications that are received by you or that you send from KCD.
- The Firm's facilities and systems (email, fax, *etc.*) should be used for business purposes only.
- Records of communications (incoming and outgoing) are retained by KCD and are subject to review by regulators and subpoena in civil actions.

11.2 Definitions

[FINRA Rule 2210(a)]

There are three broad categories of communications as defined by rule. ***"Written communications" include electronic communications.***

Retail communication: includes **any** written communication (including advertising, telemarketing and other sales scripts and other written communications) that is published, distributed or made available to **more than** 25 retail investors within any 30 calendar-day period. *Requires pre-use approval except that the following do not require pre-use approval and may be supervised like correspondence:*

- *Communications excepted from the definition of "research report"* ***unless*** *the communication makes any financial or investment recommendation;*
- *Any retail communication that is posted on an online interactive electronic forum; and*
- *Any retail communication that does not make any financial or investment recommendation or otherwise promote a product or service of KCD.*

Institutional communication: includes written communications that are distributed or made available only to institutional investors. *(Does not require pre-use approval, reviewed consistent with correspondence requirements.)*

Correspondence: Includes any written communication that is distributed or made available to 25 **or fewer** retail investors within any 30 calendar-day period. *(Does not require pre-use approval unless indicated otherwise for specific products or services.)*

Additional definitions include:

Retail investor: includes any person other than an institutional investor, regardless of whether the person has an account with KCD.

Institutional investor: includes a:

1. government entity or subdivision thereof;
2. employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans;
3. qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans;
4. FINRA member firm or registered person of such a member; and
5. person acting solely on behalf of any such institutional investor.

Institutional investor also includes [per FINRA Rule 4512(c)] an account for:

1. a bank, savings and loan association, insurance company or registered investment company;
2. an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or
3. any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

11.3 Business Communications Limited To Firm Systems, Devices And Channels

Communications relating to KCD's business MUST be communicated through Firm-provided or Firm-approved systems, devices, and channels. Important federal and SRO regulations require the retention of copies of ALL business communications, and failure to comply has resulted in multi-million dollar fines against firms and individuals. KCD has established procedures for retaining records of communications through its systems, devices, and channels.

This requirement is very important and taken very seriously by KCD and regulators. This means:

1. Personal phones may NOT be used for business communications.
2. Outside channels such as Facebook, Twitter, and others may NOT be used for communicating with customers, prospects, broker-dealers, or anyone else regarding Firm-related business matters.
3. Violation of these requirements may result in termination.

Questions regarding allowable communications should be referred to Compliance.

11.4 Retail Communications

Responsibility	• Designated Supervisor • Compliance (approval of advertising, file retail communications with FINRA (if required)
Resources	• Retail communications submitted for review
Frequency	• As required
Action	• Review proposed retail communications • Make revisions as needed • Provide requestor with approved copy or notify of disapproval

	• File communication with FINRA, if required; notify requestor of any required delay to receive FINRA approval
Record	• Dates of first and (if applicable) last use • Copies of reviewed communications, including the reviewer's approval and date of approval • For communications not requiring pre-approval, the name of the person who prepared or distributed the communication • Information regarding the source of any statistical table, chart, graph or other illustration used in the communication • Copies of communications filed with FINRA (see section *FINRA Filing Requirements*) and FINRA response/approval (as applicable) • If the communication was prepared by another member firm and filed with FINRA, the name of the firm and a copy of FINRA's review letter

Retail communications, which include advertising, require the **prior approval** of the designated supervisor prior to use or distribution. Advertising also requires the **prior approval** of Compliance and may be filed with FINRA depending on the content. The person submitting the retail communication for review (and that person's supervisor, if applicable) will be notified of approval or the need to make changes prior to release.

11.4.1 FINRA Filing Requirements

[FINRA Rule 2210(c)]

Some retail communications must be filed with FINRA. The following chart outlines those requirements and the corresponding rule cite.

- Filings must be accompanied by FINRA's Advertising and Sales Literature Filing Cover Sheet.
- Filings should identify the reference number of any communication previously submitted by KCD and already reviewed by FINRA that is similar to the current filing.
- All retail communications to be submitted to FINRA must be approved by the designated supervisor prior to submission to FINRA.
- The actual or expected date of first use or publication and the name and CRD number of the approving supervisor must be included with the FINRA filing. [FINRA Rule 2210(c)(5)]

It is not necessary to file any retail communication which has previously been filed and is used without any changes. FINRA rules should be consulted for specific requirements and some exclusions [Rule 2210(c)(7)] from the requirements.

Retail Communication Content Requiring Filing	When	FINRA Rule
New member firms only: certain broadly disseminated retail communications such as generally accessible websites, print media communications, and TV and radio commercials. Free writing prospectuses are also included other than those exempt from filing with the SEC. The rule also excludes research reports concerning only securities listed on a national securities exchange [other than those that must be filed under	One-year requirement to file at least 10 business days prior to use starting on the date the firm's membership with FINRA becomes effective, per the CRD. Free writing prospectuses may be filed within 10 business days of first use.	**2210(c)(1)(A)**

Section 24(b) of the Investment Company Act of 1940]		
Investment company communications that promote a specific registered investment company or family of registered investment companies. (Generic investment company communications are not required to be filed.)	Within 10 business days of first use or publication	**2210(c)(30)(A)**
Investment company using performance rankings or comparisons	10 business days prior to first use or publication	**2210(c)(2)(A) 2212 2214**
Security futures (with certain exceptions)	10 business days prior to first use or publication	**2210(c)(2)(B) 2215**
Bond mutual funds that include volatility ratings	10 business days prior to first use or publication	**2210(c)(2)(A) 2213**
Options communications used prior to the delivery of the Options Disclosure Document	10 calendar days prior to first use or publication	**2220(c)**
Public direct participation programs	Within 10 business days of first use or publication	**2210(c)(3)(B)**
Templates for written reports produced by or concerning an investment analysis tool *(Retail communications based on templates previously filed with FINRA where the only changes are to update statistical or other non-narrative information do not require re-filing. Also updated non-predictive narrative descriptions of market events during the period covered by the communication and factual descriptions of portfolio changes without having to re-file the template as well as updated information from a registered investment company's regulatory documents filed with the SEC. Filing exclusion includes updates supplied by third-party data providers if its information is from SEC filings; KCD should obtain assurances from the data provider regarding the quality of the data and consistency with SEC source data.)*	No filing requirement; must provide access to investment analysis tools upon request	**2214**
Registered CMOs	Within 10 business days of first use or publication	**2210(c)(3)(C) 2216**
Registered securities that are derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency	Within 10 business days of first use or publication	**2210(c)(3)(D)**
Television or video where KCD has filed with FINRA a draft version of a "story board"	Within 10 business days of first use or broadcast	**2210(c)(4)**
Certain 529 Plans communications offering registered investment company products	Within 10 business days of first use or publication	**2210(c)(2)(A)**

Certain broker-prepared widely disseminated free-writing prospectuses that are required to be filed with the SEC under Securities Act 433(d)(1)(ii) [Excludes those exempt from filing with the SEC]	Within 10 business days of first use or publication	**Regulatory Notice 10-52**

11.5 Institutional Communications

[FINRA Rule 2210(b)(3)]

Responsibility	• Designated Supervisor
Resources	• Communications sent to institutions
Frequency	• As required

Action	• Communications limited to institutions reviewed after sending:
	  ○ Review all; or
	  ○ Review on a sampling basis (see the section *Risk-Based Reviews* that follows)
	• Limit distribution to only institutions by:
	  ○ Advising the receiving institution that the material is for institutions only
	  ○ Adding a legend to material;
	  ○ Asking the receiving institution to affirm materials will be distributed to institutional investors only; or
	  ○ Taking other steps to limit distribution
	• If institutional communications will be distributed to retail customers or KCD becomes aware they are going to retail customers:
	  ○ Subject the communication to reviews required for those sent to retail customers (see *Outgoing Communications*); or
	  ○ Cease providing material to the institution
	• Include institutional communications in training and continuing education (approval requirements, requirements when institutions forward communications to retail customers, acceptable content, other subjects)

Record	• Institutional communications reviewed including record of who reviewed and date reviewed • Institutional affirmations limiting distribution • Action taken if an institution distributes institutional-only communications to retail investors • Training including subjects covered, who attended, date conducted

Institutional communications (including electronic communications) are subject to review and retention by KCD. Those sent to institutions that also will be sent to retail customers (whether by KCD or forwarded by the institution) require approval described in *Outgoing Communications*, including prior approval for any communication provided to more than 25 retail investors in a 30-day period. Institutions may be asked to provide written affirmation that communications sent to them will NOT be provided to retail customers.

In compliance with FINRA Rule 2210(b)(3), KCD: (1) provides training and education to its associated persons regarding institutional communications via continuing education and its annual compliance meeting, and (2) conducts surveillance to ensure compliance with its procedures regarding institutional communications via periodic reviews of employee emails.

Institutional communications are subject to the general standards that appear below.

11.6 General Standards

[FINRA Rule 2210(d)(1)]

Communications must meet general standards which are summarized below. The rules should be consulted for details.

- Communications must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts and must not omit any material fact where its omission would make the communication misleading.
- Communications may not contain false or misleading statements or any statement KCD knows to be untrue.
- Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.
- Statements must be clear and not misleading within the context in which they are made and must provide balanced treatment of risks and potential benefits. Communications must be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield inherent to investments.
- The nature of the audience to which the communication will be directed must be considered providing appropriate details and explanations appropriate to the audience.
- Communications may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast; provided. Exceptions include hypothetical illustrations of mathematical principals, investment analysis tools, or research reports subject to certain conditions.

11.6.1 Comparisons

Any comparison in retail communications between investments or services must disclose all material differences between them, including (as applicable) investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features.

11.6.2 Disclosure Of The Firm's Name

All retail communications (other than "blind" advertisements used to recruit personnel) and correspondence must:

- prominently disclose the name of the Firm, or the name under which business primarily is conducted (per KCD's Form BD), and may also include a fictional name by which KCD] is commonly recognized or which is required by any state or jurisdiction;
- reflect any relationship between KCD and any non-member or individual who is also named; and
- if it includes other names, reflect which products or services are being offered by KCD.

11.6.3 Use Of Non-Member Or OBA Names (DBAs)

RRs may not use names of firms that are not FINRA members or that use DBAs ("doing business as") on customer communications except under the following requirements:

- Clear and prominent identification of KCD as the entity through which securities are offered (including on websites, social media posts, seminars or emails that promote or discuss KCD's securities business)
- Prior approval from Compliance
- Inclusion of a clear explanation of the identity of the other firm and its relationship with KCD
- Communications are subject to review including content and disclosures
- Use only Firm-approved standardized templates which include approved content and disclosures (if available)
- Notify Compliance of any changes to approved communications

11.6.4 Tax Considerations

- References to tax-free income must indicate which income taxes apply, or which do not.
- Communications must not characterize income or investment return as tax-free or exempt when liability is merely postponed.
- A comparative illustration of the mathematical principles or tax-deferred versus taxable compounding must meet seven specified criteria.

11.6.5 Disclosure Of Fees, Expenses And Standardized Performance

[FINRA Regulatory Notice 13-23]

Communications about fees must be accurate and balanced. Representing that fees are not charged in connection with retail accounts and IRAs is inaccurate and a violation of rules when the account is subject to other charges or fees. Investment products have their own associated costs including commissions, management fees, and other product-level expenses. For example, stating that there are no fees charged or highlighting "no fees" and then providing separate, less-prominent disclosure of other fees is misleading. Footnotes do not meet the requirements for disclosure.

Claims regarding fees must be accompanied by clear disclosure of the types of fees that may be charged. A statement that "other account fees, fund expenses, brokerage commissions and service fees may apply" would be consistent with rule requirements. This statement could be hyperlinked to KCD's web site where fees are explained.

Communications that present certain permitted investment company performance data must disclose performance information required by SEC Rule 482 and Investment Company Act Rule 34b-1, among other things. This information must be set forth prominently, and in any print advertisement, in a prominent text box that contains only the required information.

11.6.6 Recommendations

- If a communication includes a recommendation of securities, it must comply with Regulation Best Interest [see the chapter *REGULATION BEST INTEREST (BI)*], have a reasonable basis and disclose:
  - whether KCD is making a market in the recommended security (or in the underlying security if the recommended security is an option or security future) or the security will be bought or sold on a principal basis;
  - if KCD or any associated person directly and materially involved in the preparation of the content of the communication has a financial interest in the securities of the issuer; and
  - if KCD was a manager or co-manager of a public offering of any securities of an issuer whose securities were recommended within the past 12 months.
- KCD must provide, or offer to furnish upon request, available investment information supporting the recommendation (including, for corporate equity securities, the price at the time the recommendation is made).

- Generally, a communication may not refer to past specific recommendations of KCD that were or would have been profitable; however, it may set out or offer to furnish a list of all recommendations as to the same type of securities made by KCD within the past year if the communication meets certain conditions, including the condition that the communication contain a specified, prominently displayed cautionary legend.
- These requirements do not apply to any communications that meet the definition of "research report" and include required research disclosures.
- The general disclosure requirements for recommendations do not apply to any communication that recommends only registered investment companies or variable insurance products, if such communications have a reasonable basis for the recommendation.

11.6.7 Prospectuses Filed With The SEC

Prospectuses, preliminary prospectuses, fund profiles and similar documents that have been filed with the SEC are not subject to the content standards except for investment company prospectuses published pursuant to Rule 482 and broadly disseminated free writing prospectuses that are filed with the SEC pursuant to Securities Act Rule 433(d)(1)(ii).

11.6.8 Limitations On Use Of FINRA's Name And Any Other Corporate Name Owned By FINRA

[FINRA Rule 2210(e); FINRA email address for questions: trademarks@finra.org]

KCD may indicate its FINRA membership in only three ways:

- In a communication that complies with the standards of FINRA Rule 2210 and neither states nor implies that FINRA or any other corporate name or facility owned by FINRA, or any other regulatory organization, endorses, indemnifies or guarantees KCD's business practices, selling methods, the class or type of securities offered, or any specific security; references are limited to "Reviewed by FINRA" or "FINRA reviewed;"
- In a confirmation statement for an OTC transaction that includes a specified legend; or
- On KCD's website (or any related firm website about securities business), as long as KCD provides a hyperlink to the homepage of FINRA's website in close proximity to KCD's indication of FINRA membership.

Member firms are prohibited from including FINRA's logo on web sites, business cards, stationery, or other marketing materials. The FINRA trademark or references to membership may not be included in any trademark of KCD or associated person. KCD may, however, include "FINRA Member Firm" or "Member of FINRA" on such materials.

11.7 Approval

[FINRA Rule 2210(b)]

Supervisory review and approval requirements are outlined in the following chart.

Type	Approval Required

Retail communications	Must be approved by the designated supervisor **before** the earlier of its first use or filing with FINRA. Prior approval is **not** required for the following retail communications: • Another FINRA member already filed it and received approval and the Firm does not materially alter it or use it inconsistent with FINRA's approval • Retail communications supervised as correspondence where: it is excepted from the definition of "research report" unless it makes any financial or investment recommendation; it is posted on an online interactive electronic forum; and it does not make any financial or investment recommendation or otherwise promote a product or service of the member.
Institutional communications	• Reviewed after sending
Correspondence	• Reviewed after sending
Seminar materials	Compliance prior approval
Advertising	Compliance prior approval
Pre-approved form letters, group e-mails, hedge clauses, other pre-approved communications	Require no additional approval if used without change

11.8 Testimonials

[FINRA Rule 2210(d)(6)(B); FTC Guides Concerning the Use of Endorsements and Testimonials: http://ftc.gov/os/2009/10/091005revisedendorsementguides.pdf]

There are specific requirements when using testimonials in communications with the public, including disclosure regarding payment of more than $100 in value paid for the testimonial. Compliance should be contacted before preparing any communications that include testimonials.

11.9 Telemarketing Scripts

All scripts used for telemarketing calls are considered retail communications and require the approval of the designated supervisor prior to use. The section *Cold Callers* includes further information regarding the use of scripts and callers.

11.10 SIPC Membership

[Securities Investor Protection Act of 1970; United States Code Title 15 Chapter 2B-1; SIPC web site at www.sipc.org/how/sipclogo.aspx]

Advertising must include a notation that KCD 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 http://www.sipc.org.
- Member of SIPC. Securities in your account protected up to $500,000. For details, please see 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.

When SIPC is referenced in KCD's web site, the site will include a hyperlink to the SIPC web site.

"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.

11.11 Recordkeeping Requirements For Retail And Institutional Communications

[FINRA Rule 2210(b)(4)(A); SEC Securities Exchange Act of 1934 Rule 17a-4]

Records of retail and institutional communications must include:

- Originals of all communications received and copies of all communications sent
- While not "retail" or "institutional" communications, records of inter-office memoranda and communications relating to KCD's business [SEC Rule 17a-4(b)(4)]
- The dates of first use and (if applicable) last use
- The name of the registered principal who approved the communication and the date of approval
- For communications not approved by a supervisor prior to first use, the name of the person who prepared or distributed the communication (where clerical staff prepares or distributes the communication, include the name of the person on whose behalf the communication was prepared or distributed)
- The source of statistical tables, charts, graphs and other illustrations
- For a retail communication prepared by another firm and submitted to FINRA, the name of the firm and a copy of FINRA's review letter
- A record that the item was filed with FINRA and when filed (if required)
- Changes recommended by FINRA and approval received from FINRA (if required)

11.12 Advertising And Sales Literature

Responsibility	• Designated Supervisor or Designee
Resources	• Requests regarding advertising or sales literature
Frequency	• As required
Action	• Review proposed advertising or sales literature • Make revisions as needed • Provide requestor with approved copy or notify of disapproval • Ensure only KCD approved advertising and sales literature is used in conjunction with sales of specific products (mutual funds, variable insurance, etc)
Record	• Copies of reviewed advertising, including the reviewer's initials, are retained in an Advertising file in Compliance

FINRA Notice to Members 93-36

11.12.1 Advertising And Sales Literature Defined

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, newsletters, seminar texts and reprints, or other material originated by KCD or its employees 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.

11.12.2 General Guidelines

All advertising and sales literature must meet the general standards of good taste and accuracy and should fairly represent the products or services included in the advertisement or sales literature. 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 advertising or sales literature. Portraying the performance of past recommendations or actual transactions must include an acceptable universe over a reasonable period of time.

In addition, if a recommendation is included in advertising or sales literature, the following disclosures must be included (if applicable):

- KCD acts as market maker in the recommended security or the underlying security or that associated persons will sell to or buy from customers on a principal basis.
- KCD and/or its officers or partners have a financial interest in any of the issuer's securities and the nature of that interest (options, warrants, short/long positions, *etc.*) unless the interest is nominal.
- KCD was a manager or co-manager of the issuer's securities within the past 12 months.

11.12.3 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 rules that deal 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 KCD, 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, in advertising and sales literature regarding KCD's services, may not be permitted. Compliance's review of advertising will consider such requests on a case-by-case basis.

11.12.4 Approval Prior To Publication

All advertising or sales literature must be submitted to Compliance for approval prior to publication or use with the exception of certain materials such as research that may be approved by other designated supervisors.

11.12.5 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.

11.12.6 Sales Material Provided By Third Parties

Responsibility	• Compliance or Designee
Resources	• Proposed sales material from third parties
Frequency	• As required

Action	• For all third-party sales material review for:
	    ○ Clear indication the material is advertising if KCD or the RR paid for it
	    ○ Suggestions or inferences the RR authored the material when in fact that is not the case
	    ○ Acceptable RR titles, if titles are included
	    ○ Pre-determined interviews (written or otherwise) are identified as such and include disclosure the Q&A is pre-determined and not a spontaneous interview
	• For third-party material previously filed with and approved by FINRA:
	    ○ Obtain a copy of FINRA approval
	    ○ Allow use if no material changes are made
	• For third-party material NOT previously filed with FINRA:

	○ Review the material for consistency with FINRA standards ○ File with FINRA, if required ▪ Upon receipt of review letter, make necessary changes ▪ Indicate approval including date of approval
Record	• Copy of sales material with notations, as necessary • Copy of FINRA review letter, if one has been obtained • Record of date first use and (if applicable) date of last use • Retain for three years from date of last use

Sales material provided by outside (third) parties such as newspaper or magazine articles, books or pamphlets, handouts, and other third-party provided material **must be reviewed and approved by Compliance prior to use**. When participating in an interview (written or otherwise) where the questions are pre-determined by the third party, disclosure must be made that questions and answers were pre-determined and the interview was not spontaneous. Some sales material requires the prior approval of FINRA.

The following guidelines apply when using third-party sales material:

- RRs may **not** suggest or infer that they authored investment-related books, articles, or other sales material not written by them.
- If KCD or RR has paid for the publication, production, or distribution of any communication that appears to be a magazine, article or interview, then the communication must be clearly identified as an advertisement.
- Sales material may **not** include RR titles other than those normally conferred by KCD (account executive, financial consultant, *etc.*) unless previously approved by Compliance. RRs particularly may **not** use titles inferring expertise in dealing with senior investors.
- Materials made available by KCD may be presumed to have been reviewed and approved.

11.12.7 SIPC Membership

Advertising must include a notation that KCD 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.*
- Member of SIPC. Securities in your account protected up to $500,000. For details, please see *www.sipc.org.*

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

When SIPC is referenced in KCD's web site, the site will include a hyperlink to the SIPC web site.

"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.

11.12.8 FINRA Membership

KCD may indicate its FINRA membership in only one of three ways:

1. In a communication that complies with the standards of NASD Rule 2210 and neither states nor implies that FINRA or any other corporate name or facility owned by FINRA, or any other regulatory organization, endorses, indemnifies or guarantees KCD's business practices, selling methods, the class or type of securities offered, or any specific security;
2. In a confirmation statement for an OTC transaction that includes a specified legend; or
3. On KCD's website, as long as KCD provides a hyperlink to the homepage of FINRA's website in close proximity to KCD's indication of FINRA membership.

Member firms are prohibited from including FINRA's logo on web sites, business cards, stationery, or other marketing materials. The FINRA trademark or references to membership may not be included in any trademark of KCD or associated person. KCD may, however, include "FINRA Member Firm" or "Member of FINRA" on such materials.

11.12.9 Telemarketing Scripts

All scripts used for telemarketing calls require the approval of the designated supervisor prior to use. The section *Cold Callers* includes further information regarding the use of scripts and callers.

11.12.10 Special Filing Or Approval Requirements

There are special filing or approval requirements for certain products and broker-dealers, as outlined below.

- Filings must be accompanied by FINRA's Advertising and Sales Literature Filing Cover Sheet.
- Filings to FINRA should identify the reference number of any communication previously submitted by KCD and already reviewed by FINRA that is similar to the current filing.
- All advertising or sales literature to be submitted to FINRA must be approved by the designated supervisor 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.

Who	What	When	Rule
Members who have never filed	All advertisements[1]	10 business days prior to first use for one year dating from the first submission	**2210(c)(5)(A)**
All members	Options communications used prior to the delivery of the Options Disclosure Document[2]	10 calendar days prior to first use; wait for FINRA staff approval	**2220(c)(1)**
All members	Sales literature that contains bond mutual fund volatility ratings	10 business days prior to first use; wait for FINRA staff approval	**2210(c)(3)**
All members	CMO advertisements[3]	10 business days prior to first use; cannot use until changes required by the Department have been made	**2210(c)(4)(B)**
All members	Investment company advertisements or sales literature that use rankings or performance comparison	10 business days prior to first use; cannot use until changes required by the Department have been made	**2210(c)(4)(A)**

	information that is not generally published or is created by the investment company, its underwriter or affiliate, must be filed with corroborating data		
All members	Investment company advertisements and sales literature	Within 10 business days of first use	**2210(c)(2)(A)**
All members	Public direct participation program advertisements and sales literature	Within 10 business days of first use	**2210(c)(2)(A)**
All members	Security Futures advertisements[4]	10 business days prior to first use; cannot use until changes required by the Department have been made	**2210(c)(4)(C)**
All members	Final version of TV and Video advertisements	Within 10 business days of first use or broadcast	**2210(c)(6)**
All members	Certain 529 Plans advertisements and sales literature offering registered investment company products[5]	Within 10 business days of first use	**2210(c)(2)(A)**
All members	Government securities advertisements	Within 10 business days of first use	**2210(c)(1)**
All members	Investment analysis tool, report templates, and sales literature and advertisements[6]	Within 10 business days of first use	**IM-2210-6(a)**

[1] "Advertisements" are communications with the public that appear in media (e.g., newspaper, radio, television, websites) whereas "sales literature" is directed to a specific audience or group (e.g., mailers, brochures, password protected websites). For complete definitions see NASD Conduct Rule 2210(a).
[2] See Conduct Rule 2220 Options Communications with the Public.
[3] See IM-2210-8 Communications with the Public About Collateralized Mortgage Obligations.
[4] See IM-2210-7 Guidelines for Communications with the Public Regarding Security Futures.
[5] See Special NTM 03-17 for additional guidance.
[6] See NTM 04-86 for additional guidance.

It is not necessary to file with FINRA any advertising and sales literature which has previously been filed and is used without any changes. There are other requirements regarding advertising of certain products including CMOs, municipal securities, mutual funds, and options. Refer to those specific sections for further information.

11.12.11 Institutional Sales Material

Sales material prepared for institutional investors is not subject to the same requirements as material prepared for non-institutional investors. This does **not** include material that KCD has reason to believe will be distributed to anyone who is not an institutional investor. For example, if sales material is provided to an institution for distribution to employees participating in a 401K plan, the sales material would be treated as distributed to retail investors. "Institutional investor" includes a(n):

- bank, savings and loan association, insurance company, or registered investment company

- registered investment adviser
- entity (natural person, corporation partnership, trust, or other) with total assets of at least $50 million
- government entity
- employee benefit plan under Internal Revenue Code Section 403(b) or 457 with at least 100 participants
- qualified plan under Section 3(a)(12)(C) of the '34 act with at least 100 participants
- FINRA member or someone registered with a FINRA member firm
- someone acting solely on behalf of an institutional investor

Institutional sales material is subject to KCD's correspondence review procedures and does not require pre-use approval and filing with FINRA.

11.12.12 Records Of Advertising And Sales Literature

Compliance maintains a central file of all advertising and sales literature approved by KCD. The file includes, for each item reviewed:

- the approval by the designated supervisor
- any revisions, if necessary
- a record that the item was filed with an SRO and when (if required)
- approval received from the SRO (if required)
- in what media the item appeared (if applicable)
- date of first use and (if applicable) date of last use

11.12.13 Options

This section contains specific rules for the advertising of Options.

Worksheets

Responsibility	• Designated Supervisor • Compliance
Resources	• Worksheet templates • Option worksheets prepared by RRs
Frequency	• As required

Action	• Compliance: approve templates for use
	• Designated Supervisor:
	  ○ Ensure RRs use only Firm-approved templates
	  ○ Review and approve worksheet templates

Record	• Compliance: approved templates • Designated Supervisor: Copies of worksheets provided to customers including initials and date of review

Only pre-approved templates may be used for preparing worksheets. Completed worksheets must be provided to the designated supervisor for review and retention.

11.12.14 Mutual Funds

There are specific requirements for advertising and sales literature regarding mutual funds. Advertising must be filed with FINRA within prescribed periods. There also are mandated guidelines on representations regarding performance and yield. RRs may use materials provided by the fund or KCD-approved materials. Any other advertising or sales literature must be approved by Compliance prior to use.

11.12.15 Municipal Securities

[MSRB Rule G-21]

All advertising involving municipal securities must be approved by a designated municipal securities principal or general securities principal.

Some of the requirements that apply to advertising of municipal securities include:

- 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. See the section *529 College Savings Plans (Municipal Fund Securities)* - *Advertising Municipal Fund Securities* for more information.

Compliance should be consulted regarding questions about advertisements and sales material.

11.12.16 Collateralized Mortgage Obligations (CMOs)

Criteria in addition to general advertising rules for advertising of CMOs for Radio/Television Advertisements: FINRA rules specify 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.

11.12.17 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.

KCD's central office address and telephone number may be substituted for the supervisory branch or OSJ only with the approval of Compliance. Refer to the chapter *OFFICES* for further information.

11.12.18 Testimonials

There are specific requirements when using testimonials in communications with the public. Compliance should be contacted before preparing any communications that include testimonials.

11.13 Outgoing Communications

[FINRA Rule 3110(b)(4), 3110.07, 3110.08 and 3110.09]

This section outlines requirements for outgoing communications which includes written and electronic communications. Electronic communications are subject to specific procedures for review; see the section *Electronic Mail* in this chapter and the section *Electronic Communications Policy* in the chapter *GENERAL EMPLOYEE POLICIES*.

11.13.1 Communications

Responsibility	• Designated Supervisor
Resources	• Outgoing communications
Frequency	• Daily
Action	• Review for the following: ○ Use of pre-approved letters without change other than updating data where required ○ 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 KCD) ○ 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 *Disclosure Of Material Facts* in the chapter *MUTUAL FUNDS*) ○ Performance is represented accurately and consistent with rule requirements regarding yield and return ○ Language that indicates a prospectus is enclosed • Contact Compliance for review of questionable communications • Correct unapproved content
Record	• Communications with reviewer's initials and notes of changes • Compliance retains communications it reviews

RRs should use letters pre-approved by KCD and include a prospectus or limit communications to stating that a prospectus is enclosed and the RR will be in contact with the customer. Questions should be referred to Compliance.

11.13.2 Review And Approval

Responsibility	• Designated Supervisor
Resources	• Outgoing customer communications
Frequency	• Daily
Action	• Review communications for appropriateness of language • Pre-approve retail communications that are sent to more than 25 persons in a 30-day period (other than those excluded; see *Retail Communications* under *Definitions* in this chapter) • Review other communications after sending • Identify outgoing communications that may constitute "research" under FINRA Rule 2241(a)(11) • Take corrective action, if necessary, which may include consultation with the RR and/or Compliance, sending corrected communications, added training for the RR, restrictions on communications, or other action considered appropriate for the circumstance
Record	• Communications including reviewer's initials or other record of review and action taken, if appropriate

Outgoing customer communications are subject to review and approval by the designated supervisor.

- Retail communications sent to more than 25 persons in a 30-day period require the supervisor's approval **before** sending.
- Other communications will be reviewed and approved after sending.
- Some communications (depending on type and other factors) require prior approval (see the section *Approvals*).

Pre-approved form letters and group e-mails **used without change** (other than customer name, address) may be sent to customers or prospective customers without additional approval. Records of to whom form letters and group e-mails are sent must be retained in the Firm's records.

Reviewing On A Sampling Basis

[FINRA Rule 3110.06]

Responsibility	• Compliance
Resources	• Evaluation of the Firm's size, types of business, supervisory structure
Frequency	• At inception of sampling procedures and ongoing

Action	• Determine types of sampling permissible • Develop procedures and update as necessary • Provide procedures and education/training to communications reviewers • Include communications requirements in RR training • Include sampling procedures in periodic reviews of branches, offices, and supervisory system, controls and procedures • Identify RRs with complaint/disciplinary history necessitating review of ALL communications and notify the RR's supervisor ("heightened supervision")
Record	• Procedures for sampling reviews are included in the manual • Updates to procedures are retained by Compliance • Education and training are documented including how conducted, who attended, and dates of education/training including educational memoranda • Records of "heightened supervision" retained in RR's file

Supervisors may review written outgoing correspondence on a sampling basis using the guidelines that follow, or, if sampling is not adopted, review all outgoing correspondence prior to sending.

Sampling guidelines include the following. "Pre-review" refers to review and approval of written correspondence **before** it is sent. Correspondence subject to "post-review" may be reviewed after sending. All RRs are subject to review of at least some of their correspondence on a regular basis. Sampling is permitted for the following type(s) of outgoing correspondence:

- Written (hard-copy) correspondence
- E-mails
- Faxes
- Post-review: At least 25% of all correspondence
- For correspondence that includes a recommendation, determine that the information presented balances the benefits and risks of the recommendation and, if the subject security is high-risk, determine the recommendation is appropriate for the customer by conferring with the RR and/or reviewing new account information
- If there are problems with an RR's correspondence, increased sampling, training, or other measures may be undertaken as deemed appropriate and for as long as deemed necessary.

11.13.3 Content Guidelines

Items to consider when preparing and reviewing outgoing communications (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.
- Communications regarding securities subject to pending distributions (underwritings) are generally not permitted.
- Communications regarding securities sold by prospectus (mutual funds, limited partnerships, *etc.*) must be approved by Compliance prior to sending (except for pre-approved communications where no changes are made).
- Only firm-approved hedge clauses may be used.

- Tax advice must not be provided; the customer should be referred to his or her tax adviser for such issues.
- 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 KCD and any analysis or calculation is provided for information purposes only.
- The use of firm letterhead should be restricted to firm-related matters.
- Communications regarding options is subject to specific requirements which are discussed in the chapter *OPTIONS.*

11.13.4 Letters And Notes

Copies of letters, notes, and similar correspondence must be provided to the designated supervisor on the day sent.

11.13.5 Facsimiles

Responsibility	• Designated Supervisor or Designee
Resources	• Outgoing faxes
Frequency	• Daily
Action	• Review outgoing faxes as follows: ○ Review faxes on a sampling basis. • For faxes with questionable content: ○ Confer with RR ○ Confer with Compliance, if necessary ○ Take corrective action which may include: ▪ Sending a revised fax to the recipient ▪ Training for RR ▪ Disciplinary action against RR which may include a reprimand, suspension, or termination
Record	• Outgoing faxes with reviewer's initials • Records of corrective action taken

Facsimiles are included in the definition of "outgoing correspondence" and are subject to review by the designated supervisor.

Facsimile transmissions may NOT be used for unsolicited advertising.

11.13.6 Research

Research published by KCD must be distributed in accordance with the requirements and limitations communicated by Research or another issuing department/personnel. Failure to comply may subject KCD and the RR to regulatory actions for violating rule requirements. For example:

- If KCD issues debt research, some may be restricted to institutional customers only. Institutional investors are required to affirm they meet the definition of an institution and are able to meet certain conditions regarding their investment sophistication. Such research may NOT be provided to retail customers.
- Some research may qualify for distribution only to certain jurisdictions (states) where the subject securities are qualified for sale.

Questions regarding distribution of research should be referred to the appropriate research personnel or to Compliance.

11.13.7 Other Communications Defined As "Research"

[SEC Regulation AC; FINRA Rule 2241(a)(11)]

RRs 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 communications (including electronic) that includes an analysis of equity securities of individual companies or industries (other than an open-end registered investment company that is not listed or traded on an exchange), and that provides information reasonably sufficient upon which to make an investment decision and that is distributed to at least 15 persons. This applies even if the author does not hold the title of "research analyst" and does not work in a research department.

There are specific exceptions under SRO rules. Questions regarding whether a communication constitutes "research" should be referred to Compliance.

11.14 Incoming Correspondence

[FINRA Rule 3110(b)(4), 3110.07, 3110.08 and 3110.09]

In this section, "correspondence" means written and electronic communications received by KCD.

11.14.1 Review Of Incoming Correspondence

Responsibility	• Designated Supervisor
Resources	• Incoming correspondence, including correspondence marked "personal and confidential"
Frequency	• Daily
Action	• Review all incoming correspondence • Refer customer securities and checks directly to Operations • Refer customer complaints to Compliance • Refer audit letters to Operations
Record	• Initial each piece of correspondence and maintain in branch/department incoming customer correspondence files.

All incoming written correspondence will be opened and reviewed by the designated supervisor or someone qualified and appointed by the department 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 *Electronic Mail* in this chapter and the section *Electronic Communications Policy* in the chapter *GENERAL EMPLOYEE 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 the RR's supervisor and to Compliance.
- Checks or securities will be immediately deposited with the appropriate operations personnel and the RR notified of receipt.
- 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.

11.14.2 Offices Without Resident Supervisors

For offices without a resident registered supervisor, copies of all incoming, written correspondence related to KCD's securities business must be forwarded to the designated supervisor at the end of each month for review as requested.

11.14.3 Personal Mail

Employees should direct all personal mail to their home address. Personal mail is subject to incoming correspondence and electronic mail review policies. All correspondence sent to the Firm is deemed to have been authorized by the RR for opening and review.

11.15 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.

11.16 Internal Communications

[FINRA Rule 3110(b)(4)(B), 3110.06, 3110.07, 3110.08 and 3110.09]

[SEC Securities Exchange Act of 1934 Rule 17a-4(b)(4)]

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. Electronic communications are retained for 3 years in an accessible and retrievable format.

11.16.1 Internal Use Only

Printed or electronic information marked "internal use only" may not be sent or otherwise provided to individuals outside KCD.

11.17 Complaints

[FINRA Rule 3110(b)(5), 4513 and 4530]

Responsibility	• Designated Supervisor

Resources	• Customer communications
	• Customers' complaints (written or electronic)
	• FINRA reports (Report Center, Risk Monitoring Reports):
	  ○ FINRA Sales Practice Complaint Report
	  ○ FINRA Customer Complaint Report

Frequency	• As required

Action	• Branch/Department Supervisor:
	  ○ Identify potential complaints when reviewing customer communications
	  ○ Resolve complaints of an operational nature such as late dividends, delayed delivery of stock, *etc.* If written, forward a copy to Compliance with description of resolution
	  ○ Refer all other complaints (mishandling of account by RR, improper transactions, churning, *etc.*) to Compliance
	• Compliance:
	  ○ Send initial acknowledgment of receipt of complaint
	  ○ Gather needed information and investigate the complaint
	  ○ Provide a response and resolution to the customer with a copy to the RR and RR's supervisor
	  ○ If necessary, amend the RR's U4 (or, in the case of a terminated RR, amend Form U5)
	  ○ File quarterly electronic complaint report with FINRA
	  ○ Maintain central record of complaints
	  ○ For formal civil actions (lawsuits, arbitrations), refer the matter to KCD's counsel for response
	  ○ Review FINRA reports for trends in complaints
	  ○ Include complaints in training

Record	• Copies of written complaints and related correspondence (including acknowledgment of receipt of complaint and resolution) are retained in:
	  ○ Branch file for complaints (unless KCD makes complaints promptly available to FINRA upon request at the office location)
	  ○ Compliance central file of KCD's complaints (retention for 4 years)
	• *Note:* options complaints are retained in separate files both by branches (where records are maintained at branches) and by Compliance
	• Central complaint log (MSRB requires electronic format under Rule G-8)
	• Record of electronic filings
	• Records of updates to Form U4 or U5
	• Reviewed FINRA reports

	• FINRA record retention: 4 years (Rule 4513) • MSRB record retention: 6 years with 2 years in a readily-accessible location (MSRB Rule G-8) • Records of training

11.17.1 Complaint Defined

"Complaint" is defined as any grievance by a customer or any person authorized to act on behalf of the customer involving the activities of KCD or someone associated with KCD in connection with the solicitation or execution of any transaction or the disposition of securities or funds of that customer.

11.17.2 Handling Of Customer Complaints

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

11.17.3 Oral Complaints

Oral complaints should be reported immediately to the designated supervisor 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 KCD. 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 the designated supervisor or Operations.

Oral complaints may be resolved by the designated supervisor 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 immediate attention of Compliance for review and resolution.

11.17.4 Complaints Received By Clearing Firm

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

- Provide a copy of the complaint to KCD's compliance officer.
- Notify the customer directly that their complaint has been forwarded to KCD for response.

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

11.17.5 Records Of Complaints

Compliance will maintain a central record of all customer complaints including the following MSRB rules require an electronic log.

- Complainant's name and address
- Account number or municipal advisory number or code, if any

- Date the complaint was received
- Name(s) of employee(s) identified in the complaint
- Description of the nature of the complaint including the date(s) of activity that resulted in the complaint
- Disposition of the complaint

11.17.5.1 Office Records Of Complaints

Each office of supervisory jurisdiction (OSJ) will maintain a separate file of all written customer complaints that relate to that office (including complaints that relate to activities supervised from that office) and action taken by KCD, if any, or a separate record of complaints and a clear reference to the office files that contain correspondence regarding complaints. Alternatively, KCD may make complaints promptly available at that office, upon request of FINRA.

11.17.6 Notice To Customers

Each customer is provided with notification of the address and telephone number of the department to which complaints may be directed. The CCO is responsible for establishing procedures to provide this information to customers. Our customer brochure contains this information and is provided to the customer upon account opening.

11.17.7 Reporting Of Customer Complaints

[FINRA Rule 4530]

Responsibility	• Designated Supervisor
Resources	• Complaints received from customers or referred by RRs, supervisors, or others • FINRA Disclosure Timeliness Report Card
Frequency	• Statistical Complaint Report: Quarterly • Form BD, U4s, and U5s (if applicable): Promptly after receipt of complaint
Action	• Identify reportable complaints and other reportable events • Report to FINRA the events specified in FINRA Rule 4530 within 30 calendar days of knowledge of the event • File electronically the quarterly statistical report by the 15th of the month following the calendar quarter
Record	• Quarterly complaint reports are maintained in a file for the reports • Copies of events reported

KCD will file a quarterly statistical report of complaints with FINRA. Complaints reportable in KCD's Form BD and/or an RR's Form U4 (or an amendment to Form U5, if the RR is terminated) will be promptly forwarded to FINRA.

11.18 Customer Privacy Policies And Procedures

[Gramm-Leach-Bliley Act Sections 501-503; SEC Regulation S-AM and S-P; Evolution of a Prototype Financial Privacy Notice: http://www.ftc.gov/privacy/privacyinitiatives/ftcfinalreport060228.pdf; FINRA web site Customer Information Protection: http://www.finra.org/industry/customer-information-protection; Fair Credit Reporting Act; SEC Risk Alert on Regulation S-P: https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Regulation%20S-P.pdf]

Responsibility	• Designated Supervisor
Resources	• KCD's Privacy Policy • Customer opt-out requests (if applicable)
Frequency	• When accounts are opened - provide copy of Privacy Policy and opt-out form (if opt-out is applicable) • As required- send notice of revised Privacy Policy to all customers • As determined by the designated supervisor: training for employees • As necessary - establish procedures for protecting customer information and ensuring information is only shared when it is allowed • As necessary - when new technologies are adopted

Action	• Send annual notice of Privacy Policy if required unless KCD meets certain conditions (see *Customer Notification* which follows)
	• Send revised Privacy Policy to customers when revisions are made
	• Code accounts for customers opting out (if applicable)
	• If "eligibility information" will be received from affiliates, determine that Regulation S-AM requirements are satisfied
	• Test internal computer systems periodically
	• Ensure agreements with third parties receiving customer information reflect the third party firm's privacy policies and include a confidentiality agreement
	• Include maintaining confidentiality of customer information in employee training
	• Remove access to customer information for departing employees
	• Limit employee access only to required information
	• When new technologies involving customer information are adopted:
	    o Contact KCD's information officer to:
	        ▪ Determine whether appropriate technological precautions have been taken to protect customer information
	        ▪ Determine whether existing testing/audits will include the new technology and, if not, adjust testing program
	    o Review existing policies and procedures to determine if changes/additions are required
	    o Determine whether added training of employees is necessary and implement, if required

Record	• Current Privacy Policy • Customer opt-out requests (if applicable) • Record of providing notice at time of account opening • Record of providing revised notice to all customers • Record of providing annual notice, if required • Determination that Regulation S-AM requirements are satisfied, if information from affiliates will be used for marketing purposes • Copies of signed agreements with third parties receiving customer information • Records of periodic privacy audits or other reviews conducted of KCD's computer system that retains customer information • Records of reviews of outsourced services involving the privacy of customer

	information (see the section *Outsourcing* in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*) • Records of review of new technology involving customer information

11.18.1 Introduction

The Firm has adopted a Privacy Policy which is provided to customers at the time a new account is opened. 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 web site. Customers will receive notice of revisions to the Privacy Policy when they occur.

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.

11.18.2 Customer Notification

[12 CFR Federal Reserve System Regulation P; Federal Reserve Privacy of Consumer Financial Information (Regulation P): http://www.federalreserve.gov/boarddocs/supmanual/cch/consumer.pdf; Gramm-Leach-Bliley Act Title V Section 503]

The Firm will provide notice to customers about the Firm's Privacy Policy. The notice is provided as follows:

- At the time an account is opened.
- On the Firm's web site.
- Annually, unless the Firm meets the following two conditions:
    - The Firm does not disclose nonpublic information to third parties (*e.g.,* sharing in connection with marketing activities vs. sharing solely to service customer accounts), other than disclosure permitted under exemptions available under the Gramm-Leach-Bliley Act; and
    - There has been no change in policies regarding disclosing nonpublic personal information from the last notice sent to customers

11.19 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; web sites; newspapers, magazines, or other periodicals; radio; or television program. The prohibition does not apply to clearly-identified paid advertising; a communication that discloses the amount and receipt of compensation; or a research report as defined under FINRA rules.

11.20 Calling (Telemarketing) And Fax Restrictions

[FINRA Rule 3230; NASDAQ General 9 Regulation; NYSE Rule 3230; MSRB Rule G-39; Telephone Consumer Protection Act of 1991; Telemarketing and Consumer Fraud and Abuse Prevention Act of 1994; Junk Fax Prevention Act of 2005; FINRA FAQs on Telemarketing: https://www.finra.org/rules-guidance/guidance/faqs/finra-rule-3230?utm_source=MM&utm_medium=email&utm_campaign=O%5FWeekly%5FUpdate%5F120419%5FFINAL]

Responsibility	• Compliance
Resources	• Requests to conduct telemarketing • Third parties contracted for telemarketing • Do not call requests • Federal/state do not call lists
Frequency	• As required
Action	• For third party telemarketers, confirm compliance with registration requirements and confirm their ability to comply with requirements • Establish and maintain internal do-not-call list • Obtain federal/state do not call lists and make them available to RRs or establish an internal system for automatically checking outgoing calls against lists • For abandoned calls, establish and maintain a method of ensuring compliance with requirements • Train RRs regarding telemarketing prohibitions, use of billing information (if applicable), do-not-call lists, etc.
Record	• Third party telemarketer compliance reviews • Internal do-not-call list • Records of technology (if employed) to block calls to restricted numbers • Recorded phone calls where billing information is submitted • Records of compliance with abandoned call requirements • Records of training including training materials, who attended when conducted

This section describes restrictions on telemarketing calls under Federal and FINRA rules and regulations. There may be additional regulations such as state laws and rules. Compliance will communicate any such requirements to RRs.

11.20.1 Introduction

The Firm and its employees are subject to restrictions that govern telephone solicitations as well as unsolicited facsimile advertisements to residences.

Key points include the following:

- Telephone and facsimile solicitations are allowed when the target individual has an "established business relationship" with the Firm.
- Calls may not be made to individuals included on a Do Not Call List which includes lists maintained by the federal government, state governments, and the Firm.
- "Telephone solicitation" is defined as a telephone call initiated for the purposes of encouraging the purchase of or investment in property, goods, or services. The definition exempts calls made by tax-exempt nonprofit organizations.
- "Established business relationship" includes someone who has had a transaction or security position, money balance, or account activity within 18 months preceding the call or fax or has contacted the Firm

to inquire about a product or service within 3 months preceding the call or fax. The Firm has the burden to prove an established business relationship exists.
- Calls to businesses are exempt from telemarketing restrictions; however, solicitations may not be made to induce sales or contributions by individuals employed by a business.

11.20.2 Telephone Calls

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; 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.
- Prerecorded calls to residences are prohibited unless the person has consented in writing to receive such calls and can opt out of future calls and KCD complies with the requirements of FINRA Rule 3230(k).
- 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.
- Caller identification information must be transmitted; blocking caller identification information is prohibited.
- Outbound telemarketing calls may not be "abandoned" which means a person answers the call and the call is not connected to someone at KCD within two seconds of the completed greeting. KCD employs technology to avoid abandoned calls as included in FINRA Rule 3230(j).

The restrictions do not apply to calls to customers for whom KCD carries accounts and where the account has had some activity in the last 18 months (trading, credit of interest earned, *etc.*). Calls to other broker-dealers also are not covered by these restrictions.

11.20.3 Wireless Communications

The rule also applies to outbound telephone calls to wireless telephone numbers.

11.20.4 Outsourcing Telemarketing

Compliance must review the use of third party telemarketers before they are engaged. KCD is responsible for compliance with telemarketing requirements even if the function is outsourced to a third party. Outsource firms may require registration or licensing to conduct telemarketing for KCD.

11.20.5 Unencrypted Consumer Account Numbers

KCD and its associated persons are prohibited from disclosing or receiving, for consideration, unencrypted consumer account numbers for use in telemarketing. "Unencrypted" is defined as not only complete, visible account numbers, whether provided in lists or singly, but also encrypted information with a key to its decryption.

11.20.6 Submission Of Billing Information

For any telemarketing transaction, KCD or its associated person must obtain the express informed consent of the person to be charged and to be charged using the identified account. If the telemarketing transaction involves pre-acquired account information and a free-to-pay conversion feature, KCD or its associated person must: (1) obtain from the customer, at a minimum, the last four digits of the account number to be charged; (2) obtain from the customer an express agreement to be charged and to be charged using the identified account number; and (3) make and maintain an audio recording of the entire telemarketing transaction. For any other telemarketing transaction involving pre-acquired account information, KCD or its associated person must: (1) identify the account to be charged with sufficient specificity for the customer to understand what account will be charged; and (2) obtain from the customer an express agreement to be charged and to be charged using the identified account number.

11.20.7 Abandoned Calls

KCD and its associated persons are prohibited from abandoning any outbound telemarketing call. The abandoned calls prohibition is subject to a "safe harbor" which provides that a firm or its associated person will not be liable for violating the FINRA rule if:

1. KCD or its associated person employs technology that ensures abandonment of no more than three percent of all calls answered by a person, measured over the duration of a single calling campaign, if less than 30 days, or separately over each successive 30-day period or portion thereof that the campaign continues;
2. KCD or its associated person, for each telemarketing call placed, allows the telephone to ring for at least 15 seconds or four rings before disconnecting an unanswered call;
3. whenever an associated person is not available to speak with the person answering the telemarketing call within two seconds after the person's completed greeting, KCD or its associated person promptly plays a recorded message stating the name and telephone number of KCD or associated person on whose behalf the call was placed; and
4. KCD retains records establishing compliance with the "safe harbor."

11.20.8 Credit Card Laundering

There is a prohibition against credit card laundering, the practice of depositing into the credit card system a sales draft that is not the result of a credit card transaction between the cardholder and KCD. Except as expressly permitted by the applicable credit card system, the rule prohibits a firm or its associated person from:

1. presenting to or depositing into the credit card system for payment, a credit card sales draft generated by a telemarketing transaction that is not the result of a telemarketing credit card transaction between the cardholder and KCD;
2. employing, soliciting, or otherwise causing a merchant, or an employee, representative or agent of the merchant, to present to or to deposit into the credit card system for payment, a credit card sales draft generated by a telemarketing transaction that is not the result of a telemarketing credit card transaction between the cardholder and the merchant; or
3. obtaining access to the credit card system through the use of a business relationship or an affiliation with a merchant, when the access is not authorized by the merchant agreement or the applicable credit card system.

11.20.9 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; 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.
- A facsimile transmission must include, in a margin at the top or bottom of each transmitted page or on the first page of the transmission, the date and time it is sent and the identification of the business, other entity, or individual sending the message and the telephone number of the sending machine or of the sender.
- Prerecorded calls to residences 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.
- KCD does not permit the use of pre-recorded telephone solicitations and autodialers.

The restrictions do not apply to calls to customers for whom KCD 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.

11.20.10 Other 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

11.20.11 Do Not Call Lists

Responsibility	• Designated Supervisor
Resources	• National Do-Not-Call Registry • State do not call lists • Internal do not call list • Other vendor lists
Frequency	• Ongoing
Action	• Add names to KCD's do-not-call list within 30 days of receiving the request • Provide access to do not call lists • Obtain updated national do-not-call registry every 30 days • Include telephone solicitation restrictions in RR education programs
Record	• The internal do not call list is maintained by Compliance • Federal and state lists are maintained by the vendor (if a vendor is used) or by

	Compliance

Phone solicitations may not be made to phone numbers that are included in federal, state, or KCD'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 KCD has an "established business relationship" (described below); the person called has given express written permission to call outside the applicable time; or the person called is a broker or dealer.

If someone has asked to be included on KCD'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.

11.20.12 National Do-Not-Call Registry

The Federal Trade Commission (FTC) and Federal Communications Commission (FCC) established requirements for sellers and telemarketers to participate in a National Do-Not-Call Registry of phone numbers that do not accept phone solicitations. KCD and its employees must avoid solicitation calls to any number on the list unless the person has an "established business relationship" with KCD. The list used must be no older than 31 days prior to the date any call is made.

In general, national do-not-call requirements apply to residential phone numbers. In addition, the FCC includes wireless subscribers in the national registry, presuming these are residential subscribers.

11.20.13 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.

11.20.14 Internal Do Not Call List

Employees 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 periodically distributed to employees with an explanation of KCD's telemarketing policy. It is the RR's responsibility to ensure outgoing calls are not made to anyone appearing on KCD's Do Not Call List.

11.20.15 Facsimile Transmissions

General requirements that apply to faxes include:

- A facsimile transmission must include, in a margin at the top or bottom of each transmitted page or on the first page of the transmission, the date and time it is sent and the identification of the business, other entity, or individual sending the message and the telephone number of the sending machine or of the sender.

- Unsolicited faxes may only be sent to individuals who have an established business relationship with KCD.

11.20.16 Established Business Relationship

Calls and faxes to the following are not subject to do-not-call restrictions:

- a person having made a financial transaction or having a security position, a money balance, or account activity with KCD (or its clearing firm if a clearing firm relationship exists) within 18 months immediately preceding a call or fax; or
- KCD is the "broker-dealer of record" (identified on the customer's account application for accounts held directly at a mutual fund or variable insurance product issuer) for the account of the person within the previous 18 months immediately preceding the date of the call or fax; or
- the person has contacted KCD to inquire about a product or service offered by KCD within the previous 3 months immediately preceding the call or fax.

11.21 Scripts

Responsibility	• Designated Supervisor
Resources	• Scripts to be used by RRs or non-registered cold callers
Frequency	• As required
Action	• Review and revise (as needed) • Scripts for use by non-registered personnel are strictly limited; refer to the section *Cold Callers* for more details • Ensure required elements (as described in the policy) are included in all scripts
Record	• Maintain copies of approved scripts in a file - Include initials and date approved

Scripts used for the purpose of contacting the public are subject to the requirements governing retail communications. The general requirements include the following:

- Any scripts involving options require the approval of Compliance prior to use.
- Scripts for non-option products require the approval of the designated supervisor prior to use.
- Cold callers are restricted to using scripts when making calls (see the section *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
  - the address or phone number of the branch office or OSJ where the caller may be contacted
  - a statement that the purpose of the call is to solicit interest in a security

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

11.22 Public Appearances

[FINRA Rule 2210(f)]

Responsibility	• Designated Supervisor
Resources	• Requests for public appearances • Outlines of subjects to be included • Charts or other visual aids to be used in conjunction with public speaking • Written materials to be provided to attendees
Frequency	• As required
Action	• Refer requests for contact with media to Compliance • Review outlines of information to be presented and revise, as needed • For product-specific presentations, request review by product manager, if necessary • For mutual fund presentations, materials provided by wholesalers also require the approval of Compliance • Option presentations require the review and approval of the Registered Options Principal and Compliance • Review charts and written materials to be presented • Attend sales seminars periodically to confirm compliance with requirements • Ensure presentations involving securities being offered by prospectus include provision of prospectuses to attendees • Include public appearance requirements in training or provide training prior to appearances
Record	• Maintain approved outline, samples of visual aids, and written materials in a "Public Appearances" file • Initial and date all approved materials • Obtain and maintain in the Public Appearances file a list of attendees who received prospectuses (if applicable) • The ROP and Compliance maintain a file of all approved public appearances that includes options • Compliance maintains records of approved wholesaler materials • Records of training including who participated, subjects covered

The following sections outline requirements when RRs engage in public appearances.

11.22.1 General Guidelines

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

- The general standards explained earlier in this chapter apply to public appearances.

- If a security is recommended in the public appearance, the RR must have a reasonable basis for the recommendation **and** must disclose:
    - If the RR has a financial interest in the securities of the issuer; the nature of the interest (including derivatives such as options, warrants, *etc.*) and any material conflict of interest of the RR or the Firm known at the time of the appearance. *(This disclosure does not apply to investment company securities or variable insurance products.)*
- These requirements do not apply to public appearances by research analysts where the appearance complies with the requirements of FINRA Rule 2241(d).

11.22.2 Seminars

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.

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 including date of review and initials of the reviewer and any changes to be made.

11.22.3 Approval

Prior to engaging in public speaking, the RR should prepare an outline and submit a Public Appearance/Seminar/Luncheon Request for approval by the designated supervisor and Compliance at least 3 weeks prior to the event to ensure timely review. The Request should also include a copy of any proposed advertising about the event if using materials that are not pre-approved by KCD.

11.22.4 Radio, TV, And Other Extemporaneous Presentations

The general 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 POLICIES* and the section *Media Contact Is Limited To Certain Authorized Persons* that explains restrictions on dealing with the media. Most employees 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 KCD's "Media Contact" policy. If a recommendation is made, the speaker is required to disclose material information such as when KCD is a market maker in the stock. The current price and any special risks associated with the security also must be disclosed.
- The firm's name 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 may not be understood by the general audience.
- Include products only where the speaker is licensed to sell the product.

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.

11.22.5 Securities Sold By Prospectus

When presentations include discussion of securities sold by prospectus (mutual funds, variable annuities, *etc.*), participants should receive a copy of the prospectus. A list of participants should be prepared and an indication included that prospectuses were provided.

11.22.6 Options

Seminars And Public Presentations

Responsibility	• Designated Supervisor • Compliance
Resources	• Outlines for proposed seminars or public presentations that include options including sales material to be distributed • Tapes of radio, TV, newspaper articles, or other public media presentations
Frequency	• As required

Action	• Designated Supervisor: review presentation and related sales materials and refer to Compliance for review and approval
	• Compliance:
	    ○ Pre-approve radio, TV, newspaper or other public media presentation
	    ○ Review seminars or other presentations and sales material; approve or disapprove

Record	• Compliance: record of presentation and sales material; copies of written materials or tapes of public media presentations; approval/disapproval
	• Designated Supervisor:
	    ○ Copy of presentation and sales material
	    ○ Record of approval/disapproval
	    ○ List of attendees
	    ○ Confirmation that attendees were provided options disclosure documents

Prior to conducting a seminar or other public presentation regarding options, the outline of the presentation should be provided to the designated supervisor for review. Seminar scripts, handouts, slides, or other visual presentations must be pre-approved and are deemed to be sales literature. All who attend the public presentation should be provided the current options disclosure document. A list of those who attended and received the disclosure document should be prepared and include the date of the meeting.

Appearances in public media (radio, TV, newspapers, other) require the prior approval of Compliance and copies of written material or tapes of the presentation must be provided to Compliance including where published/presented and the type of media (name of newspaper, radio/TV station, other) and date of the appearance or publication.

11.22.7 Mutual Funds

The following guidelines apply when an RR or KCD 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 or compliance prior to conducting the seminar.
- If specific mutual funds are recommended, 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 supervisor or Compliance 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 use.

11.23 Cold Callers

[FINRA Notice to Members 95-54]

The following guidelines apply to **unregistered** individuals who engage in cold calling.

11.23.1 Cold Caller Requirements

All cold callers will be employees of KCD and will be subject to the usual background investigations for all new employees. Cold callers are supervised by the designated supervisors of their respective departments.

Cold callers will be provided with a copy of KCD's policy regarding cold callers and the Calling Restrictions policy as well as KCD's Do Not Call list. Cold callers will be asked to acknowledge, in writing, receipt of the policies and the list.

11.23.2 Permissible Cold Caller Activities

Unregistered cold callers are restricted to the following:

- Inviting prospects to KCD-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 KCD and the purpose of the call. Prior to making calls, the caller must check KCD's Do Not Call List.

11.23.3 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 KCD's Do Not Call List

11.23.4 Scripts

Cold callers will be restricted to KCD-approved scripts when making calls. Scripts are approved by the designated supervisor prior to use.

11.24 Electronic Communications

[FINRA Rule 3110(b)(4) and 3110.06]

The Electronic Communications information for all employees is included in the chapter *GENERAL EMPLOYEE POLICIES*. This section provides details of these requirements and oversight of electronic communications.

11.24.1 Electronic Communications Systems And Devices

Responsibility	• Compliance or Designee
Resources	• Internal systems • External systems • Available communications devices
Frequency	• As required: determine approved systems/devices
Action	• Identify systems and devices approved for employee communications and notify employees (including changes when they occur) • Identify systems for internal-use only and notify employees • Determine whether firewalls will be established to prevent disclosure of sensitive information and breaches of information barriers • Determine whether encryption is necessary, identify communications to be encrypted, and educate employees on use of encryption • At its discretion, audit an individual employee's computer and use of communication devices • Restrict use of systems or devices where appropriate
Record	• Records of approved systems, communications to employees, audits of computer/device use and corrective action taken

Compliance will determine what systems and devices may be used for KCD business communications.

11.24.2 Education And Training

Responsibility	• Compliance: develop training • Supervisors/others designated to provide training
Resources	• Annual compliance meetings • Firm Element continuing education • Annual employee certifications • Periodic reminders distributed to employees
Frequency	• As required - develop training • At time of hire of new employees • Annually for: ○ Compliance meetings ○ Continuing education ○ Certifications • Periodically to address regulatory developments
Action	• Conduct training • Distribute and obtain certifications (Annual Employee Questionnaire) • Send periodic reminders
Record	• Records of annual compliance meetings • Records of Firm continuing education • Annual certifications • Records of period reminders

- The Firm Element continuing education program and/or annual compliance meeting for registered employees will periodically include training regarding KCD's electronic communications system.

11.24.3 Commercial E-Mail Procedures

[CAN-SPAM Act of 2003]

Responsibility	• Compliance or Designee
Resources	• Notification of recipients wanting to "opt-out"
Frequency	• Ongoing
Action	• Include any "opt-out" requests on a "Do-Not-Email" list • To the extent available in the electronic mail system, block outgoing e-mails to

	those who have opted out
Record	• Do-Not-Email list • Requests to opt out

E-mails that are "commercial electronic mail" are subject to the CAN-SPAM Act. Commercial electronic mail includes, under federal law, 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. The Act applies to "persons" who include individuals, groups, unincorporated associations, limited or general partnerships, corporations, or other business entities.

KCD's e-mail will comply with the following federal requirements.

- All commercial e-mails will include clear identification of KCD, its address and the sender's e-mail address.
- E-mails will be sent using KCD's computers or other computers specifically authorized for transmission of KCD e-mails.
- Recipients will be given the opportunity to "opt-out" from receiving future commercial electronic mail. The recipient cannot, as a condition of honoring an opt-out request, be charged a fee, be required to provide information other than the recipient's e-mail address and opt-out preferences, and be required to take any steps other than sending a reply e-mail or visiting a single page on an Internet website. Opt-out requests will be effected within 10 business days of the request, as required by the Act.
- Where KCD e-mails include other marketers (for example, a mutual fund management company), KCD will be considered the "sender" responsible for compliance with the Act unless specifically agreed in advance that another entity included in the e-mail will act as "sender."
- KCD will not use "address harvesting" or "dictionary attacks" to obtain e-mail addresses from the Internet.

11.24.4 Instant Messaging

[FINRA Notice to Members 03-33]

Responsibility	• Designated supervisor: review instant messages • Compliance: determine extent of permitted instant messaging
Resources	• Vendor or in-house program or service designed for review, retention, and retrieval of instant messages
Frequency	• Regular review of exceptions or flagged communications from available programs • Periodic or spot review of all communications for all RRs or specified RRs
Action	• Compliance: ○ Determine whether KCD will permit instant messaging and, if so, what departments and/or personnel are permitted to use instant messages ○ Determine system for review, retention, and retrieval of instant messages ○ For lexicon programs, identify key words or phrases for flagging ○ Reps must be trained and attest to the training prior to being granted

	access to Text Messaging application
	• Designated supervisor: review instant messages in accordance with sampling or review of all messages as outlined in the section *Outgoing Communications*
	• *Consequences for non-compliance can include:*
	  ○ Warning
	  ○ Fine
	  ○ Heightened Supervision
	  ○ Termination

Record	• Instant messages • Record of review including review of flagged exceptions, periodic or spot reviews, and follow-up action taken • Compliance retains agreements with outside vendors engaged to provide surveillance and written record of departments and/or personnel authorized to use instant messaging

Instant messaging is a form of electronic communication that is subject to KCD's policies and may be used for business communications only with KCD's approval regarding authorized persons and authorized devices for communications. This includes text messages. All instant messaging communications are retained and subject to review.

Clients and prospects must give prior consent to receiving text messages, as many mobile phone plans incorporate a pay per text feature. Consent must reflect the level of text messages they are granting permission for reps to send. The levels are:

- Full Texting - No Limitations
- Only Urgent or Time Sensitive Texting
- No Texting Allowed

Reps must use a special mobile phone number provided by KCD through Global Relay for supervision and archiving purposes. This special mobile phone number is for business text messaging only - no personal texting is allowed.

Text messaging may be used for these business purposes

- Appointment confirmation
- Acknowledging special events (birthday, anniversary, etc.)
- Answering GENERAL questions

Text messaging may NOT be used for these business purposes

- Marketing
- Advertising
- Recommendations
- Transactions
- Insider information
- Disparaging, defamatory or harassing statements
- Unpleasant or retaliatory statement
- No emojis allowed as they could be misinterpreted
- No acronyms allowed as they could be misinterpreted
- No personally identifiable data is EVER to be sent via Text Messaging
- No intellectual property is to be shared without giving credit where credit is due

Departments permitted to use instant messaging include:

- Internal home office staff - archived on the FacetPhone system.
- Representatives using special mobile phone numbers through KCD and supplied by Global Relay - archived through Global Relay

11.24.5 Review Of Electronic Communications

This section outlines procedures for reviewing electronic communications.

11.24.5.1 Methods Of Review

Responsibility	• Compliance
Resources	• Internal programs • External programs • Electronic communications from approved systems • Reviewers including qualified supervisors and designees
Frequency	• As required

Action	• Determine programs/methods of review
	• Identify red flags to identify communications through unapproved communication channels:
	    ○ e-mail chains that included non-approved e-mail addresses for RRs
	    ○ references in e-mails to communications with an RR that occurred outside approved firm channels
	    ○ customer complaints mentioning such communications
	• Communicate review requirements to supervisors and designees
	• For research communications, establish copies to Compliance for review
	• Determine training needs for supervisors and designees including training prior to assuming review responsibilities
	• Include electronic communications reviews in branch/department audits
	• For Lexicon-based programs, review flagged communications and take corrective action, if necessary (notify supervisor, education, restriction of access to systems or devices, suspension, termination, *etc.*)

Record	• Records of external programs used for reviews • Records of training including subject matter, names of those trained, when, and by whom or what method • Records of flagged communications that require corrective action including action taken

All electronic communications are subject to review. Types of review include:

- [methods to review electronic communications]

Delegation Of Review

The designated supervisor is responsible for reviewing electronic communications and taking necessary actions. The review may be delegated to a qualified reviewer; “qualified” means the individual has experience or has been trained in what to review and what items to refer to the supervisor and/or Compliance. Though reviews are delegated, the supervisor is ultimately responsible for compliance with review requirements. The delegated reviewer will refer the following communications:

- Questionable language to the designated supervisor or Compliance
- Objectionable language or content (profanity, *etc.*) to the supervisor or Compliance
- Complaints to the designated supervisor **and** Compliance
- Advertising/sales literature/market letters not previously approved to Compliance
- Communications regarding errors or account designation changes in orders to the supervisor
- Potential outside business activities, potential selling away, and other potential compliance violations

11.24.5.2 Communications Review Before Or After Sending

The following communications require approval by a qualified supervisor **prior to** sending. Other types of communication are subject to post-sending review.

- Advertising (Compliance approval required)
- Communications defined as "research" (see the section **Outgoing Communications** for further information)
- Form letters (approval of initial form required; subsequent communications may be sent without prior approval if there is no change in previously-approved content)
- Retail communications (communications sent to more than 25 retail investors)
- All communications to retail investors about CMOs

11.24.5.3 Outbound Email Monitoring

Outbound emails and attachments will be scanned to identify and potentially block sensitive customer information or confidential Firm data.

Review Of Retail Customer Communications

Responsibility	• Branch manager or Designee • Compliance or Designee: branch/department reviews
Resources	• Incoming and outgoing communications
Frequency	• Monthly or Periodically
Action	• Supervisor review of: ○ 50% of branch/department communications • Supervisor review for: ○ complaints

	○ appropriateness of language ○ appropriateness of recommendations • Compliance review during retail branch/department internal examinations • Take corrective action, if necessary (education, restricting access to electronic communications, or other action in consultation with Compliance)
Record	• Electronic records of communications • Electronic record of review • Corrective action (in employee's file)

Incoming and outgoing customer electronic communications are reviewed, and complaints are referred to Compliance.

Review Of Investment Banking Communications

- All communications between Research and investment banking personnel must be routed through Compliance and may not be directly sent.
- Confidentiality of communications about confidential investment banking activities must be protected by limiting access to information (passwords, closing open pages when not in use, avoiding use of PDAs in public places, *etc.*).
- Communications are subject to review and retention.

11.24.6 Internet

Responsibility	• Designated Supervisor or Designee
Resources	• KCD's or RR's web site • Requests to include information
Frequency	• Approvals - as required • Quarterly review of the web site
Action	• Review proposed materials to be included on the web site and approve or disapprove ○ For proposed material on mutual funds, variable products, and ETFs, file copies of content for approval from FINRA at least 10 days prior to first use • Review the web site to confirm that only previously approved materials are included • If SIPC is referenced on the site, provide a hyperlink to the SIPC web site • If FINRA is referenced on the site, provide a hyperlink to FINRA's home page • Contact supervisors of departments that have included unapproved materials and take corrective action • Corrective action may include changing or deleting the material and/or reminding the supervisor of the pre-use approval requirement
Record	• Approved materials • Proposals including revisions, approval, disapproval

	• Notations regarding periodic reviews and corrective action taken • FINRA approval of content related to mutual funds, variable products, and ETFs • Record of the appearance of the site over the past 3 years (including all changes)

This section outlines procedures for accessing communications systems on the web and posting information to the web, including a firm web site.

11.24.6.1 Social Media, Blogs, Web Sites And Other Electronic Communication Systems

[FINRA Regulatory Notice 17-18, 11-39 and 10-06]

Responsibility	• Designated Supervisor • Compliance
Resources	• Requests to participate in social networks, other systems • Postings on sites
Frequency	• Approval of participants - as required • Quarterly- review of sites

Action	• Compliance:
	  o Review and approve media for RR participation particularly considering the ability to monitor and retain records of communications
	  o Review requests to participate including review of RR's background
	  o Review an RR's proposed social media site in the form in which it will be launched including review of the first posting by the RR
	  o Approve or disapprove participation
	  o Approve or disapprove the use of personal communication devices particularly considering the ability to review and retain records of communications; provide guidelines to RRs if such devices are approved for use
	  o When using third-party media providers, perform due diligence including:
	    ▪ The provider's reputation in the marketplace
	    ▪ The third party's policies including:
	      ▪ collection and handling of customer information
	      ▪ the process and frequency by which the third party's policies may change
	      ▪ what control The Firm may have over the third party's policies or actions
	• Designated supervisor:
	  o Review media:
	    ▪ Complete Website Revier Form for each site
	    ▪ Update Social Media Spreadsheet
	  o Review RR sites quarterly
	  o Review and approve/disapprove static postings
	  o Remove inappropriate postings
	  o Take corrective action where problems are noted including blocking a 3rd party from posting; disciplining an RR which may include added training, removal of approval for participation, other appropriate action

Record	• RRs approved/disapproved for participation • Templates, if available • Approved static postings • Records of business communications and corrective action, if appropriate • Review of media and any corrective action taken

The use of social media (Facebook, LinkedIn, Twitter, *etc.*), blogs, web sites, and other electronic forums (collectively referred to as "media" in this policy) for the purposes of advertising, soliciting business, or in any way communicating about Firm business is subject to the following requirements. "Social media" is a form of interactive online communication in which users can generate and share content through text, images, audio, and/or video. Social media is a dynamic and constantly evolving technology, therefore the definition is meant to be illustrative and not exhaustive.

11.24.6.1.1 Complaints

KCD will treat any complaints posted by a customer of KCD on social media as a complaint subject to complaint procedures in this chapter.

11.24.6.1.2 Legal Liability

An employee is legally liable for anything he or she writes or presents online or through social media communications. Employees may be disciplined by KCD for commentary, content, or images that violate this policy including those that are defamatory, pornographic, proprietary, harassing, libelous, or that can create a hostile work environment. Employees can also be sued by co-workers, competitors, and any individual or company for posted comments/views.

11.24.6.2 Mobile Applications (Apps)

Responsibility	• Designated Supervisor
Resources	• Digital platforms • Communications • Cybersecurity software • Available reports
Frequency	• Quarterly: review and test apps • As required: update cybersecurity measures • Ongoing: review communications, if applicable
Action	• Test accuracy of displayed information including labels and data • Confirm that features work and are understandable, and update as required • Include disclosures, as necessary, regarding risks, fees, costs, conflicts of interest, margin and option accounts, and required standards of conduct as well as information to explain complex strategies and investments and associated risks • Comply with account opening requirements including approving access to options or other complex products, as applicable

	• Ensure products and services of KCD and affiliates or third parties are identified as such • Establish procedures to identify recommendations subject to Reg BI, or prohibit recommendations on the app • Update features as required including new cybersecurity measures as necessary • If customer communications are included, review communications for compliance with communication rules • Review whether it includes recommendations subject to Reg BI and, if it does, confirm compliance with requirements including providing Form CRS
Record	• Reviews including manual or electronic record of reviews • Updates • Reg BI reviews, if applicable

KCD offers apps for download as outlined below:

KCD does not allow Mobile Applications for transactions or client communications regarding transactions

Social Networks, Bulletin Boards, Web Sites And Other Electronic Communication Systems

[FINRA Regulatory Notice 10-06]

Only the use of firm approved social networking sites is permitted with KCD's prior approval, review and representative acknowledgement of the firms social media policy which can be obtained through the Compliance department. The use of bulletin boards, public web sites, message boards, or other electronic communication systems on the Internet for the purpose of advertising, soliciting business, or in any communication about KCD business is prohibited.

11.24.6.3 Digital Channels

Responsibility	• Designated Supervisor
Resources	• External or internal digital channels and related content
Frequency	• Ongoing

Action	• Identify approved digital channels for RR and/or customer use and communicate this information to RRs and supervisors
	• Identify prohibited digital channels and communicate this information to RRs and supervisors and block prohibited channels where possible
	• Monitor new communication channels, apps and features
	• Establish video content protocols including prior review of scripts; review of approved presentations
	• Monitor use of digital channels for:
	    ○ Communications meeting content requirements for fair and balanced information and prohibitions against false and misleading information including prohibited predictions and projections
	    ○ Red flags which may include email chains that copy unapproved RR email addresses; references to emails to communications occurring

	outside approved firm channels; customer complaints mentioning such communications • Take corrective action when exceptions are identified which may include contacting Compliance, limiting RR access to digital channels, additional training, disciplinary actions • Ensure digital communications are maintained in accordance with required books and records rules • Identify, through correspondence (electronic and otherwise), complaints, social media, and other channels, potential misuse of approved digital channels or use of unapproved channels • Require training about appropriate use of digital channels and guidance for using permitted channels and features • Temporarily or permanently block access to those employees who do not comply with policies and require additional training prior to resuming access
Record	• Approvals/disapprovals of digital channels and communications with RRs and supervisors about digital channels • Reviews of digital channel content and activity including videos, live-streamed public appearances, or video blogs • Corrective action • Records of digital channel content and use • Training

Digital channels are communication paths and platforms which may include promotion, marketing, or selling products and services and allowing customers to access information and communicate with KCD. RRs and customers are advised of available features of Firm digital channels. This may include the use of mobile apps.

RRs may use only authorized digital channels (and tools and features); unauthorized channels, tools and features may be blocked. Activity and content on digital channels are subject to supervisory reviews and record retention requirements.

Video presentations are subject to prior approval including submission of scripts and details of contents. Video blogs must be approved prior to initiation and records retained of all video blog information.

11.24.6.4 Firm Web Site

[FINRA Rule 2210; FINRA Notice to Members 07-02; SIPC By-Laws Article 11 Section 4; SEC Guidance for public companies on the use of company web sites: http://www.sec.gov/rules/interp/2008/34-58288.pdf; FINRA BrokerCheck link requirements: https://www.finra.org/compliance-tools/rule-2210-brokercheck]

Responsibility	• Designated Supervisor
Resources	• The KCD's web site • Requests to include information
Frequency	• Approvals - as required • Periodic review of the web site
Action	• Review proposed materials to be included on the web site and approve or

	disapprove ○ Determine whether filing with FINRA is required and make necessary filings • Review the web site to confirm that only previously approved materials are included • If SIPC is referenced on the site, provide a hyperlink to the SIPC web site • If FINRA is referenced on the site, provide a hyperlink to FINRA's home page • Contact supervisors of departments that have included unapproved materials and take corrective action • Confirm hyperlinks to BrokerCheck are included • Corrective action may include changing or deleting the material and/or reminding the supervisor of the pre-use approval requirement
Record	• Approved materials and (if applicable) copies of FINRA filings • Notations regarding periodic reviews and corrective action taken • Record of the appearance of the site over the past 3 years (including all changes)

The Firm has established a web site. Any information to be included on the web site requires the **prior approval** of Compliance.

If the KCD's site refers to its membership with FINRA, a hyperlink to the FINRA internet home page will be included. If SIPC membership is included on the site, a hyperlink to SIPC's web site will be shown.

The site also includes the required hyperlink to FINRA's BrokerCheck on the initial web page for viewing by retail investors and on any web page that includes a profile of one or more RRs who deal with retail investors. The hyperlink is not required for firms that do not conduct business with retail investors or to a directory or list of RRs limited to names and contact information.

RR Web Sites

RRs are permitted to establish web sites under the following conditions:

- RRs must obtain Compliance approval to publish a web site.
- Additions or changes to the site must receive the prior approval of Compliance.
- If FINRA or SIPC membership is included, the site will show hyperlinks to FINRA's internet home page and SIPC's web site.

11.24.6.5 Data Feeds

[FINRA Regulatory Notice 11-39]

Any third-party data feeds tied to the KCD's or an RR's web site must be reviewed by Compliance prior to use. Reviews will identify the proficiency of the data provider to feed accurate and timely information. Compliance will regularly review the data feeds for red flags indicating the data may not be accurate, and will take corrective action as necessary.

Compliance will advise the requestor whether the data provider is approved and will retain records of its review.

11.24.6.6 Third-Party Postings

Compliance must review and approve any requests to include third-party postings on KCD's web site prior to inclusion of such postings on the site. If third-party postings (including customer postings) are permitted, the following requirements will apply:

- A disclaimer will be included on the web site stating that such posts are not those of KCD; do not reflect the views of KCD; and KCD does not take responsibility for the content of such posts.
- Potential third-party posters must pre-register and will be screened by Compliance before being allowed to post content.
- The site is regularly reviewed and third-party posts will be monitored as part of that review to mitigate any perception that KCD is adopting any post.
- Usage guidelines will be provided to customers or other third parties permitted to post on firm-sponsored sites.
- Compliance may develop standard responses that RRs will be authorized to use in response to third-party postings on social media web sites.

Compliance will retain records of registration and screening of third parties allowed to post.

11.24.7 Hyperlinks to Third-Party Sites

[FINRA Interpretation Letter from Thomas M. Selman to the Investment Company Institute, November 11, 1997]

When hyperlinks to third-party sites are included in KCD communications or on a KCD web site, it is important the hyperlink meets the following conditions to avoid liability for the content or regulatory filing of information included in the third-party site:

- A hyperlink may not be established to a site known (or there is reason to know) to contain false or misleading information.
- The hyperlink must be continuously available to investors who visit the site.
- KCD or its employees cannot have discretion to alter information on the third-party site.
- Investors have access to the hyperlinked site whether or not it contains material favorable to KCD.
- The linked site can be updated or changed by the third party, following which investors would still be able to use the hyperlink.

11.24.8 Prohibition Against Automatic Erasing/Deleting

[FINRA Regulatory Notice 11-39]

KCD and its employees are prohibited from sponsoring a social media site or using a communication device that includes technology which automatically erases or deletes content.

11.24.9 Policy Violations

Responsibility	• Compliance or Designee
Resources	• Records of communications
Frequency	• As required

Action	• Review the employee's file to determine if there have been prior violations • Notify employee and his/her supervisor • If appropriate action by the supervisor is not forthcoming, contact the supervisor's supervisor • Where violations are recurring, determine whether to audit the employee's computer files • Determine disciplinary action
Record	• Records of violative communications and action taken, including any extenuating or mitigating circumstances

Employees who violate KCD's Policy regarding electronic communications are subject to disciplinary action which may range from education, restricting electronic and/or Internet access, to suspension or termination depending on the nature and seriousness of the infraction. Either Compliance or supervisor may determine the appropriate action to be taken.

11.25 Identification Of Sources

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

Pre-recorded Voice Messages And Automatic Telephone Dialing Systems (Autodialers)

KCD and its associated persons are prohibited from initiating any outbound telemarketing call that delivers a prerecorded message without a person's express written agreement to receive such calls. The rule also requires that all prerecorded telemarketing calls provide specified opt-out mechanisms so that a person can opt out of future calls. The prohibition does not apply to a prerecorded message permitted for compliance with the "safe harbor" for abandoned calls discussed in the next section.

KCD does not permit prerecorded messages or the use of autodialing systems.

11.25.1 Notification To BrokerCheck

[FINRA Rule 8312]

FINRA will notify BrokerCheck when KCD becomes subject to FINRA's Taping Rule.

12 ANTI-MONEY LAUNDERING PROGRAM (AML)

12.1 AML Compliance Officer

[FINRA Rule 3310(d) and 3310.02]

Responsibility	• AML Compliance Officer
Resources	• Computer reports and other programs developed for the Program • Internal audits or outside audits of the Program • Regulations and rules for broker-dealer anti-money laundering programs • OFAC web site • Other sites and resources available

Frequency	• Annual - review policies and procedures and business lines
	• Annual and more frequently, as needed - develop and schedule AML education for employees
	• As needed - update program and provide revisions to senior management for review and approval
	• As required: revise delegation of AML responsibilities
	• Annually - review AML contact information on file with FINRA
	• Ongoing - review new regulations
	• Ongoing - monitor activity including:
	    ○ activity in micro-cap and penny stocks, particularly when transacted through omnibus accounts maintained for foreign financial institutions
	    ○ accounts for foreign customers that appear to have been opened solely to trade in IPOs and post-IPO trading in shares issued by companies based in restricted markets such as China
	    ○ due diligence with respect to SPAC sponsors and the appropriateness of disclosures in SPAC IPOs

Action	• Develop and update KCD's anti-money laundering program • Obtain senior management approval for the program and any changes to the program • Monitor (or designate monitoring) the activity of KCD, its associated persons, and customers to reasonably detect and prevent money laundering activities • Consider AML implications of new business lines and products • Develop AML education program for employees and schedule training • File required reports • Retain required records • Provide contact information to FINRA and update contact information if necessary • Review policies and procedures and new areas of business and update AML Program as needed
Record	• Designation of AML Compliance Officer • Delegation of AML responsibilities and escalation procedures • Current and past copies of anti-money laundering program with senior

	management approval • Records of AML education including who attended, date of training, and material covered • Reports filed • Reviews of the AML Program • Other records to be retained, as listed in the Program

KCD has designated an AML Compliance Officer who is responsible for developing policies, procedures, and internal controls reasonably designed to achieve compliance with AML rules and regulations.

KCD's AML Program is included by reference to these Written Supervisor Procedures. See the attached Program for information regarding our AML Policies.

12.2 Identifying And Responding To Red Flags

The following chart identifies identity theft red flags and potential responses which depend on the nature and seriousness of the red flags. **In addition, refer to FINRA Regulatory Notice 19-18 for a comprehensive list of potential red flags.**

Red Flag	Action
Category: Alerts, Notifications or Warnings from a Consumer Credit Reporting Agency	
1. A fraud or active duty alert is included on a consumer credit report.	Verify that the fraud or active duty alert covers an applicant or customer and review the allegations in the alert.
2. A notice of credit freeze is given in response to a request for a consumer credit report.	Verify that the credit freeze covers an applicant or customer and review the freeze.
3. A notice of address or other discrepancy is provided by a consumer credit reporting agency.	Verify that the notice of address or other discrepancy covers an applicant or customer and review the address discrepancy.
4. A consumer credit report shows a pattern inconsistent with the person's history, such as a big increase in the volume of inquiries or use of credit, especially on new accounts; an unusual number of recently established credit relationships; or an account closed because of an abuse of account privileges.	Verify that the consumer credit report covers an applicant or customer, and review the degree of inconsistency with prior history.
Category: Suspicious Documents	
5. Identification presented looks altered or forged.	Scrutinize identification presented in person to make sure it is not altered or forged.
6. The identification presenter does not look like the identification's photograph or physical description.	Determine that the photograph and the physical description on the identification match the person presenting it.
7. Information on the identification differs from what the identification presenter is saying.	Determine that the identification and the statements of the person presenting it are consistent.

8. Information on the identification does not match other information our firm has on file for the presenter, like the original account application, signature card or a recent check.	Determine that the identification presented and other information we have on file from the account are consistent.
9. The application looks like it has been altered, forged or torn up and reassembled.	Scrutinize each application to identify alterations or forgery (for example, a form that has been cut up and reassembled).
Category: Suspicious Personal Identifying Information	
10. Inconsistencies exist between the information presented and other things we know about the presenter or can find out by checking readily available external sources, such as an address that does not match a consumer credit report, or the Social Security Number (SSN) has not been issued or is listed on the Social Security Administration's (SSA's) Death Master File.	Check personal identifying information to determine that the SSN given has been issued but is not listed on the SSA's Master Death File. If we receive a consumer credit report, check to see if the addresses on the application and the consumer report match.
11. Inconsistencies exist in the information that the customer gives us, such as a date of birth that does not fall within the number range on the SSA's issuance tables.	Check personal identifying information to confirm that it is internally consistent by comparing the date of birth to see that it falls within the number range on the SSA's issuance tables.
12. Personal identifying information presented has been used on an account our firm knows was fraudulent.	Compare the information presented with addresses and phone numbers on accounts or applications that were reported to be fraudulent.
13. Personal identifying information presented suggests fraud, such as an address that is fictitious, a mail drop, or a prison; or a phone number is invalid, or is for a pager or answering service.	Validate the information presented when opening an account by looking up addresses on the Internet to ensure they are real and not for a mail drop or a prison; call the phone numbers given to ensure they are valid and not for pagers or answering services.
14. The SSN presented was used by someone else opening an account or other customers.	Compare the SSNs presented to see if they were given by others opening accounts or other customers.
15. The address or telephone number presented has been used by many other people opening accounts or other customers.	Compare address and telephone number information to see if they were used by other applicants and customers.
16. A person who omits required information on an application or other form does not provide it when told it is incomplete.	Track when applicants or customers have not responded to requests for required information and follow up with the applicants or customers to determine why they have not responded.
17. Inconsistencies exist between what is presented and what our firm has on file.	Verify key items from the data presented with information we have on file.
18. A person making an account application or seeking access cannot provide authenticating information beyond what would be found in a wallet or consumer credit report, or cannot answer a challenge question.	Authenticate identities for existing customers by asking challenge questions that have been prearranged with the customer and for applicants or customers by asking questions that require information beyond what is readily available from a wallet or a consumer credit report.
Category: Suspicious Account Activity	
19. Soon after KCD gets a change of address request for an account, we are asked to add additional access means (such as debit cards or checks) or authorized users for the account.	Operations (or the clearing firm) verifies change of address requests by sending a notice of the change to both the new and old addresses so the customer will learn of any unauthorized changes and can notify

	KCD.
20. A new account exhibits fraud patterns, such as where a first payment is not made or only the first payment is made, or the use of credit for cash advances and securities easily converted into cash.	Review new account activity to ensure that first and subsequent payments are made, and that credit is primarily used for other than cash advances and securities easily converted into cash.
21. An account develops new patterns of activity, such as nonpayment inconsistent with prior history, a material increase in credit use, or a material change in spending or electronic fund transfers.	Review accounts on at least a monthly basis and check for suspicious new patterns of activity such as nonpayment, a large increase in credit use, or a big change in spending or electronic fund transfers.
22. An account that is inactive for a long time is suddenly used again.	Review our accounts on at least a monthly basis to see if long inactive accounts become very active.
23. Mail KCD sends to a customer is returned repeatedly as undeliverable even though the account remains active.	Note any returned mail for an account and immediately check the account's activity.
24. We learn that a customer is not getting his or her paper account statements.	Record on the account any report that the customer is not receiving paper statements and immediately investigate them.
25. We are notified that there are unauthorized charges or transactions to the account.	Verify if the notification is legitimate and involves a firm account, and then investigate the report.
Category: Notice From Other Sources	
26. An outside agency, law enforcement, a clearing firm, or other source notifies KCD that an account has been opened or used fraudulently.	Verify that the notification is legitimate and involves a firm account, and then investigate the report.
27. KCD is notified of potential unauthorized access to customer personal information due to data loss from an outside provider or a breach of an outside provider's data.	In consultation with the outside provider, determine the extent of the loss of data or breach of the provider's systems and determine action to be taken which may include notification of customers and notification of regulatory authorities including states depending on state requirements.
28. Notice from a customer of the loss of information (e.g., loss of wallet, birth certificate, etc.).	Contact the customer to learn the details of the unauthorized access to determine if other steps are warranted.

12.3 Detecting Potential Money Laundering

Responsibility	• AML Compliance Officer • Other designated supervisor for review of AML Compliance Officer accounts • Reviewer of systems/procedures (*i.e.,* Internal Audit, Compliance)
Resources	• Internal reports of transactions, available exception reports
Frequency	• Daily and ongoing: review of transactions • Annual: test systems and data
Action	• For accounts that provide "banking-like services" (*i.e.,* wire transfers, check

	writing, ATM withdrawals) review for large movements of money with little or no securities trading
	• Monitor foreign currency-denominated wire transfers
	• Monitor customers' deposits and trades in penny stocks for potential suspicious activity
	• Monitor correspondent accounts maintained for foreign financial institutions
	• Supervisor(s):
	  ○ Review reports of transactions (cash and security transactions) to identify potential money laundering (including employee accounts)
	  ○ Another designated supervisor will review the AML Compliance Officer's accounts
	  ○ Report suspicious activity (see the policy in this chapter)
	  ○ Notify RRs, supervisors, and close accounts when necessary
	• Reviewer(s): Conduct reviews of systems and data sources to confirm potential suspicious activity will be identified and reported

Record	• Reviews including manual/electronic record of reviews of:
	•
	  ○ banking-like services
	  ○ reports
	  ○ foreign currency wire transfers
	  ○ IPOs in emerging markets
	  ○ Correspondent accounts for foreign financial institutions
	• Action taken, when necessary
	• Suspicious activity reports
	• Reviews of systems and data and corrective action taken, if applicable

KCD has an ongoing program to identify potential money laundering. Monitoring will be conducted using available exception reports or review of a sufficient amount of account activity to permit identification of patterns of unusual size, volume, pattern or type of transactions, geographic factors such as whether jurisdictions designated as "non-cooperative" are involved, or involve "red flags" (indicators of potential money laundering) which are included in the *Money Laundering* policy in the chapter *GENERAL EMPLOYEE POLICIES*. Items reviewed include trading and wire transfer transactions in the context of other account activity to determine if a transaction lacks financial sense or is suspicious because it is an unusual transaction or strategy for that customer. Among the information used to determine whether to file a suspicious activity report are exception or transaction reports that include transaction size, location, type, number, and nature of the activity.

Trading accounts will be identified and monitored where a series of financial transactions may help obscure the origins of the funds. This may include effecting securities transactions, closing the account, and transferring funds to a bank or other account, particularly to an offshore location. Trading penny stocks (which may involve unregistered distributions) or engaging in retail forex trading will, in particular, be monitored when they occur.

KCD has included an educational policy *(Money Laundering)* in the chapter *GENERAL EMPLOYEE POLICIES* to educate employees on money laundering and guidelines for detecting money laundering activities. Periodically detection of money laundering and the obligation to report suspicious activities will be included in continuing education and other educational programs for employees.

12.4 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 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.
- **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).
- **Correspondent and Private Banking accounts.** See the section *Due Diligence For Correspondent And Private Banking Accounts*.

12.4.1 Identifying Potential Suspicious Activity

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

- Transaction information including disbursement of funds or securities
- Education of firm personnel, particularly supervisors in Operations areas
- Employee reports of potential suspicious activity forwarded to the AML Compliance Officer
- Internal reports or reports provided by a clearing firm

12.5 Suspicious Activity Reports (SARs)

[Bank Secrecy Act 31 CFR Chapter X Part 1023 Subpart B; USA PATRIOT Act Section 356; SEC Risk Alert: https://www.sec.gov/announcement/risk-alert-anti-money-laundering; FINRA Notice to Members 02-47; FinCEN Guidance FIN-2008-G005; FinCEN FAQs: Answers to Frequently Asked Questions Regarding Suspicious Activity Reporting and Other Anti-Money Laundering Considerations https://www.fincen.gov/resources/statutes-regulations/guidance/answers-frequently-asked-questions-regarding-suspicious; 2022 FINRA Report: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• AML Compliance Officer
Resources	• Reports from employees of crimes or suspected crimes • Suspicious activities detected through ongoing reviews • Exception and other reports (internal and/or provided by a clearing firm) • FinCEN advisories • Other available information
Frequency	• As required
Action	• Maintain the confidentiality of SAR reviews and filings: ○ Limit the sharing of information to those authorized and need to know ○ Electronic files should be password-protected and use a file name that does not identify files as SARs-related ○ Use a header on documents: CONFIDENTIAL ○ In redaction markings or privilege logs, identify the redacted or privileged information as "nonpublic supervisory information" ○ For production of documents, produce SAR documents separately from other documents and identify as confidential SAR information ○ Destroy copies of SARs when retention periods have past ○ Confer with counsel or other outside expert regarding confidentiality questions

	• Include FinCEN red flags in suspicious activity identification • Review and investigate suspicious transactions referred by employees or identified in review of surveillance reports • Respond to red flags associated with the movement or settlement of cash or securities (*e.g.*, wire and ACH transfers, debit card and ATM transactions, securities trading (including order entry), and journal transfers) • Review and investigate inquiries from law enforcement, regulators or other federal and state agencies that concern red flags of suspicious activity • Notify AML Officer of events that may require filing of an SAR, including cybersecurity events, account compromise or takeovers or fraudulent wire or ACH transfers. • Respond to red flags regarding the Firm's business operations including activity related to high-risk products and services (*e.g.*, cash management products and services; trading of low-priced, thinly traded securities; and suspicious activity introduced to the Firm by other BDs) • Review and investigate suspicious transactions referred by a clearing firm, if applicable • Periodically review reports to confirm integrity of captured data and adjust reports as necessary • Determine whether the Firm (or its clearing firm, if applicable) will file a SAR • If appropriate, file Form SAR with FinCEN and state authorities • Notify senior management, as appropriate, of forms filed • Provide copy to parent company, if applicable • File SARs jointly with other financial institutions, if applicable
Record	• Notes and other documented reviews including record of manual/electronic review and actions taken, if applicable • Review of reports for integrity and adjustments made • Copies of SARs filed by the Firm are retained in the SAR file with notation of when and to whom sent

KCD has an obligation to identify suspicious activities and file Suspicious Activity Reports (SARs) for transactions that may be indicative of money laundering activity. Suspicious activities include a wide range of questionable activities; examples include trading that constitutes a substantial portion of all trading for the day in a particular security; trading or journaling between/among accounts, particularly between related owners; late day trading; heavy trading in low-priced securities; unexplained wire transfers, including those to known tax havens; unusually large deposits of funds or securities. For business introduced to a clearing firm, the KCD will rely on the clearing firm to make filings on its behalf and to provide copies to KCD.

13 IDENTITY THEFT POLICY

Our Firm's policy is to protect our customers and their accounts from identity theft and to comply with the FTC's Red Flags Rule. Included by reference, and attached, to our Written Supervisor Procedures is our Identity Theft Policy. RRs should review frequently to help protect the identity of our clients.

13.1 Identity Theft Prevention Program (Red Flags Rule)

[Exchange Act Regulation S-ID; Fair and Accurate Credit Transactions Act (FACT Act) Section 114 and 315; FINRA Regulatory Notice 19-18; FINRA Red Flags Rule web site: https://www.finra.org/rules-guidance/key-topics/customer-information-protection/ftc-red-flags-rule; Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation: https://1library.net/document/yj714e22-department-treasury-office-comptroller-currency-cfr-docket-rin.html]

<table>
<tr><td>Responsibility</td><td>AML Compliance Officer</td></tr>
<tr><td>Resources</td><td>New account information
Order records
Transaction information about cash or security transfers
Information reported by employees
Information from third party providers, customers, victims of identity theft, law enforcement agencies or others about potential identity theft</td></tr>
<tr><td>Frequency</td><td>When new accounts are opened
When account addresses are changed
Ongoing - review of order records and transaction information
As received - employee information
As required - when a third party is engaged, confirm third party providers (including clearing firms) have identity theft program procedures which may be included in an affirmation in the third party's contract with the Firm
Annually - review of controls and procedures
As required - provide revised procedures to the Board, Board committee, or CEO
Annually - report to CEO
Annually (or more frequently) - provide training for employees</td></tr>
<tr><td>Action</td><td>Establish and maintain the Identity Theft Program
Provide initial Program and subsequent material changes to the Board, a Board Committee or CEO (if no Board exists) for review and approval
Review controls and procedures annually as part of the annual testing described in the chapter SUPERVISORY SYSTEM, PROCEDURES AND CONTROLS
Conduct reviews of orders and transactions to identify red flags
When red flags are identified, take corrective action which may include:
Consultation with the RR and/or supervisor
Monitoring the account
Contacting the customer
Changing passwords, security codes, or other security devices that permit access to an account
Reopening an account with another account number
Not opening a new account
Closing an existing account</td></tr>
</table>

	- Filing a Suspicious Activity Report - Notifying law enforcement - Taking no action if warranted • Conduct other reviews which may include: - Periodic use of internet search engines to identify web sites using the Firm's or an RR's name - Review online advertising to identify web sites for unauthorized links to promote stock fraud or that appear to be illegitimate • If the Firm's or an RR's identity is being used in a scam, take action which may include notifying regulators and the FBI, lodging a complaint at www.ftc.gov, and if it involves email solicitation or spoofing, forwarding email to spam@uce.gov • If a customer's account has been compromised, take action (described in a section that follows) • Include Identity Theft Prevention Program in the annual report to CEO (see the chapter *SUPERVISORY SYSTEM, PROCEDURES AND CONTROLS*), reporting: - Effectiveness of the policies and procedures in addressing the risk of identity theft - Third party provider arrangements - Significant incidents involving identity theft and management's response - Recommendations for material changes to the Program • Review third party providers (including clearing firms) for adequacy of identity theft programs - Contractually require them to have policies and procedures to detect Red Flags included in firm policies and report them to the Firm and/or take appropriate steps of their own to prevent/mitigate identity theft • Send confirmation of address change to the customer's old address when a change of address is made (see the section *Change Of Addresses On Accounts* in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*) • Training: - Include identity theft in AML training - Develop training, identify target employees, and administer training
Record	• Policies and procedures and revisions • Reviews of orders and transactions with record of action taken • Red flags identified and record of action taken • Annual testing of procedures (see *SUPERVISORY SYSTEM, PROCEDURES AND CONTROLS*) • Annual report to CEO (see *SUPERVISORY SYSTEM, PROCEDURES AND CONTROLS*) • Confirmation that third party providers (including clearing firms) have adequate ITPPs and include in the contracts with third parties • Records of training including subjects included, date, who administered and who attended

13.1.1 Introduction

Under Regulation S-ID, financial institutions with "covered accounts" are required to establish an Identity Theft Prevention Program (ITPP) to prevent, detect, and act on the theft of customers' identity. "Covered accounts" include accounts for individuals (vs. institutions) and accounts where credit is extended. Because the Firm has individuals as customers or it offers credit to customers, the Firm is subject to the FACT Act requirements.

KCD has established an ITPP which incorporates the Customer Identification Program as a tool for recognizing identity theft. Related policies and procedures include the responsibilities of all employees (and designated supervisors, in particular) as listed below. The chapter is in upper case and the section is in lower case.

- *GENERAL EMPLOYEE POLICIES - Money Laundering*
- *GENERAL EMPLOYEE POLICIES - Identity Theft*
- *COMMUNICATIONS WITH THE PUBLIC - Customer Privacy Policies And Procedures*
- *FINANCIAL AND OPERATIONS PROCEDURES - Risk Management - Firm Computers And Computerized Data*
- *ANTI-MONEY LAUNDERING (AML) PROGRAM - Customer Identification Program (CIP)*
- *ACCOUNTS - Customer Account Information*
- *ACCOUNTS - Identity Theft*

14 FINANCIAL AND OPERATIONS PROCEDURES

14.1 Exemptions

Because of the nature of KCD's business, KCD qualifies for an exemption under Rule 15c3-3(k) or is a "Non-Covered Firm." The FINOP is responsible for determining that KCD qualifies for one of the following exemptions.

14.1.1 Exemption Under (k)(1)

[Exchange Act Rule 15c3-3(k)(1)]

i. KCD's transactions as dealer (as principal for its own account) are limited to the purchase, sale, and redemption of redeemable securities of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company; except that where KCD is transacting business as a sole proprietor may also effect occasional transactions in other securities for its own account with or through another registered broker or dealer;
ii. KCD's transactions as broker (agent) are limited to:
    a. The sale and redemption of redeemable securities of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company;
    b. the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; **and**
    c. the sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and
iii. KCD promptly transmits all funds and delivers all securities received in connection with its activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.

14.1.1.1 Exemption As A Non-Covered Firm

[https://www.sec.gov/divisions/marketreg/amendments-to-broker-dealer-financial-responsibility-rule-faq.htm]

As a "Non-Covered Firm" KCD is not required to make a daily possession or control determination because the requirement applies only to broker-dealers that carry accounts of or for customers. KCD is also not required to make the customer reserve or PAB reserve computations because KCD is only required to make these computations to the extent it has amounts required to be deposited in the customer reserve account or the PAB reserve account.

KCD will update its FINRA membership agreement when it adopts the Non-Covered Firm exemption. When filing its FOCUS Report KCD may include a statement that "The firm has no possession or control obligations under SEA Rule 15c3-3(b) or reserve deposit obligations under SEA Rule 15c3-3(e) because its business is limited to [*list of activities*]."

This chapter provides key policies and procedures affecting the financial and operations areas of KCD. Detailed operations procedures are included in a separate operations manual maintained by KCD or, if KCD is an introducing firm, the clearing firm's operations manual.

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

14.2 Qualification Of Operations Personnel

[FINRA Rule 1230(b)(6)(A) and 1250; FINRA Regulatory Notice 11-33]

Certain operations personnel are considered "covered persons" under FINRA Rule 1230 because of their responsibilities for "covered functions" as defined in the Rule. These personnel are required to qualify as "Operations Professionals" by completing the Series 99 qualification examination or by qualifying for an exception because of the person's other registration qualifications. In general the requirements apply to senior management responsible for covered functions; persons designated by senior management to supervise, manage, or approve or authorize work relating to the covered functions; and persons with authority or discretion materially to commit KCD's capital relating to covered functions. The Rule should be consulted for definitions of covered persons and covered functions.

In addition, covered persons are required to participate in Regulatory Element and Firm Element continuing education. Refer to the chapter *TRAINING AND EDUCATION* for procedures regarding continuing education.

KCD has named a Principal Financial Officer and Principal Operations Officer (unless an exception applies). Refer to the section *Principal Financial Officer And Principal Operations Officer* in the chapter *EMPLOYMENT, REGISTRATION AND LICENSING* for detailed information about these designations.

The Principal Operations Officer is responsible for confirming that covered persons complete the necessary requirements for registration and continuing education and to restrict an employee's activities if either requirement is not completed within required timeframes.

14.3 Books And Records

[SEC Securities Exchange Act of 1934 Rule 17a-3 and Rule 17a-4; SEC FAQs: https://www.finra.org/rules-guidance/guidance/interpretations-financial-operational-rules?utm_source=MM&utm_medium=email&utm_campaign=O%5FWeekly%5FUpdate%5F030823%5FFINAL; FINRA Rule 4510, 4511 and 4512; FINRA New And Amended Recordkeeping Checklist: http://www.finra.org/industry/books-and-records; MSRB Rule G-8 and G-9]

14.3.1 Introduction

SEC Rule 17a-3 identifies the types of books and records to be retained by KCD 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 FINOP is responsible for establishing and maintaining KCD's record retention schedule.

For accounts and other business introduced to a clearing firm, the clearing firm is responsible for retaining certain records as outlined in the clearing agreement.

14.3.2 Electronic Storage Of Records

[SEC Securities Exchange Act of 1934 Rule 17a-4(f); FINRA Regulatory Notice 18-31]

KCD utilizes an electronic system to maintain and preserve required records in accordance with Securities Exchange Act Rule 17a-4. An electronic recordkeeping system is defined as a system that preserves records in a digital format in a manner that permits the records to be viewed and downloaded.

Responsibility	• Designated supervisor

Resources	• Records required to be retained under SEC and SRO rules
Frequency	• Ongoing recordkeeping, as required by rule • As required - execute and file undertakings • Audit system - ongoing and periodic

Action	• Develop internal system or choose a vendor or other third party that meets rule requirements
	• Contract with an independent third party, if appropriate, in accordance with record retention requirements including deletion or discarding of records
	• If applicable, designate an executive officer (member of senior management who has access to and ability to provide records) and designated officers and specialists reporting to the designated executive officer and who have access to and ability to provide Firm records
	• Provide undertaking(s) to the DEA:
	    ○ From a third-party vendor (traditional or alternative for services such as cloud-based storage) or
	    ○ From a designated executive officer
	• Provide revised undertakings to DEA if necessary
	• Obtain senior management approval of system configuration to store records and subsequent changes
	• Issue passwords to authorized personnel and disable passwords for terminated employees or those no longer requiring access
	• Take corrective action internally or with outside vendor if anomalies are detected
	• Establish audit system for accountability regarding the input of records into the storage system including inputting of any changes made to original or duplicate records
	• Ensure electronic records and audit trails are producible in a reasonably usable electronic format
	• If paper records are converted to electronic records, verify (with some methodology such as review all or a sampling) the conversion process by comparing electronic and original records confirming electronic records are accurate, complete and readable

Record	• Contracts with third parties • Designation of designated executive officer, designated officers, and designated specialists, if applicable • Undertakings • Written approval from senior management regarding system configuration • Record of corrective action taken, if necessary, when anomalies are detected • Record of passwords issued and disabled • Audit system and anomalies detected including corrective action taken • Verification of conversions from paper to electronic records

KCD utilizes an electronic system to maintain and preserve required records in accordance with Securities Exchange Act Rule 17a-4. An electronic recordkeeping system is defined as a system that preserves records in a digital format in a manner that permits the records to be viewed and downloaded.

Conditions

[SEC Securities Exchange Act of 1934 Rule 17a-4(f)(2)(ii)]

As required by rule, KCD's electronic storage media meets the following conditions:

- non-rewritable, non-erasable format
- automatic verification of the quality and accuracy of the process
- capacity to readily download indexes and records

KCD's electronic or micrographic storage will also meet the following requirements:

- facilities for immediate, easily readable production of records
- ability to provide facsimile enlargements
- duplicate copies stored separately from the originals
- organized and indexed accurately
- current information necessary to access records and indexes
- independent third party who has access and the ability to download records

Confidentiality Of Electronic Records

KCD (in conjunction with any vendor) protects against unauthorized access to or use of customer records by use of a password system. Passwords will be changed periodically and disabled for terminated employees or employees no longer requiring access.

14.4 Calculation And Reporting Of Net Capital

[SEC Securities Exchange Act of 1934 Rule 15c3-1, Rule 17a-5 and Rule 17a-11; FINRA Rule 4110, 4120, 4130, 4140, 4521 and 4524]

Responsibility	• Designated Supervisor or Designee
Resources	• Financial and transaction records
Frequency	• Ongoing
Action	• Maintain ongoing calculation of KCD's net capital • Report net capital as required • Report net capital deficiencies as required, when necessary

Record	• Records retained by the FINOP include:
	  ○ FOCUS reports
	  ○ Other net capital calculations

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

If KCD 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.

14.5 Reports

Responsibility	• FINOP
Resources	• Data regarding capital, sending of statements, compliance with protection of customer assets
Frequency	• Monthly: Risk reports (if applicable) • Quarterly: Custody Report • Annually: Audit Report; Exemption or Compliance Report (whichever applies)
Action	• File required reports
Record	• Records of reports and when filed

KCD is obligated to file certain reports with regulators.

14.5.1 Annual Audit Report

[Exchange Act Rule 17a-5(d); FINRA Regulatory Notice 16-05 and 11-46]

The FINOP is responsible for filing of the Firm's annual audited financial statements with regulators, not more than 60 days after the date of the statements, including the oath and affirmation page. Filing is made electronically with FINRA and the SEC. The FINOP will retain records of the filings including the filings themselves, names of regulators, and date of filing.

Reports will be as of the same fixed or determinable date each year, unless a change is approved in writing by FINRA. A copy of FINRA's written approval will be sent to the Firm's SEC regional office.

14.5.2 Risk Reports

If the Firm computes capital charges under 15c3-1e (limitations on the withdrawal of equity capital) it is required to file additional reports with the SEC. Reports are required within 17 business days after the end of each month that is not a quarter and within 17 business days after the end of each quarter. Refer to Rule 17a-5(a)(6) for details of what must be reported.

14.5.3 Custody Report And Requirements

[SEC Securities Exchange Act of 1934 Section 17(b); FINRA web page: https://www.finra.org/media/document/8365]

The Firm is required to file a quarterly Form Custody report that contains information about whether and how the Firm maintains custody of customer assets.

The Firm is also required to allow staff of the SEC and SROs to review working papers of the Firm's PCAOB-registered independent public accounting firm if requested in writing as part of an examination and allow regulators to discuss the findings of the Firm's accounting firm with the accounting firm's representatives. The FINOP is responsible for facilitating regulators' access.

14.5.4 Exemption Report

[SEC Securities Exchange Act of 1934 Rule 17a-5]

KCD will annually file with the SEC the Exemption Report (within 60 calendar days after the fiscal year-end as part of The Firm's annual compliance audit).

14.6 Reconciliations And Bank Records

Responsibility	• Designated Supervisor or Designee
Resources	• Bank records
Frequency	• Monthly
Action	• Reconcile bank accounts against KCD's records
Record	• Bank statements and other bank records, retained by FINOP

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.

14.7 Designation Of Accountant

[SEC Securities Exchange Act of 1934 Rule 17a-5(f)]

The FINOP is responsible for filing notice of the designation of its accountant by December 10 of each year with FINRA, the SEC's principal office, and KCD's SEC regional office. If the agreement with the accountant is continuous providing for successive annual audits, notice is not required annually. The following additional requirements apply:

- An agreement must exist with an independent public accountant by December 1 covering a contractual commitment to conduct KCD's annual audit during the following calendar year or;
- An agreement must exist with an independent public accountant by May 1 covering a contractual commitment to conduct KCD's annual audit for the fiscal year ending June 30.
- If the agreement is for a single audit or if the continuing agreement is terminated or amended, a filing is required by December 10 (or May 10 for the fiscal year ending June 30).
- If KCD is exempt from filing an annual audited financial statement, notice must still be filed indicating the date as of which an unaudited report will be prepared.
- Notice must be filed with FINRA and the two SEC offices within 15 days after:
    - KCD notifies the accountant that its services will be terminated;

  - the accountant notifies KCD it will not continue its engagement; or
  - a new accountant has been engaged without notice to or by KCD's current accountant.

The FINOP is responsible for maintaining a record of filing the required notices.

14.8 Guarantees By, Or Flow Through Benefits For, Members

[FINRA Rule 4150]

Whenever KCD guarantees, endorses, or assumes, directly or indirectly, the obligations or liabilities of another person (including an entity), a written request will be made to FINRA. Prior written approval from FINRA is required whenever the Firm receives flow-through capital benefits in accordance with Appendix C of SEC Rule 15c3-1. The FINOP is responsible for filing necessary requests for such arrangements; responding to subsequent FINRA requests for information; complying with FINRA rule requirements; and maintaining records regarding such arrangements.

The requirements when entering into such an arrangement include the following:

- KCD must have the authority to make available to FINRA the books and records of the other person or entity for inspection in the U.S. The other person's books and records must be kept separately from those of the Firm.
- The Firm is required to provide FINRA with the person's FOCUS reports simultaneous with their being filed with the person's designated examining authority (DEA), unless the person's DEA is FINRA. If the person is not a registered broker-dealer, the Firm will submit financial and operational statements in a format and for time periods required by FINRA.
- Guarantees executed in the normal course of business (trade guarantees, signature guarantees, endorsement of securities and the writing of options) are not subject to these requirements. Guarantees regarding the writing of options are not subject if appropriately recorded in the Firm's books and records and reflected in net capital computations.

14.9 General Ledger And Suspense Accounts

[FINRA Rule 4523]

Responsibility	• Designated Supervisor or Designee
Resources	• Ledger and suspense accounts
Frequency	• Ongoing - oversee entries • Monthly or more frequently - review of accounts
Action	• Oversee entries • Determine accounts are current and accurate • Review accounts to determine they are accurate and any aged or unresolved are promptly identified for research and possible transfer to suspense account(s)
Record	• General and suspense accounts • Resolution of aged or unresolved items • Record of reviews including reviewers initials, date reviewed, notes of action taken, if any

The designated supervisor (or supervisors, if accounts are assigned to multiple persons) is responsible for oversight of general ledger and suspense accounts. Suspense accounts must be clearly identified as such and record money charges or credits and receipts or deliveries of securities whose ultimate disposition is pending determination. The record must include all information known for each item recorded.

14.10 Financial Reporting

[SEC Securities Exchange Act of 1934 Rule 17a-5 and Rule 17a-11; SEC FAQs regarding financial responsibility rules: http://www.sec.gov/divisions/marketreg/amendments-to-broker-dealer-financial-responsibility-rule-faq.htm; FINRA Rule 4520 Series]

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 [17a-11(d)]
- Preparation and filing of unaudited financial statements
- Engaging outside accountants to conduct KCD'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 KCD's fiscal year
- Payment of assessments and fees to regulators

The FINOP is also 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 KCD'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.

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.

14.10.1 Financial Statements

[SEC Securities Exchange Act of 1934 Rule 17a-5(c)]

The FINOP will determine The Firm's obligation to provide financial statements to customers. This section discusses exemptions and requirements. Rule 17a-5 should be consulted for details regarding the requirements.

Broker-dealers are required to provide financial statements to their customers unless they qualify for an exemption, which includes: (1) an introducing broker or dealer; (2) a BD that promptly forwards subscriptions for securities to the issuer, underwriter, or other distributor and does not hold funds or securities; (3) a BD dealing with subscriptions of mutual funds, sale/redemption of savings and loan associations, or offering credit for loans to purchase insurance related to the sale of mutual funds; or (4) a BD that conducts business that is exempt under Rule 17a-3(a). These exemptions have further conditions and Rule 17a-5 should be consulted.

For firms that do not qualify for an exemption, audited statements must be provided to customers within 105 days after the end of the BD's fiscal year or within 30 days of that date if sent with the next mailing of quarterly customer statements. Unaudited statements dated 6 months from the date of the audited statements must be provided to customers within 65 days after the date of the unaudited statement or 70 days after that time if sent with the next mailing of customer quarterly statements.

Statements are not required to be sent if posted on the BD's web site not later than 90 days after the date of audited statements or 75 days after the date of unaudited statements. Statements must be accessible by hyperlinks in either textual or button format, separate prominent links that are clearly visible, and are placed in **each** of the following locations:

- On the BD's website home page; and
- On each page where a customer can enter or log in to the website; and
- If the home page website is for two or more BDs, on the home page of the website of each BD.

In addition, the BD must maintain a toll-free number that customers may call to request statements and must send statements promptly after request at no cost to the customer. The BD also must not have been required, during the year prior to the date of the statement, to give notice and transmit a report to the SEC under 17a-11(e).

14.10.2 Disclosure Of Financial Condition

[FINRA Rule 2261]

Upon request, information about KCD'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 KCD. The information may be provided in paper or electronic form (if for a customer, the customer must consent to electronic delivery).

14.10.3 Notification Rule ("Early Warning Rule")

[SEC Securities Exchange Act of 1934 Rule 17a-11]

The FINOP is responsible for notifying (within 24 hours) the SEC and other securities regulators upon the occurrence of certain events (insolvency, decrease of net capital below required minimum, or the Firm's repurchase and securities lending activities exceed 25 times its tentative net capital). As an alternative to notification regarding repurchase and securities lending activities, the Firm may report monthly as to its stock loan and repurchase activities to its DEA. The FINOP is responsible for maintaining records of any early warning notifications (or monthly reports).

14.11 Regulation T And Extension Of Credit To Customers

[FINRA Rule 4210; NYSE Rule 430-434; Federal Reserve Regulation T]

Customer Margin Balance Report

[FINRA Rule 4521(d)]

KCD does not carry customer margin accounts. KCD relies on our clearing firm to be responsible for filing the Customer Margin Balance Form on a settlement date basis.

14.12 Fees And Service Charges

[FINRA Rule 2122; NASD Notice to Members 92-11]

Responsibility	• Designated Supervisor or Designee
Resources	• Schedule of fees and charges • Information regarding changes
Frequency	• As required
Action	• Include notification to new customers when accounts are opened • Arrange for written notification to customers • Update website as needed
Record	• Notice provided to new customers • Copy of written notification sent to customers including date sent • Records of website changes and information posted

Broker-dealers are obligated to disclose fees and service charges to customers. In general, fees and charges are required to be reasonable and not unfairly discriminatory between customers.

If a fee or commission will be charged to redeem a mutual fund and the fund could be sold through the fund company itself without cost, the customer should be notified that the fund could be redeemed without cost by liquidating directly through the mutual fund.

14.12.1 Notification Of Customers

Customers will be notified of fees and changes to fees and service charges as follows:

- At the time an account is opened.
- When there is an increase in fees, at least 30 days prior to the increase to the last known address of every customer whose account is subject to the fees.
- If notification is by a method other than a letter (*i.e.,* statement stuffers, newsletters, *etc.*) notification of a fee increase will be clear and conspicuous and in plain English.
- For extensive fee changes, a letter may be sent to customers referring them to a website where complete information may be obtained.
- KCD relies upon our clearing firm to notify customers of fees and changes to fees and service charges for accounts held at the clearing firm.

14.13 Fidelity Bonding

[FINRA Rule 4360]

As required, KCD is a member of SIPC and maintains required blanket fidelity bonding coverage based on KCD's net capital requirement. The FINOP is responsible for obtaining and maintaining fidelity bonding as required by rule and verifying the adequacy of coverage and making necessary adjustments on at least an annual basis on the anniversary date of the issuance of the fidelity bond.

