

# **BASSWOOD CAPITAL MANAGEMENT, L.L.C.**

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## **FORM ADV PART 2A (“Brochure”)**

March 31, 2018

**This brochure provides information about the qualifications and business practices of Basswood Capital Management, L.L.C. If you have any questions about the contents of this brochure, please contact us at (212) 521-9500. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.**

**Additional information about Basswood Capital Management, L.L.C. also is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

## **Item 2. Material Changes**

The Investment Adviser does not consider any of the information contained in this version of the Brochure to represent a material change from the information contained in the most recent version dated March 2017 with the exception of an update to our investment strategy contained in Item 8, Methods of Analysis, Investment Strategies and Risk of Loss, Investment Strategies, Primary Strategies.

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## **Item 4. Advisory Business**

### **Structure; History and Ownership**

Basswood Capital Management, L.L.C., referred to in this brochure as “Basswood,” “we,” “us” or the “firm,” is an investment advisory firm with its principal place of business in New York, New York. Basswood also maintains a second office in White Plains, New York.

The firm is organized as a Delaware limited liability company. The firm commenced business in 1998. The principal owners of the firm are Bennett Lindenbaum and Matthew Lindenbaum.

Basswood Partners, L.L.C. and Basswood Enhanced Long Short GP, LLC are affiliates of Basswood Capital Management, L.L.C., and each serves as the general partner of certain of the private investment funds for which Basswood serves as investment adviser. Basswood Partners, L.L.C. and Basswood Enhanced Long Short GP, LLC are not separately registered with the SEC and this brochure, and references herein to “Basswood,” “we,” “us” or the “firm,” describe Basswood Partners, L.L.C. and Basswood Enhanced Long Short GP, LLC in addition to Basswood Capital Management, L.L.C.

The firm has been registered with the SEC since June of 2011. Previously, the firm was registered with the SEC from January 2006 until January 2008.

### **Types of Advisory Services**

We provide investment advisory services to a number of private investment funds (referred to in this brochure as the “funds”) as general partner or investment adviser and separately managed accounts (referred to in this brochure as the “separate accounts”). We also act as sub-advisor to an “investment company” registered under the Investment Company Act of 1940, commonly referred to as a mutual fund, by managing a portion of the investment company’s assets in a separate account structure. The funds and the separate accounts to which we provide investment advisory services are sometimes referred to together in this brochure as the “accounts.”

We manage the accounts by using two “primary strategies”, with the investment objective of generating long-term capital appreciation by investing primarily on a long basis and short basis in a select number of investments that we identify as likely to experience significant price appreciation or depreciation. Our primary strategies differ only in that one strategy is not focused by sector (“general strategy”) whereas the other primary strategy is focused on the financial services sector (“financial sector strategy”). Within the financial sector strategy, we also manage long only funds and accounts, which generally restrict short selling.

From time to time, we may also advise accounts that are established to hold securities of a single or a limited number of issuers (the “co-investment strategy”). Each such position will ordinarily be a position that is also held by some or all of the accounts using the primary strategies.

The funds we advise do not offer their interests to the public. Fund interests are offered only in private placements to qualified investors. Details concerning the terms applicable to investors in the funds are contained in the funds’ “offering documents”. Our investment advisory services to institutional investors on a separately managed account basis may be provided by way of private investment funds formed by us and open exclusively to the separate account investors; or special purpose entities formed by the separate account investors, which may also be considered to be private investment funds, each of which are referred to in this brochure as separate accounts. Our separate account arrangements are governed by the investment management agreement between us and each separate account investor.

The investment strategies we employ on behalf of the funds and the separate accounts are described in greater detail below in Item 8 and in the offering documents of the funds and the investment management agreements for the separate accounts. In general, we do not tailor our strategies to the needs of individual fund investors or separate account clients. However, in certain limited circumstances, we may agree to particular investment guidelines or investment restrictions with particular fund investors or separate account clients. We may offer other products, accounts and/or investment strategies that differ from the strategies described in this section.

## **Assets Under Management**

As of December 31, 2017, we managed approximately \$1.4 billion of client assets, all of which we manage on a discretionary basis. This amount reflects the net asset value of the assets of the accounts as of such date.

## **Item 5. Fees and Compensation**

### **Fees**

We are generally entitled to two types of fees from each of the funds and separate accounts: (i) an asset-based “management fee;” and (ii) an incentive allocation or fee, or a carried interest, based upon the performance of the fund or separate account (“incentive compensation” and together with management fee, the “fees”).

