

COMPLIANCE 3RD QUARTER 2012 NEWSLETTER

The Compliance staff is available to provide guidance regarding regulatory issues. Additionally, one of the primary goals of your Compliance Department is to keep all representatives informed of PCS policies and procedures, the use of best practices, and changes in industry rules and regulations. In order to assist with this goal, and in addition to periodic Compliance Alerts, Quarterly Compliance Newsletters will also be distributed. The information contained in our newsletter should be reviewed by all representatives and used to help clarify an existing policy or procedure, industry rule or regulation. We strongly recommend you take the time to review all of the information contained in this newsletter and direct any questions to your designated Managing Principal.

Reminders:

- **Privacy / Data Security Policy**

The PCS Data Security Policy was introduced to all associated persons on July 12, 2012, and is available for your review on the PCS Website.

- **Blotter**

"Pursuant to the Securities and Exchange Act of 1934 Rule 17a-3 (a) and NASD Notice to Members 01-80, you are required to maintain blotters. Blotters represent original order entry (trade tickets) for PCS and must be current at all times. Specifically, PCS policy requires that blotters are completed at the time of order origination, no later than daily and submitted to your designated Managing Principal weekly on Monday for transactions recorded the prior week. As discussed in the following cases, disciplinary action and fines have been levied against broker-dealers and registered persons for failure to maintain books and records, including blotters; FINRA Dept. of Enforcement v. Merrimac Corporate Securities, Inc. (No. 2007007151101), FINRA Dept. of Enforcement v. Max International Broker-Dealer Corp. (No. 20070072538-03), etc."

- **U4 Updates**

Each Registered Person must update their U4 when information changes throughout the year. U4 updates (Outside Business activity, address changes, name changes, disclosure items, etc.) should be directed to your designated Managing Principal for review. The information will then be submitted to Licensing and Registration for processing.

- **RIA Manual Updates**

There have been a significant number of amendments and updates made to the "Investment Processes" and "Supervision and Internal Controls" sections of the IA Manual located on the NRS system (Compliance Guardian). Investment Advisory Representatives should review these sections, and continue to revisit the manual for ongoing updates.

Clarifications:

- **Employee Related Accounts**

Please be advised that employee related accounts do not only include associated persons personal accounts and PCS accounts of individuals residing in the same household, but also include additional PCS accounts such as those owned by parents, in-laws, and other related individuals. FINRA Rule 5130 defines accounts of immediate family members as: "(5) *"Immediate family member" means a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material*

support. “ Any PCS account that meets this definition should be identified as an employee related account and coded as such by the Operations Department.

- **Home Equity Discussions**

Discussions related to home equity loan rates and planning is permissible when acting in an Investment Advisory Representative capacity, but should be avoided when acting as a Registered Representative. PCS does not permit recommending liquefying home equity for securities related purchases. Additional information related to home equity discussions may be found in the PCS written supervisory procedures, or by reviewing the attached FINRA Notice To Members from December 2004.

Action Items:

- **Blotter Update – VA Subaccounts**

PCS representatives need to begin logging variable annuity and variable life insurance sub-account re-allocation (re-balancing) on the securities blotter. FINRA audits are testing for original entry record keeping of variable product re-allocations as well as supervisory oversight for these transactions. PCS has not previously required these records be maintained. These entries do not include accounts set up for auto re-balancing by the product provider, but do require entries for re-allocations processed by PCS representatives. The blotter entries follow the same rules and format as when entering mutual fund rebalancing, in that each liquidation and subsequent purchase must be listed on the blotter.