14.14 Independent Verification Of Assets

[FINRA Rule 4160]

KCD may custody assets (customer or proprietary) at financial institutions that are not members of FINRA. FINRA may request written verification of Firm assets held by that institution. If FINRA notifies KCD that the institution has failed to respond to FINRA, KCD will withdraw its assets promptly and transfer them to another financial institution. This requirement does not apply to:

- proprietary assets that are treated as non-allowable assets under Exchange Act Rule 15c3-1; or
- instances where FINRA determines there is no independent custody or record ownership of assets

The FINOP is responsible for withdrawing affected assets when notified by FINRA. Contracts with non-member financial institutions may include the obligation that the financial institution comply with FINRA requests for verification of assets. The FINOP controls records of custody arrangements and contracts.

14.15 Cash Deposits Not Accepted

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

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

- Immediately provide the cash to the authorized Operations personnel.
- Operations is responsible for counting the cash (2 people must be present to verify the amount) and entering the amount into KCD's blotter.
- Immediately thereafter a cashier's check or money order made payable to its clearing firm, other vendor or customer will be obtained. The check/money order will be sent to appropriate destination (clearing firm, returned to customer, etc.) the same day.
- The Operations Manager is responsible for filing Form 104 (Currency Transaction Report) with the IRS by the 15^{th} calendar day after receipt for cash in excess of $10,000 for one person on any one day.
- The designated supervisor is responsible for retaining a file of forms filed with the IRS.

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

- Immediately return the cash to the customer with notification that KCD can only accept checks made out to a third party vendor.

14.16 Cash Equivalents

KCD also does not accept deposits of cash equivalents such as travelers checks, money orders, or cashiers checks. Customers attempting to deposit cash equivalents should be advised to instead provide a personal check for deposit to their account.

14.17 Risk Management

[FINRA Notice to Members 99-92; SEC Securities Exchange Act of 1934 Rule 17a-3(a)(23), Rule 17h-1T and Rule 17h-2T]

Responsibility	• FINOP • Risk Manager • Credit Manager • Internal Audit • Independent Risk Manager

	• Outside auditors
	• Other designated supervisors, as applicable
	• Designated committees, if appointed:
	  ○ Credit committee
	  ○ Risk management committee
	  ○ Audit committee

Resources	• Internal reports • Regulatory reports • Financial statements • Products and services offered by KCD
Frequency	• Ongoing
Action	• Establish risk management procedures and controls and modify such systems considering current market conditions • Establish risk guidelines including inventory limits, counterparty trading limits, etc. and review and adjust on a regular basis • Review regulatory risks • Evaluate risk exposure of business lines • Conduct annual risk assessment • Report to senior management (and holding company, if appropriate) as required • Take corrective action to reduce risk
Record	• Review of internal and regulatory reports, products and services • Audit reports (internal and external) • Minutes of committees designated to oversee risk, if applicable • Annual risk assessment

Risk management is the identification, management, measurement and oversight of various business risks (such as proprietary trading, credit, liquidity and new products) and is part of KCD's internal control structure.

14.17.1 Authority

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

Board Of Directors

KCD's Board of Directors meets periodically, at least annually, to take necessary action on behalf of KCD.

Chief Financial Officer

The Chief Financial Officer (or his/her designee) is responsible for the following on behalf of KCD:

- Establishing accounting procedures in accordance with generally accepted accounting principles
- Ensuring the accurate and timely filing of KCD financial reports with regulators and others where financial reports are required
- Establishing bank accounts and designating employees authorized to sign checks and transfer funds on behalf of KCD
- Interacting with KCD's public accounting firm and coordinating the providing of information requested during KCD's annual audit
- Follow up regarding exceptions or recommendations referred by the outside public accounting firm

14.17.2 Technology Management

Responsibility	• Designated Supervisor: Ongoing responsibilities • Internal Audit, Compliance or other: annual testing
Resources	• Systems, programs, vendors
Frequency	• Annual: testing of procedures and oversight • Ongoing: responsibilities below
Action	• Designated supervisor: conduct responsibilities listed below • Internal Audit, Compliance, or other: conduct annual testing of procedures and oversight of systems
Record	• Records of conducting responsibilities listed below • Record of annual review, corrective actions taken

Oversight of the Firm's technology systems is the responsibility of the Chief Technology Officer or a management person with similar responsibilities. Oversight includes:

- Review and approval of new systems or programs
- Review and approval of vendors that provide systems or programs and those that service the Firm's systems
- Review and approval of back office and vendor system changes, revisions to new systems or programs
- Development and oversight of security for systems (see *Cybersecurity* that follows)
- Oversight of the plan to adopt changes or new systems
- Periodic testing of systems and algorithms
- Documentation of systems
- Delegation of responsibility to those responsible for technology systems
- Training regarding systems and programs
- Oversight of algorithms including both proprietary and order-routing algorithms

14.17.3 Protection Of Customer Information And Records

Responsibility	• Designated Supervisor

Resources	• Internal and outside security systems • Computers, phones, PDAs, other data-retaining devices • Customer and Firm data
Frequency	• Clearing of data from devices: when device is to be retired or re-assigned • Ongoing - review of integrity of systems, monitoring for breaches • Ongoing - assigning and disabling passwords • Annual - review of internal controls and procedures • As required - when intrusions are detected • Annual - provide training to employees
Action	• Clear data from retired or re-assigned devices (internally or using an outside service) • Establish controls including firewalls and encryption of data • Require installation of security application software to all laptops or other remote devices used to access firm and customer data • Require encryption of data on laptops and other mobile devices • Limit access to customer information to employees who have a reason to see it • Issue passwords to authorized personnel including use of strong passwords through validation or periodic password changes and forced password expiration; disable them when an authorized person terminates or transfers from an authorized position, including shared user names and passwords when one of the users terminates or is no longer an authorized person • Provide training to personnel (may be part of annual compliance or other meetings or may be written instructions provided periodically) including: keeping customer information secure and confidential; limitations on use of computers, software, access to accounts; locking and securing mobile devices when not in use; customer breaches: identifying, reporting to designated supervisor • Conduct periodic audits and review of internal controls and procedures (Compliance or other assigned personnel) including audits of employee computers to confirm installation of security software and use of encryption; restricted to use of authorized software only; follow up regarding audit findings (internal or external)
Record	• Record of clearing data from retired or re-assigned devices • Review of employee use of devices, encryption, authorized devices • Record of passwords issued and disabled including names of authorized persons, their departments, date issued or disabled • Record of training provided • Records of periodic audits and reviews

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

- Restricting access to main server to authorized employees working from Home Office
- Only authorized users have access to password-protected software provided by Clearing Firm

14.17.3.1 Social Security Numbers (SSNs)

SSNs are part of the information subject to protection of customer records. SSNs are obtained when accounts are opened, as required by federal law. SSNs are retained with account records and used for federally-required year-end reporting of transactions and/or income. Access is limited to authorized employees (operations personnel, RRs, managers, *etc.*) and are provided to outsiders only when required by law or court/arbitration action or other authorized authority.

14.17.3.2 Access To Customer Information Via Wi-Fi

Because of risk of unauthorized access by outside parties and the difficulty of ensuring the security of wireless connections to the Internet, employees are not permitted to use wireless fidelity (Wi-Fi) to access customer account information, unless:

- the employee is working on Firm premises; or
- the employee has installed Firm-required firewalls or other protections and has prior approval from KCD's designated information officer to use Wi-Fi for Firm business.

14.17.3.3 Remote Access To Customer Accounts

Some employees may be authorized to work at home or while traveling during which time the Firm's network will be accessed. Authorization must be requested from the designated information officer who will assign passwords and retain a record of authorized employees. Firewalls and other protections are in place to prevent intrusion by outsiders and breaches of confidentiality.

14.17.3.4 Disposal Of Consumer Report And Customer Information And Records

[SEC Regulation S-P Rule 30(b); SEC Release No. 34-50781; Fair and Accurate Credit Transactions Act of 2003 Section 216]

Consumer report and customer information and records will be disposed of in a manner to prevent unauthorized access or use. Procedures include the following:

- Responsible employees will be identified and trained in proper disposal procedures.
- There will be secure removal of trash involving consumer report and customer information.
- Paper information will be burned, pulverized or shredded so that it cannot be practicably read or reconstructed.
- Electronic information will be destroyed or erased so the information cannot be practicably read or recontructed.

14.17.3.5 Compromised Accounts

If the Firm identifies unauthorized access to customer accounts, Compliance will be immediately notified and the following actions will be taken, as appropriate:

- Monitor, limit or temporarily suspend activity in the account
- Investigate the source of the intrusion and whether it is limited to an account or certain accounts
- Notify the clearing firm, if applicable
- Contact the SEC and the FINRA coordinator
- If appropriate, contact law enforcement such as the FBI or the U.S. Postal Inspector if mail is involved
- Contact relevant state regulatory authorities
- Determine whether specific notice to the customer is required under state law if personally identifiable information has been compromised
- Contact the customer and change access passwords and/or account numbers
- Determine whether the Firm should file a Suspicious Activity Report (SAR)

If firm data is compromised not involving customer accounts, Compliance and/or Legal (or outside counsel) must determine action to be taken which may include some of the actions listed above.

14.17.3.6 Fiduciary Rule Considerations

Products and some services sold to retirement accounts are subject to the DOL Fiduciary Rule. See the section *Fiduciary Requirements* in the chapter *ACCOUNTS*. When reviewing a new product/service that is subject to the Fiduciary Rule the following considerations will be made:

- What compensation will be paid and does the compensation comply with the "best interests" requirement of the Fiduciary Rule?
- Does the product/service fall under the BIC or another exemption?
- What notification should be made to RRs and supervisors regarding requirements specific to the product/service (BIC, *etc.*)?

14.17.3.7 Anti-Money Laundering Considerations

New products and/or business lines may represent anti-money laundering risks. Such issues will be referred to the AML Compliance Officer for review.

14.17.4 New Products

[FINRA Notice to Members 05-26]

Responsibility	• Designated supervisor or Designee
Resources	• New Product Review Checklist • Other information available about the new product
Frequency	• As required when new products are proposed

Action	• Conduct a review to:
	  ○ Determine the product is beneficial for customers
	  ○ Determine the types of customers that are the target market
	  ○ Conduct appropriate due diligence about features and risks of the product
	  ○ Determine whether written disclosures or educational information should be provided to potential purchasers
	  ○ Determine what information should be provided to RRs and supervisors, including any additional training
	• Approve or disapprove the product for distribution

Record	• Approved New Product Review Checklists are retained in a file for the product • Other reviewed Checklists are retained in a New Product Review Checklist file

All new products require review and approval prior to offering new products to customers. A "new product" may include a product that:

- is new to the marketplace or KCD.
- was previously sold only to a limited segment of KCD'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 the new product review.

New Product Review Checklist

Individuals and departments wanting to offer new products are required to prepare information for the review by completing the New Product Review Checklist. Information to be provided includes a description of the product, to whom the product would be offered, and economic justification of the product. The requestor will be notified regarding approval/disapproval or the need for modifications or additional information.

Training

A determination will be made by the supervisor reviewing the new product after discussing with compliance regarding the need for training before the product is made available for sale. Considerations include:

- Whether RRs are already knowledgeable about the product including pre-existing training
- Sophistication of targeted investors
- Complexity of the product

14.18 Business Continuity Plan

[FINRA Rule 4370; FINRA Regulatory Notice 13-25; FINRA Notice to Members 06-74 and 04-37; NASDAQ Equity 9 Business Conduct; FINRA Small Firm Business Continuity Plan Template: https://www.finra.org/compliance-tools/small-firm-business-continuity-plan-template/; SIFMA Business Continuity Planning website: https://www.sifma.org/resources/general/bcp/]

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.

14.18.1 Designation Of Responsibilities

The following is a list of those responsible for KCD's Business Continuity Plan.

Responsibility	Names or Titles
Maintain and update Plan	Chief Compliance Officer
Approve Plan and Plan revisions; conduct annual review	*[FINRA requirement: a registered principal who is a member of senior management.]* *Chief Compliance Officer*
Annual testing of Plan	Compliance Department
Implementation of Plan when a disruption occurs	Emergency Response Team
Quarterly review of Emergency Contact Persons and report changes to regulators	FINRA Executive Representative (or written designee) Chief Compliance Officer
Maintain and distribute Emergency Contact List and provide updates, when necessary	Chief Compliance Officer
Maintain and update Books and Records Chart	Financial Operations Principal
Provide Plan information to customers: • At time of account opening • Upon request	Registered Rep, Home Office Personnel
Post Plan disclosure on KCD's web site and update, as required	Chief Compliance Officer
Review critical third party assurances or disaster plans or plan summaries: • At initial engagement of third party • Annually when KCD's Plan is reviewed	Chief Compliance Officer
Contact FINRA to provide information about: • the activation or implementation of the BCP • if possible, written notification of emergency office locations • emergency contacts • requests for extension of deadlines to open inquiries, investigations, or upcoming filings and qualifications examinations or continuing education	Chief Compliance Officer

14.18.2 Alternative Business Locations

In the event employees can no longer conduct business at one of the Firm's office locations, the following actions may be taken:

- Transfer employees to the closest unaffected office location and notify personnel
- Transfer critical systems to another office or a back-up firm or system
- Transfer business operations to another KCD office unaffected by the disruption
- Transfer business operations to a different broker-dealer or other entity

Considerations that will be made include:

- Geographic diversity in the event of regional service outages
- Accessibility of alternative sites and the ability of employees to travel to the site and methods of relocating employees and living arrangements, if needed
- Number and composition of staff needed and supervisors for alternative sites
- Generator and other back-up sources at alternative sites
- Resources needed at alternative sites (desks, chairs, telephones, equipment, and supplies, *etc.*)
- Moving staff in advance of a significant BCP event, if it can be anticipated
- Whether employees should work from home and what resources they would need

14.18.3 Alternative Market Entry

The Firm may use its clearing firm (if applicable) or other broker-dealers as alternative market entry points when the Firm cannot access markets through its own systems.

14.18.4 Alternative Communications

The Firm may use a wide range of communication systems to communicate with its customers, employees, counter-parties, and regulators including telephone; mail; fax; e-mail; vendor systems (such as Bloomberg); and personal meetings. The Firm may establish contracts with multiple telecommunications carriers to provide redundant systems and devices and to provide key employees with technology at remote locations, including home locations. Procedures for instituting alternative communications in the event of a significant business disruption include the following, depending on the nature of the disruption:

- Identify the most expedient remaining means of communication
- Notify employees if an off-site command center has been activated
- Notify employees of alternative communication systems to be used
- Transfer communications to another firm

Determination of what communication system will be used depends on the nature of the disruption and which communication systems (electronic mail, telephone calls, *etc.*) are functional and the availability of personnel in the event telephone contact is necessary.

14.18.4.1 Between The Firm And Trading Counterparties

Communications between the Firm and its trading counterparties regarding conduct of business will be implemented by alternative systems which may include:

- Via a clearing or other alternative business partner
- Phone
- Electronic communications
- Web site postings
- Other alternative means of communicating

14.18.4.2 Firm's Web Site

The Firm has established an alternative means of maintaining its web site in the event servers and other systems regularly used are unavailable. The web site will be used to communicate information to customers, counterparties, and others needing access to the Firm. It will include information about operations and contact information, including contact information at a clearing firm or other alternative business partner.

14.18.5 Education Of Employees

The Business Continuity Plan is communicated to employees as follows:

- A summary is included in the chapter *GENERAL EMPLOYEE POLICIES* in the section *Emergency Business Recovery Procedures* and is provided to all employees.
- A current copy of the Plan is provided to the Emergency Response Team and key employees with responsibilities for aspects of the Plan. When changes are made to the Plan, new copies will be distributed to these employees.
- The most recent Emergency Contact List is provided to key employees.
- The BCP is included in training of employees.

14.18.6 Updating, Annual Review, And Testing

The Plan will be reviewed on at least an annual basis and revised as needed. Each revision will be approved by the designated senior manager and copies of the revised Plan distributed to the Emergency Response Team and key employees. Some material events require updating the Plan when they occur, including:

- Material changes to the Firm's business
- A change in the Firm's main office location
- Added office locations
- A change in a major service provider

When the Plan is reviewed, the procedures and accompanying lists and charts will be reviewed and updated as needed including the:

- Plan itself
- Emergency Response Team list
- Emergency Contact List
- Books and Records chart (Appendix A)
- Mission Critical Systems chart (Appendix B)
- Business Constituent, Bank, and Counter-Party chart (Appendix C)
- *Designation Of Offices* section of the chapter *DESIGNATION OF SUPERVISORS AND OFFICES*
- Any other charts or information related to the Plan

When appropriate, the Firm will participate in industry-wide testing programs. A written record of the annual review including the date reviewed and name and signature of the reviewer will be retained by Compliance.

14.19 Industry Testing

[Exchange Act Regulation SCI; FINRA Rule 4380; MSRB Rule A-18]

Regulators designate certain firms to participate in industry-wide business continuity/disaster recovery testing. Testing is conducted once a year; firms are notified that they are required to participate. Firms may also participate on a voluntary basis by submitting a request to FINRA.

The Chief Financial Officer (or other designated supervisor) is responsible for complying with mandatory testing or designating someone to oversee the testing within the timeframes established by FINRA. Firms are expected to fulfill certain testing requirements which could include, for example, bringing up systems on the designated testing day and processing test scripts to simulate trading activity. Firms may also have to report test results or provide other reports to FINRA.

Records of testing conducted and information provided to FINRA will be retained by the Chief Financial Officer. Anomalies identified during testing will be reviewed and corrected and records retained, if applicable.

14.20 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

14.20.1 Checks Payable To Clearing Firm

All checks provided by customers must be made payable to KCD's clearing firm only. Questions regarding check requirements should be referred to Operations.

14.20.2 Guaranteed Accounts

A customer (the "guarantor") may provide a written guarantee to cover the margin calls in another account (the "guaranteed" account) using the equity in the guarantor's account. Written agreements for such guarantees must be provided to Operations.

RRs are prohibited from guaranteeing payment in another customer's account (unless the other customer is an employee-related account and approval has been obtained from Operations).

14.21 Transmittals Of Customer Funds And Securities

This section describes KCD's procedures for transmitting funds or securities from customer accounts. The following summarizes requirements:

- As an introducing B/D, the Firm does not transmit funds or securities from customer accounts.

14.21.1 Prepayments And Extensions

Prepayments (customer requests payment prior to settlement date on a sale) or extensions of time to make payment must be approved by the designated supervisor.

14.21.2 Transmittals To Third Parties

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.

When funds are disbursed, KCD (or its clearing firm) will send a notice to the customer confirming that funds were sent to a third party from the customer's account.

14.21.3 LOA Instructions

RRs or their assistants are responsible for obtaining completed LOAs, when necessary.

- A completed LOA is required **prior to** disbursements to third parties.
- The customer's original signature is required. In the case of a joint account, all joint owners must sign the LOA. For corporations, trust accounts, and other accounts, the authorized person must sign the LOA.
- Completed LOAs are submitted for review prior to being sent to the clearing firm or investment company and should accompany the request to disburse funds or send securities to a third party.

Standing LOAs

Customers who have a need for regular third party disbursements should be encouraged to apply for an account that provides checking account privileges.

14.21.3.1 Email Instructions

[FINRA Regulatory Notice 12-05]

Email and other electronic communications can be subject to intrusion and compromised by a third party. There have been instances of third parties sending fraudulent requests to broker-dealers to transfer customer funds to an account for the benefit of the third party. To prevent theft from customer accounts, the following apply to email or other electronic requests to transfer funds to a third party:

- The RR, assistant, or operations person receiving instructions should be aware of "red flags" (*e.g.,* funds to be transferred to an unfamiliar third party, particularly in a foreign country; transfers that appear to be out of the ordinary for the customer; and requests that indicate urgency or otherwise appear designed to deter verification of transfer instructions) and alert the supervisor or compliance of any "red flags".
- If KCD processes its transactions through a clearing firm, the clearing firm will have its own procedures to prevent unauthorized third party transmittals.
- The Operations Manager or Compliance should be contacted with any questions about questionable transfer instructions.

14.21.4 Authorization Records For Negotiable Instruments Drawn From A Customers Account

[FINRA Rule 4514]

The customer's written signature is required whenever KCD obtains or submits for payment a check, draft, or other form of negotiable paper drawn on a customer's checking, savings, share or similar account; this may include the customer's signature on the negotiable instrument. Written authorization separate from the instrument must be retained for 3 years following the date the authorization expires. No record is required when the customer signs the instrument (*i.e.,* a check).

14.21.5 Transmittals To An Alternate Address

Funds and securities will be sent to the customer's address of record, unless the customer provides **written** authorization to use an alternative address. KCD does not send customer funds; our clearing firm and third party vendors have policies in place for transmittal of fund to alternate address.

14.21.6 Transmittals To Outside Entities

Customers sometimes request the transfer of funds or securities in their accounts to a bank or other entity on their behalf. A signed LOA must be obtained to effect such a transfer including the customer's account number at the receiving bank or other entity.

14.21.7 Suspicious Or Questionable Activities

Employees are responsible for referring suspicious or questionable activities to their designated supervisor. If the activity involves the designated supervisor, the employee 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 someone else in senior management. 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 the employee considers suspicious.

14.21.7.1 Prompt Transmission Of Customer Funds And Securities

[SEC No-Action Letter dated March 12, 2015 to NYLIFE Securities: http://www.sec.gov/divisions/marketreg/mr-noaction/2015/nylife-securities-031215-15c3.pdf]

Responsibility	• Designated Supervisor
Resources	• Customer checks or securities
Frequency	• As required
Action	• Determine that timeframes for "prompt transmission" are adhered to • Approve or disapprove transactions for deferred variable annuities or subscription-way transactions • Notify RR if transaction is disapproved and return customer's check • Provide notice to customers of handling of checks payable to issuers for subscription-way securities transactions
Record	• Records of checks and securities and when they are received • Review and approval/disapproval of applicable transactions • Forwarding of checks to the clearing firm, insurance company, or issuer • Forwarding of securities to clearing firm • Return of checks to customers where transactions are disapproved • Record of notification provided to customer of handling of checks for subscription-way securities transactions

One of the requirements for an exemption under 15c3-3(k) is the prompt transmission of funds and securities. The following outlines the requirements as they apply to different securities.

1. For checks payable to an insurance company for the purchase of a deferred variable annuity product, prompt transmission is no later than 7 business days after an OSJ receives a complete and correct application package for review by the principal. (Refer to the chapter *INSURANCE PRODUCTS* for more requirements regarding variable annuities.)
2. When an RR recommends the sale of a security on a subscription-way basis:
    a. Promptly prepare and forward a complete and correct application package to an OSJ;
    b. Perform a suitability review and approval (or disapproval) by a registered principal within 7 business days after receipt of a complete and correct package at the OSJ;
    c. Transmit the check to the issuer no later than noon of the business day following the date the registered principal reviews and approves;
    d. Return the package and the check to the RR if the transaction is disapproved;
    e. Maintain a record of the check, when received, date transmitted to the issuer if approved, or date returned to the customer if disapproved;
    f. Customers will be notified of the Firm's process for handling customer checks payable to issuers for subscription-way securities transactions before such transactions. Notice may be included in customer statements or another form of notice.
3. For all other securities, prompt transmission of a check to the clearing firm is defined as no later than noon of the next business day after received.

14.21.7.2 Inadvertent Receipt Of Customer Funds Or Securities

KCD does not hold funds or securities for, or owe money or securities to, its customers. In the event that funds or securities are inadvertently received by KCD, an entry will be made in a log maintained for that purpose recording the date, the amount, and, in the case of securities, a description of the securities received, and the action taken to return such funds or securities to their rightful owner.

No later than the next business day, KCD will return the funds or securities to the sender. If the sender cannot be immediately determined, KCD will open a separate bank account, to be designated as "Special Account for the Exclusive Benefit of the Owner of Funds and Securities," into which the funds or securities will be deposited and held until the rightful owner has been identified.

14.22 Customer Confirmations And Statements

[FINRA Rule 2231 and 2232]

This section describes requirements regarding confirmations and statements. The delivery requirement may be met by paper or electronic confirmations or statements.

14.22.1 Confirmations

[Exchange Act Rule 10b-10 and 15g-3; FINRA Rule 2231 and 2232; MSRB Rule G-15]

Responsibility	• Designated Supervisor • Trading managers • Clearing firm (if transactions are introduced)
Resources	• Transactions • Trading desk records

	• Confirmations records or available reports
Frequency	• Monthly: sample reviews • Annual: audit reviews

Action	• If KCD is self-clearing:
	  ○ review sampling of confirmations, trading, or other records or reports to determine whether required information is included
	  ○ if errors or omissions are identified take corrective action which may include: identifying whether errors are systemic or human error; issuing corrected confirmations; correcting system errors; notifying those responsible for including disclosures; additional training for traders or others responsible for confirmation disclosures
	• If KCD introduces its transactions to a clearing firm:
	  ○ the clearing firm is responsible for establishing procedures to include required disclosures
	  ○ review sampling of confirmations to determine whether required information is included
	  ○ contact clearing firm if errors or omissions are identified
	• Include confirmation disclosures in audit procedures

Record	• Operations procedures for KCD and/or its clearing firm • Confirmations, trading or other records, available reports • Audit records • Documentation of corrective action • Training records

Confirmations are issued for every trade executed for a customer and include required information, some of which is listed below. This section does not duplicate applicable rules which should be referenced for details. Customers may waive delivery of confirmations and designate a third party to receive them.

- SEC Rule 10b-10 and 15g-3, FINRA Rule 2132, and MSRB Rule G-15 include details of required disclosures on customer confirmations
- Transaction information includes (among other information) the name of the security; quantity; price; markups/markdowns the time of execution (in minutes and seconds); the firm's role (agent, principal, riskless principal)
- Other types of disclosures (among others) include:
    - non-rated taxable debt securities (other than U.S. government securities) including a statement that rating information is based on a good faith inquiry of selected sources
    - control relationship with the issuer
    - call features
    - for principal transactions, the reported trade price, the net price to the customer, and the difference between the reported price and the price to the customer, the difference between the reported price and the customer's price (markup/markdown)
    - for municipal securities call features, primary revenue source for revenue bonds, securities sold as "original issue discount" (OID) bonds, yield information
    - for penny stocks bid or offer, compensation, and other disclosures (see Rule 15g-3 and the section *Penny Stocks* in the chapter *ORDERS*)
    - payment for order flow
    - Markups/markdowns in municipal securities for non-institutional customers (MSRB Rule G-15) (See the section *Mark-ups And Mark-Downs* in the chapter *MUNICIPAL SECURITIES*)

14.22.2 Continuous Statement Delivery Requirement

[FINRA Rule 2231.02]

Statements must be delivered to customers either in paper format or electronically and may not waive receipt except under the limited circumstance explained below. Customers may designate a third party, in writing, to receive copies of statements.

KCD may cease sending account statements to the customer only where there is a court-appointed fiduciary (guardian, conservator, trustee, personal representative or other person with legal authority to act on behalf of the customer) upon written instructions from the court-appointed fiduciary. The fiduciary must provide KCD with an official copy of the court appointment.

14.22.3 Firm-Generated Customer Statements Only Are Provided To Customers

[FINRA Regulatory Notice 10-19]

RRs are not permitted to create supplemental customer statements or reports for the purpose of consolidating investments not shown on customer monthly statements issued by KCD. The customer monthly statement provided by KCD is the only record to be provided to customers.

14.22.4 Undeliverable Mail

When customer mail is returned to KCD as undeliverable, Operations will contact the RR's supervisor to obtain an updated address. When a new address is provided, the customer will be sent a letter at the new address asking for signed confirmation that the new address is correct. When the letter is returned, the customer's signature will be compared to other account documents on file. Signature anomalies will be referred to Compliance for follow up.

If a corrected address is not provided, the account will be frozen by the clearing firm to preclude securities or money transactions (other than expiration of options or similar passive transactions) until a correct address is provided.

14.22.5 Holding Customer Mail Prohibited

KCD will not hold mail on a customer's behalf, even for a short duration. RRs are **not** permitted to hold customer mail. A customer who cannot receive mail at the address established on the account, must be instructed to provide a third party mailing address that is not related to KCD or any associate of KCD.

14.22.6 Customer Statements

This section describes requirements and restrictions regarding customer statements.

14.22.6.1 Disclosures

[FINRA Rule 2231.05]

Statements must include required information included in FINRA Rule 2231.05.

14.22.6.2 Assets Held Externally

[FINRA Rule 2231.06]

Where an account statement includes assets that are not held by KCD (or its clearing firm) and are not included on KCD's books and records, the assets must be clearly distinguished separately on the statement and indicate: (1) the asset is included only as a courtesy to the customer; (2) information about the asset, including valuation, is derived from the customer or another source and KCD is not responsible for the information; and (3) such assets may not be covered by SIPC.

14.22.6.3 Use Of Logos, Trademarks, Etc.

[FINRA Rule 2231.07]

Where a logo, trademark, or other similar identification of a person (other than KCD or its clearing firm) appears on the customer statement, the identity of such person(s) and relationship to KCD or other firm on the statement must be provided and may not be used in a misleading manner.

14.22.6.4 Use Of Summary Statements

[FINRA Rule 2231.08]

If a multi-entity summary statement is sent to customers, it must: (1) indicate that the summary statement is provided for the customer's convenience and includes assets that may not be held by the broker-dealer; (2) indicate that the summary statement does not replace any other statement(s) the customer may receive from other financial institutions that hold the customer's assets; (3) identify each entity from which information is provided or assets being held are included, their relationship to each other (*e.g.*, parent, subsidiary or affiliated organization), and their respective functions (introducing firm, carrying firm, fund distributor, banking or insurance product provider, etc.); (4) clearly distinguish between assets held or categories of assets held by each entity included in the summary statement; (5) identify the customer's account number at each entity and provide customer service contact information at each entity (if the account number and customer service information at each entity are included on their respective account statements, then such information need not be included on the summary statement); and (6) identify each entity that is a member of SIPC.

Rule 2231.08(b) requires a member firm to ensure that to the extent that the summary statement aggregates the values of the various accounts summarized or portions thereof, such aggregation is recognizable as having been arithmetically derived from the separately stated totals or their components. In addition, Rule 2231.08(c) requires that KCD distinguish the beginning and end of each separate statement (e.g., summary, brokerage, mutual fund, banking, insurance, etc.) by color, pagination or other distinct form of demarcation. Further, Rule 2231.08(d) requires KCD to ensure that there is a written agreement between the carrying firm and each other person jointly providing its respective customer account statements attesting that each such person has developed procedures and controls for reviewing and testing the accuracy of the information included on its respective statements. Finally, Rule 2231.08(e) requires KCD to ensure that the summary statement complies with FINRA Rule 2231.

14.22.7 Confirmation Disclosures

[SEC Securities Exchange Act of 1934 Rule 10b-10; FINRA Rule 2232]

KCD relies upon our clearing firm and direct business companies to ensure proper disclosure are on confirmation of trades.

14.22.8 Hold Mail Instructions

[FINRA Rule 3150]

Responsibility	• Compliance
Resources	• Requests to hold mail
Frequency	• As required
Action	• Obtain the customer's written authorization • Review and approve or disapprove, notify RR • If approved, provide instructions on who is responsible for holding mail and set up account to direct mail accordingly • Provide required notification to customer and obtain acknowledgment of receipt • For mail held longer than 3 months, verify that instructions still apply at least semi-annually • Send held mail to customer • Terminate hold mail arrangement after authorized period has elapsed and notify customer
Record	• Customer requests • Approval or disapproval, notification to RR, set up hold mail instructions • Customer acknowledgments of receiving required notifications • Periodic verification that instructions still apply • Record of sending mail to customer • Termination of hold mail arrangements

Any requests received from customers to hold their mail should be referred to Compliance for review and approval. The following requirements apply:

- Such requests should be in writing and include the time period for the mail to be held.
- Mail held for longer than 3 consecutive months (including any aggregation of time periods from prior requests) must be justified by the customer in writing for an acceptable reason *(e.g.,* safety or security concerns). Convenience is not an acceptable reason to hold mail longer.
- For mail held longer than 3 months, the customer will be contacted at least semi-annually to verify that the instructions to hold mail still apply.
- Customers will be notified in writing of alternative methods for the customer to view/monitor account activity such as email or access through KCD's website. The customer will be requested to acknowledge receipt of this notice. The customer should be encouraged to make alternative arrangements for mail to be forwarded to a third party on their behalf.
- All mail will be held by Compliance and sent to the customer at the expiration of hold mail instructions.
- During the time that KCD is holding mail for a customer, KCD must be able to communicate with the customer in a timely manner to provide important account information (*e.g.* privacy notices, SIPC information notices), as necessary.

Non-Rated Taxable Debt Securities

Confirmations for a taxable-debt security (other than a U.S. Government security) will disclose that the security is not rated by a Nationally Recognized Statistical Rating Organization (NRSRO). The disclosure is based upon electronic data feeds that are linked to KCD's system for generating confirmations from at least two NRSROs that KCD reasonably believes provide rating information for at least 80% of outstanding rated taxable-debt securities.

The confirmation will include a statement that rating information is based upon good faith inquiry of selected sources. These trades AND the confirmations for those trades are processed through our clearing firm.

Disclosure Of Control Relationship With Issuer

[FINRA Rule 2262]

Whenever KCD effects transactions in the securities of an issuer that controls or is under common control with KCD, a disclosure regarding the common control will be included on or with the confirmation.

Callable Common Stock

Confirmations for transactions in callable common stock will disclose that:

- the security is a callable equity security; and
- the customer may contact KCD for more information regarding the security.

Special Disclosures For Principal Transactions

Confirmations for transactions in reported securities where KCD acts as principal will disclose the reported trade price, the net price to the customer, and the difference between the reported price and the price to the customer (*i.e.,* the markup/markdown or similar remuneration). Reported securities include:

- NASDAQ Global Market (NGM) securities
- NASDAQ Capital Market securities
- All NYSE, AMEX and selected securities on regional exchanges and reported to the Consolidated Tape

Also included in this requirement are riskless principal transactions in reported securities where KCD acts as market maker in the security. Where KCD is not a market maker, the confirmation must disclose the net price to the customer and the markup/markdown and similar remuneration.

14.23 Lost Securityholders And Unresponsive Payees

[SEC Securities Exchange Act of 1934 Rule 17Ad-17]

Responsibility	• Designated Supervisor
Resources	• Customers with returned undeliverable correspondence • Customer checks not negotiated
Frequency	• As required

Action	• Identify returned correspondence and checks not negotiated
	  ○ (Notify the clearing firm, if applicable, and skip the following steps)
	• For returned correspondence:
	  ○ Conduct searches
	  ○ Update the customer's record if an address is found
	• For checks not negotiated:
	  ○ Send written notification to customer
	  ○ Issue a new check if the original was lost or not received by the customer

Record	• Undeliverable correspondence • Unnegotiated checks* • Searches conducted and results* • Notice sent to customers regarding unnegotiated checks* • Action taken pursuant to searches and notification* *These records are retained by the clearing firm, if applicable

The Firm (and/or its clearing firm) is required to search for holders of securities with whom it has lost contact and to provide notifications to persons who have not negotiated checks that have been sent to them. "Lost securityholders" are customers to whom any correspondence was sent and returned as undeliverable and for whom an updated address has not been received or is not obtainable from the customer. **The requirement does not apply when the securityholder is not a natural person.**

14.23.1 Searches For Lost Securityholders

Searches will be conducted through an information database service that contains addresses for the entire U.S. including the names of at least 50% of the U.S. adult population, is indexed by taxpayer ID number or name and is updated at least four times a year. The search will be conducted by taxpayer ID number or, if that search is not likely to locate the person, by name. Securityholders will not be charged for searches.

Searches will be conducted between three and twelve months from the later of:

- the date upon which correspondence is returned as undeliverable or
- if returned correspondence is re-sent within one month from the date it was returned and is again returned as undeliverable, the date on which the re-sent item is returned as undeliverable.

A second search will be conducted between six and twelve months after the first search.

Searches will not be conducted when (i) KCD receives documentation the securityholder is deceased or (ii) the total value of assets in the account is less than $25.

14.23.2 Unnegotiated Checks

Written notice will be provided to customers who do not negotiate checks sent to them within 6 months of sending. This does not apply to checks worth less than $25.

14.24 Subordination Agreements With Investors

[SEC Securities Exchange Act of 1934 Appendix D to Rule 15c3-1; FINRA Notice to Members 02-32 and 02-04; FINRA web site: https://www.finra.org/filing-reporting/regulatory-filing-systems/subordination-agreements]

If KCD enters into a subordination agreement with an investor, it will provide the investor with a copy of FINRA Subordination Agreement Investor Disclosure Document and obtain the investor's signature on a copy of the Document. A copy of the signed Disclosure Document will be submitted to FINRA with the subordination agreement, for approval.

The FINOP is responsible for obtaining and submitting the required documents for subordination agreements.

14.25 Expense-Sharing Agreements

[SEC Letter July 11, 2003 to FINRA and NYSE Regarding Recording Certain Broker-Dealer Expenses And Liabilities; FINRA 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 KCD complies with the SEC's guidelines if it enters into any such agreements.

In addition, the FINOP is responsible for notifying KCD's Designated Examining Authority (DEA) 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 the DEA. 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 the DEA upon request.

14.26 Electronic Delivery And Signatures

[Electronic Records and Signatures in Global and National Commerce Act; SEC Release No. 34-42728; SEC Interpretive Release No. 33-7233, 33-7856 and 33-36345; NASD Notice to Members 98-3; NASD Regulatory and Compliance Alert March 1998; SIA Legal Alert 00-12]

Federal securities law through the Electronic Signatures in Global and National Commerce Act of 2000 regulates the use of electronic media for transmitting documents and the recording and accepting of electronic signatures. This section outlines requirements when KCD uses electronic methods of delivery between KCD and its customers and the use of electronic signatures for internal purposes such as approval of new accounts.

14.26.1 Electronic Delivery To Customers

[SEC Release No. 34-42728]

If KCD electronically transmits documents to customers and/or accepts electronic signatures from customers, the following requirements will apply:

- The customer's consent will be obtained.
- Notice will be provided to customers that the information is available electronically.
- Customers who are provided electronic delivery have access to the information substantially equivalent to the access that would be provided if the information were delivered in paper form (*i.e.,* the electronically transmitted document will convey all material and required information). Customers will have ready access to the electronic document either through downloading or ongoing access online.
- KCD will evidence satisfactory delivery through the customer's informed consent agreeing to delivery of certain documents or obtaining actual confirmation the customer received the information.
- Electronic delivery is subject to KCD's policies and procedures to protect confidential customer information and ongoing review of KCD's security systems.

14.26.2 Electronic Signatures

[SEC Release No. 34-42728]

Electronic signatures may be used by designated supervisors to indicate approval/review of new accounts, orders, and other ongoing supervisory reviews. Supervisors will be assigned passwords which will be changed periodically to protect the security of the system.

14.26.3 FINRA Access

[SEC Release No. 34-42728]

As required by FINRA, FINRA and its staff will have access to downloading and printing of documents which will have appropriate references and cross-references for ready access. If batch process approval is used (as opposed to opening individual files for review/approval), the batch process will:

- Give regulators immediate access to required books and records
- Permit the examining staff to download and print hard copies of required books and records
- Be subject to KCD's policies and procedures regarding protection of customer information
- Be accessible only to authorized principals with password-based security access

Only authorized personnel will have access to the e-signature system which is password protected with periodic updating of passwords. Any branch offices that access the e-signature system will be provided KCD's policy on safeguarding electronic signatures.

As part of KCD's annual review of its systems and procedures, the use of electronic signatures will be reviewed to ensure KCD is meeting recordkeeping requirements.

14.27 Transfer Of Accounts

Customer accounts are introduced to a clearing firm; the clearing firm is responsible for timely transfer.

14.28 Solicitation Of Proxies

[SEC Securities Exchange Act of 1934 Section 14]

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.

14.29 Customer Requests For References

Customers or prospective customers sometimes request letters of reference from broker-dealers regarding their accounts or future business to be done. Some of 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.

14.30 Audit Letters

Responsibility	• Designated Supervisor or Designee

Resources	• Letters from auditors requesting verification of balances in customer accounts
Frequency	• As required
Action	• Forward requests to Operations for response
Record	• Operations will maintain copies of responses in customer account files

Auditors sometimes send letters asking KCD to verify funds and securities on behalf of their customers who also have accounts with KCD.

All requests should be forwarded to the manager of Operations for response. In no instance should an RR or other branch personnel respond to these requests.

14.31 Annual Disclosure Of FINRA BrokerCheck

[FINRA Rule 2267]

As required by FINRA rule, at least annually customers will be provided with the following information in writing about FINRA BrokerCheck (formerly known as FINRA Public Disclosure Program):

- the hotline number
- the Web Site address
- a statement regarding the availability of an investor brochure regarding FINRA BrokerCheck

KCD Is exempt from this rule because KCD is an introducing broker (FINRA Rule 2267(b).

14.32 Carrying Agreements

[FINRA Rule 4311; NASDAQ Conduct Rule 2000 and 3000]

KCD introduces its accounts and customer transactions to its carrying firm. KCD has executed a carrying agreement consistent with regulators' requirements and will amend its carrying agreement when necessary. Any new carrying agreement or amendment will be submitted to its designated SRO for review and approval. A carrying agreement where accounts are carried on a fully disclosed basis will include the responsibilities of each party to the agreement as required by rule. Accounts introduced on a fully disclosed basis will be notified in writing at the opening of the account of the existence of the carrying agreement and the responsibilities allocated to the respective parties.

The FINOP is responsible for executing required carrying agreements; providing required notices; and retaining records.

14.33 Clearing Firm Exception Reports

[FINRA Rule 4311(h); FINRA web site: http://www.finra.org/Industry/Compliance/RegulatoryFilings/ClearingNotifications/index.htm; NYSE Rule 382]

Responsibility	• Designated Supervisor or Designee
Resources	• Clearing firm lists of reports available and currently received
Frequency	• Annually, at or around July 31 of each year
Action	• Review list of reports available from clearing firm and adjust list of reports received, if appropriate
Record	• Notice from the clearing firm and request for change to reports received are retained in a file for clearing firm exception reports.

In compliance with SRO rules, KCD's clearing firm is required to provide annual notice, by July 31 of each year, as follows:

- Notice to KCD of:
  - exception reports available, and,
  - exception reports currently supplied to KCD.

When the list of available reports is received, Compliance will review the list and contact the clearing firm regarding changes to the list of reports currently received.

14.34 Short Interest Report

[FINRA Rule 4560; FINRA Regulatory Notice 16-32 and 12-38; FINRA FAQs: https://www.finra.org/filing-reporting/regulatory-filing-systems/short-interest/faq?utm_source=MM&utm_medium=email&utm_campaign=O%5FWeekly%5FUpdate%5F110222%5FFINAL]

KCD's clearing firm is responsible for filing required short interest reports.

14.35 Electronic Blue Sheets

[SEC Securities Exchange Act of 1934 Rule 17a-25; FINRA Regulatory Notice 12-47; FINRA Notice to Members 06-33 and 05-58; FINRA Electronic Blue Sheet FAQS: https://www.finra.org/filing-reporting/electronic-blue-sheets-ebs/faq/]

Regulators may request information regarding customer or KCD transactions as part of their ongoing market surveillance activities. Information is transmitted electronically through FINRA's Regulatory Filings Application (RFA) Platform or the NYSE's Datatrak platform.

The FINOP is responsible for designating a person responsible for filing responses and retaining records of responses (or promptly forwarding requests to KCD's clearing firm and retaining a record of forwarding).

14.36 Regulatory Fees And Assessments

[SEC Securities Exchange Act of 1934 Section 31; FINRA By-Laws Schedule A; FINRA Notice to Members 05-11 and 04-63]

The FINOP is responsible for paying fees and assessments required by regulators. A record of information reported and fees or assessments paid are retained in the FINOP's files.

14.37 Regulatory Requests

[FINRA Rule 8210]

Responsibility	• Compliance
Resources	• Regulatory requests received from regulators
Frequency	• As required
Action	• Process the inquiry including the following: ○ Record date of receipt ○ Flag due date in a log or other record ○ Assemble and review response ○ Encrypt responses prior to sending where required ○ Request and record any extension of due date, if necessary ○ Forward response, retaining a copy
Record	• Copy of request, response, and notations of when received, extensions, and when response was sent

Responses to regulatory requests may only be provided by authorized employees or departments such as Operations or Compliance. Requests received by employees other than those authorized must be referred to Compliance.

14.37.1 Information Provided Via Portable Media Device

[FINRA Regulatory Notice 10-59]

Information provided to FINRA by portable media device in response to requests under FINRA 8210 (Provision of Information and Testimony and Inspection and Copying of Books) will be encrypted using a method that meets industry standards for strong encryption. FINRA staff will be provided with the confidential process or key regarding the encryption in a communication separate from the encrypted information itself (separate email, fax, letter, *etc.*).

14.38 Outsourcing

[FINRA Regulatory Notice 21-29; FINRA Notice to Members 05-48]

Responsibility	• Designated Supervisor
Resources	• Third party vendors • Reviews of vendor performance • Customer complaints
Frequency	• At initial identification of need for outsourcing: identify candidate vendors • Upon engagement: Obtain written agreement • Annually: Obtain attestation or certification

	• Ongoing: monitor and periodically audit vendor activities

Action	• Identify areas of KCD's business where outsourcing is appropriate
	• Identify third party vendors that provide the needed services
	• Evaluate potential third parties and determine whether to engage using the Outsourcing Review Worksheet
	• Execute an agreement to include, among other items:
	    ○ representations that they are conducting self-assessments
	    ○ recordkeeping will comply with regulatory rules
	    ○ the vendor and/or its employees are appropriately registered where required
	    ○ authorized access to KCD's systems and customer information
	    ○ disposition of records upon termination of agreement
	    ○ existence of a Business Continuity Plan covering KCD's records
	• Determine vendor access to sensitive firm or customer non-public information and critical firm systems granting access only when required and revoking when no longer needed and upon termination
	• Require periodic attestations or certifications the vendor has fulfilled certain reviews or obligations under the agreement
	• Include vendor activities in periodic audits for compliance with the agreement and regulatory requirements
	• When problems are identified through customer complaints, monitoring of services, reports from employees, or from the vendor itself, take corrective action which may include:
	    ○ Review the problem to determine whether the source is the vendor or is internal
	    ○ Take corrective action which may include the following:
	        ▪ Contact the vendor and determine what corrective action will be taken and follow-up to determine corrective action has been taken
	        ▪ If the problem continues or is significant, determine whether vendor agreement should be continued
	        ▪ If the problem is internal, contact the appropriate supervisor to determine corrective action
	        ▪ Report issues to regulators if required
	    ○ Consult with Compliance when necessary to determine action to be taken

Record	• Outsourcing Review Worksheet • Contracts/agreements with third parties • Annual attestation • Records of third party vendor reviews including periodic audit reviews • Records of corrective action taken including reports to regulators, if applicable

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 ("covered activities") that, if performed by a firm, would be required to be the subject of a supervisory system and written supervisory procedures.

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
- Vendor's cybersecurity controls
- Vendor's ability to retain firm records in accordance with regulatory requirements
- Who at KCD is responsible for oversight and monitoring the vendor's services

An Outsourcing Review Worksheet will be completed when a new vendor is considered.

14.38.1 Cybersecurity

KCD will confirm that a vendor that will have access to customer and firm records has a viable cybersecurity program to protect such information and take corrective action when there are cybersecurity breaches. Cybersecurity considerations include:

- Review of a vendor's cybersecurity program and confirmation of continuing controls and technology changes to critical systems
- Testing of system changes and capacity to detect underlying malfunctions or capacity constraints
- Encryption of confidential firm and customer data stored at the vendor or in transit between KCD and vendors
- Disposal of customer non-public information
- Retention or transfer of data upon termination of vendor agreement

14.38.2 Books And Records

KCD's records are a critical part of any outsourced vendor agreement.

- Affirm the vendor will maintain books and records in accordance with Exchange Act Rules 17a-3, 17a-4, FINRA Rule 3110(b)(4), and FINRA Rule 4510.
- Confirm records will not be deleted upon termination of the vendor's contract with KCD.
- Review vendor's recordkeeping in audit programs for compliance with regulatory requirements.

15 INSIDER TRADING

[Insider Trading and Securities Fraud Enforcement Act of 1988; SEC Securities Exchange Act of 1934 Rule 10b-5; FINRA Notice to Members 89-5; SEC Staff Summary Report on Examinations of Information Barriers: http://www.sec.gov/about/offices/ocie/informationbarriers.pdf; SEC Guidance on the use of company web sites (application of Regulation FD): http://www.sec.gov/rules/interp/2008/34-58288.pdf; http://www.sec.gov/about/offices/ocie/informationbarriers.pdf]

<table>
<tr><td>Responsibility</td><td>Designated Supervisor
Compliance</td></tr>
<tr><td>Resources</td><td>Daily Transaction Report
Employee transactions (see the section Employee, Employee-Related and Proprietary Trading)
Customer and proprietary and affiliate asset management (if applicable) transactions
Restricted and watch lists
Inquiries from regulators
Transactions in securities on KCD's Watch or Restricted Lists (see the sections Watch List and Restricted List)
Questions or transactions referred by managers or other firm personnel
Access controls including key card controls, computer networks</td></tr>
<tr><td>Frequency</td><td>Daily and as required
Monthly - Review of controlled access
Annually and ongoing - develop and provide training</td></tr>
<tr><td>Action</td><td>Supervisors reviewing trades: refer questioned trades to Compliance
Compliance will review the referred transaction and take appropriate action which may include:
Determination if further information is necessary
Consultation with RR or other firm personnel regarding the nature of the transaction(s) including reason for transaction, solicited vs. unsolicited
Review of other transactions by the same customer and/or RR
Consultation with in-house or outside counsel
Referral of transaction(s) to appropriate regulator
Compliance
reviews transactions (employee/customer/proprietary/affiliate asset management) against restricted and watch lists to identify potential breaches
reviews access controls (key cards, network controls) for unauthorized access
investigates potential breaches
takes corrective action which may include:
Contact with affected personnel
Consultation with outside counsel
Disciplinary action
Added training
Referral to regulators
Develop and provide training for all personnel and particularly for those</td></tr>
</table>

	with access to inside information
Record	• Initials on Daily Transaction Report by the designated reviewer • Compliance's review of transactions documented to include who conducted the review; when reviewed; identification of the transaction(s) reviewed; copies of the records used to conduct the review; and notation of action taken • Compliance review of controlled access and corrective action taken, if applicable • Compliance and supervisors' records of employee training on insider trading

15.1 Prohibition Against Acting On Or Disclosing Inside Information

KCD policy prohibits employees and associated persons from effecting securities transactions while in the possession of material, non-public information. Employees 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 receive inside information, they are prohibited from trading on that information, whether for the account of KCD 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.

15.2 Tippees Are Insiders

An employee may, depending on the circumstances, become an "insider" or "tippee" when obtaining **apparently** material, non-public information by happenstance, including information derived from social situations, business gatherings, overheard conversations, "tips" from "insiders," or other third parties. In these situations, the employee must, **unless Compliance advises otherwise**, treat the information as inside information and comply with all of the policies on insider trading.

15.3 Misuse Constitutes Fraud

The misuse of material, nonpublic or "inside" information constitutes fraud, a term broadly defined under federal securities laws. Engaging in fraud is subject to civil and criminal penalties (including imprisonment), SEC administrative actions, disgorgement of profits, penalties from exchanges, and dismissal by KCD. There are no circumstances where any person becomes aware of inside information, for whatever purpose, may use that information to trade for personal benefit, for KCD's benefit, or for the benefit of another. If any employee believes he or she has received inside information, he or she should immediately advise their supervisor or Compliance.

15.4 Annual Certification

Employees and associated persons are required to annually certify their knowledge of and compliance with KCD's insider trading policy. This certification is included in the Annual Certification form.

15.5 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 KCD 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 KCD. Specific departments of KCD 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, 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 KCD 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, KCD has adopted the following guidelines which are designed to prevent violations of the insider trading rules.

WHEN KCD IS AN INSIDER

KCD may be deemed an insider when it comes into possession of inside information through its various activities such as investment banking and research. Research analysts may become insiders (or tippees) upon receiving inside information from a company officer, director or employee. In addition, the intention to update or downgrade a research recommendation might be material information and should not be disclosed, prior to public dissemination, to anyone outside the Research Department (and in some instances to some within the Research Department) unless there is a need to know the information.

KCD will remain an insider as long as it has inside information, regardless whether the prospective banking client decides to engage another investment banking firm or whether KCD declines to accept the proposed engagement.

REGULATION FD (FAIR DISCLOSURE)

SEC Regulation FD governs the release by public companies of information that may reasonably be expected to affect the market price of securities issued by the public company. While obligations under the Regulation fall primarily on public companies, it is equally important for employees of KCD to be aware of the requirements and to act appropriately if an employee becomes privy to inside information about the company. Further explanations for research personnel and investment bankers are included in the chapters *INVESTMENT BANKING* and *RESEARCH*.

The goal of the Regulation is to create a "level playing field" so that the dissemination of information that is reasonably likely to affect the market price of a security is released simultaneously to all investors. In general, the issuer, its executive officers, directors, investor relations personnel or other employees with similar duties are prohibited from selectively disclosing material, nonpublic information to securities analysts, to other securities professionals, or to a shareholder when it is foreseeable that a recipient of such information will trade on the information. The Regulation requires action by the issuer if there is intentional or unintentional selective disclosure of such information.

Employees must not expect or seek to obtain, other than in the normal course of confidential investment banking activities, material non-public information from issuers and their employees.

GUIDELINES

TREATMENT OF CUSTOMER INFORMATION. KCD 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. KCD'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. KCD 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 KCD's activities. Do not trade on the information or discuss the possible inside information with any other person at KCD. 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 KCD 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. KCD may submit these affidavits to the Exchanges, FINRA or SEC.

STEPS YOU CAN TAKE TO PRESERVE THE CONFIDENTIALITY OF MATERIAL NON-PUBLIC INFORMATION.

If you are in a position within KCD to access inside 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 KCD. Before such information is communicated to persons

within KCD, your department, or another person you believe needs to know, contact your department manager 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. Protect electronic information on laptops and other portable devices by encrypting confidential data.
8. 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. Firm policy is to require all employees to maintain their securities accounts at KCD except with the approval of Compliance. If you have an account outside of KCD 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

KCD has a vital interest in its reputation, the reputation of its associates, and in the integrity of the securities markets. Insider trading would destroy that reputation and integrity. KCD is committed to preventing insider trading and to punishing any employee 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 KCD's compliance efforts and must be adhered to.

15.6 Employee, Employee-Related, And Proprietary Trading

Responsibility	• Designated Supervisor or Designee
Resources	• Daily Transaction Report • Confirmations/statements for employees' outside accounts
Frequency	• Daily
Action	• Identify transactions in employee accounts that where traded on confirmed "insider information"
Record	• Notations are included in Compliance's files regarding identified transactions including details of each trade, action taken and initials or signature of reviewer.

Employee and proprietary trades are reviewed by by Supervisor or trades contrary to restrictions because of underwriting activities, other restrictions, and potential insider trading. This review includes employees' outside securities accounts to identify transactions in securities with potential insider information.

15.7 Information Barrier Procedures

[FINRA Rule 5280; FINRA Notice to Members 91-45]

Responsibility	• Designated Supervisor or Designee
Resources	• Information regarding confidential investment banking activities
Frequency	• As required

Action	• Investment Banking notifies Compliance regarding confidential investment banking activities
	• Compliance:
	    ○ Maintain records of companies subject to investment banking (also see *Restricted List* and *Watch List*)
	    ○ Maintain records of employees brought "over the wall" including name, date brought over, and the company the subject of confidential activities
	    ○ Issue restrictions on the "over the wall" employee's activities (issuing research reports, trading in a particular security, *etc.*), as appropriate
	    ○ Obtain certifications from affected employees

Record	• Certifications filed in employee's file in Compliance, if applicable

15.7.1 Introduction

Information barriers (also known as "Chinese walls") are established within broker-dealers to prevent the flow of material, non-public information. KCD may obtain material, non-public information while engaging in investment banking activities. Effective procedures permit KCD to continue conducting trading and other business activities while another department has knowledge of inside information affecting an issuer of securities. KCD has established procedures to isolate departments and/or employees with inside information and permit the conduct of business in other areas.

Barriers between trading and research also apply to advance non-public information about a pending research report or recommendation.

The following department(s) is (are) subject to KCD's Information Barrier confidentiality procedures:

- Operations
- Investment Banking

Departments that obtain material, non-public information in the normal course of business must maintain the confidentiality of that information. Other departments potentially affected by inside information may continue to conduct normal activities unless they become aware of inside information, in which case they are required to immediately contact Compliance for guidance regarding future activities involving the subject company or companies.

15.7.2 Confidentiality Procedures

Responsibility	• Designated Supervisors for Research, Investment Banking • Compliance
Resources	• Pending investment banking deals

	• Research reports and workpapers
Frequency	• As required when deals or research are pending

Action	• Notify and train department employees regarding confidentiality requirements
	• Secure confidential information by locking paper files; limiting computer access; using codes or deleted names on deals or reports; provide physical separation between departments that maintain confidential information
	• Monitor communications and password access
	• Contact Compliance when violations of confidentiality are identified
	• Compliance: monitor trading of an issue the subject of a deal or report
	• Compliance: take corrective action when necessary which may include:
	  ○ Withdraw research report
	  ○ Delay or suspend an IB deal
	  ○ Contact counsel
	  ○ Additional training for personnel

Record	• Training of employees including subjects covered, who attended, when occurred • Deal or research files with codes or deleted names • Assignment of passwords or other methods to limit computer access • Monitored communications and password usage • Corrective actions taken

Employees in departments with access to inside information or other information where confidentiality is required (*e.g.,* investment banking deals, research reports) are subject to strict confidentiality requirements. Confidential information may only be shared with those outside the department on a need-to-know basis (see *Bringing An Employee Over the Wall* in this chapter) with the supervisor's approval and the participation of Compliance where required (*e.g.,* communications between Research and Investment Banking). Some procedures for maintaining confidentiality include:

- Maintain all paper files in a locked and secured area.
- Access only those computer files authorized using assigned passwords. Do not reveal or share passwords.
- Refrain from discussing in public areas or with others outside the department (including family members, friends, *etc.*) any activities that are not publicly known.
- Use code names or delete names on sensitive drafts that identify projects or banking clients.
- Report any potential breaches immediately to the supervisor and/or Compliance.

Failure to maintain confidentiality may result in withdrawal from a deal, suspending issuance of reports, or internal or regulatory disciplinary action. Breaches of confidentiality could have serious consequences for the Firm and its employees.

15.7.3 Access To Confidential Information Limited To Certain Employees

Access to actual or potential inside information obtained in the normal course of KCD's banking activities is limited to the following employees:

1. Employees within the respective banking department who need to know
2. KCD's chief compliance officer
3. KCD's general counsel
4. KCD's officers

15.7.4 Notification To Compliance

When KCD is engaged to provide investment banking services to an issuer, and that engagement may result in obtaining inside information, the designated supervisor is responsible for notifying Compliance of the engagement so that the issuer may be included on KCD's Watch or Restricted Lists, if appropriate. This includes notification of any "target" companies that may become part of the investment banking transaction. Refer to the chapter *INVESTMENT BANKING* for more information about activities affecting investment banking activities.

When KCD is engaged to provide municipal finance services to a municipal issuer regarding an advanced refunding, the designated supervisor is responsible for notifying Compliance so the issue may be included on KCD's Watch List.

15.7.5 Education And Training Of Employees

To ensure employees are familiar with KCD's Insider Trading policy KCD has established the following procedures:

- Employees receive KCD's Insider Trading policy upon hire.
- Annually, employees complete KCD's Annual Certification which includes their acknowledgment of receipt and understanding of the Insider Trading policy.
- When procedures are revised, employees will be notified by memorandum.
- Insider Trading is a subject periodically included in KCD's continuing education and compliance meeting programs.

15.8 10b5-1 Plans

[Exchange Act Rule 10b5-1]

Responsibility	• Compliance
Resources	• Requests about 10b5-1 plans
Frequency	• As required
Action	• Review the request and the nature of the RR's participation/activity • Approve or disapprove • If approved, provide guidance regarding allowable activities/limitations
Record	• Requests, approval/disapproval, and communications regarding guidelines and allowable activities/limitations

Under Rule 10b-5 of the '34 Securities Exchange Act, a person can face insider trading liability for trading securities while aware of material, nonpublic information about the issuer or its securities. 10b-5 also provides some affirmative defenses or exceptions to this liability. One of the defenses for executives subject to knowledge of inside information is the use of a pre-existing trading plan (10b5-1 Plan) that complies with the requirements of 10b-5(c). This section only summarizes requirements and guidelines regarding such plans. The executive at risk for 10b-5 liability is ultimately responsible for conferring with legal counsel and assuring himself or herself that such a plan is structured properly for avoidance of liability.

- The written plan must be adopted before the individual becomes aware of any material, nonpublic information.
- The plan must specify either the amount and price and dates of for purchases or sales or a written algorithm or computer program to determine the amount and price of the securities to be purchased or sold and the dates of purchases or sales.
- The plan must not permit the executive to exercise any subsequent influence over how, when, or whether purchases or sales would be affected under the plan.
- With the exception of issuers, there is a limitation on single-trade plans to one plan per consecutive 12-month period.
- A "good faith" certification must be completed by officers and directors utilizing a 10b-5 plan.
- It must be demonstrable that purchases or sales actually took place under the plan.
- There cannot be alterations or deviations from the terms of the plan (changing the amount, price or timing) and cannot be alterations to a corresponding or hedging transaction or position.
- The plan must be entered into in good faith and not as part of a scheme to evade the prohibitions of 10b-5.
- Conditions include cooling-off periods for directors, officers, and persons other than the issuer.
- Certain disclosures by issuers are required including plans adopted or terminated by directors or officers; the issuer's insider trading policies and procedures; and issuer executive and director compensation.

The plan may have to comply with the issuer's insider trading policies and procedures and public disclosure of such a plan may be necessary. Other guidelines may strengthen the defensibility of the plan and its execution including eliminating communications between the broker and the executive; avoiding multiple plans for one executive; and minimizing modifications to a plan which may call into question the good faith basis for establishing the plan.

Compliance must be contacted prior to engaging in transactions on behalf of a 10b5-1 plan.

16 ACCOUNTS

16.1 Concentrations

Responsibility	• Designated Supervisor
Resources	• Order records • Transaction reports • Margin records • New account records
Frequency	• Depending on frequency of available reports
Action	• Identify concentrated positions, particularly in margin accounts • If the security is a low-cap or other unknown security, check blue sky status • Identify excessive concentration in a particular type of product or industry sector, *i.e.,* long-duration fixed instruments subject to interest rate shifts • Review the customer's new account profile, particularly the investment objectives • Confer with the RR about concentrations, if necessary • Confer with the customer, if appropriate • Restrict future purchases for individual or all customers, if appropriate
Record	• Reviews of concentrated positions including action taken

Accounts that are concentrated in certain security positions may increase risk for the customer, particularly if the security is purchased on margin. RRs must consider the following factors for concentrated customer accounts:

- Is the concentrated position in a margin account?
- Do trading characteristics (thinly-traded, limited markets) create added risk to the customer?
- If the concentrated position is higher-risk, is the customer aware of this risk and suitable for such a position or positions?
- Should the concentrated position be mitigated by reducing margin exposure or selling off some of the position?

16.2 Anti-Money Laundering (AML) New Account Requirements

AML rules apply to the opening of new accounts. This section summarizes the more complete requirements explained in the chapter *ANTI-MONEY LAUNDERING (AML) PROGRAM*.

16.2.1 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 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.
- **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).
- **Correspondent and Private Banking accounts.** See the section *Due Diligence For Correspondent And Private Banking Accounts*.

16.2.1.1 Customer Identification Program (CIP)

[USA PATRIOT Act Section 326; Bank Secrecy Act 31 CFR Chapter X Part 1023 Subpart B; FINRA Notice to Members 03-34; FinCEN Frequently Asked Questions: https://www.fincen.gov/resources/statutes-regulations/guidance/interagency-interpretive-guidance-customer-identification; FinCEN No-Action position on CIP requirements under clearing arrangements: FIN-2008-G002; Guidance on Obtaining and Retaining Beneficial Ownership Information, FinCEN Guidance, FIN-2010-G001 March 5, 2010]

New customer accounts are subject to CIP reviews mandated under anti-money laundering rules.

16.2.1.1.1 Definition Of Customer Under CIP Rule

The definition of "customer" under the CIP rule is different than definitions under other rules. Who is a "customer" under this Rule affects KCD's obligations.

Under the CIP rule and for purposes of this section, "customer" is defined as:

- A person that opens a new account.
- An individual who opens a new account for:
    - An individual who lacks legal capacity; or
    - An entity that is not a legal person.

"Customer" does not include a financial institution regulated by a Federal regulator; a bank regulated by a state bank regulator; those exempted under Federal rule include municipalities; or a person with an existing account at KCD providing there is reasonable belief that the true identity of the person is known.

16.2.1.1.2 Accounts Opened By Other Financial Institutions

There are certain accounts opened by financial institutions where the underlying beneficial owners are not subject to customer identification requirements (see *Customer Due Diligence*) or where KCD may rely on the other financial institution to conduct customer due diligence under their own AML program. A key issue is whether the account is a "customer" of KCD. "Customer" accounts are subject to reviews by KCD or by the financial institution opening the account. More detail is included in the AML chapter. KCD is not obligated to conduct due diligence under the Customer Identification Rule in the following circumstances, depending on conditions explained in the AML chapter. Questions should be referred to the AML Compliance Officer.

- Some financial intermediaries such as banks, clearing firms, investment advisers, *etc.* open accounts for their own customers and provide limited information when opening an account to facilitate clearing of transactions or transfer of assets. The beneficial owners of these accounts are not considered "customers" and are not subject to KCD's due diligence reviews.
- KCD may rely on the other financial institutions to conduct reviews of shared customers where it is reasonable to rely on the other institution; the other institution is subject to AML rule requirements; and the other institution enters into a contract attesting to its performance of AML reviews.

- Shared accounts opened by investment advisers are not subject to KCD's review if the investment adviser:
    - is determined to be reasonable to rely upon;
    - is registered with the SEC; and
    - enters into a written agreement with KCD.

16.2.1.2 Master Accounts And Sub-Accounts

[FINRA Regulatory Notice 10-18; SEC National Exam Risk Alert "Master/Sub-accounts:" http://www.sec.gov/about/offices/ocie/riskalert-mastersubaccounts.pdf]

Accounts are sometimes established as "master accounts" that represent multiple sub-accounts. Depending on facts and circumstances (discussed below), master/sub-accounts may be recognized as separate customer accounts subject to CIP reviews.

16.2.1.2.1 Description Of Master/Sub-Accounts

A master account may have multiple underlying accounts on behalf of underlying investors; sub-advisers may be authorized to effect transactions without the intermediation of the master account owner. Also, an individual or entity may set up sub-accounts for separate trading strategies or algorithms. Sub-accounts may be used by individual traders or groups of traders. The master account may be another broker-dealer or a partnership that provides its individual partners trading authority over separate sub-accounts.

16.2.1.2.2 Obligations To Conduct CIP Reviews

Except for accounts opened by investment advisers and financial institutions discussed under *Accounts Opened By Other Financial Institutions* and meeting the conditions of that section, when there are separate owners of the sub-accounts, KCD has an obligation to identify the beneficial owners. Indicators that there may be separate owners requiring CIP review of the sub-accounts include:

- The sub-account owner is entering orders for itself.
- KCD has actual notice the sub-accounts have different owners.
- The sub-accounts are separately documented and/or receive separate reports.
- The sub-accounts are addressed separately in terms of transaction, tax or other reporting.
- The services provided to the sub-accounts engender separate surveillance and supervision of the sub-accounts for compliance with rules or for risk management purposes consistent with the review of separately owned accounts.*
- There are financial arrangements or transactions with the sub-accounts, or separate account terms, that reasonably raise questions concerning whether such accounts represent separate beneficial owners.*
- The sub-accounts incur charges for commissions, clearance and similar expenses, separately, based upon the activity only of that subject sub-account.*
- There is evidence of financial transactions or transfers of assets or cash balances that would reasonably evidence separate beneficial ownership of the sub-accounts.*
- KCD (or RR) is aware of or has access to a master account or like agreement that evidences that the sub-accounts have different beneficial owners.
- There is evidence that a party maintaining a master/sub-account arrangement has interposed sub-accounts that have or are intended to have the effect of hiding the beneficial ownership interest.*
- The number of sub-accounts maintained is so numerous as to reasonably raise questions concerning whether such accounts represent separate beneficial owners.*

*Items above would not apply in the case of accounts opened by a registered BD or a bona fide investment adviser.

16.2.1.2.3 Market Access

Where access to markets is provided to master accounts, KCD and the master accounts are subject to SEC Rule 15c3-5 regarding controls on such access. The master account participants must be determined to confirm compliance with Market Access Rule requirements.

Refer to the section *Market Access* that appears in the following chapters:

- ORDERS
- EQUITY TRADING AND MARKET MAKING
- CORPORATE FIXED INCOME SECURITIES SALES AND TRADING
- NYSE FLOOR BROKER PROCEDURES

16.2.2 "Game-Like" Accounts

Responsibility	• Designated Supervisor
Resources	• Accounts and trading activity
Frequency	• As required
Action	• Review new accounts that will participate in game-like trading accounts ○ confirm the account's investment objectives are consistent with this type of trading ○ confirm disclosures regarding risks have been provided ○ confirm activities and communications do not represent recommendations subject to Regulation BI requirements
Record	• New accounts review and approval • Disclosures provided to customers • Trading activity and actions taken, if any

Where customers participate in accounts with "game-like" features that may involve active trading, such accounts will be subject to additional review and scrutiny.

16.2.2.1 Information Security

KCD has procedures to protect information and information systems from unauthorized access, disclosure, tampering, and other breaches of information security. Where there are master accounts with sub-account access to Firm systems, all participants will be required to participate in training, validate their participant authority to trade in sub-accounts; and use Firm-issued passwords which will be periodically changed.

16.2.2.1.1 Surveillance

Transactions for master and sub-accounts are subject to KCD's surveillance to identify potential insider trading and market manipulation activities.

This chapter outlines requirements when opening and maintaining accounts for customers. References to "suitability" apply only to those recommendations NOT subject to Regulation Best Interest (BI) which applies to retail customers and is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

16.3 New Accounts

[SEC Securities Exchange Act of 1934 Rule 17a-3(a)(17); FINRA Rule 2090; FINRA Information Notice 10/21/08 New Account Application Template]

When opening and maintaining customer accounts, KCD and its RRs are obligated to use reasonable diligence to "know the customer" by obtaining essential facts about the customer and the authority of each person acting on behalf of the customer. Key requirements include the following:

- The new account application (which is designed to include information required by rules) must be complete prior to submission for approval. If the customer refuses to provide certain information, this must be indicated on the new account application.
- Where recommendations will be made to a non-institutional customer, account information includes the customer's financial status, tax status, investment objectives, and other information used or to be considered to determine the suitability of recommendations.
- The new account form must be signed by the RR opening the account.
- Under anti-money laundering requirements, the customer's identification must be verified.
- Required account documents, which vary depending on the type of account opened, must be obtained. Failure to obtain required documents may result in closure of the account.
- The customer's new account information will be sent to the customer for verification within 30 days of opening the account and every three years thereafter. When account information is changed, the changed information will be sent to the customer for verification within 30 days of the change.
- Make an effort to collect Trusted Contact Person age 18 or older who may be contacted about the customer's account (FINRA 4512 (a)(1)(F)

This section provides an explanation of certain requirements that apply to new accounts.

16.3.1 Customer Signatures

[FINRA Rule 2010; FINRA Regulatory Notice 22-18]

Responsibility	• Designated Supervisor
Resources	• Digital Signature Audit Trail • Email correspondence • Employees of KCD • Customer authentication
Frequency	• Monthly: review available digital signature audit trail

	- Ongoing: when accounts are opened, reviews of emails - As required: reports from employees
Action	- Review the digital signature audit trail to identify: - Customer signatures originating from email addresses associated with their RR or other email addresses that are inconsistent with customer emails maintained by KCD; - Discrepancies between the location of the user (*e.g.,* the individual affixing the customer's digital signature) and the customer's residence; or - The IP addresses for the RR and customer signatures on a document are the same - Review of emails for: - Documents sent to non-customer emails, including the RR's personal email address or their assistant's email address, to an RR's firm-assigned email address, or an address associated with an RR's approved outside business activity - Changes to a customer's email address in ways indicative of attempts to conceal information from a customer including changing an email address to the RR's or unrelated customers having the same email address - Review staff inquiries where an employee such as an RR's assistant raises questions to management or Compliance after an RR directed them to manipulate the digital signature process or signed a document for the customer, in what the RR claims is an acceptable accommodation for the customer - Corrective action taken which may include: - Consulting with Compliance - Disciplinary action which may include termination
Record	- Reviews of digital audit trail and records of actions taken - Reviews of emails and actions taken - Reviews of staff inquiries and actions taken

Customers are required to sign multiple documents when opening an account; sometimes additional or new forms are required later after the account is opened. All signatures must be original by the customer. RRs and others must not agree to sign on the customer's behalf when requested. Engaging in forgery and falsification will subject the RR or other employee to disciplinary action which may include termination. Such activity is a violation of regulatory rules and may also be a criminal offense.

In addition to manual signatures, digital signatures also must be original by the customer.

If an employee, such as an assistant to an RR, is asked to sign a document on behalf of a customer, that employee may not sign for a customer and must report the incident to the RR's supervisor.

16.3.2 Trusted Contact Person (TCP)

[FINRA Rule 2165, 4512(a)(1)(F) and 4512.06; FINRA Regulatory Notice 22-31; FINRA FAQs: Frequently Asked Questions Regarding FINRA Rules Relating to Financial Exploitation of Senior Investors https://www.finra.org/rules-guidance/guidance/faqs/frequently-asked-questions-regarding-finra-rules-relating-financial-exploitation-seniors#:%7E:text=To%20this%20end%2C%20Rule%204512%20%28a%29%20%281%29%20%28F%29%2Cnatural%20persons%20from%20being%20named%20as%20trusted%20contacts]

	Designated Supervisor

Responsibility	
Resources	• New accounts for persons 65 or older or who may have physical or mental impairments • Trusted Contact Person information
Frequency	• As required
Action	• Obtain TCP information upon opening a subject account • Contact the TCP to obtain information when the customer opens another account or KCD updates new account information • Contact Compliance to place a temporary hold and notify the customer and the TCP • Include TCP and temporary hold procedures in training
Record	• New account TCP information including Trusted Contact Person Forms • Notification to customer of TCP information • Records of temporary holds and notification of customer and TCP • Training

Among other required new account information, a trusted contact person should be identified for a "specified adult" under FINRA Rule 2165 which includes natural person customers age 65 or older or who have physical or mental impairments KCD reasonably believes are unable to protect their own interest. At the time of account opening the customer will be notified, in writing (which may include electronic), that KCD is authorized to contact the trusted contact person and to disclose to the trusted person information about the customer's account to address possible financial exploitation, to confirm the specifics of the customer's current contact information, health status, or the identity of any legal guardian, executor, trustee or holder of a power of attorney. The trusted contact person may be contacted when seeking to obtain TCP information (when the customer opens a new account or when KCD updates an existing account's information). The Trusted Contact Person Form should be used to obtain this information and authorization to contact the trusted person.

The trusted contact person does not have any authority over the customer's account, cannot make trading decisions for the account and does not act as a power of attorney by virtue of being named a trusted contact. After making a reasonable effort to obtain trusted contact information, an account may be opened and maintained even if a customer fails to identify a trusted contact. Refusal to provide TCP information should be noted on the account.

KCD may place a temporary hold on securities transactions and on disbursement of funds or securities when it reasonably believes financial exploitation has occurred, is occurring, or has been attempted or will be attempted. Compliance should be contacted to review the situation prior to effecting a temporary hold. The trusted contact person will be notified, if available.

16.3.3 Regulation Best Interest (BI)

Regulation BI applies to new accounts in two key ways:

- New customers must be provided with the Form CRS Relationship Summary at the time the account is opened.
- Recommendations to open accounts are subject to Regulation BI requirements and require provision of the Form.

The standards for making account recommendations in the customer's best interest are included in the chapter: *REGULATION BEST INTEREST (BI)*.

16.3.4 Designation Of Accounts

[FINRA Rule 3250]

All accounts must be in the name of the customer except that an account may be designated by a number or symbol if the customer provides a written statement attesting to the ownership of the account.

16.3.5 Customer Due Diligence (CDD)

[USA PATRIOT Act Section 326; Bank Secrecy Act 31 CFR Chapter X Part 1010, Part 1020, Part 1023, Part 1024 and Part 1026; FinCEN 2016 FAQs: https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf; FinCEN 2018 FAQs: https://www.fincen.gov/resources/statutes-regulations/guidance/frequently-asked-questions-regarding-customer-due-0; FINRA Rule 3310; FINRA Regulatory Notice 18-19 and 17-40]

Responsibility	• Designated Supervisor
Resources	• New account application and other customer ID information
Frequency	• When accounts are opened

Action	• Before approving an account, determine that customer identification (ID) verification information is included with the new account application and meets KCD's requirements
	• For legal entity customers:
	  ○ Obtain beneficial ownership certifications
	  ○ Determine whether a threshold lower than 25% ownership is warranted depending on the customer's risk for potential enhanced monitoring or to collect additional information including expected account activity
	• For non-documentary verification, check the information included with the new account application for completeness and consistency with other customer-provided information (name, address, phone number, taxpayer ID number, *etc.*)
	• For unacceptable verification information (incomplete, inconsistent), return the application to the RR for further information or disapprove the account
	• Identify accounts where KCD may rely on other financial institutions to satisfy CIP requirements and confirm eligibility to rely on exception
	• Obtain annual certification from other financial institutions
	• Include beneficial owners in AML monitoring
	• Provide ongoing training for appropriate personnel
	• Designate and identify to FINRA the individual responsible for implementing and day-to-day operations and internal controls of the program and notify FINRA regarding any change in designation

Record	• New account records include customer ID verification as well as the supervisor's approval and customer certifications • Identification and verification of reliance on other financial institutions • Annual certifications from other financial institutions • Certifications from legal entity customers or documentation of oral certification, where applicable • Records of training including content, date of training, and attendees

	• Record of designation to FINRA of responsible person

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. This includes, under FinCEN's requirements:

1. customer identification and verification;
2. beneficial ownership identification and certification;
3. understanding the nature and purpose of customer relationships; and
4. ongoing monitoring for reporting suspicious transactions and, on a risk basis maintaining and updating customer information.

Customer ID verification does NOT apply to accounts for:

- persons with an existing account at KCD (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

In addition, for accounts defined as "legal entity customers" (defined below), information must be obtained about beneficial owners. This requirement applies to accounts established May 11, 2018 or later. If KCD becomes aware of a change of beneficial ownership after May 11 for accounts established before that date, the customer's records must be updated under CDD requirements.

16.3.5.1 Definitions

[SEC Securities Exchange Act of 1934 Rule 17a-3(a)(17)(i)(A); FINRA Rule 4512]

The regulations should be consulted for more complete definitions.

Legal entity customer: corporation; limited liability company; another entity created by a public filing with a Secretary of State or equivalent; general partnership; limited partnership; business trust created through a state filing; or any similar entity formed under federal law. Does not include sole proprietorships, unincorporated associations, and natural persons opening their own account. Other exclusions are a federal- or state-regulated financial institution; political departments and agencies of the U.S. or a State; various different types of entities registered with the CFTC or SEC; and other entities included in the regulation. [Questions 22-28, 2018 FAQs]

Beneficial owner:

- each individual, if any, who, directly or indirectly, owns 25% or more of the equity interests of a legal entity customer (*i.e.,* the ownership prong); and
- a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer or senior manager (*e.g.,* a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, or Treasurer); or any other individual who regularly performs similar functions (*i.e.,* the control prong).

Ownership and control prongs: The CDD rule utilizes a two-pronged approach to defining a beneficial owner - an ownership prong and a control prong. Under the ownership prong, a beneficial owner is defined as each individual, if any, who, directly or indirectly, owns 25 percent or more of the equity interests of a legal entity customer. However, the rule recognizes that there may be instances when no single individual owns 25 percent or more of the equity interest of the legal entity; in such instances, KCD is still required to collect the required information for one individual who controls, manages or directs the legal entity customer. Under the control prong, a beneficial owner is defined as a single individual with significant responsibility to control, manage or direct a legal entity customer, including an executive officer or senior manager (*e.g.,* a chief executive officer, chief financial officer, chief operating officer, managing member, general partner, president, vice president or treasurer) or any other individual who regularly performs similar functions. The ownership and control prongs, although related, are independent requirements. Thus, satisfaction of, or exclusion from, regulatory obligations under one prong does not mean KCD's obligations under the other prong are also satisfied or excluded. [Question 9, 2016 FAQs]

16.3.5.2 Required Customer Information

[SEC Securities Exchange Act of 1934 Rule 17a-3(a)(17)(i)(A); FINRA Rule 4512]

Basic information required **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.
- **Telephone number**
- **Employment status** (including occupation and whether the person is associated with a broker dealer)
- **Annual income**
- **Net worth** (excluding value of primary residence)
- Account's investment objectives
- For joint accounts, information on each joint owner (financial information may be combined)
- **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.
- **Beneficial owners** (see the section that follows) including information about the following:
    - the nature and purpose of customer relationships to develop a customer risk profile
    - information sufficient at the time of account opening so customer activity may be assessed for SAR requirements (may include type of customer requesting services; type of account being opened; services or products being used)

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 90 days of opening the account.

In addition, under FINRA Rule 4512 KCD will retain the name of the RR responsible for the account and, if multiple RRs are assigned to the account, a record indicating the scope of their responsibilities with respect to the account. This requirement does not apply to an institutional account.

16.3.5.3 Accounts For Individuals

When opening an account for an individual, the following information is required:

- An unexpired government-issued identification including a photo and residence such as a driver's license or passport and record information from it on the new account application. The ID must be seen by the RR opening the account, with an indication the ID was viewed by the RR, **OR**
- If not viewed by the RR, a copy of the photo ID must be provided with the new account application.
- If the photo ID is not available at the time the new account application is being completed, the RR is to indicate on the new account application whether the customer will provide a copy of photo ID within 30 days of account opening **OR,** if the customer cannot provide a photo ID, the reason why not.
- If the photo ID is not received within 30 days, the account will be restricted to liquidating transactions only until the ID is received.

If the customer has not met with the Registered Rep in person, a photo ID will be required to open the account. Non-documentary information may be required to open the account.

If the customer cannot produce the required photo ID, an explanation must be included on the new account application AND non-documentary information will be required to open the account.

16.3.5.4 Accounts For Legal Entity Customers

[SEC Release No. 34-61651: Policy Statement on Obtaining and Retaining Beneficial Ownership Information for Anti-Money Laundering Purposes]

For legal entity customers, information must be obtained and verified regarding beneficial owners [Question 4, 2018 FAQs]. Obligations when opening accounts that include underlying owners or beneficiaries include the following:

- Determine whether the customer is acting as an agent for or on behalf of another, and if so, obtaining information regarding the capacity in which and on whose behalf the customer is acting.
- Where the customer is a legal entity that is not publicly traded in the United States, such as an unincorporated association, a private investment company (PIC), trust or foundation, obtain information about the structure or ownership of the entity so as to allow KCD to determine whether the account poses heightened risk.
- Where the customer is a trustee, obtain information about the trust structure to allow KCD to establish a reasonable understanding of the trust structure and to determine the provider of funds and any persons or entities that have control over the funds or have the power to remove the trustees.
- Obtain the identities of individuals who satisfy the definition as beneficial owners, either directly or indirectly through multiple corporate structures (complex ownership structures). [Question 3, 2018 FAQs]
- Obtain from the legal entity customer's representative a completed certification form identifying beneficial owners; updating information may require re-certification. [Questions 6 & 16, 2018 FAQs] [https://www.fincen.gov/resources/filing-information]
- Determine the nature and purpose of the customer relationship to determine risk profiles and identify the need for additional monitoring. [Questions 35-37, 2018 FAQs]

If KCD has affiliates with public customers, information may be shared across the enterprise to cross-check beneficial ownership information.

16.3.5.4.1 Reliance On Customer Representations

KCD may reasonably rely on information provided by customers if it has no knowledge of facts that would call into question the reliability of the information.

- There is no requirement to independently investigate a legal entity customer's ownership structure.
- KCD may rely on information provided by the customer to determine if the legal entity is excluded from the definition of legal entity customer.

16.3.5.4.2 Retention Of Beneficial Ownership Information

Identifying information will be maintained for a period of five years after the legal entity's account is closed. Verification records must be maintained for a period of five years after the record is made. KCD will also retain a description of each document relied on for verification, any non-documentary methods and results of measures undertaken for verification and the resolution of substantive discrepancies discovered in identifying and verifying the identification information for five years after the record is made. [Questions 9 & 10, 2018 FAQs]

16.3.5.4.3 Specific Account Requirements

Existing customers: For existing customers subject to CIP, KCD may rely on information obtained through the CIP to fulfill CDD requirements, providing that a representative of the customer certifies or confirms (orally or in writing) the accuracy of pre-existing CIP information. This also applies to the opening of multiple accounts, simultaneously or not. Oral confirmation must be documented in account records, and written confirmation will be retained with account information. [Questions 7 & 13, 2018 FAQs]

Foreign customers: Companies traded on foreign exchanges are subject to CDD requirements (while companies traded on U.S. exchanges are exempt). A "risk-based" approach may NOT be taken for these foreign customers, but KCD may rely on their public disclosures as are available for other legal entity customers (whether listed or not). A foreign financial institution (FFI) is excluded from the definition of a legal entity customer if its foreign regulator collects and maintains beneficial ownership information about the FFI. KCD may rely on representations of the FFI as to whether the exclusion applies. Lacking reasonable reliance on the FFI's representation, KCD will contact the foreign regulator to confirm retention of beneficial ownership information.

Internal recordkeeping and operational accounts: When KCD opens an account or subaccount (*e.g.,* to accommodate trading strategies) relating to an existing legal entity customer, the account is not considered a new account and is not subject to CDD beneficial ownership requirements. [Question 11, 2018 FAQs]

Trusts as beneficial owners: If a trust owns 25% or more of the equity interests of a legal entity customer, the beneficial owner is the trustee, regardless of whether the trustee is a natural person or a legal entity. If there are multiple co-trustees of a trust that is a 25% or greater owner of equity interests of a legal entity customer, KCD is not required to identify and verify the identity of all co-trustees. It must collect and verify the identity of, at minimum, one co-trustee of such a multi-trustee trust. [Questions 19 & 20, 2018 FAQs]

Pooled investment vehicles (PIV): For a PIV whose operators or advisers are not excluded from the definition of a legal entity customer, KCD is not required to look through the PIV to identify and verify individuals who own 25% or more of its equity interests. However, KCD is required to collect beneficial ownership information. [Question 18, 2018 FAQs]

Lower-risk customers: For certain lower-risk customers, the nature and purpose of the relationship can be developed by inherent or self-evident information.

16.3.5.4.4 Anti-Money Laundering Requirements

Beneficial owners are subject to AML requirements. Also see the chapter *ANTI-MONEY LAUNDERING (AML) PROGRAM*.

16.3.5.4.5 Currency Transaction Reporting (CTR) Requirements

CDD requirements do not change existing CTR requirements. KCD will presume different businesses that share a common owner are operated separately and independently from each other and from the common owner.

Transactions across commonly owned legal entity customers will not be aggregated absent indications the businesses are not operating independently (*i.e.,* same staff or location, accounts of one business are repeatedly used to pay the expenses of another business). Beneficial owners of a trust or estate account are not required when completing a CTR. Beneficial owner listing is only required if KCD knows that the transaction(s) requiring filing is made on behalf of a beneficial owner and results in either cash in or cash out totaling more than $10,000 during any one business day. [Questions 32 & 33, 2018 FAQs]

16.3.5.4.6 OFAC

Beneficial owners are subject to OFAC reviews outlined in the AML chapter.

16.3.5.5 Enhanced Due Diligence (EDD)

Some types of accounts, because of the potential risk for hiding the identity of underlying beneficial owners or money laundering activities, are subject to enhanced due diligence. The AML Compliance Officer will determine which accounts are subject to EDD and what reviews are necessary. Procedures for correspondent and private banking accounts are included in a separate section of this AML program. Certain trusts, corporate entities, shell entities, and private investment companies are examples of customers that may pose heightened risk.

EDD may include steps, in accordance with the level of risk presented, to identify and verify beneficial owners, to reasonably understand the sources and uses of funds in the account, and to reasonably understand the relationship between the customer and the beneficial owner. EDD information may be used for monitoring purposes and to determine whether there are discrepancies between information obtained regarding the account's intended purpose and expected account activity and the actual sources of funds and uses of the account.

16.3.5.6 Third Party Accounts

Customer ID required for third party accounts includes the following:

On behalf of an incompetent person: Obtain customer ID of the person holding power of attorney.

With power of attorney or trading authorization held by a third party: Obtain customer ID of the owner of the account. Customer ID is not necessary for the individual with authority over the account unless that person is unfamiliar to the RR or the circumstances regarding the opening of the account raises questions (customer requires wiring funds to an offshore address; third party is a foreign citizen; *etc.*).

16.3.5.6.1 Reliance On Other Financial Institutions

[C.F.R. 1023.220(a)(6)]

KCD may rely for CIP purposes on another financial institution (including an affiliate) that opens a customer account provided that:

- reliance is reasonable under the circumstances;
- the other financial institution is subject to anti-money laundering requirements [U.S.C. 5318(h)] and is regulated by a Federal regulator; and
- the other financial institution enters into a contract requiring it to annually certify that it has implemented its AML program and it will perform (or its agent) specified requirements of KCD's CIP.

16.3.5.6.2 Intermediated Account Relationships

[Various guidance from the U.S. Treasury and SEC regarding mutual fund CIP rule, BD CIP rule, FAQs regarding FCMs and introducing brokers, and foreign accounts]

If an intermediary is the customer and KCD has no CIP obligation regarding the intermediary's underlying customers under existing guidance, KCD will treat the intermediary as its legal entity customer. For example, the intermediary may be treated as the customer for transactions through omnibus accounts if:

- the omnibus account was established to execute transactions for settlement at another institution or the intermediary provides limited customer information to KCD;
- the limited information provided is used primarily for recordkeeping purposes or to establish sub-accounts that hold positions for limited durations;
- all transactions in the omnibus account are initiated by the intermediary; and
- the beneficial ownership has no direct control over the omnibus account.

16.3.5.7 Accounts For Non-Individuals

Account documents usually obtained for non-individual accounts (trust instruments, articles of incorporation, partnership agreements, government-issued business license, *etc.*) will usually satisfy customer ID requirements. In the case of corporations, a certified copy of the articles of incorporation is required. These documents must be obtained within 5 days of account opening to satisfy the requirement. The authorizing documents must indicate who has the authority to act on behalf of the account.

16.3.5.8 Non-Documentary Methods Of Verifying Customer Identification

Non-documentary methods of verifying customer ID involve other procedures. Non-documentary methods must be used in the following circumstances:

- An individual is unable to present acceptable photo ID
- The documents presented are unfamiliar
- The account is opened without obtaining documents
- The customer opens the account without appearing in person at KCD
- Other circumstances, at the discretion of the RR's supervisor, New Accounts, and/or the AML Compliance Officer, where KCD is unable to verify the customer's identity

In these circumstances, a non-documentary method must be indicated by the RR on the new account application:

- Direct customer contact information
- Information from a consumer reporting agency or other database
- References from another financial institution
- Obtaining a financial statement

Additional Verification For Certain Customers

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.treas.gov/offices/enforcement/lists/)
- Accounts for foreign public officials (individuals in high office in other countries, their families and close associates, political party officials)

16.3.5.9 Lack Of Customer ID Verification

When the Firm cannot form a reasonable belief that it knows the true identity of a customer, the Firm will:

- not open an account
- impose terms under which a customer may conduct transactions while we attempt to verify the customer's identity
- close an account after attempts to verify customer's identity fail

For **customers who fail to provide required ID or documents within 10 days of account opening,** the account will be restricted to liquidating transactions only until satisfactory ID verification is received.

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 or will be immediately closed.

Where inability to verify raises questions about the customer, filing a Suspicious Activity Report will be considered (see the section *Suspicious Activity Reports*).

Questions regarding accounts that do not comply with requirements to verify customer ID should be referred to the AML Compliance Officer.

Customer Notice

Customers are provided notice, prior to opening an account, that their identification will be verified. This notice may be on KCD's web site, on new account applications, or in other disclosures provided at the time of account opening.

16.3.6 Identity Theft (Red Flags Rule)

[Fair and Accurate Credit Transactions Act (FACT Act) Section 114 and 315; SEC Securities Exchange Act of 1934 Regulation S-ID]

Responsibility	• Designated Supervisor
Resources	• New account information • Order and transactions records (including transfers of funds/securities) • Available reports
Frequency	• Daily and ongoing
Action	• Identify "red flags" when reviewing new accounts, orders, and transactions • If red flags are identified, contact the AML Compliance Officer to consult regarding further action

	• Include identity theft in training
Record	• New account records • Order and transactions records • Referral of red flags to Compliance and notation of action taken • Records of training including when conducted, subject matter, and who attended

Identity thieves use someone's personal identifying information to open new accounts and misuse existing accounts. The Firm has established an Identity Theft Prevention Program (ITPP) to help detect and prevent identity theft. Many elements of detecting or preventing identity theft are similar to anti-money laundering (AML) requirements that are included in these policies. A more detailed explanation of the Program is included in the section *Identity Theft Prevention Program (Red Flags Rule)* in the chapter *ANTI-MONEY LAUNDERING (AML) PROGRAM*.

The ITPP is based on identifying "red flags" that indicate identity theft may have occurred. ***It is the responsibility of all employees to be alert and report to the AML Compliance Officer any new or existing customers who may be engaged in violations of anti-money laundering regulations or identity theft or who have reported identity theft.***

16.3.6.1 Notifying The AML Compliance Officer

If an employee identifies suspicious activity or red flags involving new or existing accounts, it is the employee's obligation to **immediately** notify his or her supervisor and/or the AML Compliance Officer. Supervisors are responsible for contacting the AML Compliance Officer if notified by an employee of suspicious activity or red flags or when he or she personally identifies them.

16.3.7 SIPC Disclosure

[FINRA Rule 2266]

When new accounts are opened, new customers will be provided information about the Securities Investor Protection Corporation (SIPC) including SIPC's web site address and phone number. This information is also provided annually in writing to all customers.

16.3.8 Approval

[Exchange Act Rule 17a-3(17)(i)(A); FINRA Rule 4512]

Responsibility	• Designated Supervisor or Designee
Resources	• New Account Form
Frequency	• Daily

Action	• Review new account form for:
	    ○ Completeness
	    ○ Proper styling of account

	○ Unacceptable accounts (accounts in name of minor only, fictitious accounts, numbered accounts without disclosure of owner, *etc.*) ○ Potential improper addresses (post office boxes, addressed to RR or KCD, *etc.*) ○ Consistency of investment objectives with financial status, prior investment experience, *etc.* ○ Initial transaction consistent with investment objectives ○ RR registration in state of customer's residency
Record	• Supervisor's signature on New Account Form • New account forms are retained by Operations

A completed new account form, signed by the RR, is required for each new account opened. The designated supervisor is responsible for reviewing the new account form for the necessary information and will promptly approve each new account.

16.3.9 Customer Account Information

[SEC Securities Exchange Act of 1934 Rule 17a-3(17)(i)(A)]

Responsibility	• Designated Supervisor or Designee • Complinace - if applicable
Resources	• New Account Forms or information
Frequency	• When accounts are opened
Action	• Establish procedures for sending new account information within 30 days of account opening • Forward customer responses to Compliance • Compliance reviews customer responses and notifies the RR, the RR's supervisor, and New Accounts • If Compliance identifies a pattern of customer responses for a particular RR, Compliance will contact the RR's supervisor to discuss and take corrective action, if necessary, which may include RR training, interview with the RR, a memo of caution to the RR, or other appropriate action
Record	• Customer's signed copy of the account application acknowledges receipt of the information at the time the account is opened • Changes to new account information are retained in new account files or records • Compliance files retain records of corrective actions taken

Within 30 days of opening an account (or with the next scheduled account statement), customers will be provided with a copy of the new account information for verification. In addition, account information will be verified with the customer every three years. In the event there is a change to the customer's account (including changes in investment objectives), the changed account information will be sent to the customer for verification within 30 days of submission of the change.

Compliance will review customer responses that revise new account information and will notify the RR, the RR's supervisor, and New Accounts of the changes.

16.3.10 Addresses On Customer Accounts

[SEC Securities Exchange Act of 1934 Rule 17a-3(a)(17)(i)(B)(2)]

Responsibility	• Designated Supervisor or Designee
Resources	• New account forms
Frequency	• Daily
Action	• Identify improper address on new account forms at time of approval • When approving new accounts, ensure beneficial owner of the account will receive confirmations consistent with the policy
Record	• Supervisor's signature on New Account Form

Confirmations and statements and other account information will be transmitted to the customer at the address requested by the customer. KCD or an employee may not be the sole addressee for a customer's account unless the account is for the direct benefit of KCD or employee.

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.

Accounts **may not** be addressed to KCD, an RR or other employee of KCD with the exception of accounts for the beneficial ownership of the RR or employee. Accounts **may not** be addressed care/of (c/o) someone else unless the customer provides written authorization requesting such an address.

Address changes require written instructions from the customer. Upon notification of a change of address, a notice will be sent to the customer's old address confirming that an address change has been made to the account. Compliance will follow up regarding questions about address changes.

Where the account is opened by a fiduciary such as an investment adviser on behalf of the fiduciary's customer, KCD will provide either confirmations or periodic account statements to the underlying beneficial account holder. KCD will make a good faith effort to obtain the information necessary to send confirmations directly to the beneficial owner; however, if this information is not provided by the fiduciary, KCD will forward confirmations to the owner's custodian or, if there is no custodian or KCD is the custodian, KCD will send the confirmation directly to the fiduciary.

16.3.11 Predispute Arbitration Agreements With Customers

[FINRA Rule 2268; FINRA Notice to Members 05-32 and 05-09]

Customers will be provided with copies of any signed agreements that include a predispute arbitration agreement within 30 days of signing; the customer will acknowledge receipt of the arbitration agreement on the agreement itself or on a separate document.

In addition, within 10 days of request by a customer, KCD will provide a copy of any predispute 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.

16.3.12 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.

16.3.13 Accounts Requiring Notification To Customer's Employer

[NASD Rule 3050]

Responsibility	• Designated Supervisor or Designee
Resources	• New Account Form
Frequency	• Daily Upon Account Approval
Action	• Code account for duplicate confirmations and/or statements as requested by other broker-dealers • For accounts of employees of FINRA or the AMEX, code the accounts for duplicate confirmation and statements to FINRA or the AMEX
Record	• Record of duplicate confirmations and statements is included with new account records

Employees Of Other Broker-Dealers

When opening an account for a person employed by another broker-dealer (including accounts where the employee has control or a personal financial interest), the other broker-dealer must be notified. Our clearing firm will provide duplicate confirmations, statements, or other information requested by the employing broker-dealer.

16.3.13.1 Transactions Involving FINRA Employees

[FINRA Rule 2070]

When KCD has notice that a FINRA employee has a financial interest in, or controls trading in, an account, KCD will obtain and implement instructions from the employee to provide duplicate account statements to FINRA.

KCD or its employees are prohibited from making a loan of money or securities to any FINRA employee other than disclosed, routine banking and brokerage agreements (or loans originating from a personal or family relationship).

KCD or its employees cannot directly or indirectly give anything (other than something of nominal value such as a logo hat, pen, *etc.*) to a FINRA employee who has responsibility for a regulatory matter involving KCD. "Regulatory matter" includes examinations, disciplinary proceedings, membership applications and dispute-resolution proceedings.

16.3.14 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, which should be noted on the new account form.

16.3.15 Initial Deposits

If the initial transaction in a new account is a purchase order, a minimum deposit of $1,000.00 or the value of the transaction is required. Customer checks drawn on foreign banks should be discussed with the branch manager before the initial order is accepted.

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."

16.3.16 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

16.4 Transferring Accounts

[FINRA Rule 2140 and 11870; NSCC Rule 50]

Accounts are transferred between BDs using the Automated Customer Account Transfer Service (ACATS), an automated system administered by the National Securities Clearing Corporation (NSCC). Within one business day of receiving the transfer instruction, the firm carrying the account must either validate (or accept) or take exception to (or reject) the Transfer Instruction Form (TIF) for reasons specified in FINRA rules. The carrying firm is obligated to complete the transfer within three business days following the validation of the TIF.

16.4.1 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 provided to the receiving firm. Most accounts transfer via ACATS which expedites validation and transfer from the other BD.

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.

16.4.2 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," *i.e.,* all open orders (with the exception of option positions that expire within 7 business days) must be canceled and no new orders taken.

KCD and its employees may not interfere with a customer's request to transfer his or her account unless there is a *bona fide* reason for doing so, such as a lien for money owed.

16.4.3 ACATS Fraud

[FINRA Regulatory Notice 23-06 and 22-21]

Bad actors have been involved in fraudulent transfer of customer accounts through ACATS. Using the stolen identity of a legitimate customer, a bad actor will open an account online or through a mobile application in the name of the legitimate customer. A TIF will then be submitted to the receiving BD to transfer and create an account and transfer account assets to another financial institution.

Potential indicators of ACAT fraud are:

- Repeated rejections of TIFs
- Request for asset transfer soon after a new account is opened
- Changes in customer communication including a customer communicating exclusively by telephone prefers email only; emails not received by the customer; email transfer instructions that include significant grammatical and spelling errors or reflects a different writing style from prior emails

Practices to mitigate ACATS fraud risk are included in FINRA Regulatory Notice 23-06. Steps include, verifying transfer requests to confirm the accuracy and authenticity of the request and escalating review of a transfer request by notifying the customer of a transfer request; identifying and addressing an atypical number of accounts moving in patterns to the same receiving member; customer's RR and operations staff handling transfers confirm the transfer was expected.

KCD and its RRs are obligated to know their customers and verify account identity and report suspicious activity to Compliance.

16.5 Accounts And Securities Subject To Blocking

[Various Treasury Department regulations]

KCD is prohibited from doing business in specific countries or with organizations or individuals the subject of Government sanctions. The U. S. Treasury Department's Office of Foreign Assets Control (OFAC) is responsible for administering and enforcing economic and trade sanctions. Sanctions target foreign countries, terrorism sponsoring organizations, narcotics traffickers, money launderers, and other entities and individuals. Sanctions include the freezing of assets and blocking securities issued by embargoed foreign issuers.

As part of its anti-money laundering program, KCD monitors accounts and securities included on OFAC's lists, available at OFAC's web site at *www.treas.gov/ofac*. OFAC information is updated whenever the Government issues new sanctions that result in blocking requirements.

Blocking will occur 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 blocking requirements.
- A request is made by a customer to pay or transfer funds or securities to a blocked person or entity.

If appropriate, RRs will be notified if one of their customer accounts; a security held in one of their accounts; or a requested transfer of funds or securities is blocked. In addition to the above, open orders will be cancelled for any account that is blocked.

Compliance with blocking requirements is very important. Violations can result in substantial fines against KCD or persons engaging in prohibited transactions. Questions regarding blocked accounts, transfers, or securities should be referred to Compliance.

16.6 Updating Account Information And Periodic Affirmation

[SEC Securities Exchange Act of 1934 Rule 17a-3(a)(17)]

Responsibility	• RR • Compliance
Resources	• Information obtained from customer • Responses from customers
Frequency	• As required: update account information based on information provided by customer • Within 30 days of changes: send written information about changes to account • At least every 36 months: send customers a copy of new account information • When updating accounts, Make an effort to collect Trusted Contact Person age 18 or older who may be contacted about the customer's account (FINRA 4512 (a)(1)(F)
Action	• RR: Record changes to customer information reported by customer • Send information to customers • Compliance: follow up customer responses (contact RR, RR's supervisor, New Accounts)
Record	• New account records • Record of furnishing information within 30 days • Notation of action by Compliance for responses received from customers

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 or completing new forms. If a revision is to be made to the account, the person making the change must initial the change and include a date. New forms require the approval of the designated supervisor and signature of the customer, where required.

Within 30 days of changes to a customer's investment objectives, KCD (or its clearing firm, if applicable) will send a copy of new account information, including the change, to the customer with a request for correction of any inaccurate information.

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. Responses will be forwarded to Compliance. If no response is received, KCD will recognize this as a "No Response", with no changes to the account. This notification is not required for accounts that have been inactive for 36 months or where no recommendations are made to the customer.

16.7 Sweep And Cash Management Account (CMA) Programs

[SEC Securities Exchange Act of 1934 Rule 15c3-3(j)(2)(ii); SEC FAQs regarding financial responsibility rules: http://www.sec.gov/divisions/marketreg/amendments-to-broker-dealer-financial-responsibility-rule-faq.htm; FINRA Rule 3260]

Responsibility	• Designated Supervisor
Resources	• Proposed new programs or material changes to existing programs
Frequency	• As required

Action	• Consider net capital/customer protection implications of terminating a program or adopting a new program
	• Ensure KCD has filed the application for change in business (FINRA Rule 1017) if required
	• Confirm the bank's business continuity program complies with SRO business continuity rule requirements
	• For programs with banks that allow the customer to make deposits and/or withdrawals, include accounts in AML reviews
	• Review the new program or changes
	• Prepare/provide disclosure information for customers including:
	    ○ the nature of sweep arrangements and potential alternatives
	    ○ the distinction between KCD and banks involved in CMAs
	    ○ limitations on FDIC insurance
	    ○ the time it would take customers to access their cash
	• Obtain customer written consents to participate before opening a sweep account
	• Include required disclosures with quarterly statements
	• Send 30-day prior notice of program changes
	• Arrange for RR training, if necessary
	• If KCD has a web site, post interest rates

Record	• Change in business application, if required • Copies of programs, contracts with providers, records of distributing disclosures to customers when new programs are implemented or changes occur • Copy of bank's affirmation regarding compliance with business continuity requirements • Customer written consents and record of providing disclosures

Free credit balances held in a customer's securities account may be transferred to a product in KCD's sweep program or a customer's interest may be transferred between sweep programs. Four conditions regarding customer disclosures apply:

1. The customer must give **prior** written affirmative consent to having free credit balances included in the sweep program after being notified of (a) the general terms and conditions of the Program; and (b) that KCD may change the products available under the Program.
2. Disclosures and notices required by SROs will be provided to customers.
3. Quarterly notice is included with statements that swept funds or money market shares can be liquidated and remitted to the customer.
4. 30-day prior written notice of any changes to the sweep program and sweep products will be provided.

KCD and its RRs may not:

- Imply that a brokerage account is similar to or the same as a "checking or savings account" at a bank
- Imply that brokerage accounts themselves are bank deposit accounts insured by the FDIC

16.8 Margin Accounts

[FINRA Rule 4210; Federal Reserve Regulation T]

Responsibility	• Designated Supervisor
Resources	• New account information • Margin agreements • Order reports • Credit exposure or other available reports
Frequency	• Ongoing review of customer transactions

Action	• For accounts with large positions on margin:
	  ○ Review new account information for suitability and consistency with the customer's investment objectives
	  ○ Consider suitability of risk of thinly-traded margin positions
	• When frequent or sizeable margin transactions are identified, review account information for suitability
	• Consider contacting the customer where questions of suitability are not resolved
	• Refer margin accounts for fiduciary accounts to Compliance

Record	• Review of order and other reports and actions taken

This section outlines requirements for margin accounts.

16.8.1 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 Hilltop Securities' margin agreement which must be received within five days from the first margin trade.

16.8.2 Employee Accounts

Extensions and prepayments are not permitted in employee accounts, except under extraordinary circumstances and with approval of the designated supervisor.

16.8.3 Disclosures

16.8.3.1 Margin Disclosure Statement

[FINRA Rule 2264]

Under FINRA rules, all non-institutional customers who open a margin account must be provided with a margin disclosure statement when the account is opened. KCD's clearing firm provides disclosure on behalf of KCD. In addition, all margin customers will be provided annually with a copy of the disclosure statement or an abbreviated version of the statement from our clearing firm. KCD's clearing firm will send annual disclosures.

Under this requirement, the term **"non-institutional customer"** includes all customers **except**:

- A bank, savings and loan association, insurance company, or registered investment company.
- An investment adviser registered either with the SEC or with a state securities commission
- Any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million

The Clearing Firm is responsible for providing the initial disclosure document to new non-institutional margin account customers. The Clearing Firm is responsible for providing the annual disclosure document.

16.8.3.2 Disclosure Of Credit Terms

[SEC Securities Exchange Act of 1934 Rule 10b-16]

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. It is the FINOP's responsibility to establish procedures for providing the required disclosure.

The Clearing Firm is responsible for providing credit disclosures to margin customers.

16.8.3.3 Securities Loan Transactions

[FINRA Rule 4330(a), 4330(b)(2), 4330.04 and 4330.05]

The Firm (or its clearing firm) may engage in borrowing and lending customers' fully paid or excess margin securities. The customer's agreement is included in clearing firm's margin agreement and disclosures will be provided as described in the next section.

There must be reasonable grounds for believing that the customer's loan(s) of securities are appropriate for the customer, including consideration of (but not limited to) the customer's financial situation and needs, tax status, investment objectives, investment time horizon, liquidity needs, risk tolerance, and any other information disclosed by the customer in connection with entering into securities loans. Determining the appropriateness of customer loans of securities is not required for institutional customers under Rules 4512(c) and 2111(b).

16.8.3.4 Other Disclosures

[FINRA Rule 4330(b)(2)(B)]

Prior to entering into a securities borrowing arrangement with a customer, the customer will be provided with written (which may include electronic) notice stating that the provisions of the Securities Investor Protection Act of 1970 may not protect the customer with respect to the customer's securities loan transaction and that the collateral delivered to the customer may constitute the only source of satisfaction of The Firm's obligation in the event The Firm fails to return the borrowed securities. Other required disclosures (such as loss of proxy voting rights on margined shares and risk of receiving payments-in-lieu of dividends) will be provided in customer margin agreements, by separate notice, in customer monthly statements, and/or on The Firm's web site.

16.8.4 Suitability/Regulation BI

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/compliance with Reg BI (for retail customers) of margin trading in a customer's account including understanding the customer's investment objectives and financial profile.

16.8.5 Margin Requirements

Initial and maintenance requirements are available by contacting Operations.

16.8.6 New Issues

Margin on new issues are not permitted for a period of 30 days from the effective date of the distribution.

16.8.7 Credit On Restricted Securities

Extension of credit or margin transactions in securities for corporate insiders require the prior approval of Operations. If a customer who holds restricted securities wishes to deposit those securities in a margin account, Operations should be notified to determine the marginability of the securities.

16.8.8 Fiduciary Accounts

Margin transactions are permitted for accounts controlled by an administrator, conservator, custodian (not including UTMA/UGMA accounts), executor, 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 Compliance

RRs should submit the appropriate enabling document (trust agreement, *etc.*) to Compliance prior to engaging in margin transactions.

16.8.9 Portfolio Margin Accounts

[FINRA Rule 4210(g); FINRA Notice 08-41, 07-14 and 07-11]

Customers with portfolio margin accounts must be provided with a special written disclosure describing the nature of, and risks associated with, portfolio margining. Customers must sign and acknowledge that they have read and understand the disclosure statement and agree to the terms of maintaining a portfolio margin account. RRs are responsible for providing the disclosure and obtaining signed acknowledgment which will be retained in the customer's account file.

Portfolio margining is a margin methodology that sets margin requirements for an account based on the greatest projected net loss of all positions in a product class or group using computer modeling to perform risk analysis using multiple pricing scenarios. It is applicable to all margin equity securities, listed options, security futures products, unlisted derivatives, warrants, index warrants and related instruments.

There are eligibility requirements for customers (other than broker-dealers):

- Meet basic standards for having an account approved for uncovered writing
- Have and maintain at all times account net equity of at least $5 million (waived for accounts solely limited to listed security futures contracts and listed single stock options) aggregated across all accounts under identical ownership at the clearing broker

Portfolio margining generally permits greater leverage resulting in greater risk for loss. The time limit for meeting margin calls is shorter than for a standard margin account. Operations procedures should be consulted for more detailed information regarding portfolio margining requirements.

16.9 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, KCD 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.

KCD 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.

16.10 Discretion For Orders And Accounts

[SEC no-action letters regarding cash management accounts (http://sec.gov/divisions/investment/noaction/ubs092905.htm) and family/related accounts (http://sec.gov/divisions/investment/noaction/morganlewis111705.htm)]

For a discretionary account, an RR 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 authorization from the customer on a designated form, including the date signed.
- A record must be maintained of the signature of each named, natural person authorized to exercise discretion in the account.

- Electronic signatures may be permitted.
- A designated supervisor must approve the account as discretionary (including the date approval is granted) prior to effecting discretionary transactions.
- Discretionary authority is NOT effective until the customer has signed the discretionary agreement AND the account has been approved for discretion.
- Option discretionary accounts also require the approval of Compliance. (Refer to the chapter *OPTIONS* for specific requirements regarding discretionary option accounts.)
- Discretion is not permitted over ERISA plan accounts unless specifically permitted under a firm-authorized program such as a managed account program.
- Every discretionary order must be approved promptly, in writing, by the designated supervisor.
- Each order should indicate whether discretion was exercised or not exercised.

16.11 Accounts For Minors

[Uniform Gifts To Minors Act; Uniform Transfers To Minors Act; FINRA Regulatory Notice 20-07]

UTMA/UGMA accounts are custodial accounts that allow for the transfer of funds, securities and other assets to minors without the need for a formal trust. UGMA and UTMA are model laws developed and approved by the Uniform Law Commission for application by states.

There are a number of requirements and restrictions that affect minors' accounts:

- The donor names a custodian and donates assets to 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
- The custodianship generally terminates when the beneficiary reaches the age of majority (or other alternative age in state statutes or if the beneficiary dies)
- Some states permit extending custodianship to a higher age; the beneficiary should be notified of his or her right to compel distribution of assets upon reaching a specified age
- KCD and the RR should be aware when a custodianship is terminated and assets are to be distributed which may include flagging custodianship accounts to identify termination and notifying RRs to verify the custodian's continuing authority and to obtain instructions about distribution of the assets

The custodian manages the account assets including executing transactions and withdrawing or transferring funds for the benefit of the beneficiary (the minor).

16.12 Coverdell Education Savings Accounts

[26 USC §530 - Coverdell Education Savings Accounts]

A Coverdell Education Savings Account (ESA) is an account created as an incentive to help parents and students save for education expenses. An alternative is the 529 College Savings Plan which is included in the *MUNICIPAL SECURITIES* chapter in the section *529 College Savings Plans (Municipal Fund Securities)*. For more information, refer to the IRS site above; plan sponsors; and the customer's tax adviser.

The following summarizes some of the key features of Coverdell accounts.

- The maximum annual contribution is $2,000 subject to limits on the donor's modified adjusted gross income.

- Contributions are made from after-tax dollars; there is no tax deduction for contributions.
- ESAs are available for beneficiaries (students) who are under the age of 18 when the account is established. There are exceptions for beneficiaries with special needs.
- The funds are controlled by the account owner (*e.g.,* the parent) at all times.
- Investment choices are broad but may not include life insurance contracts.
- Assets may be used for elementary- and secondary-school tuition as well as for higher education.

The following compares some features of Coverdell and 529 plans.

Feature	Coverdell Account	529 Plan
Contribution limits	$2000 annual	No restrictions up to maximum lifetime contribution
Allowable investments	Allows almost all types of investments including stocks, bonds, and mutual funds (parallels rules for IRAs)	Limited to state-run allocation programs
Distribution of assets	Must be disbursed on qualified education expenses by the beneficiary's 30th birthday or given to another family member below the age of 30	No age limit
	Federal tax-free if used for qualified education expenses; some states offer tax benefits	Same
	Income tax and penalties may apply for ineligible distributions	Same
Qualified education	Elementary and secondary schools; higher education	Does not allow elementary and secondary education expenses
Income limits affecting contributions	Limits on modified adjusted gross income at certain levels	No limits
Ownership of assets	Owned by person establishing the account, not the child	Same
Designation of new beneficiary	Must be eligible family member of the previous beneficiary to avoid taxes or penalties	Same

16.13 Accounts For Senior Investors

[SEC/NASAA 2008 report on Protecting Senior Investors: http://www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf; 2010 addendum to 2008 report: http://www.sec.gov/spotlight/seniors/seniorspracticesreport081210.pdf; SEC web site Senior Investors: http://www.sec.gov/divisions/marketreg/seniorinvestors.htm; FINRA Rule 2165 and 4512; FINRA Regulatory Notice 22-05, 17-11, 11-52 and 07-43; FINRA FAQs re financial exploitation of seniors: http://www.finra.org/industry/frequently-asked-questions-regarding-finra-rules-relating-financial-exploitation-seniors; Senior Safe Act: Sec. 303 of Economic Growth, Regulatory Relief and Consumer Protection Act; NASAA/SEC/FINRA Senior Safe Act Fact Sheet: http://www.nasaa.org/wp-content/uploads/2019/05/Senior-Safe-Act-Fact-Sheet.pdf; Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• New account records • Order records/available reports

	• Indications of financial exploitation • Requests for temporary holds • Advertising targeting senior investors • Seminar materials
Frequency	• Training - as scheduled • Ongoing - other actions

Action	• Conduct training on dealing with senior investors including elements of this section such as holds for financial exploitation
	• Provide written disclosure to customers to explain the circumstances under which KCD may contact a Trusted Contact Person
	• When reviewing investments for seniors, take into particular consideration the factors included in the subsection *Recommendations To Senior Investors*
	• Review product-specific guidelines when reviewing for suitability of investments
	• Refer to new account information when necessary to identify investment objectives and other customer information
	• Review account activity when appropriate
	• For escalated issues:
	    ○ Contact the Trusted Contact Person
	    ○ Consider direct contact with the investor
	    ○ Notify state or other authorities (after conferring with Compliance) regarding potential elder abuse
	• Confer with RR regarding suitability questions
	• Confer with Compliance when necessary
	• Contact customer when necessary to confirm customer's understanding of and agreement with transactions
	• Modify or restrict future transactions, as appropriate

Record	• Order records/reports • Record of escalation of an issue including who reviewed the issue and what action, if any, is taken • Temporary holds (see following section)

16.13.1 General Requirements

When opening and handling accounts for specified adults (definition below), there are certain considerations in addition to usual account handling procedures. For purposes of this section, the following definitions apply.

Specified Adult: (A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.

Account: any account of a member for which a Specified Adult has the authority to transact business.

Trusted Contact Person: the person who may be contacted about the Specified Adult's Account in accordance with Rule 4512.

Financial exploitation:

A. the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or

B. any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to:
    i. obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property; or
    ii. convert the Specified Adult's money, assets or property.

In this section "financial exploitation" is understood to include where there is reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted.

16.13.2 Opening Accounts For Specified Adults

When opening accounts, the following should be considered:

- Encourage customers to identify a Trusted Contact Person and obtain permission to contact that person in the event there is an issue or event that requires clarification (such as the customer suffers diminished mental capacity in the future); document account information if the customer refuses to identify a contact person. The customer will be notified in writing (including electronically) that KCD or an associated person is authorized to contact the Trusted Contact Person to disclose information about the customer's account and possible financial exploitation.
- Indicate "retired" or similar on the new account record.
- Obtain "lifestyle" information such as when the investor plans to retire, if not already retired; how much money will be needed after retirement; whether there are prospects for future employment; whether a dependent is supported by the investor; other expenses including healthcare expenses anticipated by the investor; the existence of a will and financial power of attorney

Accounts must NOT be opened for a Specified Adult if there is evidence of financial exploitation or diminished capacity; orders should not be accepted under such circumstances, either.