#### *Asset-Based Fee*

The management fee rate charged by the funds for our primary strategies is typically 1.5% per year of the fund’s net assets, and is typically determined and payable quarterly in advance.

A prorated management fee is paid with respect to any investments made during a quarter, and the unearned portion of the management fee is reimbursed in respect of any withdrawals made other than at the end of a calendar quarter.

#### *Incentive Compensation*

The incentive compensation charged by the funds for the primary strategies is calculated as a percentage of the net profits of the fund for the relevant period (attributable to each investor’s limited partnership interest or shares in the fund). The incentive compensation is typically determined and allocated/paid on an annual basis, but will be determined and allocated/paid for shorter periods under certain circumstances (such as with respect to amounts withdrawn/redeemed from the fund).

The incentive compensation is subject to a loss carry forward or high water mark provision that requires that any losses suffered by a fund (adjusted to reflect withdrawals/redemptions) be offset by subsequent net profits before we are entitled to subsequent incentive compensation from the fund.

The incentive compensation rate for Class A investments and Class D investments is 20% for the long/short funds and 12.5% for the long only funds for the primary strategies. These investments may be withdrawn at the end of any calendar quarter on 30 calendar days’ prior written notice.

The long/short funds for the primary strategies currently offer classes of interests, which are subject to different incentive compensation rates and different liquidity terms.

The incentive compensation rate for Class B investments is generally 15%. However, Class B investments are subject to a two-year lockup (separately applied to each investment), after which the investor may withdraw all or a portion of the investment as of the last day of any calendar quarter upon at least 30 calendar days' prior written notice.

If an investor withdraws all or a portion of a Class B investment prior to the second anniversary of the date of such investment, then the withdrawal proceeds are reduced by: (i) a withdrawal fee equal to 3% of the withdrawal amount; and (ii) an adjustment amount calculated to reflect the difference between the incentive compensation rate of 15% that was applied to the investment and an incentive compensation rate of 20% applied to the investment. Such amounts are also paid/allocated to Basswood.

The incentive compensation rate for Class C investments is generally 10%. However, Class C investments are subject to a three-year lockup (separately applied to each investment), after which the investor may withdraw all or a portion of the investment as of the last day of any calendar quarter upon at least 30 calendar days' prior written notice.

If an investor withdraws all or a portion of a Class C investment prior to the third anniversary of the date of such investment, then the withdrawal proceeds will be reduced by: (i) a withdrawal fee equal to 3% of the withdrawal amount; and (ii) an adjustment amount calculated to reflect the difference between the incentive compensation rate of 10% that was applied to the investment and an incentive compensation rate of 15% or 20% applied to the investment, depending on whether the withdrawal is prior to the second anniversary of the date of issuance or on or after the second anniversary. Such amounts are paid/allocated to Basswood.

#### *General*

The management fee and incentive compensation rates charged by the funds and the details of how the fees are calculated for the funds are described in further detail in the applicable offering documents of the funds, which are provided to potential investors. The fees paid by separate account investors are negotiated individually and such fee rates agreed to and the details of how the fees are calculated for the separate accounts are included in the investment management agreement for each separate account.

The fees described above are our typical fee rates. However, each fund has the right to establish additional share classes or enter into agreements with one or more of its investors providing for the waiver or modification of certain fund terms, or certain rights and obligations of fund investors, including, but not limited to, fees, reporting and/or liquidity terms, otherwise applicable to such interest(s), in each case without notice to the other fund investors. Under certain circumstances we may agree to different management fee, incentive compensation, reporting obligations and/or liquidity terms from those described above for particular separate account clients. Therefore, the management fee, incentive compensation and/or the liquidity terms for a separate account client may be more favorable than those applicable to the funds or other separate account clients.

The fees payable by the funds are deducted from the assets of the funds and paid to us or, in the case of incentive allocations, are reallocated from the capital accounts of fund investors and into our capital account. Our fees for the separate accounts are typically billed to the client and paid from the assets of the account.

Additionally, Basswood and persons affiliated with Basswood that have investments in the funds are not charged management fees and incentive compensation with respect to their investments.