In order to make the record keeping more consistent, please begin logging all variable business on the securities blotter and not on the insurance blotter. The formats have been updated on the network if you wish to download the new Excel formats, or you may edit your current blotter to list variable products on the securities blotter tab and remove them from the insurance tab. *DO NOT move previous transactions. Please make the changes going forward.*

- **Insider Trading Restricted List**

The PCS Restricted list may now be viewed on the PCS Website under the Compliance Tab. All associated persons must review the restricted list prior to placing trades in personal/household accounts. Any securities listed on the restricted list may not be purchased (Or sold short / derivatives) in personal/household related accounts. Entries on the restricted list are identified by reviewing customer new account forms for control persons (Officers, Directors, 10% stock holders), or identified by Compliance and/or Senior Management, and are non-exchange listed or thinly traded companies. PCS will not be adding blue chip or actively traded equities to the list unless there is an identified conflict of interest.

- **Fee Based Account Suitability**

You may have already noticed that there have been some updates made to the forms associated with advisory accounts. In order to better meet the suitability guidelines for advisory accounts there were additional questions added to the Allocation Account Funding Disclosure Form. (Sample attached). Additionally, the Advisory Account Review Form used by Managing Principals to review advisory accounts has also been updated to better reflect TPAM accounts and Allocation accounts based on model portfolios. (Also attached) Please make sure you are using the current version of the forms and not using pre-printed old forms. The current version is available in the equities room and on the network and website.

- **Processing Split Business**

FINRA Rule 4512 introduced additional requirements for accounts serviced by more than one representative, requiring each representative to identify the scope of their involvement and responsibility within the account. PCS has developed a new form designed to allow each representative to select the activities they are responsible for on the account level. (Attached) The form does NOT require a client signature, but is required to be submitted with the application when establishing the

account. The form is now part of the Principal Review and account acceptance process completed at the home office.

Additionally, when logging transactions on the blotter, all split representatives on the account must be listed regardless of who places the trade. For example, if an account is serviced by three representatives and rep A places a trade for the account, rep B and rep C must also be listed on the blotter as rep of record. Last names will suffice as identifying representatives. The excel version of the blotter should expand when necessary to accommodate the additional text.

▪ **Cash and Non-Cash Compensation Meetings**

FINRA rules generally prohibit, with certain exceptions, a person associated with a broker dealer from directly or indirectly accepting payments of any non-cash compensation in connection with variable contracts and investment company securities (i.e., product vendors). However, the rules carve out certain narrow and conditional exceptions to this blanket prohibition. Under the *de minimis* exception, an associated person may accept from a product sponsor: (1) gifts and entertainment that do not exceed an annual amount per person of \$100.00 not preconditioned on the achievement of a sales target; (2) payment or reimbursement by product sponsors (i.e., free transportation, lodging, meals) in connection with meetings held by the product sponsor for purposes of training or education of associated persons of a member. (subject to certain conditions); and (3) a product vendor may contribute to a representative's advertisement, client event and/or seminar. (subject to certain conditions)

In order to comply with these rules/conditions, PCS requires that associated persons utilize the following forms:

1. Product Sponsor Training Meeting Approval Request Form. This form should be completed whenever a representative is invited to attend a product provider training meeting / conference. The form should be submitted to the compliance department for review and approval prior to committing to the meeting.
2. Client Event / Seminar/ Advertising Reimbursement Request Form. This form should be used to request approval for cost sharing / reimbursement from a product provider when sponsoring a client event, seminar, or advertising program. When a representative submits a seminar or advertisement for review through the Montoya system it will ask if there is cost sharing for the item submitted. Answer yes to this question and that will notify the compliance department that a cost sharing arrangement has been discussed. The approval of the material will include the reimbursement request form with instructions to have the form completed and returned to the compliance department prior to the event / use of the advertisement.

* Forms are not required for product vendor lunches which are conducted and tracked at the home office.

** If you plan to attend a product vendor lunch not conducted at the home office, you must advise your designated supervisor prior to the meeting so they can ensure you have not exceeded the product sponsor \$100 annual *de minimis* exemption. Your designated supervisor will work with the compliance department to verify your eligibility and also to record the event on the central logs. (no form is required by the representative)

(Sample forms are attached)