16.13.3 Recommendations To Senior Investors

[FINRA Regulatory Notice 07-43]

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

16.13.4 Diminished Mental Capacity

A difficult issue is a customer who appears to be suffering from diminished mental capacity. If a customer's behavior suggests reduced capacity, it is important to take steps to protect the customer, the RR, and KCD. Relatives or estate beneficiaries may file a complaint or lawsuit if they believe the customer was unable to understand what was occurring in his or her account.

There are a number of steps that may be taken to address the issue:

- Contact the Trusted Contact Person
- Have a conversation with the customer with the branch manager or other supervisor present to assist in making a determination.
- Raise the issue with family members and determine if the customer has given power of attorney to another person.
- Document meetings, conversations, and other exchanges with relatives about the situation.
- Document communications with the customer about investments.
- As a final alternative, decide not to continue doing business with the customer.

Contact Compliance with questions about a proper course of action.

16.13.5 Potential Indication Of Elder Financial Exploitation

[FinCEN Advisory FIN-2011-A003: https://www.fincen.gov/news/news-releases/memorandum-financial-institution-and-law-enforcement-efforts-combat-elder]

This section includes an excerpt from a FinCEN advisory. This information provides guidance to RRs and other employees when handling accounts for elderly customers. This account activity will generally relate to banking activity for the client, and would not necessarily occur with accounts at KCD. If the RR notices unusual activity in the client's account, the RR should bring to the attention of appropriate persons. Questions regarding potential elder abuse should be referred to your supervisor or Compliance.

The following red flags could indicate the existence of elder financial exploitation. This list of red flags identifies only possible signs of illicit activity. Financial institutions should evaluate indicators of potential financial exploitation in combination with other red flags and expected transaction activity being conducted by or on behalf of the elder. Additional investigation and analysis may be necessary to determine if the activity is suspicious.

Financial institutions may become aware of persons or entities perpetrating illicit activity against the elderly through monitoring transaction activity that is not consistent with expected behavior. In addition, financial institutions may become aware of such scams through their direct interactions with elderly customers who are being financially exploited. In many cases, branch personnel familiarity with specific victim customers may lead to identification of anomalous activity that could alert bank personnel to initiate a review of the customer activity.

- Erratic or unusual banking transactions, or changes in banking patterns:
  - Frequent large withdrawals, including daily maximum currency withdrawals from an ATM;
  - Sudden Non-Sufficient Fund activity;
  - Uncharacteristic nonpayment for services, which may indicate a loss of funds or access to funds;
  - Debit transactions that are inconsistent for the elder;
  - Uncharacteristic attempts to wire large sums of money;
  - Closing of CDs or accounts without regard to penalties.
- Interactions with customers or caregivers:
  - A caregiver or other individual shows excessive interest in the elder's finances or assets, does not allow the elder to speak for himself, or is reluctant to leave the elder's side during conversations;
  - The elder shows an unusual degree of fear or submissiveness toward a caregiver, or expresses a fear of eviction or nursing home placement if money is not given to a caretaker;
  - The financial institution is unable to speak directly with the elder, despite repeated attempts to contact him or her;
  - A new caretaker, relative, or friend suddenly begins conducting financial transactions on behalf of the elder without proper documentation;
  - The customer moves away from existing relationships and toward new associations with other "friends" or strangers;
  - The elderly individual's financial management changes suddenly, such as through a change of power of attorney to a different family member or a new individual;

- The elderly customer lacks knowledge about his or her financial status, or shows a sudden reluctance to discuss financial matters.

16.13.6 Escalating Issues Involving Senior Investors

When dealing with senior investors, there may be changes or events that require escalation of an issue to the RR's designated supervisor and/or Compliance. Following are some issues that may require escalation for handling. Any questions regarding dealing with senior investors should be referred to Compliance.

- Suspected elder abuse including financial abuse (contacting appropriate state or other authorities may be necessary; confer with Compliance regarding such referrals)
- Suspected diminished capacity

Having the RR's designated supervisor or Compliance make direct contact with the investor or Trusted Contact Person may be appropriate.

16.13.7 Financial Exploitation - Temporary Holds

[FINRA Rule 2165; FINRA Regulatory Notice 17-11]

Responsibility	• Designated Supervisor • Compliance
Resources	• Requests for temporary holds
Frequency	• As required: requests for holds • Within 2 business days of the hold, notify the Trusted Contact Person and all parties authorized to transact business for the account (including the customer)
Action	• Immediately review the facts and circumstances surrounding the requested hold including confirming the customer is a Specified Adult • Notify (written or oral) the Trusted Contact Person, the customer, and other authorized persons. No obligation to notify if the Trusted Contact Person or authorized party is unavailable or KCD believes is engaged in the financial exploitation • Remove the hold no later than 15 business days after placed or extend for 10 additional business days plus an additional 30 business days unless subject to a regulatory or court action • Include protection of Specified Adults and account temporary hold requirements/procedures in employee training
Record	• Hold requests including internal reviews and action taken and name/title of associated person requesting the hold and persons conducting internal reviews • Notifications • New account records including required information under Rule 4512.06 • Training records including date, how administered, who attended, content

To protect certain customers, KCD may place temporary holds on transactions and/or disbursements of funds or securities from the account of Specified Adults where there is reasonable belief that financial exploitation has occurred, is occurring, has been attempted, or will be attempted. Conditions of a temporary hold include the following:

- Temporary holds include the disbursement of funds or securities or transactions in securities.
- No later than two business days after the date the temporary hold is first placed provide notification oral or in writing (electronic included) to all parties authorized to transact business on the account unless a party is unavailable or it is believed the Trusted Contact Person(s) is involved in the financial exploitation.
- Immediately initiate an internal review of the facts and circumstances about the financial exploitation.
- The temporary hold expires 15 business days after the hold is first placed.
- Unless otherwise terminated or extended by a state regulator or agency or court of competent jurisdiction and if KCD's internal review supports the finding of financial exploitation:
  - The temporary hold may be extended 10 business days
  - The temporary hold may be extended an additional 30 business days beyond the initial 25 days (the first 15-day hold plus the extension of 10 days) for a total potential hold of 55 business days

16.13.8 Use Of Titles Inferring Expertise

[NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations]

Responsibility	• Designated Supervisor
Resources	• RR requests to use titles • Information regarding outside organizations that confer titles • Correspondence and retail communications
Frequency	• As required - review requests • Daily and ongoing - review of correspondence/communications
Action	• Review requests for use of special titles/designations: ○ Review any outside organization conferring designations for appropriate qualifications such as internal ethics policies, criteria for conferring designations ○ Review the RR requesting the title for qualifications including experience, completion of continuing education with KCD and regulatory/compliance history ○ Determine state requirements that regulate the use of designations • For those approved to use titles, notify the RR's supervisor who is responsible for review of correspondence and retail communications to determine proper use of title • Notify RR and supervisor if approval is withdrawn due to failure to complete necessary education requirements or other requirements
Record	• Review of outside organizations • Review of RRs • Approval or disapproval of correspondence and retail communications, other actions taken

RRs may use special titles indicating expertise when dealing with senior investors under the following requirements:

- A request to use a title must be provided to Compliance **prior to use** including the name and address of any outside organization conferring such titles based on meeting the organization's requirements.
- Titles may not be self-conferred, *i.e.,* the title must be based on some criteria or qualification met.
- The RR must be in good standing with the organization that confers the designation.
- The RR must be current on any continuing education requirements of the outside organization.
- The RR must complete firm training specifically relating to dealing with senior investors which may include retirement planning; ethics when working with senior investors; and the proper use of senior designations in correspondence, retail communications and seminars/luncheons.
- Compliance will review the request and notify the RR and the RR's supervisor if the request is approved or disapproved.
- Titles may be used only after Compliance approval.
- RRs who use senior designations must attest on the *Annual Employee Certification* their compliance with requirements.

16.13.9 Reverse Mortgages

[FINRA Investor Alert: Reverse Mortgages, Avoiding a Reversal of Fortune]

A reverse mortgage is an interest-bearing loan secured by the equity in a home. Generally the borrower and any other co-borrowers (such as a spouse) must own the home and be 62 or older (some lenders may have other criteria). Home equity may be converted to cash that can be used for any purpose. The homeowner makes no interest or principal payments during the life of the loan; interest is added to the principal. Unless the loan is a fixed-term loan, the loan only becomes due when the homeowner dies, sells the home, or otherwise leaves the home for more than 12 months. If any of these events occur, the borrower or heirs must repay the loan, including compounded interest, in full. Usually the home is sold and the loan is paid from proceeds of the sale.

RRs are not permitted to recommend customers use reverse mortgages to fund investments. If a customer indicates he or she has funds available for investment from the proceeds of a reverse mortgage, the following is required.

1. Provide the customer with a copy of the FINRA Investor Alert *Reverse Mortgages: Avoiding A Reversal of Fortune*. Obtain a letter from the customer acknowledging receipt of the Alert.
2. Consult with the customer about investment objectives and the need for the proceeds as living expenses.
3. Recommend investments consistent with those needs; most investments should be suitable for someone with a limited lifespan and potentially facing expenses for health issues.

16.13.10 Advertising Targeting Seniors

Advertising that targets seniors must be balanced and may only include products or services suitable for senior investors. All advertising must be approved by Compliance prior to publication or distribution.

16.14 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 the branch manager or 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.

16.15 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 Compliance
- Option trading requires approval by Compliance

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.

16.16 Registered Persons (RRs) Being A Customer's Beneficiary Or Holding A Position Of Trust

[FINRA Rule 3241; FINRA Regulatory Notice 20-38; Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• Notices to act in a role subject to Rule 3241 • Communications indicating activity subject to Rule 3241
Frequency	• As required
Action	• Review notices considering the information provided by the RR to assess the risks including: 　○ whether the activity will interfere with or compromise the RR's responsibilities to the customer 　○ whether the RR will derive financial gain other than customary fees or other reasonable charges 　○ whether the RR assuming such status does not present a risk of financial exploitation of the customer 　○ whether the activity should be approved or disapproved • Consider whether to discuss the potential beneficiary status or position of trust with the customer • Determine whether to approve or disapprove and, if approved, whether any conditions or limitations will apply • If conditions or limitations are applied, establish supervision to confirm conditions or limitations are being followed • Notify the RR and the RR's supervisor in writing of the determination and any special supervision or conditions or limitations
Record	• Request and review • Determination whether to disapprove or approve and any conditions or limitations

	• Reviews of compliance with conditions or limitations, if applicable • Retain such record for at least 3 years after the beneficiary status or position of trust is terminated

RRs are limited from being named a beneficiary, executor or trustee, or having a power of attorney or similar position of trust for or on behalf of a customer*. The RR is responsible for immediately notifying Compliance of any such potential designation. The notice requirement includes RRs who hold a beneficiary or position of trust status for an account transferring from a prior employer; the transferring RR must provide notice within 30 days of employment.

These limitations do **not** apply where the customer is a member of the registered person's "immediate family**." In addition, a registered person who does not have customer accounts assigned to him/her is not subject to these requirements.

Exceptions to this limitation must be requested, in writing, from Compliance. The request must include the name(s) of the customer's account(s) and in what role the registered person will act (beneficiary, executor, trustee, *etc.*) as well as the following:

- length and type of relationship between the customer and the registered person
- the customer's age
- the size of any bequest relative to the size of the customer's estate
- any remuneration to be paid to the RR
- any customer mental or physical impairment that renders the customer unable to protect his or her own interests

Registered persons may **not** accept such a role without **prior** approval from Compliance. In addition, a registered person may not instruct or ask a customer to name another person, such as the registered person's spouse or child, to be a beneficiary of the customer's estate or to receive a bequest from that estate.

In the event a registered person unknowingly becomes the subject of these limitations (*e.g.,* notification of receiving a bequest, being named an executor, *etc.*), the registered person is obligated to decline the role or bequest unless written notice is provided to Compliance and approval is received.

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*"Customer" under this Rule includes any customer that has, or in the previous six months had, a securities account assigned to the registered person including a brokerage account, mutual fund account or variable insurance product account and accounts held directly at a mutual fund or variable insurance product issuer. It also includes someone who is a customer of another broker-dealer which subjects the activity to Rule 3241 on limitations explained in this section as well as Rule 3270 regarding outside business activities.
**For purposes of Rule 3241, "immediate family" includes parents, grandparents, in-laws, spouse or domestic partner, sibling, children, grandchildren, first cousin, aunt or uncle, niece or nephew, and any other person who resides in the same household as the registered person and the registered person financially supports, directly or indirectly, to a material extent, and including step and adoptive relationships.

16.17 Correspondent And Private Banking Accounts And Accounts For Senior Foreign Political Figures

[Bank Secrecy Act 31 CFR Chapter X Part 1010 Subpart F; USA PATRIOT Act Section 312 and 313]

Under anti-money laundering (AML) rules, there are special requirements that apply to "correspondent" and "private banking" accounts as well as to accounts for "senior foreign political figures." Definitions of these and other terms are under the AML section. Questions should be referred to the AML Compliance Officer.

16.17.1 Summary Of Requirements

- Correspondent accounts require due diligence to determine ownership of the account.
- Accounts cannot be opened for foreign shell banks.
- When opening an account for a foreign bank, the Foreign Bank Certification form must be submitted to the AML Compliance Officer with the New Account Form for review and approval.
- Every three years foreign banks will be required to re-certify the information in the Foreign Bank Certification.
- When opening an account for a senior foreign political figure, the new account application must be submitted to the AML Compliance Officer for review and approval.

16.17.2 Prohibition Against Correspondent Accounts For Foreign Shell Banks

KCD is prohibited from establishing, maintaining, administering, or managing a correspondent account in the United States for an unregulated foreign shell bank. The prohibition does not apply to a foreign shell bank that is a regulated affiliate. If an account is inadvertently opened for an unregulated foreign shell bank, the AML Compliance Officer should be notified and the account will be immediately closed.

16.17.3 Foreign Bank Certification

When opening an account for a foreign bank, KCD is obligated to ensure the bank is not a foreign shell bank and must obtain information about the foreign bank's owners and an agent for service of process. The bank must complete the Foreign Bank Certification which must be submitted to the AML Compliance Officer with a copy of the New Account Form for review. Every three years the bank is also required to re-certify the information filed with KCD.

16.17.4 Accounts For Foreign Political Figures

Accounts for foreign political figures (as defined above) are subject to special reviews to comply with Bank Secrecy Act requirements. RRs are required to identify, on the new account application, whether an account for a foreigner falls under the definition. The application must be submitted to the AML Compliance Officer for review and approval.

16.18 Collateral/Escrow Accounts

KCD will not maintain accounts for customers where the assets in the account are pledged to a third party. Our clearing firm may maintain accounts for customers of KCD where the assets in the account are pledged to a third party.

16.19 Wealth Events

Wealth events refer to those situations where an investor faces the decision about what to do with a large amount of money arising from an inheritance, life insurance payout, sale of a business or other major asset, divorce settlement or an IRA rollover, among other events. RRs must consider the following when advising a customer about investing such funds:

- Many wealth events have tax consequences. RRs are prohibited from providing tax advice; the customer should be advised to contact their tax adviser.
- Suitability requirements are important and must be considered by the RR prior to making any recommendation.
- RRs may not infer that the customer's only choice or sound option is rolling funds to an IRA managed by the Firm; also, IRAs cannot be represented as "free" or without cost or fees.

16.20 Pension And Retirement Accounts - Non-Fiduciary

[Employment Retirement Security Act (ERISA) of 1974; Department of Labor Rule 3.0; Prohibited Transaction Exemption 2020-02; PTE2020-02 FAQs: https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/faqs/new-fiduciary-advice-exemption]

This section explains the requirements for pension and retirement accounts. These accounts are regulated under the Employee Retirement Income Security Act of 1974 (ERISA), a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry and provides protections for individuals in these 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.

ERISA is administered by the Department of Labor (DOL) which issues rules, interpretations, and exemptions. Key elements of ERISA include:

- Who is a fiduciary subject to related requirements
- Exemptions from "prohibited transactions" which are considered self-dealing and not allowed in these accounts

This section begins with KCD's policy on fiduciary status and follows with definitions and general information about retirement accounts. ERISA is complex because of its technical and legal nature; questions should be referred to Compliance or legal counsel.

16.20.1 Recommendations and Fiduciary Status Prohibited

Responsibility	• Designated Supervisor
Resources	• Transaction and other available reports; account records
Frequency	• Daily

Action	• Review/approve new accounts and confirm identification as non-fiduciary accounts
	• Review transactions to confirm:
	    ○ All orders are marked "unsolicited"
	    ○ There is no pattern of transactions in an account indicating solicitation of transactions
	    ○ Transfers of accounts to KCD do not involve liquidation of a prior investment
	• Take corrective action which may include:
	    ○ Consultation with Compliance

	○ Reversal of violating transactions ○ Contact with the customer ○ Additional training
Record	• Records of accounts and transactions and corrective action will be retained for six years • Records of training

Because of the complexity of laws and rules governing pension and retirement accounts and the legal liability when acting as a fiduciary, KCD and its RRs are not permitted to provide services to pension and retirement accounts and IRAs (including rollovers) in a manner resulting in fiduciary status. This means:

- No recommendations may be made to these accounts including for IRA rollovers.
- All orders for these accounts must be marked "unsolicited."
- The prohibition extends to recommendations to prospects.

16.20.2 Fiduciary Status Defined

In addition to the traditional fiduciary definition as included under definitions (discretionary authority and control), the DOL has outlined a "five-prong" test to identify who is a fiduciary. All five parts of the test must be satisfied to be a fiduciary making a recommendation. The person making the recommendation must:

1. Render advice to the plan, plan fiduciary, or IRA owner as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property,
2. On a regular basis,
3. Pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary, or IRA owner, that
4. The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
5. The advice will be individualized based on the particular needs of the plan or IRA.

16.20.3 Disclosures To Plans

[ERISA Section 408(b)(2); Dept. of Labor Fact Sheet: https://www.dol.gov/newsroom/releases/ebsa/ebsa20120507]

Responsibility	• Designated Supervisor
Resources	• Plan contracts or arrangements • Information regarding services provided and charges for services
Frequency	• Disclosures: reasonably in advance of the date the contract or arrangement is entered into and extended or renewed • Changes or errors in disclosures: as required (see below)
Action	• Identify plans and services subject to 408(b)(2) requirements • Assemble information necessary to make required disclosures • Provide disclosures at time of initial contract/arrangement and when changed, errors are identified, or contracts/arrangements are terminated

	• Respond to fiduciaries/plan administrators when additional information is requested
Record	• Covered plans • Disclosures provided including dates provided

Under ERISA, "covered service providers" are required to provide fee disclosures to covered plans to enable the plan fiduciary to make an informed decision about the reasonableness of fees as required under ERISA Section 404(a)(1). KCD's obligation to provide disclosures depends on KCD's role in dealing with a covered plan. This section provides a general explanation of the requirements which are complex; the ERISA section should be consulted for specific requirements.

16.20.3.1 Definitions

Covered plan: An ERISA-covered defined benefit and defined contribution pension plan. Does not include simplified employee pension plans (SEPs), SIMPLE retirement accounts, IRAs, employee welfare benefit plans, and certain annuity contracts and custodial accounts described in ERISA Code section 403(b).

Covered service provider: A service provider that enters into a contract or arrangement with the covered plan and expects $1,000 or more in direct or indirect compensation that is received in connection with providing services defined in Section 408(b)(2) including:

- ERISA fiduciary service providers to a covered plan or to a "plan asset" vehicle in which such plan invests
- Investment advisers registered under Federal or State law
- Recordkeepers or brokers who make designated investment alternatives available to the covered plan (*e.g.,* a "platform provider")
- Providers of one or more of the following services to the covered plan who also receive "indirect compensation" in connection with such services:
    - Accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administration, or valuation services

16.20.3.2 Required Disclosures

Disclosures include:

- Disruption of services
- Compensation, including:
    - Description of all direct compensation either in aggregate or by service to be received
    - Indirect compensation expected to be received
    - Description that compensation will be paid among related parties including identification of payers and recipients of compensation
    - Description of any compensation to be received in connection with termination of the contract or arrangement and how any prepaid amounts will be calculated and refunded upon termination
- Recordkeeping services, if applicable, including direct and indirect compensation related to such services or, if not explicitly compensated, a reasonable and good faith estimate of the cost to the covered plan of such services
- Manner of receipt of the compensation
- Fiduciary services provided and related compensation

- Recordkeeping and brokerage services with respect to each designated investment alternative for which recordkeeping or brokerage services are provided

16.20.3.3 Timing Of Disclosures

- Required disclosures must be provided reasonably in advance of the date the contract or arrangement is entered into and extended or renewed.
- Changes must be provided as soon as practicable but no later than 60 days from the date on which the covered service provider is informed of the change.
- In the event of an error in a disclosure, the covered service provider must correct the information as soon as practicable but no later than 30 days after knowing of the error or omission.
- Requests for other compensation information from the fiduciary or covered plan administrator must be provided within 30 days following receipt of a written request.

16.20.3.4 Disclosures To Plan Participants

[ERISA Section 404(a)(5); SEC no-action letter to the Department of Labor dated October 26, 2011: https://www.dol.gov/newsroom/releases/ebsa/ebsa20120507-0]

Responsibility	• Designated Supervisor
Resources	• Plans for participant-directed individual account plans • Performance and cost information required to be disclosed
Frequency	• As required
Action	• Determine if KCD and any firm-prepared materials for plan participants are subject to disclosure requirements • Assemble information necessary to make required disclosures • If subject investments are investment companies, contact Compliance to determine whether materials must be filed with FINRA (written materials that conform to the ERISA rule requirements are not required to be filed per the SEC no-action letter) • Provide disclosures to participants or to plan administrator for distribution to participants
Record	• Disclosures provided including when and to whom provided

ERISA Rule 404(a)(5) requires the disclosure of certain plan and investment-related information, including performance information, to participants and beneficiaries in participant-directed individual account plans. Information is required to be presented in a comparative chart format to enable participants to make an informed decision when managing their accounts.

If KCD compiles and/or provides the required information, it will comply with the requirements of Rule 404(a)(5). Where the investment alternatives include investment companies subject to other SEC and FINRA rules regarding communications with the public, the disclosures will comply with those requirements or exemptions to requirements.

16.20.4 Individual Retirement Accounts (IRAs)

[NYSE Information Memo 06-79]

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)
- Certain types of investments such as precious metals are not permitted in an IRA
- Early withdrawals (prior to age 59 1/2) may result in tax penalties
- Owners of traditional IRAs are required to begin withdrawing by the year following the year the owner turns 72

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 owner is at least 59 1/2 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 72
- 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 has limited earnings)
- 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)

16.20.4.1 Rollovers

[FINRA Regulatory Notice 13-45]

Responsibility	• Designated Supervisor
Resources	• Rollovers
Frequency	• As required
Action	• Confirm rollovers are at the customer's initiation and not recommended by the RR and orders/documents are indicated as "unsolicited"
Record	• Review of rollovers

Rollovers are transfers of IRA or other pension plans assets to a new plan. **RRs are not permitted to recommend rollovers; all such transactions must be marked "unsolicited."**

16.20.5 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.

16.20.5.1 401(k) Plans

- Established by corporations
- Permit their employees to make contributions through payroll deductions from pre-tax income [traditional 401(k) plans]; tax is applied when withdrawals are taken
- Roth 401(k) plans permit employees to make contributions through payroll from after-tax dollars; there is no tax on withdrawals made after age 59 1/2 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

16.20.5.2 Limitations On Advice

[Pension Protection Act of 2006 Title VI; U.S. Department of Labor Field Assistance Bulletin No. 2007-01]

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 firm-approved educational material and third-party advisory plans offered through KCD.

16.20.5.3 403(b) Plans

[IRS 403(b) publication: http://www.irs.gov/publications/p571/ch01.html]

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 72

- 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

16.20.5.4 457 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 in trust for the employee in an account set up in the employee's name
- Mandatory withdrawals after age 72
- No early withdrawal tax penalties if funds are paid to the employee when leaving the job prior to reaching age 59 1/2; 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

16.20.5.5 SIMPLEs (Savings Incentive Match Plans For Employees)

- Offered by small companies with 100 or fewer employees who earn at least $5,000 each during the year
- Less complicated to set up and administer than 401(k) or 403(b) plans
- Two types: SIMPLE IRA and 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 take it out; early withdrawal is subject to significant tax penalties

16.20.6 Definitions

Covered plan: An ERISA-covered defined benefit and defined contribution pension plan. Does not include simplified employee pension plans (SEPs), SIMPLE retirement accounts, IRAs, employee welfare benefit plans, and certain annuity contracts and custodial accounts described in ERISA Code section 403(b).

Covered principal transaction: For purchases from a Plan or an IRA: any security or other investment property. For sales to a Plan or an IRA, transactions involving: - US dollar denominated corporate debt securities offered pursuant to a registration statement under the Securities Act of 1933, - US Treasury securities, debt securities issued or guaranteed by a US federal government agency other than the US Department of the Treasury, - debt securities issued or guaranteed by a government-sponsored enterprise, - municipal securities, - certificates of deposit, - interests in Unit Investment Trusts.

Covered service provider: A service provider that enters into a contract or arrangement with the covered plan and expects $1,000 or more in direct or indirect compensation that is received in connection with providing services defined in Section 408(b)(2) including:

- ERISA fiduciary service providers to a covered plan or to a "plan asset" vehicle in which such plan invests
- Investment advisers registered under Federal or State law
- Recordkeepers or brokers who make designated investment alternatives available to the covered plan (*e.g.,* a "platform provider")

- Providers of one or more of the following services to the covered plan who also receive "indirect compensation" in connection with such services:
    - Accounting, auditing, actuarial, banking, consulting, custodial, insurance, investment advisory, legal, recordkeeping, securities brokerage, third party administration, or valuation services

Covered transactions: The exemption under 2020-02 covers reasonable compensation paid to financial institutions and investment professionals as well as their affiliates and related entities in connection with two types of transactions: investment advice provided to retirement investors and riskless and covered principal transactions.

Fiduciary: Generally anyone with discretionary authority or control over the management of a plan, the administration of the plan, 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. **This includes Investment Professionals and Institutions meeting the 5-part test in PTE 2020-02.**

Financial institution: An entity that: (i) is not disqualified or barred from making investment recommendations by any insurance, banking, or securities law or regulatory authority (including any self-regulatory organization); (ii) employs the Investment Professional or otherwise retains such individual as an independent contractor, agent or registered representative, and is: (iii) registered as an investment adviser under the Investment Advisers Act of 1940 or under state law; a bank or similar Financial Institution supervised by the United States or a state, or a savings association; an insurance company qualified to do business under the laws of a state, provided that it (A) has obtained a Certificate of Authority from the insurance commissioner of its domiciliary state which has neither been revoked nor suspended, (B) undergoes an annual examination by an independent certified public accountant or has undergone a financial examination by the state's insurance commissioner within the preceding five years, and (C) is domiciled in a state whose law requires an annual actuarial review of reserves to be reported to the appropriate regulatory authority; or (iv) a broker or dealer registered under the Securities Exchange Act of 1934.

Impartial Conduct Standards (applicable to fiduciary advice): The Impartial Conduct Standards have three components: a best interest standard, a reasonable compensation standard, and a requirement to make no misleading statements about investment transactions and other relevant matters.

- **Best Interest Standard:** Advice that (i) "reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor," and (ii) "does not place the financial or other interest of the Investment Professional, Financial Institution or any Affiliate, Related Entity or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own."
- **Reasonable Compensation**: Compensation received by the Financial Institution, the Investment Professional, and any Affiliates and Related Entities must not exceed reasonable compensation within the meaning of ERISA section 408(b)(2). If applicable, the Financial Institution and Investment Professional must seek to obtain best execution (as required by securities laws) as part of the "reasonable compensation" requirement. Includes the requirements for best execution.
- **No Materially Misleading Statements**: The provider must not make materially misleading statements about the recommended transaction and other relevant matters at the time when the statements are made.

Individual Retirement Account (IRA): Any plan that is an account or annuity described in IRS Code section 4975(e)(1)(B) through (F).

Investment Advice: A five-part test to determine whether the institution or professionals are engaged in providing investment advice and therefore acting as a fiduciary; **all five parts must be satisfied to meet the definition**:

- render advice to the plan as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property
- provide advice on a regular basis

- provide advice pursuant to a mutual agreement, arrangement, or understanding the plan, plan fiduciary or IRA owner, that:
    - the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and
    - the advice will be individualized based on the particular needs of the plan or IRA.

Investment Professional: A fiduciary of a Plan or IRA by reason of the provision of investment advice with respect to the assets of the Plan or IRA involved in the recommended transaction, who is an employee, independent contractor, agent, or representative of a Financial Institution, and satisfies the federal and state regulatory and licensing requirements of insurance, banking, or securities laws (including self-regulatory organizations) with respect to the covered transaction, as applicable, and is not disqualified or barred from making investment recommendations by any insurance, banking, or securities law or regulatory authority (including any self-regulatory organization).

Party-in-interest: A person or entity providing services to an ERISA plan is considered a "party-in-interest" to the plan.

Plan: Any employee benefit plan described in ERISA section 3(3) and any plan described in Code section 4975(e)(1)(A).

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 whom the fiduciary is affiliated. The Department of Labor (and other government agencies) has 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.

Prudent Investor Rule: Trading in ERISA accounts is subject to the "prudent investor" rule (also known as 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.

Retirement Investor: A participant or beneficiary of a Plan with authority to direct the investment of assets in his or her account or to take a distribution, the beneficial owner of an IRA acting on behalf of the IRA, or a fiduciary of a Plan or an IRA.

Riskless Principal Transaction: A Financial Institution, after having received an order from a Retirement Investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.

16.21 Foreign Accounts

Responsibility	• Compliance
Resources	• Requests to solicit business in foreign countries • New foreign accounts
Frequency	• As required
Action	• Review requests to solicit business in foreign countries and to open new foreign accounts: ○ Determine whether the account's country of domicile imposes additional

	requirements such as licensing ○ Notify RR and RR's supervisor of special requirements ○ If requirements cannot be met, close the account
Record	• Record of review of requests to do business in foreign countries and new foreign accounts and action taken, if appropriate • List of foreign requirements (or lack of requirements) from information gathered when reviewing accounts or from outside sources

Accounts for residents of foreign countries may be subject to special requirements under securities laws of the foreign country. Before soliciting investors or opening an account for a person or entity residing in a foreign country, contact Compliance for further information regarding any special restrictions or requirements.

16.22 Health Savings Accounts (HSAs)

[SEC investor bulletin: https://www.sec.gov/oiea/investor-alerts-and-bulletins/investor-bulletin-health-savings-accounts-hsas; IRS Publication 969]

A Health Savings Account is a tax-advantaged savings account which a taxpayer may use to pay for eligible medical expenses. Some features include:

- Payments are restricted to eligible expenses
- Qualified persons may only contribute if they participate in a high-deductible health insurance plan
- Other persons (such as Medicare participants) are not eligible to establish HSAs
- Some HSAs permit investing in securities such as mutual funds and ETFs

HSAs may only be offered to eligible customers. Because of the various requirements and exclusions, customers will be required to certify their eligibility prior to investing. RRs are not permitted to provide tax advice to customers who should be referred to their tax advisor.

Recommendations of funds or other investments in an HSA must meet Regulation Best Interest requirements.

16.23 Referrals

[SEC Securities Exchange Act of 1934 Section 15(a); FINRA Rule 2040; FINRA Regulatory Notice 15-07]

Responsibility	• Designated Supervisor • Compliance
Resources	• Requests regarding referral arrangements
Frequency	• As required
Action	Designated Supervisor: • Review requests for referral arrangements and determine compliance with regulatory and firm policy requirements and approve or disapprove; for approved arrangements establish guidelines for arrangements including any compensation • For investment adviser referrals: ○ If compensation will be received for referrals, determine whether

	investment adviser registration is required for KCD and the RR ○ Maintain a list of approved IAs ○ Review IAs to be included on the approved list including registration status, investment policies, suitability guidelines for investors ○ Establish monitoring program and monitor results vs. IA stated performance ○ Re-evaluate IA participants at least annually • For hedge fund or other investment referrals, the proposed investment is subject to new product review procedures • Refer to Compliance if necessary
Record	• Designated Supervisor review of communications and referrals to Compliance • Compliance: ○ Review/approval of referral arrangements ○ Reviews of IAs included on approved list ○ Records of monitoring and annual review

Referrals are an important part of our business. Satisfied customers may refer others to KCD. Customers may also seek referrals from the Firm or RRs when they need services not provided by KCD. It is important that referrals to others are based on sound knowledge about the other person or company. In addition, FINRA rules restrict compensation to unregistered persons or entities.

Key requirements regarding referrals include the following:

- Employees are expected to make referrals involving investments or investment advisory services only to persons or companies included in a firm-sponsored program.
- Employees are prohibited from receiving compensation for referrals except through firm-sponsored programs.
- Any proposed compensation, whether for referring or receiving referrals, must be approved **in advance** by Compliance.
- Referrals involving compensation may require disclosure to the customer of potential conflicts of interest.

16.23.1 Definition Of Eligibility

FINRA rules prohibit firms or associated persons from directly or indirectly paying compensation, fees, concessions, discounts, commissions or other allowances to:

- any person that is not registered as a broker-dealer under Exchange Act Section 15(a); or
- any registered person unless such payment complies with all applicable federal securities laws, FINRA rules and Exchange Act rules and regulations.

Rule 2040(a) directs firms to look to SEC rules to determine whether the activities in question require registration as a broker-dealer under Exchange Act Section 15(a).

16.23.2 Referrals

Referrals are an important part of our business. Satisfied customers may refer others to KCD and may also seek referrals from employees when they need services not provided by KCD. It is important that referrals to others are based on sound knowledge about the other person or company. In addition, FINRA rules restrict compensation to unregistered persons or entities.

Key requirements regarding referrals include the following:

- Employees are expected to make referrals involving investments or investment advisory services only to persons or companies included in a firm-sponsored program or on a list of firm-approved providers.
- Employees are prohibited from receiving compensation for referrals except through firm-sponsored programs.
- Any proposed compensation, whether for referring or receiving referrals, must be approved **in advance** by Compliance.
- Referrals involving compensation may require disclosure to the customer of potential conflicts of interest.
- Non-cash compensation is subject to the policy described in the chapter *ORDERS*.

16.23.3 Referrals To Others

Employees **may not** accept compensation from someone outside KCD for providing referrals. Compensation may be paid by KCD under firm-sponsored programs.

16.23.3.1 Referrals To Investment Advisers

Referring customers to investment advisers for compensation may require KCD and the RR to be registered as an investment adviser and investment adviser agent, respectively. If KCD has a program for adviser referrals, required registrations will be obtained and a list of approved advisers will be provided to RRs. All advertising, sales material, marketing materials, scripts, and proposed presentations related to investment adviser referrals must be approved by Compliance prior to use.

16.23.3.2 Referrals Outside Investments

RRs are expected to limit their investment recommendations to products or services offered by KCD. Referrals to outside investments not part of a firm program are prohibited.

16.23.4 Referrals To The Firm

When others outside KCD refer potential customers, referral fees or other compensation may not be paid to the outside person or firm. Questions and requests for exceptions should be referred to Compliance.

16.24 Fee-Based Accounts

[FINRA Rule 2122; FINRA Notice to Members 03-68]

Responsibility	• Designated Supervisor
Resources	• Applications for fee-based programs • New account information • Reports to monitor account activity

Frequency	• Daily or as required: account applications • Monthly: reports to monitor accounts
Action	• Review account applications for completeness and appropriateness of account for the customer and approve or disapprove • Review monthly reports and, where it appears the customer would benefit more from a traditional commission-type account, contact the RR (and the customer, if necessary) to recommend the customer change from a fee-based account • Where customers refuse to change from a fee-based account, obtain a letter from the customer confirming the customer understands the additional costs and still desires to maintain a fee-based account
Record	• Applications • Monthly reports monitoring accounts including reviewer's initials and date of review and notes of action taken, if appropriate

KCD offers fee-based programs where the customer is charged a fixed fee or percentage of assets in lieu of commissions. The RR must be licensed as a Investment Advisor. Such programs may not be appropriate for all customers and commission-based transactions may be more advantageous to the customer in terms of the overall cost.

RRs have an obligation to make suitable recommendations when offering fee-based programs and should consider the following prior to recommending that a customer participate:

- What is the customer's investment history, other investments, and other information necessary for suitable recommendations?
- Does the program offer investments consistent with the customer's objectives?
- Will the program reasonably meet the customer's investment goals (diversification, need for income or growth of capital, *etc.*)?
- What is the projected cost to the customer vs. standard commissions?
- Are there alternative fee structures available that could be more beneficial to the customer?
- Are there other factors particular to the customer that should be considered?

16.25 Day Trading Accounts

[FINRA Rule 2130]

KCD does not allow customers to trade their own accounts using KCD's clearing firm order entry facilities. Therefore KCD does not allow customers to day trade in their own accounts.

16.26 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 or your supervisor

- 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 unless you have been in contact with the trustee for the estate or beneficiary and all paperwork is in order
- cancel all open orders

17 MUTUAL FUNDS AND OTHER INVESTMENT COMPANY PRODUCTS

[FINRA Rule 2341]

This chapter outlines requirements when selling mutual funds or other investment company securities. References to "suitability" apply only to those recommendations NOT subject to Regulation Best Interest (BI) which applies to retail customers and is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

17.1 Introduction

This chapter includes policies and procedures for investment company products (mutual funds, closed-end funds, unit investment trusts (UITs), exchange-traded funds, *etc.*) with emphasis on mutual funds. The initial sections address mutual funds, and other investment company products are addressed in sections identifying them.

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 acknowledgment.
- RRs cannot "sell dividends" or facilitate customer "late trading" or "market timing."
- Required disclosures are included in prospectuses or summary prospectuses (open-end funds only) which must be provided to purchasers.

17.2 Mutual Funds Offered By The Firm

Responsibility	• Designated Supervisor
Resources	• Prospectuses and other information provided by mutual fund companies or other distributors • Selling agreements • Records regarding commission earned from sales of funds and revenue received from revenue sharing agreements or directed brokerage
Frequency	• As required - signing selling agreements • As required - review potential revenue sharing agreements for compliance with anti-reciprocal rules • Quarterly - compare mutual fund commissions against revenue sharing or

	directed brokerage, if applicable • Annually - training for marketing, sales, and trading staff, as appropriate, regarding anti-reciprocal prohibitions

Action	• Review information on mutual funds
	• Determine which fund companies' products to offer
	• Review dealer agreements for:
	    ○ restrictions or obligations that may affect KCD]'s sales of the mutual fund and issue instructions to RRs, if necessary
	    ○ representation by the mutual fund company that it uses reasonable criteria when selecting Selling Brokers and has reasonable policies and procedures to avoid formal or informal directed brokerage arrangements
	• Execute dealer agreements with mutual fund companies
	• Review special sales programs and promotions outside the standard commission schedule to determine compliance with the anti-reciprocal rule
	• Refer potential directed brokerage arrangements to Compliance for review and determination of corrective action
	• Review revenue sharing agreements if applicable:
	    ○ At time of proposal to determine compliance with anti-reciprocal rules
	    ○ To develop and provide disclosure to customers
	    ○ To determine ongoing compliance with anti-reciprocal rules

Record	• Information used to determine which funds to sell • Signed dealer agreements • Notices to RRs of special restrictions or requirements included in dealer agreements • Records of special sales programs and promotions including the date of review, reviewer's signature/initials, and notes of action taken, if appropriate • Revenue sharing arrangements and disclosures to customers (Initial and quarterly reviews, if applicable)

Mutual funds with a range of investments and objectives will be available for investment by customers.

17.2.1 Anti-Reciprocal Rule

[Investment Company Act Rule 12b-1; SEC Release No. IC-26591; FINRA Rule 2341(k); FINRA Notice to Members 05-04]

KCD is prohibited from favoring the sale of mutual funds based on revenues earned (directly or indirectly) from the investment company issuing the mutual fund. This includes:

- *Directed brokerage,* which is a practice where the investment company directs brokerage business to a broker-dealer to reward or compensate the dealer for selling its funds. This includes, directly referring brokerage transactions to the dealer that sells its funds and also "step-out" arrangements where brokerage is directed to another firm and then revenue is shared with the dealer selling the funds.
- *Undisclosed revenue sharing,* where the mutual fund company pays incentives to the broker-dealer to secure a prominent place in the selling dealer's distribution network ("shelf space").

If an employee becomes aware of a prohibited activity, it should be reported immediately to Compliance.

The selection and offer of mutual funds will comply with anti-reciprocal prohibitions. Specifically, KCD will not:

- Sell shares of, or act as underwriter for, any investment company where KCD 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 securities.

- Favor or disfavor sales of investment companies based on commissions received or expected and tied to sales
- 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 KCD's business
- Sponsor or encourage an incentive campaign or special sales effort of another dealer financed by commissions received related to the sale of the funds
- For retail sales, 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. RRs and managers may 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.

If KCD engages in revenue sharing, it will clearly disclose such an arrangement to customers purchasing the applicable funds.

17.3 Sales Charges

[FINRA Rule 2341(d); FINRA Regulatory Notice 21-07]

Responsibility	• Designated Supervisor
Resources	• Order records • Daily Transaction Report • Fund information (*i.e.,* prospectus, Statement of Additional Information) • Exception reports (as available)
Frequency	• Daily
Action	• Review Breakpoint Worksheets for completeness, determination of sales charge discounts available to purchaser • Review order records/exception reports to determine that discounts and waivers have been considered • Review daily transactions to determine same-day mutual fund purchases are considered for LOI and ROA discounts • Review orders for improper breakpoint sales (near but below common breakpoint levels [$25,000, $50,000, *etc.*]) • Review orders for purchases of multiple funds with similar investment objectives and confer with RR about the suitability of multiple purchases • Letter of Intent (LOI) reviews for: ○ Notation on Worksheet/order record whether an LOI will apply (including retroactive LOIs if permitted by the fund) • Rights of accumulation (ROA) review for indication on order record whether ROA applies

	• Review direct purchases/exception reports to determine available discounts/fee waivers have been applied
	• Confirm where multiple discounts are available that the largest discount is applied
	• Where a customer has not been provided an available discount:
	    ○ Confer with the RR and determine if disciplinary action is required (may include a letter of caution, enhanced supervision of mutual fund transactions, limitation/suspension of mutual fund activities)
	    ○ Notify the customer and correct the purchase to include the discount
	• Provide training to RRs and supervisors on mutual fund purchases and sales charge discounts

Record	• Breakpoint Worksheets • Order records • Daily transaction reports • Exception reports (as available) • Records of action taken, if any, on order records and/or exception reports • Training records

When investors purchase mutual funds (other than no-load funds), they incur sales charges that may be front-end or back-end charges. Mutual funds offer investors discounts to sales charges, which are explained in the fund's prospectus. This section describes different types of discounts available to mutual fund purchasers. FINRA Regulatory Notice 21-07 provides extensive guidance on sales charges.

RRs are responsible for understanding the availability of sales charge discounts to provide the customer the opportunity to purchase a mutual fund under the most favorable terms available. RRs are required to use the Breakpoint Checklist and Worksheet for every mutual fund purchase involving a sales charge. The Checklist and Worksheet are discussed at the end of this section. Customers also are provided, at the time of first purchase, with a Breakpoint Disclosure Statement explaining breakpoints and other available discounts.

Sales charge discounts include the following, which are discussed in more detail in following sections:

- **Breakpoints** - Volume-based discounts based on increasing amounts invested
- **Letters of intent** - Discounts resulting from a written statement of intent to invest more funds
- **Rights of accumulation** - Aggregation of purchases including householding and family discounts
- **Reinstatement privilege** - Some funds' consideration of reinvestment of funds
- **Sales charge reductions/waivers** - Some funds' reduction of charges for selected accounts (retirement accounts, *etc.*) or waivers/NAV transfers when reinvesting from a prior fund that included a sales charge
- **Deferred sales charge** - deferring sales charges depending on the investor holding the fund for a period of time
- **Direct investments** - purchases made directly with the investment company; any discounts/waivers offered by the investment company must be included in purchases

17.3.1 Breakpoints

[FINRA Rule 2342; FINRA FAQs: https://www.finra.org/rules-guidance/guidance/faqs/breakpoints-frequently-asked-questions; FINRA Breakpoints Guidance: https://www.finra.org/rules-guidance/key-topics/breakpoints]

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 an obligation to disclose the existence of breakpoints to enable the customer to evaluate the desirability of making a qualifying purchase. The RR also must indicate on the mutual fund order 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" 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 customer should sign a letter acknowledging his or her understanding that a breakpoint is being given up by purchasing multiple funds.

Purchases of mutual funds under a breakpoint are not subject to breakpoint violations if the purchases are made as part of a bona fide asset allocation program sponsored by KCD. Customers who participate in a Firm-sponsored program are notified, as part of the agreement to participate in the program, that they may not receive breakpoint reductions that otherwise would be available.

A Breakpoint Search Tool is available from FINRA online. The tool provides breakpoint schedules and linkage rules for mutual funds with sales charges

17.3.1.1 Breakpoint Checklist And Worksheet

When selling a front-end load fund (Class A) to a customer, the RR is required to review the Breakpoint Checklist and complete the Breakpoint Worksheet, which is submitted with the mutual fund purchase order. The purpose of the Worksheet is to document required information about the customer's holdings to determine whether the customer qualifies for a reduced sales charge, including:

- Total holdings at KCD in the fund, or a related fund in the same family
- Total holdings outside KCD in the fund, or a related fund in the same family
- Total holdings of related parties (some funds provide discounts when related persons own the same fund, or funds in the same family of funds)

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.

17.3.2 Letters Of Intent

[FINRA Notice to Members 02-85]

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 letter of intent 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 fund allows backdated LOIs.

17.3.3 Rights Of Accumulation/Householding And Family Discounts

[FINRA Rule 2341(d)(1)(B); FINRA Notice to Members 02-85]

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. The mutual fund may provide discounts by aggregating accounts in the same household or family.

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.

17.3.4 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.

17.3.5 Sales Charge Reductions/Waiver Or NAV Transfer Program

Some mutual funds waive fees for eligible retirement plans and charities. RRs are obligated to apply waivers where they are available.

A limited number of mutual funds offer a sales charge discount in the form of a waiver or NAV transfer. Investors may purchase Class A shares of a mutual fund without paying a front-end sales charge, if investing some or all of the proceeds from the sale of a mutual fund in a different mutual fund family for which the investor paid a front-end or back-end sales charge within a specified period of time. The period when the discount is available is generally 30 to 90 days from the date the investor purchased the other fund. This type of discount is explained in the fund prospectus and Statement of Additional Information.

Generally, customers will not make short-term sales of mutual funds. In those unusual circumstances, where the customer is making such a sale, the RR should investigate whether a waiver is available on the new purchase.

17.3.6 Deferred Sales Charges

[FINRA Rule 2341(n)]

If a customer purchases shares of a mutual fund that imposes a deferred sales charge on redemption, the front of 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."

17.3.7 Direct Application And Wire Order Accounts

Mutual funds allow investors to purchase funds directly (sometimes called "application way" or "wire order" purchases or accounts). In these instances RRs may complete paper account forms and the customer signs the form, writes the check, and sends the application and payment to the investment company. RRs may also use Firm (or clearing firm) systems to send customer funds electronically to the investment company. RRs are responsible for ensuring available discounts/fee waivers are applied to the purchase.

17.3.8 Sales Charge Discounts Must Be Marked On Mutual Fund Orders

Because automated mutual fund order processing systems do not generally provide the ability to monitor application of an available sales charge discount, it is important that all pertinent information be recorded on the order and entered to the system, including whether the customer's purchase qualifies for a sales charge discount. Incomplete mutual fund orders will not be accepted and will be returned to the RR for completion of necessary information about available sales charge discounts.

17.4 Switching

[FINRA Notice to Members 94-16 and 91-39]

Responsibility	• Designated Supervisor or Designee
Resources	• Order records • Daily Transaction report
Frequency	• As Needed
Action	• Review mutual fund orders for transactions where the customer sells one mutual fund to buy another mutual fund • When switching is identified, ensure the customer provides a signed disclosure or switch letter
Record	• Initials on order records • Disclosure or Switch letters signed by the customer and maintained in the client files

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 KCD as a result of effecting 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 designated supervisor'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 file for the customer or for switch letters. FINRA prohibits the use of "negative consent letters," which are used to advise a customer that there will be a switch from one fund to another unless the customer responds before a specified date.

17.5 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 unless there are specific tax or other advantages 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.

17.6 Misrepresenting "No-Load" Funds

[FINRA Rule 2341(d)(4)]

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 exceeding .25 of 1% may not be sold as "no-load" funds.

17.7 Reinvestment Of Maturing Certificates Of Deposit In Mutual Funds

[FINRA Notice to Members 93-87]

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.

17.8 Suitability

Responsibility	• Designated Supervisor
Resources	• Order records • Daily Transaction report • Customer monthly statements
Frequency	• Daily
Action	• Review mutual fund transactions for suitability with particular attention to the following: ○ Funds with high risk objectives: is the investment consistent with the customer's investment objectives? ○ 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? ○ Suitability of a particular class ○ Large purchases of class B shares that may qualify for lower sales charges if purchased as class A shares

	○ Confer with RRs regarding any transactions that raise questions • Review recommended orders for compliance with Regulation BI [see the chapter *REGULATION BEST INTEREST (BI)*] • Follow up action may include: ○ Requesting written acknowledgement from the customer that the higher costs are understood ○ Canceling transactions that appear to be inappropriate
Record	• Initials on order records and Daily Transaction Report • Notes on Daily Transaction report and/or Branch Manager's Log of follow up action, if appropriate • Customer's signed acknowledgement filed in the customer file, if appropriate

When recommending that a customer purchase, sell, or exchange a mutual fund, the following should be considered:

- Customer information including financial and tax status, investment objectives, other investments including other mutual funds
- Information regarding the fund to be recommended including sales charges, historical performance and volatility, risk, investment objective, and nature of the securities and investment strategies in the fund (use of leverage, investments in hedge funds or derivatives, *etc.*)
- Risk (fund investment risk and customer's risk tolerance)
- Appropriateness of high concentrations in any particular type of fund or investment
- Types of classes available and appropriateness of a particular class for the customer

Suitability is only one element of acting in a customer's best interest. Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI) which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

17.8.1 Multi-Class Mutual Funds

[FINRA Notice to Members 95-80]

Mutual funds often offer three classes of shares that are based on the same mutual fund portfolio but differ regarding costs incurred by the customer.

Class A shares: Generally impose a front-end sales load and no (or a low) ongoing fee to pay for sales and marketing expenses (Rule 12b-1 fees). Usually the front-end sales load will decrease at certain breakpoints depending on the size of the purchase and whether the purchase qualifies for a letter of intent or rights of accumulation which also may result in a lower sales charge. A front-end sales charge means a portion of the customer's funds are not invested and instead pay the front-end charge.

Class B shares: Generally do not impose a front-end sales charge but may impose a contingent deferred sales charge (CDSC) on share redemption and relatively high 12b-1 or other asset-based fees. The amount of the CDSC usually declines the longer the shares are held. Class B shares often automatically convert to Class A shares (with lower asset-based fees) after a period of time, usually after the CDSC declines to zero. All of the customer's funds are invested at the time of purchase. These funds may <u>not</u> be referred to as no-load funds since they impose a back-end contingent charge.

Class C shares: Have different expense features than A and B shares; may include no front or back-end load or a small back-end load; and higher 12b-1 or other asset-based fees. Class C shares are often used for managed accounts and asset allocation purposes.

Class D shares: Usually no-load shares available through mutual fund supermarkets with possible transaction and other fees.

Class R shares: Created for retirement plans and available through an employer-sponsored retirement plan and with a wide range of fees.

In addition, some mutual funds offer other classes that impose no front-end or back-end sales charges and relatively low asset-based fees. These may be offered to limited types of purchasers such as retirement plans or institutional investors.

The following are guidelines for determining which class of shares is best for the customer:

- The cost advantages of one class versus another must be considered.
- Class B or C shares generally should not be recommended to customers making purchases in large amounts that may qualify for lower costs because of breakpoints, letters of intent, or rights of accumulation available through the purchase of class A shares.
- Class B shares should not be purchased for a customer if the RR knows or has reason to know that the customer will be purchasing additional shares that would take a purchase over a Class A breakpoint within 13 months of the initial purchase.
- Class B shares should not be purchased if potential additional purchases would qualify for a NAV price.
- Class A shares may be more appropriate for a customer who intends to remain invested in the fund for a longer period of time. Over time the higher continuing sales charges of Class B and C shares may exceed the initial load and smaller 12b-1 fees of Class A shares.
- Class C shares may be appropriate for a customer who does not qualify for a reduced Class A initial sales charge and who does not intend to remain invested in the fund for a period during which the fund's Class B shares are subject to a CDSC.
- Some funds waive the sales charge under circumstances specified in the prospectus (*e.g.,* purchases by employees of broker-dealers and their immediate family members). If a Class A sales charge waiver is available, Class A shares will be less costly than Class B or C shares. A CDSC may be imposed on early fund redemptions of Class A shares where a waiver is granted; the prospectus should be consulted.

17.9 Late Trading And Market Timing

[FINRA Notice to Members 03-50]

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.

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.

17.10 Block Letter Restrictions

Mutual fund companies sometimes issue "block letters" that limit the trading activity of a particular customer. This may occur if the fund detects trading that violates trading restrictions imposed by the fund such as late trading or market timing.

When a block letter is received, the RR and the RR's supervisor will be notified, and the RR is responsible for complying with the restriction. Orders may not be entered for the customer in another account that is beneficially owned by the customer to circumvent any restrictions.

17.11 Communications

[FINRA Rule 2210]

Responsibility	• Designated Supervisor
Resources	• Outgoing communications
Frequency	• Daily
Action	• Review for the following: ○ Use of pre-approved letters without change other than updating data where required ○ 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 *Disclosure Of Material Facts*) ○ Performance is represented accurately and consistent with rule requirements regarding yield and return ○ Language that indicates a prospectus is enclosed • Contact Compliance for review of questionable communications • Correct unapproved content

Record	• Initials on communications • Compliance retains communications it reviews

RRs should use letters pre-approved by KCD and include a prospectus or limit communications to stating that a prospectus is enclosed and the RR will be in contact with the customer. Questions should be referred to Compliance.

17.12 Disclosure Of Material Facts

[FINRA Notice to Members 95-80]

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
- 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 generally includes many if not most of these disclosures.

17.13 Disclosure Of Fees, Expenses And Performance

[FINRA Rule 2210(d)(5)]

Many firms prohibit generally all written discussion of a fund's performance and simply refer 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.

Correspondence and retail communications including performance about mutual funds (other than money market funds) must disclose:

- The standardized performance information required by '34 Act Rule 482 and Rule 34b-1; and
- If applicable:
    - The maximum sales charge on purchases or the maximum deferred sales charge included in the current prospectus; and
    - The total annual fund operating expenses, gross of any fee waivers or expense reimbursements, as stated in the fee table of the current prospectus.

This information must be prominent in the communication, and in any print advertisement in a prominent text box that may also include comparative performance and fee data and disclosures required under Rules 482 and 34b-1.

17.14 Prospectuses

RRs will provide a copy of the prospectus when recommending a mutual fund purchase to a customer. A summary prospectus may also be provided (if available from the investment company) for open-end funds. The summary prospectus includes reference to an internet site where the complete statutory prospectus is available along with other required information.

RRs will provide copy of the fund prospectus to each purchaser of a mutual fund prior or at the time of sale.

17.15 Retail Communications

[FINRA Regulatory Notice 11-49; NASD Notice to Members 93-36]

Responsibility	• Compliance
Resources	• Firm-approved retail communications
Frequency	• Daily
Action	• Review and approve/disapprove retail communications are used in conjunction with sales of mutual funds • Notify RRs/supervisors of approved communications
Record	• Records of approved/disapproved retail communications

There are specific requirements for retail communications regarding mutual funds. Advertising must be filed with FINRA within prescribed periods (see the chapter *COMMUNICATIONS WITH THE PUBLIC* and the section *Special Filing Or Approval Requirements* for details). There also are mandated guidelines on representations regarding performance and yield, including specific requirements when retail communications include a TIPs fund's current yield.

RRs may use materials provided by the fund or firm-approved materials. Any other retail communications must be approved by Compliance prior to use.

17.16 Dealer-Use-Only Material

[FINRA Notice to Members 95-80]

Responsibility	• Designated Supervisor
Resources	• Outgoing communications
Frequency	• Daily
Action	• Ensure the branch does not distribute dealer-use-only materials to the public

	• Review communications to identify inclusion of restricted materials
Record	• Initials on communications

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.

17.17 Sales Contests And Incentive Programs

The following guidelines apply to sales contests and other incentive programs where mutual funds are the subject of the contest or program. Also refer to the chapter *ORDERS* and the section *Sales Contests* for general guidelines applying to all contests.

- All Sales contests must be approved by Compliance.
- Contests may not be based on the amount of brokerage commissions received or expected to be received from investment companies.
- When KCD acts as underwriter of investment company shares, KCD may not sponsor a contest or other incentive campaign of another broker-dealer with respect to the sale of shares of the investment company.
- RRs may not accept (directly or indirectly) cash or non-cash compensation from outside KCD.
- Refer to the section *Conflicts Of Interest* in the chapter *REGULATION BEST INTEREST (BI)* for details regarding conflicts involving compensation.

17.18 Prompt Transmission Of Applications And Payments

[FINRA Rule 2341(m); FINRA Regulatory Notice 15-23]

Responsibility	• Designated Supervisor
Resources	• Mutual fund applications • Record of when transmitted by the RR such as postmarks on envelopes
Frequency	• Review applications: as required when applications are received • Review delayed transmittals: Monthly

Action	• Transmit applications to the payee (underwriter, investment company, or other designee) by:
	    ○ the end of the 3rd business day following receipt of the customer's order to purchase; or
	    ○ the end of 1 business day following receipt of the customer's payment, whichever is later
	• When the Firm acts as underwriter and engages in wholesale transactions of shares received from other members, payments will be transmitted by the end of 2 business days following receipt of the payments
	• Review customer's signature date vs. postmark or other record of transmittal by

	the RR
	• Document transmittals more than 2 business days after customer signature date
	• Review delayed transmittals and:
	    ○ for 3 or more occurrences within 12 months, notify the RR's supervisor to meet with the RR
	    ○ for another occurrence within 12 months, assess a fine to the RR
	• For the sale of a security on a subscription-way basis:
	    ○ Promptly prepare and forward a complete and correct application package to an OSJ;
	    ○ Perform a suitability review and determination of approval (or disapproval) by a registered principal within 7 business days after receipt of a complete and correct package at the OSJ;
	    ○ Transmit the check to the issuer no later than noon of the business day following the date the registered principal reviews and approves; and
	    ○ Return the package and the check to the RR if the transaction is disapproved
	    ○ Customers will be notified of the Firm's process for handling customer checks payable to issuers for subscription-way securities transactions before such transactions. Notice may be included in customer statements or another form of notice

Record	• Applications • Documentation of delayed transmittals including record of who reviewed, when reviewed, and action taken • For subscription-way transactions maintain a record of the check, when received, date transmitted to the issuer if approved, or date returned to the customer if disapproved

RRs are obligated to promptly transmit mutual fund applications and customer payments to the designated office/application processor. The Firm is obligated, by FINRA rule, to transmit customer payments to the payees (*i.e.,* underwriters, investment companies or their designated agents) by the end of the third business day following receipt of a customer's order to purchase or by the end of one business day following receipt of a customer's payment, whichever is the later date.

For sales of securities on a subscription-way basis, RRs must safeguard each check and promptly prepare and forward a complete and correct application package to the designated OSJ. The Principal at the OSJ will perform a suitability review and determine whether to approve each subscription-way sale within seven business days after receiving a complete and correct application package. Checks will be transmitted no later than noon of the business day following the date the Principal reviews and approves the transaction.

Failure to transmit applications and payments promptly is a violation of FINRA rules. RRs who do not comply with prompt transmission requirements may be subject to disciplinary action.

17.19 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 signed letter authorizing liquidation. Required signature guarantees should be obtained, if required, prior to forwarding the letter to the fund.

17.20 Direct Mutual Fund Business

[Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• Exception/other reports of transactions • Data from mutual fund companies • Customer account information
Frequency	• Dependent on available exception or other reports and information from mutual fund companies

Action	• Obtain available data from mutual fund companies or clearing entities
	• Review data/reports to confirm:
	  ○ Application of sales charge discounts
	  ○ Reg BI compliance

Record	• Data received from mutual fund companies • Firm reports including record of manual/electronic review

Some mutual funds may be purchased via "check and app" that are held by mutual fund companies. RRs are responsible for making Reg BI-compliant recommendations and confirming discounted sales charges are applied.

17.21 Closed-End Funds

Responsibility	• Designated Supervisor
Resources	• Transaction reports that include closed-end funds
Frequency	• Daily

Action	• Review CEF trading for:
	  ○ Short-term trading, particularly involving IPOs
	  ○ Suitability of recommendations
	• Take corrective action, if appropriate, which may include:
	  ○ Conferring with the RR
	  ○ Contacting the customer
	  ○ Consulting with Compliance
	  ○ Cancelling trades
	• Include CEFs in training, particularly the disadvantages of short-term trading

Record	• Reviews of transactions including date reviewed, initials of reviewer, and actions taken, if any • Records of training including who attended, date conducted, and subjects included

Closed-end funds (CEFs) 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 CEFs. Certain features of mutual funds such as breakpoints, letters of intent, and rights of accumulation are not features of closed-end funds.

Since CEFs trade like stocks, requirements regarding handling orders in the chapter *ORDERS* apply. For example, RRs may not recommend or engage in excessive trading of CEFs, and recommendations are subject to suitability requirements.

Recommendations to purchase an IPO for a CEF may not be appropriate for short-term investors since there is a built-in sales charge. After the offering, CEFs typically trade at a discount from the IPO price. Recommending the sale of a CEF IPO after the penalty bid period (during which the RR would not earn commissions on the purchase) at a loss and then recommending the purchase of another CEF would be unsuitable.

The high distribution rates may be composed of dividends, interest income, capital gains and/or return of capital. RRs should consider and communicate to investors, where it applies, that a high rate of return may be a return of capital and not actual income for the investor and the funds trade at a high premium compared to NAV.

17.21.1 Business Development Companies (BDCs)

Responsibility	• Designated Supervisor
Resources	• Proposed BDC products • Selling agreements • Customer transactions
Frequency	• As required
Action	• Subject proposed BDCs to the New Product Review including due diligence on the BDC and of participating BDs with which there is a selling agreement • Conduct ongoing review of BDCs • Review customer transactions for suitability
Record	• Due diligence (new product, participating BDs, ongoing) • Selling agreements • Transaction reviews including actions taken, if applicable

BDCs are closed-end funds that invest in a company's debt (loans) or equity with the goal of generating income, capital growth or both. BDCs may represent higher risk that must be considered when recommending them and communicating risks to investors. Following are some of the risk factors that must be considered.

- BDCs primarily invest in the corporate debt and equity of private companies which may offer higher yield through leveraged high credit risk exposure.
- Fueled by the availability of low-cost financing, BDCs may over-leverage illiquid portfolios.
- Non-traded BDCs are illiquid and investors may be limited to selling only through periodic share repurchases by the BDC at high discounts.
- Distributions are not guaranteed in frequency or amount and may be paid from other sources than earnings.

- There may be a limited operating history and reliance on the advisor, conflicts of interest, and payment of substantial fees to the advisor and its affiliates.
- The underlying companies are likely small- and medium-size businesses that aren't rated by a traditional rating agency.

17.22 Leveraged Loan Products

Leveraged loans are adjustable-rate loans extended by financial institutions to companies of low credit quality that have a high amount of debt relative to equity. Floating-rate bonds do not trade on an organized exchange, making them relatively illiquid and hard to value. Funds investing in these loans may be marketed as less vulnerable to interest rate fluctuations and offer inflation protection, but the underlying loans held by the fund are subject to significant credit valuation and liquidity risks unclear to investors. RRs must consider and communicate these risks when making recommendations to investors.

17.23 Unit Investment Trusts (UITs)

Responsibility	• Designated Supervisor
Resources	• Order records • Available reports • Information regarding charges and discounts
Frequency	• As required when UIT transactions are effected

Action	• Review transactions for:
	    ○ appropriate sales charges including discounts available
	    ○ Suitability, particularly patterns of sales, switching and early rollovers
	• Provide training for RRs regarding suitability of recommendations and costs of UIT investments including discounts available and the obligation to provide available discounts

Record	• Order records including record of review, action taken • Reports reviewed including record of review, action taken • Records of training including who attended, when provided, and subjects covered

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.

Unit investment trusts have a finite life that ends when all securities in the portfolio have matured or are liquidated per the terms of the trust.

17.23.1 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.

17.23.2 Sales Charges

UITs impose sales charges including front-end and back-end loads and management fees. In addition, like mutual funds, discounts may be available through breakpoints, letters of intent, 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.

17.23.3 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.

17.23.4 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.

17.23.5 Sales Charges And Discounts

[NASD Notice to Members 04-26]

RRs are responsible for understanding the proposed investment and related sales charges and available discounts and inform customers. There is an initial sales charge applied to the purchase and many UITs assess a deferred sales charge. The deferred sales charge is generally deducted in periodic installments following the end of the initial offering period. Many UITs assess a creation and development fee that compensates the UIT sponsor for creating and developing each UIT, including determining the UIT's investment objectives, selecting portfolio securities and other administrative functions. This fee is deducted at the end of the initial offering period.

Typical discounts include:

- Discounts based on the size of a single transaction (price breaks or breakpoints)
- Rights of accumulation

- Rollover or exchange discounts that provide a reduced sales charge

17.24 Funds Of Hedge Funds

[FINRA Notice to Members 03-07]

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.

17.24.1 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

17.25 Exchange-Traded Funds (ETFs)

[SEC investor article: http://www.sec.gov/answers/etf.htm; FINRA Regulatory Notice 09-31; FINRA Non-Traditional ETFs FAQ: https://www.finra.org/rules-guidance/key-topics/etf/non-traditional-etf-faq; NASDAQ Rule 5705]

Responsibility	• Designated Supervisor
Resources	• Descriptions of proposed ETF products to be sold • Transactions and proposed transactions in ETFs • Transaction reports • New account information
Frequency	• Daily
Action	• Subject new ETFs to new product review including determination of the type of investor for whom the product is suitable and include this in training and

	marketing materials • Review for suitability of recommended ETFs, particularly non-traditional ETFs • Consult with RRs, where appropriate, when non-traditional ETFs are sold to individual investors • Include ETFs in training, particularly for non-traditional ETFs • Determine if prospectuses or product descriptions are required and provide, if necessary (refer to Sections 3 & 4 of the '33 Act for exemptions)
Record	• Records of review of proposed products and determination of for whom the product is suitable • Order records including notation of action taken, if any • Records of providing prospectuses or product descriptions where required

An ETF is a type of exchange-traded investment product that must be registered as an investment company under the Investment Company Act of 1940 and as a security under the Securities Act of 1933. An ETF is a method for investors to pool their money in a fund that makes investments in stocks, bonds, or other assets. Retail investors may purchase and sell ETF shares only in market transactions (*i.e.,* they may not purchase from the sponsor). ETF sponsors enter into contractual relationships with one or more financial institutions known as "Authorized Participants" (APs) which typically are large broker-dealers. Only APs may purchase and redeem shares directly from the ETF, and they do so in large aggregations or blocks (*e.g.,* 50,000 ETF shares) called "Creation Units."

A typical ETF is based on specific domestic and foreign market indexes. Multifactor ETFs are based on multiple models to accomplish a particular investment goal. 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. Some ETFs are actively managed and not based on a market index.

Following are considerations when recommending ETFs:

- RRs must understand the complexities of ETFs before making a recommendation to determine the suitability of the recommendation.
- 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.
- Purchasers of Portfolio Depository Receipts must be provided with a written description of the terms and characteristics of the securities, no later than the time a confirmation of the first transaction in such series is delivered to such purchaser. The description must also be included with any sales material provided to customers or the public. Any other written materials making specific reference to a series of Portfolio Depository Receipts as an investment vehicle must include a statement: "A circular describing the terms and characteristics of [the series of Portfolio Depository Receipts] has been prepared by [Trust name] and is available from your broker or NASDAQ. It is recommended that you obtain and review such circular before purchasing [the series of Portfolio Depository Receipts]. In addition, upon request you may obtain from your broker a prospectus for [the series of Portfolio Depository Receipts]." Non-NASDAQ members participating in an omnibus agreement are also subject to this obligation.
- 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. Some ETFs are more complex financial instruments that offer leverage or are designed to perform inversely to the index

or benchmark they track, or both. Leveraged ETFs amplify daily index moves; short selling provides the inverse daily return of market indexes. Targeted leverage levels don't necessarily meet targets over long periods due to compounding returns. Investors in these types of ETFs must be willing to assume higher risk.

- Some inverse ETFs track broad indices, some are sector-specific, and still others are linked to commodities or currencies.
- Most leveraged and inverse ETFs "reset" daily, meaning that they are designed to achieve their stated objectives on a daily basis. The effect of compounding affects their performance over longer periods of time when their performance can differ significantly from the underlying index or benchmark during the same time period. Volatile markets can magnify this effect.
- 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.
- ETFs may be subject to temporary price disparities during times of highly volatile markets when ETF shares may trade for significantly less than the value of underlying assets. This risk is of particular concern to short-term traders.
- 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.

17.25.1 Customer Disclosures For Pre- And Post-Market Sessions

[NASDAQ Rule 4631]

Prior to accepting a pre- or post-market session order in ETFs, the customer must be provided with the Extended Hours Trading Risk Disclosure that explains the trading risks associated with extended hours trading.

17.26 Floating-Rate Bank Loan Funds

Floating-rate loans, as opposed to typical debt offerings, are not issued by a firm directly to the public. Instead, banks and similar financial institutions extend loans to firms in need of raising capital and these loans are repackaged for sale to investors. Interest payments on the underlying loans are reset regularly to a reference rate such as LIBOR or the fed funds rate. Floating-rate loans often serve as an alternative method of financing for companies whose credit quality is rated below-investment-grade, or "junk".

RRs must consider and communicate the risks involved in investing in these funds when making recommendations to customers:

- These funds offer some protection from rising interest rates; however, the underlying loans may carry significant default and call risk.
- Interest payments will vary. In a failing interest scenario, returns of traditional bond funds increase while floating-rate funds may be stagnant or decrease.

- The funds may be difficult to value, have longer settlement times than other investments, and are relatively illiquid. Funds invested in these loans could face liquidity challenges when there are significant redemption requests.

18 INSURANCE PRODUCTS

This chapter describes policies and procedures that apply to the sale of insurance products.

18.1 Approved Insurance Products

RRs are permitted to sell only those products approved by the Home Office. The Compliance Department is responsible for evaluating and selecting products which may include, among other considerations:

- the insurance company's rating by a nationally recognized rating service
- availability of similar products from other insurance companies
- pricing of the product, including premium rates, compared with competitors' products
- sales support provided by the insurance company

The designated supervisor is responsible for reviewing proposed products and maintaining a record of information reviewed and approval of the product as well as the contract executed with the insurance company.

18.2 Licenses And Appointments

Responsibility	• Designated Supervisor or Designee
Resources	• Requests from RRs or managers • Insurance applications • Inquiries from insurance companies whose products are sold
Frequency	• As required
Action	• Review insurance applications prior to submission to determine whether RR is licensed and appointed • Obtain licenses and appointments where necessary, coordinate with compliance
Record	• Records of insurance licenses, appointments, and required continuing education are retained in the employee's registration file.

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. It the RR's responsibility to check that KCD is licensed in the state they wish to do business. The RR will be responsible for the cost of KCD to become appointed in a state not already appointed.

An RR engaged in the sale of 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 customer.
- 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.

RRs may not engage in the sale of insurance products or receive commissions from such sales unless properly licensed and appointed.

18.2.1 Requests For Licenses

RRs should contact their State Insurance Department 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 Compliance at the Home Office after receipt.

18.2.2 Non-Resident Licenses

There are some states where KCD is unable to conduct insurance sales activities. In other states, RRs may obtain non-resident licenses. The Insurance Department should be contacted to clarify requirements before offering insurance products to out-of-state customers.

18.2.3 Unsolicited Insurance Transactions

If an unlicensed 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 transferred to an unlicensed RR.

18.2.4 Additions To Existing Annuity Policies

If a customer wishes to make an additional contribution to an existing annuity policy, the RR must be licensed in the state **where the customer currently resides**.

18.3 Sales Guidelines

There are differences between insurance and securities products; it is important to understand these differences when discussing insurance products with customers. The following sections discuss sales guidelines for offering insurance products.

18.3.1 General Guidelines

- All insurance product purchases and sales MUST be conducted through KCD, *i.e.,* RRs are not permitted to accept any direct commission payments from insurance companies.
- 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. The requirements of Regulation Best Interest (BI) apply to insurance products that are securities; [refer to the chapter *REGULATION BEST INTEREST (BI)*].

18.3.2 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.
- The RR should ensure the customer fully understands the difference between guaranteed and non-guaranteed elements of life insurance.
- Illustrations of return are projections only and not guaranteed.
- 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.
- Life insurance purchased for pension or educational funding planning purposes must be disclosed as life insurance.
- 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.

18.3.3 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.
- 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 lower 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.
- 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.

18.3.3.1 Index-Linked Annuities (RILAs)

RILA is a deferred annuity that shares some characteristics with fixed-indexed and variable annuities. RILAs, which were previously referred to as buffered annuities, offer investment growth opportunity with limited downside risk. Because of their limited potential for loss, RILAs can offer protection in an economic crisis, such as the market downturn caused by the coronavirus pandemic. Features include the following:

- A RILA allows the customer to limit losses during a down market. In return; gains are capped to the same extent when the stock market goes up.
- The customer determines his/her exposure to risk and potential return by setting either a floor or a buffer.
- A RILA floor is the maximum percentage loss the customer is willing to absorb during a down market. Any losses beneath the floor are absorbed by the RILA provider.
- A RILA buffer is a percentage of loss that the customer does not wish to absorb. The customer is exposed to losses to the extent that the linked market index losses exceed the buffer.
- Upside gain is capped to the same extent that downside loss is limited.
- RILAs can help the customer accumulate money for retirement and other long-term needs. In addition to offering protection and growth options, this type of annuity allows accumulation of growth without paying taxes and fees until there is a withdrawal. The customer also has the option to convert the annuity into a stream of income payments in retirement.
- Typically, fees are only paid upon withdrawal of if the customer surrenders the RILA during the specified early withdrawal period.
- Taxes are paid on distributions.

Payout options vary including a fixed period; lifetime payments; life with a minimum fixed period; and joint-and-survivor where payments continue for the life of the annuity holder and the life of a survivor.

18.4 Sales To Military Personnel On Military Installations

[FINRA Rule 2272; Military Personnel Financial Services Protection Act]

The following requirements and guidelines apply when offering life insurance products (including annuities) to military personnel and their dependents on military installations. "Military installation" means any federally owned, leased or operated base, reservation, post, camp, building or other facility which members of the U.S. Armed Forces are assigned for duty, including barracks, transient housing and family quarters.

- Referral fees upon securities sales or solicitations are prohibited unless the fee recipient is a licensed agent of the issuer of the policy or annuity.
- Life insurance products must not be marketed as investment products.
- A suitability determination must be made for sales of securities (*e.g.,* variable annuities).
- Products that provide very low death benefits for very high premiums that are front-loaded in the first few years are inappropriate for most military personnel.
- Written disclosures must be provided that:
    - state that the federal government provides subsidized life insurance to service members under the Servicemembers' Group Life Insurance (SGLI) program, and the amount and cost of the SGLI coverage available;
    - state that the federal government does not sanction, recommend, or encourage purchase of the life insurance product being sold;
    - fully disclose any terms and circumstances under which amounts accumulated in a savings fund or savings feature under the life insurance product that is the subject of the disclosure may be diverted to pay, or reduced to offset, premiums due for continued coverage under the product;
    - state that no one has received any referral fee or incentive compensation for offering to sell the product, unless the person is a licensed agent of the person issuing the product;
    - are in plain and readily understandable language; and
    - for sales or solicitations on federal land or facilities located outside the U. S. , list the address and phone number at which consumer complaints are received by the state insurance regulator.

18.5 Purchases

The following is a summary of how insurance contracts are purchased and processed. Refer to the section *Replacements* for other procedures if the value of one policy is used to purchase a new policy.

18.5.1 Life Insurance And Other Non-Annuity Products

RRs may offer insurance products available from designated wholesalers. KCD 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

18.5.2 Annuities

KCD must have a signed selling agreement with the insurance company to permit sales of products of that company. The supervisor should be contacted to obtain a list of approved insurance companies or verify whether a particular company has an agreement with KCD.

The following are steps for purchasing annuities:

- Both the customer and the RR must sign the application. The RR will send the application to the supervisor for review.
- The supervisor will review for required licensing and appointment of the RR and suitability before forwarding to the insurance company.
- The application will be returned to the customer with an explanation if the product is not suitable, and a copy sent to the RR.

18.6 Replacements

Responsibility	• Designated Supervisor
Resources	• Insurance applications and order records • Replacement Letters
Frequency	• Daily or as required
Action	• Review insurance transactions to identify potential replacements (simultaneous or contemporaneous purchases and surrenders) • Require Replacement Letters where required • Review for patterns of an RR's customers exercising "free looks" or surrenders of contracts closely timed with the initial purchase • Identify RRs whose customers have a high rate of variable annuity replacements or rollovers and determine whether replacements or rollovers are appropriate for

	the customers • Conduct a review of each 1035 exchange effected by a customer buying an annuity contract considering the customer's age, the cost of the exchange, and what benefit the exchange is to the customer • Review proposed replacement and, if appropriate, sign Letter indicating approval • Notify RR the replacement was not approved and cancel purchase and sale, if necessary.
Record	• Replacement Letters are retained by the Insurance Department with records of the transaction.

The term "replacement" generally refers to the activity of a customer surrendering or altering existing insurance coverage in order to purchase a new insurance policy. Recommendation to a retail customer of a replacement of an insurance product that is a security must comply with Regulation Best Interest (BI) and be justified based on the reasons for the replacement. Considerations include the age of the customer, the cost involved, and what benefit is derived from the replacement.

If the RR is aware of a replacement, certain procedures must be followed, as explained in the following sections.

18.6.1 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 nonforfeiture 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.

18.6.2 Recommending Replacements

The RR must have a reasonable basis for recommending a replacement consistent with Regulation BI addressed in the chapter *REGULATION BEST INTEREST (BI)*. A replacement may not be in the customer's best interest. For example, a customer may incur new fees, extended surrender charge periods, 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:

- 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.

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

18.6.3 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.
- Complete a state replacement form where required (check with the Insurance Department regarding states requiring their own replacement form).
- Obtain the surrendering carrier's original policy or complete a lost policy statement, signed by the customer.
- Complete KCD's Disclosure Letter including signatures of the customer, the RR, and the RR's supervisor
- Send all original paperwork to the supervisor for processing.

18.6.4 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 may be required. The Insurance Department should be contacted regarding questions on 1035 exchanges.

18.6.5 Prohibited Replacement Activities

- It is an unfair practice to persuade an insurance policyholder, through misrepresentation or improper recommendations, to cancel an existing policy and buy a new one ("twisting").
- It is inappropriate to recommend the purchase of multiple insurance contracts, resulting in higher cost to the customer, when one contract will meet the customer's needs.

18.7 Variable Products

[FINRA Rule 2320; FINRA variable annuity site: http://www.finra.org/RulesRegulation/IssueCenter/VariableAnnuities/index.htm]

Responsibility	• Designated Supervisor
Resources	• Reports of transactions (internal or provided by insurance companies) • Applications • Deferred Variable Annuity Worksheet • Communications
Frequency	• As required depending on frequency of transactions
Action	• Collect data to enable supervision and review integrity of internal and third-party (including insurance carriers) information • Review reports and checklists to confirm compliance with requirements and appropriateness of exchanges and buyouts, threshold rates of exchanges and emerging trends across RRs, customers, and offices • Take follow up action, if necessary, which may include conferring with the RR and/or Compliance, conferring with the customer, correct issues of inappropriate transactions which may include canceling a purchase, surrender, or exchange
Record	• Review of reports and checklist with record of review (manual or electronic) and action taken, if any • Review of communications

Variable products are insurance contracts with underlying investments generally in investment company (mutual fund) securities. They are a hybrid of insurance and securities products. There are different types of variable products with differing requirements. Key requirements are listed below; other requirements follow in sections on specific products.

- RRs must have **necessary licensing** to sell variable products, including:
    - securities licensing with an SRO (*i.e.,* FINRA, NYSE)
    - securities licensing in the state where the customer resides (some states waive securities licensing to sell variable products)
    - insurance licensing in the state where the customer resides
- **Supervisors** of RRs who sell variable products **must have required securities supervisory licenses.**
- RRs must be **familiar with features** of variable products before recommending them and explain the features to the customer. Features may include a death benefit, fees and expenses, surrender charges, subaccount choices, special features, market risk, withdrawal privileges, and tax treatment. Each product must be reviewed because features vary considerably.
- **Recommendations to retail customers must comply with Regulation Best Interest (BI)** considering whether features of the product meet the customer's investment needs. Refer to the chapter *REGULATION BEST INTEREST (BI)* for details.
- RRs should inform customers of the various features of recommended variable annuities such as surrender charges, potential tax penalties, various fees and costs, and market risk.
- **If replacing one annuity with another,** a replacement letter or other written justification of the transaction must be submitted and the exchange must be justified including consideration of the following:
    - Age of the customer (particularly seniors 65+) and investment objectives
    - Loss of existing benefits
    - Increased fees or charges

    - Surrender charges or establishment or creation of a new surrender period
    - Consistency of customer liquid net worth invested in the variable annuity with the customer's liquidity needs
    - Whether a share class is in the customer's best interest given his or her financial needs, time horizon and riders included within the preceding 36 months
    - Prior exchanges within the preceding 36 months
- Purchases or exchanges of deferred variable annuities require completion of the **Deferred Variable Annuity Worksheet** which is provided to the supervisor with a copy of the purchase contract and new account information about the customer.
- **Customer signed applications** must be forwarded to the designated person on the day of receipt.
- **Applications for deferred variable annuities must be reviewed and approved by a principal** no later than 7 business days after the OSJ receives a complete and correct application and before sending to the insurance company.
- RRs who are asked to advise regarding buyouts must be familiar with all the features and benefits or risks to customers and document such advice, if provided, in the customer's records.
- There are specific **requirements that apply to advertising and other communications** about variable products, particularly regarding yield, dollar cost averaging, and other representations of return.
- When a **customer redeems an annuity,** a signed redemption form must be submitted with the customer's signature guaranteed.

18.7.1 Training

[FINRA Rule 2330(e)]

Variable products are included in RR training on an ongoing basis and particularly when new products are introduced. The designated supervisor or insurance company will provide necessary training relating to insurance products. Training will be provided at the annual meeting or through CE on variable insurance issues.

18.7.2 General Sales Guidelines

[FINRA Rule 2111]

Responsibility	• Designated Supervisor
Resources	• Insurance contract or other documentation of a proposed or actual purchase • Records of customer's financial information and investment objectives • Information about the insurance product (features, fees, *etc.*) • Records of exchanges from internal reports, reports from insurance carriers
Frequency	• Daily or as required when variable products are sold
Action	• Review variable contract sales for the following: ○ Insurance product objectives consistent with the customer's financial situation or investment objectives ○ Objectives of underlying securities investments consistent with the customer's financial situation and objectives ○ Allocation of monies to subaccounts are consistent with the customer's stated needs and objectives ○ Subaccount transfers are suitable (other than those part of an insurance company's automatic asset allocation and rebalancing program) ○ Contract size that is not disproportionate to the customer's overall net worth or liquid assets (less than 25%)

	◦ Customer is retired, unemployed, or lacks investment experience ◦ Customer is older (>75 years old) and may not be suitable for a long-term investment ◦ Sales to IRAs, retirement plans, or other tax-deferred accounts require review to determine whether purchase is appropriate ◦ "Commission specials" on certain products to determine sales of such products meet sales guidelines and Regulation BI standards • Review exchanges for: ◦ Compliance with Regulation BI ◦ Reasons given for VA exchange should match up with the features of the purchased VA ◦ The customer is told, and understands, the cost of an exchange and any benefits of the switch ◦ Compare all switches done by an RR within a narrow period to determine if the RR differentiated among customers • Confer with the RR to obtain more information regarding a questioned sale or regarding recommendations inconsistent with sales guidelines or Regulation BI standards and suggest alternatives where appropriate • Rescind or block purchases where a purchase would be inappropriate
Record	• Date and initials of the reviewer on a copy of the insurance contract or KCD's other record of insurance sales • Subaccount transfers, including those done on a direct-way basis • Reviews of transactions, subaccount transfers and action taken, if any

There are a number of considerations that should be made when recommending a variable product. Recommendations to retail investors must comply with Regulation Best Interest (BI) including recommendations to transfer investments in subaccounts (other than those that are part of an insurance company's automatic asset allocation and rebalancing program).

- The RR must obtain and document financial information about the customer and the customer's investment objectives.
- Is the proposed recommendation consistent with the customer's investment objectives, both for the insurance component and the objectives of the underlying investments?
- Are the features of the variable product consistent with the customer's objectives and needs (payout phase, periodic payments, death benefit, tax-deferral, *etc.*)?
- What is the customer's need for liquidity and short-term investment? Is a long-term investment suitable for the customer? Older customers typically would not be candidates for annuity investments and recommendations to these persons must be justified.
- What is the customer's investment experience and ability to understand the variable contract and underlying investments?
- What is the customer's immediate need for retirement income?
- Is the customer willing to invest a set amount on a periodic basis?
- Discuss all relevant facts with the customer including liquidity issues; fees and charges; applicable taxes or penalties and surrender charges; and market risk. Fees and charges include surrender charges, mortality and expense risk charge, administrative fees, underlying fund expenses, and other fees and charges.
- Multiple annuities, resulting in higher cost to the customer, should not be recommended when one annuity, or annuities from a family of funds, would meet the customer's investment needs and result in less cost to the customer.
- Use only sales material provided and approved by KCD.

18.7.3 Buyout Offers

[SEC Investor Bulletin re buyouts: SEC.gov | Investor Bulletin: Variable Annuities-Should You Accept a Buyout Offer?]

Responsibility	• Designated Supervisor
Resources	• Buyout offers
Frequency	• As required
Action	• Review documentation including surrender charges, loss of benefits, contract values, riders, cash surrender values, and fees and the suitability of the buyout • Approve or disapprove buyouts and exchanges
Record	• Documentation of buyouts including approval or disapproval

A buyout offer refers to an offer by an insurance company to either: (1) increase your contract value in exchange for giving up a benefit; or (2) increase your cash surrender value in exchange for surrendering your variable annuity. When consulting with the customer, the RR must include the following considerations:

- Buyout offers are optional. The customer has no obligation to accept.
- The customer will lose a particular benefit.
- Buyout offers may include:
    - surrendering the contract for a cash equivalent where the customer may receive an increased surrender value, waiving of penalties, removing the death benefit, reducing the guaranteed minimum income benefit, or tax reduction (with taxes due if the cash equivalent is more than the customer paid for the contract)
    - swap the product for other types of annuities
- The amount of the offer may fluctuate. The insurance company can advise of the current value.
- Is the buyout in the customer's best interest considering age, financial status, and investment objectives?
- Will the customer be subject to a surrender charge?
- If the customer will transfer the cash surrender value to another annuity, will there be a new sales charge, other fees, or new surrender charge period?

Acceptance of customer buyout offers requires documentation justifying the buyout and any replacement and the **prior approval** of the designated supervisor.

18.7.4 Requirements For Specific Products

This section explains requirements that apply to specific variable products.

18.7.4.1 Deferred Variable Annuities

[FINRA Regulatory Notice 09-32 and 07-53]

Responsibility	• Designated Supervisor

	• Compliance
Resources	• Application packages • Deferred Variable Annuity Worksheet + new account information • Records of purchases and exchanges
Frequency	• Supervisor: Review applications within 7 business days of receipt • Compliance: Monthly

Action	• Supervisor:
	  ○ Note date when application is received
	  ○ Review application package for completeness
	  ○ Review Worksheet and new account information for appropriateness of investment
	  ○ Contact RR for more information if necessary and revise or stop the purchase/exchange, if appropriate
	  ○ Within 7 business days of receipt, approve or disapprove the purchase noting date of action taken
	  ○ For disapproved applications, notify RR
	  ○ For approved applications, forward to insurance company
	• Compliance:
	  ○ Review RR activity for patterns of exchanges; review for appropriateness of exchanges if a pattern is detected
	  ○ Identify potential market timing of investments in sub-accounts
	  ○ Confer with RR's supervisor if necessary
	  ○ Take corrective action if necessary which may include added training for RR, changes to customer investments, limiting RR sales of variable products, or other appropriate activity
	  ○ As part of branch or office reviews, determine timeliness of receipt and review of applications

Record	• Supervisor: application packages, Worksheets with notation of date of receipt and date of review and action taken, where appropriate, signature indicating approval/disapproval • Compliance: reports or other records of purchases and exchanges with notation of action taken, where appropriate; office reviews

A variable annuity is a contract between the purchaser and the insurance company whereby the insurer agrees to make periodic payments to the purchaser, beginning either immediately or at some future date. A variable annuity may be purchased by a single payment or through a series of purchase payments. The underlying investment options typically include mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

When offering **deferred variable annuities,** there are specific requirements that apply to the purchase or exchange (not sale or surrender) and the initial subaccount allocations. They also apply to the use of these products to fund IRAs but not sales to certain tax-qualified employer-sponsored retirement or benefit plans unless recommendations are made to individual participants. **The *Deferred Variable Annuity Worksheet* form must be submitted** to the designated supervisor with the customer's contract and a copy of the customer's new account information.

The following lists the requirements that apply when recommending these products.

- **Compliance with Regulation BI must be determined.** This includes a reasonable basis to believe the customer has been informed about material features such as surrender period and charge, potential tax

penalty, mortality and expense fees, charges for and features of enhanced riders, insurance and investment components and market risk. These may be generic disclosure but the RR is also obligated to consider the material features of the specific product.
- **Determine the customer would benefit from certain features** such as tax-deferred growth, annuitization or a death or living benefit. This does not require the customer will benefit from *all* features.
- **The particular deferred variable annuity as a whole and the underlying subaccounts must be suitable.**
- **If the transaction is an exchange from one variable annuity to another, the exchange must be suitable.** Factors that must be considered include whether the customer: (1) would incur a surrender charge, be subject to a new surrender period, lose existing benefits, or be subject to increased fees or charges; (2) would benefit from product enhancements and improvements; and (3) has effected another deferred variable annuity exchange within the preceding 36 months (whether at KCD or another broker-dealer).
- **Make reasonable efforts to ascertain and obtain certain customer information.** This includes the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and other information necessary to make a recommendation.
- **Variable annuities generally are considered to be long-term investments not typically suitable for investors with short-term horizons.** The customer should be aware that withdrawals prior to age 59 1/2 - are subject to tax penalties and many variable annuities assess surrender charges for withdrawals within a specified time period after purchase.
- **Variable annuities cannot be described as "mutual funds."**

18.7.4.1.1 Market Timing

RRs may not facilitate or permit customer engagement in market timing in sub-accounts. Market timing is rapid and repetitive in-and-out trading to take advantage of market movements. Variable annuities are intended for longer-term investing and most (if not all) insurance companies do not permit market timing of investments in sub-accounts.

Engaging in market timing or knowingly aiding someone in that activity in a variable annuity is prohibited.

The RR is responsible for promptly forwarding the completed application package to an Office of Supervisory Jurisdiction (OSJ). The completed application must be reviewed and approved by the designated supervisor within 7 business days of receipt by the OSJ. Incomplete applications will be promptly returned to the RR. If an application is not approved, the RR will be notified. Approved applications will be forwarded by the designated supervisor (or other authorized person) to the insurance company for processing.

18.7.4.2 Multi-Class Variable Annuities

Responsibility	• Designated Supervisor
Resources	• Variable Annuity Worksheets • Order records • Customer account information • Customer communications

Frequency	• Daily: review orders and communications • As required: review Worksheets, approve orders

Action	• Review customer communications for references to variable annuities, accuracy of information
	• Obtain and review Variable Annuity Worksheet
	• Where necessary, review customer account information
	• Review transactions for Regulation BI including:
	  ○ Percentage of VA assets compared to other liquid assets
	  ○ Investors with long-term time horizons
	  ○ Inclusion of riders, consistency with investor's age, investment objectives, impact on costs
	  ○ Cost/benefit disclosure to investors
	  ○ Appropriateness of class for investor such as L-shares which may not be appropriate for investors with long-term investment horizons
	• Conduct training of RRs and supervisors including:
	  ○ Features of alternative classes
	  ○ Riders and impact on costs
	  ○ Appropriateness of classes and riders

Record	• Variable Annuity Worksheets • Reviews, approvals, and action taken, where appropriate • Records of training including date conducted, who attended, subjects included

Some variable annuities are "multi-class" and offer different features depending on the class of the annuity. An example of classes includes the following:

- A Shares: Up-front sales charge, typically no surrender period
- B Shares: Longer surrender period, typically lowest mortality and expense risk (M&E) fees
- C Shares: No surrender period, higher M&E fees
- L Shares: Shorter surrender period, higher M&E fees
- O Shares: No up-front sales charge, surrender period similar to B-Shares, progressively declining M&E fees
- X Shares: "Bonus Shares" or "Premium Enhanced," longer surrender period, moderate M&E fees, up-front bonus investment credit

Different variable annuities may also offer "riders" which are optional add-ons that annuity buyers may choose, usually at extra cost which may be an annual fee. Two popular types of VA living benefit riders are guaranteed minimum withdrawal benefits (GMWBs) and guaranteed minimum income benefits (GMIBs). Riders may or may not pay off depending on how long the customer holds the annuity, the age of the customer, and other factors that must be considered when determining the appropriateness of riders. In particular, long-term income riders may not be appropriate when considering L-shares for investors since L-shares have a shorter-term surrender period.

When recommending multi-class shares, RRs must consider the following:

- Assessing and documenting compliance with Regulation BI
- Education of the customer regarding class options
- Relatively higher M&E fees (one class vs. another)
- Impact of fees on overall returns
- Benefits over other share classes
- Commissions influencing recommendations
- Appropriateness of riders and related cost, potential payback

- Assure customer awareness of fee differentials
- Explanation of rationale for recommendation

Group Variable Annuity Contracts

[FINRA Notice to Members 97-27; FINRA Interpretive Letter dated February 3, 2003 to Marilyn Sponzo]

Responsibility	• Designated Supervisor or Designee
Resources	• Proposed contracts
Frequency	• As required
Action	• Review contract including underlying investments and objectives of the employer's plan
Record	• Group variable annuity contracts

Group variable annuity contracts are designed for employer retirement plans. Insurance companies directly or through broker-dealers contract with an employer to provide variable annuity investments for 401(k), 403(b), 408(k), or other types of retirement plans. The plan is sold to the employer typically with no contact with the employees who participate in the retirement plan.

When offering group plans to employers, RRs must consider the underlying investments, terms of the contract, and the needs and investment goals of the retirement plan.

Variable Life Insurance

Variable life insurance is a life insurance contract with an underlying investment component in securities investments. Variable life contracts include two types of policies: variable whole-life and variable universal life. Both allow the policyholder to invest part of the premium in mutual fund-like investment pools called sub-accounts which often include a broad selection of funds from major mutual fund companies. Variable whole-life policies require fixed premiums; variable universal life policies allow the policyholder to vary payments. Variable life insurance offers a death benefit, similar to traditional life insurance. The cash value generated by the investment element is not guaranteed by the insurance company and can fluctuate depending on the performance of the investments.

- Customers must be advised of the risks of variable life insurance including the risk of loss in the underlying investments which may result in a cash value of the policy that is either too low to maintain the value of the death benefit or will become too low if the policyholder does not pay higher premiums.
- Disclosure documents available for variable life products must be provided to the customer at the time of recommendation. A record should be made of provision of the disclosure document (when and to who provided).
- For variable life insurance contracts, has the customer's need for life insurance already been met?
- RRs should not recommend that customer finance a variable life insurance policy from the value of another insurance policy or annuity, such as through the use of loans or cash values, unless the transaction is otherwise suitable for the customer. It may be difficult to justify such a financing arrangement and the practice is strongly discouraged.

18.7.4.3 Variable Life Settlements

[SEC Investor Bulletin on Life Settlements: http://www.sec.gov/investor/alerts/lifesettlements-bulletin.htm; SEC Life Settlements Task Force, Staff Report to the SEC July 22, 2010: http://www.sec.gov/news/studies/2010/lifesettlements-report.pdf; FINRA Regulatory Notice 09-42; FINRA Notice to Members 06-38]

Responsibility	• Designated Supervisor
Resources	• Proposals from life providers • Life provider contracts including confidentiality policies • Variable life settlement transactions
Frequency	• As required - review a potential life provider • As required - review life provider's promotional material • Daily - review variable life settlement transactions • Annual and ongoing - provide training

Action	• Due diligence of potential life provider:
	    ○ Review contracts and confidentiality policies
	    ○ Determine whether licensing is required and, if required, confirm the provider is licensed
	    ○ Review other available information about the life provider's background, dealings with other firms
	• Review commissions to be charged and subject any above 5% to heightened scrutiny including a written justification of higher commissions
	• Compliance review of sales/promotional materials:
	    ○ Review for reasonableness and avoidance of unwarranted promises or high-pressure sales
	    ○ Submit to FINRA within 10 days of first use
	• Submit proposed related products (derivatives based on life settlements) to the new product review process prior to offering
	• Review of life settlements offered:
	    ○ Review for compliance with Regulation BI
	    ○ Determine 2 or more bids have been obtained and best price provided to customer
	• Review of sales of derivative life settlement products:
	    ○ Review for compliance with Regulation BI

Record	• Due diligence file includes review of life providers • Records of heightened scrutiny of proposed commissions exceeding 5% • Compliance retains copies of sales/promotional materials and record of filings with FINRA • Copies of life settlement transactions • Records sales of derivative products and action taken, if appropriate

"Life settlements" are the sale of existing life insurance policies to third parties. This secondary market for life insurance policies provides a policyholder the opportunity to sell a policy to a third party for less than the net death benefit but more than the cash surrender value. This market provides available cash to individuals who can no longer make premium payments or who need immediate cash. The value of a life settlement depends on different factors including life expectancy and the nature and terms of the policy. Usually the insured sells the policy to a life settlement provider which holds it until the death of the original policy owner and collects the benefits or sells the policy or bundled policies to other investors. Variable life insurance policies are securities subject to the rules and standards that apply to the sale of securities.

There is also a market for "related products" which are derivatives of life settlements that provide an opportunity to investors to purchase derivative securities that invest in life settlements.

18.7.4.3.1 Obligations Involving The Offer Of Life Settlements

The following are obligations when recommending or facilitating the sale of an existing variable life insurance policy to a third party.

- **Sales may be made only to Firm-approved life settlement providers and brokers.** Some jurisdictions require licensing of providers and confidentiality policies may vary. KCD conducts due diligence on accepted life providers to determine they meet standards consistent with customer protection and needs. Sales may only be made through KCD.
- **Understand the product.** As for all products recommended to customers, it is important to understand features of the life settlement being offered and obligations imposed on policyholders such as the requirement to provide notification to the provider of significant medical developments.
- **Use only approved promotional material.** Compliance reviews life provider promotional material prior to use and approves it for distribution to customers.
- **Regulation BI requirements apply.** A variable life settlement may not be suitable for the customer even if the settlement price exceeds the policy's surrender value. Factors to be considered include:
    - The policyholder's need for continued coverage
    - If the policy is to be replaced with another policy, the availability, adequacy, and cost of comparable coverage
    - The customer's financial needs and objectives
    - Tax considerations
- **Explain the product to the customer.** After understanding the product and making a Regulation BI-compliant determination, explain the potential life settlement to the customer. Risks and considerations for an investor considering a life settlement transaction include (but are not necessarily limited to):
    - There may be unexpected tax liabilities (tax treatment of a cash payment may be less favorable than tax treatment of a death benefit paid to a beneficiary).
    - Transaction-related costs may be high, particularly where there are multiple intermediaries.
    - Balancing the need for current income vs. the future financial needs of a beneficiary may be a consideration.
    - The individual may have decreased access to insurance coverage, if needed.
    - The individual's private medical information will be released to intermediaries considering the life settlement.
    - A variable life settlement transaction takes a longer time to complete than a typical securities transaction (weeks vs. days).
    - A transaction may affect eligibility for public assistance programs such as Medicaid.
- **Obtain bids from multiple approved providers.** To obtain the best price for the customer, reasonable effort should be made to obtain two or more bids and document those bids. If two or more bids cannot be obtained, document the reason why.
- **Compensation may only be received from KCD.** Under no circumstances may an RR receive compensation from an insurance company, a life provider, or other outside person or entity.

18.7.4.4 Bonus Products

[FINRA Notice to Members 02-70; FINRA Regulatory and Compliance Alert Summer 2000]

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. RRs must be aware there may be disadvantages and added costs may more than offset the benefit to the customer. For example, as compared to a variable annuity that does not have a bonus feature, there may be higher surrender charges; longer surrender periods; and higher mortality and expense risk charges or other charges. The RR is responsible for understanding the benefits and disadvantages of a bonus product before making a recommendation to a customer.

As part of the designated supervisor's Regulation BI review, bonus products should be considered regarding their overall benefit to the purchasers.

18.7.5 Customer Applications, Payments, And Contracts (Other Than Deferred Variable Annuities)

Responsibility	• Designated Supervisor or Designee
Resources	• Variable annuity applications • Customer payments • Contracts received from issuers
Frequency	• As required when applications and payments are received for processing
Action	• Review application for completeness • Return application to RR or contact RR to obtain missing information, retaining the customer's check in a pending file • Confirm payment is correct for product being purchased • Promptly transmit complete application and customer's payment to the issuer • Forward customer contracts to the customer if received from the issuer
Record	• Maintain record of any applications returned to the RR or requests for additional information forwarded to the RR • Retain copy of application and payment with notation of when forwarded to the issuer, with the reviewer's initials noted on the copy

Applications must be complete and accurate. Upon receipt of an application and payment from the customer, the application must be immediately forwarded to the designated supervisor for review. Application and payment must be immediately transmitted to the designated person upon approval.

18.7.6 Communications With The Public Regarding Variable Products

[FINRA Rule 2210 and 2211; FINRA Regulatory Notice 08-12]

Some public communications require the prior approval of Compliance. Communications that include dollar cost averaging, effective yield, and performance illustrations must meet regulatory guidelines for presenting such information.

18.7.6.1 Retail Communications

Only Firm-approved vendor material may be provided to customers. The Insurance Department is responsible for reviewing vendor materials and confirming FINRA approval has been obtained, where necessary, by the vendor. Copies are retained by the Insurance Department including the date of approval and initials of the reviewer.

Firm-developed retail communications regarding insurance products require 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.

18.7.7 Replacements

It is inappropriate to recommend replacing an existing annuity with a new annuity when there is no reasonable basis or economic justification for making that recommendation (churning) or make misrepresentations to encourage someone to replace an existing contract ("twisting"). RRs are obligated to obtain signed replacement letters or other required disclosure forms when replacing one variable annuity contract with another.

18.7.8 Redemptions

When a customer redeems a variable annuity, the following procedures must be followed:

- Obtain the customer's signature on any required redemption forms
- Follow the "replacement procedures" described earlier, if one annuity is being redeemed to buy another
- Have the customer's signature guaranteed or have the customer obtain a signature guarantee from a bank or other financial institution

18.7.9 Annuity Buybacks

Responsibility	• Designated Supervisor
Resources	• Transaction records
Frequency	• Dependent on availability of reports
Action	• Identify buybacks and review alternative investment for suitability • If less favorable, determine if customer was notified • Cancel or otherwise correct inappropriate transactions
Record	• Record of reviews and action taken

Insurance companies sometimes offer to buy back an investor's variable annuity product. RRs may not recommend the customer accept the buyback unless the customer understands if an alternative variable product has less favorable terms and those terms are disclosed to the customer.

19 ORDERS

This chapter provides policies and guidelines for the entry and handling of customer orders.

- References to "order records" in this chapter includes manual order tickets and electronic order records, where appropriate.
- References to supervisor "initials on orders" or "order records" includes electronic initials or signatures.
- Regulation Best Interest (BI) which applies to retail customers is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

19.1 Acceptance And Prompt Entry Of Orders

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, authorized investment adviser, *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 his wife's account, unless the wife has signed a trading authorization giving her husband authority to act on her behalf.

If an employee 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. Identity verification information would include:

- account number; and
- social security number; or
- other identifying information on record such as mother's maiden name.

RRs are obligated to transmit customer orders to the appropriate order execution desk or order facility promptly after receipt. Orders cannot be held for future entry; a limit order should be entered if the customer does not want to effect the transaction at the current market price.

19.2 Orders Requiring Approval

Responsibility	• Designated Supervisor
Resources	• Order records and available reports
Frequency	• Daily
Action	• Instruct wire operator or other order entry person of orders requiring approval • Have wire operator or order entry person post list in the order entry area • Review and approve or disapprove orders • In review of daily order records or Daily Transaction Report, identify orders requiring approval but not submitted for approval

	• Remind RRs and order entry person of requirement for order approval when exceptions are noted • If problem persists, take additional corrective action
Record	• Initials on order records and reports and notes of action taken, if any

Certain orders require approval because of rule requirements or Firm policy. This section summarizes the orders requiring approval, when approval is required, and the designated supervisor.

ORDERS REQUIRING APPROVAL

Type of Order	When Approval Required	Designated Supervisor
First order for new account	Prior to entry	Branch Manager
Buy or sell order for 10,000 or more shares	Prior to entry	Branch Manager
Buy or sell order for $1,000,000 or more par value of bonds	Prior to entry	Branch Manager
Buy of non-NASDAQ OTC security priced less than $5.00/share	Prior to entry	Branch Manager
Mutual fund switch orders	Same day as entry	Branch Manager
Mutual fund multiple purchases (purchases of multiple unrelated funds in same account)	Same day as entry	Branch Manager
Short sales	Prior to entry	Branch Manager
Discretionary	Same day as execution	Branch Manager
Discretionary option orders	Same day as execution	Compliance
Buy of 25 or more short-term options (options expiring within same month as order entry)	Prior to entry	Branch Manager
Buy of $10,000 or more short-term options	Prior to entry	Branch Manager
Opening option transaction of 100 or more contracts	Prior to entry	Branch Manager
Spread order of 100 or more contracts on the same day (includes group orders)	Prior to entry	Branch Manager
Buy or sell orders for research employee accounts	Prior to entry	Research Manager
Buy or sell orders for Investment Banking employee accounts	Prior to entry	Investment Banking Manager
Buy or sell orders for trading personnel	Prior to entry	Designated Trading Manager

19.3 Solicited And Unsolicited Orders

19.3.1 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.

Regulation Best Interest applies to all solicited orders for retail accounts. Department of Labor 3.0 applies to solicitations for ERISA accounts and rollovers. See the section *Pension And Retirement Accounts* in the chapter *ACCOUNTS*.

19.3.2 Solicited Orders Should Be Indicated

Customer orders that are solicited should be so marked on the order record for the transaction.

19.3.3 Prohibited Solicitations

Responsibility	• Designated Supervisor
Resources	• Order records • Available reports
Frequency	• Daily
Action	• Instruct wire operator or other order entry person to watch for orders in restricted securities or other prohibited solicited orders • Identify orders contrary to solicitation limitations • If prohibited solicitations are identified, take corrective action: ○ Solicitations contrary to KCD's Restricted List may require cancellation; contact Compliance for guidance ○ Other exceptions may require different actions including cancellation of the transactions, removal of commissions, reminder to RRs, *etc.*
Record	• Initials on order records • Initials on available reports • Records of cancelled trades maintained with daily orders • Other records as appropriate (reminder memo to RR, notes to Branch Manager Log, *etc.*)

RRs may NOT solicit transactions listed below:

- [prohibited orders/securities]

19.4 Suitability And Regulation Best Interest Recommendations

[FINRA Rule 2111; SIFMA Institutional Suitability Certificate: http://www.sifma.org/services/standard-forms-and-documentation/cross-product/]

Responsibility	• Designated Supervisor
Resources	• New account records • Order records • Transaction reports • Other available reports

<table>
<tr><td></td><td>Customer monthly transaction records
Institutional Suitability Certificates</td></tr>
<tr><td>Frequency</td><td>Daily - review transactions
Monthly - review of accounts
When required - review/approve new accounts
Periodically - training for RRs</td></tr>
<tr><td>Action</td><td>
Obtain Institutional Suitability Certificates from institutional customers
Where an institutional account fails to provide the Certificate, flag the account noting the form is not on file
Where the institution does not affirm its independence for all investments, flag the account regarding what investments are or are not affirmed
Review customer orders for suitability (other than those excepted) which includes factors among those listed below and other information known about the customer:
Customer new account information
Other securities held in the customer's account
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 transaction reports and monthly transaction records
Information obtained from the RR
Information obtained by contacting the customer
Improper trading including excessive trading (also see the section Churning in this chapter) and excessive/short-term trading of long-term products
Concentration of a security in one account or multiple accounts (also see the section Concentrations in the chapter ACCOUNTS)
Review recommended orders for compliance with Regulation BI [see the chapter REGULATION BEST INTEREST (BI)] and DOJ 3.0 (if applicable)
Refer to new account records when necessary to identify investment objectives and other customer information
Review suitability documentation recorded by the RR and pertaining to a recommended investment or strategy
Where investment profile information is incomplete, contact the RR to obtain further information or if none is available, determine whether there is a reasonable basis for making recommendations
For "hold" recommendations, confirm the RR has included adequate documentation
Where there are suitability questions:
Confer with RR regarding suitability questions
Confer with Compliance when necessary
Contact customer when necessary to confirm customer's understanding of and agreement with transactions
Modify or restrict future transactions, as appropriate
Compliance: if KCD uses portfolio or analytic tools or models, review and confirm whether the tools make recommendations subject to the suitability rule, and communicate obligations to RRs
Train RRs regarding suitability obligations
</td></tr>
<tr><td>Record</td><td>Initials or other record of review on order records and reports
Institutional Suitability Certificates</td></tr>
</table>

	• Suitability documentation on order records or in RR records • Compliance: record of reviews of portfolio or analytic tools and communications with RRs about suitability obligations (if applicable) • Training including who attended, when it occurred, and subjects included

19.4.1 General Requirements

The requirements of the suitability rule do NOT apply to recommendations subject to Regulation Best Interest (SEC Rule 15l-1). Regulation BI applies only to recommendations to "retail customers." Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). For those recommendations not subject to Regulation BI, this section outlines suitability requirements. In addition, where recommendations of products/services included in this section are made to retail investors, the reader should presume that Regulation BI applies (see the chapter *REGULATION BEST INTEREST (BI)*).

RRs must have a reasonable basis for believing that a recommended transaction or investment strategy involving a security or securities is suitable for the customer. Recommendations should be based on information obtained through reasonable diligence to ascertain the customer's investment profile which is recorded in the account records, generally at the time the account is opened and updated when necessary. The 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 in connection with the recommendation.

Suitability is only one element of acting in a customer's best interest. Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI) which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

There are exceptions to suitability obligations when dealing with certain institutional accounts as discussed in the following section *Institutional Accounts*. Note that FINRA's description of institutional accounts includes certain natural persons under the suitability rule. Regulation BI applies to ALL natural persons.

19.4.1.1 Investment Strategy

[FINRA Rule 2111.03]

"Investment strategy" is defined in FINRA rules to include, among other things, an explicit recommendation to hold a security or securities. However, the following communications are excluded as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

a. General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (*e.g.,* equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) assessment of a customer's investment profile;
b. Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan;
c. Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor's assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with FINRA Rule 2214 (Requirements for the Use of Investment Analysis Tools) if the asset allocation model is an "investment analysis tool" covered by FINRA Rule 2214; and

d. Interactive investment materials that incorporate the above.

19.4.1.2 Components Of Suitability Obligations

[FINRA Rule 2111.05]

As excerpted from the suitability rule, there are three main obligations when making a recommendation: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

a. The reasonable-basis obligation requires a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security or investment strategy and KCD's or RR's familiarity with the security or investment strategy. Reasonable diligence must provide an understanding of the potential risks and rewards associated with the recommended security or strategy. The lack of such an understanding when recommending a security or strategy violates the suitability rule.
b. The customer-specific obligation requires a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile which includes 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.
c. Quantitative suitability refers to avoiding excessive activity and requires a firm or RR who has actual or de facto control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile. No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for finding a violation of the quantitative suitability obligation.

Another approach to suitability is portfolio-based that considers the entirety of an investor's investments (or at least those known to the RR). Where a customer has multiple accounts with KCD and those accounts have inconsistent investment objectives, it is necessary to confirm the customer's intent to use different investment profiles or factors for the different accounts. Notation should be made to the customer's account record and on the order record or the recommendation.

19.4.1.3 Customer Financial Ability

[FINRA Rule 2111.06]

Rule 2111 prohibits recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities unless the member or associated person has a reasonable basis to believe that the customer has the financial ability to meet such a commitment.

19.4.1.4 Specific vs. General Recommendations

Suitability obligations apply to specific recommendations as opposed to general investment advice (*i.e.,* a recommendation generally to invest in fixed income securities vs. recommending a specific bond). However, recommending a specific strategy (such as use of a bond ladder, day trading, margin, *etc.*) would be subject to suitability obligations. The narrower the scope of the recommendation, the more likely it is subject to suitability obligations.

19.4.1.5 Allocation Models And Educational Materials

To avoid suitability obligations, allocation models or educational materials cannot include recommendations of particular securities such as those comprising the asset allocation model. An explicit recommendation to "hold" specific securities in an asset allocation model constitutes a recommendation. FINRA has indicated that as an allocation recommendation becomes narrower and more specific, suitability obligations may apply. Compliance must review and approve any models or analytic tools **prior to** use.

19.4.1.6 Hold Recommendations

Suitability obligations apply to recommendations to hold a security or securities or to continue to use an investment strategy, even if the RR did not recommend the original purchase. RRs should disclose and document (on the order record or the RR's records) that the hold recommendation is based on relevant factors known at the time of the recommendation only, and that continued monitoring or recommendations will not occur (if that is the case). Some hold recommendations should be documented including those for shorter-term investments; those that have a periodic reset or similar mechanism that could alter the investment's character over time; those that are particularly vulnerable to market conditions; or those that are otherwise potentially risky when the recommendation is made. For example, risky investments may include leveraged ETFs, mortgage REITs, an issuer facing significant financial or other material risks, an over-concentrated position, and a security inconsistent with the customer's investment profile. These hold recommendations should be documented in the RR's records.

19.4.1.7 Orders For Direct Listings

[FINRA Regulatory Notice 18-11]

Exchanges may permit the direct initial listing of shares by an issuer where such listing is not accompanied by a concurrent underwritten offering (sometimes called a "direct listing"). There is no established public market for the security and a prior public market price does not exist. There may be volatility and variance in the opening price and subsequent prices after listing.

RRs should not recommend and enter unpriced orders at and around the opening on the first day of trading of a direct listing of a security unless the risks have been clearly explained to the customer. A limit price order may be more appropriate to avoid filling the order at prices beyond the customer's reasonable expectation.

19.4.1.8 Improper Trading Of Long-Term Products

It is improper to recommend the short-term trading of long-term products (such as mutual funds, closed-end funds, variable annuities and UITs). Recommending early UIT rollovers to increase sales credits is a violation of suitability requirements.

19.4.1.9 Documenting Suitability

It is important to document suitability, particularly where there may be differing investment profiles when a customer has multiple accounts and when recommending a complex product. RRs should document the basis of their recommendations on the order record and/or in the RR's records such as Daytimers, electronic records, *etc.*

19.4.1.10 Understanding Recommended Investments

It is important that the RR understands the investment being recommended. KCD provides training and/or other materials to describe the features of certain investments offered by KCD.

If the RR does not understand a security or investment strategy, it is the RR's obligation to contact his or her supervisor, the product manager, or Compliance to receive further information before making a recommendation.

19.4.2 Non-Conventional Investments (NCIs)

[FINRA Notice to Members 03-71]

Responsibility	• Designated Supervisor
Resources	• Non-conventional investments and related information
Frequency	• As required
Action	• Conduct due diligence about the product • Prepare or obtain disclosure information for prospective investors • Review customer transactions in NCIs for suitability • Confirm required disclosure documents were provided • When necessary, consult with RR regarding suitability • When necessary, contact customer to confirm suitability and/or cancel transaction if purchase is inappropriate
Record	• New product due diligence information is retained by the Firm. • Written disclosures, when available, are retained in the product file. • Written subscription agreements or other investor agreements are retained in the product file or the customer's file. • Records of training material or programs are retained in the product file and/or Continuing Education files or compliance meeting files. • Record of review of transactions is included in order records.

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 asset-backed securities, distressed debt, and derivative products may warrant closer scrutiny to determine suitability of the security for the specific potential investor.

The RR recommending a non-conventional investment 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 also obtain signed subscription or other agreements from NCI investors, where required.

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.

Features of some hybrids include the following:

- Bonds designed for individual investors tend to carry a low face value, usually $25 or $50 rather than $1,000 value on bonds for institutional investors.
- The bond's terms may include deferral of interest payments because of changes in rates or other factors included in the bond's terms.
- Hybrids tend to have a fixed maturity, with very long maturities (*i.e.,* 50 years or more) which makes the securities assume risk similar to stock.
- Like stockholders, hybrid holders are at greater risk of receiving nothing if the issuer files for bankruptcy protection.
- Regulators and debt-rating services differ on whether hybrids should be booked and treated like bonds or stocks.
- The myriad of variations make it hard to determine the value of the securities and gauge their risk.

19.4.3 Institutional Accounts

[FINRA Rule 2111(b), 2111.07 and 4512(c); SIFMA Institutional Suitability Certificate: http://www.sifma.org/services/standard-forms-and-documentation/cross-product/]

There is an exemption from customer-specific recommendation obligations when recommendations are made to institutional customers defined by Rule 4512(c). Factors to consider when determining the scope of KCD'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 institutional customer's affirmation indicating that it is exercising independent judgment in evaluating the recommendations. An institutional customer may indicate that it is exercising independent judgment on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account. Institutional accounts will be requested to provide the Institutional Suitability Certificate to comply with the exemption.

Where an institutional customer has delegated decision making authority to an agent, such as an investment adviser or a bank trust department, these factors are applied to the agent.

Where an RR has reason to believe an institutional investor is not capable of understanding an investment or making an independent decision, the RR is obligated to make a specific suitability determination and should note this action on order records, in the RR's records, or in the account's records.