## Expenses

Each fund pays, or reimburses us or the fund's administrator for, all operating expenses and other costs of the fund as described in each fund's offering documents, which may include, but are not limited to:

- third party accounting, fund administration, valuation, bookkeeping and auditing fees and expenses;
- third party legal fees and expenses, including, but not limited to, fees and expenses incurred in connection with a fund's offering documents and the offering of the funds interests, fund contracts and investments;
- fees and disbursements of a fund's and Basswood's attorneys, consultants and other third parties performing work benefiting the fund (including, without limitation, the legal and other fees, costs and expenses of a fund in any proxy contest or other shareholder initiative or proceeding, and any threatened or actual litigation or governmental investigation or proceeding, and the amount of any judgments or settlements paid in connection with such litigation or fines or penalties levied as a result of any such proceeding or investigation);
- insurance and bonding costs, including, but not limited to, insurance premiums for errors and omissions insurance and directors and officers insurance;
- trading expenses and transaction costs, including, but not limited to, brokerage commissions and expenses relating to short sales, clearing and settlement charges, interest on loans and debit balances, margin interest and broker service fees;
- fees and costs related to any regulatory reporting and filings related to the operations of a fund;
- such research and portfolio management expenses as we deem appropriate, which may include, but are not limited to,
  - expenses incurred in connection with due diligence investigations or research as to investments or potential investments (including public and private companies and potential investments that the fund ultimately does not make), including travel, lodging and other expenses incurred in connection with visits to companies, meetings, research symposiums and communications with company management, security holders, analysts and other third parties,
  - costs of research reports, data feeds and databases, news wires and quotation/pricing services, periodical subscription fees and costs of software (including risk control) that we utilize in connection with managing a fund's portfolio;
- fees of a fund's registered agent;
- the cost of preparation and distribution of reports and statements to investors;
- the costs and fees attributable to any third-party proxy voting service or consultant;
- custodial fees, bank service fees, and fees or expenses associated with insuring a fund's assets;
- management fees;
- incentive fees or allocations;
- all applicable federal, state, local and foreign taxes payable by a fund; and
- any extraordinary expenses, such as indemnification and litigation expenses.

In addition, a fund will pay its organizational expenses (such as legal, accounting, and blue sky fees).

Separate account clients will be responsible for all trading expenses and transaction costs (including, but not limited to, brokerage commissions and expenses relating to short sales, clearing and settlement charges, interest on loans and debit balances, margin interest, broker service fees and custodial expenses), withholding or transfer taxes incurred in connection with trading for the separate account, as well as our fees applicable to the account (as described above). Depending on the structure and strategy of the separate account, the client may also be responsible for certain other expenses described above, such as, research and portfolio management expenses and, fees and disbursements of Basswood's attorneys, consultants and other third parties performing work benefiting the account (including, without limitation, the legal and other fees, costs and expenses incurred in any proxy contest or other shareholder initiative or proceeding, and any threatened or actual litigation or governmental investigation or proceeding, and the amount of any judgments or settlements paid in connection with such litigation or fines or penalties levied as a result of any such proceeding or investigation).

Permissible expenses that are incurred by the firm with respect to more than one account shall be allocated on a pro rata basis based upon the respective NAV of each applicable account or, in the case of expenses that relate to a specific investment held by more than one account, generally it will be allocated pro rata based upon the market value of such investment in each applicable account.

Any expenses that are attributable to the firm (or related firm accounts) and one or more client accounts will be allocated in good faith in a manner that we believe to be fair and consistent with disclosures made to clients of all affected accounts.

As we consider appropriate, we may invest a portion of an account's assets in one or more money market funds, mutual funds or exchange-traded funds. When any such investments are made, the account will be paying, in addition to the compensation payable to us, the account's proportionate share of any management fees charged by the manager of such money market fund, mutual fund or exchange-traded fund.

A description of the brokerage and other transaction costs that will be borne by the funds and separate accounts are described in more detail in Item 12 (Brokerage Practices) in this brochure.

## **Item 6. Performance-Based Fees and Side-by-Side Management**

As described in Item 5 above, we receive part of our compensation from the funds and separate accounts in the form of performance-based allocations and fees.

Some of the accounts we manage charge a lower performance-based allocation/fee or do not charge any such allocation/fee. These circumstances may create an incentive for us to favor some accounts over other accounts. Accordingly, we (i) strive to ensure that all clients are treated fairly and equitably; (ii) monitor the trading activity for the accounts on a daily basis; and (iii) maintain trade allocation and aggregation policies and procedures that are reasonably designed to address this potential conflict of interest.