19.4.4 OTC Equity Securities

[FINRA Rule 2114; FINRA Regulatory Notice 21-03]

Responsibility	• Designated Supervisor
Resources	• Order records and available reports • OTC Equity Securities Reg BI Review Forms • Deposits of large blocks of low-priced securities
Frequency	• Daily - review transactions for potential solicitations in low-priced securities (microcap) and deposits of large blocks

	• As required - review Forms
Action	• Review orders marked "unsolicited" for patterns that may indicate solicitation • Review daily transactions to identify solicited transactions in OTC equity securities for compliance with FINRA rules and applicable laws including red flag indicators of potential fraud • Monitor proprietary and customer accounts of RRs who primarily trade in low-priced securities • Identify and, if necessary, monitor accounts held by certain accounts and seniors for unusual purchases • Identify and monitor accounts including omnibus or DVP/RVP accounts that are liquidating low-priced securities to address engaging in an unregistered securities offering • Monitor for groups of accounts trading in the same low-priced security at the same time • Review for indications of stock promotion activity • Identify red flags such as pump-and-dump schemes; news of stock promotion campaigns; significant price and volume spikes; manipulative trading (pre-arranged trades and marking the close in thinly-traded securities) • For identified transactions, determine whether a Form was previously submitted and approved • Review deposits (physical and electronic) of microcap securities to determine compliance with or exemptions from registration requirements • For non-approved transactions, consult with Compliance regarding corrective action which may include cancellation of transactions • For submitted Forms, review financial statements, determine required information is included with the Form, approve or disapprove, and notify the RR • Include low-priced securities in training
Record	• Records of daily reviews are included on order records and/or available reports including the reviewer's initials and date of review and any action taken • Copies of Forms with attachments • Records of training

Recommendations to purchase or sell short OTC equity securities require completion of KCD's OTC Equity Securities Reg BI Review Form **prior to** making the recommendation. Securities not subject to this requirement are listed in *Exemptions* at the end of this section. An "OTC equity security" is defined as any non-exchange-listed security and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting.

OTC equity securities as defined in this section often trade at low prices and may represent a higher risk to the purchaser depending on where and how the security trades. For example, a thinly-traded OTC stock may be subject to volatile price changes and may be difficult to liquidate. There is added risk when the security is purchased on margin, since some of these securities may be difficult to liquidate. Customer trading in low-priced and microcap securities may also be an indicator of money laundering, depending on the scope and size of the trading. Any suspicious trading should be reported immediately to Compliance.

19.4.4.1 Low-Priced And Microcap Securities

These securities are subject to scrutiny because of potential risks, including the following. The SEC has identified "microcap securities" subject to their scrutiny as stocks of companies with a market capitalization of under $250 million. Some of these reviews are included in chapters specific to those activities (trading, research, *etc.*). Following are concerns and actions regarding low-priced securities.

- Identify customer's occupation or business to request additional information such as whether the customer is employed by a company that issues low-priced publicly-traded securities that will be deposited in the customer's account;
- Heightened supervision of Firm employees who maintain direct or indirect outside business activities associated with microcap and OTC companies;
- Heightened supervision of traders involved in trading microcap and low-priced OTC securities;
- Ensure that any research for microcap and low-priced OTC companies produced by KCD is accurate and balanced, and appropriately discloses risks to investors;
- Monitor customer accounts liquidating microcap and low-priced OTC securities to ensure, among other things, that KCD is not facilitating, enabling or participating in an unregistered distribution in violation of Section 5 of the Securities Act, among other potential violations including market manipulation (pump and dump schemes);
- Where there are significant purchases (>5,000 shares), conduct reasonable investigation into each microcap company which may include the company's regulatory history, the company's financial and reporting status, the disciplinary, criminal, and civil litigation backgrounds of the company's officers, directors and principal shareholders, along with the trading history of the company's securities covering issues related to spikes in price and/or spikes in volume, and any associated promotional programs, *etc.*;
- Heightened supervision of Firm activities where an affiliate of KCD is the transfer agent for the microcap or low-priced OTC securities; and
- Monitor RR solicitations of customers to trade microcap and low-priced OTC securities to ensure that any recommendations are balanced and the securities are suitable for the customer.

19.4.4.2 Red Flag Potential Indicators Of Fraud

FINRA Regulatory Notice 21-03 includes an extensive list of indicators which are not reprinted here. The Notice should be referenced for this information including covering issuers, customers, and third-party promotional activities.

19.4.4.3 OTC Equity Securities Suitability Determination

RRs have a higher obligation to determine suitability when recommending the purchase or short sale of OTC equity securities. This includes obtaining current financial statements (balance sheet, P&L, *etc.*) and "current material business information" which includes information available that relates to material events that occurred in the 12 months prior to the recommendation. "Current material business information" is defined as information that is ascertainable through the reasonable exercise of professional diligence and that a reasonable person would take into account in reaching an investment decision. If the issuer is delinquent in its filings (SEC, foreign authority, bank, or insurance regulator), an inquiry must be made about the circumstances about the failure to make current filings.

Prior to recommending a security subject to this policy, the RR is required to complete a copy of the OTC Equity Securities Reg BI Review Form and submit the form and the required financial statements and material business information (and information if the issuer is delinquent in its filings) for review and approval by the RR's designated supervisor. Upon approval, the RR may recommend the security to customers. Failure to complete the Form and obtain the required approval may result in cancellation of the transactions and assessment of resulting losses to the RR.

19.4.5 Investing Liquefied Home Equity

[FINRA Notice to Members 04-89]

Increasing home prices and refinancings 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?

The following is required **prior to** recommending investing home equity funds:

- Provide the Investing liquefied home equity disclosure
- Liquefied home equity may not be invested on margin
- Liquefied home equity may not be invested in options
- Withdrawal of home equity may not exceed 50% of the home's value
- The RR's supervisor must approve the liquefying of home equity and resulting investment
- Disclose that the firm or an affiliate will earn fees from the refinancing
- Disclose that the firm will earn fees or other remuneration from referring the investor to a third party for liquidation

19.5 Fair Prices

[FINRA Rule 2121]

Responsibility	• Designated Supervisor
Resources	• Order records • Transaction reports
Frequency	• Daily
Action	• Review orders and available reports to identify commission or mark-ups/mark-downs that are inconsistent with Firm guidelines • Where necessary, take corrective action which may include canceling/rebilling the transaction to correct charges, consult with the RR if charges were initiated by him/her, notify trading personnel of inconsistent charges, or consult with Compliance
Record	• Orders records/reports with notations of review and any corrective action taken

KCD is required to make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.

For mark-ups/mark-downs of debt securities (other than municipals), refer to the section *Mark-Up Policy* in the chapter *CORPORATE FIXED INCOME SALES AND TRADING*.

19.5.1 Mark-Up Policy

[FINRA Rule 2121.01]

Following is FINRA's Mark-Up Policy in Rule 2121.

19.5.1.1 General Considerations

1. The historical "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.

19.5.1.2 Relevant Factors

Relevant factors to consider when determining the fairness of a mark-up are as follows:

1. **The Type of Security Involved:** Some securities customarily carry a higher mark-up than others. For example, a higher percentage of mark-up customarily applies to a common stock transaction than to a bond transaction of the same size. Likewise, a higher percentage applies to sales of units of direct participation programs and condominium securities than to sales of common stock.
2. **The Availability of the Security in the Market:** In the case of an inactive security, the effort and cost of buying or selling the security, or any other unusual circumstances connected with its acquisition or sale, may have a bearing on the amount of mark-up justified.
3. **The Price of the Security:** While there is no direct correlation, the percentage of mark-up or rate of commission generally increases as the price of the security decreases. Even where the amount of money is substantial, transactions in lower priced securities may require more handling and expense and may warrant a wider spread.
4. **The Amount of Money Involved in a Transaction:** A transaction which involves a small amount of money may warrant a higher percentage of mark-up to cover the expenses of handling.
5. **Disclosure:** Any disclosure to the customer, before the transaction is effected, of information which would indicate (A) the amount of commission charged in an agency transaction or (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 which is unfair or excessive in light of all other relevant circumstances.
6. **The Pattern of Mark-Ups:** While each transaction must meet the test of fairness, FINRA believes that particular attention should be given to the pattern of a member's mark-ups.
7. **The Nature of the Member's Business:** FINRA recognizes there are differences in the services and facilities which are needed by, and provided for, customers of members. If not excessive, the cost of providing such services and facilities, particularly when they are of a continuing nature, may properly be considered in determining the fairness of a member's mark-ups.

19.5.1.3 Applicability Of Policy

The Policy applies to all securities, whether oil royalties or any other security, in the following types of transactions:

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

The Mark-Up Policy is not applicable to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price.

19.5.2 Prohibition Against Trading Ahead Of Customer Orders

[SEC Regulation NMS Rule 600(b)(30)(ii); FINRA Rule 5320; FINRA Regulatory Notice 22-04]

Responsibility	• Designated Supervisor
Resources	• Order records/reports
Frequency	• Periodically: Review exception report thresholds • Reviews: daily, weekly or monthly depending on reports available • Disclosures: when account opened and annually
Action	• Review for order protection • Provide disclosures (institutional accounts, no-knowledge exception) at account opening and annually thereafter
Record	• Order records/reports including date reviewed, reviewer's initials, action taken, if appropriate • Records of providing disclosure at account opening and annually • Equity Trading Manager Checklist

A FINRA member firm that accepts and holds an order in an equity security from its own customer or the customer of another broker-dealer without immediately executing the order is prohibited from trading that security on the same side of the market for its own account at a price that would satisfy the customer order, unless it immediately executes the customer order up to the size and at the same price or better price at which it traded for its own account. Pending orders are executed on a first-in/ first-out basis (FIFO). "Customer order" in this section applies to orders for KCD's customers as well as customers of other broker-dealers.

The rule restrictions apply to orders handled during normal market hours and outside normal market hours (if KCD and customer agree to processing the order outside normal market hours).

19.5.2.1 Minimum Price Improvement Standards

A proprietary order is subject to minimum price improvement standards to execute the order on a proprietary basis when holding an unexecuted limit order in that same security is not required to execute the held limit order. Refer to FINRA Rule 5320.06 for details of minimum price improvement standards.

KCD has no proprietary products to offer.

19.5.2.2 Order Handling Procedures

KCD must make every effort to execute a marketable customer order that it receives fully and promptly. When KCD holds a customer order that is marketable and has not been immediately executed, it must make every effort to cross such order with any other order received by KCD on the other side of the market up to the size of such order at a price that is no less than the best bid and no greater than the best offer at the time that the subsequent order is received by KCD and that is consistent with the terms of the order. In the event that KCD is holding multiple orders on both sides of the market that have not been executed, KCD must make every effort to cross or otherwise execute such orders in a manner that is reasonable and consistent with the objectives of Rule 5320 and with the terms of the orders. KCD can satisfy the crossing requirement by contemporaneously buying from the seller and selling to the buyer at the same price.

19.5.2.3 Exceptions

There are certain exceptions to the prohibition against trading ahead of customer orders.

Large orders and institutional accounts. Regarding orders for institutional accounts [as defined in FINRA Rule 4512(c)] or orders of 10,000 shares or more (unless the orders are less than $100,000 in value), KCD may trade a security on the same side of the market for its own account at a price that would satisfy the customer order providing KCD has provided clear and comprehensive written disclosure to the customer when the account is opened and annually thereafter that:

- Discloses that KCD may trade proprietarily at prices that would satisfy the customer order, and
- Provides the customer with a meaningful opportunity to opt in to the Rule 5320 protections with respect to all or any portion of the order. If the customer doesn't opt in to the Rule 5320 protections, KCD will presume the customer has consented to the exception. In lieu of written disclosure, KCD may provide oral disclosure and obtain the customer's consent on an order-by-order basis, which will be documented on the order for which consent is obtained.

Instead of written disclosure at account opening and annually after, oral disclosure may be made and consent obtained on an order-by-order basis and recorded on the order.

No-knowledge exception. Regarding NMS stocks and where KCD has effective internal controls and information barriers that prevent one trading unit from obtaining knowledge of customer orders held by a separate trading unit, the other trading units may, in a proprietary capacity, continue to trade at prices that would satisfy the customer orders held by the separate trading unit. A description of how customer orders are handled and when KCD's proprietary account may trade at prices that would satisfy the customer's order will be provided at account opening and annually thereafter. For OTC equity securities where KCD has similar controls to prevent a non-market-making trading unit from obtaining knowledge of customer orders held by a separate trading unit, the non-market-making trading unit may trade in a proprietary capacity at prices that would satisfy the customer's order.

Riskless principal exception. Rule 5320 obligations do not apply to KCD's proprietary trades if the trades are for the purpose of facilitating the execution, on a riskless principal basis, of an order from a customer ("facilitated order") providing that KCD:

- Identifies the order as riskless principal when reporting to FINRA (or other SRO); and
- Has written policies and procedures for compliance with FINRA rules regarding riskless principal transactions. Refer to the section *Riskless Principal Transactions* in this chapter.

ISO exception. The restriction against proprietary trades ahead of customer orders does not apply to trading for KCD's account that is the result of an ISO (Intermarket Sweep Order) routed in compliance with Regulation NMS where the customer order is received after KCD routed the ISO.

Odd lot and bona fide error transaction exceptions. The restrictions do not apply to a proprietary trade that is (1) to offset a customer order that is in an amount less than a normal unit of trading; or (2) to correct a bona fide error.

19.5.3 Front Running Of Block Transactions

[FINRA Rule 5270]

Knowingly trading ahead of block orders is a manipulative activity that violates securities rules. KCD and its employees are prohibited from entering or executing an order to buy or sell a security or related or underlying financial instrument when KCD or an employee has knowledge of material, non-public information about an imminent block transaction in that security or related or underlying financial instrument (stock, option, warrant, *etc.*). The prohibition applies until the information has been made publicly available or has otherwise become stale or obsolete.

This applies to executions in any account where KCD or an employee has an interest, has discretionary authority, or for accounts of customers or affiliates of KCD when the customer or affiliate has been provided the block information by KCD or an employee.

"Related financial instrument" means any option, derivative, security-based swap, or other financial instrument overlying a security where the value of the security is materially related to, or otherwise acts as a substitute for, the security, as well as any contract that is the functional equivalent of a position in the security.

"Block transaction" means a transaction involving 10,000 shares or more of a security, underlying security, or related financial instrument.

Exceptions include:

- Transactions where KCD has information barriers to prevent disclosure of information
- Transactions in the same security related to a prior customer order in that security
- Transactions to correct bona fide errors
- Transactions to offset odd-lot orders
- Facilitation of block orders (with conditions in the Rule)

Though the Rule specifically applies to block transactions, front running of other orders is not permitted where the interests of KCD or an employee are placed ahead of the interests of the customer or where misuse of information about an imminent order violates other rules. Refer to FINRA Rule 5270 for specific details regarding the prohibition.

19.5.4 Best Execution

[Exchange Act Regulation NMS; FINRA Rule 5310; FINRA Regulatory Notice 21-23 and 15-46]

KCD has an obligation to provide best execution for its customers' orders, whether executed internally or routed to other broker-dealers. "Best execution" refers to using reasonable diligence to determine the best market to buy or sell a security and obtaining a price as favorable as possible under prevailing market conditions. KCD's obligation to provide best execution also extends to handling and executing orders for customers of other broker-dealers routed to KCD (but not orders that simply execute the order against KCD's quote).

Factors for using "reasonable diligence" include:

- the character of the market for the security, *e.g.,* price, volatility, relative liquidity, and pressure on available communications;
- the size and type of transaction;
- the number of markets checked;
- accessibility of the quotation; and
- the terms and conditions of the order.

The term "markets" is broadly defined, including market centers that are trading a particular security.

19.5.4.1 Regular And Rigorous Review Of Execution Quality

[FINRA Rule 5310.09; FINRA Regulatory Notice 22-04]

Responsibility	• Designated Supervisor
Resources	• KCD's Rule 605 Market Center Reports • Order records/reports for customer and proprietary accounts • Clearing firm or other agent's report of statistics, review rationale, findings (if applicable)
Frequency	• Quarterly

Action	• Conduct regular and rigorous reviews of internal executions (if applicable) and order routing to evaluate compliance with best execution responsibilities including:
	  ○ Review of data regarding prices and executions on a security-by-security and type of order basis
	  ○ For externally routed orders, the standard of review applies only to KCD's initial determination whether to route an order
	  ○ For internalized orders, conduct reviews on an order-by-order basis
	  ○ Compare execution quality under existing routing and execution arrangements (including internal and affiliates) to the quality of executions from competing markets including off-exchange trading venues
	  ○ Address conflicts of interest in routing orders to affiliated entities and market centers that provide payment for order flow (PFOF) or other BD's customer orders for which KCD provides PFOF
	  ○ Consider information leakage when sending orders to other dealers for execution by directly entering orders to an exchange where KCD has a membership; routing to a broker who is a member of the exchange; or using independent (not bank or BD owned) third party algorithmic trading and routing services
	  ○ Considerations for equity securities (includes non-marketable limit orders as well as market and marketable limit orders):
	    ▪ the price obtained
	    ▪ the extent to which an order may obtain price improvement at

	other venues ▪ the likelihood the order will be partially or fully executed ▪ the speed of execution; the size of the execution ▪ transaction costs ▪ customer needs and expectations ○ Review pre-open orders including single or midpoint pricing as factors to consider ○ Review of aggregate or order-by-order routing of orders to review quality of executions ○ If filters are used, periodically reevaluate their use and determine whether to lift them upon request ○ Determine whether to adjust order routing to improve executions ○ Review riskless principal transactions; customer block-sized orders; orders with special pricing terms and conditions; other order types • Where order flow is routed to a BD acting as agent for KCD (clearing firm, other executing BD): ○ Obtain other BD's report of statistics, rationale of review, and findings ○ Review data to confirm agent is using reasonable diligence to provide best execution ○ Where deficiencies are noted, consult with agent and, if best execution is determined to be deficient, consider transferring order flow to another BD • Confirm exception/surveillance reports accurately reflect measures of best execution including current markets, routing practices, and prompt executions
Record	• Records of reviews of internal or routed customer orders, if applicable • Records of reviews of agent's best execution reviews, action taken, if applicable • Review of exception/surveillance report parameters and changes effected

KCD conducts regular reviews of its execution quality to determine whether KCD is meeting its obligation for best execution of customer orders. This includes orders that are routed to other broker-dealers on an automated, non-discretionary basis as well as when KCD internalizes order flow.

Where KCD routes its order flow to another broker-dealer that has agreed to handle that order flow as agent for the customer (*e.g.,* a clearing firm or other executing broker-dealer), KCD will rely on that broker-dealer's regular and rigorous review based on the statistical results and rationale of the review disclosed by the broker-dealer and reviewed by KCD.

19.5.4.2 FINRA Guidelines

The following summarizes guidelines published by FINRA; see Regulatory Notice 15-46 for more detailed information.

- Consider whether any material differences in execution quality exist among the markets trading the security.
- Consider what procedures would be used for executing the same or similar transactions for firm accounts, even if such procedures are not required to be the same.
- A firm that routinely routes a customer order to multiple trading centers (internal or external) should regularly review the execution quality that results from this practice.
- A firm that limits its review of execution quality only to those markets to which it currently routes customer order flow without considering competing markets would not satisfy the duty of best execution. Accordingly, the firm must compare the quality of the executions it is obtaining via current order routing and execution arrangements (including the internalization of order flow) to the quality of the executions that it could obtain from competing markets.

- Some firms may employ "filters," which generally refers to automated tools that allow the firm to limit its trading, with, for example, specific parties or parties with specified attributes with which it does not want to interact. If a firm uses filters on counterparties or filters on specific securities intended to limit accessing bids or offers in those securities, they may be used only for a legitimate purpose consistent with obtaining the most favorable executions for customers, and should be reviewed on a periodic basis and adjusted as needed.
- A firm must take into account market and technology changes that might alter its best execution analysis.
- With respect to customer limit orders for equity securities, a firm must consider any material differences in execution quality (*e.g.,* the likelihood of execution) among the various markets to which orders may be routed.
- An introducing firm may rely on the executing firm's regular and rigorous review of execution quality for any security, so long as the executing firm fully discloses the statistical results and rationale of its review to the introducing firm, and the introducing firm reviews both the methodology and the results of that review.
- Access fees charged by venues and payment for order flow cannot interfere with the firm's obligation to provide best execution. Decisions regarding using venues with access fees and receiving payment for order flow must be made in the context of reviewing all venues/markets for best execution.
- A firm that is handling an unsolicited directed order is not required to make a best execution determination regarding the market of execution beyond the customer's specific instructions. The firm does have an obligation to process the customer's order promptly and in accordance with the terms of the order. If the order is routed to another BD, the receiving BD is obligated to meet best execution requirements. If the firm is unable to route the order per the customer's instructions, the customer must be informed and provided the opportunity to revise or cancel the order.

19.5.5 Automatic Execution Of Orders

KCD may provide automatic execution of orders that qualify for execution through its internal system.

19.5.5.1 Use Of Automated Execution During Extreme Market Conditions

[FINRA Notice to Members 99-12]

In times of extreme market conditions where there may be large order imbalances and/or significant price volatility, the following procedure(s) will be followed:

- Orders will revert to a manual execution mode.
- Executions will be assigned on a first-in/first-out basis.
- Orders will be routed to an alternative market or trading system.
- Partial executions will be provided up to a specified size.

KCD will provide disclosure to customers (and order entry firms) of alternative handling of orders during extreme market conditions.

19.6 Regulation NMS

Regulation NMS was adopted to strengthen the national market system for equity securities. It requires markets to interact in a way that permits orders to seek the best available market. Rule 611, the Order Protection Rule, is the primary rule that affects broker-dealers and requires broker-dealers to prevent "trade-throughs."

19.6.1 Key Definitions

[SEC Regulation NMS Rule 600]

Automated trading center: a trading center that:

- has implemented systems, procedures and rules to display automated quotations in compliance with Regulation NMS;
- identifies all quotations other than automated quotations as manual quotations;
- immediately identifies its quotations as manual quotations whenever it has reason to believe it is not capable of displaying automated quotations; and
- has adopted reasonable standards limiting when its quotations change from automated to manual quotations, and vice versa, to defined circumstances that promote fair and efficient access to its automated quotations.

Directed order: a customer order that the customer specifically instructs the broker or dealer to route to a particular venue for execution.

Intermarket sweep order (ISO): a limit order for an NMS stock that meets the following requirements:

- When routed to a trading center, the limit order is identified as an intermarket sweep order; and
- simultaneously with the routing of the ISO limit order, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of limit order to buy, for the NMS stock with a price that is superior to the limit price of the ISO limit order. These additional routed orders also must be marked "ISO."

An ISO is premised on the condition that the trading center or broker-dealer responsible for routing the ISO will have attempted to access all better-priced protected quotations. This exception facilitates the execution of certain types of orders, such as large block orders.

Market center: any exchange market maker, OTC market maker, alternative trading system, national securities exchange, or national securities association.

NMS security: any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.

Protected quotation: a quotation in an NMS stock that:

- is displayed by an automated trading center;
- is disseminated pursuant to an effective national market system plan; and
- is an automated quotation that is the best bid or best offer of a national securities exchange (including NASDAQ) or the best bid or best offer of a national securities association.

To be protected, the quotation must be immediately and automatically accessible.

Trade-through: the execution of a trade as principal or agent during regular trading hours at a price inferior to protected quotations.

Trading center: a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent.

19.6.2 Trade-Throughs

[SEC Regulation NMS Rule 611; SEC Division of Market Regulation Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS]

Responsibility	• Designated Supervisor
Resources	• Internal or third-party reports on NMS compliance
Frequency	• Timeframes (daily, weekly, monthly, other) corresponding to available reports

Action	• Review reports for trade-throughs
	• For trade-throughs
	  ○ Review reason for trade-through
	  ○ Consult with trading/order desk personnel
	  ○ Take corrective action which may include:
	    ▪ Correcting the trade which may include price improvement or cancellation of trade
	    ▪ Training for trading personnel
	    ▪ Review of order routing/execution systems
	    ▪ Consultation with Compliance regarding other action

Record	• Internal or third-party reports with records of action taken

Firms that route orders have the obligation to prevent trade-throughs, i.e., execution of orders at prices inferior to protected quotations. While the purpose of the NMS is to connect markets to afford orders the best available price, broker-dealers have obligations to seek the best available market. Order routers have three tools available to control the handling of orders to comply with Rule 611:

- a limit price (preclude execution at a price inferior to the limit)
- an immediate-or-cancel (IOC) designation (triggers the requirement for automated quotations and particularly that the trading center provide an immediate response to the order)
- an ISO designation (the BD routing the order assumes responsibility)

Exceptions for transactions that trade-through a protected quotation include:

- a transaction effected by the trading center solely to correct a bona fide error (records of facts and circumstances of the error must be maintained and the transaction recorded in the trading center's error account) [SEC Release No. 34-55884]
- an order that meets the terms and conditions of a "Print Protection Transaction" [SEC Release No. 34-55883]
- an order involving one or more NMS stocks that are components of a qualified contingent trade [SEC Releases No. 34-54389 and 34-57620]
- the trading center displaying the protected quotation that was traded through was experiencing a failure, delay or malfunction
- a trade that is not "regular way"
- single-priced opening, reopening, or closing transaction by the trading center
- a trade executed at a time when a protected bid was priced higher than a protected offer in the NMS stock
- an ISO order
- the trade was effected by a trading center that simultaneously routed an ISO order to execute against the full displayed size of any protected quotation that was traded through
- a trade that was not based on the quoted price of the NMS stock at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute was made

- the trading center displaying the protected quotation that was traded through had displayed, within one second prior to execution of the trade-through transaction, a best bid or offer for the NMS stock with a price that was equal or inferior to the price of the trade-through
- an order for which, at the time of receipt of the order, the trading center had guaranteed an execution at no worse than a specified price (with conditions)
- transactions in non-convertible preferred securities [SEC Release No. 34-57621]
- other exceptions published by the SEC

19.6.3 Best Execution

Complying with trade-through obligations does not supplant the requirement for best execution. KCD is still obligated to use reasonable diligence to obtain the best execution of customer orders and will continue to conduct best execution reviews of the quality of order routing including orders executed internally.

19.6.4 Intermarket Sweep Orders (ISOs)

When an order is designated as an ISO, the receiving trading center will execute the order without regard to any better-priced protected quotations at other trading centers. When KCD enters an ISO, it is required to route additional ISOs to execute against any better-priced quotations at other trading centers.

19.7 Orders In Volatile Market Conditions

[FINRA Notice to Members 99-11; FINRA Regulatory Notice 16-19]

Customer order handling and recommendations in volatile market conditions may require added disclosures or procedures.

19.7.1 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.
- Volatile stocks may be subject to higher margin requirements or not available for purchase on margin.

19.7.2 Stop Orders

Responsibility	• Designated Supervisor

Resources	• Order records
Frequency	• As required

Action	• Establish systemic safeguards which may include:
	  ○ Prominent disclosures at time of order entry
	  ○ Controls on the use of stop orders that do not carry a limit price
	  ○ Special terms on stop orders such as restricting time of day during which stop orders may be triggered
	  ○ Expiration of good-til-cancelled stop orders
	• Train RRs regarding the risks and use of stop orders during volatile markets

Record	• Order records • Records of systemic safeguards imposed • Training of RRs

Stop orders may be used as a tool to manage market risk, but conditions during volatile market conditions may affect them differently than normal market conditions. Customers should be made aware of the risks of stop orders when markets are volatile:

- Stop prices are not guaranteed execution prices.
- Stop orders may be triggered by a short-lived, dramatic price change.
- Sell orders may exacerbate price declines during times of extreme volatility.
- Placing a "limit price" on a stop order may help manage some of these risks.
- Customers should be made aware of volatile market conditions when RRs advise customers in selecting a stop order type and the stop price (or the stop and limit prices for a stop limit order).
- If in place, customers should be notified of the expiration of good-til-cancelled stop and stop limit orders.

19.8 Illiquid Investments

[FINRA Regulatory Notice 08-30]

Customers may contact an RR, on an unsolicited basis, to sell an illiquid investment, and may have a prospective buyer. To effect the transaction, the following is required:

- The RR must have or obtain the required new account information for both the buyer and the seller.
- Both the buyer and the seller must sign a letter confirming that the orders are unsolicited; that KCD is not recommending the transactions or making a suitability determination; and KCD cannot make a determination regarding the sufficiency or competitiveness of pricing of the transactions.
- The RR must have no concerns regarding the ability of both sides to settle the proposed transaction.

The RR may advise the seller of potential buy interest. The letter described above must be signed by both parties and include disclosure that KCD will receive compensation for effecting the transactions.

If orders for illiquid securities are solicited, the RR is responsible for making a suitability determination in addition to obtaining the written acknowledgments.

19.9 Account Designation And Cancels/Rebills

[FINRA Rule 4515]

Responsibility	• Designated Supervisor
Resources	• Cancel/Rebill form • Cancel/Rebill Report • FINRA available reports
Frequency	• Daily review of forms presented • Monthly review of FINRA report
Action	• Review frequent cancellations and cancel/rebills which may be indicative of unauthorized trades • Review and approve or disapprove cancels and rebills. • For cancels from one account to another, particularly review reason for cancel and rebill prior to approval. • Review Cancel/Rebill Report for patterns by customer and/or by RR. • Where patterns appear confer with RR. • Where patterns continue to appear, contact customers whose orders were cancelled to confirm orders were originally authorized. • If customers advise transactions are unauthorized, contact Compliance. • Compliance: Review FINRA report and follow up regarding patterns of cancelled or as-of trades (contact RR and RR's supervisor, customer contact or other appropriate action)
Record	• Initials on Cancel/Rebill Form • Initials and date on Cancel/Rebill Report • FINRA report (if available) including notes of action taken retained by Compliance • For patterns of cancellations, notes of review and action taken on reports reviewed or included on supervisor's log, daytimer, or other record, if appropriate.

Each order, prior to execution, must include the account name or designation on the order with the exception of investment adviser order allocations explained in the next section.

Whenever an order is cancelled and rebilled to another account (including changes between related or same-owner accounts), the cancel and rebill form must be completed and approved by the designated supervisor and retained with the order record. The supervisor must document the essential facts relied upon to approve the change.

19.9.1 Allocation Of Investment Adviser Orders

[FINRA Rule 4515.01]

Orders may be accepted from the investment adviser allowing the investment adviser to later identify the name or designation of the accounts for which the order is to be executed. Specific account designations or customer names must be received by noon of the next business day following the trading session. This exception applies only where there is more than one customer for any particular order.

The exception applies to outside registered investment advisers and employees who provide investment advisory services on behalf of KCD acting as a registered investment adviser. This does not apply to RRs who have discretionary authority over customer accounts subject to FINRA Rule 3260 "Discretionary Accounts."

19.10 Time And Price Discretion

[FINRA Rule 3260 and 4512(a)(3)]

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 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. "Institutional account" includes a bank; savings and loan association; insurance company; registered investment company; registered investment adviser; and any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.

19.11 Trading Halts

[FINRA Rule 5260, 6120, 6121 and 6440; NASDAQ Conduct Rule 2000, 3000 and 3300; NASDAQ Equity 9 Business Conduct]

When trading halts occur, whether they are for specific securities or circuit breakers that close entire markets, orders are handled as follows:

- When trading is resumed on the same trading day, pending and new customer orders are forwarded to the appropriate market for execution upon resumption of trading, unless the customer instructs otherwise.
- When trading is closed for the duration of the trading day, pending and new customer orders are treated as follows:
    - Orders pending at the time of the halt and new orders received after the halt commences are treated as "Good Til Cancelled" and held for execution at the reopening of the next trading session (unless the customer instructs otherwise).
    - "At-the-Close" orders (including "Market-on-Close" orders) pending at the time trading is halted are treated as cancelled orders. No new orders relating to closing prices received during a trading halt are accepted or forwarded to a market.

19.12 Unexpected Market Day Closures

[FINRA Regulatory Notice 18-39]

There are occasions when the securities markets close for business such as a national day of mourning in memory of a President. Whether that day is or is not a regular business day affects various rule requirements including net capital, financial reporting, extensions of time and close-outs. Refer to FINRA Regulatory Notice 18-39 for details regarding how those rules are affected.

19.13 Consolidated Audit Trail (CAT) Trade Reporting

[FINRA Rule 6000 series and 7000 series; FINRA Regulatory Notice 20-41, 20-31, 14-23, 11-40, 10-26, 09-21 and 09-08; FINRA Trade Reporting Notice September 23, 2011: Trade Reporting Transactions in OTC Equity Securities and Restricted Equity Securities; FINRA Trade Reporting Notice September 23, 2011: FINRA Reminds Firms of Their Trade Reporting Obligations Relating to Customer Sales of Low-Value OTC Equity Securities; NASDAQ Broker-Dealer data: Equity Trader Alert 2009-33; CAT FAQs: https://www.catnmsplan.com/faq; CAT Small Firm Roadmap: 5.13.21-Small-Firm-Roadmap.pdf at https://www.catnmsplan.com; FINRA CAT FAQs for small firms: https://www.finra.org/rules-guidance/key-topics/cat/small-firm-faq; Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• FINRA/NASDAQ Broker-Dealer available data and reports • CAT resources • Other order records or reports available (if applicable) • Reporting information provided by third parties (if applicable) • Training program or materials for traders and other order personnel
Frequency	• Initially: Register with CAT • As required: Identify third parties who will report • Reviews of Firm reporting: Daily, Monthly or Weekly depending on frequency of reports/availability of data including timely and accurate reporting • Daily: clock synchronization • As required: assign Firm Designated ID (FDID) • Ongoing: Reviews of compliance with inclusion of FDID on trade reporting • Periodic reviews of third party reporting (including clearing firm) if applicable • Training: as required

Action	• Register with CAT:
	    ○ Include designation of Super Account Administrator responsible for creating users
	    ○ Update Administrator and users as required
	• FDIDs:
	    ○ Create KCD's FDID and submit to CAT
	    ○ Monitor reporting to confirm the FDID is used for reporting as required at KCD and across vendors used for reporting
	    ○ Take corrective action if errors are identified in assigning transactions to KCD's FDID
	• Daily review of the CAT Reporter Portal to:
	    ○ review file status to ensure file(s) sent by KCD or its reporting agent was accepted by CAT and to identify/address any file submission or integrity errors;
	    ○ identify late records;
	    ○ identify and repair any data ingestion errors (syntax/semantic rejections);
	    ○ identify and repair any linkage errors;
	    ○ review reporting statistics and compare them to Firm record counts to ensure KCD or its reporting agent has reported all required records;
	    ○ receive communications from FINRA CAT regarding CAT availability, announcements, software releases, *etc.;* and
	    ○ update and maintain Firm contact information.
	• Periodic comparative reviews of accepted CAT data against order and trade records and the CAT Reporting Technical Specifications to ensure:
	    ○ all reportable records are submitted to CAT;
	    ○ data fields contain accurate information;
	    ○ records are submitted in the correct time sequence (*e.g.,* executions are not time-stamped prior to the receipt of a new order);
	    ○ "Handling Instructions" are correctly populated;
	    ○ "Account Holder Type" values are populated correctly;
	    ○ the "Manual Flag" field is populated correctly; and
	    ○ data is properly reported under the member's "Industry Member Identifier" (IMID).
	• Respond to FINRA Rapid Remediation inquiries and correct identified issues.
	• Ongoing steps:
	    ○ Review CAT Announcements and CAT Frequently Asked Questions

	pages. ○ Review the CAT Reporter Portal User Guide, CAT Technical Specifications, and Industry Member Reporting Scenarios as they are updated. ○ Use the FINRA CAT Help Desk at (888) 696-3348 or help@finracat.com. ○ Report reporting issues to the FINRA CAT Help Desk. • If applicable, review third-party reporting on KCD's behalf • Confirm through internal testing/auditing that KCD's systems are reporting transactions consistent with requirements; providing appropriate exception management; maintain necessary control processes • Self-report CAT reporting issues when discovered via the FINRA CAT Self-Reporting Erroneous Events Form or through the FINRA CAT help desk • Monitor CAIS (Customer and Account Information System) for: ○ Data formatting and inconsistencies ○ Reporting of customer and account information in a secure manner ○ CAIS data consistent with prior submissions for the same customer ○ Repairing CAIS inconsistencies within the required time period (*i.e.* no later than 5pm ET on the third CAT Trading Day after the customer or account information became available to KCD) • Provide training to new traders and other order personnel and continue training as required
Record	• Designation of Super Account Administrator and users • Assignment of FDID and reviews for required use of KCD's FDID including reviews of vendor reporting • Required CAT order information • Action taken and responses to FINRA Rapid Remediation inquiries • Self-reporting to FINRA of CAT reporting issues • Monitoring of CAIS issues including repair of inconsistencies within the required time period • Available SRO reports and Firm order records/internal reports including manual or electronic record of review and action taken, if applicable • Reviews of third-party reporting, if applicable • Records of testing/auditing • Training

19.13.1 Consolidated Audit Trail (CAT)

[Exchange Act Rule 613; FINRA Rule 6800 series; CAT FAQs for small firms: https://www.finra.org/rules-guidance/key-topics/cat/small-firm-faq; FINRA guidance: https://www.finra.org/rules-guidance/key-topics/consolidated-audit-trail-cat; FINRA Regulatory Notice 19-19; Consolidated Audit Trail website: https://www.catnmsplan.com/]

All firms (regardless of size) that receive or originate orders in NMS stocks, OTC equity securities, or listed options must report to CAT. All proprietary trading activity, including market making activity, is subject to CAT reporting. There are no exclusions or exemptions of any kind for type of firm or type of trading activity. If reporting is done by a third party (*e.g.,* clearing firm), KCD remains responsible for oversight of reporting.

Under Rule 613 of Regulation NMS, FINRA and the national securities exchanges ("SROs") were required to develop a consolidated audit trail that enables regulators to oversee securities markets on a consolidated basis to enhance market and investor protections. This section outlines general and supervisory requirements; CAT resources, particularly the CAT website at https://www.catnmsplan.com should be consulted for details of requirements and technical guidance.

19.13.2 Firm Registration And Who Must Report

ALL firms are required to register with the CAT system to report. Any third party such as a clearing firm reporting for others is also required to register.

The CAT applies to all U.S. exchanges and firms, including Alternative Trading Systems (ATSs) registered with an SRO and there are no broker-dealer exemptions from reporting requirements. Any broker-dealer that is a member of a national securities exchange or FINRA and handles orders must report to CAT.

Firms can be a(n):

- **Executing firm**: Broker or dealer that processes a buy or sell order on behalf of a customer or another firm. Executing firms have a clear reporting responsibility for the orders they handle, routing of the orders and ultimate execution.
- **Introducing firm**: Broker or dealer that interacts with customers but may not execute trades on behalf of customers. Introducing firms will have a regulatory obligation to report any quotes, new orders, routes and any cancels or amendments to those events.
- **Clearing firm**: Broker or dealer that not only handles orders to buy/sell securities, but also maintains custody of securities and other assets. The act of clearing (including step-ins and step-outs) is not reportable, however, if handling orders or providing execution services, a clearing member has an obligation to report those events. If the clearing member provides reporting services to their correspondent or introducing firms, then the roles and responsibilities should be clearly defined for that operating model. If the clearing firm is reporting on behalf of another firm, then the outsourcing firm may designate the clearing firm as the CAT reporting source on their registration.

19.13.3 Designated IDs

Orders are reported using distinct identifiers:

- Customers - defined in Rule 613 and represented by the CAT Customer ID (CCID).
- Trading Accounts - addressed in the NMS Plan and represented by the Firm Designated ID (FDID). This can represent firm or customer accounts. A customer can have more than one trading account, and a trading account can have more than one customer.

19.13.3.1 CAT Customer ID (CCID)

SEC Rule 613 defines two types of customers:

- The account holder(s) of the account at a registered broker-dealer originating the order.
- Any person from whom the broker-dealer is authorized to accept trading instructions for such account, if different from the account holder(s).

A unique CCID will be assigned to each customer and will allow customers to be consistently identified across broker-dealers within the Central Repository. Examples of customers that would have a CCID include an individual investor; financial advisor; institutions; third party money managers; any individual that has trading authorization (except an individual with trading authorization that is employed by an entity that is an account holder); and any entity that has trading authorization.

Industry members and Cat Reporting Agents submit customer information to the CAT Customer & Account Information System (CAIS) for assignment of a unique identifier for each customer to be used across all dealers and markets.

19.13.3.2 Firm Designated ID (FDID)

[CAT guidance https://www.catnmsplan.com/sites/default/files/2020-01/FDID-Guidance-April-2019.pdf; CAT FAQs M10]

CAT requires that industry members assign a single FDID to **each** trading account that is unique across all vendors KCD may use to report new orders to CAT and unique across time (with limited exceptions such as closed accounts). For example, if KCD uses multiple vendors for reporting, each vendor must report activity from the same account using the same FDID. Trading accounts are represented in CAT by KCD's FDID.

19.13.4 What Is Reported

Firms must report market transaction data (Reportable Events) to the CAT in a format(s) specified by CAT. These events cover the end-to-end lifecycle of a trade, including but not limited to, quotes, original receipts or originations of an order, modifications, cancellations, routing, receipts of a routed order execution (in whole or in part), and ultimately order allocations.

Eligible securities include NMS stocks, listed options, and over-the-counter (OTC) equity securities. Under the CAT NMS Plan, "eligible security" includes equities and options with the following definitions: (1) all NMS Securities, meaning "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in Listed Options;" and (2) all OTC Equity Securities, meaning "any equity security, other than an NMS Security, subject to prompt last sale reporting rules of a registered national securities association and reported to one of such association's equity trade reporting facilities."

For eligible securities, the types of events that will need to be reported include:

- All proprietary orders, including market maker orders
- All street side representative orders (both agency and proprietary)
- Electronic listed quotes (NMS stocks) sent to an exchange or the Alternative Display Facility (ADF) (assumes exempted relief request for verbal quotes)
- Unlisted quotes (OTC Equity Securities) received by a broker-dealer operating an inter-dealer quotation system (*e.g.,* Global OTC, OTC Link)
- Unlisted quotes that meet the definition of bid or offer under the Plan sent by a broker-dealer to a quotation venue not operated by an SRO or broker-dealer
- "Simple Electronic Option Orders:" orders to buy or sell a single option that are not related to or dependent on any other transaction for pricing or timing of execution that are either received or routed electronically by an Industry Member CAT Reporter
- "Electronic Paired Option Orders:" electronic option orders that contain both the buy and sell side that is routed to another Industry Member or exchange for crossing and/or price improvement as a single transaction on an exchange. Further, the events related to Simple Electronic Option Orders subject to reporting in Phase 2b are limited to those events which involve electronic receipt of an order, or electronic routing of an order
- Electronic receipt of an order: the initial receipt of an order by an Industry Member in electronic form in standard format directly into an order handling or execution system
- Electronic routing of an order: the routing of an order via electronic medium in standard format from one Industry Member's order handling or execution system to an exchange or another Industry Member

19.14 Trade Reporting By Third Parties

[2007 Member Alert: Notice to All TRF, ADF and Other FINRA Facility Participants Regarding AGU and QSR Relationships]

When a third party is used for clearing, reporting or locking-in trades, whether under an Automated Give Up (AGU), Qualified Service Representative (QSR) or other arrangement, the third party's reporting will be periodically reviewed for compliance with requirements.

19.15 Trading Systems And Electronic Transmission Of Orders

[FINRA Notice to Members 04-66]

This section describes supervisory procedures to prevent errors when entering orders through order-routing and execution systems ("trading systems").

- Only authorized persons are permitted to access trading systems. Access is password-protected.
- Order entry personnel will receive training regarding order entry procedures and proper operation of the system.

19.15.1 Customer Access To NASDAQ Order Entry Systems

[FINRA Notice to Members 98-66]

KCD does not allow customers to enter their orders directly to NASDAQ order entry systems.

Clearing Agency Membership

KCD is a member of an SEC-registered clearing agency or has a correspondent clearing agreement with another firm that is a member of a clearing agency through which system-compared trades may be settled.

19.16 Order Records

[SEC Securities Exchange Act of 1934 Rule 17a-3 and Rule 17a-4; FINRA Rule 5340 and 7440]

Certain information must be recorded for orders accepted by KCD. Our clearing firm provides this information on our behalf. Information to be recorded includes:

- Identification of the account
- Buy or sell
- If sell, long or short
- If a short sale, an indication the security can be borrowed
- If sell long, an indication that the seller will deliver the security
- 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 (DE or DNE)
- 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 (pre-timing of orders for block positions is prohibited)

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 KCD 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

19.17 Large Trader Reporting

[SEC Securities Exchange Act of 1934 Rule 13h-1; SEC Large Trader FAQs: http://www.sec.gov/divisions/marketreg/large-trader-faqs.htm]

Responsibility	• Designated Supervisor
Resources	• Transaction records
Frequency	• Ongoing - if not already a reporting Large Trader, review transaction records to identify potential Large Trader status of KCD or its customers • One time - Notify the SEC if KCD is subject to Large Trader requirements • Annually - File Form 13H within 45 days of end of calendar year • Amend Form 13H within 45 days after the end of a calendar quarter if the prior filing becomes inaccurate • File "Inactive Status" or make a Termination Filing if appropriate

Action	• If not already a reporting Large Trader and magnitude of firm trading would potentially require KCD to file as Large Trader at some time, review trading records to identify when that status is met to initiate identification to the SEC within 10 days after meeting or exceeding the identifying activity level
	• If filing as a Large Trader:
	  ○ File Form 13H annually with the SEC
	  ○ Amend filings, if necessary
	  ○ Provide requested trade data to the SEC
	• Electronically report, upon request from the SEC, information about KCD acting as a Large Trader and/or for an account for a large trader or Unidentified Large Trader including required information under Rule 13h-1 for all transactions effected directly or indirectly
	• Obtain and report LTIDs to CAT for accounts with "reportable events" which includes the original receipt or origination, modification, cancellation, routing, execution (in whole or in part) and allocation of an order, and receipt of a routed order (which includes introducing and clearing firms)
	• Report customer identifying information to CAT regarding account holders with an LTID or an Unidentified Large Trader Identification number
	• Review transaction records to identify customers who may be Large Traders

Record	• Review of trading records to make initial filing, if necessary • Annual Form 13H reports • Review of transaction records to identify Large Trader customers

KCD is subject to "Large Trader" requirements under SEC rules. Since KCD is either a Large Trader that does **not** self-clear or it effects transactions for Large Traders limited to those whose accounts are carried by non-broker-dealers, KCD is **not** subject to the recordkeeping and reporting requirements of Rule 13h-1 until November 1, 2015. This section outlines the requirements of a very extensive rule that should be consulted directly for details of requirements.

19.17.1 Large Trader Definition

A Large Trader is defined as any person who, directly or indirectly, including other controlled persons, exercises investment discretion over one or more accounts and effects transactions in NMS securities for or on behalf of such accounts through broker dealers and whose transactions equal or exceed (in aggregate): (1) 2 million shares or $20 million during any calendar day or (2) 20 million shares or $200 million during any calendar month (the "identifying activity level" for filing Form 13H). "Transactions" for purposes of identifying a Large Trader exclude: (1) transactions part of an offering; and (2) sales by a selling shareholder in connection with an IPO or in a secondary offering if the seller is a current or former employee of the issuer and securities being sold were part of the employee's compensation.

An ownership level of 25% would generally give a person "control" for purposes of Large Trader designation. Multiple persons within a corporate group may qualify as Large Traders. If a natural person or subsidiary entity within a large organization independently qualifies as a Large Trader, a parent company of that Large Trader may file on Form 13H and identify itself as the Large Trader on behalf of the group, removing the requirement of the subsidiary to separately identify as a Large Trader.

Refer to Exchange Act Rule 13h-1(a) for more complete details.

19.17.2 Identifying Activity Level

It is the identifying activity level that identifies a person as a Large Trader. Offsetting or netting transactions among or within accounts, even for hedged positions, are added to a market participant's activity level in order to show the full extent of a trader's purchase and sale activity. When aggregating transactions, the Large Trader would determine across all accounts over which it has investment discretion:

- The volume or fair market value of transactions in equity securities and the volume or fair market value of the equity securities underlying transactions in options on equity securities, purchased and sold; and
- The fair market value of transactions in options on a group or index of equity securities (or based on the value thereof), purchased and sold.

The rule should be consulted for transactions exempt from the identifying activity level including gifts, journals/bookkeeping entries, issuer offerings, and other exemptions.

19.17.3 Large Trader Identification Number (LTID)

The SEC assigns each large trader an LTID. Large traders are obligated to disclose this number to the registered broker-dealers effecting transactions on its behalf and identify for them each account to which it applies. The LTID is one of the elements to be included in consolidated audit trail reporting.

19.17.4 Filings

Large traders are required to make filings of Form 13H which is a web-based form.

Initial filing: Large Traders are required to identify themselves to the SEC by filing Form 13H [Rule 13h-1(b)]. The initial filing is due within 10 days after the Large Trader meets or exceeds the identifying activity level.

Annual filing: Submit an annual filing of Form 13H within 45 days after the end of each calendar year.

Amended filing: Inaccurate filings must be promptly corrected following the end of the calendar quarter in which the prior filing becomes inaccurate for any reason. For example, changes to the name, business address, *etc.* would require an amended filing.

Inactive status: Form 13H is not required if a person does not meet or exceed the identifying activity level. If the person does not anticipate meeting the level again, it may file for "Inactive Status."

Reactivated status: If a person on Inactive Status meets or exceeds the identifying activity level, it must file for Reactivated Status within 10 days.

Termination filing: Persons may terminate Large Trader status by submitting a Termination Filing. For example, if a person ceases operations, dissolves, or is acquired.

19.18 Conflicts Of Interest

19.18.1 Adverse Interest

Responsibility	• Designated Supervisor
Resources	• Order records • Available reports
Frequency	• Daily
Action	• Identify transactions where an RR is on the other side of the trade from the customer • Ensure the customer's confirmation includes a trailer disclosing an employee was on the other side of the transaction, OR, • Send the customer a disclosure letter
Record	• Customer confirmation, OR • Copy of disclosure letter to customer which is maintained in the branch customer file

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. The branch manager or other designated supervisor should require a disclosure on the customer's confirmation or a letter to the customer disclosing that an employee was on the opposite side of the transaction.

19.18.2 Precedence Of Customer Orders

Responsibility	• Designated Supervisor
Resources	• Order records

	• Available reports
Frequency	• Daily
Action	• 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 • Adjust the customer's order to the better price, if appropriate
Record	• Order adjustments are included in records of the day's orders

The customer's interest has precedence over any employee'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.*).

19.18.3 Disclosure Of Control Relationship

[FINRA Rule 2262]

When a customer effects a transaction in a security where the issuer controls, is controlled by, or is under common control with KCD, KCD will provide the customer with a disclosure in writing at or before completion of the transaction. This is usually accomplished by including a disclosure on the customer's confirmation.

19.19 Review Of Customer Transactions

19.19.1 Review Of Daily Transactions

Responsibility	• Designated Supervisor
Resources	• Order records and available reports
Frequency	• Daily
Action	• Review orders for, among other possible items: ○ Completeness of order records ○ Suitability of transactions ○ Discretionary account orders ○ Orders requiring approval ○ Excessive commissions ○ Unauthorized transactions ○ Wash sales/prearranged trades ○ Prohibited orders ○ Marking most or all orders as "unsolicited"

	- Review of communications (e-mails, phone logs, other) for evidence of unauthorized trading - For orders contrary to KCD policy or rule requirements, take corrective action which may include: - Confer with the RR to clarify the transaction, if necessary - Cancel and rebill the transaction to reflect appropriate charges - Cancel the transaction to KCD's error account - Confer with Compliance regarding additional education for the RR and/or disciplinary action
Record	- Initials on order records requiring approval - Initials on day's order records and/or available reports

Orders are reviewed on a daily basis for compliance with order requirements.

19.19.2 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
- Numerous extensions
- Trading in unrelated accounts in the same security in a certain time period

The designated supervisor 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
- Confer with Compliance regarding any identified unauthorized transactions

19.19.3 Review Of Account Activity By Designated Supervisors

Responsibility	Designated Supervisor
Resources	- Customer monthly statements and/or transaction records - New account forms
Frequency	Semi-annually
Action	- Review customer transactions records for suitability of transactions - Refer to new account forms when necessary to identify investment objectives and other customer information - Confer with RR regarding suitability questions - Confer with Compliance when necessary

	• Contact customer when necessary to confirm customer's understanding of and agreement with transactions • Modify or restrict future transactions, as appropriate
Record	• Initials on records reviewed • Branch Manager's Log

Designated Supervisors are expected to review customer account activity periodically. This may be accomplished by reviewing the monthly statements, available reports, and/or other cumulative transaction information of selected RRs on a rotating basis.

19.20 Trade Errors

Responsibility	• Designated Supervisor or Designee
Resources	• Trade Error Form or other
Frequency	• Daily
Action	• 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 supervisor's responsibility to minimize trade errors in the branch; take immediate corrective action when an error is identified; and take follow up corrective action as necessary. ○ Instruct order entry person regarding action to correct the error ○ Approve Trade Error Forms ○ Identify patterns of errors by individual RRs ○ Where patterns are identified, confer with the RR regarding any order entry problems and the reasons for frequent errors ○ Take corrective action as appropriate
Record	• Initials on Trade Error Forms • Notes regarding corrective action in the RR's file or on the supervisor's log, daytimer, or other record, as appropriate

Trade errors are to be immediately reported to the designated supervisor for correction. RRs are not permitted to correct errors themselves.

KCD 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.

19.21 Sellouts

Responsibility	• Designated Supervisor • Operations
Resources	• Reports or other notices regarding sellouts
Frequency	• As required

Action	• Notify the RR and supervisor that customer's payment is due
	• If the customer does not pay for the trade, sell out the customer's position
	• Remove the transactions from the customer's account through cancel/rebill
	• Review the circumstances of the sellout
	• If there is a loss, charge the RR (unless an exception is warranted)
	• Identify patterns of customer reneges which may reflect:
	  ○ Potential unauthorized transactions
	  ○ A customer whose account should be closed
	• Take corrective action, if necessary, which may include discussing sellouts with the RR; reviewing new account documentation; contacting the customer; closing the account; contacting Compliance regarding possible disciplinary action against the RR

Record	• Sellouts are included in the day's order records • Review of sellout, cancel/rebill of transactions • Investigation of repeat sellouts and corrective action taken

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.

19.22 Time Clock Synchronization

[Regulation NMS Rule 613(d); FINRA Rule 4590 and 6820; FINRA Regulatory Notice 17-09; CAT FAQs: https://www.catnmsplan.com/faq]

Responsibility	• Designated Supervisor
Resources	• Clock Synchronization Log • Available reports • Information from third-party service providers (if applicable)
Frequency	• Weekly: review Firm compliance with synchronization requirements • Obtain information from a third-party service provider (if used). Upon engagement and quarterly thereafter review of information from a third-party service provider at frequency indicated below
Action	• Review Log • 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 • Complete the annual certification by March 15 of each year • If a registered broker-dealer third party is used to record KCD's Recordable Events:

	◦ Obtain and review a copy of the yearly certification ◦ Obtain and review a supplemental attestation for compliance with documentation requirements and violation reporting (upon engagement) • If a third party is used that is not a registered broker-dealer: ◦ Review clock synchronization procedures and copies of sample logs to confirm compliance with the following rule requirements: ▪ Correct clock synchronization standard ▪ Daily clock synchronization each business day before market open to ensure timestamps are accurate ▪ Provide for re-synchronization throughout the day as necessary ▪ Provide for sufficient log creation, retention, and accessibility ◦ Review copies of sample logs for verification (quarterly) ◦ Attestation or similar assurance to provide a sufficient basis to complete KCD's certification ◦ Receive alerts from the third party so KCD may report clock synchronization drift violations as required
Record	• Clock Synchronization Log that records the times when Business Clocks are synchronized and whenever a clock fails to be within the applicable tolerance for not less than 5 years or for the entire period KCD is required to comply with rule requirements • Non-member's clock synchronization procedures (if applicable) • Certifications • If a third-party service provided is used for reporting, records of supervisory reviews and corrective actions included under "Actions" and copies of documents including annual certifications, attestations, sample logs, and alerts of drift violations evidenced by supervisor's signature/initials and date of review and, if applicable, corrective action

All time clocks (computer system or mechanical) used for recording date and time of orders must be synchronized and maintained (other than Business Clocks used solely for Manual Order Events or solely for time of allocation on Allocation Reports) at a minimum to within a fifty (50) millisecond tolerance of the time maintained by the NIST atomic clock. Business Clocks used solely for Manual Order Events and solely for the time allocation of Allocation Reports must be synchronized within a one second tolerance of the NIST clock and maintained at that synchronization.

This tolerance includes all of the following:

1. the difference between the NIST standard and a time provider's clock;
2. transmission delay from the source; and
3. the amount of drift of the Firm's clock.

The following procedures are to be followed to synchronize business time clocks used to record order entry and execution times:

- Clocks that have not been checked according to these procedures must **not** be used for recording order information.
- All clocks will be synchronized with the National Institute of Standards and Technology (NIST) system clock **each business day:**
  - prior to market opening; and
  - at pre-determined intervals throughout the business day.
- Traders or other order desk personnel must record clock synchronization on the Clock Synchronization Log and provide the Log to the designated supervisor weekly.
- Failure to conduct required synchronization may result in disciplinary action.
- The designated supervisor is responsible for reviewing and retaining the Logs and taking corrective action, when necessary (may include repair or discontinuing use of a clock; review of systems; *etc.*).

- In the future (date not yet determined), KCD will report violations of clock synchronization requirements.

19.22.1 Certification

Each year KCD will complete the certification by March 15 of each year. The certification will be maintained in a file available to regulators upon request. Only one certification is prepared even if KCD is a member of multiple regulatory organizations.

19.22.2 Third-Party Service Providers

KCD may rely on a third-party service provider's clocks (including, but not limited to, registered broker-dealers) to record the date and time of any of KCD's Reportable Events required to be reported under Rule 613. These third-party clocks are considered to be KCD's Business Clocks for purposes of CAT clock synchronization requirements.

Third-party (including clearing firms) reliance is included in an agreement regarding their obligation to file certifications and provide copies to KCD and to self-report any drifts and notify KCD of variances. The third party is also required to provide sample logs for KCD to review for consistency with the synchronization rule.

19.22.3 Definitions

Business Clocks: Those clocks that currently capture time in milliseconds and that are used to record time related to "Reportable Events."

Reportable Events: Includes the original receipt or origination, modification, cancellation, routing, execution (in whole or in part) and allocation of an order, and receipt of a routed order in Eligible Securities (*e.g.,* NMS Securities and OTC Equity Securities).

19.22.4 Independent Contractors

If an independent contractor immediately transmits orders to the trading department, 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.

19.23 Issuer Repurchases Of Common Stock

[SEC Securities Exchange Act of 1934 Rule 10b-18]

Rule 10b-18 provides a "safe harbor" when an issuer (or its affiliate) repurchases its own outstanding common stock, including purchases to effect a merger or acquisition or as a "going private" effort. The safe harbor enables the issuer to avoid violations of the anti-manipulation rules. To come within the safe harbor, the issuer must meet four conditions on each day it bids for and repurchases shares of its common stock (manner of entry, timing, pricing, and volume conditions).

Because the Rule is technical and complex, the appropriate trader or Compliance should be consulted regarding questions about the issuer's obligations and KCD's role under the Rule. RRs may not give advice to issuers on 10b-18 compliance; issuers should be encouraged to consult with their own counsel.

The following is a brief summary of Rule 10b-18 conditions. **Other requirements not listed here are included in the Rule.**

- All bids and purchases must be made through or by only one broker or dealer in a single day.
- A purchase may not be the opening reported purchase of the day.
- Purchases may not be made at a price higher than the highest independent bid or transaction price at the time of the purchase.
- For issuers having an average daily trading volume of $1 million or more and a public float value of $150 million or more, purchases may be made until the day's last 10 minutes of trading. Other issuers are limited to purchases until the day's last 30 minutes of the primary trading session in the principal market for the security.
- The number of outstanding common shares purchased by an issuer on any single day may not exceed 25% of the average daily trading volume of the stock for the 4 calendar weeks preceding the week purchases are made.
- Issuers are permitted to make "block" transactions once a week on a day when no other 10b-18 purchases are made.
- Issuers are required to make disclosures regarding repurchases in their 10-Q and 10-K filings.

19.24 Blue Sky Of Securities

Responsibility	• Designated Supervisor
Resources	• Order records and available reports
Frequency	• Daily
Action	• Review order records and reports for patterns of solicited purchase orders in securities that are potentially not blue-skied including: ○ securities that are not potentially exempt ○ securities that are low-priced • Compliance: if a violation occurs, determine if rescission is required and offer rescission; assess loss • Consult Compliance regarding transactions in question
Record	• Initials on order records and reports • Notes of questioned transactions on Daily Transaction Report and/or supervisor's log, or other record • Records of rescission offered

19.24.1 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 *EMPLOYMENT, REGISTRATION AND LICENSING*. This section discusses blue sky requirements of securities sold by KCD.

Securities must be blue skied in the state of residence of the customer to whom the security is sold. If a security that is not blue skied is sold to a customer in violation of state blue sky laws, the customer likely has a right of "rescission," which means the customer may cancel the transaction and receive a refund of the purchase price. Losses resulting from rescissions will be charged to the RR who sold the security in violation of blue sky requirements. States may also take disciplinary action against firms and individuals for violations of state law.

There are two ways a security may be sold to a state resident under blue sky laws. First, the issuer may register with the state. Second, an exemption may apply. Exemptions generally apply to:

- Securities issued by the federal government and municipalities
- Exchange-listed securities
- NASDAQ Capital Market listed securities
- Securities sold to certain institutions

Because blue sky laws vary from state to state, Compliance should be consulted to determine specific requirements.

19.25 Exchange-Listed Index Warrants, Currency Warrants And Currency Index Warrants

[FINRA Rule 2350 series; FINRA reminder of sales practice rules dated May 14, 2007]

Customer transactions in these securities are generally subject to requirements for trading options (FINRA Rule 2360). The following chart indicates requirements when selling these securities and the corresponding language in options rules that applies.

Rule	Corresponding options rule	Explanation/requirements
2351		General requirements language
2351		Definitions of terms
2352	2360(b)(16)	Account approval: must be approved in accordance with option account approval requirements
2353	2360(b)(19)	Suitability: reasonable basis required
2354	2360(b)(18)	Discretionary accounts: must be approved by an ROP
2355	2360(b)(20)	Supervision requirements consistent with options supervision
2356	2360(b)(17)(A)	Complaints: respond, retain record of complaint/response
2357	2220	Communications: options standards apply
2358	2360(b)(17)(B)	Records: requirements mirror options requirements
2359		Position limits: cannot exceed established limits
2359		Exercise limits: cannot exceed exercise limits
2359		Liquidation of index warrants positions: May be required when position limits are exceeded

19.26 Auction Rate Securities

[FINRA Regulatory Notice 08-08; FINRA Investor Alert: Auction Rate Securities: What Happens When Auctions Fail; SIFMA Auction Rate Securities Best Practices: www.sifma.org/services/pdf/AuctionRateSecurities_FinalBestPractices.pdf]

Auction rate securities are bonds that have interest rates periodically reset by auction. Interest reset periods are usually either 7, 14, 28 or 35 days. There are some securities where auctions occur more frequently (sometimes daily) or less frequently (for example, every six months or once over a multi-year period). An auction program employs one or more dealers that solicit orders from investors who wish to own the securities over the next interest reset period. The programs require one "auction agent," typically a bank, that receives orders from the dealers and conducts auctions consistent with procedures in the program documents. This procedure determines the lowest interest rate at which all of the securities offered for sale by current holders of the securities will clear the market (the "clearing rate"). The clearing rate then becomes the interest rate for all of the securities in the issue for the next interest rate reset period.

When recommending auction rate securities to retail investors, the following features and risks must be considered and discussed with the customer.

- features of the auction process including that the securities may or may not be sold at auction; there is no guarantee an auction will take place and securities may lose value as a result; there is no assurance regarding the outcome of auctions
- duration of the interest rate period and whether the period is subject to change
- the securities may have long-term maturities or no maturities at all
- features found in official documents including how "all hold" and maximum rates are determined
- the customer's need for liquidity and the liquidity characteristics of the particular auction rate security being considered

When an initial offering of auction rate securities is being sold, investors must be provided with the prospectus or other official document describing the offering.

19.26.1 Allocations

[FINRA Rule 2010 and 4340; FINRA Regulatory Notice 08-21; FINRA Staff Interpretive Memo 7/9/08]

The Firm (or its clearing firm) uses a methodology to allocate partial redemptions that is fair and does not disadvantage any customers. Customers will be notified as follows:

- on the Firm's website of allocation procedures in the event of a partial redemption or call; and
- written notice (which may be electronic) to new customers when accounts are opened and to all customers at least once every calendar year where the information may be accessed on the website and that, upon request, a hard copy will be sent.

The FINOP is responsible for allocation procedures and providing disclosures to customers.

19.27 Security Futures

[FINRA Rule 2370]

Security futures are subject to both securities and futures laws and regulations. A security future is a legally binding agreement between two parties to purchase or sell in the future a specific quantity of shares of a security (such as common stock, an exchange-traded fund, or ADR) or a narrow-based security index, at a specified price. "Single stock futures" are based on the trading of futures on narrow-based indices and single stocks and are security futures, though not all security futures are single stock futures.

Security futures are subject to special registration and sales practice requirements.

19.27.1 Registration Requirements

[FINRA Rule 1220.02]

Each person who is registered with FINRA as a General Securities Representative, United Kingdom Securities Representative, Canada Securities Representative, Options Representative, Registered Options Principal or General Securities Sales Supervisor is eligible to engage in security futures activities as a representative or principal, as applicable, provided that such individual completes a Firm Element continuing education program that addresses security futures products before such person engages in security futures activities.

19.27.1.1 Limited Exemption From Registration Requirements

Individuals who are engaged solely in commodities business are not required to be registered as a securities registered representative to engage in security futures business.

19.27.2 Accounts

Responsibility	• Designated Supervisor
Resources	• Risk disclosures • Security Futures Agreements • Internal reports or other trade information regarding security futures transactions
Frequency	• Opening of security futures accounts - as required • Monitoring for security futures transactions - daily
Action	• Review Security Futures Agreements and approve or disapprove • Restrict security futures transactions in accounts that do not provide the signed Agreement within 15 days of the first transaction
Record	• Security Futures Agreements are maintained in new account records • Action regarding restricting accounts is noted on transaction reports with the reviewer's initials and date of review

There are special requirements for accounts that will trade security futures.

19.27.2.1 Risk Disclosure Statement

[FINRA Information Notice 'August 2010 Supplement to the Security Futures Risk Disclosure Statement' September 7, 2010; FINRA Rule 2370(b)(11)(A)]

The security futures risk disclosure statement must be provided to the customer at or prior to the time the customer's account is approved for trading security futures. New or revised statements will be provided through a mass mailing to customers who already received the statement or no later than the time a security futures transaction confirmation is provided to approved customers. Statements may also be provided electronically or through the use of a hyperlink in accordance with SEC electronic delivery requirements.

19.27.2.2 Security Futures Agreement

RRs are required to complete the Security Futures Agreement and submit the completed form to the appropriate supervisor for approval prior to the first transaction in security futures in a customer's account. Within 15 days after the account is approved for security futures, KCD must receive the customer's signed Security Futures Agreement that includes:

- acknowledgment of receiving the risk disclosure
- detailed information about the customer's financial situation and investment objectives
- verification of the background and financial information upon which the account was approved

- agreement to be bound by rules governing security futures

19.27.2.3 Account Records

In compliance with security futures rule requirements, background and financial information for approved security futures accounts will be maintained at the branch office opening the account, and the office with principal supervisory responsibility over the branch office.

19.27.3 Security Futures Orders

Responsibility	• Designated Supervisor
Resources	• Transaction reports
Frequency	• Daily
Action	• Review transactions for suitability and potential front running or trading ahead • For questionable transactions, confer with the RR and/or contact Compliance for guidance regarding corrective action
Record	• Transaction reports are retained including the date of review and reviewer's initials and notations of actions taken

19.27.3.1 Suitability Of Recommendations Of Security Futures

There is a heightened standard of suitability since security futures represent a higher degree of risk to the customer than many other securities. Key risk considerations include the following:

- losses may be unlimited
- risk is increased because of the leverage involved
- positions are marked to market daily which may result in required added deposits from the customer

Risks are explained in detail in the Risk Disclosure Statement.

The RR is required to have a reasonable basis for believing the customer has the knowledge and experience in financial matters to be capable of evaluating the risks of the recommended transaction. In addition, the customer should be financially able to bear the risks of the recommended position. This includes the recommending of trading strategies involving security futures.

Suitability standards that apply to institutional investors, as explained in the chapter *ORDERS* in the section *Suitability* apply to recommendation of security futures to institutions.

19.27.3.2 Deposits

Customers are required to deposit funds equal to a specified percentage of the current market value of the contract. Operations should be contacted regarding questions about required customers' deposits.

19.27.3.3 Trading Ahead And Front Running

As for other securities, KCD and its employees are prohibited from trading ahead of or front running customer orders for security futures.

For trading ahead, KCD may not trade ahead of customer security futures orders in a proprietary account or another account where KCD or an employee or other associated person has a direct or indirect interest. The prohibition applies only when KCD or employee knows of or reasonably would have known about the customer's order prior to transmitting the Firm or employee order. This exception tracks an NFA interpretive notice that gives two examples of when KCD or an employee would reasonably NOT be aware of a customer's order:

- when a customer's order originates in a different branch office; and,
- when KCD's trading department does not have access to information about customer orders.

The prohibition against front running prohibits trading security futures, options, or an underlying security when KCD or its employees have material, non-public market information about an imminent block transaction in the underlying security, the overlying option, or overlying single-stock futures. When the material, non-public market information becomes publicly available, the prohibition no longer applies.

Questions regarding possible front running or trading ahead should be referred to Compliance.

19.27.3.4 Short Sales In Security Futures

Short sale orders for security futures are exempt from the requirement to make affirmative determination that the underlying security may be borrowed. RRs should, however, determine that the customer can deliver the security by settlement date and indicate that on the order record.

19.27.3.5 Position Limits

All security futures contracts trading on U.S. exchanges are subject to position limits or position accountability limits. Limits vary depending on the trading activity and market capitalization of the underlying security and are generally beyond the thresholds of most retail investors.

The FINOP is responsible for establishing procedures for monitoring for compliance with position limits or position accountability limits.

19.27.3.6 Transactions On Foreign Exchanges

U.S. customers are not permitted to trade security futures on foreign exchanges.

19.27.4 Communications With The Public Regarding Security Futures

Responsibility	• Designated Supervisor
Resources	• Proposed retail communications

Frequency	• As required
Action	• Review for compliance with rule requirements • Approve, recommend changes (if needed), or disapprove
Record	• Copies of reviewed advertising and sales literature are maintained in an advertising file including the reviewer's initials, date of review, and notation of approval or disapproval

19.27.4.1 Retail Communications

Specific requirements applying to retail communications are as follows:

- Retail communications must be approved by a supervisor qualified to supervise security futures.
- Advertising that includes security futures must be filed with the appropriate regulator at least 10 days prior to use and approved by the regulator prior to use. As an alternative to securities regulators, NFA members may file with the NFA.
- General standards for communications based on fair dealing and good faith apply to security futures.
- Where recommendations about security futures are included, the material must include if the Firm makes a market in the underlying security or if it owns the security futures or any recommended underlying securities.
- Content must be limited to general descriptions of the security futures being offered and may not include historical performance or projections and include contact information to obtain a risk disclosure. Content beyond these limitations trigger a requirement that the material be accompanied or preceded by the risk disclosure document.
- Other disclosures may be required depending on the nature of the material and content.

Advertising must be approved by Compliance prior to release.

19.27.4.2 Customer Complaints Involving Security Futures

KCD's main office will maintain a separate record of all security futures-related complaints. Refer to the chapter *COMMUNICATIONS WITH THE PUBLIC* and the section *Complaints* for further details about procedures for handling complaints.

19.28 Commodity Futures-Linked Securities

[FINRA Regulatory Notice 10-51]

Responsibility	• Designated Supervisor
Resources	• Order records • Available reports
Frequency	• Training: when a new product is introduced and ongoing • Review of orders: Daily, when trades occur • Review of communications: Daily

Action	• Provide training including features and risks of the security and how to inform customers when selling the securities • Review transactions for Reg BI compliance, take corrective action when necessary which may include contact with the RR, the customer, and/or Compliance • Review communications regarding securities to confirm accuracy and completeness of descriptions of features and risks
Record	• Records of training • Records of communications • Records of order review • Records of corrective action taken regarding communications and/or orders

Commodity futures-linked securities use futures contracts to track an underlying commodity or commodity index. The security will typically roll its position before the contract's expiration and can face differing prices between the contract it sells and the new contract - for more distant delivery - that it buys. The difference is called the roll yield. There are different methodologies for achieving investment objectives, and some may not employ strategies that address roll yield. Some invest in a single futures contract while others invest in multiple contracts. Others track indices in an attempt to optimize roll yield by minimizing the impact of contango (an upward sloping forward curve [as in the normal yield curve]). Such a forward curve is said to be "in contango" [or sometimes "contangoed"]) or maximizing the impact of backwardation (a downward sloping forward curve [as in an inverted yield curve]). FINRA Regulatory Notice 10-51 should be reviewed for a more complete description of commodity futures-linked securities.

As with all recommendations, the RR must understand the security being recommended and ascertain that the investment is Reg BI compliant for the customer. The RR is obligated to discuss with a retail investor the following features:

- the commodity, basket of commodities or commodities index that a given product tracks;
- the product's goals, strategy and structure;
- that commodities prices, and the performance of commodity futures-linked securities, can be volatile;
- the use of futures contracts can affect the performance of the product as compared to the performance of the underlying commodity or index;
- the product's methodology, including its strategy, if any, for managing roll yield and other factors that may affect performance; and
- the product's tax implications. (Commodity pools have different tax implications than mutual funds or exchange-traded notes.)

19.29 Certificates Of Deposit

[FINRA Notice to Members 02-69]

Responsibility	• Designated Supervisor
Resources	• Order records • Transaction reports • Customer information • Information about CDs being offered

Frequency	• Daily - review transactions
Action	• Provide training to RRs regarding features of CDs and suitability guidelines when recommending CDs depending on type • Review transactions for suitability considering the type of CD being purchased and the customer's investment objectives and investment profile
Record	• Order records/transaction reports include supervisor's initials and date of review and note of action taken • Training materials and records of when training is administered and to whom

KCD offers certificates of deposit (CDs) as one of the products available to customers. Because CDs offered by KCD 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.

19.29.1 General Sales Guidelines

The following guidelines apply to the sale of CDs:

- Only KCD-approved sales material may be provided to customers.
- RRs should be familiar with the features of the CD prior to discussing it with the customer. 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 customer.

19.29.2 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. CDs should be reviewed by Compliance prior to offering to the public, to determine whether registration as a security is required.

"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.

19.29.3 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. KCD 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.

19.29.4 Market Index/Linked CDs

Some CDs are linked to market indices. Market Indexed/Linked CDs ("MCDs") are hybrid investments that often combine zero-coupon bonds with stock options on the underlying market index. When held to maturity, MCDs are intended to offer return of the initial investment with the potential of upside gain based on the performance of the underlying index. MCDs are insured by the FDIC for up to $100,000 per account held at each institution.

There are important differences between certificates of deposit and indexed CDs. RRs should understand those differences and disclose key risks and features when recommending purchases.

- Unlike traditional CDs, MCDs are subject to market risk if sold prior to maturity.
- A secondary market is not guaranteed and may not exist; customers may not be able to liquidate MCDs prior to maturity.
- Investors must keep MCDs for the full term of the MCD (often 4-5 years) in order to be guaranteed a return of principal plus earnings.
- Some indexed MCDs have complicated terms that can result in yields that vary greatly from what investors expect.
- Risk and return may have multiple determinants; an indexed MCD may be linked to multiple indexes and issuers can use a variety of averaging methods which, depending on the market environment, could result in no paper gains for the investor, even if the market ended higher at the end of the term.
- Some MCDs have call features that may result in the MCD being called prior to maturity.
- Some MCDs have "barriers" or "knock-out rates." Investors may receive no interest when the barriers are breached, *i.e.,* the index rises above or below the barrier.

- The tax implications of MCDs are different from traditional CDs. Because MCDs include zero coupon bonds, the customer will be required to pay tax on the increase in the accreted value of the MCD on a yearly basis ("phantom" income) even though actual interest is not received until maturity. If held in a taxable account, the investor is taxed on this phantom income.
- Customer should be advised on the method used to derive valuation. The price may or may not be based on the actual closing value of the linked index on the final maturity date. Market value of the MCD may not correspond directly to increases or decreases in the underlying linked index.

19.29.5 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 KCD's statements will include appropriate disclosures regarding pricing.

19.30 Cash Alternatives

[FINRA Regulatory Notice 08-82]

Responsibility	• Designated Supervisor • Compliance
Resources	• Retail communications that include content about cash alternatives • Order records
Frequency	• Daily - review of order records • Daily - review communications with the public • As required - Compliance review of advertising and retail communications for broad dissemination (brochures, summary sheets, *etc.*) • Quarterly - review of previously approved retail communications still being used • Periodically - include cash alternatives in training

Action	• Designated Supervisor:
	  ○ Review orders for suitability of recommendations
	  ○ Review written and electronic correspondence and retail communications for accuracy of representations and suitability of recommendations
	• Compliance: Review and approve/disapprove proposed advertising and broadly-disseminated communications for accuracy or representations, compliance with regulatory requirements; re-review approved retail communications that continue to be used at least quarterly to confirm conditions have not changed that make the material inaccurate
	• Include cash alternatives in RR training

Record	• Designated supervisor: orders records, retail communications • Compliance: advertising, broadly-disseminated communications • Training records including subjects covered, date of training, and who attended are retained by the person/department conducting the training

In addition to issues about CDs, RRs must be aware of obligations when selling other securities that might be considered "cash alternatives." General obligations include the following:

- Avoid overstating a product's similarities to cash holding and provide balanced disclosure of the risks and returns associated with a particular product;
- Understand the features of the product; and
- Consider suitability before making a recommendation.

Correspondence, retail communications and oral communications regarding cash alternatives must present a fair and balanced representation of the risks, benefits, and limitations of investing in these products. Investments may not be represented as an alternative to cash unless that is accurate. Written and electronic communications must include the following:

- Disclosure, if applicable, that the investment is not federally insured and the customer may lose money.
- Factors that may affect liquidity or price stability or the issuer's ability to repay its obligation in full.

Previously-approved retail communications may not be used where market or economic developments affect the continued accuracy of characterization of a product as a cash alternative.

19.31 Real Estate Investment Trusts (REITs)

[FINRA Rule 2310; FINRA Regulatory Notice 08-35]

REITs invest in different types of real estate or real estate related assets such as shopping centers, apartment buildings, office buildings, hotels, and mortgages secured by real estate. The three types of REITs include:

- Equity REITs that invest in or own real estate with income principally 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 over-the-counter market; some mutual funds specialize in public real estate. Some REITs invest specifically in one area of real estate (for example, apartment buildings) or in one specific geographic region. REITs generally provide ongoing dividend income along with the potential for long-term capital gains.

19.31.1 General Sales Guidelines

- When determining the Reg BI compliance 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 it is available
- For unlisted REITs, consider liquidity and marketability and advise the investor of such risks [FINRA Rule 2310(b)(3)(D)]
- Customer account statements may include valuations and disclosures regarding certain REITs [FINRA Rule 2310(b), Notice to Members 01-08]
- Requirements regarding sales contests and cash/non-cash compensation apply to REITs (Refer to the chapter *ORDERS* and the section *Cash And Non-Cash Compensation*) [FINRA Rule 2310, Notice to Members 05-40]

19.31.2 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

19.31.3 Private And Non-traded REITs

[FINRA Regulatory Notice 13-18]

Responsibility	• Designated Supervisor
Resources	• Private and non-traded REITs
Frequency	• As determined by New Product Committee
Action	• Subject REITs to new product review when initially to be offered • Periodically conduct due diligence reviews to confirm the types of investors for whom the product is Reg BI-compliant or to discontinue sales
Record	• New product review (see *New Products* in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*) • Periodic reviews and determinations

Private and non-traded REITs are companies whose shares do not trade on a national stock exchange. They generally operate like unit investment trusts by purchasing assets that are held for a fixed amount of time, often 7 to 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.

- Sales costs are deducted from the offering price.
- The investment is illiquid during the term of investment which may be 7 to 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.
- Dividends may include repayment of principal in early stages of the program.
- 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.

Refer to the section *Communications Regarding Unlisted Real Estate Programs* in the chapter *DIRECT PARTICIPATION PROGRAMS AND REITS* for details regarding FINRA guidance on communications about real estate programs.

19.32 Callable Common Stock

[FINRA Rule 2232]

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 KCD 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.

19.33 Promissory Notes

[FINRA Notice to Members 01-79]

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 KCD, 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 KCD are subject to review by the designated supervisor.

Individuals or entities outside KCD may attempt to sell unregistered promissory notes through licensed RRs. RRs are reminded that they may only sell securities offered by KCD, unless specifically approved by Compliance.

19.34 Direct Participation Programs (DPPs)

[FINRA Rule 2310]

DPPs are primarily suitable for customers who need tax advantages on passive income. DPPs can be a method of obtaining appreciation of capital. Each DPP has specified suitability/Regulation BI standards including information such as the purchaser's net worth. Following are features and requirements of DPPs:

- RRs should reasonably determine that the customer understands the ramifications of not having a high enough tax bracket or not enough passive income to receive benefits of a DPP's partnership flow-through concept.
- RRs are responsible for obtaining the required subscription agreement or, if no agreement is required, determining that the customer meets the standards outlined in the prospectus and completing the Suitability/Regulation BI Questionnaire.
- While there may be a secondary market for particular DPPs, they may have limited liquidity and should be considered a long-term investment.
- Secondary market transactions must be recorded in KCD's order records including the time of execution.
- KCD will use FINRA standard transfer forms for secondary market transactions.
- Limited partners in rollup transactions will be provided a disclosure outlining information about the rollup.

See the chapter *DIRECT PARTICIPATION PROGRAMS AND REITS* for more information.

19.35 Section 1031 Tenants-In-Common Exchanges

[Internal Revenue Code Section 1031; IRS Revenue Procedure 2002-22; FINRA Notice to Members 05-18]

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 exchanges receive favorable tax treatment. A 1031 exchange by TIC would qualify for deferral only if the TIC and the transaction meet 15 IRS conditions outlined in Revenue Procedure 2002-22.

TIC 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) which is subject to due diligence, Reg BI, training, and internal control requirements. 1031 exchanges facilitated by KCD must comply with requirements in the section *Non-Conventional Investments* in this chapter.

FINRA Notice to Members 05-18 should be referenced for a detailed discussion of tenants-in-common interests.

19.36 Complex Products

[FINRA Regulatory Notice 22-08, 17-32 and 12-03]

Responsibility	• Designated Supervisor
Resources	• Third party distributors • Orders for complex products • Account records
Frequency	• As required

Action	• When third parties are used to distribute products originated by KCD:
	    ○ Review distributor's sales practices, training, investor education efforts, and compliance efforts including how over-concentration or other potential issues are identified
	• Subject new complex products to the new product review process
	• Review applications/orders for (depending on the product):
	    ○ Age/retirement status of investor for compliance with Reg BI
	    ○ Compliance with Firm-established suitability/Reg BI guidelines
	    ○ Concentration of the investment in the customer's account and compliance with Firm- and state-established guidelines
	    ○ Compliance with state standards and customer's state of residence liquid net worth definition, state concentration limits
	    ○ Effect of early withdrawal fees, taxes or penalties on the customer and his/her liquid net worth calculation
	    ○ Use of most current version of the application form
	• Provide training to RRs and supervisors regarding the products, suitability/Reg BI standards, and required reviews
	• Perform post-issuance review after release of a new complex product including an assessment of whether the product performs in accordance with its design and whether distributors and other sellers sold the product to the types of investors for which it was intended

Record	• Reviews of third-party distributors • New product reviews and post-issuance reviews • Reviews of applications/orders and action taken, if any

	• Records of training including who attended, when conducted, subjects included

FINRA guidance has indicated that complex products warrant particular care in how they are scrutinized and sold to retail customers. FINRA indicates that a product that is complex is one that "presents an additional risk to retail investors because its complexity adds a further dimension to the investment decision process beyond the fundamentals of market forces." This is only a general description since all the potential variations in products make it difficult to clearly define the term. The last subsection of this section includes examples of complex products from FINRA Regulatory Notice 12-03.

The complexity of products imposes additional obligations on RRs who sell such products, as well as on KCD to supervise their sale. Other sections in this chapter that discuss specific complex products include:

- *Hedge Funds*
- *Exchange-Traded Funds*
- *Commodity Futures-Linked Securities*
- *Non-Conventional Investments (NCIs)*
- *Structured Products*
- *Exempt Insurance Products and Equity-Indexed Annuities*

19.36.1 Approval Of The Product

All new products are subject to KCD's new product review process, and for complex products, there is a heightened level of review. If a complex product is approved for sale, training and other informational materials will be provided to RRs and, if appropriate, to potential investors. The types of investors Reg BI-compliant for the product will also be identified and communicated to RRs.

19.36.2 Knowledge Of The Product

The RR will be provided training regarding the features of a complex product. Before recommending complex products, RRs must understand the features and characteristics of the product and any reference asset (where applicable) including its historic performance and volatility and correlation with specific asset classes; any interrelationship between multiple reference assets; the likelihood that the complex product may be called by the issuer; and the extent and limitation of any principal protection. Knowledge of these aspects as well as how the product is expected to perform in normal market conditions and the risks are necessary to be able to present accurate information to prospective investors and to be able to make Reg BI-compliant recommendations.

19.36.3 Regulation Best Interest Compliance

Knowledge of the product is key to making a recommendation. The other key aspects of a recommendation include:

- The customer's investment experience
- The customer's risk tolerance
- Whether the customer is of retirement age or is retired
- The percentage of investments (concentration) the investment will represent
- The effect of early withdrawal including fees, taxes or penalties
- State requirements regarding concentration, other state requirements
- Firm guidelines regarding Reg BI requirements, concentration, *etc.* for specific products

- A reasonable basis for believing, at the time of recommendation, that the customer has the knowledge and experience in financial matters that he/she may reasonably be expected to be capable of evaluating the risks
- The customer is financially able to bear the risks of the investment

The RR should discuss the features of the product with retail customers including how it is expected to perform under different market conditions, the risks and possible benefits, scenarios in which the product may perform poorly, and the costs of the product. The RR should consider whether it seems the retail customer understands the basic features of the product such as the fundamental payout structure and the nature of underlying collateral or a reference index or asset.

19.36.4 Other Requirements

There may be other requirements related to the sale of a complex product, including:

- Limits or conditions on the sale of the product, such as concentration limits or limits on the types of investors who may purchase the product
- Investor qualification agreements to pre-qualify potential purchasers
- Limitation on purchasers to those who have been approved for option trading, which provides a minimum qualification to participate in the investment

19.36.5 Examples Of Complex Products

- Asset-backed securities that are secured by a pool of collateral such as mortgages, payments from consumer credit cards or future royalty payments on popular music, may be difficult for retail investors to understand. With these securities, the creditworthiness of the underlying borrowers or the existence of prepayment risks, though critical to the evaluation of the product, may not be readily apparent to retail investors. Similarly, unlisted REITs may present liquidity and valuation issues for a retail investor.
- Products that include an embedded derivative component that may be difficult to understand, such as those:
    - in which repayment of principal or payment of yield depends upon a reference asset, when information about the performance of the reference asset is not readily available to investors. An example is structured notes with an embedded derivative for which the reference asset is a constant maturity swap rate.
    - that provide for different stated returns throughout the lifetime of the product. For example, "steepener" notes typically offer a relatively high teaser coupon rate for the first year, after which they offer variable rates determined by the steepness of a yield curve. Similarly, some firms have offered structured notes with payoffs contingent on whether one or more reference asset performs within a certain range.
    - under which the investor might incur a capital loss as a result of the fall in the value of the reference asset without being able to participate in an increase in its value. So-called "reverse convertible notes" may fall into this category.
    - in which a change in the performance of the reference asset can have a disproportionate impact on the repayment of capital or on the payment of return. For example, "knock in" or "knock out" features associated with reverse convertible notes, in which a drop in the value of the reference asset to a pre-defined level, can affect determination of an investor's gains or losses.
- Products with contingencies in gains or losses, particularly those that depend upon multiple mechanisms, such as the simultaneous occurrence of several conditions across different asset classes. An example is range accrual notes for which the return of principal can depend upon the value of two or more reference assets on certain pre-defined dates.
- Structured notes with "worst-of" features, which provide payoffs that depend upon the worst performing reference index in a pre-specified group. These notes can limit the return of principal at maturity if either

the reference index falls by a stated percentage (*e.g.,* 30 percent) or if any of the reference indices decline in value since the date of issue.
- Investments tied to the performance of markets that may not be well understood by many investors. For example, some exchange-traded products offer retail investors exposure to stock market volatility. Some of these products also provide inverse or leveraged exposure. The investable form of volatility may be in the form of futures on the CBOE Volatility Index (VIX) that reflect the market's expectation of volatility. Some investors may not understand that the product's return may not be based on VIX fluctuations actually experienced on a given day, but on the market's expectation of future volatility.
- Products with principal protection that is conditional or partial, or that can be withdrawn by the product sponsor upon the occurrence of certain events. Notes that can lose their principal protection based upon a stated event represent an example of a product with this feature.
- Product structures that can lead to performance that is significantly different from what an investor may expect, such as products with leveraged returns that are reset daily. Leveraged or inverse exchange-traded funds exemplify this feature. Many leveraged and inverse ETFs "reset" daily, meaning that they are designed to achieve their stated leverage or inverse objectives on a daily basis. Their performance over longer periods of time can differ significantly from what might be expected based on their daily leverage or inverse factor.
- Products with complicated limits or formulas for the calculation of investor gains. For example, some structured notes have a payout structure that tracks the upside performance of a reference asset one-for-four, but if the reference asset's performance exceeds a specified threshold the payoff is reduced to a much lower, pre-set level, regardless of how it performs afterward.
- Volatility-linked exchange traded products (ETPs) designed to track CBOE volatility index futures rather than the index itself. Many volatility-linked ETPs are highly likely to lose value over time and may be non-Reg BI-compliant for certain retail investors, particularly those with the objective to buy-and-hold. See FINRA Regulatory Notice 17-32 for more information.

19.37 Hedge Funds

[FINRA Notice to Members 03-07]

Responsibility	• Designated Supervisor
Resources	• Information from issuer • Subscription agreements • Customer account information
Frequency	• As required
Action	• Conduct due diligence for any proposed hedge fund investment to be offered to customers • Review subscription agreements for completeness and suitability of investment for the customer, considering account information on file with KCD • Approve or disapprove subscription agreements
Record	• Due diligence file including record of reviews, references, *etc.* • Notation and date of approval or disapproval, to offer the securities • Subscription agreement file including signature/initials of reviewer and approval or disapproval

This section describes the RR's obligations when selling hedge funds to customers. Funds of hedge funds are discussed in the chapter *MUTUAL FUNDS*.

19.37.1 Definition

A hedge fund includes a private and unregistered investment pool that accepts investors' money and employs sophisticated hedging and arbitrage techniques using long and short positions, leverage and derivatives, and investments in many markets. Hedge funds vary in size and trading strategies, including categories such as: relative value hedge funds, event driven hedge funds, equity hedge funds, global asset allocator hedge funds, short selling hedge funds, sectoral hedge funds, and market neutral hedge funds. Most hedge funds are not registered.

19.37.2 Features Of Hedge Funds

Many hedge funds have the following features:

- 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

19.37.3 Promotion Of Hedge Funds

Correspondence, retail communications and oral presentations promoting hedge funds must be balanced to include the risks and potential disadvantages of the investment. Specific items that may NOT be included are statements that hedge funds offer:

- superior professional management with more investment flexibility
- protection against declining markets
- better returns due to the imposition of performance fees
- target returns unless sales literature referring to the target provides enough information to substantiate and provide a sound basis for the target

unless these statements are fair, accurate, and without exaggeration.

Risks that must be disclosed are that hedge funds:

- 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; and,
- often charge high fees.

Investors must be provided with any prospectus or other disclosure document of the hedge fund.

19.37.4 Suitability

19.37.4.1 Due Diligence

Unregistered hedge funds are usually offered through private placements. KCD will conduct due diligence prior to offering hedge funds to customers, including the following:

- investigation of the background of the hedge fund manager
- reviewing the offering memorandum
- reviewing subscription agreements
- examining references
- examining the relative performance of the fund
- other due diligence reviews determined by the reviewer

19.37.4.2 Customer Suitability

Historically hedge funds have only been available to high net-worth individuals or institutions. Access to some hedge funds has been expanded to include other investors. Prior to recommending a hedge fund to a customer, the RR is obligated to:

- Understand the risks and features of the investment.
- Consider the structure and nature of the hedge fund, particularly whether the hedge fund has "side-pocket" accounts that hold hard-to-value investments that may affect liquidity and limit the ability to determine the value of the fund.
- Determine suitability considering the usual factors including financial status, tax status, investment objectives, and other information reasonable for determining suitability. A customer's level of assets does not, in and of itself, meet suitability requirements. The fact that a customer is an "accredited investor" under Regulation D does not, alone, satisfy the obligation.

19.37.4.3 Subscription Agreement

A subscription agreement, including suitability requirements, must be completed for each investor prior to purchase. Subscription Agreements will be reviewed by the supervisor for completeness and the appropriateness of the investment for the customer.

19.37.4.4 Hedge Fund Disclosure Statement

Each prospective investor will be provided with KCD's Hedge Fund Disclosure Statement that outlines the features and risks of hedge funds. A record will be retained that the Statement was provided to the customer.

19.38 Structured Products

[FINRA Notice to Members 05-59; Interagency Statement on Complex Structured Financial Transactions: http://www.sec.gov/rules/policy/2007/34-55043.pdf; SEC Summary Report of Sweep Examination of Structured Products Sold to Retail Investors: http://sec.gov/news/press/2011/2011-157.htm; SEC Risk Alert Broker-Dealer controls regarding retail sales of structured securities product: https://www.sec.gov/about/offices/ocie/risk-alert-bd-controls-structured-securities-products.pdf]

Responsibility	• Designated Supervisor - reviews of accounts and transactions, correspondence and retail communications

<table>
<tr><td></td><td>Compliance - review/approve advertising
New Product Committee or other supervisor designated to review new products - review new structured products proposed for sale</td></tr>
<tr><td>Resources</td><td>Information about a product to be sold
Order records/reports
Account records of option approval</td></tr>
<tr><td>Frequency</td><td>As necessary - conduct reviews of new products
Daily - review of correspondence and retail communications
As necessary - review/approval of advertising
As necessary - conduct training regarding products
Daily - approve accounts, review transactions
Weekly - evaluate secondary market pricing (if applicable)</td></tr>
<tr><td>Action</td><td>Submit a new structured product to the new product review process as outlined in the chapter FINANCIAL AND OPERATIONS PROCEDURES - Risk Management - New Products particularly considering necessary disclosures when selling the product
Compliance:
Review advertising
Train supervisors and RRs regarding structured products in general and about the specifics of individual products to be offered
Review purchases of structured products
For retail accounts, confirm customer has been approved for options trading and specifically a level to purchase options
For retail accounts, conduct reviews for suitability including determination that the structured product meets the customer's stated investment objectives
Identify customer concentrations in structured products and determine suitability
Confirm necessary disclosures were provided
If the Firm trades structured products, conduct independent reviews of desk prices in the secondary market</td></tr>
<tr><td>Record</td><td>New product approval including due diligence reviews and determination of necessary disclosures
Compliance: Advertising reviewed
Customer account review for suitability to purchase structured products
Order records/reports, reviews of concentration, disclosures provided, with reviewer's initials and date of review and notes of action taken, if any
Records of training including when conducted, who attended, and subjects included
Reviews of pricing in the secondary market (if applicable)</td></tr>
</table>

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.

Principal-protected notes are discussed in a specific subsection.

19.38.1 Due Diligence

New structured products are subject to KCD's new product review procedures. Refer to the section *New Products* in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*. This includes a determination of the types of eligible purchasers. In particular, the New Product Committee will review the following for structured products:

- The appropriateness of fees and other incentives
- Nature of the new structured product
- Target investors and whether the product is appropriate for the targeted investors

KCD will not solely rely on a third-party's assessment about the appropriateness of structured products for individual investors; it will conduct its own independent evaluation.

19.38.2 Public Communications

All correspondence and retail communications and oral communications must be fair and balanced regarding risks and benefits. Communications must be clear and not misleading and should enable an investor to evaluate the investment from a risk/reward perspective. If returns are discussed, it should be clearly disclosed how returns are linked to an underlying asset. Advertising and written promotional material (brochures, written presentations provided to multiple investors) must be approved by Compliance prior to distribution consistent with the requirements in the section *Retail Communications* in the chapter *COMMUNICATIONS WITH THE PUBLIC*.

The following are necessary disclosures about principal-protected notes, where appropriate:

- The level of principal protection offered
- The credit-worthiness of the guarantor
- The potential returns and pay-out structure (including any limits on upside potential)
- The investor's ability to access funds pending maturity date or the expiration of a lock-up period
- Any costs or fees that might affect the return of principal
- Description of the derivative component of the product (cannot be represented as ordinary debt securities)
- Statements about the product having a ticker symbol or is approved for listing balanced with risks that an active and liquid trading market may not develop

19.38.3 Eligible Accounts

[FINRA Rule 2360]

Only accounts approved for option trading, and specifically approved for purchasing options, will be eligible to purchase structured products.

If the structured product is issued by KCD, or an affiliate of KCD, it can be sold to discretionary accounts only with the prior specific written approval of the customer.

KCD may impose additional requirements for eligibility (investment objectives of the account, *etc.*) depending on the individual structured product.

19.38.4 Suitability

Because of the potential complexity of structured products, RRs must determine the suitability of potential purchasers, including the customer's:

- financial situation including income and liquid 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

RRs should inform the customer of the features of the structured product being recommended. Recommendations may only be made to eligible customers, as explained above.

19.38.5 Risk Disclosure

It is important that investors understand the risks involved in structured product investments. 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
- Tax implications (if applicable) and the potential need to consult with the investor's accountant, tax attorney, or other tax professional

19.38.6 Fees And Costs

Fees, costs, commissions, discounts, and any other amounts paid at the time of purchase or for acting as such, over the life of that product, must be disclosed to investors.

19.38.7 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.

19.38.8 Tax Implications

Investment in structured products may have tax consequences for individual investors depending on their personal circumstances and jurisdiction of residence. Although certain tax implications may be highlighted in product documents, investors should be encouraged to discuss the specific tax implications of structured products with their accountant, tax attorney, or other tax professional.

19.38.9 Post-Trade Information

Where available, KCD will provide information to RRs and/or investors to enable them to monitor performance of structured products and provide access to information regarding the terms of the product including maturity, pay-out details, secondary market price, and other pertinent information.

19.38.10 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. 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% to 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% and 20% and the upside is limited to the coupon amount. If the underlying stock falls below a set "barrier" level, the investor may get 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.

19.38.11 Principal-Protected Notes (PPNs)

[FINRA Regulatory Notice 09-73; SEC Investor Alert: http://sec.gov/news/press/2011/2011-118.htm]

PPN in this section refers to any structured product that combines a bond with a derivative component and that guarantees a full or partial return of principal at maturity. Sales of PPNs to retail customers are subject to particular considerations explained in this section:

- While products may be described as "guaranteed," principal protection, absolute return, minimum return, the degree of guarantee, protection, risk, and return vary depending on the specific features of the note being sold.

- The suitability of recommendations must take these features into consideration as well as the customer's objectives, needs, and willingness/ability to sustain risk.

19.38.11.1 Features Of PPNs

PPNs typically combine a zero-coupon bond with an option or other derivative product with a payoff linked to an underlying asset such as an equities index or basket of indices. There is a guarantee of a return of some or all principal at a maturity date which may be up to 10 years from issuance and participation in a return linked to a specific change in the value of the underlying asset.

RRs should review FINRA Regulatory Notice 09-73 for illustrations of how returns and guarantees may vary depending on how the note is structured.

19.38.11.2 Suitability Considerations

The following are factors to consider when recommending PPNs.

- The credit-worthiness of the guarantor and the nature and terms of guarantees
- The investment's pay-out structure, costs and fees
- The customer's need for access to their money before the maturity date arrives or a lock-up period expires
- The call risk of callable notes
- Tax consequences such as a note invested in zero-coupon bonds which could result in paying tax on imputed interest as it accrues
- Fees and costs
- Lack of inflation protection since principal guarantee generally relates to nominal principal

19.38.12 Reverse Convertibles

[FINRA Regulatory Notice 10-09]

A reverse convertible is a structured product that has features that should be communicated to potential retail investors before recommending the security. Relevant features potentially include the following:

- **How the product works** including pay-out structure, relevant information about the reference asset, and, if applicable, that the investor will not participate in any appreciation in the value of the reference asset.
- **Return of principal.** Instead of a full return of principal at maturity, the investor could receive less than a full return of principal if the value of the reference asset has fallen below a certain level, often referred to as the "knock-in" or "barrier" level. Depending on the underlying asset, the investor could receive a predetermined number of shares of common stock (or cash equivalent), which would amount to less than the investor's original investment.
- **Pay-out structure.** Pay-out structures may involve multiple variables that affect risk, cost, and potential benefits. The RR should have an understanding so these variables may be communicated to the investor.
- **Sale of product prior to maturity.** The ability to sell and the potential selling price may depend on the willingness of the issuer or another party to maintain a secondary market.
- **Issuance of research by the Firm.** If applicable, disclose to the investor that the Firm has published its own research reports regarding the reference asset, the content of the research and how the research is or is not relevant to a recommendation to purchase or sell the reverse convertible.

Communications, whether directly with a potential investor or through advertising or other communications, must be truthful and not contain any exaggerations. Following are restrictions and guidelines on communications:

- Reverse convertibles should **not** be described as ordinary debt securities.
- Any reference to the product's credit rating cannot suggest that the rating has any bearing on the expected performance of the reference asset, nor may it exaggerate the probability that the investor will receive a full return of principal.
- Annualized yield or coupon information cannot be presented in a misleading manner. For example, a 10% per annum coupon provides an actual return of roughly 2.5% (based on a 360-day year) over a 3-month term. Communications about products that mature in less than a year must balance communication about annualized yield with prominent disclosure of the actual percentage return and the term of the note.

19.38.13 Exchange Traded Notes (ETNs)

[FINRA Investor Alert: https://www.finra.org/investors/alerts/exchange-traded-notes-avoid-unpleasant-surprises; NYSE Informed Investor: What You Should Know About Exchange Traded Notes: https://etp.euronext.com/sites/etp.euronext.com/files/etf_informed_investor.pdf]

ETNs are unsecured debt obligations of an issuer which typically is a bank or another financial institution. RRs must be familiar with the features and risks of ETNs before recommending them, and explain features to prospective investors. The complexity of an ETN is a factor to consider before recommending it to an investor.

Features include the following:

- ETNs are sold by prospectus which must be provided to the investor.
- ETNs usually do not pay interest but rather make distributions determined by the performance of an underlying index or benchmark on the ETN's maturity date (which may be 10, 30, or 40 years from issuance) minus fees. An individual ETN may or may not provide for periodic payments or cash distributions prior to maturity.
- Underlying indexes may be familiar and broad-based or less familiar asset classes or complex and sometimes proprietary indexes.
- Some ETNs offer leveraged exposure to the index or benchmark they track.
- Leveraged and inverse ETNs are short-term trading investments not intended for long-term investing.
- The creditworthiness of the issuer is important since the ETN itself is not rated.
- ETNs may have a repurchase feature allowing qualified investors to redeem notes of a minimum denomination or value daily or weekly at a predetermined price. Other investors may sell in an available secondary market (ETNs are often listed), sell if called by the issuer, or allow them to mature.
- The issuer charges an annual fee through the term of the ETN. Fees are explained in the prospectus.
- ETNs trade on exchanges; the sales price in the secondary market is determined by supply and demand. ETNs do not sell at net asset value (NAV).

Risks include:

- As unsecured debt obligations, the issuer may default on the note.
- ETNs are influenced by the value of the underlying index subjecting the investor to market risk.
- A trading market may not develop, even though an ETN is listed on an exchange.
- An ETN's market price may not track the underlying index.
- Some ETNs (particularly some leveraged, inverse and inverse leveraged) are short-term trading tools that may reset daily. The performance of these products over long periods can differ significantly from the stated multiple of the performance (or inverse performance) of the underlying index or benchmark.
- ETNs containing components traded in foreign currencies are subject to foreign currency exchange risk.
- Some ETNs are callable at the issuer's discretion; the notes may be called when the investor may incur a loss.
- The issuer may engage in trading activities at odds with investors who hold the notes.

19.39 Retail Foreign Currency Exchange (Forex) Transactions

[Exchange Act Rule 15b12-1; FINRA Regulatory Notice 08-66; NFA forex brochure: https://www.nfa.futures.org/investors/investor-resources/files/forex.pdf; SEC investor alert: http://www.sec.gov/investor/alerts/forextrading.pdf]

Responsibility	• Designated Supervisor • Compliance
Resources	• Correspondence and retail communications • Order records • Retail account records
Frequency	• As required - review advertising • Daily - review correspondence and retail communications • Daily - review orders • Monthly or more frequently, if necessary - review account records

Action	• Designated Supervisor:
	  ○ Refer advertising to Compliance for review/approval
	  ○ Review correspondence and retail communications for accuracy, fairness of explanations or recommendations including a balanced discussion of risks
	  ○ Review orders and accounts for suitability
	• Compliance
	  ○ Review/approve advertising
	  ○ Conduct due diligence on forex dealers and solicitors who execute orders/introduce customers to the Firm

Record	• Designated Supervisor: Correspondence, retail communications about forex transactions; orders/account records • Compliance: Advertising; due diligence reviews of forex dealers/solicitors

Retail forex transactions are conducted in the OTC market between customers and dealers. RRs who intend to offer foreign currency exchange to their customers must comply with the requirements of this policy. Questions should be referred to Compliance.

19.39.1 Qualifying Customers

Customers who may engage in forex transactions must:

1. have an investment objective of speculation or high risk;
2. be willing to lose all of their investment; and
3. be provided the NFA brochure *"Trading in the Retail Off-Exchange Foreign Currency Market."*

19.39.2 Risks

Trading in foreign currencies includes the following risks which must be explained to the customer:

- The currency market is extremely volatile; some currencies are more volatile than others and retail forex customers are exposed to substantial currency risk.
- Leverage may be at ratios of 400:1 or higher which magnifies even minor fluctuations in currency rates resulting in increased losses or gains.

- Unlike margin on securities, forex customers are typically closed out of their position once their loss exceeds their initial investment. Customers are liable for additional losses if the close out doesn't zero balance.
- There is no central clearing organization for forex transactions and funds deposited for currency transactions are not covered by SIPC. Customers face counterparty risk and may not know where their funds are held or by whom.
- Deposits in accounts for these investments are not protected by SIPC.
- The customer may lose his or her entire investment.

19.39.3 Forex-Related Correspondence And Retail Communications

As for all communications, forex communications must be fair and balanced. Advertising must be submitted to Compliance for approval prior to use (refer to the section *Retail Communications* in the chapter *COMMUNICATIONS WITH THE PUBLIC*).

Communications must not mislead the public regarding aspects of forex trading, including:

- the likelihood of profits or the risks of forex trading, including leveraged trading;
- the Firm's role in or compensation from trades;
- the Firm's or the customer's access to the interbank currency market; or
- the performance or accuracy of electronic trading platforms or software sold or licensed by or through the Firm to customers in connection with forex trading, including falsely advertising claims regarding slippage rates.

Forex communications cannot include references to SIPC since SIPC does not cover currency transactions.

19.39.4 FINRA/NFA Requirements

FINRA has stated that retail currency exchange activities must be conducted consistent with NFA (National Futures Association) requirements, some of which duplicate rules applicable to FINRA members. Following are the standards included in FINRA Regulatory Notice 08-66.

- Misappropriating or mishandling customer funds;
- Failing to disclose that KCD is acting as counterparty to a transaction;
- Failing to adequately disclose the risks associated with forex trading;
- Using, selling or leasing electronic trading platforms that allow "slippage" of trade executions in a manner that disproportionately or unfairly affects the customer;
- Manipulating or displaying false quotes;
- Offering mock or "demonstration" accounts that do not accurately reflect the risks of forex trading;
- Issuing to customers false reports or account statements that represent false profits or that conceal misappropriations or losses;
- Making post-execution price adjustments that are inappropriate and unfavorable to the customer;
- Creating false books and records;
- Failing to adequately disclose to customers the risks and terms of leveraged trading;
- Soliciting business for and introducing customers to a forex dealer without doing adequate due diligence about the forex dealer, or in a way that misleads the customer about the forex dealer or forex trading, including how customer funds will be held;
- Failing to conduct due diligence into any solicitors that introduce forex customers to KCD, and failing to supervise any unregistered solicitors that are employees or agents of KCD; and
- Accepting forex-related trades from an entity or individual that solicits retail forex business on behalf of KCD in a misleading or deceptive way.

19.40 Digital Assets

[FINRA Investor Alert re cryptocurrency-related stock scams: http://www.finra.org/investors/alerts/dont-fall-cryptocurrency-related-stock-scams; FINRA 2022 examination report: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program; FINRA content on digital assets: https://www.finra.org/investors/investing/investment-products/digital-assets/types; SEC Public Statement 12/17: https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11; SEC report of investigation: https://www.sec.gov/litigation/investreport/34-81207.pdf; SEC no-action letters: https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm and https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1-incoming.pdf; SEC analysis of digital assets and whether securities laws apply: https://www.sec.gov/files/dlt-framework.pdf; SEC Risk Alert 2-26-21: https://www.sec.gov/files/digital-assets-risk-alert.pdf]

Responsibility	• Designated Supervisor
Resources	• Requests to trade digital assets • Account records • Transaction records/available reports
Frequency	• Prior to initial trading: product review and due diligence • As required: approval of accounts and RRs to trade digital assets • Daily: Review of transactions • Ongoing: Review digital asset communications • Prior to an RR initially trading digital assets and at least annually: Training of RRs

Action	• New Product Committee or comparable review:
	  ○ Determine whether the proposed investment is a security, commodity, or subject to other registration requirements
	  ○ Determine whether existing Firm insurance coverage (*i.e.,* D&O, E&O, professional liability, cybercrime) includes digital assets
	  ○ Conduct due diligence including where and how traded; liquidity; volatility; and whether the value of the asset can be determined consistent with current accounting rules
	  ○ Determine what types of accounts would be Reg BI-compliant to purchase
	  ○ Determine disclosures to be made to investors
	• Submit a CMA with FINRA
	• Approve individual RRs allowed to offer digital assets
	• Require approval of any account that will trade digital assets
	• Review transactions on a daily basis
	• Review digital asset communications to confirm compliance with requirements included in this section
	• Include digital asset securities in AML reviews
	• Identify conflicts of interest and confirm adequate disclosures are made
	• Provide training to RRs who will offer these investments
	• Notify FINRA if KCD will engage in digital assets transactions (requested by FINRA, not mandatory)

Record	• New Product Committee (or other) review and due diligence • CMA filing • Account approvals • RR approvals • Transaction reviews including any action taken • Training including subjects, date of training, who attended • Notice to FINRA, if KCD chooses to notify

Digital assets such as cryptocurrencies and initial coin offerings (ICOs) have received significant media, public and regulatory attention. Features and requirements include the following:

- A virtual currency or virtual token or coin is a digital representation of value that can be digitally traded and functions as a medium of exchange, unit of account, or store of value.
- A virtual currency exchange is a person or entity that exchanges virtual currency for fiat currency, funds, or other forms of virtual currency. Exchanges typically charge fees; secondary trading may occur. These exchanges may not be registered securities exchanges or alternative trading systems subject to federal securities laws.
- Virtual tokens or coins may be issued by a virtual organization or other capital raising entity.
- They may or may not be considered securities or commodities products and may be unregulated.
- They are highly speculative considering the lack of real markets and transparency.
- They are Reg BI-compliant only for accounts with speculation as an investment objective.
- An affiliate of KCD effecting transactions in digital asset securities may be required to register as a broker-dealer.
- RRs requesting to offer digital assets must be approved by the designated supervisor and are subject to special training.
- Accounts that will trade digital assets must be approved prior to engaging in such activity. Retirement accounts and accounts for seniors are generally not Reg BI-compliant for these investments. Retirement accounts may require an opinion of counsel prior to investing in digital assets.

Questions regarding digital assets should be referred to Compliance.

19.40.1 Communications

Communications regarding digital assets must include fair and balanced presentations including addressing risks presented by digital asset investments (*e.g.,* such investments are speculative, involve a high degree of risk, are generally illiquid, may have no value, have limited regulatory certainty, are subject to potential market manipulation risks, may expose investors to loss of principal) and not misrepresenting the extent to which digital assets are regulated by FINRA or the federal securities laws or eligible for protections such as SIPC coverage.

In addition, communications should differentiate digital assets from BD products and services from those offered by affiliates or third parties, including digital asset affiliates. Communications should clearly and prominently identify entities responsible for non-securities digital assets businesses and explain that such services were not offered by the BD or subject to the same regulatory protections as those available for securities.

19.41 Fractional Share Investing

[SEC Investor Alert on Fractional Share Investing: https://www.sec.gov/oiea/investor-alerts-and-bulletins/fractional-share-investing-buying-slice-instead-whole-share]

A fractional share is a portion of one whole share of a company. Fractional shares can be bought and sold just like whole shares and allow investors to invest and diversify their portfolios with smaller amounts of money. Exchange-traded funds are also available for fractional share investing.

Following are features or requirements of fractional share investing:

- Companies that pay dividends also pay on fractional shares.
- Not all shares qualify for fractional share investing.
- Voting rights for fractional shares are not guaranteed and depends on how the fractional investing program works.
- Investing may be limited to only certain companies' shares, depending on the fractional investing program.

- Fractional investments may be difficult to transfer to another broker-dealer.
- Owning fractional shares may not be as advantageous for some option trading techniques like selling covered calls.
- Orders may be executed in real time or aggregated for execution.
- Added fees may apply.
- Minimum size or dollar amounts may apply to investments.
- Fractional share transactions are subject to transaction reporting requirements of CAT, TRF (FINRA trade reporting facility) and ORF (OTC trade reporting facility) and other trade requirements such as order handling rules and NMS Rule 606 reporting.

Recommendation of fractional share investing is subject to suitability and Regulation Best Interest standards that apply to full-share investing.

19.42 Short Sales

[SEC Regulation SHO; SEC Division of Market Regulation Responses to Frequently Asked Questions Concerning Regulation SHO: http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm]

Responsibility	• Designated Supervisor
Resources	• Order records
Frequency	• Daily
Action	• Comply with short sale price test requirements through systems to: ○ Determine when a covered security becomes subject to the price test ○ Monitor, on a real-time basis, the national best bid to determine permitted execution or display prices ○ Record a "snapshot" of the national best bid at the time a short sale order is submitted ○ Confirm only orders that are exempt are marked "short exempt" ○ Monitor and address latencies in obtaining data regarding the national best bid • For riskless principal transactions that are marked "short exempt," systems are in place to confirm that: (i) the offsetting transaction occurred after the customer order was received; and (ii) the offsetting transaction is allocated to a riskless principal or customer account within 60 seconds of execution • Take reasonable steps to enforce the policies and procedures, including conducting regular post-trade analysis • Review for: ○ compliance with price test requirements ○ sell orders marked "long" or "short" or "short exempt" ○ locate information (affirmative determination) on short sells including who was contacted and the date advised the stock could be borrowed
Record	• Record of the national best bid at the time of execution or display of a short sale order (*e.g.,* a "snapshot" of the market) • Records (available in a time-sequenced manner) that enable KCD to accurately and readily reconstruct, in a time-sequenced manner, all orders executed based on the riskless principal exemption • Initials or other record of review on order records and action taken, if any

	• Locate information on order records

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. The exercise of a long put by someone who does not own the underlying stock to deliver against the exercise will have engaged in a short sale and the stock must be borrowed and delivered within the required timeframe.

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.

19.42.1 Key Defined Terms

"Listing market" means the effective transaction reporting plan for the covered security. While the two reporting plans define the term "listing market" similarly, their treatment of dually listed securities differs. Specifically, the CTA Plan looks to where the security was first listed, while the NASDAQ UTP Plan looks to the market with the highest number of the average of the reported transactions and reported share volume for the preceding twelve-month period. The listing market is responsible for monitoring the trading in stocks listed on its marketplace and for notifying market participants when a circuit breaker has been imposed.

The Short Sale Price Test applies to **"covered securities"** which are "NMS Stocks" as defined under Rule 600(b)(47)[4] of Regulation NMS. The Short Sale Price Test covers all securities, except options, that are listed on a national securities exchange whether traded on an exchange or in the OTC market, but does not include non-NMS stocks quoted on the OTC Bulletin Board or elsewhere in the OTC market.

Rule 201 applies to **"trading centers,"** which are defined in Rule 600(b)(78) of Regulation NMS as a "national securities exchange or national securities association that operates an SRO trading facility; an alternative trading system; an exchange market maker; an OTC market maker; or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent." Consequently, any entity that executes a short sale order in a covered security must comply with the Short Sale Price Test.

19.42.2 Short Sale Price Test

[SEC Regulation SHO Rule 201; SEC FAQ concerning Regulation 201: http://www.sec.gov/divisions/marketreg/rule201faq.htm]

Short sales of covered securities are subject to a circuit breaker and uptick rule. When a circuit breaker is triggered by the listing market, short selling is permitted only at a price above the current national best bid. The following requirements apply:

- A short sale order may not be executed or displayed at a price that is less than or equal to the current national best bid if the price of the covered security decreases by 10% or more from the security's closing price determined by the listing market as of the end of regular trading hours on the prior day.

- The above requirements apply for the remainder of the day and the following day when a national best bid for the covered security is calculated and disseminated on a current and continuing basis by a plan processor pursuant to an effective national market system plan.

KCD's systems identify covered securities subject to price test requirements. Traders are responsible for complying with price test requirements.

19.42.2.1 Exemptions To The Short Sale Price Test

There are several exemptions to the Short Sale Price Test. The exemptions apply when the price test circuit breaker is triggered. When relying upon the following exemptions, a broker-dealer must mark the order "short exempt."

- **Broker-Dealer Provision.** Rule 201 permits a broker-dealer to mark certain qualifying sell orders as "short exempt" if the broker-dealer reasonably determines that it is submitting the short sale order to the trading center at a price that is above the current national best bid at the time of submission.
- **Sellers Delay in Delivery.** Orders may be marked "short exempt" when a broker-dealer has a reasonable basis to believe that a seller owns the securities, but is unable to deliver them prior to settlement because of circumstances outside of the seller's control.
- **Odd Lot Transactions.** An odd lot short sale order may be marked "short exempt" by a market maker if it has a reasonable basis to believe that the order offsets a customer odd-lot order or liquidates an odd-lot position that changes such broker-dealer's position by no more than a unit of trading.
- **Domestic and International Arbitrage.** Certain domestic or international arbitrage transactions may be marked "short exempt."
- **Over-Allotments and Lay-Off Sales.** Rule 201(d)(5) permits a broker-dealer to mark as "short exempt" short sale orders by underwriters or members of a syndicate in connection with over-allotments, or in connection with lay-offs by the same persons through a rights or standby underwriting commitment.
- **Riskless Principal Transactions.** Rule 201(d)(6) permits a broker-dealer to mark short sale orders "short exempt" when the broker-dealer facilitates customer buy orders or sell orders where the customer is net long, and the broker-dealer is net short but is effecting the sale as riskless principal. Rule 201(a)(8) defines the term "riskless principal" to mean "a transaction in which a broker or dealer, after having received an order to buy a security, purchases the security as principal at the same price to satisfy the order to buy, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee, or, after having received an order to sell, sells the security as principal at the same price to satisfy the order to sell, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee."
- **Transactions on a Volume-Weighted Average Price Basis.** Orders executed on a volume-weighted average price ("VWAP") may be marked "short exempt" provided that they satisfy several conditions in Rule 201(d)(7).

19.42.3 Marking Orders

[SEC Regulation SHO Rule 200(g)]

All sell orders are required to be identified on the order record as "long," "short," or "short exempt" (if applicable) 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 KCD or it is reasonably expected that the security will be in the physical possession or control of KCD 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 *Locate And Delivery Requirements* regarding the requirement to borrow securities.

Short sales effected in covered securities when a circuit breaker price test is triggered may be marked "short exempt" if they qualify for the exemption.

19.42.4 Locate And Delivery Requirements

[SEC Regulation SHO Rule 203]

Prior to effecting 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 (or consult a "borrow" list if available) to confirm whether the security being sold short may be borrowed. The borrow list relied upon must be less than 24 hours old. The following locate information must be recorded on the order:

- 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 KCD, the order record must also include the name of the person's employer.

19.42.4.1 Exceptions From The Locate Requirement

The following short sale orders are not required to comply with the locate requirement:

- Orders received from another broker-dealer (the originating broker-dealer has the obligation to comply with the locate requirement)
- *Bona-fide* market making transactions

19.42.5 Close-Out Requirements For Fail To Deliver

"Naked short selling" is an abusive practice where the seller does not intend to deliver securities in time for settlement (including deceiving a broker-dealer about their locate source or ownership of shares). Close-out requirements apply to **all** equity securities. Obligations to close-out fails to deliver are the responsibility of the participant of a registered clearing agency, *i.e.,* a broker-dealer that self-clears its own trades or the clearing firm on behalf of an introducing firm. The SEC's rules apply to "reporting securities" which are issuers registered under Section 12 of the Exchange Act or that are required to file reports under Section 15(d) of the Exchange Act. FINRA requirements apply to securities not covered by SEC Regulation SHO.

Operations (or a clearing firm if orders are introduced to a clearing firm) is responsible for closing out positions.

19.42.5.1 SEC Requirements For Reporting Securities

[SEC Securities Exchange Act of 1934 Rule 10b-21; SEC Regulation SHO Rule 204]

To prevent this abusive practice, the SEC has imposed requirements that **securities must be delivered for short sales of all equity securities by settlement date (T+3)**. If securities are not delivered by settlement day, the broker-dealer is obligated to close out the position by borrowing or purchasing securities by the beginning of regular trading hours on the following settlement day (T+4). **For long sales and bona fide market making activity,** the BD must close out the position no later than the beginning of regular trading hours on the 3rd consecutive settlement day following the settlement date (T+6).

For sales of securities under Rule 144 and other securities the seller is "deemed to own" and intends to deliver (such as securities not yet received after exercising an option or warrant): transactions must be closed out no later than the beginning of regular trading hours on the 35th calendar day following the settlement day for the transaction.

The purchase or borrow of securities does not qualify as a close-out if the BD or participant knows or has reason to know the securities will not actually be delivered by settlement [Rule 204(f)].

When a BD fails to close out a position as required under this rule, the BD 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.

19.42.5.2 FINRA Requirements For Non-Reporting Securities

[FINRA Rule 4320]

Participants of registered clearing agencies must take action on failures to deliver that exist for 13 consecutive settlement days in certain non-reporting securities. If the fail to deliver position is not closed out in the requisite time period, the participant or any firm for which it clears is prohibited from effecting further short sales in the security without borrowing, or entering into a bona fide arrangement to borrow, the security until the fail to deliver position is closed out.

19.42.6 Short Sales Of Securities Subject To A Public Offering

[SEC Regulation M Rule 105; SEC Release No. 34-56206]

A person may **not** purchase a security from an underwriter or broker or dealer participating in a public offering if the person sold the security short during the "Rule 105 restricted period." The Rule 105 restricted period is the shorter of:

- the period beginning five business days before the pricing of the offered securities and ending with such pricing; or
- the period beginning with the initial filing of the registration statement or notification on Form 1-A or Form 1-E and ending with the pricing.

Exceptions to the short sale limitation include the following.

1. **Bona fide purchases:** Restricted period short sellers may purchase offered securities if they make a bona fide purchase of the same security prior to pricing. A *bona fide purchase* must be:

- at least equal in quantity to the entire amount of the Rule 105 restricted period short sale(s);
- effected during regular trading hours;
- reported pursuant to an effective transaction reporting plan; and
- made after the last Rule 105 restricted period short sale and no later than the business day prior to the day of pricing.

In addition, the person may not have effected a short sale that is a reported transaction within 30 minutes before the close of regular trading hours on the business day prior to the day of pricing.

2. **Separate accounts:** A purchase of the offered security may be made in an account that sold short during the Rule 105 restricted period in a separate account if decisions regarding transactions for the account are made separately and without coordination of trading or cooperation among or between accounts.

3. **Investment companies:** An individual fund within a fund complex, or a series of a fund, will not be prohibited from purchasing the offered security if another fund within the same complex or a different series of fund sold short during the Rule 105 restricted period.

There are conditions that apply to these exceptions; Compliance should be consulted for further guidance regarding covering short sales in securities subject to a public offering.

19.43 Sale Of Control Or Restricted Stock

[SEC Securities Act of 1933 Rule 144 and Rule 145; SEC Rule 144 Guidance: http://www.sec.gov/divisions/corpfin/guidance/rule144interp.htm]

Responsibility	• Designated Supervisor
Resources	• Proposed 144 or 145 sales
Frequency	• As required
Action	• Determine the seller's status (affiliate or non-affiliate) • Determine eligibility for selling the amount and timing of sale • Assist the customer in preparation of required forms
Record	• Records of forms filed and determinations are included in a file for Restricted Stock sales

19.43.1 Introduction

SEC Rule 144 provides a safe harbor method for affiliates (e.g., controlling shareholders, directors, and executive officers) to sell securities of their company (control securities). Rule 144 applies to non-affiliates on only a very limited basis. Rule 144:

- limits the number of shares sold in any three-month period (affiliates only);
- requires current public information about the issuer;
- imposes a holding period on shares prior to sale;
- places restrictions on how shares may be sold; and
- requires affiliates to file Form 144 (Notice of Intent to Sell)

Rule 145 governs the offer or sale of securities received in connection with reclassifications, mergers, consolidations and asset transfers. Rule 145 applies only to affiliates selling securities of a shell company.

Compliance should be consulted for assistance regarding the processing of Rule 144 and Rule 145 sales. This section is provided for quick reference only.

19.43.2 Definitions

Restricted securities: Restricted securities generally are securities which were:

- acquired directly or indirectly from the issuer or from an affiliate of the issuer in a transaction or series of transactions not involving a public offering.
- acquired from the issuer and are subject to the resale limitations of various rules including Regulation D, Rule 144A, Regulation CE, and other rules and regulations providing for resale of unregistered securities [Rule 144(a)(3)].

Debt securities: Any security other than an equity security; non-participatory stock (non-convertible capital stock where holders are entitled to a preference for dividends and a share of assets upon liquidation of the company but not entitled to participate in residual earnings or assets); and asset-backed securities [Rule 144(a)(4)].

Affiliate: A person who, directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with the 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 acting in a similar capacity. The term applies for purposes of Rule 144 sales to anyone who had affiliate status within 90 days before the sale and for the 90 days after ceasing to have affiliate status.

Reporting issuer: An issuer who is, and has been for a period of at least 90 days prior to the 144 sale, subject to SEC reporting requirements and has filed all required reports during the 12 months preceding the sale.

Non-reporting issuer: An issuer not subject to SEC reporting requirements but where there is publicly-available information as specified by Rule 144.

Control securities: Securities owned by an affiliate of an issuer; these securities are considered "restricted" and "control" securities.

19.43.3 Summary Chart Of Rule 144 And 145 Requirements

Subject	Requirement
Holding period for affiliates and non-affiliates Rule 144(d)	• Reporting company: 6 months • Non-reporting company: 1 year *(To qualify as a reporting company, issuer must be subject to SEC reporting requirements for at least 90 days prior to sale.)*
Rule 144 restrictions *(Affiliate restrictions apply if the person was an affiliate at any time during the period 90 days before the sale and for 90 days after the person ceases to be an affiliate.)*	• Apply to affiliates ONLY; the following limited requirement applies to non-affiliates • For **non-affiliates** selling securities of a **reporting company,** Rule 144(c) regarding the current public information requirement applies if securities are held less than 1 year *(may not sell under 144 if the issuer is late in filing an SEC report during the second 6 months after the minimum 6-month holding period)* • For **non-affiliates** selling securities of a **non-reporting company,** after complying with the 1-year holding period, no other Rule 144 restrictions apply

Volume limitations for affiliates
(calculated with all sales of restricted and other securities of the same class for the same person within the preceding 3 months)
Rule 144(e)
	• Apply to affiliates ONLY *(non-affiliates may make unlimited resales)*
	• Cannot exceed the greater of:
	    ○ 1% of the outstanding shares or other units, or
	    ○ the average weekly reported volume on all national exchanges and/or reported through the automated quotation system during the 4 calendar weeks preceding filing of Form 144 (or date of broker's receipt of the order or date of execution by a market maker), **or**
	    ○ the average weekly volume reported under a

Subject	Requirement
	transaction reporting plan or national market system plan during the 4-week period explained above. • For debt securities, an amount that does not exceed 10% of a tranche (or class when the securities are non-participatory preferred stock), aggregated with all sales of securities of the same tranche sold for the seller within a three-month period • For convertible securities, applies to amount of securities into which they are convertible • Other standards apply to sales by pledgees, donees, estates, and acting in concert and exclusions for determining volume limits [Rule 144(e)(3)]
Manner of sale restrictions for affiliates *(in essence, require an ordinary marketplace sale with no special selling efforts)* Rule 144(f)	• Apply ONLY to resales by affiliates • Apply ONLY to equity securities • Seller or broker cannot solicit buyers or arrange to solicit buyers • Agency and riskless principal transactions permitted
Brokers' transactions *(applies to affiliate and non-affiliate transactions)* Rule 144(g)	• Allows inquiries to other broker/dealers who indicated an interest within the preceding 60 days or to customers who indicated an unsolicited bona fide interest within the preceding 10 business days • Broker receives no more than usual and customary broker's commission • Broker may publish quotations in an inter-dealer quotation system if they are incident to usual market making activities and quotations were published at least 12 days within the preceding 30 calendar days with no more than 4 business days in succession without a 2-way quotation • Brokers may insert bid and ask quotations for a restricted security in an alternative trading system if the broker has published bona fide bid and ask quotations for that security on the ATS on each of the 12 preceding business days • Broker should obtain written evidence of indications of bona fide unsolicited interest and when received
Form 144 filing requirements Rule 144(h)	• Apply to affiliates ONLY • *de minimis* filing threshold of 5,000 shares or $50,000 in value, whichever is lower, within a 3-month period *(no filing requirement below these levels)* • 3 copies to be filed with SEC; one copy with the exchange if listed on a national securities exchange
Rule 145	• "Presumptive underwriter" provision applies ONLY to affiliates of shell companies

Other Notes:

- Non-affiliate: to qualify as a non-affiliate, must not have been an affiliate of the issuer for at least 3 months prior to the sale.

- Various staff positions also apply regarding tacking of the holding period; sales by a pledgee; and other staff opinions.
- Rule 144 is not available to sellers of a shell company's securities whether the company is reporting or non-reporting.

19.43.4 New Account Information Regarding Affiliates

KCD's new account form includes an inquiry whether the customer is an affiliate of an issuer. RRs are responsible for obtaining this information and, if the customer is an affiliate and places an order to sell shares of the issuer, contacting Compliance for instructions on executing the order under Rule 144.

19.43.5 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. Compliance 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. Compliance should be contacted to determine the salability of the underlying securities prior to writing covered options.

19.44 Unregistered Resales Of Restricted Securities

[FINRA Regulatory Notice 09-05; SEC FAQs http://www.sec.gov/divisions/marketreg/faq-broker-dealer-duty-section4.htm; SEC National Exam Program Risk Alert: http://www.sec.gov/about/offices/ocie/broker-dealer-controls-microcap-securities.pdf]

Responsibility	• Designated Supervisor • Operations personnel
Resources	• New accounts at opening • Proposed sales of potentially unregistered securities • Order records or transaction reports • Physical certificates
Frequency	• When new accounts are opened with a potentially questionable transaction • As required - assist RR in evaluating a potential sale • Daily - review of order records/transaction reports • As required - review certificates
Action	• Review for "red flags" listed in this section • If a red flag is identified, contact the RR for more information about the customer and the block being sold; contact the customer if necessary to confirm the securities are not unregistered or restricted • Operations personnel should refer questionable certificates to the designated supervisor for follow up with the RR or customer
Record	• Order records/transaction reports • New account records • Records of certificates received • Designated supervisor's record of action taken, if applicable, in a log, on the

	order record, in a daytimer, or in another record

Broker-dealers are prohibited from selling unregistered securities unless the sale falls within an available exemption such as Rule 144 or Section 4(a)(4) discussed in the prior section. Avoiding such sales is based on knowing the customer and the securities to be sold. The RR should be aware of "red flags" that may indicate a customer is selling unregistered securities, including the following examples:

- A customer opens a new account and delivers physical certificates representing a large block of thinly-traded or low-priced securities.
- A customer has a pattern of depositing physical share certificates, immediately selling the shares and then wiring out the proceeds of the resale.
- A customer deposits share certificates that are recently issued or represent a large percentage of the float for the security.
- Share certificates reference a company or customer name that has been changed or that does not match the name on the account.
- The lack of a restrictive legend on deposited shares seems inconsistent with the date the customer acquired the securities or the nature of the transaction in which the securities were acquired.
- There is a sudden spike in investor demand for, coupled with a rising price in, a thinly-traded or low-priced security.
- The company was a shell company when it issued the shares.
- A customer with limited or no other assets under management at the Firm receives an electronic transfer or journal transactions of large amounts of low-priced, unlisted securities.
- The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies.
- The issuer's SEC filings are not current, are incomplete, or nonexistent.
- Omnibus accounts are opened for purported stock loan companies which may hold restricted securities of corporate insiders who have pledged the securities as collateral for, and then defaulted on, purported loans, after which the securities are sold on an unregistered basis.
- Accounts are held in the name of a corporate entity (or LLC), either for the company's own use or as a third-party custodian on behalf of other beneficial shareholders or customers, which disguise the unregistered sales of securities owned by corporate insiders of the company and allow for those insiders to withdraw proceeds individually.
- Accounts are held in the names of foreign financial institutions, such as offshore banks and/or broker-dealers that sold shares of the stock on an unregistered basis on behalf of customers, who may have been stock promoters.
- Accounts may use a master/sub-structure, which allows for trading anonymity with respect to the sub-accounts' activity.

When confronted with a customer wanting to sell a block of stock where there may be a question about the registered status of the stock, the following questions should be asked:

- How long has the customer held the securities?
- How did the customer acquire the securities?
- Does the customer intend to sell additional shares of the same class of securities through other means?
- Has the customer solicited or made any arrangement for the solicitation of buy orders in connection with the proposed resale of unregistered securities?
- Has the customer made any payment to any other person in connection with the proposed resale of securities?
- How many shares or other units of the class are outstanding, and what is the relevant trading volume?

19.44.1 Suspicious Activities

Trading in microcap securities may involve suspicious activity subject to the filing of a Suspicious Activity Report under the Bank Secrecy Act. Compliance is responsible for identifying transactions subject to reporting and filing required reports. Employees who suspect questionable activity should contact Compliance immediately. Also refer to the section *Suspicious Activity Reports (SARs)* in the chapter *ANTI-MONEY LAUNDERING (AML) PROGRAM*.

Activity that has been previously identified by regulators as potential red flags include:

- Atypical trading patterns in the issuers' securities, including trading involving sudden spikes in price and volume;
- Certain patterns of trading activity being common to several customers, including, but not limited to the sales of large quantities of the shares of multiple issuers by the customers;
- Notifications received from a clearing firm that the clearing firm has identified potentially suspicious activity in the securities of certain issuers or certain customer accounts. Such notifications may take the form of alerts, expressions of concern, or actions taken by the clearing firm to restrict trading in certain issuers' securities and/or certain customer accounts;
- The involvement of certain types of accounts, including those that provide anonymity to the beneficial owners in the liquidation of the shares of the microcap issuers;
- Requests received from FINRA for information relating to certain issuers and the broker-dealers' customer accounts;
- Certain types of issuer information, such as nominal assets and low operating revenue, and frequent changes to the type of activity in which the business was engaged, the name of the corporate entity, directors, and/or management; and
- Sales through the Firm by individuals known throughout the industry to be stock promoters.

19.45 Reporting Of Insider Transactions

[SEC Securities Exchange Act of 1934 Section 16(a); SEC Exchange Act Section 16 and Related rules & Forms (Q & A): http://www.sec.gov/divisions/corpfin/guidance/sec16interp.htm]

Under Section 16(a) of the Exchange Act, directors, officers, and >10% holders of equity securities of a publicly-traded company are required to report their purchases and sales of the issuer's securities to the SEC (and, if the security is listed on a national exchange, with the exchange where listed) as follows:

- at the time the security is registered on a national securities exchange or by the effective date of the registration statement
- within 10 days of becoming a 10% beneficial owner, director or officer
- by the end of the second business day following a purchase or sale 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.

If the issuer maintains a corporate website, the issuer is required to post the filing on the site no later than the end of the business day following the filing.

Transactions by directors or officers that result in "short-swing" profits but that are exempt from Section 16(b) are also subject to the two-day reporting requirement.

The obligation to report is the responsibility of the insider. Customers should be encouraged to contact their counsel if they have questions, and Section 16 should be referenced for specifics regarding filing requirements.

19.46 Penny Stocks

[SEC Securities Exchange Act of 1934 Rule 15g-9, Rule 15g-100 and Schedule 15G; FINRA Notice to Members 93-55, 92-42 and 92-38]

Responsibility	• Designated Supervisor
Resources	• New Account Form • Order records and available reports • Risk Disclosure Documents
Frequency	• Daily

Action	• Identify customers who are not "established"
	• FINOP:
	  ○ Include required disclosures on confirmations
	• RR's supervisor, for customers who are not "established" customers:
	  ○ Determine required signed risk disclosure document is received prior to effecting the first 3 penny stock purchases and the two-business-day cooling-off period has been satisfied
	  ○ Review new account form and determine investment objectives are consistent with penny stock purchases
	  ○ Review and initial signed risk disclosure document
	  ○ Submit document to Compliance or New Accounts

Record	• Initials on the Risk Disclosure Document • Risk Disclosure Documents are retained in the customer's new account file

19.46.1 General Requirements

[SEC Securities Exchange Act of 1934 Rule 15g-1 through 15g-6 and Rule 15g-9]

Securities that are identified as "designated securities" (penny stocks) are subject to certain requirements including:

- provision of risk disclosure to a customer other than an "established customer"
- 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 KCD's requirements for penny stock transactions subject to the rules.

19.46.2 Penny Stock Defined

[SEC Securities Exchange Act of 1934 Rule 3a51-1; SEC Guide to Broker-Dealer Registration Section V(F)]

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 following sections:

- A reported security as defined in Regulation NMS Rule 601.
- The stock is priced at $5.00 or more per share.
- Shares of investment companies.
- The stock is listed on an exchange.
- Security futures.
- 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.

Penny stocks include the equity securities of private companies with no active trading market if they do not qualify for one of the exclusions from the definition of penny stock.

RRs should assume that any unlisted securities priced less than $5.00 per share may be subject to the penny stock requirements.

19.46.3 Established Customer Defined

The requirements of the Rule do not apply to penny stock transactions for "established customers." The term established customer includes a customer who:

- has maintained an account (effected a transaction, made a deposit of funds or securities) more than one year previously, or
- has made three purchases of penny stocks that occurred on separate days and involved different issuers.

19.46.4 Regulation Best Interest Information

RRs are required to obtain information from the customer including prior investment experience, investment objectives, and financial situation. This information is recorded on KCD'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 Reg BI compliant 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 penny stocks are Reg BI compliant.

19.46.5 Risk Disclosure Document

Prior to effecting a penny stock transaction for a customer, the RR must furnish the customer with a copy of KCD'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 KCD letterhead but must be reproduced on plain paper.

Furnishing this disclosure and obtaining the customer's signature evidencing receipt is required for each of the first three penny stock transactions before orders are entered.

19.46.6 Two-Business-Day Waiting Period

Penny stock transactions may **not** be executed until at least two business days after the Risk Disclosure Document and agreement to the transaction has been sent either electronically or by mail. These documents must also be signed by the customer and received by KCD.

19.46.7 Disclosure Of Quotations And Other Information

Rule 15g-3 prescribes certain required information that must be disclosed to the customer at or prior to the time of effecting a penny stock transaction. The designated supervisor is responsible for establishing procedures to ensure the necessary disclosures are included on customers' confirmations. Traders are responsible for including notations on order tickets that include the required information regarding bids or offers. A copy of Rule 15g-3 will be provided to traders responsible for recording the required information. The designated supervisor is responsible for establishing procedures to ensure the bid or offer information is included with customer confirmations of penny stock transactions.

19.46.8 Disclosure Of Compensation

KCD'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 KCD 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. Where KCD dominates the market, contemporaneous cost will be used to calculate mark-ups or mark-downs.

Traders are responsible for recording the required information on order records. 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.

19.47 Tax Switching Transactions

Transactions that are effected to accomplish certain tax results (*i.e.,* establishing a gain or a loss) must be handled consistent with prevailing securities and tax rules and laws. Riskless tax switching trades (also known as "wash sales") are not allowed and may represent a violation of rules prohibiting pre-arranged trades.

Under tax laws, a "wash sale" occurs when someone sells a stock, mutual fund, or some other security at a loss and buys the same thing, or something "substantially identical," within 30 days before or after the sale. The seller cannot deduct the loss on that sale on his or her tax return for that year. "Substantially identical" means buying and selling the same security or one that is almost the same, such as selling an index fund and buying another index fund based on the same underlying index. Customers should be referred to their tax advisers when questions arise regarding tax loss strategies and what may be considered a security that is substantially identical.

A cross transaction must represent a beneficial change in ownership of the security sold and purchased. Where a customer wishes to sell a security and buy it back in their own account, this transaction must be effected at the risk of the market with no guarantee of the price at which the security may be repurchased. The prohibition applies to equity and debt securities. The following is an example of this type of transaction.

A customer wishes to sell Company A at year-end to establish a loss for tax purposes. He also ultimately wants to maintain his position in the security in his account. He asks that you sell the shares and buy them back in his IRA account 31 days later at the same price.

Even though the proposed transaction would meet the 30-day test, this transaction would be disallowed by the IRS because there is no beneficial change in ownership of the security and the customer would be guaranteed to sell and repurchase the security at the same price. In this example, an appropriate method of handling these orders would be to enter a sell transaction and, after it has been executed, enter a buy transaction at market risk after 30 days have elapsed. This places both transactions at the risk of the market and does not involve a guaranteed cross.

19.48 Payment For Order Flow

[SEC Securities Exchange Act of 1934 Rule 10b-10; SEC Regulation NMS Rule 607]

Responsibility	• Designated Supervisor
Resources	• Agreements to receive payment for order flow
Frequency	• Ongoing (confirmation and new account disclosures) • Annual (disclosures to customers)
Action	• Ensure confirmations include required disclosures • Ensure new accounts receive disclosure of payment for order flow arrangements as required • Annually send disclosure to customers with December customer statements
Record	• Confirmations, new account records include required disclosures • FINOP retains a record of the annual disclosure sent to customers

19.48.1 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.

Compliance should be contacted if there are questions as to whether an arrangement is subject to payment for order flow disclosure requirements.

19.48.2 Disclosures

If KCD receives payment for order flow, KCD will provide customers with the following information, as required by rule:

- Confirmation disclosures required under Rule 10b-10.
- Disclosures required at account opening and annually thereafter describing KCD's policies on receipt of payment for order flow and description of the nature of compensation received. The policy disclosure includes KCD'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.

19.48.3 Best Execution Of Orders

Customer orders associated with KCD's receipt of payment for order flow will be subject to the same best execution requirements applicable to all customers orders and outlined in the chapter *EQUITY TRADING AND MARKET MAKING*.

19.48.4 Definitions

Foreign broker or dealer: any non-U.S. resident person (including any U.S. person engaged in business as a broker or dealer entirely outside the U.S., except as otherwise permitted under Rule 15a-6) that is not an office or branch of, or a natural person associated with a registered broker or dealer whose securities activities, if conducted in the U.S., would be described by the definition of "broker" or "dealer" in Sections 3(a)(4) or 3(a)(5) of the '34 Act.

Major U.S. institutional investor: A person that is:

- a U.S. institutional investor that has, or has under management, total assets in excess of $100 million; provided, however, that for purposes of determining the total assets of an investment company under this rule, the investment company may include the assets of any family of investment companies of which it is a part; or
- an investment adviser registered with the SEC under Section 203 of the Investment Advisers Act of 1940 that has total assets under management in excess of $100 million.

U.S. institutional investor: A person that is:

- an investment company registered with the SEC under Section 8 of the Investment Company Act of 1940; or
- a bank, savings and loan association, insurance company, business development company, small business investment company, or employee benefit plan defined in Rule 501(a)(1) of Regulation D under the '33 Act; a private business development company defined in Rule 501(a)(2); an organization

described in Section 501(c)(3) of the Internal Revenue Code, as defined in Rule 501(a)(3); or a trust defined in Rule 501(a)(7).

19.48.5 Firm Responsibilities

If KCD determines to accept an arrangement on behalf of a foreign BD, it accepts certain responsibilities with regard to communications with customers and handling of transactions.

The foreign broker-dealer may conduct visits to U.S. institutional investors if it is accompanied by an associated person of KCD and any transactions discussed during the visit are effected only through KCD. In addition, KCD is required to participate in all oral communications with a U.S. institutional investor (but not a major U.S. institutional investor).

In connection with transactions on behalf of a foreign broker-dealer, KCD is responsible for:

- Effecting transactions (other than negotiating their terms)
- Issuing confirmations and statements
- Extending or arranging for credit to the customer
- Maintaining required books and records of transactions
- Complying with Rule 15c3-1 regarding transactions
- Receiving, delivering, and safeguarding funds and securities

19.49 Extended Hours Trading

[FINRA Rule 2265; FINRA Regulatory Notice 14-54]

Responsibility	• Designated Supervisor
Resources	• Order records and available reports
Frequency	• Daily
Action	• Review transactions for suitability, active trading, and other areas as described in this chapter • Confer with Compliance, if necessary • Take corrective action, if necessary, which may include consulting with the RR; reviewing information about the customer's account including new account information and prior trading activity; restrict activity in the customer's account.
Record	• Initials and date of review on reports reviewed and/or notations in supervisory log or other record

KCD offers its customers the ability to enter orders during extended hours trading. All customers are provided the "Extended Hours Trading Risk Disclosure" prior to giving customers access to extended trading sessions.

19.49.1 Reporting Exemption For Manual Orders

[FINRA Rule 7470 and 9610(a)]

KCD has applied to FINRA and has received exemptive relief from manual order electronic recording and reporting requirements. The Firm:

- and current control affiliates and associated persons have not been subject, within the past five years, to any final disciplinary action, and within the last 10 years to any disciplinary action involving fraud;
- has annual revenues of less than $2 million;
- does not conduct market-making activities in NMS stocks or OTC equity securities;
- does not execute principal transactions with its customers;
- does not conduct any clearing or carrying activities for other firms; **and**
- has requested and received approval of the exemption from the FINRA.

Compliance is responsible for determining KCD meets the above criteria and filing the exemptive relief request and maintaining records relating to the request and FINRA's response. The exemption is effective for two years, and Compliance will apply for a subsequent exemption if appropriate.

19.49.1.1 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.

19.49.1.2 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 8:00:00 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 8:00:00 a.m. ET. An order received at 10:00:00 p.m. ET on Friday must be reported by Tuesday at 8:00:00 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.

19.49.2 Rejections And Repairs

Responsibility	• Designated Supervisor
Resources	• OATS Web interface data on rejected Reportable Order Events (ROEs)

Frequency	• Daily - review rejected ROEs
Action	• Repair rejected ROEs • Ensure repaired ROEs are resubmitted with appropriate resubmit flag • For patterns of rejections, take corrective action, which may include additional education for personnel inputting trade data and evaluation of staffing to minimize errors
Record	• Daily OATS Supervisory Log

KCD will review rejections and make corrections, as necessary.

19.49.3 Other Daily Reviews

Responsibility	• Designated Supervisor
Resources	• OATS Web interface reports and data
Frequency	• Daily -
Action	• Review Firm Order Report (FORE) files are accepted • Identify any ACT Matching deficiencies • Identify Late Reports
Record	• Daily OATS Supervisory Log and data reviewed

On a daily basis, OATS interface data will be reviewed for exceptions and corrective action will be taken.

19.49.4 Monthly Reviews

Responsibility	• Designated Supervisor
Resources	• OATS Web interface reports and data
Frequency	• Monthly
Action	• Review selected trade date(s) to determine: ○ All reportable events are submitted to OATS ○ Data fields contain accurate information ○ ROEs are submitted in the correct time sequence (executions are not time-stamped prior to the receipt of a new order) ○ Special Handling Codes are submitted correctly

	○ Account Type Codes are populated correctly ○ Received Method Codes are populated correctly ○ Routed Order IDs are passed properly to the Routing Firm from the Receiving Firm ○ Data is properly reported under KCD's MPID • Where exceptions are identified: ○ Review exceptions with KCD personnel responsible for data input ○ Determine whether additional education, staffing, or other corrective action is necessary if repeated exceptions occur
Record	• Monthly OATS Supervisory Log and data reviewed

On a monthly basis, accepted OATS data will be reviewed for selected trade date(s) to verify that trade data is being reported accurately.

19.50 Disclosure Of Order Execution Procedures

[SEC Regulation NMS Rule 605; SEC FAQS Regulation NMS Rule 605: http://www.sec.gov/divisions/marketreg/nmsfaq605.htm]

Since KCD is not engaged in OTC market making or exchange specialist activities, it is not required to publish information regarding order executions in National Market System securities on a monthly basis. This information is available on the Internet.

19.51 Order Routing And Reporting

[SEC Regulation NMS Rule 601]

As required by Rule, KCD routes and executes orders in NMS securities only through exchanges and other facilities that have an effective transaction reporting plan filed with the SEC and will promptly report all information required by the reporting plan.

19.51.1 Disclosure Of Order Routing

[SEC Regulation NMS Rule 606; SEC FAQs https://www.sec.gov/tm/faq-rule-606-regulation-nms; Report on FINRA Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program; SEC Risk Alert https://www.sec.gov/exams/announcement/observations-related-regulation-nms-rule-606-disclosures]

Responsibility	• Designated Supervisor
Resources	• Customer agency order trade data
Frequency	• Publish reports - quarterly • Review of reports - quarterly • Provide individual customer order routing information - as requested • Notify customers of availability of information - annually
Action	• Collect necessary data for Regulation NMS Rule 606 report including from downstream venues • Confirm whether KCD routes orders to non-exchange venues and whether such

	venues are covered under Rule 606(a) and, if included, obtain and retain sufficient information to report material terms of its relationships including payment for order flow and any profit-sharing relationship • Publish report on the internet by the end of the month following each calendar quarter • Collect individual customer order routing information • Review quarterly reporting to confirm reports include required material disclosures • If reports are provided by third party vendors, conduct due diligence to confirm accuracy and completeness of reports and periodic review of reports • If KCD claims an exemption from providing order reports, verify that customer order activity falls below the relevant reporting thresholds • Respond to requests from customers for order routing information and provide information for the prior six months within 7 business days of receiving the request • Send annual notification to customers of availability of information • Verify, at least annually, that KCD's website hyperlink provided to access information is accurate and up-to-date.
Record	• Copies of quarterly reports • Record of review of quarterly reports for material disclosures • Records of customer requests and fulfillment of requests • Records of annual customer notification including when and how provided

KCD is required to publish quarterly statistics regarding routing of non-directed orders in NMS stocks that are submitted on a held basis and of non-directed orders that are customer orders in NMS securities that are option contracts. The purpose of the report is to provide the public with information on how broker-dealers route their customers' orders including payment for order flow, fees, rebates, and economic incentives, 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 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, certain information under the Rule about the routing of individual customer orders is available to customers, upon request, for the prior six months' trading activity. This includes directed or non-directed orders and the transaction time, separated for NMS held orders, NMS not held orders and options on NMS securities. In addition, upon request of a customer who places a not held order KCD must provide a standardized set of individualized disclosures.

In addition, KCD will send an annual notification to customers that the above information is available, as required by the Rule.

19.51.2 Information Included In The Reports

Extensive statistical information is available in the reports including listed option orders, if applicable. In summary, KCD reports on the top ten venues to which orders are routed (including internal routing) and any other venues that receive more than 5% of KCD's order flow.

The Rule also requires disclosures regarding internalization of orders and any relationship KCD has with a venue, such as payment for order flow.

19.51.3 Customer Requests For Order Routing Information

[Exchange Act Regulation NMS Rule 606(b)(3)]

Customers may request information on how their individual orders were handled for the past six months. This request must be satisfied within seven business days of receiving it. The information may be obtained by making a request to Operations.

19.51.3.1 Exceptions To Providing Reports

[Exchange Act Regulation NMS Rule 606(b)(4) and (5)]

Exceptions to the requirement to make reports available include the following:

- Not held orders where the percentage of shares of not held orders in NMS stocks over the past 6 calendar months was less than 5% of the total shares in NMS stocks [Rule 606(b)(4)].
- The customer traded on average each month for the prior six months less than $1,000,000 of notional value of not held orders in NMS stocks through KCD [Rule 606(b)(5)].

19.52 Distribution, Consolidation, And Display Of Information

[SEC Regulation NMS Rule 603]

If the Firm is the exclusive source of information regarding quotations or transactions in an NMS stock, it is obligated to:

- Provide information to a securities information processor on terms that are fair and reasonable.
- Provide quotation or transaction information on terms that are not unreasonably discriminatory.
- When providing display of information where trading or order routing decisions are made, provide a consolidated display (not including displays on the trading floor or through a national securities exchange or a market linkage system under a national market system plan).

19.53 Sales Contests

Responsibility	• Designated Supervisor
Resources	• Proposed and ongoing sales contests
Frequency	• As required
Action	• Review proposal for compliance with guidelines • Confirm sales contest is carried out in accordance with guidelines
Record	• Approved sales contest • Review of ongoing /completed contest including supervisor's initials

19.54 Cash And Non-Cash Compensation Policy

[FINRA Rule 2310, 2320 and 2341; MSRB Rule G-20]

Responsibility	• Designated Supervisor or Designee
Resources	• Requests from RRs, managers, or outside firms regarding sponsorship of cash or non-cash compensation relating to the sale of securities
Frequency	• As required
Action	• Review request and ensure compensation is consistent with rule requirements and limitations • Obtain Sponsor Request Form • Approve or disapprove compensation in writing • Obtain Reimbursement Form from sponsor with RR payment • Establish and maintain required records of approved compensation programs
Record	• Requests • Sponsor Request Forms • Reimbursement Forms • Approval/disapproval of compensation arrangement

Regulators' rules restrict compensation relating to the sale and distribution of debt, equity, direct participation program (DPP), REIT securities, and municipal 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 KCD.

19.54.1 Definitions

Cash compensation is defined as follows:

Any discount, concession, fee, service fee, commission, asset based sales charge, loan or override, or cash employee 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.

19.54.2 Approval

Any compensation as defined in this section and paid directly to the RR requires sponsor submission of the Sponsor Request Form and approval by Compliance **prior to** accepting compensation. The following section outlines types of non-cash compensation permitted without specific approval, unless otherwise noted.

19.54.3 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. All gifts must be reported to Compliance under KCD's Gifts, Gratuities and Entertainment policy.
- 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.,* a U.S. office of the offeror or member holding the meeting, or a facility located in the vicinity of such office, or a U.S. regional location with respect to meetings of associated persons who work within that region or where a significant or representative asset of a DPP or REIT is located (inspection of real estate, oil and gas production facilities, and other types of assets that will be held and managed by the program). The designated supervisor will determine the appropriateness of the meeting.
- Only expenses incurred by KCD or its employees are eligible for payment. Expenses for guests of employees (spouse, *etc.*) will not be reimbursed.
- Refer to the section *Conflicts Of Interest* in the chapter *REGULATION BEST INTEREST (BI)* for details regarding conflicts involving compensation.

Non-cash sales incentive programs **may be preconditioned on achieving a sales goal** provided they are pre-approved in-house incentive programs sponsored by KCD 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 KCD (investment company, DPP, *etc.*).
- Credit received for each security is equally weighted.
- Only KCD employees 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.

19.55 Prohibited Transactions And Practices

Responsibility	• Designated Supervisor
Resources	• Order records and available reports • Customer monthly statements • Available FINRA reports
Frequency	• Daily/other review of order records and reports • Review of customer monthly statements (if applicable)
Action	• 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. • Some specific guidelines for review include the following. Contact Compliance for

	guidance regarding corrective action: ○ Wash transactions result from cross transactions between two accounts with the same beneficial owner and at no market risk, *i.e.,* 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. ○ Cross transactions on a frequent basis particularly in thinly-traded securities may be an indicator of supporting the market. ○ 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. ○ A pattern of purchasing securities in one account and transferring to another account at a later date may indicate parking. ○ Excessive trading may be an indicator of churning. See the section *Active Accounts* for guidance regarding action on actively traded accounts. ○ RRs trading ahead of customer block orders that may affect the market price of a security may indicate frontrunning. ○ Transactions reflective of market manipulation. • Review available FINRA reports for layering and spoofing and follow up exceptions to identify manipulative activity and take corrective action
Record	• Initials on order records and available reports • Branch Manager's Log • Notes/memos to RR's file, if appropriate • FINRA reports and notation of review and action taken, if applicable

19.55.1 Introduction

RRs are required to handle customer transactions in compliance with regulators' rules. This section highlights certain types of prohibited transactions.

19.55.2 Unauthorized Trading

No employee may enter a transaction before contacting the owner of the account (or the authorized agent for the owner) unless the employee 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 employee to regulatory and Firm discipline which may include fines and/or termination depending on the seriousness of the violation. If KCD 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 KCD to potential liability for losses from unauthorized transactions.

19.55.3 Market Manipulation

[SEC Securities Exchange Act of 1934 Rule 10b-5; FINRA Rule 6140]

Responsibility	• Designated Supervisor
Resources	• Customer transaction reports • Proprietary account transaction reports • Account information • Available transaction exception reports • FINRA Cross-Market Equities Supervision Manipulation Report
Frequency	• Daily and ongoing • Monthly: review FINRA Cross-Market Equities Supervision Manipulation Report
Action	• Establish thresholds to capture manipulative activity in customer and proprietary trading • Monitor customer activity for patterns of potential manipulation • Consider non-surveillance sources for red flags such as inquiries from regulators or service providers • Take corrective action which may include contacting the RR, the RR's supervisor, and/or customers; closing a customer's account; disciplinary action for the RR and other involved employees; reporting illegal activity to regulators and/or authorities • Include market manipulation in employee training
Record	• Reviews and records of actions taken • Training

KCD and its employees 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. Such activity may include:

- **Matched trades** where a person buys or sells a stock, with knowledge that a substantially offsetting transaction is going to be entered by someone, in order to mislead others about the extent of activity in, or the market for, a given stock is a form of market manipulation.
- **Momentum Ignition** including layering and spoofing; transactions in cross-product securities that manipulate the price of an underlying security influencing the price at which a market participant can either establish or close an overlying options position
- **Exchange-traded product** manipulation regarding leakage of information and misuse of material, non-public information and strategies that exploit the unique characteristics of ETPs
- **Wash trading** to collect liquidity rebates from exchanges by related or in-concert trading

Rules for market manipulation apply to customer as well as proprietary accounts.

19.55.4 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.

19.55.5 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.

19.55.6 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.

19.55.7 Wash Transactions

[FINRA Rule 6140(a) and 6140(b)]

Firms and individuals are prohibited, for purposes of creating or inducing a false or misleading appearance with respect to the market in such security, from:

- Executing any transaction in a security which involves no change in beneficial ownership;
- Entering any order or orders for the purchase of a security with the knowledge that an order or orders of substantially the same size, and at substantially the same price, for the sale of the security has been or will be entered by or for the same or different parties; or
- Entering any order or orders for the sale of any security with the knowledge that an order or orders of substantially the same size, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

19.55.8 Cross Transactions

Firms and their employees may not engage in a practice of effecting cross transactions for the purpose of supporting or maintaining the market price of a security.

19.55.9 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.

19.55.10 Parking Securities

"Parking" is a prohibited practice where a trade or series of trades are effected 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.

19.55.11 Churning

[FINRA Rule 2111.05(c) and 6140(c)]

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.

KCD also may not engage in excessive trading in a proprietary account considering KCD's financial resources and/or considering the market for the security.

19.55.12 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. KCD and its employees are prohibited from engaging in breaking up orders for the purpose of maximizing KCD's revenues or for any other prohibited purpose.

20 OPTIONS

[FINRA Rule 2360; FINRA Regulatory Notice 21-15]

This chapter outlines requirements when offering options to customers. Key requirements include the following:

- RRs and supervisors must be registered to sell and supervise options.
- Customers must submit an option agreement, and accounts must be approved for options trading levels.
- Writing uncovered options requires a separate disclosure and approval.
- Customers will be provided with a standard options disclosure document when option trading is approved.
- Customers are subject to position limits and methods of exercise disclosed in the agreement.
- Options communications require inclusion of the special risks associated with options.
- Compliance must approve discretionary accounts that will trade options.

20.1 Option Registration

[FINRA Rule 1220]

RRs must be qualified to engage in the sales of options contracts. Anyone who has successfully completed the Series 7 General Securities Representative examination is qualified to sell options.

RRs engaged in the sale of options are required to be supervised by a qualified Registered Options Principal (ROP). Supervisors are qualified as ROPs by passing prerequisite supervisor exams and the Registered Options Principal examination or by passing the General Securities Sales Supervisor (Series 10) examination.

20.2 Supervision Of Option Activities

[FINRA Rule 1220(A)(8), 1220.03 and 2360(b)(20)]

ROPs are responsible for approval of accounts, review of transactions and communications, and other supervision required by rule. The designated supervisor for each office that conducts options business will be qualified as an ROP, except for offices with three (3) or fewer RRs which may be supervised by an ROP or General Securities Sales Principal in another location.

Where secondary approval is required (discretionary accounts, accounts requesting trading levels where the customer does not meet minimum requirements, *etc.*), a qualified ROP in Compliance will review and approve such accounts.

If KCD has only one ROP, it will promptly notify FINRA if that person terminates and KCD may be required to limit or terminate options activities until a new ROP is appointed.

Ongoing supervision includes:

- Periodic reviews of customer trading activity to confirm they meet eligibility criteria and, if appropriate, revise trading levels including contacting the customer to renew their option trading status
- Review of customers' trading eligibility as market conditions change
- Identifying customers trading beyond approved levels

20.3 Opening Option Accounts

[FINRA Rule 2360(b)(16); FINRA Update on Options Sweep https://www.finra.org/rules-guidance/guidance/targeted-examination-letters/sweep-update#:%7E:text=FINRA%20Provides%20Update%20on%20Sweep%3A%20Option%20Account%20Opening%2C%2Crelated%20areas%2C%20including%20account%20supervision%2C%20communications%20and%20diligence]

20.3.1 Option Agreements And Approval Of Option Accounts

Responsibility	• Designated Supervisor • Compliance
Resources	• Customer Option Agreement and other account documents • Order records • Daily Transaction Report
Frequency	• Daily

Action	• Review option agreements and approve for appropriate trading level considering:
	  ○ consistency with the customer's investment objectives
	  ○ higher requirements for more complex strategies such as the customer's product knowledge and trading experience
	  ○ potential red flags when comparing the agreement with other information on file with KCD; logical inconsistencies such as a 21-year-old claiming 10 years of investing experience, financial status including higher income than reasonably expected
	• When an agreement is rejected and resubmitted, compare new agreement to rejected agreement; consider a waiting period to resubmit
	• Ensure option agreements are submitted for approval prior to the customer's first option transaction
	• Restrict accounts from further opening transactions where the customer's signed option agreement has not been received within 15 days of the first option transaction
	• Compliance: A qualified ROP will review accounts where the customer does not meet minimum criteria for the level of trading requested and approve or disapprove.

Record	• Customer's signed Option Agreement signed and dated by the approving supervisor • Records of providing option disclosure document • Records of providing uncovered short options disclosure • Compliance written justification if an account is approved for a level of trading for which the customer does not meet minimum criteria

Prior to the first option trade, a completed option agreement must be approved by a ROP or qualified sales supervisor (Series 10). In offices where no qualified supervisor resides, a local supervisor may approve the option account but a qualified supervisor must approve the account within 10 days of the local supervisor's approval.

RRs are responsible for obtaining the required information on KCD'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 KCD's agreement.

The customer's signed option agreement must be submitted to KCD within 15 days of approval. Failure to receive the customer's signed option agreement within 15 days will result in restricting the customer's account to closing option transactions until the agreement is received.

20.3.1.1 Levels Of Option Trading

The following guidelines apply to accounts requesting approval to trade at various levels:

- Covered call writing: 1 year investing experience
- Short puts: 1 year options or 2 years investing experience
- Long calls and puts: 1 year options or 2 years investing experience
- Spreads and combinations: 2 years options or 5 years investing required, Margin agreement required
- Uncovered call writing: generally not allowed

Accounts approved for these trading levels that do not meet the minimum criteria require the review and written notation by the Options Principal to explain why the account was approved for that level.

20.3.1.2 Requalifying An Account's Approved Option Levels

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 or qualified sales supervisor and sent to the customer for verification of account information on the form.

20.3.2 Uncovered Short Options

[FINRA Rule 2360(b)(11)(A)(ii) and 2360(b)(16)(E); FINRA Notice to Members 06-54]

Responsibility	• Designated Supervisor • Compliance
Resources	• Customer Option Agreement • Special Statement for Uncovered Option Writers
Frequency	• As required
Action	• Compliance: For accounts not meeting minimum criteria for approval but submitted for approval, review and, if approved, a qualified ROP will document why the account is approved for uncovered short option trading • For accounts approved for uncovered short options, provide the Statement • When the Special Written Statement is revised, provide the revised copy to existing customers approved for uncovered short option trading before or with the confirmation of the next uncovered short option transaction

Record	• Copy of customer's acknowledgement of receiving the Statement retained in the customer file • Documentation of approving an account that does not meet minimum criteria is included with option account approval documentation

As a general policy, KCD does not allow uncovered call activity. Only under extreme circumstances will the options supervisor consider this activity.

All accounts that are approved for uncovered short options will be provided with the Special Statement for Uncovered Option Writers ("Statement") by our clearing firm before or with the confirmation of the first uncovered short option transaction. If the Statement is revised, the revised version will be provided before or with the confirmation of the next uncovered short option transaction.

Following are the minimum criteria for approval of an account to trade uncovered options:

- 3 years of experience trading options
- Minimum net equity of $50,000
- Minimum maintenance in the account of $50,000 or 70% underlying stock.

If the account does not meet the above criteria and the account wishes to trade uncovered short options, Compliance review and approval is required.

20.3.3 Option Disclosure Document (ODD)

[FINRA Rule 2360(b)(11)(A)]

All customers will be provided the required disclosure document at or prior to the time the account is approved for option trading.

In addition, whenever the disclosure document is revised, a revised copy will be provided to customers no later than the time of delivery of a confirmation for a transaction in a category of option that is the subject of a revision.

20.3.3.1 Hyperlink Delivery Of The ODD

[SEC Securities Exchange Act of 1934 Release No. 39356 dated November 25 1997; FINRA Notice to Members 98-03]

- Communications that contain clear and prominent hyperlinks to the ODD are considered to have been preceded or accompanied by the ODD.
- The ODD may be delivered via hyperlink to that document if the customer has consented to receive documents electronically from KCD.

20.3.4 Fiduciary Accounts

Compliance 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.

20.4 Option Orders

20.4.1 Suitability Of Option Transactions

[FINRA Rule 2360(b)(19)]

References to "suitability" apply only to those recommendations NOT subject to Regulation Best Interest (BI) which applies to retail customers and is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

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.

Suitability is only one element of acting in a customer's best interest. Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI) which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

20.4.2 Orders Requiring Prior Approval

Responsibility	• Designated Supervisor
Resources	• Order records • Daily Transaction Report
Frequency	• Daily
Action	• Provide wire operator or other order entry person with list of transactions requiring approval prior to entry • Approve (*or disapprove*) orders requiring prior approval • Identify orders not previously approved as required • Remind wire operator or other order entry person of requirement • Remind RR that order required prior approval
Record	• Initials on order records • Initials on Daily Transaction Reports

The following option transactions require the approval of the designated supervisor prior to entry:

- Opening purchase transactions in options expiring within one month of entry
- Opening purchase transactions for an order of 100 contracts
- Opening purchase transactions greater than $25,000
- Opening spread transactions greater than 50 per side contracts

20.4.3 Review Of Option Orders And Accounts

[FINRA Rule 2360(b)(20)(C)]

Responsibility	• Designated Supervisor
Resources	• Order records • Daily Transaction Report • Customer monthly transaction records • Option Agreements • Other available reports
Frequency	• Daily (order records, Daily Transaction Report) • Periodically (customer monthly transaction records)
Action	• Review for completeness of orders (open or close, put or call, *etc.*) • Review for orders requiring prior approval and prohibited transactions • Review daily transactions for suitability of option transactions, including the following: ○ Compatibility of option transactions with investment objectives and approved trading levels ○ Size and frequency of option transactions ○ Commission activity ○ Profit or loss in the account ○ Undue concentration in any options class or classes ○ Compliance with Reg T • Take corrective action which may include consulting with the RR and/or Compliance, requalifying an option account, canceling the order, education for the RR, or other appropriate action
Record	• Initials on order records or Daily Transaction report

The designated supervisor is responsible for review of option orders to identify transactions inconsistent with policy requirements including incomplete orders and transactions that appear to be unsuitable for the customer. Supervisory offices will have available (electronically or in hard copy) records enabling review of option accounts.

20.4.3.1 Accounts Trading Outside Approved Levels

Responsibility	• Designated Supervisor
Resources	• Customer Option Agreement • Order records • Daily Transaction Report
Frequency	• Daily

Action	• If a customer is trading outside the approved level on the customer's option agreement: • Confer with the RR regarding whether the customer's trading level should be amended • If yes, require a new option agreement from the customer and review for higher level of trading • If no, immediately inform the RR trading outside approved levels must cease • Consider contacting the customer to determine whether the violative transaction should be canceled, and cancel if appropriate
Record	• Initials on order records and Daily Transaction report • Notes of action taken on Daily Transaction Report or supervisory log or other written record

KCD has established procedures to identify accounts that trade outside approved option levels. RRs may be required to complete a new option agreement to re-qualify the customer or orders may be canceled if deemed inappropriate for the customer.

20.4.4 Prohibited Trading To Evade Short-Sale Requirements

[SEC Risk Alert: http://www.sec.gov/about/offices/ocie/options-trading-risk-alert.pdf]

Responsibility	• Designated Supervisor
Resources	• Option transaction reports
Frequency	• Daily
Action	• Review option transactions for indicators of attempts to circumvent Regulation SHO: ○ Trading exclusively or excessively in hard-to-borrow securities or threshold list securities, or in near-term listed options on such securities ○ Large short positions in hard-to-borrow securities or threshold list securities ○ Large failure to deliver positions in an account, often in multiple securities ○ Continuous failure to deliver positions ○ Using buy-writes, married puts or both, particularly deep in-the-money buy-writes or married puts, to satisfy the close-out requirement ○ Using buy-writes with little to no open interest aside from that trader's activity, resulting in all or nearly all of the call options being assigned ○ Trading in customizable Flexible Exchange (FLEX) Options in hard-to-borrow securities or threshold list securities, particularly very short-term FLEX Options ○ Purported market makers trading in hard-to-borrow or threshold list securities claiming the exception from the locate requirement of Regulation SHO (often these traders do not make markets in these securities, but instead effect trades only to take advantage of the option mispricing) ○ Multiple large trades with the same trader acting as a contra party in several hard-to-borrow or threshold list securities (often traders assist each other to avoid having to deliver shares) • If potential violations are identified, take corrective action which may include

	consulting with the trader, RR, and/or customer; reversing the transaction; closing the account or restricting dealing with another firm's trader engaged in such activity; consulting with Compliance
Record	• Record of transaction reviews, questionable trades, and action taken

Regulation SHO governs short sales to ensure that trades settle promptly, reducing settlement failures. Short sellers who fail to deliver securities are required to close out their position immediately, unless an exception applies. Some options trading strategies have been used to evade those requirements, particularly in hard-to-borrow securities.

Option strategies to circumvent Regulation SHO requirements are prohibited.

20.4.5 Prohibited Transactions

[FINRA Rule 2360(b)(13) and 2360(b)(14)]

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 an 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.

20.4.6 Best Execution

Options transactions are subject to best execution requirements. Refer to the section *Best Execution* in the chapter *ORDERS*.

20.4.7 Disclosure Of Option Order Routing

[SEC Regulation NMS Rule 606]

KCD is obligated to publish statistics regarding customer agency orders in options. Procedures for publishing the required information are detailed in the chapter *ORDERS* in the section *Disclosure Of Order Routing*.

20.5 Option Programs

Responsibility	• Designated Supervisor • Compliance
Resources	• Programs proposed by RRs • Outgoing communications regarding option programs • Order records • Transaction reports

Frequency	• As required

Action	• Compliance: Review proposed program and approve or disapprove; review and approve written explanation
	• Designated supervisor:
	    ○ Refer all option programs to Compliance for review and approval
	    ○ If an option program is approved, monitor communications and transactions to ensure consistency with the stated program

Record	• Compliance retains a copy of the approved option program and written explanation • Designated supervisor record of review on order records/transaction reports

The use of option programs that involve the systematic use of one or more options strategies requires the prior review and approval by Compliance. The customer must be provided with a written explanation of the nature and risks of the options program, including an explanation of the strategies and the purposes of the program. The written explanation must be approved by Compliance prior to use. The RR is required to maintain a record of the date and to whom the explanation was sent.

Where retail communications describe an options program, the cumulative history or unproven nature of the program and its underlying assumptions will be disclosed.

20.6 Option Operations Procedures

This section describes some of the operations procedures relating to options. The Options Principal is responsible for these areas.

20.6.1 Reporting Positions

[FINRA Rule 2360(b)(5)]

The designated operations supervisor is responsible for reporting option positions in accordance with SRO requirements. KCD relies on our clearing firm to report option positions in accordance with SRO requirements.

When KCD is not a member of the options exchange upon which the standardized options are listed and traded, KCD is required to file a report with FINRA regarding the following accounts which have established an aggregate position of 200 or more option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security or index:

- each account in which KCD has an interest
- each account of a partner, officer, director or employee of KCD
- each customer, non-member broker, or non-member dealer account

Reporting combines long positions in put options with short positions in call options and short positions in put options with long positions in call options.

20.6.2 Position Limits

[FINRA Rule 2360(b)(3)]

Customers are subject to limits on how many contracts may be accumulated in a particular option at any one time. Total positions include all accounts under "common control" by one party. An example of common control would be a registered investment adviser who manages multiple accounts and establishes option positions in accounts under the adviser's management. Position limits also include accounts "acting in concert" to accumulate a position. KCD (or its clearing firm or other firm executing transactions on its behalf) has systems to prevent entry of orders that would violate position limits.

Some qualified hedge strategies and positions are exempt from position limits, including a delta hedging exemption for FINRA members and non-member affiliates. The designated supervisor is responsible for applying the Permitted Pricing Model to all positions in or relating to the security underlying the relevant options position that are owned or controlled by such member or non-member affiliate and providing FINRA with written certification that KCD or its affiliate are using the Permitted Pricing Model and that the affiliate will provide immediate notice to KCD if it ceases to hedge stock positions; KCD is responsible for carrying all option positions relying on the exemption. KCD is responsible for reporting any positions. [FINRA Rule 2360(b)(A)(vii)]

The designated operations supervisor is responsible for identifying positions that exceed allowable limits under SRO rules. When a position limit violation is identified, the SRO will be notified as required by rule and the customer will be notified and asked to reduce the position to within the permitted levels.

20.6.3 Liquidation Of Positions And Restrictions On Access

[FINRA Rule 2360(b)(6)]

When FINRA determines that a person or group of persons acting in concert holds or controls, or is obligated in respect of, an aggregate position in option contracts covering any underlying security or index in excess of position limits, it may direct a member or all members carrying a position in option contracts covering such underlying security or index for such person or persons to liquidate such position or positions, or portions thereof, as expeditiously as possible and consistent with the maintenance of an orderly market, to bring such person or persons into compliance with the position limits. When directed by FINRA, KCD will liquidate positions and will not permit such person or persons to execute an opening transaction and will not accept and/or execute for any person or persons named in such directive, any order for an opening transaction in any option contract, unless in each instance express approval is given by FINRA, the directive is rescinded, or the directive specifies another restriction appropriate under the circumstances.

FINRA will notify the subject person or persons who have the right to appeal the decision.

20.6.4 Exercise Of Options

[FINRA Rule 2360(b)(4) and 2360(b)(23)(A)(ii) (vi) and (ix); FINRA Regulatory Notice 11-35]

The exercise of options is subject to regulatory rules; the method used for exercising options is disclosed on KCD's option agreement.

The following records will be retained by the designated supervisor regarding exercise of options:

- Sufficient work papers and other documentary materials relating to the allocation of options exercise assignment notices to establish the manner in which allocation of the exercise assignment notices is in fact being accomplished
- Memorandums of exercise instructions received from customers showing the time the instruction was received
- Memorandum if KCD receives and acts on exercise instructions after set cut-off times because of some unusual circumstances (including the details explaining the exception), as required under option rules

The designated supervisor is responsible for ensuring the exercise of options does not exceed limitations specified in options rules. If KCD has reason to believe someone acting alone or in concert with others has exceeded or is attempting to exceed position or exercise limits, KCD will promptly contact FINRA.

The exercise cut-off is established by regulators or KCD may establish an earlier time which is communicated to customers trading options. Exercise instructions will not be accepted after the cut-off time. Submission of exercise instructions may be submitted electronically in which case the instructions will include an electronic record of the time it is submitted to comply with the cut-off time. If not submitted electronically, a manual record will be maintained of the time when the exercise instructions are submitted. Mistakes or errors in submitted exercise instructions will be reviewed and resolved by Operations (at KCD or its clearing firm).

20.6.4.1 Tendering Procedures

[FINRA Rule 2360(b)(A)(ii) (vi) and (ix)]

Special procedures apply to the exercise of standardized equity options on the last business day before their expiration ("expiring options"). Unless waived by The Options Clearing Corporation, expiring standardized equity options are subject to the Exercise-by-Exception ("Ex-by-Ex") procedure under The Options Clearing Corporation Rule 805. This Rule provides that, unless contrary instructions are given, standardized equity option contracts that are in-the-money by specified amounts are automatically exercised. In addition to The Options Clearing Corporation rules, the following FINRA requirements apply with respect to expiring standardized equity options. Option holders desiring to exercise or not exercise expiring standardized equity options must either:

- take no action and allow exercise determinations to be made in accordance with The Options Clearing Corporation's Ex-by-Ex procedure where applicable; or
- submit a "Contrary Exercise Advice" by the deadline.

For both customer and proprietary positions (as well as positions of other firms where KCD has accepted responsibility to exercise options), KCD is responsible for confirming that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. KCD may establish a cut-off time prior to FINRA's specified cut-off.

The filing of a final exercise decision, exercise instruction, exercise advice, Contrary Exercise Advice or Advice Cancel does not serve as a substitute to the effective notice required to be submitted to The Options Clearing Corporation for the exercise or non-exercise of expiring standardized equity options.

20.6.5 Adjustments In Terms Of Options

The number of shares underlying an option contract and/or the exercise price are 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. Branches are notified and RRs should advise customers who hold option positions in the affected security.

20.6.6 Branch Copies Of Account Information And Statements

[FINRA Rule 2360(b)(17)(B)]

For all accounts trading options, each branch office servicing the account and the principal supervisory office having jurisdiction over the branch office will retain copies of background and financial information for approved options accounts and customer statements for the prior 6 months. These records may be in electronic format if readily accessible and promptly retrievable.

20.7 Option Complaints

[FINRA Rule 2360(b)(17)(A)]

Responsibility	• Designated Supervisor • Compliance
Resources	• Incoming correspondence • Written complaints
Frequency	• As required
Action	• Immediately provide the original of any written complaint to Compliance • Retain a copy of the complaint for branch files • Compliance (*in consultation with the branch manager*) will respond to the complaint

Record	• Copy filed in branch Option Complaints file
	• For branch offices that report to an OSJ in another location, the OSJ will retain copies of complaints for branch offices under their supervision
	• Compliance retains KCD's central complaint files including:
	    ○ 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

RRs are required to notify their supervisor or compliance when a complaint is received. All written option complaints are to be forwarded to Compliance immediately upon receipt.

20.8 Option Communications With The Public

[FINRA Rule 2210 and 2220]

Requirements for options communications (including electronic communications) include the following, which are explained in more detail below:

- The rules governing retail communications, institutional communications and correspondence apply to options communications. Refer to the chapter *COMMUNICATIONS WITH THE PUBLIC* for more information about these policies.
- Retail communications (communications distributed to more than 25 retail investors) require supervisory approval **prior to** distribution.
- Institutional communications (for institutions only) do not require prior approval and are subject to review consistent with correspondence reviews (see the chapter *COMMUNICATIONS WITH THE PUBLIC*). Institutional communications require review by the designated supervisor.
- All options communications (other than institutional communications) must include a statement that supporting documentation for any claims (including claims on behalf of options programs or the options expertise of sales persons); comparisons; recommendations; statistics; or other technical data, will be supplied upon request.
- Consider providing supplementary information to customers approved to trade complex options.
- All advertising requires Compliance approval **prior to** publication.

20.8.1 Definitions

Retail investor: includes any person other than an institutional investor, regardless of whether the person has an account with KCD.

Institutional investor: See the definition in the chapter *COMMUNICATIONS WITH THE PUBLIC*.

Retail communication: includes **any** written communication (including advertising, telemarketing and other sales scripts and other written communications) that is published, distributed or made available to **more than** 25 retail investors within any 30 calendar-day period.

Institutional communication: includes written communications that are distributed or made available only to institutional investors.

Correspondence: Includes any written communication that is distributed or made available to 25 **or fewer** retail investors within any 30 calendar-day period.

Options [FINRA Rule 2360(a)(20)]: Any put, call, straddle or other option or privilege, which is a "security" as defined in Section 2(1) of the Securities Act of 1933 but not including any tender offer, registered warrant, right, convertible security or any other option in respect to which the writer is the issuer of the security which may be purchased or sold upon the exercise of the option.

Options Disclosure Document (ODD) [FINRA Rule 2360(a)(12)]: The options-market document containing explanatory information relating to the mechanics of buying, writing and exercising options; the risks involved; and other required information about options. The ODD must be provided to all options customers and provided with certain options communications.

Public appearance: Any participation in a seminar, forum (including an interactive electronic forum), radio, television or print media interview, or other public speaking activity, or the writing of a print media article, concerning options.

Standardized Option: Any options contract issued, or subject to issuance, by The Options Clearing Corporation, that has standardized terms for the strike price, expiration date, and amount of the underlying security, and is traded on a national securities exchange registered pursuant to section 6(a) of the Securities Act.

20.8.2 Option Content Standards

- All options communications (other than institutional communications) must include a statement that supporting documentation for any claims (including claims on behalf of options programs or the options expertise of sales persons); comparisons; recommendations; statistics; or other technical data, will be supplied upon request.
- All options communications (other than institutional communications) must include a statement that options are not suitable for all investors including risk disclosures required by FINRA Rules 2210 and 2220.
- Communications including historical and/or performance figures or projections must be preceded or accompanied by the Options Disclosure Document (ODD). For historical performance projections, specific guidelines apply [see FINRA Rule 2220(d)(3) and (4)].

20.8.3 Correspondence And Retail Communications

Responsibility	• Designated Supervisor

Resources	• Correspondence and retail communications
Frequency	• Daily
Action	• Review to ensure appropriate language and options disclosure document is provided including the required content statement
Record	• Record of review including any changes required

All communications (written or electronic) 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, other than advertising that meets the requirements of SEC Rule 134, must be preceded or accompanied by the options disclosure document.

20.8.4 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 KCD 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 KCD.

Distribution of copyrighted material is subject to the copyright holder's approval. KCD will obtain approval for independent reprints it distributes to RRs for sending to customers. For other reprints, Compliance should be consulted for assistance in obtaining the publisher's approval.

20.8.5 Communications Regarding Standardized Options Prior To Delivery Of The ODD

Prior to providing the ODD, communications are limited to a brief description of options including a statement that identifies the registered clearing agency for options and a brief description of the general attributes and method of operation of the option exchanges including a discussion of how an option is priced. Such pre-ODD communications must include contact information for obtaining a copy of the ODD and must not contain recommendations or past or projected performance figures including annualized rates of return or the names of specific securities. They may include statements required by state law and administrative authority and may include advertising designs and devices, providing such material is not misleading.

20.8.6 Seminars And Public Presentations

Responsibility	• Designated Supervisor • Compliance
Resources	• Outlines for proposed seminars or public presentations that include options including sales material to be distributed • Tapes of radio, TV, newspaper articles, or other public media presentations
Frequency	• As required
Action	• Designated Supervisor: review presentation and related sales materials and refer to Compliance for review and approval • Compliance: ○ Pre-approve radio, TV, newspaper or other public media presentation ○ Review seminars or other presentations and sales material; approve or disapprove
Record	• Compliance: record of presentation and sales material; copies of written materials or tapes of public media presentations; approval/disapproval • Designated Supervisor: ○ Copy of presentation and written sales material provided to attendees ○ Record of approval/disapproval ○ List of attendees ○ Confirmation that attendees were provided options disclosure documents

Prior to conducting a seminar or other public presentation regarding options, the outline of the presentation must be provided to the designated supervisor for review. Seminar scripts, handouts, slides, or other visual presentations must be pre-approved and are deemed to be retail communications. All who attend the public presentation should be provided the current options disclosure document. A list of those who attended and received the disclosure document should be prepared and include the date of the meeting.

Appearances in public media (radio, TV, newspapers, other) require the prior approval of Compliance and copies of written material or tapes of the presentation must be provided to Compliance including where published/presented and the type of media (name of newspaper, radio/TV station, other) and date of the appearance or publication.

20.8.7 Filing Requirements

[FINRA Rule 2220(c)]

Responsibility	• Compliance
Resources	• Proposed communications subject to filing
Frequency	• As required

Action	• Review communication and make necessary changes • Submit communication to FINRA for approval at least 10 calendar days prior to first use • Communicate approval or disapproval to originator of the communication
Record	• Copies of communications with FINRA approval/disapproval and contact with originator regarding permissible use or restriction on use

Communications that are likely to be widely disseminated such as advertisements and independently prepared reprints are subject to filing with FINRA at least ten calendar days prior to use. If changed or disapproved by FINRA, the originator of the communication will be notified, and the communication will be withheld from distribution until resubmitted to FINRA and approved by them.

Filing with FINRA is not required:

- if the communication is filed with another regulator with standards comparable to FINRA
- for communications which only reference that options are available from KCD
- for the ODD and prospectus
- for targeted communications (such as correspondence) used once the ODD or prospectus has been delivered

20.9 OTC Options (Non-Standardized Options)

ROP approval is required prior to writing OTC non-standardized options. Margin requirements may vary from standardized options.

20.10 Trade Reporting

[FINRA Rule 6000 series and 7000 series; FINRA Regulatory Notice 14-23, 11-40, 10-26, 09-21 and 09-08; FINRA Trade Reporting Notice September 23, 2011 “Trade Reporting Transactions in OTC Equity Securities and Restricted Equity Securities”; FINRA Trade Reporting Notice September 23, 2011 “FINRA Reminds Firms of Their Trade Reporting Obligations Relating to Customer Sales of Low-Value OTC Equity Securities”; NASDAQ Broker-Dealer data: Equity Trader Alert 2009-33]

Responsibility	• Designated Supervisor
Resources	• FINRA/NASDAQ Broker-Dealer available data and reports • CAT resources • Other order records or reports available (if applicable) • Reporting information provided by third parties (if applicable) • Training program or materials for traders and other order personnel
Frequency	• Initially: Register with CAT • As required: Identify third parties who will report • Reviews of Firm reporting: Daily, Monthly or Weekly depending on frequency of reports/availability of data • Periodic reviews of third party reporting (depending on information available) • Training: as required
Action	• Register with CAT:

	◦ Include designation of Super Account Administrator responsible for creating users ◦ Update Administrator and users as required • If a third party (*e.g.,* clearing firm) reports on behalf of KCD: ◦ Identify third party and review in accordance with "Outsourcing" policy requirements included in the chapter *FINANCIAL AND OPERATIONS PROCEDURES* ◦ Maintain a written agreement with the third party outlining requirements for reporting to CAT and other trading facilities and providing data allowing KCD to conduct oversight to ensure the timely, accurate, and complete reporting on KCD's behalf ◦ Conduct periodic reviews of third party reporting which may include the third party's policies and procedures, leakage escalation processes, mitigating controls, ongoing operational issues, open items, security, access, and performance reports ◦ Take corrective action reporting discrepancies to the third party, as necessary • For Firm reporting: ◦ Review available SRO compliance report cards for compliance with trade reporting requirements, including timely reporting, correct indicator for sales transactions (long, short, or short exempt) and mixed capacity trade reporting (if used), accurate use of trade modifiers ◦ Review for proper reporting of riskless principal transactions ◦ Take corrective action which may include consultation with the trader; additional education for the trader, and/or consult with Compliance regarding corrective action ◦ Confirm through internal testing/auditing that KCD's systems are reporting transactions consistent with requirements; providing appropriate exception management; maintaining necessary control processes • Provide training to new traders and other order personnel and continue training as required
Record	• Equity Trading Manager Monthly Checklist • Designation of Super Account Administrator and users • Available SRO reports including date of review, reviewer's initials, and action taken, if applicable • Firm order records/internal reports including date reviewed, reviewer's initials, and action taken, if applicable • Record of reviews of third party reporting and action taken, if any • Records of testing/auditing • Records of training

KCD is obligated to report trades to the Consolidated Audit Trail (CAT) and a Trade Reporting Facility (TRF). The obligation to report depends on the security, the type of transaction (buy or sell), and the capacity in which KCD executes the transaction. Transactions must be reported to a FINRA trade reporting facility unless transactions in eligible securities are reported on or through an exchange. Rules specify the latest time ("no later than _") by which a trade must be reported, but the obligation is to report "as soon as practicable," *i.e.,* without delay after execution or cancellation.

The following explains some terms regarding trade reporting.

Executing party: The member firm that receives an order for handling or execution or is presented an order against its quote, does not subsequently re-route the order, and executes the transaction.

Consolidated Audit Trail (CAT): CAT is jointly owned by regulators and collects every order, cancellation, modification and trade exchanges for all FINRA and exchange-listed equities and options across all U.S. markets. CAT was developed to provide a central record of all orders to enhance regulatory oversight and customer protection.

FINRA / NASDAQ TRF: The FINRA/NASDAQ Trade Reporting Facility (TRF) compares trade information and submits locked-in trades to NSCC and handles all NASDAQ trade reporting. NASDAQ execution systems such as NASDAQ Market Center have an automatic interface with the TRF that routes execution reports through the facility for reporting and comparison.

FINRA/NASDAQ TRF Chicago: FINRA members may report OTC trades in NMS stocks (which is in addition to other TRFs that accept NMS trades). This TRF is governed by the rules for the FINRA/NASDAQ TRF (FINRA/NASDAQ TRF Carteret).

FINRA/NYSE TRF: For reporting NMS securities transactions executed away from an exchange.

OTC Reporting Facility: For reporting transactions in OTC equity securities (any equity security that is not an NMS stock as defined in SEC Regulation NMS). Transactions in foreign securities and direct participation programs (DPPs) are also reported to the OTC Reporting Facility.

Clearing and comparison: The Rule 7000 series explains requirements for clearing agency members and related trade reporting requirements. Some transactions, such as odd-lot transactions, are reported for clearing purposes and not for tape dissemination. Generally all trades (other than those specifically excluded) are required to be reported for clearing and regulatory transaction fee purposes.

System: Includes the FINRA/NASDAQ TRF and the OTC Reporting Facility.

20.10.1 Consolidated Audit Trail (CAT)

All firms (regardless of size) that receive or originate orders in NMS stocks, OTC equity securities, or listed options must report to CAT. All proprietary trading activity, including market making activity, is subject to CAT reporting. There are no exclusions or exemptions of any kind for type of firm or type of trading activity. If reporting is done by a third party (*e.g.,* clearing firm), KCD remains responsible for oversight of reporting.

Complete policies and procedures are included in the chapter *ORDERS* in the section *Consolidated Audit Trail (CAT) Trade Reporting*.

21 MUNICIPAL SECURITIES

[MSRB compliance resources: https://www.msrb.org/Regulatory-Documents?f%5B0%5D=regulatory_documents%3A110]

This chapter describes requirements that apply to municipal securities. Rule references (*i.e.,* G-3) refer to Municipal Securities Rulemaking Board (MSRB) rules, unless otherwise noted.

References to "suitability" apply only to those recommendations NOT subject to Regulation Best Interest (BI) which applies to retail customers and is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). MSRB Rule G-19 (Suitability) only applies in circumstances where Regulation BI does not apply and applies to recommendations to customers by bank dealers. Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

21.1 Administration And Operations

21.1.1 Fees And Assessments

[MSRB Rule A-12, A-13 and A-7]

Responsibility	• Designated Supervisor
Resources	• Data regarding inter-dealer sales transactions in municipal securities and municipal underwriting activity (MSRB Rule A-13) • MSRB Rule A-14 regarding annual fee
Frequency	• Inter-dealer transactions and underwriting assessments as required • Annual fee - annually by October 31
Action	• Verify, update (if necessary), and file Form A-12 within 17 business days of the beginning of the calendar year • Calculate and pay inter-dealer transaction and underwriting assessment fees • Pay annual fee for receipt by the MSRB by October 31
Record	• Record of annual Form A-12 affirmation. • Records of all assessment and fee payments are retained in files by respective subject.

The designated supervisor is responsible for reporting required information and paying assessment fees to the MSRB. The designated supervisor is also responsible for paying the annual fee to the MSRB.

21.1.2 Registration Requirements

[MSRB Rule G-3; MSRB chart of registration and supervisory responsibilities: https://www.msrb.org/sites/default/files/2022-10/Principals-Supervisory-Responsibilities-Chart_0.pdf]

Employees engaged in municipal activities must be registered as outlined in this section. References to "sales" also include the solicitation of sales to and/or purchases from customers.

Firms are required to have at least two municipal securities principals unless the firm is engaged in general securities business and is a member of a registered securities association; or, firms with fewer than eleven employees may have one principal.

Responsibility	• Designated Supervisor
Resources	• Employees engaged in municipal advisor activities
Frequency	• Initially determine registration requirements • Annually update Form MA with SEC within 90 days after the end of KCD's fiscal year (calendar year for sole proprietors) • As required: update Forms MA and MA-1
Action	• Designate at least one person as municipal advisor principal responsible for supervising municipal advisory activities • Determine which employees required registration as municipal advisors or supervisors • Require identified employees to complete necessary examinations and obtain registration • File Form MA with the SEC through EDGAR and update annually • File Form MA-1 for each MA employee and update forms as required • Promptly file updates to Form MA for any material changes • Update MA-1 forms when necessary
Record	• Employee registration records • Registration filing with MSRB • Forms MA and MA-1 filed with SEC • Annual and interim updates to Form MA • Updates to Forms MA-1 as required

Registration requirements include the following:

- RRs must be qualified as municipal advisor representatives prior to engaging in these activities.
- Municipal advisor principals, who are directly engaged in the management, direction or supervision of municipal advisory activities, must pass the municipal advisor principal examination (prerequisite: registration as a municipal advisor representative).
- A representative who acts as a principal must complete the principal examination within 120 days of becoming a municipal advisor principal.
- Registration statuses lapse after two years of non-registration.
- Those engaged in the management, direction or supervision of municipal advisory activities and associated persons must take and pass the Series 54 examination. Individuals qualified with the Series 50 examination have a one-year grace period until November 20, 2020 when the Series 54 must be completed.

21.1.3 Municipal Securities Representatives

[MSRB Rule G-3]

Municipal Securities Representatives engage in one or more of the following:

- underwriting, trading or sales of municipal securities;
- financial advisory or consultant services for issuers in connection with the issuance of municipal securities;
- research or investment advice with respect to municipal securities; or
- any other activities which involve communication, directly or indirectly, with public investors in municipal securities.

Municipal Securities Representatives qualify by completing the Securities Industry Essentials Examination (SIE) and the Series 52 Municipal Securities Representative examination and may engage in a wide range of transactions in municipal securities including sales, trading, underwriting, and other non-supervisory municipal activities.

21.1.4 Limited Representatives

[MSRB Rule G-3]

Municipal Securities Sales Limited Representatives are limited exclusively to handling customer sales and purchases of municipal securities. The term "limited representative - investment company and variable contracts products" means a municipal securities representative limited exclusively to the sale and purchase of municipal fund securities. Limited representatives may not engage in other municipal activities such as trading or underwriting. For offices where RRs are qualified as Limited Representatives, the designated supervisor is responsible for determining that those RRs do not exceed the limited activities permitted under this registration status.

The SIE and Series 7 examinations qualify a Municipal Securities Sales Limited Representative.

The SIE and Series 6 examinations qualify an Investment Company/Variable Contracts Limited Representative.

21.1.5 Exceptions

[MSRB Rule G-3(a)(ii)(B)]

SIE and MSRB exams are not required for the following:

- Municipal securities representatives who qualified via the general securities representative exam prior to November 7, 2011
- Municipal securities sales limited representatives qualified as a general securities representative via the general securities representative exam
- Persons qualified as a limited representative-investment company and variable contracts products via taking the exam for that qualification

Anyone who ceases association with a municipal dealer for two or more years is required to re-qualify.

21.1.6 Municipal Securities Sales Supervisors

[MSRB Rule G-3]

Individuals who complete the Series 8 General Securities Sales Supervisor examination are qualified as municipal securities sales supervisors. Prerequisites are registration as a municipal sales representative or general securities representative or passing the exam for either status. Supervision is limited to sales of municipal securities to customers.

21.1.7 Municipal Securities Principals

[MSRB Rule G-3]

Status as a municipal securities representative or general securities representative plus the Series 53 examination qualifies individuals for the registration status of municipal securities principal which permits the individual to supervise all aspects of KCD's municipal business. Qualified municipal principals will be designated to supervise the areas of underwriting, trading, and pricing of inventories.

21.1.8 Grace Period For Designated Principals With Prior Registration

Persons without prior registrations must qualify as a Municipal Principal before acting in that capacity. For those who meet the following requirements, they may act as a principal for 120 days prior to qualification:

- already registered as a representative (the type depending on the category of principal registration); and
- at least 18 months of experience functioning as a representative within the five-year period immediately preceding the principal designation.

The above exception also applies to those designated as a Municipal Fund Securities Limited Principal and who were previously registered as a general securities representative or investment company/variable contracts limited representative, and with the 18-month experience.

21.1.9 General Securities Principals

[MSRB Rule G-27(b)(ii)(C)(3)]

Individuals qualified as General Securities Principals may conduct limited supervision without municipal principal qualification. Those qualified as a General Securities Principal are limited to supervision of books and records; review and approval of the opening of customer accounts; overseeing the gathering of information on associated persons; and approval of advertising. A General Securities Principal may not supervise and review customer transactions, customer complaints, or correspondence related to municipal securities. He/she also may not supervise the processing of municipal securities transactions including trade reporting to the MSRB.

21.1.10 Non-Registered Employees

[MSRB Rule G-3 and G-3.03]

Employees who are not registered are limited to clerical and ministerial functions when contacting public customers 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 KCD. The designated supervisor to whom the non-registered employee reports is responsible for reasonably ensuring the employee does not exceed the limitations listed above.

Where persons are not required to be registered for their responsibilities, KCD may sponsor (or transfer) registration ("permissive qualification"). These individuals will be assigned to a supervisor who is responsible for confirming the individual does not act beyond his or her designated responsibilities.

21.1.11 Permissive Qualification

[MSRB Rule G-3.03]

KCD may permit any employee to become registered as a representative or a principal, including individuals working in a clerical or ministerial capacity. If not required for the person's responsibilities, approval by the supervisor and Compliance is required. These individuals are subject to regulatory conduct rules such as outside business activities, private securities transactions, *etc.,* and will be assigned to a registered principal. All registered persons, including those who solely maintain a permissive qualification, are required to satisfy the Regulatory Element of continuing education.

21.1.12 Waivers

[MSRB Rule G-3.04]

When an individual with a lapsed qualification has worked for a financial services industry affiliate of a BD or Municipal Securities Dealer, the requirement to requalify by examination may be waived upon request if the following conditions are satisfied:

1. An individual must have been registered with a broker, dealer or municipal securities dealer for a total of five years within the most recent 10-year period, including the most recent year with the broker, dealer or municipal securities dealer having designated the individual as eligible for a waiver by having met the requirement of this subparagraph;
2. The waiver request is made within seven years of the individual's initial designation;
3. The individual continuously worked for a financial services industry affiliate(s) of a broker, dealer or municipal securities dealer since terminating association with a broker, dealer or municipal securities dealer;
4. The individual has completed the Regulatory Element portion of continuing education based on the person's most recent registration status and on the same Regulatory Element cycle had the person remained registered; and
5. The individual does not have any pending or adverse regulatory matters or terminations and has not otherwise been subject to a statutory disqualification while the individual was working for a financial services industry affiliate(s) of a broker, dealer or municipal securities dealer.

"Financial services industry affiliate of a broker, dealer or municipal securities dealer" means any legal entity that controls, is controlled by or is under common control with a broker, dealer or municipal securities dealer and is regulated by the SEC, CFTC, state securities authorities, federal or state banking authorities, state insurance authorities, or substantially equivalent foreign regulatory authorities.

21.1.13 Qualified Persons Serving In The Armed Forces

[MSRB Rule G-3.05]

The MSRB provides exceptions for qualified persons who volunteer for or are called into active U.S. military service. The supplementary material should be consulted for details of the requirements.

21.1.14 Continuing Education (CE)

[MSRB Rule G-3(i); MSRB Notice 2022-09]

Responsibility	• Compliance
Resources	• Employee records of those engaged in municipal activities • Commission/revenue records of municipal activities
Frequency	• Annually: identify those subject to CE • Annually: develop continuing education to be administered • Annually: conduct training
Action	• Identify employees subject to the requirement (and those engaged in municipal activities so limited as not to warrant CE training) • Develop CE subjects to be included in training • Conduct training sessions for those subject to the requirements • Restrict activities of those failing to meet the annual requirement; restrictions may include ceasing conduct of business with the public or ceasing other municipal activities
Record	• Record of subject employees • Record of employees engaged in limited activities excluded from requirement • Annual CE training program including subjects covered • Record of employees completing CE training • Record of limiting activities for those who do not complete requirements

Registered employees are subject to annual Regulatory Element and Firm Element continuing education which must be completed by December 31 of each year. Compliance will notify those employees subject to CE training. Failure to complete required CE by December 31 will result in suspension from registration.

Firm Element continuing education covers, at minimum, the following:

- General investment features and associated risk factors
- Suitability and sales practice considerations
- Applicable regulatory requirements
- Ethics and professional responsibility

Previously registered persons who have temporarily stepped away from the industry may maintain their qualification through continuing education up to five years.

Also see the section *Continuing Education* in the chapter *TRAINING AND EDUCATION* for further information.

21.1.15 Offices

[MSRB Rule G-27(b)(iii) and G-27(g)]

Compliance is responsible for identifying offices, where municipal business is conducted, and identifying designated supervisors. Designations are included in the chapter *DESIGNATION OF SUPERVISORS AND OFFICES*. The designation of supervisors will consider the following:

- Retail sales or other activities involving public contact with respect to municipal securities
- A substantial number of RRs conduct municipal securities activities at, or are otherwise supervised from, the location
- The location is geographically distant from another municipal OSJ

- RRs are geographically dispersed
- Municipal activities at a location are diverse and/or complex

Office designations include offices of municipal supervisory jurisdiction, branch offices, and other offices as defined in the Rule. MSRB rule definitions track FINRA's office definitions; refer to the chapter *OFFICES* for detailed information about types of offices.

21.1.15.1 Office Inspections

[MSRB Rule G-27.01]

All offices are subject to annual inspection with a record maintained of the inspections. In the case of remote offices, inspections may be conducted remotely through June 30, 2024, with the following requirements:

1. Offices for remote inspection must be identified as such.
2. Ongoing review of business activities and functions are subject to ongoing review, whether or not remotely inspected.
3. A record will be maintained of any additional supervisory procedures or more frequent monitoring imposed.

21.1.16 Notifications To MSRB

Compliance will notify the MSRB in writing if KCD ceases to engage in business activities either voluntarily or because of being barred or suspended by a regulator from engaging in securities activities.

Compliance will also promptly notify the MSRB of any change in name or address.

21.1.17 Fidelity Bonding Requirements

[MSRB Rule G-6]

The designated supervisor is responsible for arranging, maintaining, and verifying the adequacy of appropriate fidelity bond coverage.

21.1.18 Books And Records

[MSRB Rule G-8 and G-9]

KCD complies with MSRB Rules G-8 and KCD maintains municipal records specifically identified in G-8 subparagraph (a)(iv)(D); paragraph (a)(viii); and paragraphs (a)(xi) through (a)(xxii).

Procedures on books and records are included in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*.

21.1.19 Confirmations

[MSRB Rule G-15; MSRB Notice 2018-05]

Responsibility	• Designated Supervisor

Resources	• Confirmations or available reports
Frequency	• Monthly

Action	• Review a sampling of confirmations to determine whether required information is included
	• Where omissions are found:
	    ○ Have corrected confirmations issued
	    ○ Confirm whether the problem is systemic or human error
	    ○ If systemic, contact the appropriate supervisor to make corrections to the system
	    ○ If human error, notify the person responsible of the problem and provide added training, if necessary
	    ○ Contact the clearing firm, if applicable
	• If KCD relies on its clearing firm to issue confirmations, sample confirmations or other records and contact the appropriate person at the clearing firm to correct the problem
	• Include reviews of confirmations in audit procedures

Record	• Review of confirmations, reports, or other records including notation of omissions found, corrective action taken • If a clearing firm is involved, documentation of who was contacted and what corrective action will be taken • Audit reviews

The designated supervisor is responsible for establishing procedures regarding the preparation and transmission of customer confirmations, including information required under MSRB Rule G-15.

21.1.20 Control Relationships

[MSRB Rule G-22]

A "control relationship" exists when KCD 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, KCD 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.

21.1.21 Disclosure Of Interest In Distribution

[SEC Securities Exchange Act of 1934 Rule 15c1-6]

Rule 15c1-6 of the Securities Exchange Act of 1934 specifies requirements for disclosures when KCD is involved in a primary or secondary distribution of municipal securities. KCD will provide the required disclosure on or with the customer's confirmation of a transaction in the subject securities.

21.1.22 Reciprocal Dealings

[MSRB Rule G-31]

KCD and its employees are prohibited from soliciting municipal transactions from accounts for investment companies in return for sales of shares in the investment company.

21.1.23 Use Of Ownership Information

[MSRB Rule G-24]

KCD is prohibited from using information regarding the owners of municipal securities obtained in a fiduciary or agency capacity (*i.e.,* as paying agent, transfer agent, registrar, indenture trustee, safekeeping agent, correspondent of another municipal dealer, *etc.*) for the purpose of soliciting purchases, sales or exchanges of municipal securities. KCD 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.

21.1.24 Customer Account Transfers

[MSRB Rule G-26]

Transferring Firm Accounts To Another Firm

When a customer wishes to transfer an entire account to another broker-dealer and presents a properly-executed transfer notification, the account will be transferred in accordance with the requirements of MSRB Rule G-26 and other regulators' applicable requirements either by KCD or a clearing firm, if applicable.

Transferring An Account From Another Firm

For transfers to KCD from another broker-dealer, operations personnel should be consulted for instructions on completing transfer instructions which will be submitted to the carrying broker-dealer.

21.1.25 Transactions For Employees Of Other Municipal Dealers

[MSRB Rule G-28]

When an account is opened for the employee of another municipal dealer, KCD 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. The RR 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.

21.1.26 Written Supervisory Procedures

[MSRB Rule G-27(c)]

KCD 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*.

21.1.27 Contact Information

[MSRB Rule A-12]

On an annual basis, Compliance will affirm contact information electronically on Form A-12 regarding the following contact persons:

- Primary regulatory contact (must be a registered municipal principal)
- Master account administrator
- Billing contact
- Compliance contact
- Primary data quality contact

Changes will be filed within 30 days of information becoming inaccurate. KCD may, at its discretion, also provide one or more of the following contacts: optional regulatory contact; data quality contact; or technical contact. Compliance is responsible for making the required filings and retaining records of contact information and filings.

21.1.28 Compliance With Regulatory Requests

[MSRB Rule A-12(h)]

Compliance will respond to regulatory requests for information within 15 days (or a longer agreed-upon period).

21.2 Sales Of Municipal Securities

[MSRB Notice 2009-42; FINRA Regulatory Notice 09-35]

This section outlines requirements when selling municipal securities, particularly to retail customers.

21.2.1 Conduct Of Municipal Securities Business

[MSRB Rule G-17; MSRB Notice 2007-17]

It is KCD's policy to deal fairly with all persons. Deceptive, dishonest, or unfair practices are prohibited.

21.2.2 Suitability

[MSRB Rule G-19 and G-48; MSRB Notice 2020-13 and 2010-37; FINRA Regulatory Notice 10-41]

Responsibility	• Designated Supervisor
Resources	• Order records • Daily Transaction Report • Customer Monthly Statements

Frequency	• Daily (order tickets and Daily Transaction Report) • Semi-annually (Customer Monthly Statements)

Action	• Review municipal transactions for suitability with particular consideration of:
	  ○ Non-rated issues
	  ○ Long-term bonds [>10 years to maturity]
	  ○ Regulation BI requirements

Record	• Initials on order records and Daily Transaction Report

Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). MSRB Rule G-19 (Suitability) only applies in circumstances where Regulation BI does not apply and applies to recommendations to customers by bank dealers. Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

RRs are required to obtain pertinent information about customers (depending on the type of customer) 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 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.

Suitability is only one element of acting in a customer's best interest. Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI) which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

21.2.2.1 Non-Rated Municipal Securities

Non-rated municipal securities may represent a higher level of risk to the investor. RRs should discuss the risks of purchasing non-rated bonds when such bonds are recommended for purchase. Risks may include less liquidity; more price volatility; and higher risk of default. As required by MSRB Rule G-15, customer confirmations include a disclosure when a municipal security is not rated.

21.2.2.2 Distressed Municipalities

[MSRB Notice 2018-07]

Distressed municipalities represent a higher risk to investors. The following must be considered before customers purchase these securities:

- The securities may be subject to substantial price fluctuations.
- Disclosure of all material information is required before or prior to the time of a trade, whether the order is solicited or unsolicited. This may include credit risks and ratings; insured status; sales below the minimum denomination; and failure by the issuer to make continuing disclosure filings. Sales below minimum denominations must satisfy Rule G-15(f) exceptions.
- Recommendations must be suitable for the investor's investment objectives and profile.

- Securities must meet fair pricing requirements, particularly considering the effect of material information.

21.2.2.3 Sophisticated Municipal Market Professionals (SMMPs)

[MSRB Rule D-15, G-19 and G-48; MSRB Notice 2020-13 and 2016-29]

Responsibility	• Designated Supervisor
Resources	• Account information
Frequency	• As required
Action	• Identify SMMPs • Obtain affirmation of SMMP status from SMMPs and document
Record	• Identified SMMPs • Records of SMMP affirmations

Suitability obligations differ for institutional customers that are "sophisticated" and capable of making their own suitability determinations. SMMP is defined by three essential requirements: the nature of the customer; a determination of sophistication by the BD or municipal dealer; and an affirmation by the customer. When making a recommendation under MSRB Rule G-19 (and not Regulation BI), KCD has no obligation to perform either (a) a customer-specific suitability analysis or (b) a quantitative suitability analysis (unless KCD has actual or de facto control of the SMMP's account).

The customer must be:

1. a bank, savings and loan association, insurance company, or registered investment company; or
2. an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or
3. any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million; AND,
4. an institution that the BD has a reasonable basis to believe is capable of evaluating investment risks and market value independently, both in general and with regard to particular transactions and investment strategies in municipal securities.

An SMMP may affirmatively indicate that it is exercising independent judgment in evaluating the recommendations of a BD or municipal securities dealer. This may be documented by the SMMP's oral affirmation recorded in the account's records on a trade-by-trade basis, a type-of-transaction basis, a type-of municipal-security basis (*e.g.,* general obligation, revenue, variable rate) or on an account-wide basis.

The SMMP must affirmatively indicate that it:

1. is exercising independent judgment in evaluating:
    a. recommendations;
    b. the quality of execution of transactions; and
    c. the transaction price for non-recommended secondary market agency transactions as to which (i) KCD's services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and (ii) KCD does not exercise discretion as to how or when the transactions are executed; and

2. has timely access to material information that is available publicly through established industry sources as defined in MSRB Rule G-47(b)(i) and (ii).

21.2.2.3.1 Quantitative Suitability

[MSRB Rule D-15.02 and G-48; MSRB Notice 2022-04]

"Quantitative suitability" (which is the MSRB's version of churning) requires KCD to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile. The obligation to perform a quantitative suitability analysis for recommendations to SMMPs do not apply where KCD does not have actual or de facto control over the account.

KCD's obligations to an SMMP include:

- time of trade disclosures
- transaction pricing
- bona fide quotations
- best execution
- suitability

21.2.2.3.2 Reasonable Basis Analysis

KCD must have a reasonable basis for determining SMMP status which includes the amount and type of municipal securities owned or under management by the customer.

21.2.2.3.3 Disclosures Not Required

[MSRB Rule G-48]

For SMMPs, there are certain disclosures that do NOT have to be made:

a. *Time of Trade Disclosure* (material information that is reasonably accessible to the market).
b. *Transaction Pricing* (ensure that transactions meeting all of the following conditions are effected at fair and reasonable prices):
    i. the transactions are non-recommended secondary market agency transactions;
    ii. the broker, dealer, or municipal securities dealer's services with respect to the transactions have been explicitly limited to providing anonymity, communication, order matching, and/or clearance functions; and
    iii. the broker, dealer, or municipal securities dealer does not exercise discretion as to how or when the transactions are executed.
c. *Suitability*. The Firm has no obligation under Rule G-19 to perform a customer-specific suitability analysis.

21.2.2.3.4 Summary

The following describes how SMMPs are treated differently from other customers under specific MSRB rules. Refer to the interpretation for more explanation of these specific applications of the SMMP concept.

Rule G-13	The Firm must apply the same standards to an SMMP's quotation as if the quotation were made by another BD or municipal securities dealer.

Rule G-44	SMMPs are excluded from best execution requirements.
Rule G-19	For a recommended security, the dealer is not required to make a suitability determination.
Rule G-30	If a dealer effects non-recommended secondary market transactions for SMMPs and its services have been explicitly limited to providing anonymity, communication, order matching, and/or clearance functions and the dealer does not exercise discretion, the dealer is not required to take further actions on individual transactions to ensure that its agency transactions are effected at a fair and reasonable price.
Rule G-48	Time of trade disclosure, transaction pricing, and suitability obligations do not apply

21.2.3 Minimum Denominations

[MSRB Rule G-15(f) and G-17]

Responsibility	• Designated Supervisor
Resources	• Transaction reports • Available exception reports • Customer account records
Frequency	• Daily

Action	• Identify customer transactions in municipal securities issued after June 1, 2002 in an amount lower than the minimum denomination for the issue
	• Confirm whether the transaction meets an exception to the rule through customer account records or obtaining a written statement by the customer
	• For those transactions not meeting the exceptions to this rule, take corrective action which may include:
	  ○ Contacting the RR and the customer
	  ○ Cancelling the transaction

Record	• Transaction reports and/or exception reports with a record of action taken, if any • Written statements from customers, if applicable

KCD may not sell municipal securities to customers below the minimum denomination for securities issued after June 1, 2002, with limited exceptions explained below.

21.2.3.1 Exceptions

The prohibition does not apply to the purchase of securities from a customer in an amount below the minimum denomination if the Firm determines that the customer's position in the issue already is below the minimum denomination and that the entire position would be liquidated by the transaction.

The prohibition does not apply to the sale of securities to a customer in an amount below the minimum denomination if the Firm determines that the securities position being sold is the result of a customer liquidating a position below the minimum denomination. The Firm is obligated to provide the customer a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination.

For either exception the Firm may rely on customer account records in its possession or on a written statement provided by the customer selling the securities (in the first exception) or the party from which the securities are purchased (in the second exception).

21.2.3.2 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.

21.2.4 Disclosures

[SEC Securities Exchange Act of 1934 Rule 15c2-12; MSRB Rule G-17, G-32 and G-47; MSRB Notice 2018-07, 2017-18, 2016-27, 2014-07, 2011-67, 2010-37 and 2009-42; Interpretive Notice Regarding Disclosure of Material Facts dated 3/20/02; Interpretive Notice "Guidance on Disclosure and Other Sales Practice Obligations to Individual and Other Retail Investors in Municipal Securities" dated July 14, 2009; MSRB 1998 Interpretive Guidance regarding disclosure obligations for new municipal securities; FINRA Regulatory Notice 10-41]

KCD and RRs have disclosure obligations when effecting municipal securities transactions. These disclosure obligations extend to municipal advisors, where relevant.

21.2.4.1 Underwritings

[MSRB compliance resource re WSPs about new issue pricing: https://www.msrb.org/sites/default/files/2022-11/Dealer-Pricing.pdf]

Responsibility	• Designated Supervisor
Resources	• Municipal underwritings • EMMA
Frequency	• As required
Action	• As managing underwriter, review official statement and obtain written assurances from issuers of compliance with Rule 15c2-12 disclosures • As participating underwriter obtain assurance from managing underwriter of compliance with reviews and issuer compliance requirements • Review EMMA for potential disclosures and provide information to customers when appropriate
Record	• Reviews of official statements, commitments with issuers • Contract with managing underwriter who agrees to perform the above obligations

As a municipal underwriter, the Firm is obligated to comply with disclosure requirements of SEC Rule 15c2-12 that applies to primary offerings of municipal securities with an aggregate principal amount of $1,000,000 or more (unless an exemption applies). These obligations may be satisfied by the managing underwriter for an underwriting group, though each underwriter remains responsible for compliance.

A summary of requirements includes the following (refer to the Rule for details):

- The final official statement must be reviewed prior to bidding, purchasing, offering, or selling the issue.
- Except for competitive offerings, preliminary official statements must be sent to potential purchasers upon request.
- The issuer must agree by contract to provide sufficient final official statements.
- Execute continuing disclosure agreements with issuers and reasonably determine that the issuer will provide required information to the MSRB including material events such as principal and interest payment delinquencies; defaults; bond calls, *etc.*
- When recommending the purchase or sale of a municipal security subject to the Rule (applies to all BDs and secondary market transactions), material events must be disclosed to the customer. Simply referring the customer to EMMA for material event disclosures is not sufficient. (See the next section.)

21.2.4.2 Primary And Secondary Market Transactions

Responsibility	• Designated Supervisor
Resources	• Primary and secondary municipal market transactions • EMMA
Frequency	• Daily
Action	• Review to determine disclosures are identified and provided
Record	• Order records including disclosure requirements

RRs are required to disclose material information to customers about municipal transactions. This requirement applies to purchases and sales and solicited or unsolicited transactions. MSRB Rule G-47 states that all material information known about a transaction as well as material information about the security that is reasonably accessible to the market must be made to the customer, orally or in writing, at or prior to the time of trade. "Time of trade" refers to at or before the point at which the investor and the dealer agree to make the trade and may be made orally or in writing, though either method must be documented on the order.

21.2.4.3 Definitions

Established industry sources: include the MSRB's Electronic Municipal Market Access ("EMMA") system, rating agency reports, and other sources of information relating to municipal securities transactions generally used by brokers, dealers, and municipal securities dealers that effect transactions in the type of municipal securities at issue.

Material information: Information that is considered to be material if there is a substantial likelihood that the information would be considered important or significant by a reasonable investor in making an investment decision.

Reasonably accessible to the market: means that the information is made available publicly through established industry sources.

21.2.4.4 Manner And Scope Of Disclosure

The disclosure obligation includes a duty to give a customer a complete description of the security, including a description of the features that likely would be considered significant by a reasonable investor, and facts that are material to assessing the potential risks of the investment.

Whether the customer is purchasing or selling the municipal securities may be a consideration in determining what information is material.

Simply directing a customer to EMMA or another repository or through advertising materials is not sufficient; specific disclosures are required. The level of inquiry for material information will depend on varying factors such as less inquiry for an AAA general obligation bond and more inquiry for a non-rated conduit issue or a more complex security.

If an RR becomes aware of **non-public** material information, the RR should contact Compliance immediately and maintain the confidentially of the information.

21.2.4.5 Record Of Disclosures

RRs must record on the order record (or other method available) the source and information provided to the customer.

21.2.4.6 Disclosure Obligations In Specific Scenarios

The following examples are provided by the MSRB to describe information that may be material in specific scenarios and require time of trade disclosures to a customer. This list is not exhaustive and other information may be material to a customer in these and other scenarios.

a. **Market discount.** The fact that a municipal security bears market discount. (The amount of market discount is equal to the excess, if any, of the stated redemption price at maturity over the basis of the security immediately after its purchase by the investor.)
b. **Variable rate demand obligations.** A description of the basis on which periodic interest rate resets are determined and the role of the remarketing agent.
c. **Auction rate securities.** Features of the auction process that likely would be considered significant by a reasonable investor and the basis on which periodic interest rate resets are determined. Additional facts that may also be considered material are the duration of the interest rate reset period, information on how the "all hold" and maximum rates are determined, any recent auction failures, and other features of the security found in the official documents of the issue.
d. **Credit risks and ratings.** The credit rating or lack thereof, credit rating changes, credit risk of the municipal security, and any underlying credit rating or lack thereof.
e. **Credit or liquidity enhanced securities.** The identity of any credit enhancer or liquidity provider, terms of the credit facility or liquidity facility, and the credit rating of the credit provider or liquidity provider, including potential rating actions (*e.g.,* downgrade).
f. **Insured securities.** The fact that a security has been insured or arrangements for insurance have been initiated, the credit rating of the insurance company, and information about potential rating actions with respect to the bond insurance company.
g. **Original issue discount bonds.** The fact that a security bears an original issue discount since it may affect the tax treatment of a municipal security.
h. **Securities sold below the minimum denomination.** The fact that a sale of a quantity of municipal securities is below the minimum denomination authorized by the bond documents and the potential adverse effect on liquidity of a customer position below the minimum denomination. See also Rule G-15(f).

i. **Securities with non-standard features.** Any non-standard feature of a municipal security. Additionally, if price/yield calculations are affected by anomalies due to a non-standard feature, this also may be material information about the transaction that must be disclosed to the customer.
j. **Bonds that prepay principal.** The fact that the security prepays principal and the amount of unpaid principal that will be delivered on the transaction.
k. **Callable securities.** The fact that a municipal security may be redeemed prior to maturity in-whole, in-part, or in extraordinary circumstances, including sinking fund calls and bonds subject to detachable call features.
l. **Put option and tender option bonds.** Information concerning the put option or tender option features.
m. **Stripped coupon securities.** Facts concerning the underlying securities which materially affect the stripped coupon instruments. The unusual nature of these securities and their tax treatment warrants special efforts to provide written disclosures.
n. **The investment of bond proceeds.** Information on the investment of bond proceeds.
o. **Issuer's Intent to Pre-refund.** An issuer's intent to pre-refund an issue.
p. **Failure to make continuing disclosure filings.** Discovery that an issuer has failed to make filings required under its continuing disclosure agreements.

21.2.5 Customer Accounts

Customer accounts must be reviewed on a regular basis. The designated supervisor is responsible for reviewing daily transactions as well as patterns of account activity by reviewing monthly statements or comparable reports or electronic records that show cumulative activity. Refer to the chapter *ACCOUNTS* for details of KCD'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.

21.2.6 Complaints

[MSRB Rule G-8, G-10 and G-17; MSRB Notice 2017-03; MSRB Sample Checklist for handling client complaints: http://msrb.org/Rules-and-Interpretations/MSRB-Rules/General/%7E/media/A96CC106F5BA4E16936941E6661C1431.ashx]

Responsibility	• Designated Supervisor
Resources	• Incoming correspondence • Oral or written complaints
Frequency	• As required
Action	• Immediately refer original copy of complaint to Compliance • Retain copy for office or branch files • Maintain electronic complaint log using standard codes (MSRB-specific requirement) • Contact Compliance regarding oral complaints, if needed • Compliance will respond to the complaint, in consultation with the office supervisor
Record	• Electronic complaint log • Compliance retains all written complaints in a central complaint file

	• Copy of written complaint in office or branch complaint file • Records are retained for six years, two years in a readily accessible location (MSRB-specific requirement)

The handling of customer complaints is described in the section *Complaints* in the chapter *COMMUNICATIONS WITH THE PUBLIC*. Customer complaint procedures cover all types of municipal activities including municipal advisor services and complaints received in writing or electronically.

Upon receipt of a complaint, 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.

21.2.7 529 Savings Plans (Municipal Fund Securities)

[MSRB 529 Plan Basics: https://www.msrb.org/529-Plan-Basics; FINRA Regulatory Notice 19-04]

Responsibility	• Designated Supervisor
Resources	• Plan applications
Frequency	• When applications are received
Action	• Include 529 plans in RR training • Review applications for compliance with Regulation BI including: ○ underlying investments ○ share class expenses ○ expected duration of the investments ○ tax considerations ○ out-of-state vs. in-state plan benefits and disadvantages • Confirm necessary disclosures have been provided • Confer with RR if necessary • Confer with customer if necessary • Take corrective action, if required, which may include advising the RR to make alternative recommendations; canceling a purchase
Record	• Plan applications • Record of supervisory reviews and action taken, where appropriate

529 Savings Plans are education savings plans for future educational expenses of a designated beneficiary and 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.

Registration Requirements

The following registrations are required to sell municipal fund securities:

- 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).

21.2.7.1 Share Classes

529 plans may have three or more different share classes (*e.g.,* A, B, C) with different fees and expenses. RRs must consider whether a particular class is appropriate before recommending it to a customer. "A" shares may be more economical over a longer period of time than "C" shares that do not offer cost reductions such as breakpoints. The beneficiary's time horizon should be considered in determining the appropriate share class. C-shares may not be appropriate for beneficiaries younger than 10 years old; A-shares may not be appropriate for beneficiaries older than 10 years old and purchases are made within just a few years of reaching 18 years old. FINRA's fund share class analyzer is a tool that may be used to evaluate classes. When making a recommendation, documentation of the choice of class and its justification should be included with the purchase.

21.2.7.2 Disclosures

[MSRB Notice 2006-23, 2006-16 and 2006-07]

There are two primary forms of written disclosure that must be provided to customers when marketing 529 savings plans, the official statement/program disclosure document and out-of-state plan disclosures. Providing disclosures does not relieve the obligation to make Regulation Best Interest-compliant recommendations to the customer.

Official Statement/Program 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.

21.2.7.2.1 Out-of-State Plans

When marketing out-of-state 529 savings plans, disclosure will be provided to the customer prior to or at the time of the trade as follows:

1. 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 savings plan.
2. State-based benefits should be one of many appropriately weighted factors to be considered in making an investment decision.
3. The customer should consult with his or her financial tax or other adviser about how such state-based benefits would apply to the customer's specific circumstances and may wish to contact his or her home state or any other 529 savings plan to learn more about their features.

21.2.7.3 Rollovers

[MSRB Notice 2010-19]

A 529 savings plan may be rolled over and avoid tax consequences and other penalties if the funds are rolled over from one 529 plan to another state's 529 plan for the same beneficiary or to another 529 plan for a different beneficiary, if certain conditions are met. RRs should consider the associated fees and charges assessed to assure such fees are appropriate.

21.2.7.4 NIIDS Filings

[MSRB Notice 2019-21 and 2010-19]

The primary distributor of a 529 Savings Plan is obligated to file Form G-32 and related documents with NIIDS. Supplements must also be submitted on a timely basis. The primary distributor is also obligated to determine that the issuer has undertaken a written agreement to provide the MSRB with information required under MSRB Rule G-32 and SEC Rule 15c2-12.

If KCD is the primary distributor of an issue, the designated supervisor is responsible for making the required filings and obtaining the issuer's assurance and for maintaining a record of filings and the assurance.

21.2.7.5 Rule G-45 Report

[MSRB Rule G-45]

Each underwriter of a primary offering of municipal fund securities (not interests in local government investment pools) is required to report information on the offering to the MSRB electronically via Form G-45. Filings are due no later than 60 days following each semi-annual reporting period of June 30 and December 31. Underwritings of ABLE programs are included in the requirement to file under Rule G-45.

The designated supervisor is responsible for submitting Form G-45 and retaining records of filings.

21.2.7.6 Selling Considerations

Recommendations of 529 plans must comply with the requirements of Regulation BI, addressed in the chapter *REGULATION BEST INTEREST (BI)*, 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 in-state vs. out-of-state tax benefits.
- 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.
- Whether out-of-state customers qualify for a particular plan.
- Which class of shares is appropriate for the customer.
- Whether a state's plan permits the use of 529 plan funds for K-12 expenses. Making contributions for K-12 expenses to a state plan where they are not permitted could subject the customer to additional tax and other penalties.

21.2.7.7 529 Savings Plan Checklist

The RR's designated supervisor must approve transactions where an out-of-state plan or replacement of an existing plan is being recommended. RRs are required to complete the 529 Savings Plan Checklist and submit it to the designated supervisor prior to effecting the transaction.

Sales Material For Municipal Fund Securities

Special requirements apply to sales material for municipal fund securities. 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

21.2.7.8 Advertising Municipal Fund Securities

[SEC Rule 482; MSRB Rule G-21(e); MSRB Notice 2017-16]

The following is a summary of requirements for municipal fund securities advertising. Other conditions apply that are not detailed here. Compliance approval is required prior to publication of any municipal fund advertisement.

Subject	Rule	Requirement
General product advertisement disclosures	G-21(e)(i)	• investor considerations • more information available in OS • source of OS is a BD underwriter • read the OS carefully
Product specific advertising disclosures	G-21(e)(i)	• source of OS if OS available • home state plan benefits • if a money market fund, enhanced disclosure about risks for each of three categories, no FDIC guarantee, possibility of loss, imposition of a liquidity fee or suspension of redemptions and no expectation the underlying fund sponsor will provide financial support to the underlying fund
Performance disclosures	G-21(e)(i)(A)(3)(a)	• legend about past performance doesn't guarantee future performance • investment return and value may fluctuate resulting in loss • current performance may be lower or higher than data included in

Subject	Rule	Requirement
		advertisement • if total return quoted is not current, a toll-free number or website where more current information is available • may provide a hyperlink to a web site including current total return quotations • if sales load or nonrecurring fee is charged, maximum amount and if not included in performance statements, disclosure is not included • total annual operating expense ratio (except for money market funds)
Out-of-State disclosures	G-21(e)(i)(A)(2)(b)	• whether home state offers other benefits such as financial aid, scholarship funds, and protection from creditors
Format of disclosure	G-21(e)(i)(4)	Differing requirements for print and other advertising
Generic advertising (does not refer by name to any specific investment option or portfolio but includes name of dealer or other sponsor of the advertisement)	G-21(e)(i)(B)(1)	Does not require general disclosures
Blind advertisements (promote an issuer and its public purpose without naming a product or dealer)	G-21(e)(i)(B)(2)	Does not require general disclosures
Annual financial reports or similar information required by state law, rules, or regulations		Not considered an advertisement if provided solely as required by state laws, rules, or regulations
Communications with existing customers	G-21(e)(i)(B)(3)	Permits form letters that omit some or all required disclosures if sent to existing customers who have previously invested in municipal fund securities
Tax-related disclosures	G-21(e)(v)	If a product advertisement discusses tax benefits, include disclosure that benefits may be conditioned on meeting certain requirements and if specific benefits are described, include the factors that may materially limit their availability

21.3 Achieving A Better Life Experience (ABLE) Programs

[https://www.ablenow.com/blog/articles/investors-guide-for-able/; Section 529A of the Internal Revenue Code; ABLE National Resource Center: https://www.ablenrc.org/get-started/what-is-able/]

States create ABLE programs to provide tax-advantaged savings programs for eligible people with disabilities. Eligible payments help designated beneficiaries pay for qualified expenses without jeopardizing eligibility for public benefits.

Key provisions of ABLE programs include (refer to ABLE requirements for current and complete requirements):

- States establish, administer, and regulate their ABLE plans. Almost all ABLE plans are direct-sold where individuals open accounts directly through the plan.
- Individuals receiving benefits under SSI and/or Social Security Disability Insurance (SSDI) are eligible as well as individuals with demonstrated qualifying disabilities.
- A beneficiary is limited to only one ABLE account at a time and can be used over a lifetime.
- Owners can make changes to investments two times a year.
- Annual contributions may not exceed the IRS gift tax exclusion amount.

When offering an ABLE Program, the RR must comply with policies governing securities sales including, if the transaction is solicited, Regulation Best Interest (Reg BI).

21.4 Investor And Municipal Advisory Client Education And Protection

[MSRB Rule G-10]

KCD will provide the following information annually to each customer in writing (by regular mail or e-mail):

- a statement that KCD is registered with the SEC and the MSRB;
- the website address for the MSRB; and
- a statement regarding the availability of an investor brochure that is posted on the MSRB website describing the protections that may be provided by the MSRB rules and how to file a complaint with an appropriate regulatory authority.

For broker-dealer customers the information will be provided once every calendar year. For municipal advisor customers the information will be provided promptly after the establishment of a municipal advisory relationship or promptly after entering into an agreement to undertake a solicitation of a municipal entity or obligated person and not less than once each calendar year thereafter for the duration of the relationship or agreement.

21.5 Sponsoring Meetings And Conferences Involving Issuer Officials

[MSRB Notice 2007-13]

Responsibility	• Designated Supervisor
Resources	• Requests to sponsor meetings or conferences where an issuer official will participate
Frequency	• As required
Action	• Review request for sponsorship, including the official's role • Approve or disapprove the event • Send to the issuer official a letter outlining the prohibitions against soliciting political contributions • If, after the event, there is concern about whether contribution solicitations took place, confer with Compliance to review the activity and determine whether a filing is required with the MSRB and a ban on business may result
Record	• Request and approval or disapproval

	• Letter to issuer official

When KCD and/or its employees sponsor a meeting or conference that features an issuer official as a speaker or participant, it is important to avoid activities that could be considered soliciting political contributions for the issuer official. Activities that could be considered solicitation of contributions include (but are not limited to):

- The issuer official solicits contributions at the meeting or conference.
- The issuer uses an attendee list to solicit contributions.

If it is determined that activities constitute solicitation or coordination of political contributions for the participating issuer official, expenses for the meeting or conference may be considered a political contribution reportable to the MSRB and may trigger a ban on business with the issuer for two years.

If an issuer official will participate in a firm-sponsored meeting or conference, the following are required:

- The content of the meeting and participation by an issuer official (including the official's role) must be approved by a municipal principal.
- The issuer official must be notified in writing by the municipal principal, prior to the meeting or conference, of the prohibition against solicitation of contributions either at the event or afterwards (using the attendee list).

21.6 Communications With The Public

[MSRB Rule G-27]

Communications (electronic or written) require the approval of the designated supervisor. Refer to the chapter *COMMUNICATIONS WITH THE PUBLIC* for detailed procedures.

21.6.1 Performance Data

Communications that include performance data is subject to advertising disclosure requirements and requires the approval of Compliance prior to sending. Refer to the section *Advertising Municipal Fund Securities* for more information.

21.7 Telemarketing

[MSRB 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.

21.8 Advertising

[MSRB Rule G-21 and G-40; MSRB Notice 2023-05, 2019-07 and 2018-08]

Responsibility	• Designated Supervisor

Resources	• Requests to advertise • Unapproved advertising brought to the supervisor's attention
Frequency	• As required

Action	• Refer all requests and unapproved items to the designated supervisor for review and approval/disapproval
	• Review and approve/disapprove interactive content
	• For testimonials involving municipal advisors form a reasonable belief that the testimonial complies with the requirements under Rule G-40(a)(iv)(G) including:
	    ○ forming a reasonable belief that a third party making a testimonial has the knowledge and experience to make a statement concerning their experience with the municipal advisor or with the municipal advisory services rendered by the municipal advisor;
	    ○ ascertaining if more than $100 in total value in cash or non-cash compensation was paid for the testimonial and confirming that the person or entity was not paid, directly or indirectly, more than $1000 in total value in cash or non-cash compensation during the preceding 12 months; and
	    ○ reviewing the advertisement to establish that the requisite disclosures are made, including those required if more than $100 in total value was paid for the testimonial, and that such disclosures are made close to the associated testimonial statement and with the same prominence.
	• Review social media posts as required
	• Make required FINRA filings for municipal fund securities advertising/sales literature

Record	• Advertising reviews • Interactive content reviews • Social media reviews • Municipal advisor advertising records including any compensation provided for a testimonial • Filings with FINRA

21.8.1 Advertising

[MSRB Rule G-40; MSRB Notice 2023-05, 2018-24 and 2018-08; MSRB supervision of municipal advisor advertising: https://www.msrb.org/sites/default/files/2023-06/Assessing-Supervision-of-Municipal-Advisor-Advertising-Regulations.pdf; MSRB FAQs on use of Municipal Advisory Client Lists and Case Studies: http://www.msrb.org/%7E/media/Files/Resources/FAQs-On-Use-Of-MA-Client-Lists.ashx; MSRB FAQs on social media: https://www.msrb.org/sites/default/files/FAQs-on-Use-of-Social-Media-under-MSRB-Advertising-Rules.pdf]

The rule governing municipal advisor advertising parallels Rule G-21 governing municipal securities advertising with the following noted:

- G-40 includes a definition of a municipal advisory client which is substantially similar to the definition in Rule G-8.
- Content standards parallel those of Rule G-21.
- Municipal advisors may use testimonials in advertising (a statement of a person's or entity's experience concerning the municipal advisor or concerning the municipal advisory services rendered by the municipal advisor). Use of testimonials is subject to the following conditions:
    - the advisor must have a reasonable belief that the person or entity making the testimonial has the knowledge and experience regarding the advisor or advisor services
    - disclosures must be made near the testimonial and with the same prominence:

    - whether the testimonial is or is not from a current advisory customer
    - the fact that the testimonial may not be representative of other customers' experience
    - the testimonial is not a guarantee of future performance or success
- If the municipal advisor pays more than $100 in total value in cash or non-cash compensation for the testimonial, then the advertisement also must include the following clear and prominent disclosures:
  - the fact that it is a paid testimonial; and
  - a brief statement by the municipal advisor of any material conflicts of interest on the part of the person or entity providing the testimonial resulting from the municipal advisor's relationship with such person or entity.
- In advertising an advisor may state it is MSRB registered; however, it may neither state nor imply that the MSRB endorses, indemnifies or guarantees the advisor's business practices, services, skills, or any specific municipal security or municipal financial product.
- An advisor may not publish any professional advertisement that contains any untrue statement or material fact or is otherwise false or misleading. A professional advertisement is an advertisement concerning the facilities, services or skills regarding municipal advisory activities.
- Each advertisement must be approved by a municipal advisor principal prior to first use.
- Refer to the section *Advertising* earlier in the chapter that provides more information about G-21 and G-40 requirements including supervision.
- Refer to the FAQs regarding the use of municipal advisory client lists and case studies.
- Refer to the MSRB FAQS on social media.
- Contact Compliance regarding questions on MA advertising.

21.8.2 Political Contributions

Municipal advisors are subject to MSRB Rule G-37 regarding limitations on and reporting of political contributions. Refer to the section *Political Contributions* elsewhere in this chapter.

21.8.3 Introduction

This section discusses requirements under MSRB advertising rules. The MSRB has provided social media FAQ guidance which should be consulted since requirements may have multiple conditions. Questions regarding advertising should be referred to Compliance.

21.8.4 Definitions

Advertisement: any material (other than listings of offerings) published or used in any electronic or other public media, or any written or electronic promotional literature distributed or made generally available to customers or the public, including any notice, circular, report, market letter, form letter, telemarketing script, seminar text, press release concerning the products or services of the broker, dealer or municipal securities dealer, or reprint, or any excerpt of the foregoing or of a published article. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by brokers, dealers or municipal securities dealers.

Form Letter: any written letter distributed to 25 or more persons within any period of 90 consecutive days. Supplementary Material .03 explains that the number of "persons" is determined for the purposes of a response to a request for proposal (RFP), request for qualifications (RFQ) or similar request at the entity level. Therefore, for example, if a dealer were to respond to an RFP from an issuer, the issuer entity would count as one person, no matter how many persons employed by the issuer reviewed the dealer's response to the RFP.

21.8.5 Content Standards

The following content standards apply:

- An advertisement must be based on principles of fair dealing and good faith, be fair and balanced and provide a sound basis for evaluating the facts about any particular municipal security or type of municipal security, industry, or service.
- A dealer may not distribute advertising that includes any untrue statement of material fact or is otherwise false or misleading.
- A dealer may not omit any material fact or qualification if such omission, in light of the context presented, would cause the advertisement to be misleading.
- An advertisement may not contain any false, exaggerated, unwarranted, promissory or misleading statement or claim.
- A dealer may not limit the types of information placed in a legend or footnote of an advertisement so as to inhibit a customer's or potential customer's understanding of the advertisement.
- An advertisement must provide statements that are clear and not misleading within the context that they are made.
- The advertisement must provide a balanced treatment of the benefits and risks, and the advertisement must be consistent with the risks inherent to the investment.
- A dealer must consider the audience to which the advertisement will be directed and that the advertisement provide details and explanations appropriate to that audience.
- An advertisement may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast.
- An advertisement may not include a testimonial unless it satisfies certain conditions.

21.8.6 Social Media

[MSRB FAQs on social media: https://www.msrb.org/sites/default/files/FAQs-on-Use-of-Social-Media-under-MSRB-Advertising-Rules.pdf]

The use of social media may be deemed "advertising" subject to the advertising rules. The MSRB's FAQs, as excerpted from Regulatory Notice 2019-07, include the following:

> The FAQs clarify that, depending on the facts and circumstances and with limited exceptions, any material (including material that is posted on an associated person's personal social media) that relates to (i) the products or services of the dealer, (ii) the services of the municipal advisor or (iii) the engagement of a municipal advisory client by the municipal advisor may constitute an advertisement under the MSRB's advertising rules, if it is published or used in any electronic or other public media or written or electronic promotional literature distributed or made generally available to either customers or municipal entities, obligated persons, municipal advisory clients or the public.

Other key issues include the following. The FAQs should be consulted for more complete explanations.

- A social media post that contains an advertisement is subject to approval by a principal prior to first use.
- Advertising rules apply to hyperlinked content on an independent third party's website or social media page if the regulated entity either were to be entangled with or adopts that content.
- Third party posts on KCD's or an associated person's social media page may be considered advertising.
- "Posts," "chats," text messages or messages sent through messaging applications are subject to review and recordkeeping by KCD.

21.8.7 Approval

All advertising involving municipal securities must be approved in writing by a Compliance-designated municipal securities principal or general securities principal prior to first use.

Some of the requirements that apply to advertising of municipal securities include:

- 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.
- Advertising involving municipal fund securities may be subject to additional requirements, including filing advertising with FINRA, if it discusses underlying investment company securities. See the section *529 Savings Plans (Municipal Fund Securities)* - *Advertising Municipal Fund Securities* for more information.
- Interactive content posted or disseminated in an interactive electronic forum is subject to the same reviews as for correspondence (review and approval after posting or dissemination) but is not subject to prior approval.

Compliance should be consulted regarding questions about advertisements that include municipal securities.

21.9 Supervisory System, Procedures And Controls

[MSRB Rule G-27]

The MSRB has adopted rule requirements that parallel FINRA rule requirements for supervisory controls. Refer to the chapter *SUPERVISORY SYSTEM, PROCEDURES AND CONTROLS* for KCD's procedures addressing these requirements.

21.10 Underwriting

[MSRB Rule G-11, G-12, G-17 and G-34; MSRB Notice 2011-52 and 2012-38; Interpretive Notice Regarding Disclosure of Material Facts dated 3/20/02; SIFMA forms: http://www.sifma.org/Services/Standard-Forms-and-Documentation/Municipal-Securities-Markets/]

Responsibility	• Designated Supervisor
Resources	• Agreement with issuers and underwriters, bond counsel information, and other sources of information regarding pending underwritings
Frequency	• As required for each underwriting
Action	• Conduct necessary reviews • Sign agreement with issuer • Sign underwriting agreement • Review official statements • As senior syndicate manager, comply with MSRB rule requirements regarding running the syndicate including inviting other dealers; preparing the official statement and making it available to purchasers and other dealers; designating and allocating securities; preparing syndicate expense statements and providing notification to syndicate members as required • As sole manager comply with MSRB rule requirements • Confirm priority provisions

	• As an underwriter of a primary offering subject to disclosure requirements, reasonably determine that the issuer or an obligated person agrees to provide required information to the MSRB within 10 business days of the occurrence of a "listed event" • As placement agent for a private placement, obtain private placement letters from investors, if applicable • Conduct other activities necessary to complete the underwriting • Provide **public** material information (that is available internally but not from the official statement or other standard industry sources) to trading and/or sales personnel to meet G-17 obligations regarding required disclosures to customers when effecting municipal transactions
Record	• Documents are included in a file for the underwriting • Record of providing internal public information to sales/trading personnel are retained in the underwriting file

KCD's obligations are different depending on its role in a municipal underwriting. It assumes a number of responsibilities when acting as senior syndicate manager, sole manager, or as a syndicate member. Some of these responsibilities are summarized in the section *Syndicate Practices* for easy reference.

21.10.1 Due Diligence

[SEC National Exam Risk Alert "Strengthening Practices for the Underwriting of Municipal Securities": http://www.sec.gov/about/offices/ocie/riskalert-muniduediligence.pdf; MSRB Notice 2017-14]

An underwriter is responsible for conducting due diligence to be able to make a representation that it has reasonable belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offering. KCD will conduct due diligence and document its review in the underwriting file. The following are elements of due diligence conducted by KCD.

- Underwriter's counsel generally takes the lead in a public financing in preparing and working with the financing team to produce an offering document (official statement) which meets the standards of the antifraud provisions and Rule 15c2-12. It is important that underwriter's counsel provides independent, competent, and appropriately critical review, guidance, and counseling. The MSRB has recommended that issuers refrain from involvement in the selection of counsel to ensure the counsel's independent advice to the underwriter [MSRB Regulatory Notice 2017-14].
- The senior or sole underwriter must review a near final official statement (see the section that follows *Obligations When The Firm Acts As Senior Syndicate Manager Or Sole Underwriter*).
- The underwriter must carefully evaluate the likelihood that an issuer or obligated person will comply on a timely basis with its disclosure undertakings (see *Disclosure Requirements*).
- The underwriter should obtain reasonable evidence to determine whether and when annual filings and event notices, under the issuer's or obligated person's disclosure undertakings, were in fact provided.

The SEC has indicated the following non-exclusive factors would be relevant in reasonably assessing the truthfulness of key representations in the final statement:

- the extent to which the underwriter relied on municipal officials and other persons whose duties have given them knowledge of particular facts;
- the role of the underwriter (*e.g.,* manager, syndicate member, selling dealer);
- the type of bonds being offered (general obligation, revenue, or private activity);
- the past familiarity of the underwriter with the issuer;
- the length of time until maturity of the securities; and
- whether the bonds are competitively bid or are distributed in a negotiated offering.

21.10.2 Commitment Approval

Responsibility	• Designated Supervisor • Commitment Committee (if applicable)
Resources	• Requests for review of potential underwritings
Frequency	• As required
Action	• Review proposals • Approve or disapprove or request more information • Notify the banker of the Committee's decision
Record	• Information submitted for review • Review for approval • Notification to banker, appropriate supervisor of approval/disapproval

The banker must submit the following (and any other pertinent information) to the designated supervisor for review (and submission to the Commitment Committee, if applicable) for approval prior to committing to an underwriting:

- Materials in response to an issuer request for proposal or qualification to the designated supervisor
- Due diligence checklist
- Due diligence memorandum describing due diligence calls, issues noted and how they were resolved, and the banker's review of the final or "deemed final" OS
- On-site examinations including meetings with municipal officials, visits to facilities and examination of an issuer's records and current economic trends and forecasts bearing on the issuer's ability to pay its debt
- Financial and risk disclosures (the "deemed final" official statement)
- Review of EMMA filings by the issuer (and other data repositories prior to EMMA)

The banker will be notified regarding approval or disapproval of the proposed commitment.

21.10.3 Duties Of Underwriters To Issuers

[MSRB Notice 2019-20; (MSRB FAQS Regarding Underwriter's Disclosure Obligations to Issuers under G-17)]

Responsibility	• Designated Supervisor
Resources	• Proposed underwritings including related documents, disclosures, information about investors • RFPs • Expenses/compensation related to issue • Expense reports
Frequency	• As required
Action	• Identify Complex Financings and confirm appropriate disclosures are made

	• Confirm disclosures for other financings are made • Identify potential conflicts of interest and correct or disclose where disclosure is permitted to mitigate the conflict • If there are other transaction participants, such as a conduit borrower, evaluate the participant's role and relationship with KCD to determine duties to disclose and other necessary actions to meet obligations to the issuer • Confirm required disclosures are made within required timeframes • Confirm acknowledgment of disclosures is received or specifically document why acknowledgment was not received • Confirm compensation and pricing are fair for the deal • Confirm orders identified as "retail" are actually retail • Review payments, entertainment, other expenses to the benefit of issuer personnel

Record	• Deal file including:
	  ○ Identification of Complex Financings
	  ○ Disclosures
	  ○ Evaluation of the role of other transaction participants and steps taken to make disclosures or to take other actions to comply with obligations to issuer
	  ○ Issuer acknowledgment of disclosures
	  ○ Expenses/compensation
	  ○ Disclosure/correction of conflicts
	  ○ Records of retail orders and notations of any corrections as to identification of customer
	  ○ Review of payments to/for issuer personnel

Underwriters have a duty to deal fairly with issuers. An underwriting relationship is considered to have begun at the time the delivery of the first disclosure is triggered (the earliest stages of an underwriter/issuer relationship). The fair practice duties are those a dealer owes to a municipal entity when the dealer underwrites a new issue of municipal securities. This section is a summary of requirements and the Interpretative Notice should be consulted for details.

The duties of underwriters to issuers are discussed in more detail in this section and include the following:

- Underwriters have a basic obligation to deal fairly with issuers precluding any deceptive, dishonest, or unfair practice and must not misrepresent or omit the facts, risks, potential benefits, or other material information about municipal securities activities undertaken with the municipal issuer.
- Underwriter disclosures to issuers are required to mitigate potential conflicts of interest.
- Underwriter representations to issuers, whether written or oral, must be truthful and accurate and must not misrepresent or omit material facts.
- Underwriters must have a reasonable basis for representations and other material information contained in documents they prepare, and underwriters must refrain from including representations or other information they know or should know is inaccurate or misleading.
- Responses to requests for proposal (RFP) must (1) fairly and accurately represent the underwriter's capacity, resources, and knowledge to perform the specific underwriting; (2) contain only items that are either within the personal knowledge of those preparing it or confirmed by those with knowledge; and (3) not represent that the underwriter has the requisite knowledge or expertise for the financing unless those who will work on the deal have the necessary knowledge or expertise.
- When other transaction participants are involved (such as a conduit borrower), the underwriter has an obligation to deal fairly with other participants. Underwriter obligations depend on the relationship with the participant and its role in the underwriting.

- Underwriters are prohibited from recommending that the issuer not retain a municipal advisor or otherwise imply that hiring a municipal advisor would be redundant to hiring the underwriter.
- The underwriter's obligations apply to negotiated and not competitive deals (unless noted otherwise) and do not apply to selling group members. The obligations generally apply to primary offerings by a dealer acting as underwriter as well as placement agent and when serving as primary distributor.

21.10.3.1 Disclosures

The following summarizes required disclosures that underwriters must make to issuers. Disclosures must be made in a fair and balanced manner based on the principles of fair dealing and good faith.

There are requirements regarding the timing of disclosures. The MSRB notes that not all issues proceed on the same timeframes. Disclosures should be timed so that the issuer (1) has clarity throughout all substantive stages of a financing regarding the roles of its professionals; (2) is aware of conflicts of interest promptly after they arise and well before the issuer effectively becomes fully committed (either formally or due to having already expended substantial time and effort) to completing the transaction with the underwriter; and (3) has the information required to be disclosed with sufficient time to take such information into consideration before making certain key decisions on the financing.

Underwriter's Role	(i) Municipal Securities Rulemaking Board Rule G-17 requires an underwriter to deal fairly at all times with both municipal issuers and investors; (ii) the underwriter's primary role is to purchase securities with a view to distribution in an arm's-length commercial transaction with the issuer and it has financial and other interests that differ from those of the issuer; (iii) unlike a municipal advisor, the underwriter does not have a fiduciary duty to the issuer under the federal securities laws and is, therefore, not required by federal law to act in the best interests of the issuer without regard to its own financial or other interests; (iv) the underwriter has a duty to purchase securities from the issuer at a fair and reasonable price, but must balance that duty with its duty to sell municipal securities to investors at prices that are fair and reasonable; and (v) the underwriter will review the official statement for the issuer's securities in accordance with, and as part of, its responsibilities to investors under the federal securities laws, as applied to the facts and circumstances of the transaction. *Disclosures concerning the role of the underwriter and the underwriter's compensation may be made by a syndicate manager on behalf of other syndicate members. Other conflicts disclosures must be made by the particular underwriters subject to such conflicts.*
Underwriter Compensation	The underwriter must disclose to the issuer whether its underwriting compensation will be contingent on the closing of a transaction. It must also disclose that compensation that is contingent on the closing of a transaction or the size of a transaction presents a conflict of interest, because it may cause the underwriter to recommend a transaction that is unnecessary or to recommend that the size of the transaction be larger than is necessary.
Other Conflicts Disclosures	(i) any payments described below under *Conflicts Of Interest - Payments To Or From Third Parties*; (ii) any arrangements described below under *Conflicts Of Interest - Profit-Sharing*

	With Investors; (iii) the credit default swap disclosures described below under *Conflicts of Interest - Credit Default Swaps*; and (iv) any incentives for the underwriter to recommend a complex municipal securities financing and other associated conflicts of interest.
Structure Of Issue	(i) The underwriter must provide disclosures on the material aspects of deal structures where the underwriter reasonably believes that issuer personnel lack knowledge or experience with the structure of the deal. (ii) For a complex municipal securities financing (*e.g.,* VRDOs), more particularized disclosures may be needed. The underwriter must disclose the material financial characteristics of the complex financing as well as the material financial risks of the financing that are known to the underwriter and reasonably foreseeable at the time of the disclosure. Also any incentives to recommend the financing and other associated conflicts must be disclosed. (iii) Required level of disclosure varies according to the issuer's knowledge or experience with the proposed financing structures or similar structures, capability of evaluating the risks of the recommended financing, and financial ability to bear the risks of the recommended financing, in each case based on the reasonable belief of the underwriter. In all events, the underwriter must disclose any incentives for the underwriter to recommend the complex municipal securities financing and other associated conflicts of interest.

21.10.3.1.1 Complex Financings

Particular attention should be given to "Complex Financings" which the MSRB defines as a new issue financing that is structured in a unique, atypical, or otherwise complex manner that issuer personnel responsible for the issuance of municipal securities would not be well positioned to fully understand or to assess the implications of the financing in its totality. Examples include VRDOs; financings involving derivatives (such as CDS); and financings in which the interest rate is benchmarked to an index that is commonly used in the municipal market which may be complex to an issuer that does not understand the index or its possible interaction with other indexes.

The MSRB provides the following list of practical factors for identifying Complex Financings (there may be other factors than these):

- Whether the underwriter's internal risk management process for approving an underwriting engagement could be helpful in identifying Complex Financings.
- Whether the particular type of structure or product is handled exclusively by the underwriter's most experienced or specialized professionals.
- Whether the particular type of structure or product gives rise to significant disclosures when assisting the issuer in preparing the official statement.
- Whether a particular feature or other characteristic of the structure or product creates more difficult secondary market pricing determinations as compared to the rest of the marketplace.

Key requirements when a Complex Financing is recommended are:

- Disclosure is only required if the underwriter recommends the Complex Financing.
- Where there is a recommendation, the level of disclosure may vary according to the issuer's knowledge with the structure of the financing and may vary over time depending on the knowledge and experience of issuer personnel.

- The level of disclosure may vary if the issue includes routine elements of financing that issuer personnel understand, Disclosures for complex financings must address specifics and may not be broad and general "boilerplate" disclosures.

Refer to MSRB Notice 2012-38 for specific guidance on VRDO and other disclosures.

21.10.3.1.2 Timing And Manner Of Disclosures Regarding Underwriter's Role; Underwriter Compensation; And Other Conflicts Disclosures

These disclosures must be made in writing to an official of the issuer that the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter and that, to the knowledge of the underwriter, is not a party to a disclosed conflict.

- Disclosures must be clear and include implications for the issuer.
- The disclosure concerning the arm's-length nature of the underwriter-issuer relationship must be made in the earliest stages of the underwriter's relationship with the issuer with respect to an issue (*e.g.,* in a response to a request for proposals or in promotional materials provided to an issuer).
- Other disclosures concerning the role of the underwriter and the underwriter's compensation generally must be made when the underwriter is engaged to perform underwriting services (*e.g.,* in an engagement letter), not solely in a bond purchase agreement.
- Other conflicts disclosures must be made at the same time, except with regard to conflicts discovered or arising after the underwriter has been engaged. For example, a conflict may not be present until an underwriter has recommended a particular financing. In that case, the disclosure must be provided in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation.

21.10.3.1.3 Timing And Manner Of Disclosures Regarding Structure Of Issue

Disclosures regarding the structure of the issue must be made in writing to an official of the issuer whom the underwriter reasonably believes has the authority to bind the issuer by contract with the underwriter (i) in sufficient time before the execution of a contract with the underwriter to allow the official to evaluate the recommendation and (ii) in a manner designed to make clear to such official the subject matter of such disclosures and their implications for the issuer. The disclosures concerning a complex municipal securities financing must address the specific elements of the financing, rather than being general in nature. If the underwriter does not reasonably believe that the official to whom the disclosures are addressed is capable of independently evaluating the disclosures, the underwriter must make additional efforts reasonably designed to inform the official or its employees or agent.

21.10.3.1.4 Acknowledgment Of Disclosures

The underwriter must attempt to receive written acknowledgement (other than by automatic e-mail receipt) by the official of the issuer of receipt of the foregoing disclosures. If the official of the issuer agrees to proceed with the underwriting engagement after receipt of the disclosures but will not provide written acknowledgement of receipt, the underwriter may proceed with the engagement after documenting with specificity why it was unable to obtain such written acknowledgement.

21.10.3.1.5 Issuer Disclosure Documents

Underwriters often play an important role in assisting issuers in the preparation of disclosure documents, such as preliminary official statements and official statements. These documents are critical to the municipal securities transaction, in that investors rely on the representations contained in such documents in making their investment decisions. Moreover, investment professionals, such as municipal securities analysts and ratings services, rely on the representations in forming an opinion regarding the credit. A dealer's duty to have a reasonable basis for the representations it makes, and other material information it provides, to an issuer and to ensure that such representations and information are accurate and not misleading, as described above, extends to representations and information provided by the underwriter in connection with the preparation by the issuer of its disclosure documents (*e.g.,* cash flows).

21.10.3.2 Excessive Compensation

An underwriter's compensation for a new issue (including both direct compensation paid by the issuer and other separate payments, values, or credits received by the underwriter from the issuer or any other party in connection with the underwriting), in certain cases and depending upon the specific facts and circumstances of the offering, may be so disproportionate to the nature of the underwriting and related services performed as to constitute an unfair practice with regard to the issuer that it is a violation of Rule G-17. Among the factors relevant to whether an underwriter's compensation is disproportionate to the nature of the underwriting and related services performed are the credit quality of the issue, the size of the issue, market conditions, the length of time spent structuring the issue, and whether the underwriter is paying the fee of the underwriter's counsel or any other relevant costs related to the financing.

21.10.3.3 Fair Pricing

The duty of fair dealing under Rule G-17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the issue at the time it is priced. In general, a dealer purchasing bonds in a competitive underwriting for which the issuer may reject any and all bids will be deemed to have satisfied its duty of fairness to the issuer with respect to the purchase price of the issue as long as the dealer's bid is a bona fide bid (as defined in Rule G-13) that is based on the dealer's best judgment of the fair market value of the securities that are the subject of the bid. In a negotiated underwriting, the underwriter has a duty under Rule G-17 to negotiate in good faith with the issuer. This duty includes the obligation of the dealer to ensure the accuracy of representations made during the course of such negotiations, including representations regarding the price negotiated and the nature of investor demand for the securities (*e.g.,* the status of the order period and the order book). If, for example, the dealer represents to the issuer that it is providing the "best" market price available on the new issue, or that it will exert its best efforts to obtain the "most favorable" pricing, the dealer may violate Rule G-17 if its actions are inconsistent with such representations.

21.10.3.4 Conflicts Of Interest

The following are potential conflicts of interest some of which are mitigated by disclosure and others by diligence in complying with requirements or avoiding conflicts.

21.10.3.4.1 Payment To Or From Third Parties

In certain cases, compensation received by the underwriter from third parties, such as the providers of derivatives and investments (including affiliates of the underwriter), may represent a conflict of interest. An underwriter should disclose to the issuer the existence of payments, values, or credits received by the underwriter in connection with its underwriting of the new issue from parties other than the issuer, and payments made by the underwriter in connection with such new issue to parties other than the issuer (in either case including payments, values, or credits that relate directly or indirectly to collateral transactions integrally related to the issue being underwritten). The amount of such third-party payments is not required to be disclosed. The underwriter must disclose to the issuer whether it has entered into any third-party arrangements for the marketing of the issuer's securities.

21.10.3.4.2 Profit-Sharing With Investors

Arrangements between the underwriter and an investor purchasing new issue securities from the underwriter (including purchases that are contingent upon the delivery by the issuer to the underwriter of the securities) according to which profits realized from the resale by such investor of the securities are directly or indirectly split or otherwise shared with the underwriter also would, depending on the facts and circumstances (including in particular if such resale occurs reasonably close in time to the original sale by the underwriter to the investor), constitute a violation of the underwriter's fair dealing obligation under Rule G-17. Such arrangements could also constitute a violation of Rule G-25(c), which precludes a dealer from sharing, directly or indirectly, in the profits or losses of a transaction in municipal securities with or for a customer.

21.10.3.4.3 Credit Default Swaps

The issuance or purchase by a dealer of credit default swaps for which the reference is the issuer for which the dealer is serving as underwriter, or an obligation of that issuer, may pose a conflict of interest, because trading in such municipal credit default swaps has the potential to affect the pricing of the underlying reference obligations, as well as the pricing of other obligations brought to market by that issuer. The dealer must disclose the fact that it engages in such activities to the issuers for which it serves as underwriter. Activities with regard to credit default swaps based on baskets or indexes of municipal issuers that include the issuer or its obligation(s) need not be disclosed, unless the issuer or its obligation(s) represents more than 2% of the total notional amount of the credit default swap or the underwriter otherwise caused the issuer or its obligation(s) to be included in the basket or index.

21.10.3.5 Retail Order Periods

"Retail order period" means an order period during which orders that meet the issuer's designated eligibility criteria for retail orders and for which the customer is already conditionally committed will be either (i) the only orders solicited or (ii) given priority over other orders.

The Firm has certain obligations to the issuer when it underwrites a transaction with a retail order period:

- Accepting only those retail orders that are consistent with the issuer's expectations and meet the qualification requirements.
- Allocating securities in a manner inconsistent with an issuer's requirements only with the issuer's consent.
- Taking reasonable measures to ensure retail customers are bona fide.

21.10.3.6 Dealer Payments To Issuer Personnel

MSRB Rule G-20 governs gifts, gratuities, and non-cash compensation, and Rule G-17 addresses certain payments made to, and expenses reimbursed for issuer personnel during the municipal bond issuance process. Payments made in regard to expenses of issuer personnel in the course of the bond issuance process, including in particular, but not limited to, payments for which KCD seeks reimbursement from bond proceeds or issuers, must comply with the requirements of Rule G-20. Excessive or lavish travel, meal, lodging and entertainment expenses in connection with an offering (such as may be incurred for rating agency trips, bond closing dinners, and other functions) that benefit issuer personnel may violate the Rule.

21.10.4 Sales To Investors

The Firm is obligated to offer new issue bonds to customers at the initial offering price negotiated with the issuer of the bonds. The Firm is prohibited from taking new issues into inventory and then offering the bonds to customers at higher prices. The Firm may sell bonds higher than the offering price after trading commences in the secondary market.

21.10.5 Issuer Continuing Disclosures

[SEC Securities Exchange Act of 1934 Rule 15c2-12; MSRB Rule G-32]

SEC Rule 15c2-12 imposes obligations on municipal firms that act as underwriters and remarketing agents to ensure that issuers and borrowers have in place contractual obligations to prepare and file certain information with the MSRB. The purpose of the rule is to ensure municipal issuers for issues of a certain size (generally an aggregate principal amount of $1,000,000) provide disclosure to the public regarding financial information and certain events (including rating changes) as defined by the rule. The financial and event information is filed with the MSRB's NIIDS system by the issuer.

When KCD acts as an underwriter, placement agent, or remarketing agent for a primary municipal securities offering, it is obligated to obtain and file with NIIDS information about continuing disclosure undertakings by the issuer. This includes (i) whether the issuer or other obligated person has agreed to provide continuing disclosures; (ii) the identity of any obligated person other than the issuer; and (iii) the timing by which issuers or obligated persons have agreed to provide annual financial and operating data. This is generally accomplished through the issuer's written agreement with the underwriter to comply with Rule 15c2-12 disclosure requirements. If KCD does not act as manager, the underwriters' agreement may include assurances that the issuer's written agreement has been provided to the senior syndicate manager. The SEC has issued interpretive guidance that states that the final official statement must disclose instances of non-compliance over the past 5 years, when material. An underwriter may not be able to reasonably rely on the issuer's certifications of compliance if that issuer has a history of non-compliance; in those circumstances the underwriter must independently determine compliance. A finding of continued non-compliance could preclude the underwriter from relying on an issuer's future continuing disclosure undertakings.

Secondary sales of municipal securities are also subject to disclosure requirements under Rule 15c2-12 and are discussed in the section *Sales Of Municipal Securities* and the subsection *Disclosures When Making Recommendations*.

21.10.5.1 Obligations When The Firm Acts As Senior Syndicate Manager Or Sole Underwriter

For issues subject to Rule 15c2-12, KCD is required to review a near final official statement ("deemed final official statement" under the Rule) which omits certain information permitted by the rule. The following summarizes some of KCD's requirements:

- Obtain a representation from the issuer as to what is the "deemed final official statement."
- Review the deemed final official statement to confirm that only permitted items are left blank.
- Obtain a written undertaking from the issuer that the issuer has agreed to provide notice to the MSRB within 10 business days of the occurrence of a "listed event" (as defined in the Rule) in an electronic format and accompanied by identifying information as prescribed by the MSRB.*
- Obtain a covenant from the issuer to supply final official statements within the required time frame.
- Obtain a covenant from the issuer to provide updated information at least during the period of the distribution and during any period where there is an obligation to distribute the final official statement.
- Review the public record of filings with NIIDS.

*Filing within 10 days of the occurrence applies to bonds issued after December 1, 2010.

Obligations When The Firm Is A Syndicate Member

While it is not necessary for KCD to replicate all of the diligence activities of a managing underwriter, prior to agreeing to participate in an underwriting, KCD will review a near final official statement. A copy of the OS will be retained in the file for the underwriting.

KCD must also assure itself that the issuer has agreed to provide the continuing disclosure required under 15c2-12. This may be included in the agreement among underwriters.

Obligations When The Firm is a Bidder in a Competitive Sale

For competitive issues, KCD will, at minimum, review the bid documents to assure itself that the issuer will take the actions necessary for KCD to comply with its obligations regarding disclosure and official statements.

21.10.6 CUSIP Numbers

[MSRB Rule G-34]

When required, application will be filed with the MSRB for CUSIP numbers for new issues as follows:

- for negotiated sales, the CUSIP number must be obtained prior to the effective date of the underwriting;
- for competitive sales, in time for receipt by the date of reward.

In addition, CUSIP numbers must be obtained when:

- KCD acts as a placement agent in a private placement of municipal securities, including direct purchase transactions
- acting as a municipal advisor when advising on a competitive transaction in municipal securities

There is an exception from the requirement to obtain CUSIP numbers when KCD (or municipal advisor in a competitive sale) reasonably believes the purchaser's present intent is to hold the municipal securities to maturity or earlier redemption or mandatory tender. To rely on the exception, the bond purchaser may be a bank, control affiliate of a bank or consortium of these entities, or a municipal entity that meets certain other criteria under MSRB Rule G-34.

21.10.7 Underwriter Registration

[MSRB Rule G-34]

When acting as underwriter on a new issue of municipal securities with nine months or greater effective maturity, KCD will be registered with Depository Trust and Clearing Corporation's (DTCC) New Issue Information Dissemination System (NIIDS). NIIDS will be used to file an application for depository eligibility for new issues of municipal securities.

21.10.8 Limited Use Of NRO Designation

[MSRB Rule G-34(a)(iv); MSRB Notice 2012-48]

The term "not reoffered" or "NRO" may not be used in any written communication (electronic or otherwise) from and after the time of the initial award of a new issue unless the applicable price or yield information is included.

21.10.9 Expenses In Connection With New Issues

[MSRB Rule G-17 and G-20; MSRB Notice 2007-06]

Expenses which are reimbursed from bond proceeds must be reasonable and related to the municipal bond issuance process. Payments to issuers, depending on the nature of the expense reimbursement, may be subject to Rule G-20 regarding gifts and gratuities which includes a limit of $100 per year (with some exceptions). Reimbursement of issuer expenses which might be characterized as excessive or lavish may be a violation of fair dealing and gift limitations, subjecting KCD to regulatory action.

The designated supervisor is responsible for confirming that only those expenses reasonably related to the offering are reimbursed from bond proceeds.

21.10.10 New Issue Sales During The Underwriting Period

[MSRB Rule G-11; MSRB issuer considerations for priority of orders: https://www.msrb.org/sites/default/files/2023-09/Issuer-Considerations-for-Distributing-Bonds-Establishing-Priority-of-Orders.pdf]

KCD will comply with requirements for sales during the underwriting period, as summarized below:

- At the time an order is submitted to the syndicate, disclose for whom the order is being submitted (including group orders)
- When acting as senior syndicate manager, KCD will:
    - Establish priority provisions
    - Communicate priority provisions and other syndicate requirements to syndicate members
    - Confirm sales directly to a related portfolio, municipal securities investment trust or accumulation account directly to the account or to the broker or dealer submitting the order
    - Within 24 hours of sending the commitment wire, allocate securities and within 2 business days following the date of sale disclose allocations to syndicate members
    - Within 10 business days following the date of sale disclose designations paid to syndicate and non-syndicate members
    - By the later of 15 business days following the date of sale or 3 business days following receipt of notification of set asides of the take-down, disclose to each syndicate member their portion of the take-down
    - At or before settlement of the syndicate account, provide syndicate members a statement of syndicate expenses and other information

21.10.11 Contingency Offerings

[SEC Securities Exchange Act of 1934 Rule 10b-9 and Rule 15c2-4]

If KCD participates in a contingency offering such as a "best efforts," "all-or-none," or other offering, an escrow account will be established at a separate bank and customers payments will be promptly transmitted to the bank account. When the conditions of the offering are met, payments will be transmitted to the issuer. If the conditions of the contingency offering are not met, payments will be refunded to the customers.

KCD and RRs cannot misrepresent the terms of a contingency offering and infer that purchasers will receive a refund of their purchase price if that is not a condition of the offering.

21.10.12 Private Placements

A private placement is a negotiated offering where the new issue of municipal securities is sold on an agency basis by KCD, acting as placement agent, directly to institutional or private investors rather than through an offering to the general investing public. Engaging in a private placement requires that KCD follow the underwriting procedures included in this section regarding due diligence and making regulatory filings, if required. In addition, investors may be subject to restrictions regarding resale of the securities and may be required to provide a private placement letter.

KCD is prohibited from engaging someone to solicit business on behalf of KCD and making payments to anyone not affiliated with KCD [MSRB Rule G-38]; therefore, placement agents must be employed by KCD if acting on behalf of KCD subject to KCD's policies and procedures including political contribution limitations.

21.10.13 Recordkeeping

A file will be maintained for each municipal underwriting in which KCD participates. The file will include at least the following records relating to the underwriting:

- a copy of the official statement and other information reviewed pursuant to KCD's due diligence review under Rule 15c2-12
- if KCD acts as senior syndicate manager or sole underwriter, as applicable, records of:
    - whether there was a retail order period and the issuer's definition of "retail," if applicable
    - whether KCD has deviated from customer priority provisions and the reasons for doing so
    - the underwriting agreement
    - any written agreement with the issuer
    - other records of underwriting activities including communications with syndicate members
- records of KCD's activities if it is a syndicate member, or submits orders to a syndicate, as outlined in the prior section
- records of all orders, whether filled or unfilled, for six years
- a record of to whom official statements or notice of electronic availability were provided, and the date provided
- any other records required under MSRB Rule G-8.

21.10.14 Official Statements

21.10.14.1 Providing Official Statements To Dealers, Purchasers, And Others

[MSRB Rule G-32]

Responsibility	• Designated Supervisor
Resources	• List of purchasers of the primary offering • Purchasers in the secondary market of primary offering securities during the primary offering disclosure period • Other dealers involved in the offering • Requests from dealers and others • MSRB Municipal Primary Offering Disclosure Report
Frequency	• As required
Action	• Provide purchasers and others with copies of the OS or information regarding

	accessing the information electronically through EMMA; also provide any other additional information required by rule
Record	• Records of providing official statements or notice regarding EMMA to purchasers are retained in the file for the underwriting and include: ○ customer name ○ security description ○ settlement date(s) ○ type of disclosure sent (preliminary or final OS) ○ date sent or notice provided ○ name of person who sent the OS or provided notice

The following charts summarize some of the requirements for providing official statements (OS), presuming an OS is prepared for the issue. Rule G-32 should be consulted for details regarding these requirements.

"Primary offering disclosure period" means, regarding a primary offering, the period commencing with the first submission to an underwriter of an order for the purchase of offered municipal securities or the purchase of such securities from the issuer, whichever first occurs, and ending 25 days after the final delivery by the issuer or its agent of all securities of the issue to or through the underwriting syndicate or sole underwriter.

Description	What and When to Provide
Request from a customer for a preliminary or final OS	Preliminary OS by next business day by first class mail or equally prompt means
Customer purchases of new issue in the primary offering where final OS available	By settlement date provide a copy of the OS or notice advising how to obtain the OS from EMMA (along with notice of availability of the OS from a qualified portal, if applicable, and that a copy of the OS will be provided upon request). Customer must also be provided with the following for a negotiated issue if not included in the OS: (1) the underwriting spread, if any, (2) the amount of any fee received as agent for the issuer in the distribution, and (3) the initial offering price for each maturity in the offering, including maturities not re-offered.
Customer purchases of new issue in the primary offering where a preliminary OS is prepared and a final OS is not prepared	Preliminary OS by settlement date with notice no final OS will be prepared or if information has been submitted to EMMA (via NIIDS), notice to the customer of availability of that information
Customer secondary market purchases of primary offerings during the primary offering disclosure period	By settlement date provide a copy of the OS or notice advising how to obtain the OS from EMMA (along with notice of availability of the OS from a qualified portal, if applicable, and that a copy of the OS will be provided upon request).
Customer purchases of municipal fund securities	If the customer previously received an OS in connection with a prior purchase, send by settlement any new, supplemented, amended, or "stickered" OS by first class mail or equally prompt means including a statement that the complete OS is available. Include written disclosure of any fee received as agent for the issuer. If periodic statements are provided in lieu of confirmations, annual disclosure is permissible and any change in fee must be disclosed with the next periodic

Description	What and When to Provide
	statement
When acting as financial advisor that prepares the OS	Make the final OS available to the managing underwriter, or sole underwriter in a designated electronic format promptly after the issuer approves its distribution

21.10.14.2 Filing Official Statements And Advance Refunding Documents With The MSRB

[MSRB Rule G-32; NIIDS Dataport Manual: https://www.msrb.org/sites/default/files/MSRBGatewayUserManual.pdf]

Responsibility	• Designated Supervisor
Resources	• Underwritings and advance refundings where KCD is underwriter or financial adviser
Frequency	• As required
Action	• File required information with NIIDS
Record	• A record of sending the required information is maintained in the underwriting and/or public finance file for the issue.

Underwriters are required to electronically file information with the MSRB's New Issue Information Dissemination Service (NIIDS) system using Form G-32. Where a syndicate is formed, the managing underwriter is responsible for complying with G-32. The following chart summarizes the filing requirements; certain exemptions apply and are detailed in Rule G-32.

Description	When electronic filing required	Rule
Initiate submission of Form G-32 information	On or prior to the date of first execution (defined as the date on which the underwriter executes its first transactions with a customer or another broker, dealer, or municipal securities dealer)	G-32(b)(i)(A)
Official statements	Within one business day after receipt of the OS from the issuer or its designee, but by no later than closing date. If for any reason the OS is not submitted to NIIDS by the closing date, the underwriter is obligated to submit to NIIDS by the closing date notice that the OS has not been submitted and will be submitted when it becomes available. The delayed OS must be submitted within one business day after receipt from the issuer and the POS.	G-32(b)(i)(B)
No OS prepared for issue exempt from 15c2-12	No later than closing date submit notice that no OS was prepared and submit the POS or notice described in the next section	G-32(b)(i)(C)
Preliminary official statement	No later than closing date submit POS or, if no POS	G-32(b)(i)(D)

Description	When electronic filing required	Rule
(POS) submission	prepared, notice that none was prepared	
Issues exempt under Rule 15c2-12(d)(1)(l) for which an OS is prepared	Not required to submit the OS to NIIDS if the underwriter (1) makes the information submission described under section (A); (2) submits notice to NIIDS no later than closing date that the issue is exempt and an OS has been prepared and will not be submitted to NIIDS and contact information, including mailing address, telephone number, e-mail address and name of an employee from whom customers may request the OS and delivers the OS to customers who request an OS or purchase within one business day after request or settlement of a transaction	G-32(b)(i)(E)
Exemption for certain commercial paper offerings or remarketings	Not required to send OS to purchasers or submit the OS or POS to NIIDS if no OS was prepared or the OS was previously filed with NIIDS in connection with a prior offering and has not been supplemented or amended subsequent to such prior submission	G-32(b)(i)(F)
Advance refunding documents	No later than 5 business days after closing date file the advance refunding document	G-32(b)(ii)
Amendments to OS, POS and advance refunding documents	Within one business day after receipt of the amendment from the issuer or an agent	G-32(b)(iii)
Cancellation of all or part of a primary offering	Promptly notify NIIDS. If only a portion is cancelled, amend or supplement information submitted to NIIDS no later than closing date	G-32(b)(iv)

21.10.15 Short-term Obligation Rate Transparency (SHORT) System

[MSRB Rule G-34(c); MSRB Notice 2011-17]

Responsibility	• Designated Supervisor
Resources	• Variable rate securities documents
Frequency	• As required
Action	• Submit information to the SHORT System within specified deadlines • If a designated agent is used, obtain electronic filing record to confirm filing has been made as required • If designated agent filing was not submitted on a timely basis, consult with agent regarding reason for the deficiency and take corrective action, as appropriate, which may include changing reporting agents
Record	• Records will be retained for three years of:

	○ all of the ARS for which KCD acts as Program Dealer ○ all of the VRDO for which KCD acts as Remarketing Agent ○ all information submitted to the SHORT system

Firms are required to report information about Auction Rate Securities (ARS) and municipal Variable Rate Demand Obligations (VRDO) to the MSRB's SHORT System. Submissions to the SHORT system are through an MSRB Gateway account and are allowed only for authorized classes of submitters including:

- ARS program dealers;
- VRDO remarketing agents;
- ARS auction agents; and
- Designated Agents designated by one of the above categories of submitters.

Documents to be filed include ARS documents defining current auction procedures and interest rate setting mechanisms and VRDO documents relating to Letter of Credit Agreements, Stand-By Purchase Agreements, and any other documents that establish an obligation to provide liquidity as well as other information under Rule G-34(c). Certain confidential information may be redacted prior to filing with the SHORT system.

21.10.16 Syndicate Practices

Underwriters and syndicate members have specific responsibilities when participating in underwritings of municipal securities. The following summarizes some of those responsibilities under MSRB rules and the timeframes when certain actions must be completed. This is only a summary of requirements; the rules should be consulted for details regarding specific requirements.

1. CUSIP and depository application requirements [G-34]:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
For new issues with 9 months or more effective maturity, file application through NIIDS for depository eligibility	Prior to acting as underwriter	G-34(e)	X	X	
If needed, apply for CUSIP number	Negotiated deal: no later than the time that pricing information for the issue is finalized Competitive deal: immediately after receiving notification of the award from the issuer	G-34(a)(i)(A)	X	X	

2. Communications (in writing) relating to issuer syndicate requirements, priority provisions and order period [G-11(f)]:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
All terms and conditions required by the issuer	Prior to 1st offer of securities	G-11(f)	X		
Priority provisions	Prior to 1st offer of securities	G-11(f)	X		
The procedure, if any, by which such priority provisions may be changed	Prior to 1st offer of securities	G-11(f)	X		
If the senior syndicate manager or managers are permitted on a case-by-case basis to allocate securities in a manner other than in accordance with the priority provisions, the fact that they are to be permitted to do so	Prior to 1st offer of securities	G-11(f)	X		
If there is to be an order period, whether orders may be confirmed prior to the end of the order period	Prior to 1st offer of securities	G-11(f)	X		
Any change in the priority provisions must be provided to other syndicate members	Promptly	G-11(f)	X		
Information about retail orders under a retail order period must be provided to syndicate members and reported to EMMA	Prior to the first offer of securities	G-11(f)	X		
When submitting an order pursuant to a retail order period, provide required information to the syndicate manager or sole underwriter about retail orders	From the end of the retail order period but no later than the Time of Formal Award	G-11(k)			X

Information above, requested by others	Promptly	G-11(f)	X		
If the senior syndicate manager rather than the issuer prepares the written statement of all terms and conditions, provide statement to issuer	Promptly	G-11(f)	X		

3. Other G-11 requirements:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
Establish priority provisions	Prior to 1st offer of securities	G-11(e)	X		
Disclose any orders submitted for dealer account or a related portfolio	At time of submission	G-11(b)			X
Confirm directly to a related portfolio, municipal securities investment trust, or accumulation account	At time of sale	G-11(c)	X		
For group orders, disclose identity of person for whom order is submitted	At time of submission	G-11(d)			X

4. Designations and allocations of securities [G-11(g)]:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
Complete the allocation of securities	Within 24 hours of sending commitment wire (some exceptions apply)	G-11(g)(i)	X		
Notify syndicate members, in writing, of a summary, by priority category, of all allocations accorded priority over members' take-downs	Within 2 business days following date of sale	G-11(g)(ii)	X		
Disclose to syndicate	Within 10 business	G-11(g)(iii)	X		

members, in writing, all available designation information	days following date of sale				
Disclose to syndicate members, in writing, all information about designations paid	With the sending of designation checks	G-11(g)(iii)	X		
Disclose to syndicate members, in writing, amount of any portion of the take-down directed to each member of the syndicate by the issuer	By the later of 15 business days following date of sale or 3 business days following receipt by senior syndicate manager of notification of such set-asides	G-11(g)(iv)	X		

5. Syndicate member designations:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
Syndicate members must provide designations to manager	Within 2 business days after bond closing	G-11(i)			X

6. Disclosure of syndicate expenses and other information [G-11(h), (i), (j) & G-12]:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
Provide syndicate members, in writing, with itemized statement of nature and amounts of all actual expenses	Competitive: prior to submission of bid; Negotiated: prior to purchase contract with issuer	G-11(h)(i)	X		
Provide syndicate members with written summary statement including information regarding identity of each related portfolio, trust, or accumulation account, identity of persons submitting group orders, and aggregate and par values and prices of	At or before final settlement of syndicate account	G-11(h)(ii)	X (does not apply to senior syndicate manager of a qualified note syndicate)		

all securities sold					
Settle syndicate, secondary market trading or similar account	Within 30 calendar days following date all securities delivered to syndicate members or account members	G-11(i) G-12(i)	X		
Submit allocations of designations to syndicate manager	Within 2 business days following date issuer delivers securities to syndicate	G-11(j)			X
Distribute designated credits	Within 10 calendar days following date issuer delivers securities to syndicate	G-11(j)	X		

7. Provide official statements:

Requirement	When	MSRB Rule(s)	Managing Underwriter	Sole Underwriter	Syndicate Member
To purchasers	No later than settlement	G-32(a)	X	X	X
To brokers, dealers, and municipal dealers that purchase the new issue	By the business day following a request	G-32(b)	X	X	X
To the MSRB	See section on "Filing Official Statements With the MSRB"	G-36	X	X	

21.11 Direct Purchases And Bank Loans

[MSRB Notice 2016-12 and 2011-52; FINRA Regulatory Notice 16-10]

Responsibility	• Designated Supervisor
Resources	• Proposed direct purchases or loans • Outside counsel
Frequency	• As required
Action	• Review proposed purchases or loans to determine whether they are "securities" • If necessary, engage outside counsel to conduct the review • If the financial instrument is deemed a security, conduct transaction complying with requirements elsewhere in this chapter regarding underwritings and private

	placements
Record	• Review to determine whether the purchase or loan is a security

Some state and local governments use "direct purchases" (private placements of their municipal securities with banks) and bank loans as a method of raising funds and as an alternative to public offerings. The MSRB has indicated that certain financings may be municipal securities subject to MSRB rules.

Outside counsel should be consulted when the Firm is involved in bank loan transactions or acts as a placement agent for a direct purchase or bank loan to determine whether such transactions or activities would be deemed municipal securities subject to MSRB rule requirements.

21.12 Municipal Advisor (MA) Activities

[MSRB Rule G-42 and G-44; Exchange Act Section 15B; SEC FAQs regarding Registration of Municipal Advisors: sec.gov/info/municipal/mun-advisors-faqs.shtml; FINRA Regulatory Notice 19-28; MSRB Notice 2018-24, 2018-12, 2018-08, 2017-08, 2014-10 and 2009-42; Interpretive Notice Regarding Disclosure of Material Facts dated 3/20/02; MSRB answers to webinar questions: http://www.msrb.org/News-and-Events/Past-Webinars/MSRB-Answers-to-Webinar-Questions.aspx; Municipal advisor model documents: http://www.sifma.org/services/standard-forms-and-documentation/municipal-securities-markets/#MAforms; MSRB advisory re municipal advisors: http://www.msrb.org/%7E/media/Files/Resources/Municipal-Advisor-Compliance-Advisory-June-2017.ashx; MSRB compliance resource re municipal advisory WSPs: https://www.msrb.org/sites/default/files/2022-11/MA-Pricing.pdf]

Responsibility	• Compliance
Resources	• Reviews of municipal activities
Frequency	• Initially determine KCD is not engaged in MA activities • Quarterly: reconfirm exemption
Action	• Review municipal activities to confirm they are outside MA requirements • Review municipal activities to confirm KCD does not fall under MA requirements
Record	• Initial review to determine no MA activities • Quarterly review to reconfirm

The Firm does NOT act as a municipal advisor under Rule 15B. Compliance is responsible for confirming the Firm is **not** required to register as an MA.

21.12.1 Definitions

Exchange Act Section 15B and the SEC's FAQs should be consulted for more detailed explanations of municipal advisor activities. The following summarizes some key terms.

Municipal advisor: A person (not a municipal entity or employee of one) that provides advice to a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues or undertakes a solicitation of a municipal entity.

The term includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors (as described in the rule).

Excluded from the definition:

- Public officials, employees of municipal entities, and obligated persons to the extent they are acting within their official capacity.
- Municipal entities or obligated persons represented by an independent municipal advisor, subject to conditions.
- Broker-dealers and municipal securities dealers serving as underwriters, commencing when the municipal issuer engages the underwriter on a particular transaction and continuing until the end of the underwriting period for the transaction. Included in the underwriter exemption: acting as a private placement agent; providing ancillary advice as described in the rule; and structuring of refunding escrow cash flow requirements necessary to provide for the refunding and defeasance of an issuance of municipal securities.

Municipal entity: any State, political subdivision of a State, or municipal corporate instrumentality of a State (the rule includes further specifics of the definition).

Obligated person: any person, including a municipal issuer, who is either generally or through an enterprise, fund, or account of such person, committed by contract or other arrangement to support the payment of all or part of the obligations on the municipal securities to be sold in an offering of municipal securities.

21.13 Financial Advisor Activities

[MSRB Rule G-17 and G-23; MSRB Notice 2009-42; Interpretive Notice Regarding Disclosure of Material Facts dated 3/20/02]

Responsibility	• Designated Supervisor
Resources	• Determine engagements with municipalities • Notify Compliance of advanced refundings to be added to KCD's Watch List
Frequency	• As required
Action	• Accept engagements • Ensure required contracts are obtained • Conduct or engage outside counsel to conduct due diligence where necessary • Provide **public** material information (that is available internally but not from the official statement or other standard industry sources) to trading and/or sales personnel to meet G-17 obligations regarding required disclosures to customers when effecting municipal transactions
Record	• Contracts, engagement agreements, and other documents included in the issuer file • Record of providing internal public information to sales/trading personnel are retained in the issuer file

21.13.1 Financial Advisory Relationship Defined

A financial advisory relationship exists when KCD renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer, for a fee or other compensation, with respect to a new issue of municipal securities, including advice with respect to the structuring, timing, terms and other similar matters. "Financial advisor" is also included in the definition of "municipal advisor" addressed in the section *Municipal Advisor (MA) Activities*. A financial advisory relationship does not exist where, in the course of acting as an underwriter, KCD renders similar advice to an issuer.

21.13.2 Professional Qualifications

Financial advisors are included in the definition of "municipal advisor" and are required to be qualified by exam to act as a municipal advisor.

21.13.3 Written Agreements

Written agreements will be obtained for all financial advisory relationships prior to, upon, or promptly after the inception of the relationship. The agreement will include provisions specified in MSRB Rule G-23(c).

21.13.4 Prohibition Against Underwriting Or Placement Activities

[MSRB Rule G-23(d); MSRB Notice 2011-65]

If KCD acts as financial advisor to an issuer, it is prohibited from participating in a negotiated or competitive offering of the same issue of securities the subject of financial advisor activities. In addition, KCD is prohibited from serving as initial remarketing agent for the same issue. KCD may, when it acts as a financial advisor:

- Place an issuer's entire issue with another governmental entity, such as a bond bank, as part of a plan of financing by such entity for or on behalf of the issuer client
- Serve as successor remarketing agent for the issue if the financial advisor relationship has been terminated for at least one year
- Purchase such securities from an underwriter, either for its own trading account or for the account of its customers (but not to circumvent the Rule)

21.13.5 Official Statements

If KCD, in its role as financial advisor, prepares a final official statement on behalf of an issuer, it will provide the official statement to the managing underwriter or sole underwriter promptly after the award is made. If KCD, as financial advisor, is responsible for printing the final official statement, it will make adequate copies available to the managing underwriter or sole underwriter promptly after the award is made but no later than two business days before the date all securities are delivered by the syndicate manager to the syndicate members.

21.13.6 Advanced Refunded Securities

This section discusses policies when KCD is financial advisor to an issuer involved in an advanced refunding of its securities.

21.13.6.1 Timely Dissemination Of Information

Timely dissemination is important to ensure investors and other market participants are aware of issues that are subject to an advance refunding. When KCD as financial advisor is in control of information regarding an advanced refunding, it will provide such information to the market through information vendors or by other means. This information will be provided at the appropriate time, which generally will be by or shortly after the date of sale of the refunding issue.

21.13.6.2 Confidentiality Of Non-Public Information

Responsibility	• Designated Supervisor
Resources	• Information regarding pending advance refundings
Frequency	• As required
Action	• Notify Compliance of pending advance refunding • Compliance is responsible for monitoring trading in the issue and following up transactions in accordance with KCD's Insider Trading procedures
Record	• Include notation in the deal file when Compliance is notified

Because knowledge of an advance refunding may affect the value of outstanding securities, it is important that, prior to public announcement, this information be maintained on a confidential basis. This information is subject to KCD's policy on Insider Trading. In general:

- Knowledge of advanced refundings (that have not been publicly announced) may constitute knowledge of inside information.
- KCD has information barrier procedures to protect inside information. This means that prior to public announcement, communications about advance refundings are limited to authorized personnel in the financial advisory area and other personnel as outlined in KCD's information barrier policy.
- Financial advisory personnel must protect confidential information in locked files, password-protected computer files, *etc.,* and may not discuss the confidential information in public areas such as elevators and other public locations where others may gain access to the information.
- KCD has procedures in place to detect and prevent trading on inside information. The designated supervisor is responsible for notifying Compliance of potential refundings that have not yet been announced. Compliance will monitor trading for transactions in the subject security.

21.13.7 Recordkeeping

Files will be maintained for each financial advisory relationship and will include at least the following:

- A copy of the financial advisory agreement
- A copy of the final official statement, if prepared by KCD in its role as financial advisor

- Records of providing the final official statement, if prepared as financial advisor, to the managing underwriter or sole underwriter and the date when provided

21.14 Solicitation Of Municipal Securities Business

[MSRB Rule G-38]

KCD will not, directly or indirectly, make payment to anyone who is not an affiliated person for the solicitation of municipal securities business on behalf of KCD.

An "affiliated person," for purposes of this policy, includes anyone who is a partner, director, officer, employee, or registered person of KCD, or of an affiliated company of KCD. "Affiliated company" includes any entity directly or indirectly controlling, controlled by, or under common control with KCD, and whose activities are not limited solely to soliciting municipal securities business.

"Solicitation" is defined in Rule G-38 and interpretive notices which exclude certain limited communications with issuers from being defined as a solicitation of business. Limited communications include providing information about general capabilities of the dealer; communications incidental to completing tasks related to business for which the dealer has been engaged (*e.g.,* engaging an outside contractor to provide cash flow expertise); communications with conduit borrowers; and communications with unaffiliated professionals who provide legal, accounting, engineering, or other professional services where the professional is paid for services rather than for soliciting municipal business. Because of the complexity of the definition of "solicitation," Compliance should be contacted regarding questions about activities that may or may not be deemed soliciting municipal business.

21.15 Broker's Brokers

[MSRB Rule G-43; MSRB Notice 2012-34; SIFMA Rule G-43 Best Practices: https://www.sifma.org/wp-content/uploads/2017/08/Municipal_MSRB-Rule-G43-SIFMA-Best-Practices.pdf]

Responsibility	• Designated Supervisor
Resources	• Agreements with other dealers • Transactions where KCD acts as a broker's broker
Frequency	• As required - execute agreements • Daily or weekly, depending on availability of reports - review transactions • Initially and ongoing - provide training to traders • Annually - disclose policies and procedures
Action	• Execute agreements (including required disclosures) to act as a broker's broker and provide dealers with KCD's commission or similar schedule • Post bid-wanted parameters on KCD's website • Post policies and procedures on KCD's web site and notify dealers annually • Review transactions to determine compliance with bid-wanted and other execution requirements including recording of deadlines and disclosure of customer or affiliates allowed to place bids • Take corrective action which may include: ○ Cancel/correct transactions ○ Confer with trader ○ Provide added training for trader • For new and existing traders: provide training in requirements for handling

	broker's broker transactions
Record	• Agreements with other dealers • Annual notice to dealers regarding policies and procedures • Reviews of transactions including action taken, if any • Training including who was trained, when it occurred, subjects included

KCD may act as a broker's broker, an intermediary between selling dealers and bidding dealers. Its obligations in that role include the following. Rule G-43 should be consulted for definitions and details regarding these obligations.

- Make a reasonable effort to obtain a fair and reasonable price relating to prevailing market conditions.
- Not take any action that works against the dealer's interest to receive advantageous pricing.
- Presumably act for or on behalf of the seller in a bid-wanted for municipal securities, unless both the seller and bidders agree otherwise in writing in advance of the bid-wanted.

21.15.1 Disclosures

KCD will disclose its broker's broker activities including the following:

- The nature of its undertaking for the seller and bidders in bid-wanteds and offerings
- The manner in which KCD will conduct bid-wanteds and offerings
- A description in detail of the manner in which it will satisfy its obligation to obtain a fair and reasonable price in the case of offerings and bid-wanteds not conducted in accordance with the section "Bid-Wanted"
- The policies and procedures to meet the requirements of Rule G-43 to sellers of, and bidders for, municipal securities in writing at least annually and post the policies and procedures in a prominent position on its website.

Transaction disclosures (in addition to others in this section) include the following:

- If KCD allows customers [as defined in Rule D-9] or affiliates [as defined in Rule G-11(a)(x)] to place bids, it must disclose that fact to both sellers and bidders in writing and require disclosure to the seller if the high bid in a bid-wanted or offering is from a customer or an affiliate of KCD; KCD is not required to disclose the name of the customer or affiliate.

21.15.2 Bid-Wanted

- A reasonable effort must be made to disseminate a bid-wanted widely to obtain exposure to multiple dealers. No fixed number of bids is required; bid-wanteds include (but are not limited to) the underwriter of the issue and prior known bidders on the issue.
- For securities of limited interest, make a reasonable effort to reach dealers with specific knowledge of the issue or known interest in securities of the type being offered.
- Each bid-wanted must have a deadline for the acceptance of bids, after which KCD will not accept bids or changes to bids. The deadline must be noted in the order record; refer to G-43 for a description of types of deadlines.
- If KCD believes that a high bid received above or below the predetermined parameters may have been submitted in error, the bidder may be contacted prior to the deadline to determine if the bid was submitted in error; consent from the seller is not required. If the high bid is within parameters but KCD believes the bid may have been submitted in error, the seller's oral or written permission must be

obtained prior to contacting the bidder to determine whether the bid was submitted in error (the seller's permission must be noted on the order).
- If the high bid is below the predetermined parameters, this must be disclosed to the seller; the trade may still be effected if the seller acknowledges the disclosure either orally or in writing. The disclosure and acknowledgment must be noted on the order.
- If the winning high bidder's bid or cover bid in a bid-wanted has been changed, KCD will disclose the change to the seller prior to execution and provide the seller with the original and changed bids (the disclosure must be noted on the order).
- To conduct bid-wanteds, KCD has adopted predetermined parameters which will be disclosed prominently on its website in advance of the bid-wanted in which they are used. KCD will periodically test the predetermined parameters to determine whether they have identified most bids that did not represent the fair market value of municipal securities that were the subject of bid-wanteds to which the predetermined parameters were applied.

21.15.3 Compensation

KCD will be compensated on the basis of commissions or other economically similar basis and will provide the seller and bidders with a copy of its commission or other economically similar schedules for transactions, with such schedules reflecting at a minimum the maximum charge that KCD could impose on a given transaction.

21.15.4 Prohibitions

As a broker's broker, KCD is prohibited from:

- maintaining municipal securities in any proprietary or other accounts, other than for clearance and settlement purposes;
- self-dealing;
- encouraging bids that do not represent the fair market value of municipal securities that are the subject of a bid-wanted or offering;
- giving preferential information to bidders in bid-wanteds, including but not limited to, "last looks," directions to a specific bidder that it should "review" its bid or that its bid is "sticking out;"
- changing a bid price or offer price without the bidder's or seller's respective permission;
- failing to inform the seller of the highest bid in a bid-wanted or offering;
- accepting a changed bid or a new bid from a bidder in the same bid-wanted after KCD has selectively informed that bidder whether its bid is the high bid ("being used") in the bid-wanted; and
- subject to the provisions of bid-wanted requirements, if applicable, and the prohibition in the above bullet, providing any person other than the seller (which may receive all bid prices) and the winning bidder (which may only receive notice that its bid is the winning bid) with information about bid prices, until the bid-wanted has been completed, unless KCD makes such information available to all market participants on an equal basis at no cost, together with disclosure that any bids may not represent the fair market value of the securities, and discloses publicly that it will make such information public.

21.16 Trading And Handling Customer Orders

Responsibility	• Designated Supervisor
Resources	• Order records

Frequency	• Daily and Ongoing
Action	• Oversee trading and execution activities • Establish procedures for maintaining records of orders • Review fairness of mark-ups and mark-downs • Review daily inventory positions for compliance with firm limits • Review errors and error accounts • Report system outages or technology-related problems that prevent timely reporting of trades to the MSRB
Record	• Initials and date reviewed on available transaction reports or order records; notations of action taken where appropriate • Notations in Daytimer or supervisor's log • Record of reporting system outages/technology problems

KCD will handle orders in accordance with MSRB Rule G-18 and will make reasonable efforts to obtain prices for customers that are fair and reasonable in relation to prevailing market conditions.

21.16.1 Quotations

[MSRB Rule G-13]

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 KCD's inventory 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 KCD 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 KCD's advertising policy.

21.16.2 Fair Prices

[MSRB Rule G-30]

Traders 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.

21.16.3 Best Execution

[MSRB Rule G-18, G-48 and D-15; MSRB Guidance on MSRB Rule G-18: http://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-18.aspx?tab=2]

Responsibility	• Designated Supervisor
Resources	• Order records including supporting information such as screenshots • Technology, as available

	• Regulators' reports, if available
Frequency	• Annually or more frequently, if necessary

Action	• Review transactions to identify:
	  ○ Outlying prices away from executions in the same or similar securities in reasonable proximity (consider changing market conditions)
	  ○ Cancels/rebills
	  ○ Unusual concentrations with particular customers
	  ○ Reasonableness of executions considering technology reports providing post-trade market transaction data, models for pricing (if available)
	• Evaluate the execution quality of venues used and, if available, assess whether other venues not currently accessed may provide the opportunity for best execution, particularly for retail order flow
	• Compare the quality of customer executions via current order routing and execution arrangements (including executing against orders as principal) to the quality of the executions that could be obtained from competing markets
	• Periodically consider whether incorporating pricing information available from electronic trading platforms should be incorporated into best execution reviews
	• When using auto-execution systems, these systems should routinely analyze information from other systems that offer bona fide, executable prices and determine whether those systems should be incorporated into best execution reviews
	• If filters are used to route orders, the use of filters will be periodically evaluated to determine their use is consistent with best execution and determine whether to lift them upon request
	• If the Firm routes its transactions to another dealer for execution, it will rely on the best execution policies and procedures of the other dealer and will periodically review their methodology

Record	• Order records and/or reports with notations indicating review and action taken, if any • Review of other dealers' procedures, if applicable

The Firm has an obligation to provide best execution for its customers' orders, whether executed internally or routed to other broker-dealers and whether as agent or principal. "Best execution" refers to using reasonable diligence to determine the best market to buy or sell a security and obtaining a price as favorable as possible under prevailing market conditions. The Firm's obligation to provide best execution also extends to handling and executing orders for customers of other broker-dealers routed to the Firm (but not orders that simply execute the order against the Firm's quote).

Factors for using "reasonable diligence" include:

- the character of the market for the security, *e.g.,* price, volatility, and relative liquidity
- the size and type of transaction
- the number of markets checked
- the information reviewed to determine the current market for the subject security or similar securities
- accessibility of the quotation
- the terms and conditions of the order
- review of multiple market venues, if they are available
- contact with other dealers
- the liquidity of the bonds
- size of the transaction
- reasonable mark-ups/mark-downs

- the customer's instructions and expectations
- the availability of pricing of recent sales in the same, similar, or benchmark securities (*i.e.,* EMMA)

Other considerations for best execution include the following:

- Best execution requirements do not apply to transactions with SMMPs (see the section on SMMPs in this chapter). SMMPs are required to provide affirmations regarding their independence of judgment.
- In any customer transaction (including those for another dealer's customer), the Firm is prohibited from interjecting a third party between itself and the best market for the security inconsistent with the factors above (interpositioning). This does not prohibit the use of broker's brokers unless it is inconsistent with the best execution obligation.
- Customer orders should be executed promptly, taking into account prevailing market conditions; certain conditions may necessitate additional time to ascertain the best market.
- "Markets" include a variety of venues which may include broker's brokers; alternative trading systems; or other counterparties. Best execution involves considering a wide variety of venues without considering that some venues have less relevance.
- Where there is limited pricing information or quotations available, the Firm has added obligations for best execution, discussed in the following section *Limited Price Availability*.
- Best execution requirements do not apply to customer orders where the customer designates a particular market for execution; such orders should have prompt processing in accordance with the customer's terms.
- The requirements of MSRB Rule G-18 do not apply to:
    - Municipal fund securities
    - Transactions with SMMPs that have provided the required affirmations
    - Orders received from another dealer when it is simply executed against the Firm's quote and not sent for handling and execution
    - Transactions with other broker-dealers

21.16.3.1 Determining Best Available Price

Orders are not required to be exposed to every available market.

- More than one market should be checked
- Expose customer orders to multiple offerings or bids
- Show external offerings and bids to retail customers
- Evaluate offers or bids versus relevant market information to determine whether other markets or dealers should be checked
- Evaluate pricing

21.16.3.2 Limited Price Availability

Where price information for a security is limited because of infrequent trading or other factors, the following may be considered:

- Prices from or recent transactions with other dealers
- Recent Firm executions of the same or similar securities
- Prices on similar securities
- Prices available from services such as EMMA

21.16.3.3 Orders For SMMPs

Orders for SMMPs are not subject to best execution requirements. Refer to the section *Sophisticated Market Maker Professionals (SMMPs)* in this chapter.

21.16.3.4 Extreme Market Conditions

When there are extreme market conditions (*e.g.,* a shortage of liquidity and divergent prices during periods of significant rating changes or interest rate movements or other market-wide events), the following apply:

- Treatment of customer orders must remain fair, consistent and reasonable.
- Any changes to trading protocols should be reviewed by the supervisor to consider the facts and circumstances of market conditions and any changes needed.
- Any revised order handling procedures during extreme market conditions will be disclosed to customers outlining the differences from normal market conditions and when revised procedures will be activated.

21.16.3.5 Documenting Order Pricing

Traders have an obligation to document the basis for pricing of orders. This may include screenshots documenting current/recent pricing of the securities and may include:

- Bids/offers from other dealers
- Recent executions of the same or similar securities at the Firm
- EMMA pricing
- Other sources of pricing

21.16.4 Filtering

[MSRB Notice 2018-01]

KCD may implement ATS automated tools that are used to screen out bids received or offers made available by certain dealers, or when a selling dealer directs a broker's broker to limit the audience for a bid-wanted (*i.e.,* a request for quote).

The designated supervisor is responsible for documenting why filtering is not anti-competitive. A list will identify the firms which would be unacceptable as counterparties and the reasons why.

21.16.5 Minimum Denominations

[MSRB Rule G-15 and G-17]

KCD 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, KCD has an obligation to make written disclosure to the customer regarding the potential affect on liquidity.

Municipal traders 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

21.16.6 Official Statements

[MSRB Rule G-32]

Customers who purchase municipal securities during the "primary disclosure period" will be provided copies of official statements (OS's) or information regarding accessing OS information electronically through EMMA.

This requirement to provide OS information applies whether or not KCD is an underwriter or participates in the underwriting and applies during the "primary offering disclosure period." "Primary offering disclosure period" means, regarding a primary offering, the period commencing with the first submission to an underwriter of an order for the purchase of offered municipal securities or the purchase of such securities from the issuer, whichever first occurs, and ending 25 days after the final delivery by the issuer or its agent of all securities of the issue to or through the underwriting syndicate or sole underwriter.

21.16.7 Records Of Orders

[MSRB Rule G-8]

The trading department will maintain a record of orders in municipal securities consistent with the requirements of MSRB Rule G-8. The designated supervisor is responsible for daily review of transactions in municipal securities.

21.16.8 Mark-Ups And Mark-Downs

[MSRB Rule G-30; MSRB Notice 2018-05; MSRB Resource on Disclosing Mark-ups and Determining Prevailing Market Price]

Responsibility	• Designated Supervisor
Resources	• Orders • Trading reports
Frequency	• Ongoing (Traders) • Spot-check

Action	• Establish required mark-up disclosures on confirmations
	• Review mark-ups and mark-downs that exceed Firm guidelines or not related to contemporaneous Firm transactions:
	    ○ For automated prevailing market price (PMP) determinations, review overrides
	    ○ Review order records for written documentation of prevailing market determination (*e.g.,* yields on comparable securities)
	    ○ Notify Trading Manager of missing documentation and request correction of the deficiency
	    ○ Confer with Trading Manager regarding orders where documentation is not justified
	• Compliance:
	    ○ Document functional separation of trading desks, if applicable

Record	• Order records maintained by the Trading Dept. • Trading reports including initials of reviewer and review notes, if any • Documentation of functional separation of trading desks

KCD is obligated to execute customer orders on a principal basis at a fair and reasonable (including mark-up or mark-down) price considering the prevailing market price. Traders are required to document how mark-ups/downs are calculated if not related to the presumptive prevailing market price. Alternative methods for documenting the presumptive market price are in "hierarchical" order with the first alternative to be used, and if not available the second may be used, *etc.*

21.16.8.1 Prevailing Market Price

[MSRB Rule G-30.06]

This section summarizes guidance included in the MSRB rule (G-30.06). The Rule should be consulted for detailed explanations.

(1) Presumptively the prevailing market price for a municipal security is established by referring to the dealer's contemporaneous cost when buying or contemporaneous proceeds when selling.

(2) Other evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases or sales of the security.

(3) A dealer's cost is (or proceeds are) considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the municipal security.

(4) When using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds), KCD (*i.e.,* the trader) must be prepared to provide evidence that is sufficient to overcome the presumption that such contemporaneous cost (or proceeds) provides the best measure of the prevailing market price.

(5) The following types of pricing information must be considered (in the order presented) to determine prevailing market price:

A. Prices of any contemporaneous inter-dealer transactions in the municipal security in question;
B. In the absence of transactions described in (A), prices of contemporaneous dealer purchases (sales) in the municipal security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same municipal security; or
C. In the absence of transactions described in (A) and (B), for actively traded municipal securities, contemporaneous bid (offer) quotations for the municipal security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

A dealer may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information. Because of the lack of active trading in most municipal securities, it is not always possible to establish the prevailing market price for a municipal security based solely on contemporaneous transaction prices or contemporaneous quotations for the security. Accordingly, dealers may often need to consider other factors, below.

(6) Other factors that may be taken into consideration (not in any required order or combination) for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices, or yields calculated from prices, of contemporaneous inter-dealer transactions in a "similar" municipal security, as defined below;

- Prices, or yields calculated from prices, of contemporaneous dealer purchase (sale) transactions in a "similar" municipal security with institutional accounts with which any dealer regularly effects transactions in the "similar" municipal security with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" municipal securities for customer mark-ups (mark-downs).

(7) Finally, if information concerning the prevailing market price of the subject municipal security cannot be obtained by applying any of the above factors, dealers may consider as a factor in assessing the prevailing market price of a municipal security the prices or yields derived from economic models (*e.g.,* discounted cash flow models) that take into account measures such as reported trade prices, credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (*e.g.,* coupon frequency and accrual methods).

(8) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. In addition, in considering yields of "similar" municipal securities, except in extraordinary circumstances, dealers may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" municipal securities taken as a whole.

21.16.8.2 Similar Municipal Securities

(1) A "similar" municipal security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the municipal security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a municipal security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a municipal security is "similar" to the subject security may be determined by all relevant factors, including but not limited to the following:

A. Credit quality considerations, such as whether the municipal security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information concerning either the "similar" security's issuer or subject security's issuer that is not yet incorporated in credit ratings should be considered (*e.g.,* changes to ratings outlooks));
B. The extent to which the spread (*i.e.,* the spread over an applicable index or U.S. Treasury securities of a similar duration) at which the "similar" municipal security trades is comparable to the spread at which the subject security trades;
C. General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the municipal security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security;
D. Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security; and
E. The extent to which the federal and/or state tax treatment of the "similar" municipal security is comparable to such tax treatment of the subject security

(3) When a municipal security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, pricing information with respect to other securities may not be used to establish the prevailing market price.

21.16.8.3 Pricing Disclosure

[MSRB Rule G-15 and G-30; MSRB Notice 2018-05]

The amount of mark-ups and mark-downs will be disclosed on non-institutional customer confirmations. Two additional disclosures include: (1) a reference (or hyperlink if the confirmation is electronic) to the MSRB's EMMA website containing publicly-available trading data for the security traded; and (2) the execution time expressed to the second. Disclosure is required if KCD executes one or more offsetting principal trades in the same security on the same trading day which, in aggregate, meet or exceed the size of the customer trade. Disclosure may also be required because of an offsetting principal trade executed by a Firm affiliate that did not occur at arm's length.

Disclosure is not required for principal trades executed on a trading desk functionally separate from a trading desk that executes customer trades. It is also not required for municipal fund securities or bonds acquired in a fixed-priced offering and sold to non-institutional customers at the same offering price the same day KCD acquires the bonds.

21.16.9 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 KCD
- the amount of any other compensation received by KCD in connection with the transaction
- factors considered in principal transactions
- any other relevant factors at the time of execution

21.16.10 Reports Of Transactions

[MSRB Rule G-14; MSRB Rule G-14 RTRS Procedures; MSRB Notice 2016-19; MSRB RTRS Users Manual; MSRB dealer data web site: https://www.msrb.org/RTRS-Users-Manual]

Responsibility	• Designated Supervisor
Resources	• Trade data • MSRB dealer data and other available reports • RTRS alerts of unmatched or DK trades • MSRB customer report edit register
Frequency	• Weekly and monthly review of sampling of MSRB or clearing firm data or reports
Action	• Review MSRB data to determine accuracy of clearing firm's reporting which may include: ○ Uncompared trades ○ Invalid trade time ○ Compared trades deleted or withheld ○ Input errors ○ Ineligible trade records ○ Late reports ○ Canceled and amended trades • When patterns of errors are detected, contact the clearing firm to determine what

	corrective action will be taken
Record	• Initials and date reviewed on clearing firm, MSRB or other reports or data; notations of action taken where appropriate

Inter-dealer and customer municipal transactions are submitted to KCD's clearing firm for reporting transactions in municipal securities to the MSRB's Real-Time Transaction Reporting System (RTRS).

21.16.10.1 Time Of Trade Reporting

[MSRB Rule G-14; RTRS Users Manual: http://www.msrb.org/RTRS-Users-Manual]

Transactions in municipal securities are required to be reported to the MSRB within 15 minutes of the Time of Trade to an RTRS (Real-time Transaction Reporting System) Portal with some exceptions included in Rule G-14(a)(ii). The RTRS Manual should be consulted for details regarding portal reporting requirements.

Fictitious Reports

[MSRB Rule G-14(a)]

Reports of transactions must represent bona-fide purchases or sales. No dealer may report a trade that it knows or has reason to know is fictitious or misleading.

21.16.10.2 Step Outs

[MSRB Notice 2005-22, 2004-09 and 2003-20; Notice on Certain Inter-Dealer Transfers of Municipal Securities: Rules G-12(f) and G-14 dated June 4, 2004]

A "step out" is the delivery of securities between dealers that is not the result of a purchase-sale transaction between those dealers, *i.e.,* delivery of securities to satisfy an investment adviser allocation instruction or transfer of assets between two DTCC accounts of a dealer. The Firm has the obligation to ensure step outs are designated properly for G-14 and comparison reporting purposes to prevent the inadvertent reporting of a purchase/sale transaction that did not, in fact, occur. Incorrect designation of step outs is a violation of G-12 on comparisons and G-14 on trade reporting.

21.16.10.3 System Outages

[MSRB Notice 2012-49]

If KCD experiences a system outage or other technology-related problem that affects the ability to comply with MSRB transaction reporting rules or other reporting requirements such as current interest rates and documents for certain variable rate securities to the MSRB Short-term Obligation Rate Transparency System or information or documents about new issues filed with EMMA, the outage will be reported online through KCD's MSRB Gateway account.

21.16.11 Inventory Positions

KCD does not maintain an inventory.

21.16.12 Short Positions

[FINRA Regulatory Notice 15-27]

Short positions may occur when trading activity inadvertently results in creating a firm short position or when the Firm fails to receive securities it purchased to fill a customer's municipal securities order. These occurrences may affect the tax exempt status of a customer's municipal securities interest if the securities become a short position. The customer may receive substitute interest which could be taxable.

If a short position occurs where a customer has purchased the municipal securities in question, the following procedures will be followed by the designated supervisor:

- The short position will be evaluated to determine whether the customer's tax-free interest is in question.
- The customer will be notified and offered the opportunity to cancel the order and substitute for a different municipal security.
- A record of the short position and corrective action will be maintained.

21.16.13 Prohibited Activities

Responsibility	• Designated Supervisor
Resources	• Trading reports • Observation of traders' activities
Frequency	• Ongoing
Action	• Take corrective action depending on the nature of the prohibited activity
Record	• Trading Dept. files and/or the Trading Manager's Log

Improper Use of Assets

[MSRB Rule G-25]

Rule G-25 provides general prohibitions applicable to municipal securities transactions as well as other types of securities and accounts. The following summarizes the prohibitions under G-25:

- No improper use of municipal securities or funds held on behalf of someone else
- No guarantees against loss
- No sharing by employees, indirectly or directly, in the profits or losses of a customer's account

The chapter *GENERAL EMPLOYEE POLICIES* includes similar prohibitions and limitations on activities.

21.16.13.1 Market Manipulation

[SEC Securities Exchange Act of 1934 Rule 10b-3]

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.

21.17 Gifts, Offering Expenses, And Sales Contests

[MSRB Rule G-20; MSRB Notice 2020-13]

Responsibility	• Designated Supervisor
Resources	• Requests to give gifts
Frequency	• As required
Action	• Review and approve or disapprove gift requests • Maintain record of gifts
Record	• Record of gift requests and gifts given

21.17.1 Introduction

Gifts relating to KCD's business are limited to $100 per year per person. Employees are required to notify Compliance of gifts relating to customers or prospective customers prior to giving the gift. Other guidance regarding gifts is included at the end of Rule G-20. Also refer to *Gifts, Gratuities And Entertainment* in the chapter *GENERAL EMPLOYEE POLICIES*. Sales contests, sales quotas, bonuses, and non-cash compensation based on the sale of specific securities or securities types within a limited period of time are not permitted. These activities must be consistent with the applicable requirements of Regulation Best Interest.

21.17.2 Sales Contests

[MSRB Rule G-20.20]

When a municipal securities broker or dealer sponsors a contest and provides gifts or payments to employees of a different broker-dealer, certain requirements apply **prior to** conducting the contest. The sponsoring dealer must obtain a written agreement between the employing broker-dealer and the person who will perform services subject to the contest including the nature of proposed services, amount of proposed compensation, and the written consent of the person's employer.

All proposed contests must be submitted to Compliance for review and approval. Refer to the section *Conflicts Of Interest* in the chapter *REGULATION BEST INTEREST (BI)* for details regarding conflicts involving compensation.

21.18 Political Contributions

[MSRB Rule G-37 and G-37 Q and A; MSRB Interpretive Guidance: https://www.msrb.org/Rules-and-Interpretations/MSRB-Rules/General/Rule-G-37?tab=2#_A9C7E7CB-8A9C-43EF-ACC7-372370BAF4CB; SEC Risk Alert: http://www.sec.gov/news/press/2012/2012-173.htm]

Responsibility	• Designated Supervisor
Resources	• Requests to make political contributions • Quarterly certifications
Frequency	• As required (*requests*) • Quarterly (*certifications and filing G-37 report*)
Action	• Review requests and determine permissibility • Identify municipal securities professionals covered by Rule G-37 • Maintain list of current municipal securities professionals • Request quarterly certifications from municipal securities professionals • Prepare and file Form G-37 • Notify appropriate department managers if KCD's activities must be restricted • Contact Compliance to determine corrective action if prohibited activities using Firm resources are identified

Record	• Compliance maintains files for:
	  ○ Requests and responses
	  ○ Quarterly certifications
	  ○ Quarterly reports
	  ○ List of municipal securities professionals
	  ○ Restrictions, if appropriate

21.18.1 Introduction

MSRB Rule G-37 specifies restrictions and requirements regarding political contributions to individuals who may influence the placement of municipal securities business as defined in the rule. The purpose of the rule is to sever any connection between political contributions and the awarding of municipal business. The rule does not prohibit political contributions; it does, however, prohibit KCD from engaging in municipal business for two years with any issuer where contributions subject to this rule are made. Because KCD does not want to be subject to a two-year restriction on its municipal business, employees are required to adhere to the requirements of the rule.

Because the rules are extensive and there may be different interpretations depending on the circumstances, it is important to consult with Compliance regarding any questions about the effect of the rule.

21.18.2 Summary Of Key Requirements

Some of the key requirements that apply to KCD and KCD employees are summarized below.

- The types of public finance business included in this rule are acting as a negotiated underwriter (as manager or syndicate member), financial advisor or financial consultant, placement agent, and negotiated remarketing agent.
- The rule applies to contributions made by KCD, any PAC controlled by KCD, public finance professionals, municipal traders and professionals, KCD's executive committee, and anyone deemed to be a Municipal Finance Professional (MFP) as defined in the rule.
- Political contributions by KCD or affected employees must be cleared through Compliance prior to making the contribution.

- "Contributions" are defined by rule and the recipient of contributions ("official of the issuer") is also defined. Some minimal contributions ($250 or less) by affected employees who are contributing to officials for whom they may vote are excluded from the rule.
- KCD and its employees are prohibited from soliciting others to make contributions to an official of an issuer.
- Employees are prohibited from using Firm resources (phones, email, computers, office space, *etc.*) for political activities subject to Rule G-37. This includes (but is not necessarily limited to) fund-raising; drafting speeches or fund-raising solicitations, writing campaign memoranda, contracts, letters, talking points, position papers, and responses to issues; approving campaign invoices and expenditures.
- KCD, its municipal finance professionals (MFPs), and affiliates are prohibited from soliciting any person or political action committee (PAC) to make or coordinate contributions to an official of an issuer with which KCD is engaged in business, or is seeking to engage in business.
- KCD will be required to maintain internal records of affected employees and their contributions and report quarterly to the MSRB.
- KCD cannot pay compensation for soliciting municipal business to anyone who is not affiliated with KCD (see the prior section *Solicitation Of Municipal Securities Business*).

21.18.3 Definition Of Municipal Securities Business

The types of business subject to the rule include acting as a negotiated underwriter (as manager or syndicate member), financial advisor or financial consultant (on a negotiated underwriting), placement agent, and negotiated remarketing agent. The rule does NOT apply to acting as a competitive underwriter or competitive remarketing agent. Note that if KCD engages a consultant to secure municipal business, the consultant's contributions will affect KCD's ability to handle municipal business on behalf of the issuer. "Seeking to engage in municipal securities business" is also included under the rule and includes responding to Requests for Proposals, making presentations of public finance capabilities, and other soliciting of business with issuer officials.

21.18.4 Definition Of Municipal Finance Professional

Municipal finance professionals subject to political contribution limitations and reporting requirements include (other than employees whose functions are solely clerical or ministerial) employees engaged in:

- municipal securities representative activities (including sales, except that sales to natural persons are NOT included)
- underwriting or trading
- financial advisory or financial consultant services for municipal issuers
- research or investment advice regarding municipal securities
- soliciting municipal securities business as defined in this section
- supervision of the above activities
- acting as CEO or a similar position
- serving on a dealer's executive or management committee

RRs who sell municipal securities to individual investors are not included in this definition or the restrictions on political contributions.

21.18.5 Definition Of Non-MFP Executive Officer

Non-MFP Executive officer is defined as an employee who is NOT deemed a municipal finance professional and is in charge of one of KCD's principal business units, division or department or an employee who performs similar policy making functions for KCD. For purposes of this definition, a "principal" business unit, division or department will be defined as one that generates more than 5% of KCD's annual revenues.

For purposes of MSRB Rule G-37, Non-MFP Executive Officers are required to report their political contributions but their contributions would not result in a prohibition on municipal securities business.

21.18.6 Types Of Contributions Included

The following types of contributions made by KCD or affected employees are subject to the Rule. Those excluded are also explained below.

- "Contributions" include any gift, subscription, loan, advance, or deposit of money or anything of value made: (i) for the purpose of influencing any election for federal, state or local office; (ii) for payment or reduction of debt incurred in connection with any such election; or (iii) for transition or inaugural expenses incurred by the successful candidate for state or local office. "State" includes any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Contributions also include those made to bond ballot campaigns which typically occur as a result of a state or local government placing a ballot measure before voters to approve specified municipal borrowing.
- Contributions to an "official of an issuer" are subject to the rule. An "official of an issuer" is defined as any incumbent, candidate or successful candidate for elective office of the issuer, which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business. This includes any issuer official or candidate (or successful candidate) who has influence over the awarding of municipal securities business so that contributions to certain state-wide executive or legislative officials (including governors) would be included within the rule.
- Indirect contributions by affected employees are also subject to the rule, including contributions to a local political party who is soliciting contributions to specifically support an issuer official.
- Specifically excluded from this requirement are contributions by municipal finance professionals that do not exceed, in total, $250 to each official, per election, but only if the municipal finance professional is entitled to vote for such official. The MSRB has defined "entitled to vote" to mean the municipal finance professional's principal residence is in the locality in which the issuer official seeks election.
- The definition of "contribution" does not restrict the personal volunteer work of municipal finance professionals in political campaigns other than soliciting or coordinating contributions. However, if the resources of KCD are used (a political position paper is prepared by KCD personnel, KCD supplies or facilities are used, *etc.*) or expenses are incurred by a municipal finance professional in the course of the volunteer work, the value of the resources or expenses would be considered a contribution and could trigger the restriction on business.

21.18.7 Contributions Subject To Political Contribution Limitations And Reporting

Covered contributions include those by KCD, any PAC controlled by KCD, and by municipal finance professionals listed above. The rule does NOT apply to other employees, provided that contributions are not made for the purpose of inducing or influencing the obtaining or retaining of public finance business from an issuer.

21.18.8 Look-Back And Look-Forward Provisions

[MSRB Rule G-37(b)(ii)(B)]

Individuals who are employed as municipal finance professionals are subject to rules requiring a "look-back" at their political contributions prior to joining KCD. Prior contributions to issuer officials may restrict KCD's ability to do municipal securities business with that issuer until the "look-forward" period has expired. At the time of hire, new municipal finance professionals will be asked to provide information regarding contributions during the look-back period, and the designated supervisor will determine whether restrictions will apply. The individuals affected and the periods are:

Person Affected	Look-Back	Look-Forward
MFPs primarily engaged in municipal securities representative activities (trading or underwriting, financial advisory or consultant services for municipal issuers)	2 years	1 year
Those soliciting municipal finance business for KCD	2 years	1 year
Supervisors and management-level MFPs	6 months	1 year

21.18.9 Approval

Responsibility	• Designated Supervisor
Resources	• Requests from employees to make contributions • Proposed firm or firm-controlled PAC contributions
Frequency	• As required
Action	• Review proposed contributions for compliance with Rule G-37
Record	• Requests and approval and/or action taken are retained by Compliance

Political contributions by KCD, a firm PAC or an MFP or MAP to officials of issuers, PACs, or political parties must be cleared through the designated supervisor prior to making the contribution. In addition, any political activities by MFPs or MAPs (volunteer work, *etc.*), on behalf of an official of an issuer, must be cleared through the designated supervisor prior to participation.

21.18.10 Prohibited Solicitations And Activities

[MSRB Notice 2005-50]

KCD, its MFPs and MAPs, and any affiliate may not solicit others, including employees, family members, PACs, and any others outside KCD, to make contributions to an official of an issuer with whom the dealer engages or is seeking to engage in municipal securities business, or to coordinate such contributions. This includes a prohibition against soliciting a person or PAC to make or coordinate a payment to a political part of a state or locality where KCD is engaged, or seeking to engage, in municipal securities business. With regards to family members, contributions made from a joint checking account are attributable to the employee regardless of who signs the actual check.

KCD, MFPs and MFAs may not engage in fund-raising activities for officials of issuers.

21.18.10.1 Prohibited Indirect Payments

G-37 prohibitions also extend to "housekeeping," "conference," or "overhead" type political party accounts. KCD, its PAC, MFPs, MAPs, or Non-MFP or Non-MAP Executive Officers cannot contribute indirectly to officials of issuers through these types of accounts when they are prohibited from such contributions directly. Making such contributions, with instructions accompanying the payment that the specific payment is not to be used for the benefit of an official of an issuer, does not ensure the contribution complies with G-37.

21.18.11 G-37 Records To Be Maintained By The Firm

KCD is required to maintain information in its files identifying affected employees and the states in which the dealer is engaged or is seeking to engage in municipal securities business; issuers with whom KCD is doing and has done business for the past 2 years; and all contributions made to issuer officials subject to Rule G-37, including contributions of affected employees, KCD, and any PAC controlled by KCD. This does not include the minimal $250 contributions allowed under the rule. This will be an internal record subject to scrutiny by regulatory authorities. Records are also not required for affiliate companies and their employees, spouses of covered employees, or any other person or entity unless the contributions were directed by persons or entities subject to Rule G-37. These records will be retained for six years per MSRB Rules G-8 and G-9.

21.18.12 Quarterly Report

KCD will file Form G-37 by the last day of the month following each calendar quarter (January 31, April 30, July 31, and October 31), as required. KCD is not required to file a report under the No Business Exemption of MSRB Rule G-37 for the calendar quarter if:

- KCD has not engaged in municipal securities business; and
- there are no reportable political contributions to issuer officials or payments to state and local political parties.

The following procedures apply:

- The designated supervisor is responsible for determining if a report is required or whether the No Business Exemption obviates the need for filing.
- Employees subject to political contribution reporting will complete a quarterly certification regarding their contributions during the quarter to be reported.
- Form G-37 will be completed and signed by the appropriate supervisor.
- Two copies will be sent to the MSRB by certified or registered mail or by some other method where a receipt of sending is retained or required. G-37 information will be submitted electronically.
- A copy of the signed form and proof of sending is retained in a file for Form G-37.

21.19 Issuer-Directed Charitable Contributions

[MSRB 1994 FAQ on MSRB Rule G-37]

Dealers and municipal advisors are sometimes asked by issuers or their officials to make donations to charitable organizations. While this is not considered a political contribution, other obligations may be triggered:

- Rule G-17 requires underwriters in a negotiated underwriting to disclose actual or potential material conflicts of interest. If the contribution is made to secure the municipal securities business, disclosure would be required.
- Rule G-42 prohibits municipal advisors from making payments to obtain or retain an engagement.
- A directed donation to a charity may be considered an indirect gift or gratuity under Rule G-20 which limits these activities to $100.

Any such requests should be cleared with Compliance prior to making a contribution.

22 GOVERNMENT SECURITIES

This chapter outlines general requirements when offering government securities to customers.

22.1 Government Securities Act Amendments Of 1993

The original Government Securities Act was limited in scope. The amendments of 1993 gave authority to the SEC to oversee certain aspects of the governments markets and imposed requirements on broker-dealers selling government securities. This section summarizes key sections of the amendments.

22.1.1 Sections 102, 105, and 106 - Rulemaking Authority

These sections grant regulators the authority to establish rules governing the sale of government securities.

22.1.2 Section 103 - Transaction Records

KCD is obligated to prepare and maintain records regarding its government securities transactions. Books and records requirements are included in the chapter *FINANCIAL AND OPERATIONS PROCEDURES*.

22.1.3 Section 104 - Large Position Reporting

The designated supervisor is responsible for ensuring large position reports are filed with the Treasury Department as required.

22.1.4 Section 107 - Market Information

Regulators are directed to provide for timely dissemination of market information about government securities.

22.2 Sales

Responsibility	• Designated Supervisor
Resources	• Order records • Transaction reports
Frequency	• Daily
Action	• Review transactions for appropriate markups/markdowns, suitability of

	transactions • Contact trader or RR for questioned transactions • Take correction action which may include adjusting the trade, conferring with Compliance, or other appropriate action
Record	• Initials and date reviewed on available transaction reports or order records; notations of action taken where appropriate • Notations in Daytimer or supervisor's log

The general sales practice procedures included in the chapters *ACCOUNTS* and *ORDERS* apply to the sales of government securities. Also refer to the chapter *COLLATERALIZED MORTGAGE OBLIGATIONS (CMOs)* for specific policies affecting CMOs.

22.3 Mark-Up Policy

[FINRA Rule 2121]

Responsibility	• Designated Supervisor
Resources	• Orders • Trading reports
Frequency	• Ongoing (Traders) • Spot-check (Compliance)
Action	• Traders: ○ Ensure mark-ups and mark-downs are within general Firm guidelines ○ For mark-ups and mark-downs that are outside guidelines, include a written justification on the order record • Compliance review mark-ups and mark-downs that exceed general Firm guidelines: ○ Review order records for written justification (*e.g.,* yields on comparable securities) ○ Notify Trading Manager of missing justifications and request correction of the deficiency ○ Confer with Trading Manager regarding orders where justification does not seem warranted
Record	• Order records maintained by the Trading Dept. • Trading reports including initials of reviewer and review notes, if any, maintained by Compliance • Compliance reviews and action taken

The Firm has an obligation to provide customers with fair prices on government securities transactions. Considerations in determining the fairness of mark-ups and mark-downs include:

- The type of security
- The availability of the security in the market
- The price of the security
- The amount of money involved in the transaction

- Disclosure to the customer
- Pattern of mark-ups
- The nature of the Firm's business

The following is FINRA's Mark-Up Policy for debt securities, excluding municipal securities.

22.3.1 Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. The presumptive prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with FINRA pricing rules. (See, *e.g.,* Rule 5310).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is buying the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous sales in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where:

- interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing;
- the credit quality of the debt security changed significantly after the dealer's contemporaneous transaction; or
- news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction.

(5) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described under *Prevailing Market Price*, sub-paragraph (4), a member must consider, in the order listed, the following types of pricing information to determine prevailing market price:

a. Prices of any contemporaneous inter-dealer transactions in the security in question;
b. In the absence of transactions described in (a), prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security; or
c. In the absence of transactions described in (a) and (b), for actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

[A member may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (*e.g.,* a member may consider pricing information under (b) only after the member has determined, after applying (a), that there are no contemporaneous inter-dealer transactions in the same security). In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (*i.e.,* either a particular transaction price, or, in (c) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (*i.e.,* such as whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction and timeliness of the information).]

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a "similar" security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a "similar" security with institutional accounts with which any dealer regularly effects transactions in the "similar" security with respect to customer mark-ups (mark-downs);
- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (*i.e.,* whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

(7) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, FINRA or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (*e.g.,* discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (*e.g.,* coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(8) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of "similar" securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" securities taken as a whole.

(9) "Customer" does not include a qualified institutional buyer ("QIB") as defined in Rule 144A under the Securities Act of 1933 that is purchasing or selling a non-investment grade debt security when the dealer has determined, after considering the factors set forth in Rule 2111(b), that the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction. "Non-investment grade debt security" means a debt security that:

- if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated lower than one of the four highest generic rating categories;
- if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by any of the NRSROs; or
- if unrated, either was analyzed as a non-investment grade debt security by the dealer and the dealer retains credit evaluation documentation and demonstrates to FINRA (using credit evaluation or other demonstrable criteria) that the credit quality of the security is, in fact, equivalent to a non-investment

grade debt security, or was initially offered and sold and continues to be offered and sold pursuant to an exemption from registration under the Securities Act of 1933.

22.3.2 "Similar" Securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar" to the subject security may be determined by factors that include but are not limited to the following:

- Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (*e.g.,* changes to ratings outlooks));
- The extent to which the spread (*i.e.,* the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;
- General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and
- Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

22.4 Government Sponsored Enterprise (GSE) Distributions

Responsibility	• Designated Supervisor
Resources	• Agreements with GSEs • Master Agreements • Records of orders
Frequency	• As required when participating in an offering
Action	• Complete agreements or other documents required by GSE, if applicable • Execute Master Agreements, when applicable • Designate contact persons responsible for distributing printed documents and/or access to electronic versions • Obtain and distribute offering documents in accordance with Guidelines • Provide offering documents to REMIC purchasers for the period up to 120 days after settlement (including secondary market transactions)

	• Provide training to RRs regarding distributions of GSEs, required documents
Record	• Distribution report • Records of compliance with Primary Dealer GSE requirements (if applicable) • Master Agreements • Designation of contact persons • Record of to whom offering documents are provided • Order records for all purchases and unfilled orders • Records of training including how conducted, when occurred, materials used, who attended/received materials

GSEs are quasi-governmental organizations that are corporate entities created under U.S. law. GSEs are instrumentalities and not agencies of the U.S. As such, they are privately owned institutions not subject to U.S. general management laws and regulations and are supervised but not directly managed by the federal government. They primarily act as financial intermediaries to assist borrowers in housing and agriculture. GSE securities are not guaranteed by the federal government.

The term "securities" in this section refers to securities issued by GSEs.

22.4.1 Definitions

Following are selected definitions for terms used in this section. Other definitions (and expanded definitions of the following terms) are included in SIFMA's *Guidelines on Delivery of Offering Materials Relating to GSE Securities*.

Distribution period: The period of time when a dealer acts as underwriter or offers or sells securities constituting the whole or a part of an unsold allotment to distribution participants. With respect to the sale of a Single Class Security or Mortgage-Backed Security by a dealer, the later of (a) 90 days following issue date or (b) the end of the period in which the dealer is acting as underwriter.

Issue date: For any Single-Class Security or Mortgage-Related Security, the first day of the calendar month that includes the settlement date for the initial issuance of the security.

Notice of offering: A notice provided by the Principal Dealer to offerees of securities regarding the availability of offering documents and how they may be accessed.

Notice of sale: A notice prepared by the Principal Dealer to purchasers of securities regarding offering documents.

Principal Dealer: Any dealer acting as (i) an underwriter; (ii) a member of a primary selling group; (iii) an agent for the issuer under any selling agreement with the issuer; or (iv) a dealer engaged in a swap with the issuer in exchange for Mortgage-Related Securities under an agreement. If the issuer specifies that only one dealer should contact the issuer regarding offering documents, then that dealer is the only Principal Dealer.

22.4.2 Master Agreements

KCD, as underwriter, will require other dealers selling GSE securities during the distribution period to execute a Master Agreement where the dealer agrees to provide offering documents in accordance with the *Guidelines*.

When KCD executes a Master Agreement with a dealer that sells securities to it, KCD will comply with all requirements regarding delivery of offering documents.

22.4.3 Delivery Of Offering Materials

[SIFMA Guidelines on Delivery of Offering Materials Relating to GSE Securities: https://www.sifma.org/wp-content/uploads/2017/08/GSE_Guidelines-on-Delivery-of-Offering-Materials-Relating-to-GSE-Securities-2011.pdf]

The delivery of offering documents will comply with SIFMA's *Guidelines on Delivery of Offering Materials Relating to GSE Securities*. This includes the following:

- If acting as Principal Dealer:
    - Request that the issuer or its agent deliver to KCD (and to other dealers, if the issuer agrees to deliver to other dealers) a specific number of printed offering documents. The issuer may deliver an electronic version in lieu of printed copies.
    - Deliver to the dealers to whom it sells securities during the distribution period the requested number of documents unless the issuer delivers them directly.
- Request from the Principal Dealer an adequate number of offering documents to provide to purchasers and others who request documents.
- During the distribution period, deliver the Notice of Offering to each offeree who requests documents and the Notice of Sale and confirmation (which may be the same document) to each purchaser and a copy of the offering documentation to any offeree or purchaser who requests a copy. If a confirmation is sent before all information required to be included in the Notice of Sale is available, the confirmation will note (if the offering documentation was not previously provided) that a Notice of Sale will be sent promptly when the information is available.
- KCD will designate one or more contact persons as responsible for providing electronic access to offering documents and distribution of printed materials and notify other dealers with whom it does business.
- For all new issues of REMICs, whether or not KCD participates in the underwriting, KCD will provide purchasers with offering documents for the period up to 120 days after settlement. This includes secondary market transactions in the new issue for the 120-day period.

22.4.4 Order Records

All orders must be recorded including identification of the customer and the date and time the order was entered. Records of orders must be retained whether or not the order is filled.

22.4.5 No Assurance Of Execution

There is no assurance that an order submitted to purchase a GSE security in distribution will be executed. At the time orders are entered, customers should be advised, if they are not already familiar with GSE distribution orders, that there is no assurance their order will be executed.

22.4.6 Distribution Report

KCD will prepare a distribution report identifying the allocation of orders and purchasers.

22.4.7 Single Class TBAs

Confirmations sent during the distribution period for single class TBAs will include a notation that "Additional pool information is available to each purchaser by telephoning *[issuer's phone number]* or by emailing *[issuer's email address]*."

22.5 Trading

22.5.1 Fair Prices

Traders 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.

22.5.2 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 KCD 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 KCD's business
- any other relevant facts at time of execution

22.5.3 Commissions On Agency Transactions

The designated supervisor is responsible for reviewing the reasonableness of commissions on agency transactions on a daily basis when a trade occurs. 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 KCD
- the amount of any other compensation received by KCD in connection with the transaction
- factors considered in principal transactions
- any other relevant factors at the time of execution

22.5.4 Best Execution

Transactions in government securities are subject to best execution requirements, taking into account characteristics such as liquidity. Execution factors priority include:

1. Price
2. Size

3. Speed
4. Costs
5. Likelihood of execution and settlement
6. Any other consideration relevant to the execution

Price will normally be the most important execution factor. Size is a matter of priority where an order is sufficiently large, depending on availability, to have an impact on the security. Likelihood of settlement will be a factor where there is an extended settlement date.

Also refer to the section *Best Execution* in the chapter *CORPORATE FIXED INCOME SALES AND TRADING*.

22.5.5 Inventory Positions

KCD does not maintain inventory positions.

22.5.6 Review Of Transactions

The designated supervisor is responsible for daily review of transactions executed in government securities trading area(s).

22.6 Transaction Records

[GSA Section 103; SEC Securities Exchange Act of 1934 Section 15C(d)(3)]

Records of government securities transactions will be provided to the SEC or other appropriate regulator upon request, in a form acceptable to the regulator. A record will be retained of transaction information provided to regulators.

22.7 Large Position Reporting

[GSA Section 104; SEC Securities Exchange Act of 1934 Section 15C(f)]

Periodically, the Treasury Department asks government securities dealers to provide information on large positions in specific issues of government securities. The designated supervisor (or someone delegated by the supervisor) is responsible for compiling the information and submitting it to the Treasury Department by the date due. Records of all reports filed will be retained in the supervisor's files.

A sample of the Large Position Report is available at:

http://www.treas.gov/press/releases/docs/FormulaSampleReport.doc

22.8 Prohibited Activities

Prohibited activities can be viewed in Chapter 15 - Orders: Prohibited Transactions.

23 CORPORATE FIXED INCOME SALES AND TRADING

23.1 Order Entry/Quotation Controls

The Firm (or its clearing firm) has established controls to prevent the entry of orders that:

- exceed appropriate pre-set credit or capital thresholds
- exceed a customer's trading limit
- appear to be erroneous including duplication of orders
- do not include all required conditions of the order (price, quantity, security, *etc.*)
- on an order-by-order or quote-by-quote basis the entry of erroneous and/or duplicate orders/quotes by rejecting those that exceed short period time checks
- entry of orders/quotes to market centers before satisfying all pre-trade regulatory requirements, on a pre-trade/quote basis
- the customer is restricted from trading
- is a short sale without the required verification the security may be borrowed
- other controls if determined necessary

Erroneous order/quote validations will take place immediately prior to submission.

23.1.1 Post Order-Entry Controls

The Firm (or its clearing firm) has established post-entry order controls that:

- identify trades or patterns of trading that may violate firm or regulatory rules or policy
- identify post-trade execution reports including those provided by other members to ensure post-trade execution reports via market access are provided to the proper parties for review in a timely fashion
- other controls if determined necessary

23.1.1.1 Authorized Access

Access to trading systems and technology is only available to employees and customers pre-approved and authorized by the Firm. This includes:

- Obtaining written contracts with broker/dealer customers meeting regulatory requirements over which control is being allocated
- Vetting and approving employees (including non-trading personnel) and customers
- Physically securing access to trading systems or technology including limited access to terminals and assigning of passwords that are periodically changed and validation of identity
- Establishing procedures for code deployment and testing prior to initiation of trading

References to "suitability" do NOT apply to recommendations subject to Regulation Best Interest (SEC Rule 15l-1). Regulation BI applies only to recommendations to "retail customers." Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

23.2 Fair Prices

[FINRA Rule 2121]

Traders 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.

23.3 Quotations

[Exchange Act Rule 15c2-11; SEC Release No. 34-98819; SEC letter to FINRA dated November 30, 2022: https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-113022.pdf]

Exchange Act Rule 15c2-11 requires broker dealers to review information and retain information prior to initiating or resuming quotations in the OTC market. This applies to quotations submitted to a quotation medium other than a national securities exchange. Securities sold under the safe harbor of Rule 144A fixed income securities are exempt from this requirement.

The SEC has adopted a temporary position (expiring January 4, 2025) of no enforcement if the BD has met the criteria in Appendix A to the letter included in rule cites above.

23.4 Best Execution

[FINRA Rule 5310.03; SIFMA Best Execution Guidelines for Fixed-Income Securities: https://www.sifma.org/resources/general/best-execution-guidelines-for-fixed-income-securities/]

Responsibility	• Designated Supervisor
Resources	• Order records including supporting information such as screenshots • Technology, as available • Regulators' reports, if available
Frequency	• Quarterly
Action	• Review transactions to identify: 　○ Outlying prices away from executions in the same or similar securities in reasonable proximity (consider changing market conditions) 　○ Cancels/rebills 　○ Unusual concentrations with particular customers 　○ Reasonableness of executions considering technology reports providing post-trade market transaction data, models for pricing (if available) • Evaluate the execution quality of venues used and, if available, assess whether other venues not currently accessed may provide the opportunity for best execution, particularly for retail order flow • Compare the quality of customer executions via current order routing and execution arrangements (including executing against orders as principal) to the quality of the executions that could be obtained from competing markets • Periodically consider whether incorporating pricing information available from electronic trading platforms should be incorporated into best execution reviews • When using auto-execution systems, these systems should routinely analyze information from other systems that offer bona fide, executable prices and

	determine whether those systems should be incorporated into best execution reviews
Record	• Order records and/or reports with notations indicating review and action taken, if any

The concept of "best execution" is somewhat different in the fixed income market vs. the equity market. Fixed income securities have a more fragmented market with fewer participants, no central market, and limited published quotations. The Firm has an obligation to determine it is using reasonable methods to provide best execution to customers. FINRA Regulatory Notice 15-46 provides an extensive discussion of fixed income best execution obligations including examples.

Traders have an obligation to determine a fair price by considering the following factors when pricing a debt transaction.

- Accessibility of quotations (either dollar [or other currency] pricing or yield pricing). Quotations may be "indicative" quotes only, indicating a quote relevant for only a short time or interest in buying or selling a particular issue to solicit bids or offers
- The availability of pricing of recent sales in the same, similar, or benchmark securities (*i.e.,* TRACE for corporate bonds)
- Review of multiple market venues, if they are available
- Character of the market for the security itself including an analysis of price, volatility and relative liquidity
- Contact with other dealers
- The liquidity of the bonds
- Size of the transaction
- Internal capabilities to execute large blocks vs. smaller blocks that may not fill an order
- Reasonable mark-ups/mark-downs as discussed in the next section
- The customer's instructions and expectations

Copies of screenshots should be included with orders when available to document pricing.

23.4.1 Extreme Market Conditions

When there are extreme market conditions (*e.g.,* a shortage of liquidity and divergent prices during periods of significant rating changes or interest rate movements), the following apply:

- Treatment of customer orders must remain fair, consistent and reasonable.
- Any changes to trading protocols should be reviewed by the supervisor to consider the facts and circumstances of market conditions and any changes needed.
- Any revised order handling procedures during extreme market conditions will be disclosed to customers outlining the differences from normal market conditions and when revised procedures will be activated.

23.4.2 FINRA Guidelines

The following summarizes guidelines published by FINRA; see Regulatory Notice 15-46 for more detailed information.

- Consider whether any material differences in execution quality exist among the markets trading the security.
- Consider what procedures they use or would use for executing the same or similar transactions for their own firm accounts, even if such procedures are not required to be the same.

- A firm that routinely routes a customer order to multiple trading centers (internal or external) should regularly review the execution quality that results from this practice.
- A firm that limits its review of execution quality only to those markets to which it currently routes customer order flow without considering competing markets would not satisfy the duty of best execution. Accordingly, the firm must compare the quality of the executions it is obtaining via current order routing and execution arrangements (including the internalization of order flow) to the quality of the executions that it could obtain from competing markets.
- Some firms may employ "filters," which generally refers to automated tools that allow the firm to limit its trading, with, for example, specific parties or parties with specified attributes with which it does not want to interact. If a firm uses filters on counterparties or filters on specific securities intended to limit accessing bids or offers in those securities, they may be used only for a legitimate purpose consistent with obtaining the most favorable executions for customers, and should be reviewed on a periodic basis and adjusted as needed.
- A firm must take into account market and technology changes that might alter its best execution analysis.
- With respect to customer limit orders for equity securities, a firm must consider any material differences in execution quality (*e.g.,* the likelihood of execution) among the various markets to which orders may be routed.
- An introducing firm may rely on the executing firm's regular and rigorous review of execution quality for any security, so long as the executing firm fully discloses the statistical results and rationale of its review to the introducing firm, and the introducing firm reviews both the methodology and the results of that review.
- Access fees charged by venues and payment for order flow cannot interfere with the firm's obligation to provide best execution. Decisions regarding using venues with access fees and receiving payment for order flow must be made in the context of reviewing all venues/markets for best execution.
- A firm that is handling an unsolicited directed order is not required to make a best execution determination regarding the market of execution beyond the customer's specific instructions. The firm does have an obligation to process the customer's order promptly and in accordance with the terms of the order. If the order is routed to another BD, the receiving BD is obligated to meet best execution requirements. If the firm is unable to route the order per the customer's instructions, the customer must be informed and provided the opportunity to revise or cancel the order.

23.5 Mark-Up Policy

[FINRA Rule 2121]

Responsibility	• Designated Supervisor
Resources	• Orders • Trading reports • FINRA Mark-up/Mark-down Analysis Report
Frequency	• Ongoing (Traders) • Spot-check (Compliance)
Action	• Establish required disclosures that are included on confirmations • Traders: ○ Ensure mark-ups and mark-downs are within general Firm guidelines ○ For mark-ups and mark-downs that are outside guidelines, include a written justification on the order record • Designated supervisor review mark-ups and mark-downs that exceed general Firm guidelines: ○ Review order records for written justification (*e.g.,* yields on comparable

	securities) ○ Notify Trading Manager of missing justifications and request correction of the deficiency ○ Confer with Trading Manager regarding orders where justification does not seem warranted • Compliance: ○ Document functional separation of trading desks, if applicable
Record	• Order records maintained by the Trading Dept. • Trading reports (including FINRA report) including initials of reviewer and review notes, if any • Documentation of functional separation of trading desks (if applicable)

The following is FINRA's Mark-Up Policy for debt securities, excluding municipal securities.

23.5.1 Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. The presumptive prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with FINRA pricing rules. (See, *e.g.,* Rule 5310).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is buying the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous sales in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where:

- interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing;
- the credit quality of the debt security changed significantly after the dealer's contemporaneous transaction; or
- news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction.

(5) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described under *Prevailing Market Price*, sub-paragraph (4), a member must consider, in the order listed, the following types of pricing information to determine prevailing market price:

a. Prices of any contemporaneous inter-dealer transactions in the security in question;
b. In the absence of transactions described in (a), prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security; or
c. In the absence of transactions described in (a) and (b), for actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

[A member may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (*e.g.,* a member may consider pricing information under (b) only after the member has determined, after applying (a), that there are no contemporaneous inter-dealer transactions in the same security). In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (*i.e.,* either a particular transaction price, or, in (c) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (*i.e.,* such as whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction and timeliness of the information).]

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a "similar" security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a "similar" security with institutional accounts with which any dealer regularly effects transactions in the "similar" security with respect to customer mark-ups (mark-downs);
- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (*i.e.,* whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

(7) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, FINRA or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (*e.g.,* discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (*e.g.,* coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(8) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of "similar" securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" securities taken as a whole.

(9) "Customer" does not include a qualified institutional buyer ("QIB") as defined in Rule 144A under the Securities Act of 1933 that is purchasing or selling a non-investment grade debt security when the dealer has determined, after considering the factors set forth in Rule 2111(b), that the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction. "Non-investment grade debt security" means a debt security that:

- if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated lower than one of the four highest generic rating categories;
- if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by any of the NRSROs; or
- if unrated, either was analyzed as a non-investment grade debt security by the dealer and the dealer retains credit evaluation documentation and demonstrates to FINRA (using credit evaluation or other demonstrable criteria) that the credit quality of the security is, in fact, equivalent to a non-investment grade debt security, or was initially offered and sold and continues to be offered and sold pursuant to an exemption from registration under the Securities Act of 1933.

23.5.2 "Similar" Securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar" to the subject security may be determined by factors that include but are not limited to the following:

- Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (*e.g.,* changes to ratings outlooks));
- The extent to which the spread (*i.e.,* the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;
- General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and
- Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

23.5.3 Pricing Disclosure

[FINRA Rule 2232; FINRA Regulatory Notice 17-08; FINRA FAQs: http://www.finra.org/industry/faq-fixed-income-confirmation-disclosure-frequently-asked-questions-faq]

The amount of mark-ups and mark-downs will be disclosed on retail customer confirmations. Two additional disclosures include: (1) a reference (or hyperlink if the confirmation is electronic) to a FINRA web page containing publicly-available trading data for the security traded; and (2) the execution time expressed to the second. Disclosure is required if KCD executes one or more offsetting principal trades in the same security on the same trading day which, in aggregate, meet or exceed the size of the customer trade. Disclosure may also be required because of an offsetting principal trade executed by a Firm affiliate that did not occur at arm's length [defined in FINRA Rule 2232(f)(3)].

Disclosure is not required for principal trades executed on a trading desk functionally separate from a trading desk that executes customer trades. It is also not required for bonds acquired in a fixed-priced offering and sold to non-institutional customers at the same offering price the same day KCD acquires the bonds.

23.6 Crossing OTC Bonds

Responsibility	• Designated Supervisor
Resources	• Order records • Available reports
Frequency	• Daily
Action	• Review crossed bond orders for pricing documentation • Take corrective action if pricing is not documented or appears to be incorrect by consulting with the trader, correcting the price, or other appropriate action
Record	• Reviews of transactions including corrective action, if appropriate

When crossing OTC bonds, the following must be considered:

- Crossing transactions must represent a change in ownership, *i.e.,* bonds may not be crossed between accounts for the same beneficial owner ("wash transaction").
- Determining a fair crossing price involves one or more of the following, **which must be documented on the order record**:
    - The price relates to the current quoted market price for the bonds. Indicate where they are quoted and the quote at the time bonds are crossed.
    - The price is determined from a recent transaction in the security (indicate when and where the transaction took place).
    - The price relates to a recent transaction in a similar bond (maturity, rating, coupon). Indicate the related transaction including description of the bond, when the transaction took place, and the price.
    - Other documentation for determining a fair price to cross the bonds.

23.7 144A Transactions

[SEC no-action letter November 30, 2022: https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-113022.pdf]

Prior to effecting a 144A transaction, the trader must have a reasonable belief that the issuer will provide the Rule 144A information prior to the Rule 144A transaction, upon request. The trader is responsible for documenting the transaction with this information.

23.8 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 and Rebill/Error Report form which requires a designated principal's approval.

23.9 Cancels And Rebills

[FINRA Rule 4515]

Cancellations and rebills in customer accounts are documented on the Cancel and Rebill/Error Report form which requires a designated supervisor's signature.

23.10 Extended Settlements; Delayed Deliveries

[FINRA Rule 11320]

Extended settlements or delayed deliveries are transactions that should be reviewed by the designated trading supervisor. Variances from normal settlement or delivery should be available only to those customers where the supervisor is reasonably confident regarding the customer's ability and willingness to pay or deliver securities on a timely basis.

Any pattern of extended settlements or delayed deliveries with a particular RR or client could indicate a credit problem, potential unauthorized trading or other improper activity and should be investigated. If such a problem is discovered by the supervisor, Compliance is to be notified.

23.11 Inventory Positions

Responsibility	• Designated Supervisor • FINOP
Resources	• Pricing provided by traders • Independent pricing services
Frequency	• Daily

Action	• Designated supervisor:
	  ○ Review daily pricing, marks
	  ○ If pricing appears unreasonable, contact trader and make necessary adjustments
	  ○ Review requests for exceptions to inventory limits and, in consultation with the FINOP, approve or disapprove
	  ○ Provide training to traders on proper pricing
	• FINOP:
	  ○ Establish inventory limits
	  ○ Review daily inventory to confirm compliance with limits
	  ○ If limits exceeded, contact the trader's supervisor; reduce the position or approve an exception; take corrective action (in conjunction with the designated supervisor) which may include restricting the trader's activities, added training for the trader, or other action as appropriate
	• Risk management:
	  ○ Monitor intra-day risk (size, exposure, net buys vs. short positions, *etc.*)

Record	• Inventory limits • Daily pricing of inventory

	• Designated supervisor's review of marks • FINOP review of compliance with inventory limits • Risk management actions when anomalies are detected

KCD has established guidelines for maintaining inventory positions. Traders are responsible for complying with inventory position limits. Exceptions require the approval of the designated supervisor.

23.11.1 Pricing Positions

For positions where automated pricing is unavailable, it is the traders' responsibility to price inventory positions at the end of each trading day. Positions are priced using one or more of the following resources:

- Transactions that day in the security being priced
- If no transactions, transactions in similar securities (rating, maturity, type, *etc.*)
- Index values
- Treasury curve, yield curve changes
- Consideration of overall market
- Conversations with other dealers regarding the market
- Pricing available from Bloomberg, other vendors

Traders should be conservative when pricing positions. Daily pricing of inventory positions is communicated to the FINOP.

23.12 Market Access

[Exchange Act Rule 15c3-5; SEC FAQs concerning market access risk management: http://www.sec.gov/divisions/marketreg/faq-15c-5-risk-management-controls-bd.htm; SEC Small Entity Compliance Guide: http://www.sec.gov/rules/final/2010/34-63241-secg.htm; NASDAQ Rule 4615; Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	• Designated Supervisor
Resources	• Order entry systems • Order data • FINRA report cards
Frequency	• Ongoing: oversight of systems • Daily, weekly, annually: provide reports of orders to supervisors for supervision • Annual: review of risk controls and CEO certification • Monthly: review report cards • Periodically: test market access controls
Action	• Establish pre- and post-order entry controls (such as order entry limits and kill switches) to monitor and respond to aberrant behavior by trading algorithms or other impactful market events • Establish and maintain credit risk controls including: ○ Credit limits/capital thresholds for customers and principal accounts considering the customer's trading patterns and order entry and/or quote history

	- Monitor for compliance with limits and take corrective action when exceeded - Entry of orders/quotes that exceed aggregate credit/capital thresholds - Approval of credit/capital thresholds by appropriate supervisor - Review of sub-limits at each exchange/ATS accessed - Review credit limits periodically - Notify the appropriate supervisor of exceptions/breaches for corrective action - Provide reports to supervisors - Review report cards to identify potential layering and spoofing and take corrective action, when necessary - Conduct review of risk controls - Obtain CEO certification - Provide training to traders including steps and requirements for requesting ad hoc credit limit adjustments - When third-party vendor systems are used (including those of an ATS or exchange): - determine whether the vendor can meet the obligations of the rule and how KCD maintains direct and exclusive control of applicable thresholds - review for independence from their customers and appropriate controls - confirm vendor is able to independently adjust its controls - maintain direct and exclusive control over controls set by the ATS, if applicable - Test market access controls - Where direct market access is provided via multiple systems, employ controls to confirm system records are aggregated and integrated in a timely manner and conduct post-trade and supervisory reviews for potentially manipulative trading patterns
Record	- Reviews of reports - Credit limit approvals and reviews and corrective action taken, if appropriate - Review of third-party vendors - Annual review - Training of traders - Annual certification - Report cards and actions taken

SEC Rule 15c3-5 requires broker-dealers (BDs) with market access, including BDs that provide a customer or any other person with market access through use of the BD's market participant identifier or otherwise, to establish appropriate risk management controls and supervisory systems. These requirements are designed to limit the financial exposure of a BD that could arise as a result of market access, and to ensure compliance with all regulatory requirements that apply to providing market access.

The Rule applies to BDs with market access to trading securities by virtue of being an exchange member, an ATS subscriber, or an ATS operator with non-broker-dealer subscribers. It applies to security-based swaps if they become traded on an exchange and to BDs engaged in proprietary trading.

The Rule prohibits "naked" or "unfiltered" sponsored market access for third parties accessing markets through the BD.

23.13 TRACE

[FINRA Rule 6700 series; FINRA Regulatory Notice 22-12, 16-38, 13-15 and 12-56; FINRA TRACE web site: http://www.finra.org/RegulatorySystems/TRACE/index.htm; TRACE FAQS Reporting Notice /1/13: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p314034.pdf]

Responsibility	• Designated Supervisor
Resources	• TRACE-eligible transactions • Available TRACE reports
Frequency	• Monthly

Action	• If a third-party (such as a clearing firm) is used for TRACE reporting, confirm the agent is reporting as required
	• Review available reports to determine whether trades are properly reported
	• Where exceptions are noted, take corrective action which may include:
	  ○ Conferring with person responsible for input
	  ○ Additional training when necessary
	  ○ If a third party is used to report, contact with appropriate person to obtain assurances regarding corrective action
	• Confirm only authorized persons are accessing TRACE

Record	• Review of third-party reporting, if applicable • Copies of reports reviewed with note of action taken, reviewer's initials, and date reviewed • Review to confirm only authorized persons have access to TRACE

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 and timeframes for reporting.

23.13.1 TRACE Eligible Securities And Reportable Transactions

[FINRA Rule 6710; FINRA Regulatory Notice 16-39, 14-23 and 08-75]

"TRACE-eligible securities" include securities that are:

- U.S. Treasury securities (all securities issued by the Treasury Dept. including separate principal and interest components; savings bonds and U.S. Treasury securities bought in an auction are NOT included)
- U.S. dollar denominated debt securities issued by a U.S. or foreign private issuer (and, if a restricted security, sold under Rule 144A);
- U.S. dollar-denominated foreign sovereign debt securities;
- Hybrid securities (both debt- and equity-like features) as specified by FINRA;
- A debt security that is U.S. dollar-denominated and issued or guaranteed by an Agency or a Government-Sponsored Enterprise (as defined in Rule 6710);
- FDIC-guaranteed debt securities under the federal "Temporary Liquidity Guarantee Program;" **and**
- Asset- and mortgage-backed securities (as broadly defined in FINRA Rule 6710(a) including CMOs, CDOs, CBOs, and other asset-backed securities) [FINRA Rule 6730(a)(3)].

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 also include:

- primary market transactions in TRACE eligible securities
- identification of corporate bond trades where the price of the trade is based on a spread to a benchmark Treasury security that was agreed upon earlier in the day (*i.e.,* a "delayed Treasury spot trade") and report the time at which the spread was agreed upon
- identification of corporate bond trades that are a part of a larger portfolio trade

23.13.1.1 Securities Excluded

[FINRA Regulatory Notice 22-13]

"TRACE-eligible securities" (governed by definitions within the Rule) exclude:

- debt issued by a foreign sovereign
- money market instruments
- eligible ATS transactions that involve only one FINRA member (other than the ATS)

23.13.2 Transaction Reporting

[FINRA Rule 6730; FINRA Regulatory Notice 16-30]

The Firm is obligated to report to TRACE any transactions in the securities subject to TRACE requirements. Refer to FINRA Rule 6730 for details of timeframes for reporting and transaction information to be reported.

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.

Our clearing firm will report transactions to TRACE, per our contract.

23.13.2.1 Transactions Exempt From Reporting

[FINRA Rule 6730(e) and 6732]

The following transactions are not reportable:

- Transfers of TRACE-Eligible Securities for the sole purpose of creating or redeeming an instrument that evidences ownership of or otherwise tracks the underlying securities transferred (*e.g.,* an exchange-traded fund).
- Transactions in TRACE-Eligible Securities that are listed on a national securities exchange, when such transactions are executed on and reported to the exchange and the transaction information is disseminated publicly.
- Transactions where the buyer and the seller have agreed to trade at a price substantially unrelated to the current market for the TRACE-Eligible Security (*e.g.,* to allow the seller to make a gift).
- Provided that a data sharing agreement between FINRA and NYSE related to transactions covered by this Rule remains in effect, transactions in TRACE-Eligible Securities that are executed on a facility of NYSE in accordance with NYSE Rules 1400, 1401 and 86 and reported to NYSE in accordance with NYSE's applicable trade reporting rules and disseminated publicly by NYSE.
- Transactions resulting from the exercise or settlement of an option or a similar instrument, or the termination or settlement of a credit default swap, other type of swap, or a similar instrument.

- Transfers of securities made pursuant to an asset purchase agreement (APA) that is subject to the jurisdiction and approval of a court of competent jurisdiction in insolvency matters, provided that the purchase price under the APA is not based on, and cannot be adjusted to reflect, the current market prices of the securities on or following the effective date of the APA.
- Transfers of TRACE eligible securities to create or redeem instruments such as ETFs.
- A sale from an issuer to an underwriter(s) or initial purchaser(s) as part of an offering, except a sale of an Agency Pass-Through Mortgage-Backed Security from a securitizer (Rule 6710(c)).
- Alternative Trading System (ATS) transactions exempted by FINRA (FINRA Rules 6731 and 6732).

23.13.2.2 Underwriter Obligation To Obtain CUSIP And Provide Notice

[FINRA Rule 6760]

The managing underwriter or group of underwriters of a distribution or offering (excluding a secondary distribution or offering) of a TRACE-eligible debt security must obtain the CUSIP number and report required information to FINRA Operations. Information must be provided to FINRA prior to the execution of the first transaction with exceptions under Rule 6760(c) including same-day pricing/trading and CMO issues.

System Outages

[FINRA Regulatory and Compliance Alert Winter 2000]

System outages involving fixed income transactions and TRACE reporting will be reported to FINRA by e-mail to *bondreporting@finra.org*. The trading supervisor at our clearing firm is responsible for determining whether to report outages and will retain copies of e-mail communications sent to FINRA.

Information To Be Reported

Information that will be reported includes the following:

- the date(s) the system problem occurred;
- the specific systems that were affected (*e.g.,* internal systems, third party vendor system);
- the exact nature of the problem (*e.g.,* complete outage, slow transmission times);
- the time the problem began;
- the time the problem was first detected;
- the time the problem was resolved and a brief description of the resolution;
- the level of activity impacted (*e.g.,* the approximate number of trades not reported) and a description of how the impact will be addressed (*e.g.,* trade reports to be submitted on an "as of" basis the next business day);
- contact name and telephone number; and,
- any additional information deemed relevant.

23.13.3 Time Clock Synchronization

[FINRA Rule 4590]

Responsibility	• Designated Supervisor
Resources	• Clock Synchronization Log

Frequency	• Weekly
Action	• Review Log • Take correction 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. • If a non-member is used to record order times, obtain a current copy of the procedures used by the non-member to ensure their clocks are synchronized • Complete the annual certification by March 15 of each year
Record	• Clock Synchronization Log that records the times when Business Clocks are synchronized and whenever a clock fails to be within the applicable tolerance • Non-member's clock synchronization procedures (if applicable) • Certifications

All time clocks (computer system or mechanical) used for recording date and time of orders must be synchronized and maintained (other than Business Clocks used solely for Manual Order Events or solely for time of allocation on Allocation Reports) at a minimum to within a fifty (50) millisecond tolerance of the time maintained by the NIST atomic clock. Business Clocks used solely for Manual Order Events and solely for the time allocation of Allocation Reports must be synchronized within a one second tolerance of the NIST clock and maintained at that synchronization.

This tolerance includes all of the following:

1. the difference between the NIST standard and a time provider's clock;
2. transmission delay from the source; and
3. the amount of drift of the Firm's clock.

The following procedures are to be followed to synchronize business time clocks used to record order entry and execution times:

- Clocks that have not been checked according to these procedures must not be used for recording order information.
- All clocks will be synchronized with the National Institute of Standards and Technology (NIST) system clock **each business day:**
    - prior to market opening; and
    - at pre-determined intervals throughout the business day.
- Traders must record clock synchronization on the Clock Synchronization Log and provide the Log to the designated supervisor weekly.
- Failure to conduct required synchronization may result in disciplinary action.
- The designated supervisor is responsible for reviewing and retaining the Logs and taking corrective action, when necessary (may include repair or discontinuing use of a clock; review of systems; *etc.*).
- In the future (date not yet determined), KCD will report violations of clock synchronization requirements.

23.13.3.1 Certification

Each year KCD will complete the certification by March 15 of each year. The certification will be maintained in a file available to regulators upon request. Only one certification is prepared even if KCD is a member of multiple regulatory organizations.

23.13.3.2 Definitions

Business Clocks: Those clocks that currently capture time in milliseconds and that are used to record time related to "Reportable Events."

Reportable Events: Includes the original receipt or origination, modification, cancellation, routing, execution (in whole or in part) and allocation of an order, and receipt of a routed order in Eligible Securities (*e.g.,* NMS Securities and OTC Equity Securities).

Independent Contractors

If an independent contractor immediately transmits orders to the trading department, 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.

23.14 Systems Issues

[FINRA Trade Reporting Notice 1/20/16: OTC Equity Trading and Reporting in the Event of Systems Issues]

Responsibility	• Designated Supervisor
Resources	• Notice of systems issues
Frequency	• As required
Action	• Evaluate the nature of the systems issue notification from FINRA • Determine course of action • Notify traders and other affected personnel, and customers, if appropriate
Record	• Documentation of actions taken

In the event of FINRA notification of a system issue preventing trading and reporting during regular market hours, FINRA will notify firms to switch to an alternative facility or market. If there is a widespread system failure it would be likely that FINRA would impose a trading halt. If a systems issue is not widespread and affects a limited number of firms, the affected firms would be notified. If there is a system issue where FINRA has not issued an announcement, the Firm will continue trading and, where necessary, report trades late once the issue is resolved.

After receiving FINRA notification of a system issue, the Firm will activate its response procedures which may include the following, as determined by the designated supervisor:

- Evaluate the scope of the systems failure(s)
- Establish connectivity with a second FINRA facility, route orders to an exchange or to another FINRA firm (or cease OTC trading)
- Continue trading and report trades late
- For limited systems issues: Make intraday changes to trade reporting processes
- For limited systems issues: Continue trading, working with FINRA facility operations staff to manually enter or re-submit rejected (or otherwise unsuccessfully reported) trades
- For widespread systems issues: Continue to directly execute OTC trades in NMS stocks if the Firm has connectivity and the ability to report to another FINRA facility

For Firm or vendor system issues, the Firm has back-up capabilities which may include switching to another system or referring trading and report to another FINRA firm until system issues are resolved.

23.15 Prohibited Activities

23.15.1 Inside Information

[SEC Securities Exchange Act of 1934 Rule 10b-5; FINRA Notice to Members 89-15; Insider Trading and Securities Fraud Enforcement Act of 1988]

Traders are prohibited from acting on, passing on, or discussing any inside information regarding any fixed income security issues, including any material non-public information regarding, for example, a credit-rating change, default or advance refunding. Any knowledge of such information must be brought to the attention of the designated supervisor and Compliance. No KCD proprietary account or employee account may enter a transaction in a security based on material non-public information about that security.

23.15.2 Financial Arrangements

Traders are prohibited from entering into financial arrangements with customers or issuers (*i.e.,* sharing in profits or losses, sharing in commissions, rebating commissions, *etc.*).

23.15.3 Market Manipulation

[SEC Securities Exchange Act of 1934 Rule 10b-3; FINRA Rule 2020]

No purchase or sales order shall be entered or executed 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.

23.15.4 Front Running

[FINRA Rule 5270 and 5320]

No firm proprietary or employee account may trade a security while in possession of material information about an imminent block-sized transaction in that security or a derivative security or trade ahead of customer orders. Refer to the chapter *ORDERS* and the sections *Prohibition Against Trading Ahead Of Customer Orders* and *Front Running Of Block Transactions*.

23.15.5 Parking Securities

No arrangement may be used to conceal the true ownership of securities through a fictitious sale or transfer to another party or nominee who agrees to later sell or transfer the securities to the true owner (or his agent) at the agreed upon time at essentially the same terms. Legitimate repurchase or "repo" transactions, usually entered into as financing transactions, are not included in this prohibition if they are not entered for a manipulative purpose.

23.15.6 Secret Profits

A trader may not permit the charging of a mark-up or mark-down in addition to a commission on any transaction.

23.15.7 Adjusted Trading

[FINRA Regulatory and Compliance Alert Fall 1993]

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
- interpositioning the broker-dealer between two customers where the broker-dealer acts as a conduit allowing the two customers to "swap" losing positions by paying an inflated price for each other's securities

All transactions must be executed at prices reasonably related to current market prices and all books and records of KCD must show an accurate price for securities purchased or sold.

23.15.8 Wash Sales

A wash sale occurs when a purchase and sale takes place where there is no change in beneficial ownership. For example, someone sells bonds from their personal account to their IRA account. Wash sales are sometimes effected to create the false appearance of activity in a security. Wash sales sometimes occur when a customer wants to take a tax loss selling the security on one day and then re-purchasing it within 30 days of the sale. The IRS considers such transactions wash sales and disallows the loss as a tax deduction.

23.15.9 Daisy Chain/Round Robin Transactions

These transactions represent a fraudulent scheme in which a security is traded in a circular manner among those involved in an attempt to manipulate the price of the security. The circular transactions result in a small profit to those involved and result in artificial pricing of the security.

23.16 Review Of Transactions

[FINRA Rule 3110(d)]

Responsibility	• Designated Supervisor
Resources	• Order records • Available reports (internal or external)

Frequency	• Daily

Action	• Review orders for:
	  ○ Price
	  ○ Fairness of markups/markdowns
	  ○ Time stamps
	  ○ Clearing firm reporting of trade, if applicable
	  ○ Patterns that may violate regulatory requirements
	  ○ Cancellations and rebills
	  ○ Error accounts
	  ○ Extended settlements
	• Establish procedures for maintaining records of orders
	• Review daily inventory positions for compliance with firm limits
	• Review errors and error accounts

Record	• Transaction reports or order records with notations of action taken where appropriate

The designated supervisor will review transactions for compliance with regulatory requirements and 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 KCD 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.

23.17 Trading Ahead Of Research Reports/Recommendations

[FINRA Rule 5280]

Responsibility	• Designated Supervisor
Resources	• Date/time when research reports/recommendations are issued • Inventory records • Daily transaction report
Frequency	As required
Action	Review trading that occurred prior to issuance of a research report to identify potential frontrunning Take corrective action, if necessary, which may include: Confer with Trading Manager Formal reprimand of trader' Other action as appropriate
Record	Retain file of reviewed trades in Compliance with documentation of any action taken

KCD may not establish, increase, decrease, or liquidate an inventory position in a security or derivative of the security based on non-public advance knowledge of the content or timing of a research report in that security. This restriction applies to inventory positions with respect to any security (listed or unlisted), including debt or derivative securities related to the underlying securities the subject of the research report.

Normal trading activity may continue when the trading department is not aware of a pending research recommendation. If a trader becomes aware of non-public information about research reports, he or she should contact Compliance immediately to determine what, if any, action is necessary to protect the trader and the Firm from violations of rules governing "trading ahead" on confidential information.

23.18 High Yield Debt Securities

[FINRA Notice to Members 04-30]

Responsibility	Designated Supervisor
Resources	Order records Account records
Frequency	As required when transactions in high yield securities are effected
Action	Review that disclosures have been provided to the customer Review the customer's investment objectives to confirm high risk is part of the customer's profile Review recommended orders for compliance with Regulation BI [see the chapter *REGULATION BEST INTEREST (BI)*] Consult with the RR if questions arise Consult with customer if necessary Take corrective action, if necessary, which may include cancelling the transaction(s)
Record	Order records with record of review including corrective action taken, if any

High yield debt securities (also known as "junk bonds") generally involve a higher degree of risk and are typically rated BB or less by Standard and Poor's or Ba or below by Moody's. Because of the higher risk, RRs have enhanced suitability and disclosure obligations.

23.18.1 Suitability

[FINRA Rule 2111]

RRs must consider the following risk factors (and any other factors that may exist) before recommending high yield debt securities to customers:

- The bond may default resulting in loss of investment.
- Markets for such bonds may be relatively illiquid, impacting the investor's ability to sell and the price of the bond.
- In a low-interest, low-yield environment, there may be a compression of risk premium resulting from investors bidding up prices and driving down yields while default rates remain high.

Customers who purchase high yield debt securities must have higher risk as at least one of their investment objectives.

Suitability is only one element of acting in a customer's best interest. Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI) which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

23.18.2 Disclosures

RRs are obligated to disclose the risks listed above to potential purchasers of high risk bonds. Any other known risks particular to the issue must also be disclosed.

23.18.3 Catastrophe Bonds

Catastrophe bonds (also known as cat bonds) are risk-linked securities that transfer a specified set of risks from a sponsor to investors. Cat bonds are linked to specific types of disasters and are issued on the condition proceeds won't be used by the insurer for claims payments until the insurer's claims costs top a set of pre-determined amounts. Catastrophe bonds are typically used by insurers as an alternative to traditional catastrophe reinsurance.

If no catastrophe occurs, the insurance company pays a coupon to the investors. On the contrary, if a catastrophe did occur, then the principal would be forgiven and the insurance company would use this money to pay its claimholders.

These bonds are inherently risky and often have a maturity of three years or less. Investors can lose their entire investment. Cat bonds are suitable only for customers with high risk investment profiles and where the risks have been clearly communicated.

23.18.4 Underwriting And Investment Banking

The procedures outlined in the chapters *CORPORATE SECURITIES UNDERWRITING* and *INVESTMENT BANKING* are to be followed for the underwriting of high yield debt securities, as well as policies included in the chapter *INSIDER TRADING* and particularly procedures regarding information barriers.

23.18.5 Creditors' Committee

Any employee that anticipates serving on the creditors' committee should notify Compliance prior to accepting the position. The following will be considered in determining whether the employee should serve on the committee:

- Whether access to inside information would unduly restrict KCD from issuing research or trading the issuer's securities
- Whether adequate information barrier procedures are in place to permit unrestricted activities in other business areas of KCD while the employee serves on the creditors' committee
- Whether disclosure of the employee's role should be included in footnotes on any research reports on the issuer's securities

24 CORPORATE SECURITIES UNDERWRITING

[FINRA FAQ on Public Offering Review: http://www.finra.org/industry/compliance/regulatoryfilings/publicofferingsystem/faq/; SEC Securities Offering Reform Questions and Answers November 30, 2005 (www.sec.gov/divisions/corpfin/faqs/securities_offering_reform-qa.pdf); NASDAQ Equity Regulatory Alert #2022-9]

This chapter outlines procedures for participating in corporate securities underwritings and a summary of key rule requirements. The term "syndicate supervisor" is used in this chapter to denote the person responsible for supervising underwritings and delegating responsibilities to other employees, where appropriate.

References to "suitability" apply only to those recommendations NOT subject to Regulation Best Interest (BI) which applies to retail customers and is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

24.1 Deal File

At the initial involvement in a potential underwriting, regardless of KCD's role, the syndicate supervisor will establish a "deal file" for the prospective underwriting. Following is a list of items that should be included in the deal file, depending on KCD's role in the offering:

- Letter of Intent with issuer
- Due diligence records
- Approval/acceptance of participation in underwriting
- Final registration statement
- Agreement Among Underwriters
- Underwriting Agreement
- Purchase Agreement (for competitive deals)
- Selected Dealer Agreement (selling agreement)
- Regulatory filings
- Preliminary and final prospectus
- Indications of interest
- Reviews for IPO certifications
- Road show materials and lists of potential investors who attended and received preliminary prospectuses
- When acting as managing underwriter:
    - Record of providing participants with prospectuses
    - Stabilizing activities
    - Designated orders
    - Other records of syndicate management activities
    - Underwriting Checklist

Drafts should be discarded and final documents retained in the file. Attorney-client privileged communications may be maintained in a separate file.

24.2 Managing Underwriter

As managing underwriter, KCD is responsible for dealing with the issuer, drafting a registration statement, developing the prospectus and other offering documents, forming the syndicate (if others will participate), submitting required regulatory filings, and running the syndicate. If KCD acts as co-manager and the other co-manager takes the lead in the offering, some of KCD's responsibilities will be more limited with the lead manager assuming many of the syndicate responsibilities.

24.2.1 Letter Of Intent

KCD and the issuer will usually sign a Letter of Intent which is a non-binding agreement that defines the framework of the potential offering.

24.2.2 Due Diligence

[SEC Securities Exchange Act of 1934 Rule 10b-5; FINRA Regulatory Notice 22-25]

Responsibility	Syndicate Supervisor
Resources	Information from issuer Information from outside sources Review by outside counsel or others engaged by KCD Review conducted by KCD personnel
Frequency	As required for each potential underwriting
Action	Engage outside counsel or others to assist with due diligence review, if appropriate Evaluate information on the company Determine structure of issue and potential pricing Conduct heightened due diligence when dealing with small-cap issues involving foreign issuers and foreign broker-dealers to identify potential fraud including pump-and-dump schemes usually resulting in significant unusual price increases on the day of or shortly after the IPO
Record	Records to be retained in due diligence records include records of meetings and interviews; documents reviewed (including summaries or copies as appropriate); visits to facilities; discussions with third-party personnel; reports by investigators or other independent experts engaged to review the issuer; reviews of small-cap issues involving foreign issues and foreign broker-dealers; and other records of the review. Where visits, meetings, and interviews occur, the files will include the dates, attendees, and subjects reviewed or discussed.

KCD has the primary responsibility for evaluating the potential issuer and the structure of any proposed offering and when and how to bring the issue to market. The extent of due diligence review and the subjects reviewed will vary depending on the issuer, knowledge of and past experience with the issuer, whether the issue is an IPO, and any number of factors that may affect the due diligence process. The types of reviews conducted may include:

- Review of financial reports
- Evaluate the issuer's business model and how it fits into its business sector
- Review of information available from financial and other publishers
- Independent verification of management's representations (contact with issuer's customers; lenders, vendors, lower-level employees, *etc.*)
- Reviewing news articles and industry publications regarding the issuer, its market, and competition

- Reviewing the company's internal documents such as operating plans, product literature, corporate records, financial statements, contracts and lists of distributors and customers
- Physical inspection of the company's facilities
- Contact with the issuer's auditor and other experts knowledgeable about the company
- Written company assurances as to the accuracy of records and financial statements
- Contact with outside directors
- Interviews of key personnel or customers
- Particular review, to prevent potential fraud, of IPOs involving offshore participants and foreign broker-dealers receiving allocations of shares
- Updating due diligence as needed until effectiveness of the offering

24.2.3 Net Capital Considerations

[SEC Securities Exchange Act of 1934 Rule 15c3-1]

If an underwriting commitment may impact KCD's net capital, the syndicate supervisor is responsible for contacting the FINOP regarding KCD's prospective commitment and noting in the deal file that net capital requirements will be satisfied for the prospective deal.

24.2.4 Investment Committee Approval

KCD's Senior Management is responsible for reviewing and accepting participations in underwritings where KCD will act as manager or co-manager. The following are requirements for Investment Committee review and approval.

- The due diligence package and written recommendation must be signed off before presenting to the Investment Committee.
    - Provide due diligence package to Investment Committee members 48 hours before presentation.
    - IC members are expected to read this material prior to the presentation.
- Investment Committee Presentation
    - Those involved in making the recommendation should participate.
    - Prepare and deliver presentation that includes all relevant information.
    - The presentation must explicitly estimate the economics of the engagement for KCD. This will include proposed terms.
- Investment Committee Vote
    - Majority vote of the IC is required to accept participation.
    - Votes must be in writing.
    - Record of the vote will be maintained in the deal file.

Approval extends only to the terms proposed in Part b above. **Material variances must receive separate approval.**

24.2.5 Forming The Underwriting Group

[FINRA Rule 5160]

If other dealers will be invited to participate in the underwriting, KCD will:

- Extend invitations to other dealers
- Execute with participants, depending on their invited role:
    - Agreement Among Underwriters (defines rights and obligations of the underwriters with respect to each other)
    - Underwriting Agreement (agreement between underwriters and the issuer committing to purchase the security in a negotiated underwriting)

- Purchase Agreement (agreement between the issuer and underwriting firms in a competitive bidding)
- Selected Dealer Agreement (selling group agreement, also covers underwriters whose net take-down exceeds their underwriting commitment)

24.2.6 Agreement Among Underwriters

[FINRA Rule 5131(d)(3)]

The Agreement will include the following provisions regarding any shares trading at a premium to the public offering price that are returned by the purchaser to a syndicate member after secondary market trading commences:

- The shares will be used to offset the existing syndicate short position, or
- If no syndicate short position exists, the member must either:
  - Offer returned shares at the public offering price to unfilled customers' orders using a random allocation methodology, or
  - Sell returned shares on the secondary market and donate profits from the sale to an unaffiliated charitable organization with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to the member.

24.2.7 Underwriting Compensation

[FINRA Rule 5110(c)]

Responsibility	Syndicate Supervisor
Resources	Underwriting agreement with issuer and/or other documents regarding potential compensation
Frequency	As required for each underwriting
Action	Review compensation for fairness and reasonableness and ensure compensation is within rule guidelines. Identify any patterns of consistent compensation levels among underwritings; such patterns may indicate a failure to negotiate each deal individually to determine pricing of KCD's services. Adjust compensation if necessary to comply with firm and rule requirements and remind personnel of requirements if inconsistencies are identified. Ensure compensation is disclosed in the prospectus.
Record	Underwriting records, including compensation negotiated with the issuer, are included in the deal file. The syndicate supervisor's initials or signature is included on records reviewed. Records of adjustments to compensation.

KCD will review underwriting compensation issues to ensure compliance with FINRA's Corporate Financing Rule. Underwriting compensation earned by KCD is determined through negotiation with the issuer and is reviewed by FINRA before the issue may be offered to the public. FINRA's Corporate Financing Rule regulates underwriting compensation and prohibits unfair arrangements in connection with public offerings of securities.

24.2.8 Lock-Up Agreements

[FINRA Rule 5110(e), 5131(d)(2) and 5131.03]

For an offering of equity securities, the issuer and its officers, directors, and principal security holders may enter into agreements ("lock-ups") promising not to sell any additional securities of the same class, or any securities convertible or exchangeable into the same class, for a specified period of time after the date of the prospectus. Securities subject to a lock-up restriction cannot be sold during the offering or sold, transferred, assigned, pledged, or hypothecated, or be the subject of any hedging, short sale, derivative, put, or call transaction that would result in the effective economic disposition of the securities. The restricted securities may not be sold for a period of 180 days immediately following the date of effectiveness or commencement of sales of the public offering [unless an exception applies under FINRA Rule 5100(g)(2)].

Lock-up agreements include language that restrictions on sale apply to issuer-directed shares. At least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer's shares, KCD as book-running lead manager will notify the issuer of the impending release or waiver of a lock-up or other restriction on the transfer of the issuer's shares and announce the impending release or waiver through a major news service unless the release or waiver is effected solely to permit transfer of securities that are not for consideration and where the transferee has agreed in writing to be bound by the same lock-up agreement terms in place for the transferor. The announcement may be made by the book-running lead manager, another member, or the issuer as long as the announcement complies with FINRA's rule requirement.

24.2.9 Non-Cash Compensation

[FINRA Rule 5110(f)]

Responsibility	Designated Supervisor
Resources	Requests from offerors, others
Frequency	As required
Action	Review non-cash compensation arrangements for compliance with rule requirements limitations including conflicts of interest under Regulation Best Interest Approve or disapprove arrangements
Record	Review and approval or disapproval of arrangements Record of compensation received; names of offerors, non-members or other members making contributions; names of employees participating; nature and value of compensation received; location of training and education meetings; other information, as applicable

Regulators' rules restrict compensation relating to the sale and distribution of debt, equity, direct participation program (DPP), REIT securities, and municipal securities. Employees 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 KCD. Sales contests, sales quotas, bonuses, and non-cash compensation based on the sale of specific securities or securities types within a limited period of time are not permitted. These activities must be consistent with the applicable requirements of Regulation Best Interest.

24.2.9.1 Definitions

Cash compensation is defined as follows:

Any discount, concession, fee, service fee, commission, asset based sales charge, loan or override, or cash employee 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.

Offeror is an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

24.2.9.2 Restrictions On Non-Cash Compensation

KCD and its employees are prohibited from directly or indirectly accepting or making payments or offers of payments of any non-cash compensation, except for the following:

- Gifts amounting in aggregate value not exceeding $100 annually, per person. All gifts must be reported to Compliance under KCD's Gifts, Gratuities and Entertainment policy.
- 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 by offerors in connection with meetings held by an offeror or by KCD for the purpose of training or educating Firm employees, subject to several conditions.
- Approval must be obtained from the designated supervisor prior to attending the meeting; attendance may not be conditioned on achievement of a sales target or other incentives.
- The location of the meeting is appropriate for its purpose, *e.g.,* an office of the issuer or issuer affiliate, a Firm office, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings.
- Only expenses incurred by KCD or its employees are eligible for payment. Expenses for guests of employees (spouse, *etc.*) will not be reimbursed.
- Payment or reimbursement by the issuer or issuer affiliate may not be conditioned by the issuer or affiliate on the achievement of a sales target or any other non-cash compensation arrangement explained next.
- Non-cash compensation arrangements are permitted between KCD and its employees or a company that controls KCD and its employees, provided no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in KCD's or non-member's organization of a permissible non-cash compensation arrangement.
- Contributions are permitted by a non-member company or other member to a non-cash compensation arrangement between KCD and its employees, provided the arrangement meets the criteria in the bulleted item above.
- Refer to the section *Conflicts Of Interest* in the chapter *REGULATION BEST INTEREST (BI)* for details regarding conflicts involving compensation.

24.2.10 Reports To Issuer Of Indications Of Interest And Final Allocation

The book-running lead manager must provide information about the demand for the issuer's securities to the issuer. As book-running lead manager, KCD will provide the following to the issuer's pricing committee (or if no committee exists, to the issuer's board of directors):

- A regular report of indications of interest including the names of interested institutional investors and the number of shares indicated by each and a report of aggregate demand from retail investors; and, After settlement date of the new issue, a report of the final allocation of shares to institutional investors including the names of purchasers and the number of shares purchased by each, and aggregate sales to retail investors.

24.2.11 Greenshoe

[SEC Securities Exchange Act of 1934 Rule 16c-2]

A greenshoe ("over-allotment option" in the prospectus) gives underwriters the right to sell additional shares in a registered securities offering if demand for the securities is in excess of the original amount offered. The greenshoe enables an issuer to place additional shares on the market under the original underwriting's conditions. The greenshoe is a condition of the offering agreed to between the underwriter and the issuer prior to the offering. A reverse greenshoe gives the underwriter the right to sell shares back to the issuer and may be used as a stabilization method where the underwriter buys shares in the open market and then sells them back to the issuer.

The syndicate manager is responsible for exercising a greenshoe when appropriate for a particular offering that includes this option.

24.2.12 Preliminary And Final Prospectuses

[SEC Securities Act of 1933 Rule 154, Rule 172, Rule 173, Rule 174, Rule 434, Rule 460, Section 2(a)(10), Section 10 and Section 12; SEC Securities Exchange Act of 1934 Rule 15c2-8; SEC Regulation C Rule 421]

The preparation and filing of the prospectus includes:

- Preparation of the preliminary prospectus
- Filing preliminary prospectus with regulators
- Providing preliminary prospectus with invitations to other potential participants
- File prospectus with SEC
- Prepare final prospectus with price information
- Provide final prospectuses to participants in printed form or provide notice that prospectuses may be accessed electronically ("access equals delivery")

24.2.13 Regulatory Filings And Notifications

[SEC Regulation M; FINRA Rule 5110 and 5190; FINRA Regulatory Notice 14-22]

Responsibility	Syndicate Supervisor
Resources	Underwritings
Frequency	As required depending on type of filing
Action	For registration statement filings: Engage counsel to draft registration statement Follow procedures listed in Registration Statement below Determine filing requirement: If KCD is managing underwriter, under Rule 101 determine one-day or five-day restricted period or if the security is "actively traded" without a restricted period

	If KCD is an issuer or selling security holder of a security that is a covered security subject to a restricted period under Rule 102 Whether another member has assumed filing requirements, in writing File information electronically with FINRA, when required Notify of cancellation or postponement of an issue where a prior notice was filed Request Underwriting Activity Report (UAR)
Record	Determination of restricted period and filing requirements Notifications Written consent when another firm agrees to make filings (occurs when there is no managing underwriter)

Underwritings are subject to FINRA notification requirements. All public offerings (including unregistered offerings unless there are restrictions on resale) are subject to regulatory filing requirements unless exempt under FINRA Rule 5110(b)(8).

Covered security means any security that is the subject of a distribution, or any reference security.
Distribution means an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.
Rule 101 prohibits distribution participants (underwriters, selling group members, *etc.*) from engaging in manipulative activity that would influence the price of the security in a distribution.
Rule 102 prohibits issuers and selling security holders from engaging in manipulative activity that would influence the price of the security in a distribution.

Registration Statement

The registration statement is prepared and filed as follows:

Coincident with due diligence and approval of KCD's role managing the underwriting, begin the process of drafting the registration statement.
Finalize registration statement and file Form S-1 with the SEC.
File registration statement with SROs.
File interim amendment to registration statement, if necessary, with SEC.
Registration statement becomes effective.

24.2.13.1 Regulation M Notification Requirements

[FINRA Rule 5190; FINRA Regulatory Notice 08-74; FINRA filing requirements: https://www.finra.org/filing-reporting/regulation-m-filings; SEC FAQS: https://www.sec.gov/interps/legal/mrslb9.htm]

Distribution participants are required to file Regulation M notifications with FINRA. The following are responsible for electronic filing the required notification which may be assumed by another firm if the obligation to file is in writing.

The member firm acting as manager (or in a similar capacity); if no member firm acts as manager, each firm participating in the distribution is required to file unless one firm has assumed responsibility in writing for compliance
A firm that is an issuer or selling security holder
A firm that intends to impose a penalty bid or effect a syndicate covering transaction

The Firm must update any submitted notification as necessary (*e.g.,* the manager would update for any distribution participants added after the restricted period commenced; if a deal was oversubscribed; the over-allotment was exercised; *etc.*).

Firms with an obligation to file notification under FINRA and NASDAQ requirements are only required to file with FINRA.

24.2.13.1.1 Summary Chart Of Notification Required

Notification Requirement	Rule	Form	Deadline for Filing
Determination of applicable restricted period, including contemplated commencement of restricted period	5190(c)(1)(A)	Regulation M Restricted Period Notification	No later than the business day prior to the first complete trading session of the applicable restricted period
Determination that no restricted period applies under the "actively traded" securities exception	5190(d)(1)	Regulation M Restricted Period Notification	No later than the close of business the next business day following the pricing of the distribution
Pricing of distribution (applicable to distributions subject to a restricted period and distributions of "actively traded" securities)	5190(c)(1)(B) 5190(d)(2)	Regulation M Restricted Period Notification	No later than the close of business the next business day following the pricing of the distribution
Cancellation or postponement of distribution (applicable where prior notice of commencement of restricted period has been provided)	5190(c)(1)(C)	Regulation M Restricted Period Notification	Immediately upon cancellation or postponement
Intent to effect syndicate covering transaction	5190(e)(1)	Regulation M Notice of Intent to Impose a Penalty Bid and/or Effect a Syndicate Covering Transaction	Prior to effecting transaction
Confirmation of syndicate covering transaction	5190(e)(2)	Regulation M Trading Notification	Within one business day of completion
Intent to impose penalty bid	5190(e)(1)	Regulation M Notice of Intent to Impose a Penalty Bid and/or Effect a Syndicate Covering Transaction	Prior to effecting bid
Confirmation of penalty bid	5190(e)(2)	Regulation M Trading Notification	Within one business day of bid

NASDAQ IPO Process

[NASDAQ Head Trader Alert 2005-096 and 2005-086; http://www.nasdaqtrader.com/TraderNews.aspx?id=hta2005-096]

NASDAQ has an IPO process to price a new issue when it comes to market. The lead underwriter is responsible for calling NASDAQ to communicate the IPO offering price by 6:45 p.m. E.T. on the day of pricing (the night before trading will begin). The offering price will be used by NASDAQ as the first bid (represented by the lead underwriter's MPID) in the NASDAQ Market Center at the start of IPO trading.

If the lead underwriter does not provide price information by the deadline, pricing will default to the IPO process.

TRACE-Eligible Securities

[FINRA Rule 6760]

For IPOs of TRACE-eligible securities, FINRA Operations will be provided with new issue notification prior to the execution of the first transaction in the distribution or offering. For new issues that are priced and commence on the same business day between 9:30 a.m. E.T. and 4:00 p.m. E.T., as much information as available prior to execution of the first transaction must be provided, and all other information must be provided within 15 minutes of the time of execution of the first transaction.

For deals where there is no managing underwriter, the underwriting group is responsible for filing the required information or, if there is no underwriter, the initial purchaser. "Underwriter" includes firms acting as agents for issuers of new TRACE-eligible securities.

24.2.14 Blue Sky Considerations

The syndicate supervisor is responsible for determining whether the issue qualifies for the NSMIA exemption from blue sky requirements and if it does not, making the necessary filings and registering the issue with individual states.

24.2.15 Road Shows

Responsibility	Syndicate Supervisor
Resources	Proposals for road shows Proposed invitees
Frequency	As required
Action	Review road show presentation and approve or disapprove Provide preliminary prospectuses for invitees For video or internet road shows, ensure all requirements are completed
Record	Road show presentation and related materials Record of who attended and received preliminary prospectuses Record of required items for video or internet road shows

KCD may conduct road shows and invite broker-dealers and potential investors to review the proposed underwriting. Those invited may include institutional investors, securities firms, trading and sales personnel, research analysts, and qualified individual investors.

Video And Internet Road Shows

[SEC No-Action Letters including those to: Wit Capital (July 14, 1999), Private Financial Network (March 12, 1997), Net Roadshow (July 30, 1997) and Charles Schwab and Co. (November 12, 1999 & February 9, 2000), Bloomberg L.P. (October 22, 1997), Thomson Financial Services (September 4, 1998)]

Following are some of the requirements that apply when road shows are conducted via video or the internet:

- The registration statement will be on file with the SEC.
- The audience is limited to pre-selected or pre-qualified investors; for internet road shows, password access will be required.
- The viewer will be provided a prospectus before or concurrently with the transmission.
- Transmission is protected against downloading, copying, and printing.
- Viewers are required to represent they will not copy or distribute the transmission to others.
- The road show will be transmitted in its entirety, except for minor editing to eliminate dead time or to correct mistakes. Viewers may prematurely end the transmission at their option.
- Audio-visual materials (such as slides) will be presented for approximately the same amount of time as in a traditional show.
- The road show will not be transmitted to any one viewer more than a limited number of times or restricts the viewer's access to a limited time period.
- The road show will display a Rule 134(b) legend stating that because the registration statement is not yet effective, the securities cannot yet be sold and offers to buy cannot yet be accepted.

Compliance should be consulted regarding specific electronic road show requirements.

24.2.16 Pricing The Underwriting

The deal will be priced considering a wide range of factors which may include:

- The company's real or expected growth
- Company's operating history
- Quality of company's management
- Company's approach to research and development
- Prospects for the industry in which the company operates
- Market comparables, such as price-to-earnings ratio of a similarly-situated company that is publicly traded
- Growth prospects for the company's products and services and the expected impact on those
- General conditions of the securities market at the time of the offering

24.2.17 Aftermarket Activities

24.2.17.1 Stabilizing Activities

[SEC Securities Exchange Act of 1934 Rule 17a-2; SEC Regulation M Rule 104; NASDAQ Rule 4614 and 4625]

KCD may engage in stabilizing activities to prevent or retard the decline in the price of the security. Refer to the chapter *EQUITY TRADING AND MARKET MAKING*, the section *Distribution Of Securities* and the subsection *Stabilizing Bids*.

- Potential stabilizing activities will be disclosed in the prospectus.
- Only one stabilizing bid may be entered.
- Stabilizing transactions will be identified as such when entered.
- Stabilizing transactions will comply with price requirements in the market where entered.

The syndicate supervisor will notify each syndicate or group member of the name and class of the security stabilized and the time when the first stabilizing purchase was effected and when stabilizing was terminated.

Penalty Bid And Syndicate Covering Transactions

[SEC Regulation M Rule 100 and Rule 104; NASDAQ Rule 4624; FINRA Rule 5131(c)(2) and 5190]

A penalty bid (reclaiming the selling concession) may be imposed on a syndicate member when the securities originally sold by the syndicate member are purchased in a syndicate covering transaction. If penalty bids may be imposed, it will be disclosed in the IPO registration statement. The appropriate SRO(s) will be notified when a penalty bid is imposed.

KCD, as managing underwriter, will maintain records of any penalties or disincentives assessed on its associated persons in connection with a penalty bid.

Records Of Stabilizing, Penalty Bid, and Syndicate Covering Activities

The syndicate supervisor is responsible for maintaining the following records in a separately retrievable format:

- name and class of security stabilized or where syndicate covering transactions were effected or a penalty bid is imposed
- price, date, and time at which each stabilizing purchase or syndicate covering transaction was effected by KCD or any participant in the syndicate or group and whether any penalties were assessed
- names and addresses of members of the syndicate or group
- commitments or, for a standby or contingent underwriting, the percentage participation of each syndicate or group member
- dates when any penalty bid was in effect

24.2.17.2 Settlement Of Syndicate Accounts

[FINRA Rule 5160 and 11880; FINRA Regulatory Notice 22-24]

For corporate equity offerings:

- Final settlement will be effected within 90 days following the syndicate settlement date.
- Syndicate members will be provided with, no later than the date of final settlement of the syndicate account, an itemized statement of syndicate expenses.
- FINRA Uniform Practice Dept. will be notified of any anticipated delay in closing a firm commitment offering beyond the closing date in the offering document or any subsequent delays in the closing date previously reported to FINRA.

For corporate debt security offerings:

- The syndicate manager will remit to each syndicate member at least 70% of the gross amount due each member within 30 days following the syndicate settlement date.
- Any final balance due will be remitted within 90 days following the syndicate settlement date.
- Syndicate members will be provided with, no later than the date of final settlement of the syndicate account, an itemized statement of syndicate expenses.
- FINRA Uniform Practice Dept. will be notified of any anticipated delay in closing a firm commitment offering beyond the closing date in the offering document or any subsequent delays in the closing date previously reported to FINRA.

Designated Orders

KCD will maintain records of designated orders including:

name of person making the designation
identity of brokers or dealers designated
identity and amount of securities for which each broker/dealer is designated
date of commencement and termination of the offering

24.3 Syndicate Member Procedures

Responsibility	Syndicate Supervisor
Resources	Invitations to participate as a syndicate group member Prospectus Registration statement Other information provided by the managing underwriter
Frequency	As required for each underwriting
Action	Review agreement, related documents, and accept or decline Notify Compliance of proposed deal for consideration whether to add the security to KCD's Restricted List and notify Compliance when price and trading restrictions are lifted Notify Research if necessary Allocate available securities Provide prospectuses to purchasers, if required Handle returned shares trading at a premium in the aftermarket by returning them to the Syndicate Manager to offset an existing syndicate short position or, if none exists, allocate to unfilled customer requests or sell them in the market and donate profits
Record	The invitation, signed agreements, prospectus, registration, and other information provided by the managing underwriter as well as Compliance and Research notification and tombstone ads are retained in the deal file. Disposition of returned shares trading at a premium in the aftermarket

When invited to participate as a syndicate member, the syndicate supervisor will review the deal, accept or decline, and oversee the distribution of securities sold by KCD.

24.3.1 Returned Shares Of An Issue Trading At A Premium

[FINRA Rule 5131(d)(3)]

If new issue shares are returned by a purchaser when the shares trade at a premium in the aftermarket, the returned shares will offset the existing syndicate short position. If no short position exists, KCD will:

Offer returned shares at the public offering price to unfilled customers' orders using a random allocation methodology, or
Sell returned shares on the secondary market and donate profits from the sale to an unaffiliated charitable organization with the condition that the donation be treated as an anonymous donation to avoid any reputational benefit to KCD.

24.3.2 Tombstone Ads

KCD may publish tombstone announcements of participation as a syndicate member. Tombstone ads must be approved by Compliance prior to publication.

24.3.3 Research

If KCD issues research regarding the subject company, participation as a syndicate member requires compliance with SRO rules regarding research activities. The syndicate supervisor is responsible for notifying the Research Department of pending deals since issuance of research reports may be restricted.

24.4 Selling Group Member Procedures

Responsibility	Syndicate Supervisor
Resources	Invitations to participate as a selling group member Prospectus Registration statement Other information provided by the managing underwriter
Frequency	As required for each underwriting
Action	Review agreement, related documents, and accept or decline Notify Compliance of proposed deal for consideration whether to add the security to KCD's Restricted List and notify Compliance when price and trading restrictions are lifted Notify Research if necessary Allocate available securities Return unsold allotment to managing underwriter
Record	The invitation, signed agreements, prospectus, registration, and other information provided by the managing underwriter as well as Compliance and Research notification and tombstone ads are retained in the deal file.

This section describes procedures when KCD participates in an underwriting as a selling group member.

24.4.1 Returning Unsold Allotment

As a selling group member, KCD has no financial commitment to sell underwritten shares and will return unsold allotments, unless the terms of the selling agreement dictate otherwise.

Unsold shares will be returned to the managing underwriter within the timeframe specified by the selling group agreement.

24.4.2 Tombstone Ads

KCD may publish tombstone announcements of participation as a selling group member. Tombstone ads must be approved by Compliance prior to publication.

24.4.3 Research

If KCD issues research regarding the subject company, participation as a selling group member requires compliance with SRO rules regarding research activities. The syndicate supervisor is responsible for notifying the Research Department of pending deals since issuance of research reports may be restricted.

24.5 Special Purpose Acquisition Companies (SPACs)

[FINRA Regulatory Notice 08-54; Report on FINRA Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	Designated Supervisor
Resources	Information from sponsors/managers and related parties
Frequency	As required when a SPAC will be offered
Action	Conduct due diligence at the IPO and merger stages including: relevant officers, directors and control persons and SPAC sponsor(s) pre-identified acquisition targets registration statements independent review of due diligence materials prepared by or received from a third party participation in due diligence meetings, calls or presentations conducted by the third party or other participating members Establish information barriers, if appropriate Review employees who are involved in the SPAC to approve or disapprove the activity, and, if approved, confirm appropriate disclosures are made For firm-commitment underwritings, confirm KCD is correctly taking net capital charges relative to the size of the commitment or using a written agreement with another syndicate member ("backstop provider") Review draft or final prospectus (or similar document) and coordinate with the issuer to ensure the document meets the disclosure requirements in FINRA Rule 5110(b) including inclusion of all items of underwriting compensation received or to be received and: securities to be acquired by KCD or an affiliated SPAC sponsor whether KCD or an affiliate is under common control with the issuer any services, or payments received for providing additional services to the SPAC (advisory or other services) Monitor compensation to ensure it conforms with the proposed compensation submitted to FINRA Identify conflicts of interest including pre-existing relationships between the SPAC,

	the sponsor, or members of its management and board of directors and companies operating in the SPAC's expressed business or target area (pre-merger) including: disclosures of conflicts employee trading Review/approve proposed marketing materials Review customer transactions for compliance with Reg BI Confirm required disclosures are provided for potential investors
Record	Records of due diligence, information barriers, reviews of employee involvement, and net capital considerations, if applicable Review of sponsors/managers/registration statement Review/approval of marketing materials Review of customers transactions and actions taken, if any Copy of disclosure document(s) provided to prospective investors and record of providing

SPACs are shell companies that raise capital through IPOs for the purpose of merging with or acquiring an operating company. KCD may sponsor or is under common control with the sponsor of a SPAC or engages in underwriting SPACs. SPAC offerings are subject to Firm policies and procedures, FINRA rules and Regulation Best Interest (Reg BI).

This section outlines the differences between SPACs and traditional equity IPOs. RRs are responsible for understanding the features of a SPAC before recommending purchase to a potential investor and communicating the differences to the investor.

	Traditional IPO	**SPAC**
Revenue or operating history of issuer	Available and subject to underwriter due diligence	No history
Operates as blank check company	n/a	Yes - no specific business plan or purpose; may have indicated plans to engage in a merger or acquisition with unidentified companies
Due diligence	Underwriter conducts due diligence on issuer	No due diligence on targeted acquisitions since they are not identified at time of offering
Penny stock	n/a	May issue penny stock; if so, investor funds must be held in escrow and returned if an acquisition does not occur within 18 months of the initial registration statement. Most SPACs structure to be exempt from penny stock designation which means escrow does not apply.
Price	Offered at price per share	Offered at unit price
Dissolution	n/a	Typically must complete an acquisition within 18 to 24 months and use at least 80% of its net assets for any acquisition; if it does not, it must dissolve. Upon dissolution, investors receive a pro rata share of the assets in escrow which usually is all of principal invested but without a share of returns on the assets since those are used for operating expenses of the SPAC.
Secondary market	Listed or OTC	SPACs sell as units which typically are comprised of common

trading	market for shares	stock and a warrant which trade separately within weeks of the IPO. Common shares often trade at a discount to cash held in escrow; warrants are exercisable only upon successful completion of any acquisition and will expire worthless if the SPAC is liquidated.
Targeted acquisitions	n/a	Subject to shareholder vote; investors receive proxy materials outlining the proposed acquisition which may or may not be approved. After a target is announced, it may be weeks before audited financial statements regarding the target are available through the preliminary proxy filing. Acquisition terms and arrangements may change during the proxy filing and review period. SPACs typically require 60% shareholder approval of an acquisition; some require as high as 80% of shareholders.
Completed acquisition	n/a	SPAC sponsors may have a conflict of interest to complete acquisitions. They do not receive a pro rata distribution if the acquisition is not completed and are typically prohibited from selling their shares in the secondary market prior to completion of an acquisition. SPAC managers have a strong incentive to buy a company since they will get 20% of the company at a nominal price.

24.5.1 Suitability/Reg BI Compliance

RRs must comply with Regulation BI requirements for recommendations to retail investors or conduct a suitability analysis for non-retail investors before offering a SPAC to an investor. This includes understanding the features and risks of the SPAC and communicating them to the investor. Potential investors should have no current need for the funds invested since SPACs are longer-term investments that tie up funds without any immediate return.

Reg BI includes recommendations for orders, types of accounts, and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

24.5.2 Risk Disclosures

The following risks must be disclosed to potential investors. This may be accomplished by communicating this information directly or through written disclosures/preliminary prospectuses provided at the time of solicitation.

- SPAC managers may be unqualified or incompetent with no history of operations or past performance of the SPAC.
- No acquisition may occur and the SPAC will be liquidated. While investors have some protection since escrowed funds are returned on a prorated basis (with no guarantee of full principal return) and may be able to sell units on the secondary market, there is an opportunity cost of waiting for acquisitions to be completed.

24.5.3 Secondary Market

Buying units in the secondary market involve other considerations. The **common stock** value may depend on whether or not an acquisition target has been announced and whether an announced target is an attractive investment. Release of more information about a target sometimes results in decline in the price of the common stock.

Warrants are suitable only for sophisticated investors with speculative investment objectives who are willing to assume the risk the warrants may expire worthless. Buying warrants after a targeted acquisition is announced includes the risk of increased price at the time of the announcement and potential price decline during a period of delay and release of information about the target.

FINRA research indicates SPAC share prices outpace the market on the day an acquisition target is announced and significantly lag the market after the acquisition is completed.

24.6 Communications Around The Time Of Registered Offerings

[SEC Securities Act of 1933 Rule 134, Rule 135, Rule 163, Rule 163A, Rule 164, Rule 168, Rule 169, Rule 405 and Rule 433; SEC Release No. 34-52056; FINRA Rule 2210; FINRA Regulatory Notice 10-52; JOBS Act, Title I; SEC JOBS Act Frequently Asked Questions: http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm]

Issuing communications (other than the prospectus) to investors around the time of an offering may constitute "gun-jumping." Certain types of communications are permitted or are exempt from gun-jumping restrictions under federal rules. This section summarizes key elements of communications about offerings. The rules are complex and technical; questions should be referred to Compliance.

24.6.1 Categories Of Issuers

Permitted communications depend, at least in part, on the category of the issuer, summarized below (the rules should be consulted for details regarding eligibility and ineligibility).

Well-known seasoned issuer: An issuer current and timely in its '34 Act reports for at least one year and has either $700 million of worldwide public common equity float, or has issued $1 billion of non-convertible securities (other than common equity) in registered offerings for cash in the preceding three years.

Seasoned reporting issuer: An issuer eligible to register as a primary offering of securities on Form S-3 (among other requirements). To be Form S-3 eligible for a primary offering, a company must have an aggregate market value of $75 million or more of common equity held by non-affiliates.

Non-reporting and unseasoned issuers: An issuer that does not fall within the above categories (this category is subject to specific restrictions).

Ineligible issuers: Issuers that are ineligible as defined in Rule 405 and where communications outside the prospectus are not permitted. Rule 164 regarding free writing prospectuses also excludes investment companies registered under the Investment Company Act of 1940 and offerings involving an issuer registering a business combination transaction.

Emerging growth company ("EGC"): A company that conducts an IPO after December 8, 2011 and had annual gross revenues of less than $1 billion during its most recent fiscal year. A company will retain EGC status until the earliest of:

- the first fiscal year after its annual revenues reach $1 billion;
- the first fiscal year following the fifth anniversary of its IPO;
- the date on which the company has, during the previous three-year period, issued more than $1 billion in non-convertible debt; and
- the date on which the company becomes a "large accelerated filer."

24.6.2 Other Definitions

Free writing prospectus: A written communication (including electronic communications) outside the statutory prospectus that after the filing of the registration statement, may be filed with the SEC, with certain conditions depending on the type of issuer.

Written communications: All methods of communication other than oral communications are defined as "written." Written communications include any communication that is written, printed, a radio or television broadcast, or graphic communication. *Graphic communication* excludes communications that are carried live and in real-time to a live audience, regardless of the method of transmission. All electronic communications (other than telephone and other live, in real-time communications to a live audience) are "written."

Electronic roadshows: Live electronic roadshows, even though transmitted to a live audience via an electronic medium, are not considered "written" material. Electronic road shows that are not live are considered free writing prospectuses. Electronic road shows for IPOs of common equity or convertible equity securities do not have to be filed with the SEC if a version of the bona fide electronic road show is made readily available to an unrestricted audience. No other road shows are subject to filing with the SEC.

24.6.3 Permitted Offering Activity And Communications

The following is an overview of permitted communications.

- Well-known seasoned issuers may engage, at any time, in oral and written communications, including the use of a free writing prospectus.
- Emerging Growth Companies (EGCs) are subject to fewer restrictions than other issuers. Contact Compliance for clarification of permitted communications. Some restrictions or permissible activities involving EGCs include:
  - Any firm subject to the Global Settlement remains restricted by any applicable terms of the settlement.
  - When "testing the waters," an underwriter may ask customers for nonbinding indications of interest, including how many shares the customer may seek to purchase, without violating rules requiring the provision of a preliminary prospectus when soliciting orders.
- All reporting issuers may, at any time, continue to publish regularly released factual business information and forward-looking information.
- Non-reporting issuers may, at any time, continue to publish factual business information that is regularly released and intended for use by persons other than in their capacity as investors or potential investors.
- Communications by issuers, more than 30 days before filing a registration statement, are permitted, if they do not reference the securities offering that is the subject of a registration statement.
- All issuers and offering participants may use a free writing prospectus after the filing of the registration statement, subject to conditions. The statutory prospectus has to accompany or precede the free writing prospectus for unseasoned or non-reporting issuers, if the issuer or an offering participant prepares or pays for the free writing prospectus.
- Some routine communications are permitted, including an offering schedule or about account opening procedures.
- Research reports (other than reports on EGCs) may be issued under the safe harbors of Rules 137, 138, and 139. There are no restrictions on issuing research reports on EGCs.
- Media interviews are permitted if they meet the conditions of Rule 433 and conditioned on whether the issuer or participant paid for the media communication.
- Any prospective issuer (and underwriters authorized to communicate with potential investors), under SEC Rule 163B, may "test-the-waters" with communications prior to or following the filing of a registration statement. Communications must be limited to potential investors who are, or that the issuer or underwriter reasonably believes are, "qualified institutional buyers" (defined in Rule 144A) or institutional accredited investors (defined in Rule 501). Rule 163B-compliant communications are not required to be filed with the SEC or include any specific legends. Such communications are not included in the definition of a free writing prospectus under Rule 405 and 424(b), but any such communications are considered offers subject to anti-fraud provisions. Issuers subject to Regulation FD need to consider whether such communication triggers Regulation FD requirements or if another exemption applies.

24.6.4 Social Media

[SEC Securities Act Rules Compliance and Disclosure Interpretations (re applicability of rules to use of social media relating to offerings): https://www.sec.gov/divisions/corpfin/securities-act-rules (search for “social media”)]

The SEC has provided guidance regarding use of social media for certain written communications otherwise subject to SEC regulation, as follows. The Compliance and Disclosure interpretations should be referenced for details.

Rule 134 announcements
Free writing prospectuses
Business combination communications
Proxy solicitations
Pre-commencement communications in tender offers

The SEC's guidance addresses legend requirements. Existing rules restricting the permitted content of these communications and/or that impose filing requirements are unchanged. The legend requirement may be satisfied by using an active hyperlink under the following conditions:

The electronic communication is distributed through a platform that has technological limitations on the number of characters or amount of text that may be included;
Including the required statements in their entirety, together with the other information, would cause a communication to exceed the limit on the number of characters or amount of text; and
The communication includes an active hyperlink to the required legend (and other required information) and prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

24.6.5 Free Writing Prospectus

Any free writing prospectus distributed in a manner reasonably designed to lead to "broad unrestricted dissemination" [described in Securities Act Rule 433(d)(1)(ii)] is subject to FINRA Rule 2210 (Communications with the Public). Free writing prospectuses are subject to the following:

Review and approval by a registered principal prior to distribution
Filing with FINRA within 10 days of first use
For FWPs provided to institutional investors [defined in FINRA Rule 2210(a)], approval prior to distribution is **not** required.

Unrestricted dissemination includes posting an FWP on an unrestricted website or releasing it to the media. Posting to a restricted website or an FWP sent directly to customers (regardless of the number of customers) does not constitute broad unrestricted dissemination.

24.7 New Issue Allocations And Distributions

[FINRA Rule 5131]

The following sections outline policies and procedures that govern the sale of new issues of equity securities. A "new issue" refers to an initial public offering of an equity security [as defined in Section 3(a)(11) of the Exchange Act] made pursuant to a registration statement or offering circular.

24.7.1 Fixed Priced Offerings

[FINRA Rule 5141]

Offerings must be sold at the stated public offering price to buyers, i.e., preferences cannot be granted to purchasers. A reduced price below the stated price is prohibited other than to those that are a member participating in a selling syndicate or selling group. This prohibition applies until the termination of the offering or until, after making a bona fide public offering of the securities, securities remain unsold.

A member of a selling syndicate or selling group may sell securities in the offering to an affiliated person (subject to restrictions under Rule 5130) if the securities are not sold at a reduced price. The prohibition does not apply to research provided under a soft dollar arrangement under Section 28(e) of the '34 Exchange Act.

A "**reduced price**" includes any direct or indirect offer or grant of a selling concession, discount, or other allowance, credit rebate, reduction of any fee (including any advisory or service fee), any sale products or services below reasonable commercially available rates for similar products and services (except research as described below) or any purchase of or arrangement to purchase securities from the person or account at more than their fair market price in exchange for securities in the offering.

"**Fair market price**" refers to a price or range of prices at which a buyer and a seller, each unrelated to the other, would purchase the securities in the ordinary course of business in transactions that are of similar size and similar characteristics and are independent of any other transaction.

24.7.2 Indications Of Interest

Indications of interest are accepted prior to the effective date of the underwriting. Indications of interest are not orders and do not become orders until the syndicate supervisor confirms that securities are available to satisfy indications; RRs are responsible for re-confirming the customer's purchase of the securities at the time the issue is effective and allocated to customers. There is no assurance of an adequate quantity of securities to meet indications of interest.

24.7.3 Conditional Offers

KCD may allow "conditional offers" for an underwriting; RRs will be notified if such orders are allowed and during what period the customer may revoke the order.

24.7.4 Prospectuses And Confirmations To Purchasers

[SEC Securities Act of 1933 Rule 172 and Rule 173]

Responsibility	Syndicate Supervisor
Resources	Indications of Interest Record of purchasers
Frequency	As required
Action	Provide preliminary prospectuses to RRs when available Notify Operations to include the required disclosure on confirmations sent to purchasing customers If a final prospectus is required to be provided to investors, obtain prospectuses and forward to appropriate Operations personnel for sending or establish electronic access to the prospectus and notify purchasers

Record	A record of purchasers and sending of prospectuses (if required) is maintained in the deal file or establishment of electronic access and notice provided to purchasers

Confirmations And Notices Of Allocations Of Shares

Written confirmations and notices of allocations of shares offered, may be sent after the effectiveness of a registration statement (for an issue complying with Rule 172) without being accompanied or preceded by a final prospectus. Written communication from a broker-dealer to a customer, or from an underwriter to participating dealers in the selling group, may notify them of the basic terms of the transaction or their allocations of the securities. Notices of allocation may include the identity of the securities; CUSIP number; amount allocated; price; date or expected date of settlement; and incidental information.

When final prospectuses are not required, purchasers will be provided, no later than two business days after the sale a notice that the sale was made pursuant to a registration statement or in a transaction in which a final prospectus would not have been required to have been delivered in the absence of Rule 172.

24.7.4.1 Preliminary And Final Prospectuses

Preliminary prospectuses will be provided to RRs if available. These should be provided to customers submitting an indication of interest in the new issue.

The issuer is not required to print and physically deliver a final prospectus to investors, if the issuer files the prospectus with the SEC within a prescribed period of time and complies with certain other conditions. For issuers that are required to provide prospectuses, copies will be obtained and forwarded to purchasers. In lieu of sending prospectuses, purchasers may be notified of electronic access to prospectuses if the issue qualifies for this alternative under Rule 172.

An investor may request a physical copy of the final prospectus, but the prospectus is not required to be provided prior to settlement.

Purchases During The Post-Effective Period

[SEC Securities Act of 1933 Rule 174 and Section 4(3)]

There is no obligation to provide a prospectus to purchasers in the post-effective period if the issuer is a reporting company under Section 13 or 15(d) of the '34 Act; is a shelf offering (other than the first bona fide offering); or if the registration statement is on Form F-6. This exemption does **not** apply to blank check companies.

For issues not included above, customers who purchase in the post-effective period and where the issue satisfies the requirements of Rule 172, will be provided with the required notice (see *Confirmations And Notices Of Allocations Of Shares*, above) within two business days of the sale. This requirement applies for a period of 25 calendar days after the offering date.

For issues that do not qualify under Rule 172, purchasers during the period of 25 calendar days after the offering date will be sent a copy of the final prospectus.

Term Sheets

[SEC Regulation C Rule 421]

Term sheets may be provided to prospective purchasers and will meet the requirements of a plain English summary that includes most material terms of the proposed offering. Bullet points will cross-reference detailed information in the prospectus or other offering document.

Term sheets may also be provided to new issue purchasers who have received a preliminary prospectus. The term sheet is included with the customer's confirmation and supplements the preliminary prospectus to disclose final terms such as price and effective date.

Electronic Delivery Of Prospectuses

[SEC Securities Exchange Act of 1934 Release No. 37182 (May 1996) and Release No. 36345 (Oct. 1995)]

Where KCD determines to provide prospectuses through electronic media, the following guidelines apply:

- The prospectus itself may be sent to the investor by disk, tape, email, or similar method.
- If a prospectus is posted on KCD's web site, separate written notice by email or regular mail will be forwarded to the investor.
- Customers must agree to accept electronic delivery and consent retained in the customer's records.
- Delivery must be evidenced (confirmation document has been downloaded, record of hyper link access; *etc.*)
- Current updated versions of the preliminary prospectus may be posted on KCD's website available to all potential investors. Notice of updates is sent to investors expected to purchase the offered securities.
- Final prospectuses will be posted to the website and written notice mailed to purchasers notifying them how they may access the prospectus.
- When a prospectus is amended, (1) a postcard or email will be sent to investors notifying them of the availability of the amended prospectus or (2) a paper copy of the amendment will be sent to investors.

24.7.5 Restrictions On Purchase And Sale Of IPOs Of Equity Securities

[FINRA Rule 5130; FINRA Regulatory Notice 19-37]

Responsibility	Syndicate Supervisor
Resources	Indications of interest for IPOs
Frequency	As required, when equity IPOs are offered
Action	Review indications to determine no purchasers are restricted persons If potential purchasers are restricted, notify RR and offer the shares to a qualified purchaser
Record	Indications of interest and review to identify restricted persons are included in the underwriting file

When selling IPOs, the distribution of shares must be a *bona fide* public offering and fair distribution to the public. This means sales will not be made to benefit insiders in the securities industry or to other closely-related parties that might unfairly benefit at the expense of public customers. This section describes key elements of FINRA rule that limits the types of investors that may purchase equity IPOs.

The Rule should be consulted for specific details. Questions regarding restrictions should be directed to the syndicate supervisor or to Compliance.

24.7.5.1 Restricted Persons

Equity IPOs **may not be purchased** by "restricted persons" as defined in FINRA Rule 5130 including accounts where the restricted person has a beneficial interest. Restricted persons include:

- **FINRA members or other broker-dealers**
- **Broker-dealer personnel**
  - Any officer, director, general partner, associated person or employee of a member or any other broker-dealer;
  - Any agent of a member or any other broker-dealer that is engaged in the investment banking or securities business; or
  - An immediate family member or a person listed above if the above person:
    - Materially supports, or receives material support from, the immediate family member;
    - Is employed by or associated with the member, or an affiliate of the member, selling the new issue to the immediate family member; or
    - Has the ability to control the allocation of the new issue.
- **Finders and fiduciaries**
  - With respect to the security being offered, a finder or any person acting in a fiduciary capacity to the managing underwriter, including, but not limited to, attorneys, accountants and financial consultants; and
  - An immediate family member of a person above if the person materially supports or receives material support from the immediate family member.
- **Portfolio managers** (any person who has authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account) and their immediate family members if the person materially supports or receives material support from the immediate family member
- **Persons who have ownership in a broker-dealer including:**
  - **Direct owners** (any person listed, or required to be listed, on Schedule A of Form BD) unless ownership is less than 10%
  - **Indirect owners** (any person listed or required to be listed on Schedule B of Form BD) unless ownership is less than 10%
  - **Persons listed** or required to be listed **on Schedule C** of Form BD
  - **Persons that directly or indirectly own 10% or more of a public reporting company** listed or required to be listed in Schedule A or **persons that directly or indirectly own 25% or more of a public reporting company** listed in Schedule B of Form BD (other than reporting companies listed on an Exchange, the NASDAQ National Market, or that is a limited business broker-dealer)
  - **Immediate family members** of the above, with some exclusions in the Rule

Excluded from the definition of "restricted person" is an **employee** or immediate family member of an employee of a **"limited business broker-dealer"** which is defined as any broker-dealer whose business is limited solely to the purchase and sale of investment company/variable contract securities and direct participation program securities.

General Prohibitions

The following summarizes the general prohibitions that apply to the sale of equity IPOs.

- Restricted persons are not allowed to purchase IPOs, unless there is an available exemption.
- A broker-dealer or associated person (AP) may not purchase an equity IPO in an account where the BD or AP has a beneficial interest.
- A broker-dealer may not continue to hold new issues acquired as underwriter or selling group member except when the issue is under-subscribed (described in a later section).

Certification Of Non-Restricted Status Required From All Purchasers

Responsibility	Syndicate Supervisor Compliance - annual negative consent
Resources	Indications of interest IPO certifications
Frequency	As required, when equity IPOs are offered Annual - negative consent letter
Action	Determine whether proposed purchaser has submitted the IPO certification If not, contact RR or otherwise obtain the required certification For accounts lacking certification, exclude from IPO purchasers Compliance - arrange for annual negative consent and change the customer's eligibility to purchase IPOs if the customer's non-restricted status has changed
Record	Notation that indications have been reviewed for certifications are included in the underwriting file Certification is noted on the account record and retained in customer records Record is retained that the annual negative consent has been sent

An IPO may not be sold to an account unless, during the prior 12 months, KCD has received certification that the account is eligible to purchase new issues. This includes certification from conduit accounts (discussed below). KCD or an RR cannot rely on a certification that it has reason to believe is not accurate.

Initial And Annual Certification

Prior to the first purchase of an equity IPO, the prospective purchaser must sign and submit the IPO Certification form that certifies that the underlying beneficial owners are not restricted persons. The account will be considered non-restricted based on the customer's certification.

After receiving the IPO Certification, KCD will annually send a negative consent letter asking the customer to notify KCD if the initial certification is no longer accurate.

Conduit Accounts

Certification must be obtained when a potential IPO purchaser is a "conduit" account, which includes, for example, an investment partnership or corporation, a foreign investment company, an investment adviser, and an account for which a bank or trust company is acting as a conduit. The conduit is required to certify that the beneficial owner or ultimate purchaser is not a restricted person.

24.7.5.1.1 Indirect Beneficial Owners

[FINRA Rule 5131.02(b)]

Where it is difficult to identify indirect beneficial owners such as participants in unaffiliated private funds (such as a fund of funds), the Firm may rely on a written representation obtained within 12 months by a person authorized to represent an account that does not look through to the beneficial owners of any unaffiliated private fund invested in the account, except for beneficial owners that are control persons of the investment adviser to the private fund. An unaffiliated private fund that qualifies under this exception:

- is managed by an investment adviser;
- has assets greater than $50 million;
- owns less than 25% of the account and is not a fund in which a single investor has a beneficial interest of 25% or more; and
- was not formed for the specific purpose of investing in the account.

An "unaffiliated private fund" is a private fund defined in Section 202(a)(29) of the Investment Advisers Act, whose investment adviser does not have a control person in common with the investment adviser to the account.

Third Party Vendor Certifications

[FINRA Interpretive Letter dated 2/17/04 to Tom Fleming of Dealogic]

KCD may use a third party that obtains certification that potential purchasers are eligible to buy IPOs. Under this approach, the syndicate supervisor is responsible for confirming that the third party has procedures in place that comply with FINRA Rule 5130 and for signing an agreement with the vendor. When a third party is used, KCD's records will include verification of IPO purchasers' eligibility against the third party's records and at least annual review that the third party's procedures comply with FINRA requirements. Record of third party certifications is retained in the deal file.

Exemptions

Equity IPOs **may be sold** to the following types of accounts and are **not subject to** restricted person prohibitions or requirements.

- Registered investment companies.
- Common trust funds with investments from 1000 or more accounts and that do not limit interests in the fund principally to trust accounts of restricted persons.
- Insurance company general, separate, or investment accounts provided that:
    - the account is funded by premiums from 1000 or more policyholders, or, if a general account, the insurance company has 1000 or more policyholders; and,
    - the insurance company does not limit the policyholders whose premiums are used to fund the account principally to restricted persons, or if, a general account, the insurance company does not limit its policyholders to restricted persons.
- *De minimis* exemption for purchase by an account if the beneficial interests of restricted persons do not exceed the aggregate 10% of the account.
- Publicly traded entities listed on a national securities exchange or traded on the NASDAQ Global Market (NGM) or are foreign issuers that meet the quantitative designation criteria for listing on a National securities exchange or NGM. This exemption **does not** include sales to publicly-traded broker-dealers or a publicly-traded affiliate of a broker-dealer.
- Foreign investment companies organized under the laws of a foreign jurisdiction that are listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority provided that no person owning 5% or more of the investment company is a restricted person.
- ERISA benefit plans qualified under Section 401(a) of the Internal Revenue Code (IRC) provided the plan is not sponsored solely by a BD.
- State or municipal government plans subject to state and/or municipal regulation.
- Tax-exempt charity organized under Section 501(c)(3) of the IRC.

Church plans described in Section 414(e) of the IRC.

Issuer-Directed Securities

[FINRA Rule 5130(d) and 5130.01]

Issuers often direct the underwriter to offer shares to certain persons. Issuer-directed securities may not be sold to:

- a broker-dealer.
- an account in which any restricted person (broker-dealer personnel/immediate family and finders/fiduciaries as defined by the rule) has a beneficial interest. This applies unless such a person or an immediate family member is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer or the issuer's parent. A parent/subsidiary relationship exists if the parent has the right to vote 50% or more of a class of voting security of the subsidiary, or has the power to sell or direct 50% or more of a class of voting security of the subsidiary.

The following are exempt from the restrictions on sales of IPOs.

- Shares are specifically directed by the issuer and are part of an offering in which no broker-dealer:
  - underwrites any portion of the offering;
  - solicits or sells any new issue securities in the offering; and
  - has any involvement or influence, directly or indirectly in the issuer's allocation decisions with respect to any of the new issue securities in the offering.
- Offering shares are 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.
- 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.

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.

Stand-By Purchasers

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

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

Firm Account

KCD is not permitted to retain shares in an initial IPO that is oversubscribed. If a customer cancels his or her indication of interest, the shares will be reallocated to fill another customer's interest. If, in the unusual circumstance another buyer cannot be found, Compliance must be contacted regarding proper placement of the securities which, if retained in a firm account, will be held for a minimum of 60 days.

If KCD is unable to sell all shares for which it has committed and the issue is under-subscribed, KCD may place those shares in a firm account.

24.7.5.2 Definitions Applying To New Issue Allocations And Distributions

[FINRA Rule 5130(i) and 5131(e)]

The following are selected Rule definitions; the Rule should be consulted for other definitions.

Beneficial interest: Any economic interest such as the right to share in gains and losses. This excludes receipt of a management or performance-based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity.

Collective investment account: Any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle engaged primarily in the purchase or sale of securities. This does not include a family investment vehicle or investment club.

Flipped: The initial sale of new issue shares purchased in an offering within 30 days following the offering date of the offering.

Immediate family member: Parents, in-laws, spouse, siblings, and children. The definition also includes anyone else to whom the person provides material support.

Material support: Directly or indirectly providing more than 25% of a person's income in the prior calendar year. Members of the immediate family living in the same household are deemed to be providing each other with "material support."

New issue: Any initial public offering of an equity security as defined in Section 3(a)(11) of the Exchange Act made through a registration statement or offering circular. FINRA Rule 5130(i)(9) excludes a number of offerings from this definition (refer to the rule for details) including sales under Rule 144, 144A, or 506; offerings of exempt securities; commodity pools; rights offerings; exchange offers; investment-grade asset-backed securities; convertible securities; preferred securities; investment companies; ADRs; and DPPs. This list does not include all exempt securities listed in the FINRA rule.

Penalty bid: An arrangement that permits the managing underwriter to reclaim a selling concession from a syndicate member in connection with an offering when the securities originally sold by the syndicate member are purchased in syndicate covering transactions.

Restricted person: Defined at the beginning of this section.

24.7.6 Disclosure Of Interest In Distribution

[SEC Securities Exchange Act of 1934 Rule 15c1-6; FINRA Rule 2269]

At or before completion of a transaction in a primary or secondary distribution with managed accounts or other accounts where a fee is charged, the customer will be provided with written notice of the existence of KCD's participation in the distribution.

24.7.7 State Blue Sky Requirements

The syndicate supervisor is responsible for reviewing purchasers, prior to confirming transactions, to ensure the issue is sold only to purchasers in states where the issue is blue skied or is eligible for sale under an exemption.

24.7.8 Cancellation Policy

Indications of interest are not orders until the customer is contacted and confirms that securities allocated to the customer are accepted. At that point, a confirmation and final prospectus will be provided and the customer will be expected to pay for the transaction.

If the customer then cancels the purchase, Compliance should be contacted to resolve the matter, which may include:

- Consideration of whether the customer received a preliminary prospectus prior to confirming the purchase.
- Determination whether the customer should be held responsible for the purchase or the purchase cancelled.
- If cancelled and all other securities were sold in the underwriting, offer the new issue to another customer whose interest was not filled.
- If no other customer is available to purchase the securities, cancel the purchase to KCD's account. The RR who sold the shares may be held responsible for any loss incurred due to the cancellation.

24.7.9 Designated Orders

When the firm has been designated by a customer and is not acting as underwriting manager, the following information will be retained for 24 months:

- name of customer making designation
- identity and amount of securities designated
- identity of manager or managers of the offering
- date of commencement of the offering

24.7.10 Flipping

[FINRA Rule 5131(c)]

Customers may be limited or prohibited from purchasing future new issues at the syndicate supervisor's discretion because the customer engages in short-term trading of new issues (selling the new issue immediately or shortly after it becomes effective).

Flipping refers to the practice of selling new issues into the secondary market at a profit within 30 days following the offering date. KCD and its employees are prohibited from directly or indirectly recouping, or attempting to recoup, any portion of a commission or credit paid or awarded to an associated person for selling shares of a new issue that are subsequently flipped by the customer, unless the managing underwriter has assessed a penalty bid on the entire syndicate. Under a penalty bid, KCD itself is required to forfeit its compensation to the managing underwriter(s).

24.7.11 Quid Pro Quo Allocations

[FINRA Rule 5131(a)]

KCD (and its employees) are prohibited from offering or threatening to withhold shares it allocates of a new issue as consideration or inducement for the receipt of compensation that is excessive in relation to the services provided by KCD. The rule prohibits a firm from using an allocation of a new issue as a means of obtaining a "kick back" from the recipient in the form of excessive compensation for services offered by KCD. The prohibition applies not only to trading services but also to any service offered by KCD. The rule does not prohibit providing services where the customer does not pay excessive compensation.

24.7.12 Spinning

[FINRA Rule 5131(b)]

FINRA rule prohibits firms from allocating shares to obtain the investment banking business of a customer. KCD and its employees are prohibited from allocating shares of a new issue to any account where an executive officer or director of a public company or a covered non-public company, or a person materially supported by such executive officer or director, has a beneficial interest:

- If the company is currently an investment banking services customer of KCD or KCD has received compensation from the company for investment banking services in the past 12 months;
- If the person responsible for making the allocation decision knows or has reason to know that KCD intends to provide, or expects to be retained by the company for, investment banking services within the next 3 months; or
- On the express or implied condition that such executive officer or director, on behalf of the company, will retain KCD for the performance of future investment banking services.

These prohibitions do not apply to allocations to any account exempt under FINRA Rule 5130(c) listed in the section *Restrictions On Purchase And Sale of IPOs Of Equity Securities – Exemptions* in this chapter **with the exception** of the *de minimis* exemption if beneficial interest does not exceed 10%. The spinning exception applies to persons materially supported by them in aggregate do not exceed **25%** of such account.

The New Issue Certification includes inquiry whether the potential purchaser is an executive officer or director or person materially supported by them.

24.8 Trading Restrictions While Participating In A Distribution

[SEC Regulation M; FINRA Notice to Members 97-10; FINRA Reg M Frequently Asked Questions: https://www.finra.org/rules-guidance/faq/regulation-m]

Responsibility	Compliance - Restricted List, review of transactions for compliance Designated supervisor - Review for prohibited short sales
Resources	Notification from the syndicate supervisor regarding pending deals Customer transaction reports Available exception reports
Frequency	As required

Action	Compliance: Add to and remove from the Restricted List securities subject to Regulation M trading restrictions Review transactions for compliance Where exceptions are identified, contact the RR/RR's supervisor regarding the transaction Determine whether the transaction must be cancelled Designated supervisor: Review transactions for five business days before pricing of the offering and ending with pricing; or for the period beginning with the initial filing of the registration statement or notification on Form 1-A and ending with pricing (whichever period is shorter) to identify violating short sales If violating short sales are identified, contact the RR and the RR's supervisor and cancel the transactions or take other corrective action in consultation with Compliance Identify market orders for new issues entered prior to trading of shares in the secondary market and, if found, take corrective action which may include consultation with the RR and the RR's supervisor and cancellation of the transaction
Record	Notification from the syndicate supervisor Record of orders reviewed including exceptions and corrective action and reviewer's initials and date reviewed

Trading restrictions apply to securities that are the subject of a distribution and also apply to a "reference security," a security into which the distributed security may be converted, exchanged, or exercised or where the terms of the distributed security may determine the value of the reference security. Bids for and purchases of outstanding nonconvertible debt securities are not restricted unless the security being purchased is identical in all terms to the security being distributed. Investment grade nonconvertible debt securities, nonconvertible preferred securities, and asset-backed securities are excluded from restrictions.

24.8.1 Distribution Participant Restrictions

[SEC Regulation M Rule 101]

Orders may not be solicited in the outstanding securities of an issue the subject of an underwriting (and reference securities) under certain conditions of Regulation M:

- No restriction for securities with average daily trading volume (ADTV, as defined in Rule 101) of $1 million or more and a public float of at least $150 million
- One business day restriction for securities with ADTV of at least $100,000 but less than $1 million and a public float of at least $25 million
- Five business days for all other securities

The syndicate supervisor will notify Compliance when an issue is subject to these restrictions. Compliance will update KCD's Restricted List and will monitor daily transactions to inquire whether transactions are solicited or unsolicited, if not included on the order record. If transactions are solicited, Compliance will determine what corrective action is necessary.

The restriction remains in effect until price and trading restrictions are lifted.

24.8.2 Issuer And Selling Security Holder Restrictions

[SEC Regulation M Rule 102]

Issuers, selling security holders, and their affiliated purchasers are restricted from engaging in bidding for, purchasing, or attempting to induce someone else to bid or purchase for a distributed security.

24.8.3 Short Sales

[SEC Regulation M Rule 105; SEC Release No. 34-56206]

A person may **not** purchase a security from an underwriter or broker or dealer participating in a public offering if the person sold the security short during the "Rule 105 restricted period." The Rule 105 restricted period is the shorter of:

- the period beginning five business days before the pricing of the offered securities and ending with such pricing; or
- the period beginning with the initial filing of the registration statement or notification on Form 1-A or Form 1-E and ending with the pricing.

Exceptions to the short sale limitation include the following.

1. Bona fide purchases: Restricted period short sellers may purchase offered securities if they make a bona fide purchase of the same security prior to pricing. A *bona fide purchase* must be:

- at least equal in quantity to the entire amount of the Rule 105 restricted period short sale(s);
- effected during regular trading hours;
- reported pursuant to an effective transaction reporting plan; and
- made after the last Rule 105 restricted period short sale and no later than the business day prior to the day of pricing

In addition, the person may not have effected a short sale that is a reported transaction within 30 minutes before the close of regular trading hours on the business day prior to the day of pricing.

2. Separate accounts: A purchase of the offered security may be made in an account that sold short during the Rule 105 restricted period in a separate account if decisions regarding transactions for the account are made separately and without coordination of trading or cooperation among or between accounts.

3. Investment companies: An individual fund within a fund complex, or a series of a fund, will not be prohibited from purchasing the offered security if another fund within the same complex or a different series of fund sold short during the Rule 105 restricted period.

There are conditions that apply to these exceptions; Compliance should be consulted for further guidance regarding covering short sales in securities subject to a public offering.

24.8.4 Market Order Prohibition

[FINRA Rule 5131(d)(4); FINRA Regulatory Notice 11-29]

Market orders accepted in both NMS stocks and OTC equity securities **are prohibited** when purchasing shares of a new issue in the secondary market prior to commencement of trading of the shares in the secondary market. The market order prohibition applies whether the order is from a customer of KCD, a customer of another broker-dealer, or another broker-dealer. Priced orders such as limit orders are not subject to the prohibition.

"Commencement of trading" in the secondary market is evidenced by the first trade on the listing national securities exchange as indicated by dissemination of an opening transaction in the security by that exchange. For OTC equity securities, commencement is evidenced by the first regular way, disseminated trade reported to the OTC Reporting Facility during normal market hours.

"Not held" orders are not considered "market orders" under this rule. The prohibition applies to "acceptance" of any market order. In the case of a proprietary order, if it is sent directly to an exchange, the prohibition does not apply. If the proprietary order is routed to a member firm, the order is "accepted" by the firm and therefore the restriction applies.

KCD may reject a market order for a new issue at any point within its order management system prior to executing or routing the order. If KCD rejects a previously-accepted customer order that is reportable, KCD must indicate on the report that KCD, not the customer, cancelled the order.

24.8.5 Prohibited Conduct

[SEC Release No. 34-51500; SEC Guidance Regarding Prohibited Conduct in Connection with IPO Allocations]

Responsibility	Designated Supervisor
Resources	Order records regarding IPO purchase and aftermarket transactions
Frequency	As required, when issues are over-subscribed
Action	Review purchases of IPOs vs. aftermarket purchases and sales to identify patterns which may indicate prior inducements Contact supervisors and RRs regarding questionable transactions If violations are determined, take corrective action in consultation with Compliance regarding disciplinary action against the RR
Record	Transactions reviewed including reviewer, date reviewed, and action taken, if any

Underwriters often engage in "bookbuilding" which involves seeking information from potential investors regarding their interest in the prospective issue including number of shares and price. Bookbuilding helps the pricing and success of the new issue.

There are related practices that are prohibited because they constitute attempts to induce aftermarket bids and purchases, which negatively affect the integrity of the distribution process. The following practices are **prohibited**, per the SEC:

- Agreements to purchase shares in the aftermarket in exchange for an IPO allocation, prior to completion of the distribution. This includes agreements to purchase shares in another less desirable stock to obtain an IPO allocation.
- Communicating to customers that expressing an interest in or buying shares in the immediate aftermarket would help them obtain allocations of over-subscribed ("hot") IPOs.
- Soliciting customers before the completion of the distribution about whether and at what price and in what quantity the customer intends to place immediate aftermarket orders for IPO stock where the clear expectation and understanding is that the customer will submit aftermarket orders at the prices and quantities discussed if the customer receives an allocation of shares.
- Proposing aftermarket prices to customers or encouraging customers who express aftermarket interest to increase the prices at which they are willing to place orders in the immediate aftermarket.
- Soliciting interest from customers in purchasing aftermarket shares in some fixed proportion to the customer's IPO allocation.
- Soliciting aftermarket orders from customers before all IPO shares are distributed or rewarding customers for aftermarket orders by allocating additional IPO shares to such customers.
- Communicating to customers in connection with one offering that expressing an interest or buying in the aftermarket would help them obtain IPO allocations of other over-subscribed IPOs.

24.9 Market Making Activities

[SEC Regulation M Rule 103; FINRA Notice to Members 93-29; NASDAQ Rule 4600]

When KCD is a market maker in an issue in which KCD is participating in the underwriting, one of the two following procedures will be followed:

- KCD will withdraw as a market maker during the restricted period, or,
- KCD will engage in passive market making as defined in Rule 103 of Regulation M.

Passive market making procedures are discussed in the chapter *EQUITY TRADING AND MARKET MAKING*.

The designated supervisor of equity trading is responsible for determining whether KCD will act as a passive market maker and ensuring the required procedures are followed.

24.10 At-The-Market (ATM) Offerings

[SEC Regulation M Rule 100 and Rule 104]

An "at-the-market" offering is a form of shelf registration that allows a company to sell newly-issued shares into the market at prevailing market prices from time to time over a period extending to 36 months rather than through a traditional underwriting offering a fixed number of shares at a fixed price in one event.

The following summarizes key requirements and characteristics of ATM offerings.

- The company files a shelf registration statement on Form S-3 or Form S-3ASR for issuers that qualify as well-known seasoned issuers (WKSI).
- The basic prospectus states that sales of stock may be made from time to time at prevailing market prices by the issuer or through a designated agent.
- The issuer enters into a sales agreement with a broker-dealer that acts as placement agent.
- The issuer may establish terms of sales orders such as minimum required pricing, volume limitations, *etc.* and the terms may be altered at any time. Orders may be executed over an ECN or sold in block trades, private sales, and otherwise.
- Programs may last up to 36 months.
- The issuer will typically disclose aggregate sales and commission amounts on a quarterly basis in a prospectus supplement to update the base prospectus.
- The terms of an ATM offering generally do not restrict an issuer's ability to issue equity securities in traditional underwritten public offerings or PIPE sales.
- Lock-up provisions in a typical underwritten offering will also restrict sales under an ATM offering program, unless otherwise agreed.

24.10.1 Placement Agent Responsibilities

KCD will follow procedures outlined in the section *Managing Underwriter* in this chapter including executing a letter of intent; conducting due diligence; and submitting the deal to the Investment Committee for review. Upon acceptance of the deal, KCD will execute a sales agreement with the issuer.

24.10.2 Restrictions on Purchasers of New Issues

[FINRA Rule 5130]

The restrictions on purchasers of new issues apply to at-the-market offerings. This restricts employees of broker-dealers and others from buying new issue shares. Refer to the section *Restrictions on Purchase and Sale of IPOs of Equity Securities* in this chapter for further details.

24.10.3 Settlement

KCD will submit a trade blotter to the issuer on an agreed-upon basis (which may be daily). The blotter includes all trades made during the preceding period and specifies gross proceeds. KCD will remit proceeds, net of the agreed-upon sales commission, to the issuer on or prior to settlement against electronic delivery of the requisite number of shares.

24.10.4 Program Maintenance

The program may last as long as 36 months. As long as it is effective, KCD will require periodic updates (or "bring downs") of its business and legal due diligence including legal opinions, negative assurance letters, and comfort letters. The frequency of bring-downs will be determined by the designated supervisor and will generally be quarterly, but no less frequent than annually. Material events (a change to the issuer's status including acquisitions or mergers; significant changes in business strategy or financial condition; *etc.*) will trigger an immediate bring-down to re-evaluate the program.

24.10.5 Stabilizing Activities

[SEC Regulation M Rule 104(e)]

Stabilizing is prohibited in an at-the-market offering.

24.11 Structured Finance Product Rating Requests

[SEC Securities Exchange Act of 1934 Rule 17g-5]

Responsibility	Designated Supervisor
Resources	Requests for rating of a structured finance product
Frequency	As required
Action	Request rating from an NRSRO Establish a password-protected web site (accessible to other NRSROs) that includes the information provided to the NRSRO from which a rating is requested
Record	Record of rating request and information provided to NRSRO Records of password-protected web site and information posted

The Rules for Nationally Recognized Statistical Rating Organizations (NRSROs) impose requirements on broker-dealers (and other entities under the Rule) that seek to obtain a rating for a "structured finance product." Structured finance product refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. This includes (but is not limited to) asset-backed securities such as residential mortgage-backed securities and other types of structured debt instruments such as collateralized debt obligations (CDOs), including synthetic and hybrid CDOs, or collateralized loan obligations (CLOs).

When a rating is requested for a structured finance product, KCD will establish and maintain a password-protected web site containing the information provided to the NRSRO rating the product.

24.12 Crowdfunding

[Securities Act Section 4(a)(6); JOBS Act Regulation Crowdfunding; FINRA By-Laws Section 15; FINRA Funding Portal Rules; FINRA Rule 4518; FINRA funding portal web site: http://www.finra.org/industry/funding-portals; SEC Compliance & Disclosure Interpretations: https://www.sec.gov/divisions/corpfin/guidance/reg-crowdfunding-interps.htm; Report on FINRA's Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program; FINRA written supervisory checklist for funding portals: https://www.finra.org/compliance-tools/written-supervisory-procedures-for-funding-portals#:%7E:text=Written%20Supervisory%20Procedures%20Checklist%20for%20Funding%20Portals%201%2C3%20Updates%20...%204%20Staff%20Contact%20%28s%29%20]

Responsibility	Designated Supervisor
Resources	Requests to participate in crowdfunding
Frequency	As required
Action	Qualify KCD as a funding portal through FINRA Review the potential crowdfunding issue including: Conduct due diligence on the issuer including confirming the issuer's compliance with crowdfunding rule requirements Determine whether there is an impact on Firm capital Review membership rules to confirm a Continuing Membership Application is not required; file if required Confirm investors meet rule limitations Document the deal and investor participation Confirm all required issuer information is publicly available on KCD's platform including officers and directors of the issuer and positions of these individuals held for the past 3 years; descriptions of the purpose and intended use of proceeds; and financial statements Transmit funds to issuers upon successful completion of offerings or return funds to investors upon cancellation of the offering or in the event of oversubscription Obtain attestation when using a third-party vendor to store records Make required filings including the funding portal's Statement of Gross Revenue, updates or changes to contact information within 30 days of change; complaints; changes to ownership Obtain prior FINRA approval for changes in ownership
Record	Funding portal registration records Deal file including due diligence on the issuer and the issue, records of investors Transmission of funds Information on KCD's platform Third party vendor attestation (if applicable)

This section explains the requirements if KCD engages in crowdfunding. "Crowdfunding" generally refers to the use of the internet by small businesses to raise capital through limited investments from a large number of investors. Regulation Crowdfunding imposes certain gatekeeper responsibilities on intermediaries (*i.e.*, both funding portals and BDs that engage in Regulation Crowdfunding transactions). Funding portals are prohibited from offering investment advice or recommendations.

24.12.1 Introduction

Crowdfunding is an exemption to securities laws requiring registration of an issue. Following is a summary of key features of crowdfunding:

- Offer or sale of securities by an issuer through crowdfunding includes all entities controlled by or under common control of the issuer.
- The aggregate amount sold during the 12-month period preceding the date of the transaction cannot exceed $1 million.
- The amount sold to any investor cannot exceed:
  - The greater of $2,000 or 5% of the annual income or net worth of the investor if either the annual income or net worth of the investor is less than $100,000; and
  - 10% of the annual income or net worth of the investor cannot exceed a maximum aggregate amount or net worth of the investor is equal to or more than $100,000.
- The transaction must be conducted through a broker or funding portal.
- Rule 301(c)(2) requires that an intermediary has a reasonable basis for believing the issuer complies with Regulation Crowdfunding requirements. An intermediary also has an obligation to deny access if it has a reasonable basis believing the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection.
- The issuer must comply with crowdfunding requirements under '33 Act section 4A(b).

24.12.2 Funding Portal Registration

KCD is obligated to notify FINRA if it will act as an intermediary for crowdfunding transactions:

- Prior to the first transaction involving the offer or sale of securities in reliance of the crowdfunding exemption; or
- Within 30 days of directly or indirectly controlling, or being controlled by or under common control with a funding portal.

In addition, KCD may be required to apply for approval of a material change in business operations by filing a continuing membership application (FINRA Rule 1017).

24.12.3 Offers To Investors

RRs are responsible for making suitable/Reg BI-compliant determinations including confirming the investor qualifies based on limitations on crowdfunding issues.

24.12.4 Communications

Communications with investors are limited to Firm-approved communications which comply with funding portal requirements.

24.13 Intrastate Offerings

[Securities Act Section 3(a)(11); Securities Act Rule 147 and 147A]

Responsibility	Designated Supervisor
Resources	Information obtained regarding issuer from the issuer or other sources
Frequency	As required
Action	Evaluate issuer information and determine issuer's qualification under the Rules and KCD's participation Review information about potential purchasers to determine qualification to purchase and note acceptance or rejection of each purchaser Affirm required disclosures are provided to purchasers
Record	Issuer information and purchaser information are retained in the deal file

24.13.1 Introduction

Section 3(a)(11) of the Securities Act of 1933 provides an exemption from the registration requirements of the Act for any underwritten security that is offered or sold only to potential purchasers residing or doing business within, or, if a corporation, incorporated by and doing business within a single state or territory. SEC Rule 147 also includes specific requirements regarding the issuer to qualify as an intrastate offering. Rule 147A provides an exemption from SEC registration requirements allowing issuers that are incorporated in a different state to offer and sell securities in the state of their principal place of business as long as sales are limited to residents of that state. In addition under Rule 147A, issuers may make offers of securities across state lines, including via the internet, as long as sales are limited to residents of the state of the issuer's principal place of business.

The rules should be consulted for details regarding the requirements summarized below:

- the issuer's principal place of business in the state of the offering and the issuer must satisfy at least one "doing business" requirement demonstrating the nature of the business in the state of the offering;
- a "reasonable belief" standard in the determination of residence of a purchaser at the time of the sale of securities, which allows an issuer to rely on the Rules so long as the issuer has established a reasonable belief as to each purchaser's state of residence, even if it is ultimately determined that one or more purchasers did not reside in the state of the offering;
- a requirement that issuers obtain a written representation from each purchaser as to the purchaser's residency;
- for a period of six months following the sale by the issue to the purchaser, a restriction on resales of the securities to persons that were not resident within the state or the territory of the offering at the time of the offering;
- a safe harbor preventing the integration of the applicable offering with prior or certain future offers and sales of securities; and
- disclosure requirements to offerees and purchasers about the limitations on resales.
- Issuer must meet one of the following criteria:
  - Derive 80% of its revenues from the operations of a business or property within the State (allowing for revenues to come from out of state)
  - Maintain 80% of its assets within the State
  - 80% of the offering proceeds must be used within the State
  - Have a majority of its employees in the State

24.13.2 Qualifying The Issuer

The designated supervisor is responsible for ensuring the issuer is qualified under the requirements of Rules 147 and 147A if the Rules are to be applied as a safe harbor in the offering.

24.13.3 Purchasers

The designated supervisor is responsible for establishing procedures to review potential purchasers to ensure they meet the requirements of Rules 147 and 147A. A record of the purchasers and their qualifications under the rule requirements will be included in a file for the offering as well as any written notification to purchasers or affirmations from purchasers that they will not sell the securities to non-residents for 6 months after the offering.

24.13.4 FINRA Rule Obligations

[FINRA Notice to Members 00-12]

Intra-state offerings are subject to the filing requirements of FINRA Rule 5110 (Corporate Financing Rule - Underwriting Terms and Arrangements); the obligations of FINRA Rule 5121 (Public Offerings Of Securities With Conflicts Of Interest) and FINRA Rule 5130 (Restrictions on Purchases and Sales of IPO Equity Securities).

24.14 Regulation S Underwritings

24.14.1 Introduction

Regulation S provides safe harbor from registration requirements in the U.S. for offers and sales of securities outside the U.S. The Regulation includes extensive requirements for compliance and should be consulted. This section is provided as a synopsis of some of the restrictions and requirements.

The following restrictions apply to sales under Regulation S:

- Purchasers may not be a U.S. citizen or U.S. company
- Purchasers must be outside the U.S. at the time the buy order is originated
- Securities sold under Regulation S are classified as "restricted securities" within the meaning of Rule 144
- Securities may not be re-sold to U.S. persons (unless they are registered, meet the requirements of "Category 1" securities under Regulation S 230.903(b), or are subject to an exemption) during the distribution compliance period as defined in Regulation S (40 days for debt securities; one year for equities ["Category 2 or 3" securities])
- Purchasers must agree not to engage in hedging transactions
- Promissory notes may not be used to pay for securities

24.14.2 Purchaser Questionnaires

Responsibility	Syndicate Supervisor
Resources	Purchaser questionnaires
Frequency	As required, prior to purchases
Action	Review Purchaser Questionnaires to ensure they are complete and prospective purchasers meet the requirements of Regulation S Approve or disapprove Questionnaires
Record	Questionnaires are signed and dated by the syndicate supervisor and retained in a file for the Regulation S offering

Each purchaser of securities under Regulation S will be required to complete KCD's Regulation S Purchaser Questionnaire. The syndicate supervisor is responsible for approving the Questionnaires prior to the purchase of shares.

24.15 Eurobond And Foreign Sovereign Debt Offerings

Responsibility	Syndicate Supervisor
Resources	Information obtained regarding issuer from the issuer or other sources
Frequency	As required
Action	Determine whether seasoning requirements, if any, have been met Evaluate issuer information and determine KCD's participation Review information about potential purchasers to determine qualification to purchase and note acceptance or rejection of each purchaser
Record	Issuer information and purchaser information are retained in the deal file

24.15.1 Introduction

The Securities Act of 1933 permits foreign offerings to be sold in the U.S. KCD may participate in the primary offerings of Eurobonds and foreign sovereign debt securities. The syndicate supervisor is responsible for determining the applicability of the Securities Act to foreign offerings.

24.15.2 Seasoning Requirements

Certain foreign issues are subject to "seasoning requirements" prior to being offered in the United States. The syndicate supervisor is responsible for identifying foreign offerings subject to this requirement and ensuring offers are made only after the requirements have been satisfied.

24.15.3 Continuous Or Periodic Offerings

For foreign offerings that are offered on a continuous or periodic basis, the syndicate supervisor will notify traders and RRs when the securities may be offered for sale to customers. The supervisor will maintain a record of the basis for determining the offering is eligible for sale and the date when eligible.

24.15.4 Suitability

These securities will be offered only to purchasers who are suitable for assuming the additional risks in foreign issuers. Purchasers will be provided with a disclosure statement regarding the nature of foreign offerings; the disclosure will confirm KCD's understanding that the purchaser understands the risks and is willing to assume those risks.

24.15.5 Purchases By Non-U.S. Customers

Non-U.S. customers may purchase foreign offerings that do not meet the seasoning requirement for sales to U.S. customers. The syndicate supervisor is responsible for reviewing purchasers to ensure non-U.S. customers are, in fact, not considered U.S. persons. Non-U.S. customers will be forwarded a letter confirming KCD's understanding that the purchaser is not a U.S. person for purposes of the transaction. If a foreign purchaser is represented by an investment adviser or other agent, the letter will be forwarded to the adviser or agent and will state that the adviser or agent has confirmed to KCD that the ultimate purchaser is not a U.S. person.

24.15.6 Financial And Operations Considerations

The FINOP is responsible for establishing procedures for identifying positions in foreign debt instruments for net capital purposes and the ready market test for foreign securities, Regulation T, and possession and control considerations.

24.16 Regulation A Offerings

[SEC Regulation A; FINRA Regulatory Notice 15-32]

Responsibility	Designated Supervisor
Resources	Information obtained regarding issuer from the issuer or other sources
Frequency	As required
Action	Determine issue meets Regulation A requirements and integration issues Evaluate issuer information and determine the Firm's participation File offering statement electronically

Record	Regulation A and integration issue determinations and issuer information are retained in the deal file SEC filings

24.16.1 Introduction

This type of offering is available to domestic or Canadian issuers not subject to '34 Act reporting requirement or disqualification under "bad boy" provisions of Rule 262. Not available to investment companies, blank check companies, or issuers of oil, gas or mineral rights. The offering is limited to $5,000,000 within prior 12 months, but not more than $1,500,000 by selling security holders.

Regulation A is an amendment to the Securities Act of 1933 and provides for reduced requirements for smaller issuers in limited public offerings of issues up to $1.5 million. For a Regulation A offering, a limited registration statement is filed with the SEC. In addition, there are further exemptions for small issuers (known as Regulation A+ adopted under the JOBS Act) outlined in the section *Exemptions For Small Issuers* that follows. Key considerations for the syndicate supervisor include:

- whether the issuer is disqualified from distributions under Regulation A
- dollar limitations of the offering
- offers cannot be made prior to the filing of the registration statement and sales may not be effected until the offering statement is qualified

24.16.2 Dollar Limitation Of Offering

The syndicate supervisor is responsible for ensuring the issue is not oversold relative to the dollar amount disclosed in the offering document compared to the limitations provided in the rules. The supervisor should consider any "integration" of similar offerings by the same issuer for substantially identical purposes for determining whether the issuer meets the dollar limitation under the exemption within a 12-month period of time. The supervisor's review for integration may include one of the following or another procedure determined adequate by the supervisor:

- Reviewing the issuer's financial statements for the past 12 months and/or contact directly with the issuer
- Obtaining a representation letter from the issuer that states that no other offerings will be distributed in a succeeding 6-month period that would cause the exemption to be lost

The supervisor will retain a written record of this review in the offering's underwriting file.

24.16.3 Initiation Of Offers And Sales

The syndicate supervisor is responsible for notifying KCD personnel when a Regulation A offering is available for offering and when the registration statement is qualified to permit sales. A written record of these notices will be retained in a file for the offering.

24.16.4 Exemptions For Small Issuers

Responsibility	Designated Supervisor

Resources	Small offerings
Frequency	As required
Action	Determine eligibility for exemption Conduct due diligence into red flags such as insiders of the issuer with regulatory histories, conflicts of interest among parties, non-compliance with escrow requirements Confirm issuer is in compliance with requirements File offering statement electronically; where applicable, submit a draft offering statement to the SEC for non-public review (no less than 21 calendar days before qualification of the offering statement)
Record	Deal file include review for exemption and records of compliance with requirements SEC filings Records of solicitation of interest and filing of solicitation materials

There are two tiers of offerings for small issuers that enable them to offer and sell up to $50 million of securities in a 12-month period. Both tiers are subject to basic requirements with additional requirements for Tier 2 offerings.

- Tier 1 is for offerings of up to $20 million in a rolling 12-month period with no more than $6 million in offers by selling security holders that are affiliates of the issuer. These offerings are subject to federal and state registration and qualification requirements.
- Tier 2 is for offerings of securities of up to $50 million in a rolling 12-month period with no more than $15 million in offers by selling security holders that are affiliates of the issuer. These offerings are not subject to state requirements but are subject to federal registration and qualification requirements.
- Limits on secondary sales by affiliates limit sales by all selling security holders to no more than 30% of a particular offerings initial Regulation A offering and subsequent offerings for the first 12 months following the initial offering.
- For offerings up to $20 million, the issuer may choose Tier 1 or Tier 2 requirements.
- Both tiers permit issuers to submit draft offering statements for non-public review by SEC staff before filing, permit the continued use of solicitation materials after filing the offering statement, require the electronic filing of offering materials and otherwise align Regulation A with current practice for registered offerings.
- Tier 2 offerings also require:
    - Annual audited financial statements
    - Annual, semi-annual and current event reports
    - Limitation on the amount of securities non-accredited investors can purchase to no more than 10% of the greater of the investor's annual income or net worth
    - A transfer agent registered with the SEC
- The exemption is limited to companies organized in and with their principal place of business in the U.S. or Canada and is not available to certain companies outlined in the Rule.

24.16.4.1 Solicitation Of Interest

Regulation A+ allows eligible issuers and intermediaries to conduct a solicitation of interest in an offering (testing the waters), including solicitation of non-accredited investors, both before or after the filing of the offering statement. Solicitation materials must be filed with the SEC as exhibits to the offering statement.

24.17 Best Efforts Underwritings

[Exchange Act Rule 10b-9 and 15c2-4; FINRA Regulatory Notice 16-08; FINRA Notice to Members 84-7]

Responsibility	Designated Supervisor
Resources	Information obtained regarding issuer from the issuer or other sources
Frequency	As required
Action	Evaluate issuer information and determine the Firm's participation including: Reasonable investigation of the security and the issuer's representations Review of the terms of the contingency, including any agreement and disclosure by the issuer regarding the contingency Follow up any red flags such as inconsistencies between the escrow agreement and the offering document Establish a "separate account" or escrow account Confirm purchasers are *bona fide* purchasers where necessary Identify insiders, firm or employee account purchasers and obtain affirmation regarding holding period Require subscribers to reconfirm their investments if the issuer extends the offering period Return subscriber funds if the issuer changes the contingency by reducing the offering minimum Close escrow account and, if contingency met, immediately forward purchaser funds to issuer or, if contingency is not met, immediately return funds to potential purchasers
Record	Escrow account, issuer information and purchaser information are retained in the deal file

24.17.1 Introduction

Best efforts underwritings may take different forms including "all or none," "minimum-maximum," or other offerings contingent on the sale of a certain amount of the issuer's securities. Two primary concerns are that customer funds be transmitted to the issuer or to an escrow account and that only *bona-fide* purchasers are included in order to meet a stated minimum number of shares or units. Where the minimum is not sold within the deadline specified by the prospectus, all customer funds must be refunded.

Sales will be made only to *bona-fide* purchasers to meet any minimum amount of the securities to be sold.

24.17.2 Handling Investor Funds

The Firm will promptly:

Establish an independent bank escrow account.

Funds will be released to the issuer only after the contingency is satisfied.

24.17.3 Customer Funds - Escrow Account

[Exchange Act Rule 15c2-4]

The designated supervisor is responsible for establishing procedures for the protection of customer funds including the establishment of an escrow account where required.

- Establish an escrow account and execute escrow agreement with a bank that is not affiliated with the Firm. The escrow account may not be controlled by the issuer.
- Maintain copies of bank statements for the escrow account and review the statements when received, to ensure funds are not withdrawn prior to the date the contingency is met.
- Ensure customer funds are promptly deposited to the escrow account.
- Maintain records of all potential purchasers including the quantity to be purchased, when funds are received, and when funds are forwarded to the issuer or escrow account.
- Ensure checks are forwarded to the issuer (where an escrow account is not used) or to an escrow account by noon of the business day following receipt.
- Authorize release of funds to the issuer from an escrow account after the contingency is met and after a review of purchasers, as discussed in the next section, has been conducted.
- If the contingency is not met, promptly refund funds to potential purchasers.
- If the issuer extends the offering period, require investors to reaffirm their investments.
- If the issuer reduces the offering minimum, return funds to investors.

24.17.4 Purchasers

The syndicate supervisor is responsible for establishing procedures regarding purchasers of securities issued through a best efforts underwriting including the following:

- Where the offering is contingent upon the sale of a certain quantity of the issue, confirm that all purchasers are *bona-fide* purchasers. Non-bona fide sales generally include sales of undisclosed purchases by the issuer or broker-dealer, their affiliates or associated persons, or any entities through nominee accounts that are designed to create the appearance of a successful completion of an offering.
- Identify purchases by issuer insiders, the Firm's proprietary account, or employees of the Firm and, for those identified, obtain a written affirmation that the purchaser intends to hold the security as an investment or, in conjunction with the issuer, determine restrictions on immediate sale by such accounts.
- Record the review of purchasers in the deal file.

24.18 Offerings Of Firm Or Affiliate Securities

[SEC Securities Exchange Act of 1934 Rule 15c1-5 and Rule 15c1-6; FINRA Rule 5121; FINRA Regulatory Notice 09-49]

Responsibility	Syndicate Supervisor - underwriting responsibilities FINOP - Net capital filings
Resources	Information about KCD's or affiliate's offering
Frequency	As required
Action	**Syndicate Supervisor:** Determine whether KCD will comply with the prominent disclosure

	requirement or engage a QIU If a QIU is to be engaged, determine the proposed QIU meets the requirements to be a QIU under the Rule Confirm required disclosures are included in offering documents Establish an escrow account for offering proceeds Obtain written approval for any discretionary accounts purchasing the offering Notify FINRA when the offering is terminated Release escrowed payments If net capital requirements are not met, return escrow payments to purchasers For private offerings, comply with disclosure and filing requirements **FINOP:** Calculate net capital and make the filing with FINRA If net capital requirements are not met and no exemption is available, notify the Syndicate Supervisor
Record	**Syndicate Supervisor:** Maintain deal file including filings, engagement of QIU, disclosures, escrow account information, and other information about the offering to comply with applicable rule requirements **FINOP:** Maintain record of net capital computations and filing with FINRA; notice to Syndicate Supervisor if net capital requirements are not met

KCD is subject to requirements when it is subject to a conflict of interest (defined below) involving an underwriting of its own or an affiliate's securities or other related conflicts. The requirements apply whether KCD acts as an underwriter, member of the underwriting syndicate or selling group, or otherwise assists in the distribution of the public offering (*i.e.,* not when KCD acts solely as a finder, consultant or advisor). The next section defines important terms that affect such underwritings.

24.18.1 Definitions

[FINRA Rule 5121(f)]

The following are some key definitions; other definitions are included in the Rule.

Affiliate: an entity that controls, is controlled by or is under common control with a member firm.

Conflict of interest requirements apply when KCD participates in a public offering where:

- The securities are to be issued by KCD.
- The issuer controls, is controlled by or is under common control with KCD or KCD's associated persons.
- At least 5% of the net offering proceeds, not including underwriting compensation, are intended to be: (i) used to reduce or retire the balance of a loan or credit facility extended by KCD, its affiliates and its associated persons, in aggregate; or (ii) otherwise directed to KCD, its affiliates and associated persons, in the aggregate.
- If, as a result of the public offering and any transactions contemplated at the time of the public offering: (i) KCD will be an affiliate of the issuer; (ii) KCD will become publicly owned; or (iii) the issuer will become a member firm or form a broker-dealer subsidiary.

Control: includes the following (and the right to receive an interest in the following within 60 days of the offering for the first 4 items):

- beneficial ownership of 10% or more of the outstanding common equity of an entity
- the right to 10% or more of distributable profits or losses of a partnership

beneficial ownership of 10% or more of outstanding subordinated debt of an entity
beneficial ownership of 10% or more of outstanding preferred equity of an entity
the power to direct or cause the direction of the management or policies of an entity

Entity: includes a company, corporation, partnership, trust, sole proprietorship, association or organized group of persons. The definition excludes a registered investment company; a "separate account" defined in the Investment Company Act of 1940; an REIT; or a DPP.

Investment grade rated: securities that are rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

Qualified independent underwriter (QIU): Refer to Rule 5121(f)(12) for the lengthy description.

24.18.2 Participating In A Public Offering

To participate in an underwriting of its own or an affiliate's securities, KCD must comply with **one** of the following two requirements:

Prominent disclosure of the nature of the conflict of interest in the prospectus, offering circular or similar document, AND one of the following must be met:
The member(s) primarily responsible for managing the offering does not have a conflict of interest and meets the requirements of (f)(12)(E) which prohibits participation by someone subject to regulatory violations related to offerings (refer to the rule for details);
The securities offered have a bona fide market; **or**
The securities offered are investment grade or are securities in the same series that have equal rights and obligations as investment grade rated securities.
A qualified independent underwriter (QIU) has participated in the preparation of the registration statement and the prospectus, offering circular or similar document and has exercised usual standards of "due diligence" for the offering; and there must be prominent disclosure of the nature of the conflict of interest, the QIU, and a brief statement regarding the role and responsibilities of the QIU.

In addition to the above, an offering subject to the QIU requirements is also subject to Rule 5110 (Corporate Financing Rule) whether or not the offering would be otherwise exempted from the filing or other requirements of that Rule.

24.18.3 Escrow Of Proceeds And Net Capital Computation Requirements

Proceeds must be placed in an escrow account and not released or used by KCD until net capital requirements described in the next bullet are satisfied.
When offering the securities, FINRA must be immediately notified when the offering terminates and settlement is effected. KCD will file a net capital computation as of settlement date. Where net capital fails to equal certain requirements, proceeds from the offering must be returned to purchasers and the offering withdrawn unless the SEC grants an exemption. [See Rule 5121(b)(2).]

24.18.4 Sales To The Public

Sales to customers are subject to sales practice requirements including the obligation to determine the suitability of the recommendation. Securities may not be sold to discretionary customers unless previous written approval is obtained from the customer.

24.18.5 Private Placements

[FINRA Rule 5122; FINRA Regulatory Notice 09-27]

This section describes requirements if KCD engages in a private placement of unregistered securities issued by itself or a control entity of KCD. KCD is required to:

- disclose to investors the intended use of the offering proceeds and offering expenses and the amount of selling compensation that will be paid to KCD and its associated persons;
- file the private placement memorandum, term sheet or other offering document with the FINRA Corporate Financing Department prior to or at the time it is provided to any investor (amendments must be filed within 10 days of providing to investors); and
- commit that at least 85% of the offering proceeds will be used for business purposes, which may not include offering costs, discounts, commissions and any other cash or non-cash sales incentives.

Exempted from the Rule requirements are:

- private offerings sold exclusively to institutional accounts [as defined in FINRA Rule 4512(c)]; qualified purchasers; QIBs; investment companies; banks; and entities composed exclusively of QIBs
- offerings of Rule 144A and Regulation S securities
- securities of a commodity pool operated by a commodity pool operator
- offerings to employees and affiliates of the issuer or its control entities, among others

Other exemptions are also included in the Rule which should be consulted for details regarding requirements and exemptions.

"Control entity" means any entity that controls or is under common control with the member, or that is controlled by a member or its associated persons. Under this Rule, "control" is defined as having a beneficial interest of more than 50% of the outstanding voting securities of a corporation, or the right to more than 50% of the distributable profits or losses of a partnership or other non-corporate legal entity.

24.19 Asset-Backed Securities (ABS)

[SEC Regulation AB; Dodd-Frank Act Section 621, 941, 942, 943 and 945; SEC release: http://www.sec.gov/spotlight/dodd-frank/assetbackedsecurities.shtml]

Asset-backed securities (ABS) are created by buying and bundling loans and creating securities backed by those assets which are then sold to investors. Bundles of loans are often divided into different levels or tranches of risks and returns. Payments on the loans are made first to the holders of lower-risk, lower-interest securities and then to holders of higher-risk securities.

ABS public offerings are often done through shelf offerings and are also sold as private placements exempt from registration and sold to QIBs. There are specific registration, disclosure, and reporting requirements for publicly issued asset-backed securities (ABS) under SEC rules and sections of the Dodd Frank Act, some of which are still in the process of rulemaking. This section summarizes some of the key provisions of Regulation AB which should be consulted for specific requirements.

- An underwriter, placement agent, initial purchaser, sponsor, or any affiliate or subsidiary of any such entity is prohibited from engaging in any transaction that involves or results in a material conflict of interest to any investor in a transaction arising out of such activity for a period of one year after the date of the first closing of the sale of the ABS.
- The securitizer is obligated to retain an economic interest in a material portion of the credit risk. This requirement is pending rulemaking. [Section 941 of Dodd Frank]
- There are specific disclosure and reporting requirements. [Section 942 of Dodd Frank]
- The issuer is required to perform a review of the assets underlying the ABS and disclose the nature of the review. This requirement is pending rulemaking. [Section 945 of Dodd Frank]

24.20 Prohibited Activities

24.20.1 Misrepresentation Of Registration With Regulators

[SEC Securities Exchange Act of 1934 Rule 15c1-3]

KCD and its RRs will not misrepresent its affiliation with any regulatory body including an implication that regulatory registration indicates a regulator has passed upon or approved the financial standing, business, or conduct of KCD or the merits of any security or transaction it performs.

KCD and its employees may not:

- make material misstatements or omissions in the registration statement.
- fail to comply with applicable registration requirements.
- fail to provide a final prospectus when required.
- engage in fraudulent transactions.

24.20.2 Anti-Competitive Activities

The following are prohibited anti-competitive activities:

- The exchange of current price information among competitors to influence another firm's pricing of services
- Directing, requesting, or attempting to influence another member to maintain or adjust a price
- Engaging, directly or indirectly, in any conduct that threatens, harasses, coerces, intimidates, or otherwise attempts improperly to influence another firm or employee of another firm

24.20.3 Tying

[FINRA Notice to Members 02-64]

IPOs may not be sold to customers where:

- the purchase is tied to a promise from the customer to buy additional shares once trading begins in the new issue.
- the purchase of a highly desirable IPO is tied to the customer's promise to buy IPOs with less market interest.

24.20.4 Laddering

"Laddering" is another prohibited tying arrangement where an underwriter requires IPO investors to submit orders to buy additional shares of the same stock at higher prices after trading begins.

24.20.5 After-Market Sales

Other prohibited after-market activities include:

- attempts to keep investors from selling IPOs in the aftermarket

- soliciting after-market orders during an IPO
- imposing penalties on retail brokers in connection with immediate "flipping" by retail IPO investors but not by other categories of IPO participants, such as institutions
- requiring customers to sell back IPO shares to KCD

24.20.6 Misrepresenting Pricing

[SEC Securities Exchange Act of 1934 Rule 15c1-8]

When participating in a primary or secondary distribution of a security which is not admitted to trading on a national securities exchange, KCD or any employee cannot make a representation that the security is being offered to a customer "at the market" or at a price related to the market unless KCD is aware of a *bona fide* market for the security which it or any affiliate does not control.

25 INVESTMENT BANKING

25.1 Introduction

These policies and procedures outline requirements for KCD's Investment Banking ("IB") activities. Questions regarding the policies and procedures outlined in this chapter should be directed to Compliance.

25.2 Information Barrier and Confidentiality Issues

25.2.1 Information Barrier Procedures

In order to control the flow of confidential and material, non-public information, KCD has created Information Barriers to separate the public side employees (*e.g.,* sales, trading and research) from private side employees (*e.g.,* advisory and investment banking).

For more detailed information regarding KCD's Insider Trading and Information Barriers policies, and the Watch and Restricted Lists policies, refer to the chapter *INSIDER TRADING*.

25.2.2 Origination Meeting Process And Information Sharing

This meeting provides a venue for IB and origination personnel to meet and discuss significant firm opportunities. To that end, open dialogue and communication is crucial, however Compliance guidelines must accompany this open forum in order to address: potential conflict situations; the flow of material, non-public information ("MNPI"); and compliance with KCD's information barrier policy of sharing information only with those that have a *"need to know."* Separate requirements apply to dealings between IB and Research, outlined in a later section of this Policy titled *"Interaction between Research and Investment Banking."* The following compliance guidelines address information sharing issues other than interaction with Research personnel.

1. As conversations in this meeting will cross industry and product lines, participants will be privy to information that they previously have not been privy to. Senior Origination participants will be held to the same higher standard as Senior Management and above-the-barrier employees.

Participants should always use good judgment when discussing potential transactions or situations and should limit the content and context of the information they present. In the event that MNPI is shared during the meeting, the information should be limited only to essential information (*i.e., "need to know"*).

2. Unlike other forums, project code names are not required. However, if information does not need to be shared or if assistance can be gained by having conversations with colleagues in a separate, smaller venue, this route should be taken.

3. Identifying and discussing common relationships and communication strategies are permissible.

4. Participants should not hand out any materials at the meeting, except for senior management and board of director lists. To the extent that contact lists are handed out or emails are distributed, the documents should:

> have a cover sheet (as applicable),
> be clearly marked Confidential,
> use a project code name in the header or reference field (for emails), and

be collected and shredded at the end of the meeting by the person handing the material out.

5. At a minimum the use of project code names and limited details should be used as soon as possible, *e.g.,* after the idea comes together and the deal team proceeds with the pitch. Generally, the group should not be updated until the transaction is announced or dead.

6. All MNPI must remain confidential outside the meeting and should be used only for the business purpose it was communicated. Sharing information outside the group should be limited to those with a *"need to know."*

7. When communicating MNPI outside of the group meeting, individuals should utilize project code names in written and in oral communications when appropriate, *i.e.,* public places, meetings outside the group, e-mail, and broadly disseminated correspondence.

8. Participants should only give their proxy information to other Senior Origination participants in the event they are unable to attend. Participants may not ask members of their industry or origination group to attend as their proxy. Given the above-the-barrier nature of the conversation, it is inappropriate for anyone other than the designated participants to attend the meeting.

25.3 Restricted And Watch Lists

Compliance maintains and monitors a "Restricted List" and a "Watch List" as described in *INSIDER TRADING*. Investment Bankers have an obligation to notify Compliance of pending deals as outlined in the policy.

25.3.1 Watch List

The Watch List is a confidential list of companies and issuers of securities maintained by Compliance for the purpose of monitoring the possession of confidential or material, non-public information obtained by KCD during its normal course of business, usually when it has been retained to advise a customer regarding a transaction, to underwrite an offering, or to provide debt financing. The contents of the Watch List are highly confidential and access to the Watch List is limited to Compliance and persons granted access by Compliance. No person may discuss the contents of the Watch List or any of its information with anyone outside of the immediate deal team and senior management in the respective business unit, where appropriate, without permission of Compliance.

The Watch List is used to review the sales, trading and research activities of KCD and the personal trading activities of employees without restricting such activities. The Watch List helps to ensure the integrity of the Information Barrier and is used to support and monitor compliance of these policies and procedures. For these reasons, Compliance is authorized to break trades in proprietary or employee accounts, restrict trading and research, and prohibit other activities relating to securities or issuers included on the Watch List.

25.3.1.1 Additions To The Watch List

Notification

The Lead Banker is responsible for PROMPTLY informing Compliance when KCD is reasonably likely to be engaged by a customer or they obtain information that is substantially material to the customer and/or KCD. Examples include:

M&A advisory or fairness opinion
Underwriting or placement agent activities
Acquisition finance involving public companies
Conflict clearance when both the acquirer and target are customers
Auctions

Hostile situations

Investment Banking Commitment Committee

The Lead Banker is responsible for notifying Compliance prior to going to the Investment Banking Commitment Committee when KCD is reasonably likely to be buyside or sellside advisor for a private or a public company, financial or general advisor, advisor in a going-private transaction, to explore strategic alternatives, to place private equity, or to provide a fairness opinion.

Compliance will place the name of the issuer(s) involved on the Watch List and conduct a firm-wide review in an attempt to identify, manage and resolve potential conflicts of interest arising from KCD's participation.

Deal Teams

At the time the Lead Banker reports a project for Watch List addition, the Banker should also communicate to Compliance the proposed deal team and a project code name to control the flow of information. The deal team should include employees representing a cross-section of business units and product expertise relevant to the transaction. Those "above the barrier" are not added to a deal team. Compliance will assist with resolving situations where limited resources are available to adequately staff multiple, competing deal teams.

The deal team is required to use the project code name in all communications relating to the transaction to ensure security.

25.3.1.2 Updates To The Watch List

The Lead Banker is responsible for informing Compliance of all material events regarding the transaction. Examples include:

the approved additions and deletions of employees to and from deal teams
timing and launching of transactions
notification prior to a public announcement for an M&A transaction or rendering a fairness opinion
notification after a shareholder vote is complete or a tender offer expires

25.3.1.3 Deletions From The Watch List

The Lead Banker who added the security or issuer to the Watch List is responsible for PROMPTLY informing Compliance when a security or issuer should be removed from the Watch List. Generally, the removal of a security or issuer from the Watch List is warranted when the information possessed by KCD is no longer deemed confidential, material or non-public in nature or when it has aged to the point where it is no longer relevant. Removal of a security or issuer from the Watch List is also warranted when the project has been abandoned or when the probability of a project occurring is no longer great enough to continue to monitor the sales, trading and research activities of KCD and the activities of employee accounts.

25.3.2 Restricted List

In order to comply with securities laws, to avoid the appearance of impropriety, and to supplement the Information Barrier, KCD maintains a Restricted List, if applicable. The Restricted List is an internal-use-only list of companies and issuers of securities in which certain restrictions apply in handling customer orders, trading for proprietary accounts, trading for employee and employee-related accounts, and other activities.

25.3.2.1 Prohibitions And Effects Of The Restricted List

The Restricted List is most often used in the following situations to restrict the appropriate sales, trading and research activities in the applicable securities of an IB customer. Compliance will determine when one of the following conditions requires addition of a security to the Restricted List.

- When KCD has been retained as a financial advisor in a material public transaction
- When KCD is a participant in a publicly announced offering of securities
- When KCD, in some cases, is a provider of debt financing
- In situations where a research analyst, salesperson, or trader is brought over-the-wall
- Prior to the initiation of Equity research coverage with a rating other than hold/market perform
- Prior to dissemination of an equity research report with a material change
- When appropriate, securities of an issuer that is on the opposite side of a material, public transaction with KCD's customer

The Restricted List generally will not indicate why a particular security or issuer is restricted but will identify what activities are restricted and, conversely, permitted.

25.4 Review Of Investment Banking Business

[FINRA Rule 3110(b)(2)]

Responsibility	Designated Supervisor (IB)
Resources	Proposed and pending IB deals
Frequency	As required
Action	Review proposed deals working with the Commitment Committee and consulting with outside counsel and others as needed Oversee assignment of passwords and compliance with confidentiality requirements
Record	Deal file including review of deals, assignment of passwords and imposition of other confidentiality requirements

The supervisor of Investment Banking (IB) is responsible for oversight of IB transactions and compliance with Firm policies and securities rules, laws, and regulations. Compliance reviews IB and other transactions for compliance with insider trading and related requirements (see the chapter *SUPERVISORY SYSTEM, PROCEDURES, AND CONTROLS* and the sections *Review Of Transactions*) and *Internal Investigations*. Individual transactions by investment bankers are subject to requirements explained in the next section.

25.5 Investment Banker Personal Investments

[FINRA Rule 3110(b)(2) and 3110(d)(3)]

Responsibility	Designated Supervisor Compliance

Resources	Requests from Bankers to enter personal transactions
Frequency	As required
Action	Check for potential conflicts Approve or disapprove the request Compliance: review and monitoring of transactions, initiate an internal investigation if necessary (see section *Internal Investigations* in the chapter *SUPERVISORY SYSTEM, PROCEDURES, AND CONTROLS*)
Record	Records of transaction requests/approval or disapproval Compliance records of reviews, internal investigations

Because investment bankers (Bankers) have access to MNPI, they are subject to specific requirements affecting their personal investments to avoid conflicts of interest and rule violations. Failure to comply with this Policy may result in disciplinary actions up to and including termination of employment.

<u>Bankers are prohibited from trading in securities:</u>

- that they cover.
- for one (1) reporting period after a publicly-announced deal is finalized (but under no circumstances for any period where there is knowledge of material, non-public information).
- in industries where the Banker is aligned.
- where the Banker has knowledge of material, non-public information (this includes a prohibition against passing on such information to others).
- when the Banker is part of a deal team (includes others supporting the deal team and having knowledge of the deal). Includes knowledge of current or proposed deals.
- that are securities of an issuer that is a customer of the Banker.
- when aware of a proposed or pending follow-on offering.
- if <u>currently</u> involved in an underwriting or distribution of securities for the issuer.
- if <u>previously</u> involved in an underwriting or distribution of securities for the issuer, less than one reporting period has elapsed since the close of the underwriting.
- if aware of an ongoing relationship with the issuer/customer of the group you are working in.
- if aware of any current or potential transactions for the issuer as a result of access to financial or other systems, write rights (the ability to view or change information) to shared folders or applications or work on specific projects.
- if aware of any pitches or other communications planned with the issuer.

<u>Pre-clearance of Banker Transactions</u>

Bankers are required to pre-clear all personal transactions with their supervisor or his/her designee.

25.6 Licensing And Registration

[FINRA Rule 1200; NASD Regulatory Notice 09-41]

Bankers are required to pass the SIE, Series 79 (Investment Banking Representative), and Series 63 (Uniform State Law) examinations. Registered personnel should be licensed in each state or jurisdiction (via Series 63) in which they will potentially conduct or solicit securities or investment banking business, unless a specific exemption applies as determined by Compliance.

25.7 Gifts And Entertainment

[FINRA Rule 2310(c)(2)(A), 2320(g)(4)(A), 2341(l)(5) and 3220]

All employees are subject to KCD's policies on gifts and entertainment (*GENERAL EMPLOYEE POLICIES* chapter). Additional requirements that apply to Bankers are included in this section.

Deal Closing Events

Closing dinners or similar events recognizing a successful transaction are permissible, but are considered "entertainment" for the purpose of the applicable rules and are subject to KCD's entertainment policy.

Customer Restrictions On Gifts, Gratuities, And Entertainment

Many institutions adopt policies and procedures restricting the receipt of gifts, gratuities and entertaining. Firm personnel should conduct business development activities consistent with such policies and procedures to the extent such policies and procedures are effectively communicated to KCD.

Governmental agencies, municipalities, political subdivisions, federally insured deposit institutions, public utilities and bank holding companies typically have adopted policies and procedures or may be subject to state or federal laws and regulations that govern or limit receipt of gifts, gratuities and entertaining. Employees who cover any such customers or sectors should become familiar with the limitations imposed on the receipt of gifts, gratuities or entertainment by the customers themselves or laws applicable to the customer.

Gifts, Gratuities, And Entertainment Provided By Related People

It is not permissible to use spouses or other family members to evade the limitations of the rules. Any gift giving or entertaining of firm customers by a spouse or other family members of an employee will be subject to the rules' limitations except to the extent (i) it solely relates to business development by the spouse's or other family member's employer, or (ii) it is permissible personal gift giving or entertainment to family members and personal friends as provided above and such gift or entertainment is not directly or indirectly paid for by KCD.

25.8 Participation In Compliance Meetings, Continuing Education, And Internal Audits/Reviews

[FINRA Rule 1250 and 3110(a)(7)]

Bankers are required to attend an annual compliance meeting, as required by FINRA, at which attendance is mandatory. The meeting provides a forum for education and guidance concerning legal or regulatory requirements and KCD's internal policies and procedures. Bankers are also subject to continuing education requirements. Registered personnel must complete Regulatory Element continuing education (required every three years) administered by regulators and Firm Element continuing education (required annually) administered by KCD. Compliance will notify employees when they are subject to the requirements; failure to complete the requirements within specified deadlines given at that time will result in the employee ceasing business activities until continuing education is satisfied.

IB is subject to reviews to detect and deter violations of applicable legal requirements and internal policies and procedures. Reviews typically include an assessment of the supervisory structure and internal policies and procedures. Bankers and supervisors are expected to cooperate and provide requested materials promptly to auditors.

25.9 Inquiries And Investigations

KCD is subject to supervisory oversight by multiple regulators. When a representative of any of these regulatory bodies contacts or requests information from an employee in IB, the employee must immediately contact Compliance. IB personnel should only communicate with regulators after consultation with Compliance and/or Legal.

25.10 Communications

IB personnel are subject to KCD's communications policies (see the chapter *COMMUNICATIONS WITH THE PUBLIC*). Only firm-sponsored communications networks and computers may be used for public communications. KCD is required to review and retain electronic communications. Electronic communications of any type should be considered the equivalent of written communications for purposes of creating a record of communications and should not be considered "conversations" or phone calls.

The following are included in the definition of communications with the public.

- Press Releases
- Single and Multiple Tombstone Advertisements
- Underwriting proposals to issuers
- Pitchbooks, marketing materials
- Research reports
- Recommendations List
- Offering sheets, fact sheets, or prospectus summaries
- Seminar texts
- Any material designed to be published in the public media
- Electronic communications such as e-mail and Bloomberg
- Communications via electronic networks such as instant messaging
- Facsimile ("Fax")

Communications that refer to KCD as a legal entity (in contracts, *etc.*), must state the full legal name of KCD and KCD's capacity in relation to the product or service offered. Any brand name may be used for marketing purposes, but may not be used in place of the legal entity. If a firm affiliate is mentioned, the relationship between KCD and its affiliate must be clear. If an individual is named in a communication containing the names of KCD and an affiliate, the nature of the relationship of the individual with KCD should be clear.

25.10.1 Prohibited Communications Between Bankers And Customers

Except for Emerging Growth Companies ("EGCs") as discussed in a following section, prior to the effective date of a registered offering, communications mentioning the offering are prohibited including press releases, advertisements, and written communications. There should be **no** written communications (including email or fax) between Bankers and customers during the offering period. Private placements, by their nature, may not be announced prior to the transaction via press releases, advertisements and other media with broad distribution.

"Internal Use Only" material should not be disseminated externally and should be marked "Confidential" to prevent copying or forwarding.

25.10.2 Communication With Other Business Units

This section is intended only to provide general guidelines regarding appropriate levels of communication between IB and other firm business units (other than Research which is discussed in the next section). **If there is any question related to whether or not something can be discussed or shared with other business units, contact Compliance.**

In the event that an employee believes that he or she may have inadvertently signaled that a confidential commitment or project is underway, or may have communicated confidential information about a project to a person not entitled to such information, the employee should immediately contact the senior business person on the transaction, who should then contact Compliance to determine what, if any, actions are advisable or necessary as a consequence of these communications.

25.10.3 "Public Side" Employees (Sales and Trading, etc.)

In the ordinary course of business, IB will possess non-public and potentially material information regarding corporations whose securities are traded by the public side of KCD, specifically Trading and Sales. It is the responsibility of Bankers to prevent such information from being shared with the public side of KCD. However, there exists a great deal of information received by IB that is public and of interest to employees on the public side of KCD. To facilitate the sharing of such information the following list of items is pre-approved by Compliance for distribution to the public side of KCD and is considered public information:

- Annual Reports, Press Releases, or other company prepared material which is made available to the public;
- Publicly registered documents, 10Ks, 10Qs, and Credit Agreements filed with the SEC;
- Information from publicly available industry media sources; and
- Publicly distributed research published by other institutions.

Written information **not pre-approved** in the above categories must be reviewed by Compliance before being distributed to the public side of KCD.

25.10.4 Interactions Between Research Analysts And Investment Bankers

[FINRA Rule 2241]

Communications and interaction between IB and Research are subject to restrictions by regulatory rules. No Research Analyst may be subject to the supervision or control of any member of the Firm's IB groups. IB will have **no** input into company-specific coverage decisions made by the Research Department (*i.e.,* whether or not to initiate or terminate coverage of a particular company).

No Banker may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the Firm or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the Firm's present or prospective IB relationship with the subject company of a research report.

There are some Emerging Growth Company exceptions regarding investment banker/research analyst interactions which are discussed in a section that follows.

25.10.5 Emerging Growth Companies (EGCs)

[JOBS Act, Title I; SEC JOBS Act Frequently Asked Questions: http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm]

Responsibility	Designated Supervisor
Resources	Potential EGCs
Frequency	As required

Action	Contact Compliance to: Verify that an IB customer/potential issuer qualifies as an EGC Obtain pre-approval regarding analyst activities relating to an EGC (meetings, *etc.*) Compliance will notify the designated supervisor, bankers, and analysts that the issuer qualifies as an EGC and advise as to any applicable restrictions on activities/communications or notify that the issuer **does not** qualify as an EGC Provide training for investment bankers regarding permitted activities involving EGCs
Record	Compliance record of review of issuer to determine EGC status and notification to IB supervisor, Research supervisor, and applicable bankers and analysts about permissible activities involving research analysts

The Federal JOBS Act creates a category of issuers known as EGCs that have had total annual gross revenues of less than $1 billion during its most recently completed fiscal year. An issuer remains an EGC until the earliest of:

- The last day of the fiscal year during which it had total annual gross revenues of at least $1 billion;
- The last day of the fiscal year following the fifth anniversary of the issuer's initial public offering;
- The date on which it has issued more than $1 billion in non-convertible debt during the previous three-year period; or
- The date it becomes a "large accelerated filer."

EGCs receive the following treatment under the Act:

- Confidential filing and review of initial public offerings;
- Permitted publication of research reports at the time of a proposed public offering;
- Permitted broker-dealer public appearances following an IPO and after the expiration of a "lock-up" agreement;
- Limited communications between research analysts and potential investors;
- Limited participation by a research analyst in meetings with management and others regarding securities offerings; and
- Permitted oral and written communications (including offers), both before and after the filing of a Securities Act registration statement, with potential investors that are QIBs or accredited investors.

EGCs also have certain disclosure advantages regarding IPO audited financial statements, less financial information to be filed for IPOs, and fewer disclosures under the Act as well as fewer corporate governance requirements than are imposed on non-EGC issuers.

Compliance must be contacted for review of the potential EGC prior to engaging in activities permissible for EGCs but not permissible for other issuers and prior to involvement with research analysts. Compliance will notify the banker, analyst, and appropriate supervisors whether the issuer meets EGC status and whether any restrictions apply.

25.11 Prohibition Against Offering Favorable Research To Induce Investment Banking Business

[FINRA Rule 2241(b)(2)(K) and 2242.01; FINRA Regulatory Notice 11-41]

Responsibility	Designated Supervisor and/or Compliance

Resources	Notification or indication that an issuer has expressed an expectation of favorable coverage
Frequency	As required - take action when favorable research is expected by potential IB customers Annually (or more frequently) - train IB personnel regarding prohibited promises of favorable research
Action	When becoming aware of an issuer's expectation for favorable research: Provide affected IB personnel with information regarding the prohibition Confirm disclaimer language is included in pitch materials and RFPs Confirm repudiation has been documented Establish heightened supervision to review research materials for objectivity
Record	Repudiation to the issuer Heightened supervision of research on the subject company Records of disclaimers

The Firm may not agree to provide favorable research to an issuer to obtain the issuer's investment banking business. Pitch materials may not include information about the Firm's research in a manner that suggests, directly or indirectly, that the Firm may provide favorable research coverage. FINRA has indicated that the publication in a pitch book or related materials of an analyst's industry ranking will imply the potential outcome of future research because of the manner in which such rankings are compiled. The Firm is permitted to include in pitch materials the fact of coverage and the name of the research analyst. Pitch materials and responses to requests for proposals (RFPs) will include disclaimer language that the Firm is not, and is unable to, make any promises about research coverage. An example of an inducement would be a CEO of an issuer to requiring candidates for the company's next offering to demonstrate their ability and willingness to follow the company and articulate why investors should own their stock.

If an issuer expresses its expectation, directly or implicitly, that the awarding of investment banking business is conditioned on the Firm providing favorable research, the following steps must be taken:

- Notify the IB supervisor or Compliance of the issuer's communication;
- Expressly repudiate to the issuer any expectation with respect to the content of research coverage and document the repudiation;
- Heightened supervision will be implemented regarding solicitation activities, including pitch meetings and materials and other communications with the issuer; and
- Increased oversight of the preparation and content of research on the subject company.

25.12 New Issues

[FINRA Rule 5131(b)]

Firms are prohibited from engaging in "spinning" which is a prohibited practice. KCD's policy regarding spinning appears in the chapter *CORPORATE SECURITIES UNDERWRITING*. The IB Manager is responsible for ensuring IB personnel do not participate in allocation of new issues or attempt to influence employees responsible for allocations.

25.13 Pitch Materials

[FINRA Regulatory Notice 11-41 and 07-04]

25.13.1 Definition

"Pitch materials" are defined as any written (electronic or hard-copy) communication prepared in whole or in part by origination professionals that is delivered to the "public" (*i.e.,* customers) for the solicitation of business. This includes "short form" and "follow-up" materials prepared by origination professionals that are sent to customers via hard copy and/or email.

25.13.2 Approval Of Pitch Materials

Pitch materials require the supervisor's approval **prior to use**.

25.13.3 Other Disclosures And Guidelines

- Sources for all charts, graphs, *etc.* are cited (*i.e.,* Bloomberg, FactSet, *etc.*).
- Information is factual and correct to the best of the preparer's ability.
- Presentation is fair and balanced.
- If research or analyst commentary is included in the pitch material, it must be approved by the Equity Research supervisor and **MAY NOT** include firm research. Quotes must be complete and not out of context, and sources must be cited.
- Pitch materials and response to requests for proposals (RFPs) will include disclaimer language that KCD is not, and is unable to, make promises about research coverage.
- Testimonials from customers regarding the quality of KCD's advisory/execution capabilities must adhere to the following:
  - Inclusion of the following: *"This testimonial may not be representative of the experience of other customers and is not indicative of future performance or success."*
  - If an amount is paid for the testimonial, the fact that it is a paid testimonial must be included.
  - If the testimonial concerns a technical aspect, the person providing the testimonial must have the experience/knowledge necessary to form a valid opinion.
  - ***NOTE: This provision does not pertain to case studies listing only the names and contact numbers of customers as references.***
- Offers of Free Service. Reports, analyses or other services offered as "free" must be furnished entirely free and without condition or obligation.

25.13.4 Pitch Materials: Non-Permissible Items

Pitch Materials may **not** include the following:

- Any item not adhering to the guidelines listed above.
- Pitch materials may not include information about the Firm's research in a manner that suggests, directly or indirectly, that KCD may provide favorable research. Also see the section *Prohibition Against Offering Favorable Research To Induce Investment Banking Business* in this chapter.
- Claims and Opinions - Specifically defined as: "Promises of specific results, exaggerated or unwarranted claims, misleading statements, unwarranted superlatives, opinions for which there is no reasonable basis or forecasts of future events that are unwarranted or that are not clearly labeled as forecasts."
- Hedge Clauses - Specifically defined as: "Cautionary statements or caveats that are misleading or inconsistent with the content of the material."
- "Internal Use Only" Material - not permitted in full or in part.

Research analysts may not participate in pitches, assist with the preparation of specific pitch materials, or review pitch materials prior to use.

Any questions regarding whether pitch material content can be considered as "approved" or as "non-permissible" should be brought to the attention of the appropriate supervisor and Compliance, **prior to the pitch material's use**.

25.13.5 Document Retention

Pitch materials must be retained for three years. Retained materials must include who prepared the material; other business units/individuals who contributed to the materials; and who approved the material, and when.

25.14 Commitments

Responsibility	Senior Management
Resources	Requests for review of potential commitments
Frequency	As required
Action	Review proposed commitments Approve or disapprove or request more information Notify the Banker of the Committee's decision
Record	Information submitted for review Committee action

The Lead Banker must submit each advisory assignment, fixed income, equity, and equity-linked products deals to be undertaken by KCD to the Senior Management for approval prior to entering into any engagement.

25.15 Commitments

When an investment banking customer has agreed to have KCD represent it in an investment banking transaction, a signed agreement detailing the terms and conditions of the commitment will be obtained and signed by all parties. Copies will be provided to the customer and retained by KCD in the deal file.

25.15.1 Representing Two Sides Of A Banking Transaction

In general, KCD will not represent both sides of an investment banking transaction. In those cases where this may be appropriate, the following is required:

- The proposed dual engagements must be submitted to and approved by the Commitment Committee.
- The proposed dual engagements must be reviewed and approved by in-house or outside counsel as well as the designated supervisor prior to engagement.
- Each side must be represented by separate investment banking teams separated physically and separated in their electronic and other communications. Each team will be notified in writing and acknowledge in

writing that their activities are separate from the other team, and their activities are confidential and may not be communicated to the other team.

The written agreement with the customer must include clear disclosure that KCD is representing both sides of the transaction, and the customer must separately acknowledge in writing their understanding and acceptance of this arrangement.

The designated supervisor is responsible for ensuring that these requirements are satisfied and for retaining records documenting them.

25.16 Fairness Opinions

[FINRA Rule 5150]

Responsibility	IB supervisor Review committee
Resources	Fairness opinion Fairness Opinion Review/Approval forms
Frequency	As required
Action	Manager: Review and approve opinion and forward to committee Confirm that required changes are made to the opinion Committee: Review and approve opinion or refer back to manager for changes
Record	Fairness opinions Fairness Opinion Review/Approval forms

FINRA Rule 5150 outlines requirements when KCD issues a fairness opinion. The rule requires that investors-shareholders be informed about potential conflicts of interest between KCD and the issuer and addresses specific procedures when issuing fairness opinions. This includes fairness opinions issued to the board of directors and/or any special committee or subset or committee of the board.

Specific requirements are explained below. In summary:

- Required disclosures must be included in the fairness opinion.
- The Fairness Opinion Review/Approval form must be completed.
- The IB supervisor must approve the opinion and forward it, with the form, to the review committee.
- The review committee will review the opinion and notify the manager of approval or required changes.
- Revised opinions must be re-submitted to the committee for review and approval.

25.16.1 Disclosures

Disclosures include "significant" payment or compensation. FINRA does not assign a quantitative number to "significant" but defines it as a payment or compensation that a reasonable person who reads a fairness opinion would have an interest in knowing in order to assess whether KCD has a potential conflict of interest. The receipt of *de minimis* fees (such as trading fees or other small incremental fees from account assets or activity) are not required to be disclosed. Disclosures may be descriptive rather than quantitative.

The fairness opinion must disclose if KCD:

- has acted as financial advisor to any party to the transaction that is the subject of the fairness opinion.
- will receive compensation, contingent on the successful completion of the transaction, for issuing the fairness opinion and/or serving as advisor. *[Includes significant payments or compensation from related transactions (e.g., stapled financings) if such transactions are contingent upon the completion of the transaction for which the fairness opinion was issued.]*
- will receive any other significant payment or compensation contingent upon the successful completion of the transaction.
- has had any material relationships that existed during the past two years or that are mutually understood to be contemplated in which any compensation was received or is intended to be received as a result of the relationship between KCD and any party to the transaction that is the subject of the fairness opinion. *[Includes material relationships between KCD and all parties to the transaction, not just the party requesting the fairness opinion. A fairness opinion issued to a target's board of directors would have to include disclosure of any relationship with the acquirer.]*
- has independently verified information provided by the company requesting the opinion where that information is used for a substantial basis of the fairness opinion. *[If verified, must include a description of the information or categories of information verified and the process or standards for independent verification. Where no information provided by the company is verified, include a blanket statement that no independent verification took place.]*
- has approved the fairness opinion through a fairness committee or whether approval is required. *["Fairness committee" is deemed by FINRA to include any committee or group that approves a fairness opinion in accordance with Rule 5150(b).]*
- expresses an opinion about the fairness of the amount or nature of the compensation to any of the company's officers, directors or employees, or class of such persons, relative to the compensation to the public shareholders of the company. *[Disclosure is required as to whether or not such an opinion is expressed.]*

25.16.2 Approval

Fairness opinions must be approved prior to issuance.

- Opinions will be approved by a committee comprised of three or more individuals including representation from non-investment banking areas such as Compliance, Operations, or Sales, and representation from Investment Banking personnel who are not involved on the deal team to the transaction. At least two persons must be from non-investment banking departments. All committee members must be sufficiently experienced or knowledgeable in investment banking matters to render approval.
- The deal team must present the complete fairness opinion, including required disclosures and an explanation of valuation analyses used in the fairness opinion, to the manager of Investment Banking for review prior to submission to the committee. The manager is responsible for confirming that all required disclosures are included.
- The committee is responsible for reviewing the opinion (including a determination of whether the valuation analyses used in the opinion are appropriate) and approving or disapproving the opinion. The approval or disapproval and comments regarding necessary changes or other comments will be forwarded to the manager of Investment Banking.
- The manager is responsible for confirming that changes are made consistent with the instructions of the committee. If the fairness opinion is revised, it must be re-submitted to the committee for review.
- The committee will retain records of who is serving on the committee, its reviews, and its actions.

25.17 Origination, Record Retention, Closed Deal Files

25.17.1 Due Diligence

The Securities Act of 1933 can impose substantial civil liability on various parties, including the issuer, the underwriters, and the accountants involved in the preparation of a registration statement or offering document. In particular, these participants are subject to potential liability if any part of the effective registration statement contains an untrue statement of material fact or omits to state a material fact. Moreover, failure to conduct proper due diligence can result in the revocation by the SEC of a broker-dealer's registration.

An underwriter may avoid liability if it can affirmatively demonstrate that it, after a reasonable investigation or "due diligence," had grounds to believe and did believe that the registration statement or offering document did not contain a material misstatement or omission.

25.17.2 Investment Banking's Responsibility

Although the product origination groups have the primary due diligence responsibility, Bankers should work closely with their product origination partners to help ensure a thorough due diligence review has been conducted and documented. Contact Compliance or Legal with any questions.

25.17.3 Required Document Retention

Because an underwriter has the burden of proving its due diligence defense under the securities laws, it is essential that the investigation conducted by KCD be documented. One central "deal file" should be maintained and controlled by the Lead Banker. All other files shall be either merged into the central file or destroyed once the offering has been completed.

The central closed deal file should contain only clean, final copies of deal documents which may include, but not be limited to:

- Final closing documents (any preliminary drafts and all copies with other extraneous records such as handwritten notes should be discarded)
- Investment Committee deal package (where applicable)
- Rating Agency Presentation (where applicable)
- Computational materials provided to investors (where applicable)
- Due diligence questionnaire
- Regulatory filings
- Pitchbooks or other marketing materials
- Other pertinent correspondence

All documentation related to a securities underwriting must be maintained for a period of three years; two years in an easily accessible place.

25.17.4 M&A Closed Deal Files

To comply with federal securities regulations, an M&A Closing File Checklist is designed to assist in collecting and retaining important documents relating to the engagement of KCD as financial advisor to customers in connection with M&A transactions.

This list of documents is not intended to be exhaustive. Given storage space constraints, KCD wishes to keep **final** copies of the **formal** documentation that is necessary to reflect KCD's relationship with the party or parties to the engagement and our work product. KCD does not want to retain copies of documents that are readily available from other sources, are merely drafts or contain information that is available in other documents that are being retained. Space constraints and the increasing lists involved in the retention of large transaction files make it desirable to retain only those items reflected on the list below or deemed by the deal team leader to be an important record that is in keeping with firm policies.

Promptly upon closing of a transaction or after the expiration or termination of KCD's engagement, an associate on the deal team, with the guidance of the deal team leader, will compile the documents listed below, as applicable. Upon compilation of the file, the supervisor who supervises the deal team will review the file and include in the file a signed statement signifying that the file is ready for storage. The file will consist of paper documents. Copies of the file may also be kept in "pdf" format in addition to, but not in lieu of, paper documents. Any other electronic copies of documents should be deleted or redacted to remove transaction-specific or confidential information and should be stored in the forms library.

These files will be maintained in a readily accessible central location for a period of three years, with the most recent two years readily accessible.

Compliance and the appropriate supervisor will periodically review these files to ensure that all (and only) appropriate documents are being properly maintained, and that the supervisor has reviewed the files.

Materials required to be maintained (if applicable):

- **Commitment Committee Materials.**
  - Memorandum.
  - Engagement letter.
- **Fairness Opinion Materials** (presentation materials vs. engagement letters, contracts or other exhibits).
- **All board presentations during the engagement (only final).**
- **Contractual Agreements with Customer and other Parties.**
  - Engagement Letters.
  - Confidentiality Agreements.
  - Indemnity Agreements.
  - Right of Refusal Letters.
  - Amendments or Terminations.
  - Approvals of Marketing Materials or Potential Purchasers, *etc.*
- **SEC Filings** that refer to KCD and include copies or descriptions of our fairness or adequacy opinions.
  - Proxy statements, information statements, Schedules 14D-9 and TO.
- **Marketing Materials approved by Customer.**
- **Substantive Letters to SEC or Other Governmental Agencies from KCD or its counsel.**
  - Consents of KCD.
- **Financing Commitments** (related to the transaction, *i.e.,* to either buyer or seller from KCD or its affiliates [if shared with deal team]).
- **Opinion Letters or Formal Advice from outside counsel to KCD.**
- **Working Group Lists.**
- **Other Pertinent Correspondence.**

26 COLLATERALIZED MORTGAGE OBLIGATIONS (CMOs)

Responsibility	Designated Supervisor
Resources	Transaction reports or order records
Frequency	Daily
Action	Review for suitability of purchases Obtain signed disclosure statement from customer where appropriate
Record	Initials and date reviewed on available transaction reports or order records; notations of action taken where appropriate Notations in Daytimer or supervisor's log

26.1 Introduction

CMOs are identified in this separate section because of certain special requirements under the rules. CMOs may be government, municipal, or corporate securities.

26.2 Characteristics And Risks

CMOs have characteristics that RRs must be acquainted with in order to assess the suitability of them for investors who also should be aware of these characteristics prior to investing. Following is a list of key characteristics, which are different among various CMO issues.

- Underlying mortgage payments may be unpredictable and variable which may cause either an earlier than anticipated return of principal or a holding period longer than anticipated.
- There is reinvestment risk associated with early prepayments and various tranches of the same issue have different risk profiles.
- There is significant risk associated with less predictable tranches which subject customers to the possibility of losing their entire principal.
- The time to maturity, as well as the amount of principal returned, will vary based on the accuracy of prepayment assumptions.
- Prepayment assumptions are estimates based on historical prepayment rates and are factored into the price, yield and market value of a CMO.
- The more complex and esoteric the issue, the less likely it is that there will be current pricing information available or a ready market for the security.

26.2.1 Interest Only Securities (IOs)

Investors must be aware than an IO tranche is:

- Created deliberately to pay investors only interest;
- Sold at a deep discount to the principal amount;

Has no face or par value and increases in value as interest rates rise and prepayment rates slow;
Decreases in value as interest rates decline; and
Investors may receive less cash than the original investment.

26.2.2 Principal Only Securities (POs)

Investors must be informed that POs:

Are created so that investors receive only principal payments generated by the underlying collateral;
Are extremely sensitive to prepayment rate increases; and
Sell at a deep discount from face value and investors ultimately receive the entire face value.

26.2.3 Floating Rate Tranches (Floaters) and Inverse Floaters

Investors should be advised that:

Floaters carry interest rates that are tied in a fixed relationship to an interest rate index such as LIBOR or COFI and are subject to an upper limit or "cap" and sometimes to a lower limit or "floor;" and
Performance of these investments depends on the way interest rate movements affect prepayment rates and average lives.

Investors must be informed that inverse floaters (IFs) are:

Structured to offset floating-rate tranches, and therefore interest rate payments on IFs vary inversely from the index selected;
More highly leveraged than other tranches and therefore have a higher price volatility as interest rates move; and
Only suitable for sophisticated investors with a high risk profile.

26.2.4 Accrual Bonds Or Z-Tranches

The final tranche of a CMO is often structured as a Z-tranche or accrual bond and has the following characteristics:

Investors receive no cash for an extended period of time, instead they accrue interest which is not paid out until all other tranches are retired.
Prices can fluctuate wildly and depend on other aspects of the offering.
Interest is taxable when credited, even though no actual payment will occur.
The suitability of an investment must be evaluated based on the combination of the Z-tranche with other investments, as well as the investor's risk profile.

26.3 Suitability

References to "suitability" apply only to those recommendations NOT subject to Regulation Best Interest (BI) which applies to retail customers and is addressed in a separate chapter by that name. Suitability requirements apply to entities and institutions (*e.g.,* pension funds) and natural persons who will not use recommendations primarily for personal, family, or household purposes (*e.g.,* small business owners and charitable trusts). Refer to the chapter *REGULATION BEST INTEREST (BI)* for requirements when dealing with retail customers.

As for all recommendations, RRs have an obligation to determine suitability when recommending CMOs to individuals. The RR has the 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 or 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
- Disclosure of risks (see the following sections on *Required Education Material* and *Inverse Floaters, IOs, POs Disclosure*)

In addition, RRs must consider market factors affecting CMOs at the time they are recommended. For example, in a low-interest, low-yield environment there may be a considerable compression of risk premium where investors bid up prices and drive down yields while default rates remain high compared to historical norms.

26.4 Ginnie Mae REMICs

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.

26.5 Required Education Material

[FINRA Rule 2216(b)(2)]

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 Securities Industry And Financial Markets Association (SIFMA) publication "An Investor's Guide To Collateralized Mortgage Obligations" (the "SIFMA brochure") satisfies those disclosure requirements.

The SIFMA brochure will be provided to all purchasers of CMOs.

26.6 Inverse Floaters, IOs, POs Disclosure

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. Compliance 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.

26.7 Communications With The Public

[FINRA Rule 2216]

26.7.1 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."

26.7.2 Disclosures

Communications (including retail communications, institutional communications, and correspondence) regarding CMOs must include the following disclosures and may not include certain statements. Because the requirements are extensive, all written (including electronic) communications about CMOs must be approved by Compliance prior to sending to retail investors.

- 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 contain yield information. These requirements are complex and Compliance should be consulted when preparing this type of communication.

26.7.3 Bloomberg And Other Financial Services

When providing Bloomberg or other comparable reports to customers regarding CMOs, the report should show, at minimum, PSAs at 200 basis points above and below current interest rate levels. Copies of Bloombergs or comparable reports provided to customers should be reviewed and retained by the designated supervisor.

26.8 Trading

26.8.1 Fair Prices

[FINRA Rule 2121]

Traders 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.

26.8.2 Mark-Up Policy

[FINRA Rule 2121.02]

Responsibility	Designated Supervisor
Resources	Orders Trading reports
Frequency	Ongoing (Traders) Spot-check (Compliance)
Action	Traders: Ensure mark-ups and mark-downs are within general Firm guidelines For mark-ups and mark-downs that are outside guidelines, include a written justification on the order record Compliance review mark-ups and mark-downs that exceed general Firm guidelines: Review order records for written justification (*e.g.,* yields on comparable securities) Notify Trading Manager of missing justifications and request correction of the deficiency Confer with Trading Manager regarding orders where justification does not seem warranted
Record	Order records maintained by the Trading Dept. Trading reports including initials of reviewer and review notes, if any, maintained by Compliance Compliance reviews and action taken

The following is FINRA's Mark-Up Policy for debt securities, excluding municipal securities.

26.8.2.1 Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. The presumptive prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with FINRA pricing rules. (See, *e.g.,* Rule 5310).

(2) When the dealer is *selling* the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer's *contemporaneous cost* is not indicative of the prevailing market price. When the dealer is buying the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous sales in the security or can show that in the particular circumstances the dealer's *contemporaneous proceeds* are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where:

- interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing;
- the credit quality of the debt security changed significantly after the dealer's contemporaneous transaction; or
- news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction.

(5) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described under *Prevailing Market Price*, sub-paragraph (4), a member must consider, in the order listed, the following types of pricing information to determine prevailing market price:

- Prices of any contemporaneous inter-dealer transactions in the security in question;
- In the absence of transactions described in (a), prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security; or
- In the absence of transactions described in (a) and (b), for actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

[A member may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (*e.g.,* a member may consider pricing information under (b) only after the member has determined, after applying (a), that there are no contemporaneous inter-dealer transactions in the same security). In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (*i.e.,* either a particular transaction price, or, in (c) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (*i.e.,* such as whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction and timeliness of the information).]

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a "similar" security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a "similar" security with institutional accounts with which any dealer regularly effects transactions in the "similar" security with respect to customer mark-ups (mark-downs);
- Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;
- Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and
- Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (*i.e.,* whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

(7) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, FINRA or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (*e.g.,* discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (*e.g.,* coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(8) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of "similar" securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" securities taken as a whole.

(9) "Customer" does not include a qualified institutional buyer ("QIB") as defined in Rule 144A under the Securities Act of 1933 that is purchasing or selling a non-investment grade debt security when the dealer has determined, after considering the factors set forth in Rule 2111(b), that the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction. "Non-investment grade debt security" means a debt security that:

- if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated lower than one of the four highest generic rating categories;
- if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by any of the NRSROs; or
- if unrated, either was analyzed as a non-investment grade debt security by the dealer and the dealer retains credit evaluation documentation and demonstrates to FINRA (using credit evaluation or other demonstrable criteria) that the credit quality of the security is, in fact, equivalent to a non-investment grade debt security, or was initially offered and sold and continues to be offered and sold pursuant to an exemption from registration under the Securities Act of 1933.

26.8.2.2 "Similar" Securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar" to the subject security may be determined by factors that include but are not limited to the following:

- Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (*e.g.,* changes to ratings outlooks));
- The extent to which the spread (*i.e.,* the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;
- General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and
- Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

26.8.3 Inventory Positions

KCD does not maintain an inventory in CMOs.

26.8.4 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 and Rebill/Error Report form which requires a designated principal's approval.

26.8.5 Cancels And Rebills

[FINRA Rule 4515]

Cancellations and rebills in customer accounts are documented on the Cancel and Rebill/Error Report form which requires a designated supervisor's signature.

26.9 Prohibited Activities

Prohibited activities are described in Chapter 15 - Orders in the prohibited activities section.

26.10 Review Of Transactions

[FINRA Rule 3110(d)]

The designated supervisor is responsible for daily review of transactions in CMOs.

26.11 Confirmations

[SEC Securities Exchange Act of 1934 Rule 10b-10]

Senior Management or the FINOP is responsible for establishing procedures for including the required 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.

27 DIRECT PARTICIPATION PROGRAMS AND REITS

[FINRA Rule 2231(c) and 2310; FINRA Regulatory Notice 15-02]

Responsibility	Designated Supervisor
Resources	Information about the sponsor/issuer (for underwritten issues) Subscription agreements Other purchase records
Frequency	As required when DPPs and REITs are offered
Action	For new issues where KCD may act as underwriter: Confirm the sponsor or general partner of the DPP or REIT will make required value disclosures Include appropriate valuations on customer statements Conduct due diligence Confirm expenses and compensation are within guidelines Make required filing with FINRA and obtain "no objections" opinion Review agreements for completeness Determine customer's proposed purchase is suitable considering: Qualification for the purchase depending on issuer's suitability standards The customer's income, net worth, liquid net worth and investment objectives The amount of the investment considering diversification in the customer's portfolio Review recommended DPP orders for compliance with Regulation BI [see the chapter *REGULATION BEST INTEREST (BI)*] Approve or disapprove purchase Provide liquidity disclosure, if required
Record	Review for required general partner/sponsor value reports to investors, due diligence, expense/compensation reviews, FINRA no objection opinion, and agreements or other purchase records retained in deal file Review of proposed investments including suitability of purchase and approval or disapproval

27.1 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 KCD's procedures regarding the underwriting and sale of Direct Participation Programs (DPPs) and Real Estate Investment Trusts (REITs). DPPs and REITs are also subject to the rules governing corporate underwritings and general underwriting procedures.

DPPs are subject to suitability requirements as well as Regulation Best Interest (BI). Recommendations to retail customers who are natural persons are subject to Reg BI which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. ALL natural persons are included in Reg BI including those deemed "institutional investors" under other FINRA rules.

27.2 New Issues

[FINRA Rule 2310(b)]

New issue requirements apply to DPPs and REITs as well as rollup transactions, in some instances.

27.2.1 Due Diligence

The designated supervisor will be responsible for reviewing prospectuses on any proposed DPP offerings. Prior to participating in an offering of direct participation program or REIT securities:

- The Firm must confirm that the general partner or sponsor will disclose a per share estimated value in each annual report, as defined by rule.
- The issuer must agree to disclose:
  - a per share estimated value of the DPP or REIT security, developed in a manner reasonably designed to ensure it is reliable, in the DPP or REIT periodic reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act;
  - an explanation of the method by which the value was developed; and
  - the date of the valuation.
- The issuer must also agree to disclose, in a periodic or current report within 150 days following the second anniversary of breaking escrow and in each annual report thereafter, a per share estimated value:
  - based on the valuations of the assets and liabilities of the DPP or REIT performed at least annually by, or with the material assistance or confirmation of, a third-party valuation expert or service;
  - derived from a methodology that conforms to standard industry practice; and
  - accompanied by a written opinion or report by the issuer, delivered at least annually, that explains the scope of the review, the valuation methodology used and the basis for the reported value.
- The disclosure requirements do not apply to DPPs that are subject to the 1940 Act.
- The Firm must have reasonable grounds to believe that all material facts are adequately and accurately disclosed and provide a basis for evaluating the program.
- To determine the adequacy of the disclosed facts, the Firm will obtain information on material facts relating to (among other things) the financial stability and experience of the sponsor and the program's risk factors. This includes, for an REIT, an inquiry into the amount or composition of a real estate investment program's dividend distributions including the amount of distributions that represent a return of investors' capital and whether the amount is changing.
- For REITs, the Firm will also consider whether there are impairments to the real estate investment program's assets or other material events that would affect the distributions and whether disclosure regarding dividend distributions needs to be updated to reflect these events.
- For DPPs, suitability standards must have been established by the program for participants in the program.

Per FINRA rules, the following minimum material facts should be disclosed in the prospectus:

- items of compensation
- physical properties
- tax aspects
- financial stability and experience of the sponsor
- the program's conflicts and risk factors
- appraisals and other pertinent reports

The designated supervisor will establish due diligence procedures for reviewing potential DPP offerings. If the Firm is a participant in an offering underwritten by another firm, it may rely on the managing underwriter's due diligence under the following guidelines:

- The Firm has reasonable grounds to believe that the managing underwriter's inquiry was conducted with due care;
- The results of the other firm's due diligence inquiry were provided to the Firm with the consent of the firm or firms that conducted the due diligence inquiry; and,
- The firm that conducted or participated in the inquiry is not a sponsor or affiliated with the sponsor of the DPP.

27.2.1.1 Investment Committee Approval

The Firm's does not have a formal Investment Committee however, all acceptance and participations in direct participation programs and REITs, is dicussed by senior management.

27.2.2 Expenses And Compensation

Prior to participating in a public offering of a DPP (unless the filing is made by another participant), KCD will make the required filing with the FINRA Corporate Financing Department. Prior to offering the DPP, KCD must receive a "no objections" opinion regarding the proposed terms and arrangements in the offering. The following sections explain key requirements that are considered by FINRA.

Organization And Offering Expenses

Organization And Offering Expenses (O&O expenses) are limited to 15% of the gross proceeds of the offering. O&O expenses are comprised of: (1) issuer expenses reimbursed or paid for with offering proceeds; (2) underwriting compensation; and (3) due diligence expenses. These elements are explained in the next three sections.

Issuer Expenses

Issuer expenses include:

- assembling and mailing offering materials, processing subscription agreements and generating advertising and sales materials
- legal and account services provided to the sponsor or issuer
- salaries and non-transaction-based compensation paid to employees or agents of the sponsor or issuer for performing services for the issuer
- transfer agents, escrow holders, depositories, engineers and other experts
- registration and qualification of securities under federal and state law, including taxes and fees and FINRA fees

FINRA will consider unaccountable payments to a sponsor or issuer or payments identified as "miscellaneous" as issuer expenses includable in underwriting compensation.

Underwriting Compensation

Underwriting compensation from whatever source paid to underwriters, broker-dealers or affiliates is limited to 10% of the gross proceeds of the offering. The 10% limit is included as part of the 15% limit on O&O expenses. Refer to Regulatory Notice 08-35 for a detailed explanation of the types of compensation considered underwriting compensation.

Due Diligence Expenses

All bona fide due diligence expenses included on a detailed and itemized invoice detailing such expenses are included as part of the O&O expenses. The amount of due diligence expenses may be treated in the calculation of underwriting compensation as a non-accountable expense provided that, when aggregated with all other non-accountable expenses, the amount does not exceed 3% of the offering proceeds.

Allocation Of Compensation

Rule 2310 (and Regulatory Notice 08-35) outlines specific requirements for allocating employee compensation as underwriting compensation. The Rule and Notice should be consulted for specific guidance when considering what is included as underwriting compensation.

27.2.3 Suitability

[FINRA Rule 2310]

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. For offerings where a subscription agreement is not required, the RR is responsible for ensuring the purchaser meets the standards outlined in the prospectus. The RR will complete a Suitability Questionnaire for each purchaser of a DPP where a signed subscription agreement is not required. The designated supervisor is responsible for ensuring required Suitability Questionnaires have been received prior to confirming purchases and retaining the Questionnaires in a file for the offering.

Suitability is only one element of acting in a customer's best interest. Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI) which is broader than the suitability requirement. Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

27.2.4 Subscription Agreements

The designated supervisor is responsible for the following:

Determining when subscription agreements signed by purchasers will be required for a DPP offering.
Ensuring completed and signed agreements are on file, when required, prior to confirming purchases.
Retaining copies of the signed subscription agreements in a file for the DPP offering.

27.2.5 Prospectuses

Prospectuses will be provided to all purchasers of DPP offerings. A prospectus will be included with the confirmation of purchase and the designated supervisor 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.

27.2.6 Liquidity Disclosure

Disclosure will be provided to prospective investors if the sponsor has offered prior DPPs for which the prospectus disclosed a date or time period when the program might be liquidated, and whether the prior programs in fact liquidated on or around that date or time period.

27.3 Rollups

[FINRA Rule 2310(b)(6); FINRA Notice to Members 94-70]

All rollup transactions in which KCD participates will be conducted in accordance with the Limited Partnership Reform Act and applicable FINRA rules. The purpose of the Act and the rules is to ensure fair treatment and protect the rights of limited partners whose partnership interests are proposed for restructuring. Compensation and the rollup's structure must meet fairness requirements included in rule requirements.

The designated supervisor is responsible for ensuring all rollup transactions comply with requirements included in the Act and FINRA rules.

27.3.1 Standard Agreement

The designated supervisor will execute a standard agreement with the general partner of the limited partnership subject to the rollup transaction. The agreement will outline the terms of the rollup including compliance with requirements to protect the rights of the limited partners. The agreement will be retained in a file for the rollup transaction.

27.3.2 Disclosure Letter

The designated supervisor will provide a disclosure letter to limited partners, outlining pertinent information regarding the rollup transaction. A record of to whom and when disclosures were sent will be retained by the designated supervisor in a file for the rollup transaction.

27.4 Secondary Market Transactions

[FINRA Notice to Members 91-69]

27.4.1 Order Records

Each secondary market transaction in a Direct Participation Program will be recorded in order records (written or electronic) that will include the time of execution, which is defined as the time the parties have agreed to the essential terms of the transaction.

27.4.2 Reporting Transactions

[FINRA Rule 6622; FINRA Regulatory Notice 10-24; FINRA Notice to Members 97-8]

Secondary market transactions in non-exchange listed direct participation program (DPP) securities must be reported to FINRA within 30 seconds of execution. The "date of execution" and the "time of execution" are defined as the date and time, respectively, when the parties to a transaction in a DPP have agreed to all of the essential terms of the transaction, including the price and number of units to be traded.

Those required to report are as follows:

- Between two members, the executing party reports
- Between a member and a customer, the member reports

The designated trader is responsible for reporting secondary DPP transactions.

27.4.3 Standard Transfer Forms

[FINRA Notice to Members 96-14]

KCD 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.

27.5 Communications Regarding Unlisted Real Estate Programs

[FINRA Regulatory Notice 13-18; SEC Division of Corporate Finance guidance: http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic3.htm]

There are FINRA guidelines for communications concerning unlisted real estate investment programs (real estate programs) which include REITs or DPPs that invest in real estate assets or mortgages and that are not listed on a national securities exchange. Following is a summary of the guidance; refer to FINRA Regulatory Notice 13-18 for details.

- **Disclosure**: When describing real estate programs, communications must accurately and fairly explain how the products operate. Communications must be consistent with the program's current prospectus and must not imply an investment in the program is a direct investment in real estate or other assets. If the program has not yet qualified for REIT status under the U.S. tax code, communications must disclose that the program has not yet qualified and that it may never qualify for REIT status. Potential benefits must be balanced with disclosure of potential risks, which must be presented in a clear and prominent manner (not in a footnote and not in a separate document such as the prospectus even if the communication is accompanied or preceded by a prospectus).
- **Distribution Rates**: Distributions from real estate programs sometimes include return of capital. The composition of distributions may not be misrepresented or described as a yield comparable to a fixed income investment. FINRA's guidance states that communications should include clear and prominent disclosure (as applicable):
  - That distributions are not guaranteed and may be modified;
  - If the distribution consists of return of principal (including offering proceeds) or borrowings, include a breakdown of the components of the distribution rate that represent cash flows, return of principal, and borrowing;
  - The time period during which distributions have been funded from return of principal (including offering proceeds), borrowings or any sources other than cash flows from investment or operations;
  - That distributions that include return of principal will lessen the money available for the program to invest, which may lower overall returns; and

- If distributions include borrowed funds, that because borrowed funds were used to pay distributions, the distribution rate may not be sustainable.
- Communications may not include an annualized distribution rate until the program has paid distributions that are, on an annualized basis, at a minimum equal to that rate for at least two consecutive quarterly periods.

Stability/Volatility Claims:
- Communications may not assert or imply that the value of a real estate program is stable or that volatility is limited without providing a sound basis to evaluate this claim.
- Communications may not state that the offering price at par value or at another relatively stable price evidences stability in the value of the underlying assets.
- Representations that the offering price is stable or volatility is limited must include disclosure that the value of underlying assets will fluctuate, may be worth less than what the program initially paid, and that the investor may not be able to sell the investment.

Redemption Features and Liquidity Events:
- Restrictions and limitations on redemption features (such as the fact that the real estate program's management may terminate or modify the ability to redeem) must be clearly and prominently explained.
- Communications must disclose if the real estate program has not satisfied all investor redemption requests in the past.
- Any discussion about potential liquidity events or the timing of such events should disclose if the date of the liquidity event is not guaranteed if it may be changed at the program's discretion.

Performance of Prior Related Real Estate Programs: Discussions of prior or historical performance of related or affiliated entities should include information about such related entities with equal prominence, may not "cherry pick" those favorable to the current program, and should be clearly differentiated from information regarding the current program.

Use of Indices and Comparisons: Communications about real estate programs sometimes include a real estate index's performance to demonstrate the sector's risk or return characteristics. The use of index performance may be misleading if its underlying components do not correspond with those of the program's portfolio. Communications that compare a real estate program against a real estate index must indicate that the performance of the index does not reflect a particular program and must describe the index's components and any relevant differences between the index and the program's investments.

Pictures of Specific Properties: Where a communication includes pictures or images of properties that are not owned by the real estate program - such as similar properties owned by other programs the sponsor manages or properties that are collateral for mortgages owned by the program - the pictures must include prominent text explaining that the property is not owned by the program.

Capitalization Rates: Communications may include the capitalization rate of an individual property within a real estate program if the rate is based on current information contained in the prospectus, and the communication explains (i) how the rate was calculated, (ii) that the rate applies to the individual property, and (iii) that it does not reflect a return or distribution from the program itself. In general it is misleading to include a blended capitalization rate representing multiple individual properties as the factors that go into such rates will differ between individual properties.

28 PRIVATE PLACEMENTS AND OFFERINGS

[FINRA Rule 5122 and 5123; FINRA Regulatory Notice 23-08; FINRA Frequently Asked Questions: https://www.finra.org/rules-guidance/guidance/faqs/private-placement-frequently-asked-questions-faq; Securities Act Regulation D Rule 504, Rule 506(b) and Rule 506(c)]

This chapter explains the requirements when offering private placements and engaging in private offerings. Private placements and offerings are subject to strict requirements that are imposed on the issuer and those who sell the issue. The requirements for offering a specific private placement will be announced at the time the private placement becomes available for sale. It is important to understand and comply with the requirements for each offering.

28.1 Introduction

This section provides general information about private placements and the regulations that govern their offer and sale. A general understanding of private placements is helpful when considering whether to offer a specific issue to a customer.

There are several general areas of requirements and limitations that affect most private placements.

- No general solicitation of purchasers other than those permitted under Rule 506(c) and 144A
- Limits as to the size of the offering
- No advertising or general public meetings about specific private placements other than those permitted under Rule 506(c) and 144A
- Issuers must provide information to potential investors
- Securities purchased are generally restricted as to resale
- Number of purchasers is restricted

28.1.1 Private Securities Offerings Principal

Principals solely responsible for supervising specified activities relating to private securities offerings may register as Private Securities Offerings Principals, instead of registering as General Securities Principals. Individuals can qualify for registration as a Private Securities Offerings Principal in several ways.

Individuals registering as Private Securities Offerings Principals are required to satisfy the Private Securities Offerings Representative prerequisite registration which includes passing the SIE and the General Securities Principal (Series 24) qualification examinations.

28.1.2 Definition Of Terms

The following are common terms included in this chapter.

Accredited investor	An investor who meets certain criteria that are indicative of sophistication (see the section *Accredited Investors*)
Letter of Non-Distributive Intent	A letter or form signed by the purchaser of a private placement, affirming that the investor is purchasing the securities for their own account and are not to be resold unless registered or subject to an available exemption.
Non-Disclosure Agreement	An agreement signed by the offeree stating that proprietary information

	learned about the issuer will not be divulged to third parties.
Offer	An attempt to sell a security to a potential purchaser
Offeree	A prospective purchaser to whom an offer is made
Purchaser questionnaire	A questionnaire completed by an offeree to establish the offeree's suitability/Reg BI eligibility to purchase the investment
Purchaser representative	A person (not affiliated with the issuer or the broker-dealer selling the issue) who acts on the purchaser's behalf to evaluate the investment for the purchaser
Subscription agreement	The document signed by the purchaser and evaluated by the issuer prior to the purchase

28.1.3 "Private Placement" Defined

Private placements are unregistered, non-public securities offerings that rely on an available exemption from registration with the SEC under either Sections 3 or 4 of the Securities Act. Most private offerings are sold pursuant to one of three "safe harbors" under Rules 504, 506(b), and 506(c) of Regulation D. Private placements sold by FINRA member firms to individuals generally must file offering documents with FINRA.

28.1.3.1 Section 4(2) Of The Securities Act Of 1933

Some private placements are offered under Section 4(2) which provides an exemption for "transactions by an issuer not involving any public offering." While the section does not specifically outline the requirements for establishing an exemption, the following is a summary of requirements gleaned from SEC interpretations and court decisions.

- There may be no general solicitation of purchasers other than those permitted under Rule 506(c) and 144A.
- Offerees and purchasers must have access to information about the issuer and must be able to comprehend and evaluate the information.
- The issuer, broker-dealer, and others acting for the issuer must conduct due diligence to reasonably insure information given to offerees and purchasers is complete and accurate.
- Offerees must have access to meaningful information concerning the issuer and be able to comprehend and evaluate the information.
- Purchasers must acquire the securities for investment and not for resale.

28.2 Blue Sky Requirements

State securities laws ("blue sky" laws) that apply to private placements vary from state to state. Some states have differing definitions for accredited investors; some states require registration of a securities issue that is otherwise exempt under Federal securities laws.

KCD and its sales personnel are required to comply with any blue sky requirements that apply to a specific private placement issue. Requirements may differ depending on where the issue originates and where it is sold.

28.3 The Firm's Participation In Private Placements

Responsibility	Designated Supervisor
Resources	Information provided by the issuer and/or issuer's counsel
Frequency	As required - process the private placement Within 15 calendar days of the date of first sale - provide submissions to FINRA
Action	Execute an agreement with the issuer Conduct due diligence or engage counsel or other qualified person to conduct due diligence Document the file regarding due diligence Provide information to KCD's New Product or Underwriting Committee or appropriate senior manager for review and approval to proceed with the deal Determine limitations on the offering, including integration issues and obtain representation letter from issuer if needed Determine what information to provide to sales personnel Authorize the sale of the offering Within required timeframes, submit private placement memorandum, term sheet or other document (including material amendments) to FINRA or notify FINRA no offering documents were used Consider conducting a post-closing assessment to ascertain whether offering proceeds were used in a manner consistent with the offering memorandum
Record	The deal file will include due diligence information; approval/disapproval from the appropriate committee or senior manager; the issuer agreement; issuer representation letter; offering materials; authorization to sell; post-closing assessment, if applicable Record of submissions to FINRA and when submitted

28.3.1 Due Diligence

Due diligence will be conducted for each private placement issue to be offered by KCD and is documented in the file for the private placement. Outside counsel or another third party may be engaged to assist in due diligence and other aspects of the private placement offering. If the counsel or third party is affiliated with or somehow associated with the issuer, KCD will conduct additional independent due diligence. Due diligence may include the following reviews (which may include engaging attorneys or other third parties to conduct some or all reviews), as appropriate for the particular potential offering:

- Financial reports
- Written company assurances as to the accuracy of records and financial statements
- Determination of the issuer's creditworthiness
- Evaluate the validity and integrity of the issuer's business model and how it fits into its business sector
- Review information available from financial and other publishers
- Independent verification of management's representations (contact with issuer's customers; lenders, vendors, lower-level employees, *etc.*)
- Independent verification of information key to the performance of the offering such as unrealistic costs projected to execute the business plan coupled with aggressively projected timing and overall rate of return for investors
- Identify conflicts of interest such as firm affiliates or issuers whose control persons were also employed by KCD and address conflicts (such as by confirming that the issuer prominently and comprehensively discloses these conflicts in offering documents or mitigating them by removing financial incentives to recommend a private offering or other more appropriate investments)
- Reviewing news articles and industry publications regarding the issuer, its market, and competition

- Review the company's internal documents such as operating plans, product literature, corporate records, financial statements, contracts and lists of distributors and customers
- Physical inspection of the company's facilities
- Contact with the issuer's auditor and other experts knowledgeable about the company
- Contact with outside directors
- Interviews of key personnel or customers
- Determination of the plausibility of expected rates of return as compared to industry benchmarks, particularly considering complex fee structures associated with many of these types of investments
- Identifying red flags such as questionable business plans or unlikely projections or results, and conflicts of interest and following up
- Updating due diligence as needed until effectiveness of the offering

28.3.2 Agreement With The Issuer

KCD will execute an agreement with the issuer to define the terms of KCD's role in the offering and the issuer's obligations as well as other covenants of the offering.

28.3.3 Dollar Amount Of The Offering And Integration Issues

The designated supervisor is responsible for ensuring the issue is not oversold relative to the dollar amount disclosed in the offering document compared to the limitations provided in the rules. The supervisor should consider any "integration" of similar offerings by the same issuer for substantially identical purposes for determining whether the issuer meets the dollar limitation under the exemption within a 12-month period of time. The supervisor's review for integration may include one of the following or another procedure determined adequate by the supervisor:

- Reviewing the issuer's financial statements for the past 12 months and/or contact directly with the issuer
- Obtaining a representation letter from the issuer that states that no other offerings were distributed during the 6-month period prior to the current private placement offering or will be distributed in a succeeding 6-month period that would cause the exemption to be lost

28.3.4 Submissions To FINRA

[FINRA Rule 5123; FINRA Regulatory Notice 13-26 and 12-40]

For private placements sold by the Firm (other than those exempt under Rule 5123), filings will be made electronically with FINRA within 15 calendar days of the date of first sale including the private placement memorandum, term sheet or other offering document (including any material amendments). If no offering documents were used, FINRA will be notified.

28.4 Sales Of Private Placements

28.4.1 Regulation Best Interest (BI)

A primary objective when selling a private placement is that all securities will be placed with retail investors consistent with Regulation BI. The RR recommending a private placement is responsible for determining that the recommendation is appropriate for the offeree based on information known about the potential offeree. The

RR must consider minimum investor requirements and other suitability standards for each private placement offering.

Recommendations to retail customers who are natural persons are subject to Regulation Best Interest (BI). Reg BI includes recommendations for orders; types of accounts; and investment strategies, including recommendations to prospects. It is important to be familiar with those requirements which are included in the chapter *REGULATION BEST INTEREST (BI)*.

28.4.1.1 Accredited Investors

[Securities Act Rule 215; Securities Act Regulation D Rule 501]

An accredited investor is defined in Rule 501 as someone who meets certain financial criteria which may include minimum net worth, minimum income levels and other standards set by federal or state laws and regulations. It also includes natural persons holding professional certifications or designations or other credentials; knowledgeable employees of private funds; rural business investment companies; limited liability companies that meet certain criteria; other entities meeting an investments owned test; family offices and family clients; and spousal equivalents. The Rule should be consulted for specific criteria. Typically, accredited investors are not counted toward the limitation on the number of purchasers of a private placement.

Information about each private placement (and where it is sold) must be consulted to determine who qualifies as an "accredited investor" for a particular issue.

Non-Accredited Investors

Private placements sometimes may be offered to purchasers who do not meet the criteria of accredited investors. The number of allowable non-accredited purchasers will be limited, to preserve the registration exemption and meet requirements specified under federal and state law.

28.4.2 Restricted Nature Of Private Placement Securities

Private placement securities are considered "restricted securities," other than those purchased in Rule 504 offerings. Certificates will typically include a legend and securities cannot be resold unless registered or the securities qualify for sale under an exemption.

Purchases must be for investment purposes and not for the purpose of resale. Subscription documents typically include an affirmation that the purchaser is buying the private placement for investment purposes and understands they may not be resold (Letter of Non-Distributive Intent).

RRs must consider the illiquidity of most private placements when making suitability/Reg BI determinations. For example, a private placement would not be a suitable investment for a purchaser who expects to invest his funds on a short-term basis.

28.4.3 Retail Communications

[FINRA Rule 2210; FINRA Regulatory Notice 20-21 and 13-18]

This section includes requirements for retail communications about private placements. FINRA Regulatory Notice 20-21 should be referenced for more detail and guidance.

Under Rule 2210(d) all communications must be fair, balanced, and not misleading;
Any promotion of potential awards must be balanced by disclosure of the associated risks;

Communications must be accurate and provide a sound basis to evaluate the facts with respect to the products or services discussed; and
Retail communications must be approved by a registered principal.

This also applies to communications prepared by third parties and used by KCD. If a retail communication is included in the same electronic file with an issuer-prepared private placement memorandum and distributed by KCD, it is considered a Firm communication in its entirety subject to FINRA Rule 2210. Retail communications must balance any discussions of benefits with a discussion of related risks and must be in the same retail communication (*i.e.,* cannot be in a separate document or different section of the website).

Retail communications may not contain any prediction or projection of performance, subject to certain exceptions, as well as any exaggerated or unwarranted claim, opinion, or forecast. Reasonable forecasts of issuer operating metrics, along with a sound basis for evaluating the facts and related risks, would be permitted. FINRA Regulatory Notice 20-21 provides more detailed guidance when including forecasts.

Regulatory Notice 13-18 provides guidance for public and non-public REITs including principles relating to distribution rates which refers to issues where a portion of distributions are funded through return of principal or loan proceeds. Refer to the Notice for details of necessary disclosures.

Internal Rate of Return (IRR) is a measure of performance commonly used in connection with marketing private placements of real estate, private equity and venture capital. A drawback of IRR calculations is an inherent assumption that investors will be able to reinvest distributions at the IRR rate, which is unlikely to occur. In addition, calculations may include holdings that have not yet been sold (or liquidated or matured) resulting in subjective factors and assumptions. IRR may not be used in retail communications regarding privately placed new investment programs with no operations or that operate as a blind pool. IRR may be used for completed investment programs (holdings matured or all sold).

28.4.4 Filing Requirements For Private Placement Of Securities

[FINRA Rule 5123(a)]

The designated supervisor is responsible for the following filings with FINRA within fifteen calendar days of the date of first sale or notify FINRA that no such documents were used:

private placement memorandum
term sheet or other such document
any retail communication (defined in FINRA Rule 2210) that promotes or recommends the member private offering
amendments to the above within 10 days of providing to any investor or prospective investor

Excluded from this requirement are private offerings sold only to institutional investors [defined in FINRA Rule 4512(c)]; qualified purchasers [defined in the Investment Company Act of 1940]; investment companies [defined in the Investment Company Act] and qualified institutional buyers [defined in Rule 144A].

28.4.5 Filing Requirements For Private Placement Of Securities Issued By A Member Firm

[FINRA Rule 5122(b)(2)]

The designated supervisor is responsible for the following filings with FINRA at or prior to the first time the document is provided to any prospective investor:

private placement memorandum
term sheet or other such document
any retail communication (defined in FINRA Rule 2210) that promotes or recommends the member private offering

amendments to the above within 10 days of providing to any investor or prospective investor

Excluded from this requirement are private offerings sold only to institutional investors [defined in FINRA Rule 4512(c)]; qualified purchasers [defined in the Investment Company Act of 1940]; and qualified institutional buyers [defined in Rule 144A].

28.4.6 Purchaser Questionnaires

Where necessary, the potential investor will be requested to complete a Purchaser Questionnaire which confirms that the investor meets certain minimum requirements to participate in the private offering.

When Purchaser Questionnaires are required, the RR is responsible for obtaining the completed Questionnaire from the potential purchaser and submitting it for review and approval within the timeframe established for the offering.

28.4.7 Purchaser Representatives

If a purchaser is not sufficiently sophisticated to effectively evaluate the investment opportunity, he or she may have a "purchaser representative" (chosen by the investor and **not** an affiliate of the issuer or broker-dealer) who assists in evaluating the investment. The purchaser representative will be required to sign the offering documents attesting to his or her role acting as purchaser representative.

28.4.8 Offering Memorandum

Responsibility	Designated Supervisor
Resources	Offering memorandum
Frequency	As required for each private placement
Action	Establish a distribution control sheet Number each offering memorandum, consecutively Record the number of each offering memorandum and the name of the offeree and the RR or RR number For unnumbered memoranda, mark copies "File Copy" or "For Information Only" If changes or corrections are made to the offering memorandum prior to closing, provide copies to each offeree who received the original memorandum and note on the control sheet that copies were provided including the date provided
Record	A copy of the offering memorandum, corrected/changed memorandum, and the control sheet are retained in the deal file.

An offering memorandum is prepared for each private placement, depending on the specific issue. The offering memorandum includes disclosures of information obtained from the issuer including the nature, character, and risk factors relating to the offering. Purchasers will be required to acknowledge, in writing, that they have received the offering memorandum.

An offering memorandum must be provided to all offerees. Offering memorandums are numbered, to enable KCD to maintain a record of offerees who received them.

Offering memorandums are available private placement company. RRs must provide information regarding the offeree at the time the memorandum is provided to the prospective purchaser.

If it is necessary to update or correct information in the private placement memorandum prior to closing of the issue, the revised information will be provided to offerees, in writing.

28.4.9 Oral Representations

RRs must not deviate from written private placement memorandum information or other pre-approved information when discussing private placements with potential investors. Written notes of conversations with offerees (and their purchaser representatives) should be made, dated and placed in the customer's file.

28.4.10 Offeree Access To Information

Most private placement memoranda state that it was prepared by counsel from information provided by the issuer. Offerees are invited to meet with representatives of the issuer to make an independent investigation and verification of information in the memorandum.

28.4.11 Solicitation

[Securities Act Regulation D Rule 506(b) and Rule 506(c); SEC Compliance & Disclosure Interpretations (C&Ds) on verification methods, see 255.48, 255.49, 260.35, 260.36, 260.37, 260.38: http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#255.48; SEC explanation of 506(b): https://www.sec.gov/smallbusiness/exemptofferings/rule506b; SEC explanation of 506(c): https://www.sec.gov/smallbusiness/exemptofferings/rule506c; SIFMA Guidance on Rule 506(c) verification: http://www.sifma.org/issues/item.aspx?id=8589949595; SEC Compliance and Disclosure Interpretations 256.23-256.33 8/6/15 re solicitations]

Responsibility	Designated Supervisor
Resources	Rule 506 offerings
Frequency	As required
Action	For offerings under Rule 506(b): Ensure there are no media (including internet) or public event announcements of the offering If there is to be solicitation of investors with a pre-existing, substantive relationship, confirm those to be solicited meet SEC guidance If other exemptions apply, confirm compliance with requirements For offerings under Rule 506(c): Confirm that the issuer has determined that purchasers qualify as accredited investors or conduct verification of purchasers File forms and pay fees as required
Record	Record of confirming accredited investor status of all purchasers Record of confirming the pre-existing substantive relationship to satisfy Rule 506(b) requirements or other SEC guidance requirements

	Records of filing forms/paying fees

Solicitation of private placement offerings under Rules 506(b) and 506(c) differ as explained below.

28.4.11.1 Offerings Under Rule 506(b)

Companies conducting an offering under Rule 506(b) may raise an unlimited amount of money and may sell to an unlimited number of accredited investors. 506(b) offerings are subject to the following:

- no general solicitation or advertising to market the securities
- may not be sold to more than 35 non-accredited investors subject to the following:
  - must provide disclosure documents; if information is provided to accredited investors, the same must be provided to non-accredited investors
  - must provide financial statement information
  - should be available to answer questions from prospective purchasers

Purchasers receive restricted securities. Notice to the SEC on Form D is required within 15 days after the first sale of securities in the offering. Some states may require notice filings and fees.

506(b) offerings are subject to "bad actor" disqualification provisions (see *Disqualification Of Felons And Other "Bad Actors"* in this chapter).

28.4.11.2 Offerings Under Rule 506(c)

Under Rule 506(c) issuers may broadly solicit and generally advertise an offering subject to the following restrictions:

- All purchasers must be accredited investors as defined under Rule 501.
- The issuer is obligated to take reasonable steps to verify that purchasers are accredited investors under Rule 501 of Regulation D. Depending on KCD's role, KCD may be responsible for verification.
- Certain other conditions in Regulation D are satisfied.

Purchasers receive restricted securities. The issuer must file notice to the SEC on Form D within 15 days after the first sale of the securities in the offering. Some states may require notice filings and fees.

The SEC has provided a non-exclusive list of methods that issuers (or someone acting on behalf of the issuer) may use to satisfy the verification requirement for individual investors, including:

- Reviewing copies of any IRS form that reports the income of the purchaser and obtaining a written representation that the purchaser will likely continue to earn the necessary income in the current year.
- Receiving a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney, or certified public accountant that such entity or person has taken reasonable steps to verify the purchaser's accredited status.

The verification rule does NOT apply if there is no advertising or general solicitation.

28.4.12 Investment Seminars Or Meetings

Responsibility	Designated Supervisor

Resources	Requests to conduct meetings or seminars
Frequency	As required
Action	Request a written outline of the information to be presented, including any written materials to be provided to those attending Request information about how the seminar or meeting will be publicized Review the outline, written materials, and method of publication Approve or disapprove, providing any revisions necessary Require that all invitees receive copies of the offering memorandum
Record	Include copies of the outline, list of invitees, written materials, and the approver's initials and date of approval/disapproval in the deal file.

Rule 504 offerings may be solicited without limitation. There may be general solicitation for Rule 506 and 144A offerings though the issuer is subject to requirements to verify that purchasers are accredited investors (Rule 506) or QIBs (Rule 144A). See the sections *Solicitations* and *Rule 144A Transactions* for more information.

- Seminars or meetings on specific private placements must be approved by the designated supervisor prior to conducting the seminar or meeting. Prior to approval provide the supervisor with:
  - a written outline of information to be presented and any graphic or written materials to be provided to attendees.
  - a description of how the seminar or meeting will be publicized to prospective attendees.
- Attendees must be provided with an offering memorandum. No other written material may be provided, unless previously approved by the Firm.

28.4.13 Subscription Agreements

Responsibility	Designated Supervisor
Resources	Subscription agreements and accompanying checks
Frequency	As required
Action	Log agreements and checks received onto Sales Blotter for the deal Review subscription agreements and checks for acceptability Reject unacceptable agreements or checks and return to RR Forward accepted checks to escrow agent or issuer, retaining a copy in the deal file Initial accepted agreements Forward accepted agreements to issuer, retaining a copy in the deal file Issue confirmations to issuer-accepted purchasers when the purchase is effected
Record	Retain in deal file: Sales blotter Copies of subscription agreements and checks

Each potential purchaser will be required to complete the necessary subscription agreement to purchase a private placement. The agreement must be accompanied by a check for the purchase.

Subscription agreements are processed as follows:

- The RR obtains the signed subscription agreement (and other required offering documents) and a check for payment from the offeree and submits them to the designated supervisor.
- Subscription agreements and checks received are logged into the Sales Blotter for the private placement.
- The designated supervisor reviews the agreement and check for acceptability.
- The check is forwarded to the escrow agent or the issuer, together with the purchaser's name, address, social security number, and number of shares/units, as required.
- Rejected agreements/checks are returned to the RR with an explanation for the rejection.
- Accepted agreements are signed/initialed by the supervisor, a copy retained by KCD, and the original forwarded to the issuer.
- The issuer reviews and accepts or rejects the agreement.
- A confirmation is sent to accepted purchasers when the purchase is effective.

RRs should be aware that **purchasers are not accepted until the issuer accepts them**. Final acceptance rests with the issuer who is responsible for ensuring conditions of the offering are satisfied to qualify under the operative exemption.

28.4.14 Contingency Offerings

[Exchange Act Rule 10b-9 and 15c2-4; FINRA Regulatory Notice 16-08 and 10-22; FINRA Notice to Members 98-4]

Responsibility	Designated Supervisor
Resources	Issuer agreement Subscription agreements
Frequency	As required
Action	Evaluate issuer information and determine the Firm's participation including: - Reasonable investigation of the security and the issuer's representations - Review of the terms of the contingency, including any agreement and disclosure by the issuer regarding the contingency - Follow up any red flags such as inconsistencies between the escrow agreement and the offering document Establish a "separate account" or escrow account Confirm purchasers are bona fide purchasers where necessary Identify insiders, firm or employee account purchasers and obtain affirmation regarding holding period Require subscribers to reconfirm their investments if the issuer extends the offering period Return subscriber funds if the issuer changes the contingency by reducing the offering minimum Close escrow account and, if contingency met, immediately forward purchaser funds to issuer or, if contingency is not met, immediately return funds to potential purchasers
Record	Escrow account, issuer information and purchaser information are retained in the deal file

28.4.14.1 Introduction

Best efforts underwritings may take different forms including "all or none," "minimum-maximum," or other offerings contingent on the sale of a certain amount of the issuer's securities. Two primary concerns are that customer funds be transmitted to the issuer or to an escrow account and that only *bona-fide* purchasers are included in order to meet a stated minimum number of shares or units. Where the minimum is not sold within the deadline specified by the prospectus, all customer funds must be refunded.

Sales will be made only to *bona-fide* purchasers to meet any minimum amount of the securities to be sold.

28.4.14.2 Handling Investor Funds

The Firm will promptly:

- Deposit funds into a "separate bank account" for which the Firm is the account holder and is designated as agent or trustee for the investors (only if the Firm maintains at least $250,000 in net capital and is allowed to carry customer accounts); or
- Establish an independent bank escrow account.

Funds will be released to the issuer only after the contingency is satisfied.

28.4.14.3 Customer Funds - Escrow Account

[Exchange Act Rule 15c2-4]

The designated supervisor is responsible for establishing procedures for the protection of customer funds including the establishment of an escrow account where required.

- Establish an escrow account and execute the Firm's standard escrow agreement with a bank that is not affiliated with the Firm. The escrow account may not be controlled by the issuer.
- Maintain copies of bank statements for the escrow account and review the statements when received, to ensure funds are not withdrawn prior to the date the contingency is met.
- Ensure customer funds are promptly deposited to the escrow account.
- Maintain records of all potential purchasers including the quantity to be purchased, when funds are received, and when funds are forwarded to the issuer or escrow account.
- Ensure checks are forwarded to the issuer (where an escrow account is not used) or to an escrow account by noon of the business day following receipt.
- Authorize release of funds to the issuer from an escrow account after the contingency is met and after a review of purchasers, as discussed in the next section, has been conducted.
- If the contingency is not met, promptly refund funds to potential purchasers.
- If the issuer extends the offering period, require investors to reaffirm their investments.
- If the issuer reduces the offering minimum, return funds to investors.

28.4.14.4 Purchasers

The designated supervisor is responsible for establishing procedures regarding purchasers of securities issued through a best efforts underwriting including the following:

- Where the offering is contingent upon the sale of a certain quantity of the issue, confirm that all purchasers are *bona-fide* purchasers. Non-bona fide sales generally include sales of undisclosed purchases by the issuer or broker-dealer, their affiliates or associated persons, or any entities through nominee accounts that are designed to create the appearance of a successful completion of an offering.

Identify purchases by issuer insiders, the Firm's proprietary account, or employees of the Firm and, for those identified, obtain a written affirmation that the purchaser intends to hold the security as an investment or, in conjunction with the issuer, determine restrictions on immediate sale by such accounts.

Record the review of purchasers in the deal file.

28.5 Regulation D

[SEC Securities Act of 1933 Regulation D; FINRA Regulatory Notice 10-22]

Regulation D is a series of six rules, Rules 501-506, that include exemptions from the registration requirements of the 1933 Act. The specific exemptions are included in Rules 504-506 and differ as to the size of the offering and conditions imposed to qualify for the exemption. The following chart summarizes the three exemptions available under Regulation D. This is only a very general summary of requirements and does not include legal definitions and technicalities that may apply to certain types of private placements.

	Rule 504	**Rule 506**
Who may invest	Anyone suitable for the investment	Qualified investors
Number of investors	Unlimited	35 non-accredited, unlimited accredited investors
Size of offering sold in any consecutive 12 months	$5,000,000	Unlimited
Restricted securities?	No	Yes
Public solicitation/advertising allowed?	Yes	Yes
Disclosure document required?	No	Yes*
Opportunity to ask questions of issuer?	No	Yes

*Under the rule, disclosure documents are not required to be given to accredited investors though a note to Rule 502(b) states that an issuer should consider providing such information to accredited investors in view of anti-fraud statutes.

The reference to "unlimited accredited investors" in the section "Number of investors" above does not imply that a private placement will, in fact, have an unlimited number of accredited investors. The issuer and KCD will consider limitations on accredited investors, as appropriate, to preserve the exemption as a private placement and avoid the appearance of a broad solicitation of the issue.

28.5.1 Disqualification Of Felons And Other "Bad Actors"

[SEC Regulation D Rule 506(d)(1)]

Rules 504 and 506 are frequently-used exemptions from registration under Regulation D. The exemptions are NOT available if the issuer or any person covered by the disqualification rule had a "disqualifying event." Disqualifying events include certain criminal convictions; SEC and CFTC actions; and other events. Refer to the rule cited above for a list of covered persons and disqualifying events.

There is an exception from disqualification if the issuer can show it did not know, and in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering.

28.5.2 Due Diligence

This section includes due diligence guidelines provided by FINRA. the Firm will conduct due diligence appropriate for the particular Regulation D offering and document its reviews and investigations in the deal file.

When engaging in a Regulation D offering, due diligence will include, at minimum, reasonable investigation of:

- the issuer and its management;
- the business prospects of the issuer;
- the assets held by or to be acquired by the issuer;
- the claims being made; and
- the intended use of proceeds of the offering (including whether investors' money is likely to be applied according to the stated use of proceeds, and whether the stated use of proceeds is reasonable in light of the issuer's business purpose and prospects).

The scope of investigation may depend on a number of specific factors included in FINRA guidance, described below.

BD affiliation with the issuer. If there is affiliation with the issuer, a BD must not compromise its independence in performing a thorough and independent investigation and must resolve any conflict of interests impairing that responsibility.

BD that prepares the private placement memorandum or other offering document. The BD has a duty to investigate the securities offered and representations made by the issuer. Where a BD assists with preparation of a memorandum or document, the BD is subject to FINRA communications rules. **Retail communications are subject to FINRA rule requirements whether or not the BD assisted in their preparation.**

"Red flags" (such as an issuer's refusal to provide information for the BD to meet its obligation to investigate or inaccurate financial statements) must be reviewed and simple reliance on representations by the issuer's management is not sufficient to meet the BD's investigatory obligations.

The use of counsel or experts to perform an investigation on the BD's behalf must be done by firms and individuals that the BD is satisfied are qualified and competent. When the Firm is a member of a syndicate or selling group, it may rely upon the reasonable investigation by the syndicate manager if the BD believes the syndicate manager has the expertise and absence of conflicts to conduct the investigation. Reliance may be substantiated by meeting with the manager; obtaining a description of the manager's reasonable investigation efforts; and inquiry regarding the independence and thoroughness of the investigation.

28.5.3 Investigation Practices

The following are FINRA guidelines for what may be included in a reasonable investigation of a Regulation D offering. KCD will conduct investigation into the issuer as appropriate for the proposed offering.

A. Issuer and Management

Reasonable investigations of the issuer and its management concerning the issuer's history and management's background and qualifications to conduct the business might include:

- For Rule 506 offerings, determine whether the issuer or any covered person under Rule 506(d)(1) has been the subject of a disqualifying event precluding the use of the Rule 506 exemption.
- Examining the issuer's governing documents, including any charter, bylaws and partnership agreement, noting particularly the amount of its authorized stock and any restriction on its activities. If the issuer is a corporation, a BD might determine whether it has perpetual existence.

- Examining historical financial statements of the issuer and its affiliates, with particular focus, if available, on financial statements that have been audited by an independent certified public accountant and auditor letters to management.
- Looking for any trends indicated by the financial statements.
- Inquiring about the business of affiliates of the issuer and the extent to which any cash needs or other expectations for the affiliate might affect the business prospects of the issuer.
- Inquiring about internal audit controls of the issuer.
- Contacting customers and suppliers regarding their dealing with the issuer.
- Reviewing the issuer's contracts, leases, mortgages, financing arrangements, contractual arrangements between the issuer and its management, employment agreements and stock option plans.
- Inquiring about past securities offerings by the issuer and the degree of their success while keeping in mind that simply because a certain product or sponsor historically met obligations to investors, there are no guarantees that it will continue to do so, particularly if the issuer has been dependent on continuously raising new capital. This inquiry could be especially important for any blind pool or blank-check offering.
- Inquiring about pending litigation of the issuer or its affiliates.
- Inquiring about previous or potential regulatory or disciplinary problems of the issuer. A BD might make a credit check of the issuer.
- Making reasonable inquiries concerning the issuer's management. A BD might inquire about such issues as the expertise of management for the issuer's business and the extent to which management has changed or is expected to change. For example, a BD might inquire about any regulatory or disciplinary history on the part of management and any loans or other transactions between the issuer or its affiliates and members of management that might be inappropriate or might otherwise affect the issuer's business.
- Inquiring about the forms and amount of management compensation, who determines the compensation and the extent to which the forms of compensation could present serious conflicts of interest. A BD might make similar inquiries concerning the qualifications and integrity of any board of directors or similar body of the issuer.
- Inquiring about the length of time that the issuer has been in business and whether the focus of its business is expected to change.

B. Issuer's Business Prospects

Reasonable investigations of the issuer's business prospects, and the relationship of those prospects to the proposed price of the securities being offered, might include:

- Inquiring about the viability of any patent or other intellectual property rights held by the issuer.
- Inquiring about the industry in which the issuer conducts its business, the prospects for that industry, any existing or potential regulatory restrictions on that business and the competitive position of the issuer.
- Requesting any business plan, business model or other description of the business intentions of the issuer and its management and their expectations for the business, and analyzing management's assumptions upon which any business forecast is based. A BD might test models with information from representative assets to validate projected returns, break-even points and similar information provided to investors.
- Requesting financial models used to generate projections or targeted returns.
- Maintaining in the BD's files a summary of the analysis that was performed on financial models provided by the issuer that detail the results of any stress tests performed on the issuer's assumptions and projections.

C. Issuer's Assets

Reasonable investigations of the quality of the assets and facilities of the issuer might include:

- Visiting and inspecting a sample of the issuer's assets and facilities to determine whether the value of assets reflected in the financial statements is reasonable and that management's assertions concerning the condition of the issuer's physical plants and the adequacy of its equipment are accurate.
- Carefully examining any geological, land use, engineering or other reports by third-party experts that may raise red flags.

Obtaining, with respect to energy development and exploration programs, expert opinions from engineers, geologists and others are necessary as a basis for determining the suitability of the investment prior to recommending the security to investors.

D. Other Areas For Review

Regulatory and litigation history of the issuer and its management, including the criminal, disciplinary, regulatory, and litigation history associated with the issuer, its management, and any affiliate that may be materially involved in the issuer's business, as well as the issuer's compliance with the bad actor provisions under Rule 506(d)-(e).35 X New material developments, including events that are or should be reasonably known to the member during an offering, for example, when there are ongoing legal proceedings or regulatory inquiries involving the issuer.
Transactions or payments between an issuer and the issuer's affiliates involving offering proceeds, including the terms of the transaction between the related parties and whether an arrangement presents a material conflict of interest for the issuer and, if so, the sufficiency of disclosure.
Representations of past performance of the issuer, its sponsor, or its manager to identify any such representations that may be misleading or exclusively selected based on positive results (or "cherry-picking"). This is particularly important when the representations pertain to specific prior issuances

E. Additional Evidence Of Reasonable Review

FINRA provides the following guidance for demonstrating a reasonable, independent investigation by:

Documenting the inquiries, research, and analysis that the member conducted.
Obtaining additional information from an issuer, such as primary documents, to perform an independent analysis of issuer representations. For example, if the PPM contains a representation concerning the contracts or permits the issuer has in place, a reasonable independent review may involve obtaining and reviewing copies of the contracts or permits.
Critically analyzing third-party due diligence reports. When a member encounters red flags through its own review, the member must address those issues prior to recommending the offering. For instance, where a due diligence report contains inconsistencies or inadequately addresses potential concerns, a member should obtain a more thorough explanation of the issue from the source of the report or by independently researching the matter.

28.6 Rule 144A Transactions

[SEC Securities Act of 1933 Rule 144A]

Responsibility	Designated Supervisor
Resources	Requests to purchase securities under 144A Trader referrals of potential 144A transactions
Frequency	As required
Action	Confirm the securities to be sold qualify for sale under Rule 144A Review potential purchasers to ensure they meet the qualification for Qualified Institutional Buyers (QIB) prior to purchase Provide written notification to all purchasers disclosing the nature of the 144A transaction and confirming that it is KCD's understanding that the purchaser is a QIB as defined in Rule 144A Notify traders regarding securities that are to be sold only under the restrictions of 144A

	When KCD includes 144A securities in its inventory, determine the marketability of the securities for net capital purposes and notify the FINOP of the status of such securities in inventory
Record	Review of securities for qualification for sale under 144A Review of customers for qualification as QIBs and copies of 144A letters Notification to traders Records of the written notification provided to purchasers including the date and to whom provided

Rule 144A permits private placement of securities with certain institutional purchasers that qualify as Qualified Institutional Buyers (QIBs) as defined in Rule 144A. While general solicitation and advertising is permitted for these offerings, all purchasers must qualify as QIBs. The seller (issuer) and anyone acting on behalf of the seller must reasonably believe the purchase meets the qualification of a QIB.

For 144A transactions in TRACE-eligible debt securities, traders are required to comply with TRACE requirements. For more information, refer to the section *TRACE* in the chapter *CORPORATE FIXED INCOME SALES AND TRADING*.

28.7 Private Investment In Public Equity (PIPE)

This section describes PIPE transactions.

28.7.1 Introduction

A PIPE is defined as a privately negotiated sale (*i.e.,* private placement) of securities of an already public company. In a PIPE transaction, a public company sells its unregistered securities (*e.g.,* common stock, preferred stock or convertible securities) in a private placement to a select group of sophisticated individuals or institutions and subsequently files a resale registration statement with the SEC at the completion of the private placement to enable the investors to resell the securities into the public market. KCD's role in a PIPE transaction is to act as the placement agent for the issuer.

28.7.2 Underwriting

PIPE transactions will be managed by Investment Banking (IB) which is also responsible for:

Obtaining transaction approval from the Investment Banking Commitment Committee;
Working with other appropriate personnel/departments, as needed (*e.g.,* Compliance, Legal), to execute an engagement letter; and
Maintaining a Master Log, which includes among other things an investor log and list of firm employees brought "over the wall."

Non-IB employees approached by an issuer to participate in a PIPE should contact Compliance and/or their supervisor immediately and must handle such information as confidential unless advised otherwise by Compliance or Legal.

28.7.3 Compliance Notification

All PIPE offerings in which KCD is involved, including offerings that are reasonably likely to occur or that KCD is actively pursuing, must promptly be added to KCD's Watch List. Consistent with KCD's Information Barrier Policy, the IB manager is responsible for immediately contacting Compliance when there is a reasonable likelihood of receiving a PIPE mandate. Once a company has been added to the Watch List, IB must notify Compliance of any significant developments with respect to the transaction, including intended pricing and announcement dates.

28.7.4 Registration Statement Integration

In order to avoid potential registration statement integration (a risk whenever a public and private offering of an issuer's securities are conducted concurrently or within a short period of time to each other), a PIPE offering must be completed before the related resale registration statement is filed. In the event a registration statement covering the same (and/or similar) securities that will be sold in the PIPE offering has been filed but is not yet effective, the issuer must withdraw the registration statement before the PIPE offering can commence. Note the foregoing restriction is not applicable to offerings structured as a registered direct issuance off of an existing/effective registration statement. IB should work with Compliance to ensure compliance with these rules.

28.7.5 Eligible Investors

In general, companies are prohibited from selling unregistered securities unless an exemption is available under SEC rules. With respect to the private placement phase of a PIPE transaction, issuers normally rely on the exemption from registration contained in Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and the safe harbor provisions of Regulation D. As a general matter, in its role as placement agent, KCD may only offer and sell PIPEs to investors whom KCD reasonably believes to be "accredited investors." Generally, KCD may only solicit potential investors who qualify as accredited investors.

Regulation D does not limit the number of accredited investors who may purchase securities in a private placement.

28.7.6 Marketing Restrictions

This section outlines restrictions on marketing pipe offerings.

28.7.6.1 Prohibition On General Solicitation And Advertising

The federal private placement exemption prohibits the issuer of a PIPE and any person acting on its behalf (including placement agents such as KCD) from offering or selling the securities by any form of general solicitation or general advertising. Contacting potential investors with whom KCD has a **pre-existing, substantive relationship** does not constitute a general solicitation. As a general matter, KCD may only contact investors with whom KCD has such a relationship, and generally, initial contact should be made directly with the customer (*i.e.,* contact must be with the ultimate investor with investment discretion).

The general guideline for establishing that a potential investor has had a pre-existing, substantive relationship with KCD is that such potential investor:

- Has invested in other PIPE offerings where KCD acted as placement agent; or
- Has maintained an investment advisory account with KCD (or an affiliate) or a brokerage account or similar relationship with KCD (or an affiliate) for at least 30 days prior to the distribution of information to such investor concerning the offering; and
- Was not solicited to become a customer of KCD in contemplation of the offering.

Failure to observe restrictions that may be imposed on KCD's activities in connection with an offering may have severe consequences, including, depending on the timing of the violation, a forced delay in the ability to market or close the offering or civil and criminal penalties and rescission rights for investors. Any questions concerning whether an activity is appropriate in light of the private nature of a PIPE transaction should be directed to Compliance.

After the **final** closing, "tombstone" advertisements and public statements as to the PIPE offering may be permitted. Compliance should review each such advertisement and statement prior to its publication or use.

28.7.6.2 Written Presentation Content

PIPE transactions are generally marketed via an oral presentation. Any written materials used during the presentation must adhere to the content standards specified below and must be collected from attendees at the end of the presentation.

Written materials created for the purpose of marketing a PIPE transaction should never be based on anything other than the issuer's existing publicly available information (typically the 10K) accompanied by the following:

- Offering summary;
- Key investment highlights; and
- Business summary.

Further, the written presentation:

- Must also contain customary legal legends and disclaimers including preamble language related to: (1) forward looking statements; and (2) confidentiality and Regulation FD obligations (to be reviewed by issuer counsel).
- Should always be accompanied by a disclaimer letter from KCD to prospective investors (to be reviewed by issuer's counsel).
- Should never reference KCD, except to refer to its role as placement agent, and, when appropriate, to disclose potential conflicts of interest to prospective investors (*e.g.,* a firm employee serving on the issuer's board of directors or a material firm ownership position of securities of the issuer).
- Should never be on firm letterhead or other formats containing the firm logo.
- Should never contain forward-looking projections unless such projections have been publicly disclosed. During the marketing process, if prospective investors ask about projections, they should be directed to existing, publicly available research reports and information.

28.7.6.3 FINRA Filings

IB should discuss the specific facts and circumstances of each PIPE transaction with Compliance, Legal and/or external counsel, as necessary, to determine whether to file documents and information with FINRA or whether the offering is clearly exempt from filing.

28.7.6.4 Regulation M

Upon receiving a PIPE mandate, Compliance should be contacted to preliminarily determine if the proposed transaction is subject to Regulation M. Based on the issuer's float, trading volume and a determination of whether the PIPE transaction constitutes a distribution, the issuer's securities may be subject to restrictions on engaging in transactions and quotation activity with respect to the issuer's stock for the applicable restricted period (*i.e.,* 0, 1 or 5 trading days) as required by Regulation M.

If subject to Regulation M, the designated supervisor will make required submissions to FINRA. Upon receiving the UAR from FINRA, Underwriting will consult with Compliance to determine the appropriate firm market maker status (passive or active) and the applicable Regulation M restricted period. If co-agents are involved, Underwriting will consult with the co-agents to determine their desired market maker status as well.

Underwriting will notify the FINRA Market Regulation Department and KCD's trading desk of KCD's and the other co-agents' market making status during the appropriate Regulation M period. Compliance will add the issuer to KCD's Restricted List.

After the subject transaction has priced, but no later than the market open on the day following pricing, Underwriting will fax a Regulation M Trading Notification Form (*i.e.,* Reg M Wire) to the FINRA Market Watch Department and the FINRA Market Regulation Department. IB is responsible for notifying Compliance, as well as other co-agents, upon the completion of the PIPE transaction. Compliance will un-restrict the security and notify Trading.

28.7.7 Information Flow

This section outlines information flow for PIPE transactions.

Treatment Of Confidential And Inside Information

Prior to the time that an issuer makes a public announcement of a PIPE transaction, information surrounding the offering is confidential information. As PIPE issuers typically see a drop in their share price following the public announcement of the transaction due to the dilution that results from the issuance of additional shares, a PIPE offering will generally constitute a material transaction for an issuer. Accordingly, knowledge of a PIPE transaction prior to a public announcement by the issuer of the transaction may constitute material nonpublic information ("inside information"). As placement agent for an issuer customer, KCD has an obligation not to breach the customer's trust by misusing any information furnished during the course of an engagement. Thus, firm employees with knowledge of a PIPE transaction must:

- Not act on or give this information to others;
- Not trade or advise others to trade based upon the information, misappropriate the information or tip other customers or third parties; and
- Immediately notify Compliance and take appropriate steps to protect the information.

Persons guilty of misusing inside information may be subject to civil and criminal penalties (including imprisonment), SEC administrative actions, disciplinary action by various self-regulatory organizations, and dismissal by KCD.

Sharing Transaction Details With Potential Investors

Before a firm employee reveals an issuer's name to a prospective investor, commences discussions concerning the details of a PIPE offering, or otherwise furnishes an investor with material nonpublic information regarding an issuer, such employee should mention that the offering constitutes a private transaction and must ask the prospective investor if he/she is interested in learning more about the PIPE transaction. Firm employees, moreover, should obtain from the prospective investor an agreement that the investor will keep such information confidential, and an acknowledgment that the investor understands how such confidential information must be treated under the securities laws. As soon as is practicable and typically within one (1) business day after receipt of a prospective investor's positive response, KCD will send such prospective investor a follow-up email confirming such prospective investor's receipt of material, nonpublic information and acknowledging such prospective investor's agreement to hold such information in confidence. In addition, the email will remind such prospective investor of his/her obligation not to use any such information in contravention of applicable securities laws.

Investor logs must be maintained by IB during the marketing process and must contain, among other things: (1) the identity of the investors contacted; (2) such investor's level of interest in the subject transaction; and (3) the date that the management presentation was given (in person or via conference call) to such investor. Upon completion of the marketing process, IB must forward to Compliance a copy of the investor log.

Sharing Information With Sales And Trading Personnel

Any decision to bring sales personnel "over the wall" must be discussed and approved by the designated sales supervisor in consultation with the IB manager and Compliance. Sales personnel brought "over the wall" may continue to conduct their normal sales activities but may not communicate information related to the PIPE transaction to customers. To the extent that sales personnel are asked to assist in the marketing of the PIPE transaction, sales personnel should make the marketing calls off of the trading floor in an area where their conversation cannot be overheard.

Any decision to bring trading personnel "over the wall" must be discussed and approved by the manager of Trading (NASDAQ or Listed) in consultation with the IB manager and Compliance. Trading personnel brought "over the wall" may not trade or make markets in the securities of the issuer subject to the PIPE transaction. The Trading manager should assign trading responsibilities for such securities to another trader without divulging the details of the PIPE transaction. Trading personnel brought "over the wall" may continue to trade and make markets in other securities pursuant to their normal responsibilities but are prohibited from disclosing information regarding the PIPE transaction to anyone that is not already "over the wall."

Sharing Information With Research Analysts

Any decision to bring a firm research analyst "over the wall" must be discussed and approved by the Research manager and Compliance.

28.8 Conservation Donation Transactions (CDTs)

[Report on FINRA’s Examination and Risk Monitoring Program: https://www.finra.org/rules-guidance/guidance/reports/2022-finras-examination-and-risk-monitoring-program]

Responsibility	Designated Supervisor
Resources	Proposed CDT offerings Data regarding the offering Customer transactions
Frequency	As required
Action	Conduct due diligence including: inquiries in the presence of red flags such as: donation deductions that are more than 2 1/2 times an investor's investment concerns surfaced in third-party due diligence reports large markups associated with land acquisition certain types of fees to related parties marketing communications promoting CDTs solely on their tax benefits confirm whether the CDT sponsor, appraiser or other related service

	providers have any prior adverse audit history other reviews as applicable, in the section *Due Diligence* in this chapter Engage third parties such as attorneys to assist in due diligence, if appropriate Review offering documents for disclosures that present potential conflicts of interest among sponsors, consultants, land developers, prior landowners, broker-dealers, and registered persons having employment or affiliated relationships For contingency offerings, transfer funds to an escrow agent or a separate bank account Review customer transactions for compliance with Reg BI
Record	Due diligence reviews including review of offering documents Deposit of funds with an escrow agent or separate bank account, if the offering is on a contingency basis Review of customer transactions for compliance with Reg BI

CDTs commonly involve private placement offerings where investor returns are based on a share of tax savings from a charitable donation. In practice, CDTs involve unrelated investors acquiring an interest in a pass-through entity (*i.e.,* a partnership or limited liability company) owning unimproved land.

Before year-end, the pass-through entity either grants a conservation easement - which forever limits future development of the land - or outright donates the land to a land trust. In exchange, the pass-through entity receives charitable donation tax deductions, which serve as a return on investment to investors and often have values based solely on land appraisals that are predicated on an alternative plan to develop the land, oftentimes the equivalent of four to more than 10 times the price paid to acquire the land. Common CDTs involve syndicated conservation easement transactions [SCETs] or substantially similar fee simple donations of land.

Recommendations must comply with the requirements of Reg BI.

28.9 Private Equity Funds

Responsibility	Designated Supervisor
Resources	Proposed private equity fund investments Partnership agreements, customer eligibility documents
Frequency	As required
Action	Review proposed funds, conduct due diligence, and determine whether KCD will offer the investment Review partnership agreements, customer eligibility documents and accept or reject
Record	Due diligence file Partnership agreements, customer eligibility documents

Private equity funds pool investments from individuals and institutions and invest in businesses. Investors are usually limited partners in a limited partnership controlled by a general partner that determines the investing of funds. There is no public market for private equity funds but there may be a secondary market for interests.

Private equity funds may offer a high rate of return with a corresponding high rate of risk of loss. In a growing economy funds may exit the earliest portfolio investments providing distributions to limited partners, but a slowing economy may restrict the fund's ability to liquidate investments. Most investors are institutions that have the ability to develop a diversified portfolio of private equity funds or that invest through a fund of funds to provide a diversified portfolio.

Features of private equity funds include the following:

- Entry requires a substantial initial investment (which may be $1,000,000 or more) allowing the fund's manager discretion over the first few years of the fund.
- Funds may provide for obligatory capital contributions throughout the life of the fund obligating the limited partners to make additional contributions. Failure to meet capital calls may result in the defaulting limited partner forfeiting interest in the fund.
- These are illiquid investments that are not publicly traded. An investor's capital is locked up in a long-term investment which may last ten years or more with no redemption rights. Distributions are made only as investments are converted to cash.
- Limited partners typically have a passive role with no say in the actions of the general partner.
- The general partner may not find suitable investments for the fund resulting in the investors' funds remaining uncommitted
- Funds are high risk; the investor may lose all of the investment.

Recommendations are subject to Reg BI and RRs must obtain necessary partnership agreements and any customer eligibility documents required for the investment and submit them to the appropriate supervisor for review.

29 INVESTMENT ADVISERS

Responsibility	Designated Supervisor
Resources	Business activities of the Firm Requests to act as independent investment advisers
Frequency	As required
Action	Determine whether investment adviser registration is required for KCD and its RRs Review RR requests to act as investment advisers (see the chapter *INDEPENDENT CONTRACTORS*) Review outside investment advisers for inclusion on KCD's approved list Confirm SEC or state registration Review adviser's background
Record	Registration records Requests to act as independent advisers Reviews of advisers for inclusion on the Firm's approved list

This chapter provides guidance when KCD and its RRs engage in investment adviser activities, recommend advisers, or otherwise deal with advisers.

If KCD is registered as an investment adviser to engage in adviser activities (managing accounts, discretionary accounts, *etc.*), the Firm's investment adviser policies will be included in a separate manual addressing the Investment Adviser's Act and other requirements.

29.1 Investment Adviser Defined

An investment adviser, as defined in the Investment Advisers Act of 1940, includes anyone who, for compensation, engages in the business of advising others. The definition of an investment adviser under most states' blue sky laws is similar. This does not include a broker or dealer that receives compensation (commissions) incidental to the rendering of advice. The following are considered investment adviser activities where a separate fee is received for providing these services:

- recommending investments
- managing a portfolio on a discretionary basis
- other services for which the RR receives a fee including publishing an investment newsletter

29.2 Investment Adviser Activities Must Be Authorized

RRs are prohibited from engaging in investment advisory services unless they are offering adviser services specifically authorized by KCD. If the RR has received permission from the Firm to register as an investment adviser independent of KCD, the RR is required to disclose this as an outside business activity. Refer to the chapter *INDEPENDENT CONTRACTORS* for more information.

29.3 Investment Adviser Activities Must Be Authorized

29.4 Registration Requirements

This section outlines registration requirements when a firm or individual acts as an investment adviser and some instances where registration is required.

29.4.1 Introduction

Investment advisers are required to be registered with the SEC and applicable states prior to offering investment adviser services. The federal (SEC) requirement excludes certain advisers who provide adviser services to only a nominal number of customers. Many states have a requirement that anyone acting on behalf of an investment adviser and providing investment adviser services pass an examination and be registered as an investment adviser agent.

Compliance will determine whether KCD or its affiliates are required to register as an investment adviser.

Questions regarding investment adviser registration requirements should be referred to Compliance.

29.4.2 Fee-Sharing With Investment Advisers

Acting as an investment adviser includes sharing in the fees paid to investment advisers. RRs may not share such fees except through KCD-sponsored programs or unless the fee-sharing arrangement is approved by Compliance.

Compliance will review the registration status of any RR who will participate in a KCD-sponsored fee-sharing program and will request registration where required. Compliance is also responsible for reviewing and approving any fee-sharing arrangements outside KCD-sponsored programs. This review includes a review of any investment adviser registration requirements and requests for needed registration, if the outside activity will be permitted.

29.4.3 Discretionary Accounts

KCD must be registered as an investment adviser to maintain discretionary accounts. Discretionary accounts are included in a section in the chapter *ACCOUNTS*.

29.5 Recommending Outside Investment Advisers

RRs may recommend only those investment advisers on the Firm's approved list of advisers. Approval of an adviser is not needed for an adviser which is a bank trust department, a trust company, an insurance company, or a mutual fund adviser and which has assets under management of at least $100 million.

Requests to add an adviser to the approved list should be directed to Compliance and include:

- Name and address of outside adviser
- Date the firm was established
- Total assets under management
- Number of full-time professional employees (portfolio managers, analysts, *etc.*)
- Name and contact information for the contact person at the adviser
- Any other information deemed relevant to the Firm's evaluation of the investment adviser or any third party asset manager

This information will be updated annually and a written record retained by Compliance.

29.6 Solicitors For Investment Advisers

Responsibility	Compliance RR's designated supervisor
Resources	Investment adviser firms that will engage solicitors Requests to act as solicitors Firm's list of approved investment advisers
Frequency	As required
Action	Compliance: Review investment adviser participants Approve or disapprove adviser for inclusion on the Firm's list of approved advisers Execute agreement with the adviser Review RR's background including disciplinary history, customer complaints Determine RR is registered as required Review and approve or disapprove related sales material Schedule training regarding solicitor activities Notify RR of approval or disapproval Notify RR's supervisor of required supervision Designated supervisor: Review transactions
Record	Compliance records of reviews, approved advisers and agreements, notification to supervisors, record of training and supervision to be conducted, sales materials Designated supervisor record of reviews

RRs may act as "solicitors" for investment advisers, *i.e.,* acting as a "salesperson" to potential customers of the adviser. This may include providing investment advice to customers including guiding the customer's selection of an investment program and the underlying products in the program.

The following conditions apply:

- The adviser must be included on KCD's list of approved advisers.
- The RR must be approved by Compliance to act as a solicitor including a background review, having required registrations, and completing required training.

Where the RR is responsible for the suitability of recommendations, the RR's supervisor is responsible for reviewing transactions. Compliance will notify the supervisor of his/her responsibility for reviews.
Any sales material promoting the solicitor's activities is subject to review and approval as described in the chapter *COMMUNICATIONS WITH THE PUBLIC*.

29.7 Wrap Fee Programs

Responsibility	Designated Supervisor
Resources	Terms and description of wrap fee program(s) Investment adviser registration records including Form ADV Investment guidelines for the program List of approved investment advisers
Frequency	As required - revise programs offered; qualify participating investment advisers When wrap account initiated - review for reverse churning Monthly - prepare and provide portfolio analyses Semi-annually - evaluate list of approved advisers and make adjustments where appropriate
Action	Review new wrap fee accounts to determine appropriateness of a fee-based account vs. commissions Identify costs beyond wrap fee program charges, including sub-advisers that trade away with a broker-dealer outside the wrap fee program, resulting in added commission costs Provide customer disclosure of added costs beyond the program Take added costs in consideration when reviewing new wrap fee accounts Maintain terms and description of wrap fee programs and publish changes when appropriate Review investment advisers for participation in the program(s) including confirming investment adviser registration status Prepare portfolio analyses and distribute to participating customers Review participating investment advisers for performance, adherence to investment guidelines, and make adjustments to list when appropriate
Record	Reviews of new wrap fee accounts for reverse churning and action taken, if any Review of investment and advisers Description of wrap fee program(s) and investment guidelines Copies of monthly portfolio analyses Lists of approved advisers (including prior lists for three years)

29.7.1 Introduction

KCD sponsors a wrap fee service, through our clearing firm, where the customer pays a fee that includes multiple services such as transaction costs and investment adviser fees.

29.7.2 Fees And Commissions

For some customers, a fee-based account may be inappropriate. When a customer will engage in minimal trading, a fee charge may be higher than paying commissions on transactions ("reverse churning"). RRs must make a determination that a fee-based account is appropriate for the customer prior to recommending.

Also, there may be commission costs beyond the wrap fee program charges. Sub-advisers may "trade-away" with a broker-dealer outside the Firm's wrap program, resulting in added commission costs. This must be considered when recommending a wrap fee program and all costs should be disclosed to the customer.

29.7.3 Fees

The designated supervisor is responsible for determining the schedule of fees to be charged to customers for KCD's wrap fee program. The RR may charge fees based on the approved schedule.

29.7.4 Agreements

Each customer who participates in our clearing firm's wrap fee program through KCD is required to sign a wrap fee account agreement with the clearing firm. The designated supervisor is responsible for reviewing and approving the wrap fee agreement and retaining the agreement in KCD's records.

The designated supervisor will establish procedures to ensure customers do not participate in the wrap fee program unless the necessary agreement has been signed.

29.7.5 Disclosure Document

Each wrap fee customer will receive KCD's disclosure document regarding the wrap fee program as follows:

- 48 hours prior to entering into any written or oral investment adviser contract, or,
- if provided at the time the customer enters into the contract, the customer has the right to terminate the contract without penalty within five business days after entering into the contract.
- In addition, the disclosure document will be offered annually to wrap fee customers.

Acknowledgment of receipt of the disclosure document will be included in the customer application or a separate form for that purpose. Applications and separate forms are retained by the designated supervisor.

The designated supervisor is responsible for updating the disclosure document promptly to reflect any material changes to the information included or within 90 days after the end of KCD's fiscal year to reflect other changes.

29.7.6 Periodic Reports To Customers

Our clearing firm is responsible for establishing procedures regarding the preparation and providing of reports to customers to whom adviser services are provided. Copies of the reports will be retained by the designated supervisor at the clearing firm.

29.7.7 Review Of Wrap Fee Accounts

KCD's clearing firm is responsible for reviewing, at least quarterly, the reports provided to wrap fee customers.

29.7.8 Communications With The Public

Any communications regarding the performance of a wrap fee program will include the effect of any fees associated with the program.

29.8 Adviser Compensation Arrangements

KCD will not share in the profits of accounts under investment management except as permitted by rule. Any compensation arrangement with an investment adviser will be included in a written agreement between KCD and the adviser.

30 SOFT DOLLARS

[Exchange Act Section 28(e); SEC Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934 - Release No. 34-54165; SEC Brokerage and Research Activities Release No. 34-23170; SEC Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds: http://www.sec.gov/news/studies/softdolr.htm]

Responsibility	Designated Supervisor
Resources	Soft Dollar Arrangement Request Form
Frequency	As required - review and approve/disapprove arrangements and send Soft Dollar Letter to adviser Quarterly - review accounts Annually - provide statements to advisers
Action	Review requests for soft dollar arrangements and approve or disapprove Maintain a list of soft dollar arrangements including advisers and products/services provided For third party soft dollar arrangements, review and approve payments to vendors directly billed to the Firm (do not accept invoices from the adviser for payment) Review accounts and commission paid for consistency with soft dollar arrangement and contact adviser if there is a material imbalance Confirm trades are within the SEC safe harbor for transactions Confirm research or services provided are within the SEC safe harbor Prepare and provide annual statement to adviser
Record	Soft Dollar Arrangement Request Forms Soft Dollar Letters Account review including notations of action taken Records of compliance with SEC safe harbors regarding trades and research/services provided and cost/value of research or other services provided that reduce/eliminate accrued soft dollar credits Annual statements to advisers Vendor bills paid directly by the Firm Master list of soft dollar arrangements

This chapter provides a summary of key requirements for soft dollar arrangements between the Firm and an adviser or customer. References to "adviser" include money managers and other fiduciaries with investment discretion over their client accounts. Because of the complex legal nature of this subject, this chapter should not be used to determine compliance of any arrangement since each arrangement must be reviewed on a case-by-case basis. While compliance with soft dollar rule requirements is primarily the responsibility of the adviser, KCD has procedures for review of these arrangements to facilitate compliance with the rules.

All proposed soft dollar arrangements require the **prior approval** of Compliance. Advisers will be provided with a letter explaining some basic understandings regarding their obligations in the arrangement (see the *Soft Dollar Letter*).

KCD Financial Inc.'s Written Supervisor Procedures