## **Item 7. Types of Clients**

We generally provide investment advice to private investment funds and institutional separate accounts. The private investment funds are generally organized as either a U.S. limited partnership, under the laws of the state of Delaware (referred to in this brochure as the "onshore funds") or an exempted company, under the laws of the Cayman Islands (referred to in this brochure as the "offshore funds"). The onshore funds and corresponding offshore funds are structured either as separate funds (managed pari-passu) or



within a master-feeder structure. The types of investors in the funds we advise include, pension and profit sharing plans, trusts, estates and charitable organizations, sovereign wealth funds, funds of funds (whether organized as partnerships, corporations or other entity types), high net worth individuals and family offices. Our separate account clients are typically funds of funds, family offices, pension and profit sharing plans, or other institutional investors. We also act as sub-advisor to an investment company registered under the Investment Company Act of 1940, commonly referred to as a mutual fund.

The minimum amount of assets for a separate account that we will advise is generally \$50 million.

Minimum investment amounts for our primary strategy funds are \$1 million. Additional investments to any of those funds must be in increments of \$100,000. These minimums may be reduced or waived by us, or the general partner or boards of directors of the funds, subject to any applicable statutory minimums.

Fund interests are generally offered only to a limited number of individual and institutional investors that qualify as: (i) “accredited investors”, as defined in SEC Regulation D promulgated under the U.S. Securities Act of 1933; and (ii) “qualified purchasers” or “knowledgeable employees”, as defined in the U.S. Investment Company Act of 1940 and the rules promulgated thereunder.

## **Item 8. Methods of Analysis, Investment Strategies and Risk of Loss**

### **Investment Strategies**

#### *Primary Strategies*

For certain accounts we implement our primary strategy solely within the financial services sector (the “financial sector strategy”), and for other accounts we implement our strategy without any sector limitation (the “general strategy”). With the exception of the long only funds and accounts, which generally restrict short selling, the investment objective of our primary strategies is to generate long-term capital appreciation by investing primarily on a long basis and short basis in a select number of investments that we identify as likely to experience significant price appreciation or depreciation. Our primary investment methodology is value-oriented and opportunistic, employing extensive fundamental research and analysis to identify investments that are undervalued (or, in the case of short positions, overvalued) by the marketplace, and to identify proper entry and exit points.

We expect to cause the accounts for which we use the financial sector strategy to invest in a variety of industries within the financial services sector including, without limitation, one or more of the following: banks, savings and loans, asset managers, brokerage, insurance, specialty finance, mortgage-related and real estate investment trusts. There are no limitations on the industries within the financial services sector in which we may cause the accounts to invest. The accounts may also invest in companies of other sectors and industries that we consider to be indirectly related to the financial services sector, such as real estate, construction, homebuilders and other housing-related companies.

We expect to cause the accounts for which we use the general strategy to invest in a variety of industries including, without limitation, one or more of the following: industrials, business services, healthcare, restaurants, construction/machinery, insurance, recreation/leisure, retail and financial services. There are no limitations on the industries or sectors in which we may cause the accounts to invest.

With respect to the primary strategies, there is also no limitation on the amount of the account’s assets that may be invested in any single industry, subsector, issuer or security. It is possible that an account will

hold one or more relatively large positions. As a result, the account may be considered to be concentrated from time to time or at all times with respect to industry, subsector, issuer and/or securities.

While our primary strategies involve investing primarily in common stocks, the accounts are authorized to invest in any other securities, instruments, derivatives and other investments we deem appropriate including, without limitation: preferred stock, options on stocks and indices, warrants, bonds, debentures, convertible securities and other debt obligations, exchange traded funds, credit default swaps and other swaps, forwards, futures, indices, structured and other synthetic securities and related derivative instruments (including those relating to equity securities, equity indices, interest rate products, fixed-income products, currencies and indices), and securities of foreign issuers.

An account's exposure to derivative instruments and their related risks may be significant. The accounts may also hold cash, U.S. Treasury and agency securities, commercial paper, bankers' acceptances, certificates of deposit and short-term money-market obligations. Up to 5% of a fund's assets (based on cost at the time such a security is purchased) may be invested in securities that are not publicly traded or are subject to restrictions on transfer (which restriction will not apply to "convertible preferred" securities or restricted securities that are to be filed for registration with the SEC within a reasonable period after acquisition); provided, however, that certain funds may offer a separate share class that will not participate in (and will not receive gains or losses from, or be subject to limitations on liquidity as a result of) such investments by the fund.

Our strategies utilize leverage on a selective basis, primarily for investment purposes. We expect to cause the accounts to buy securities on margin and arrange with banks, brokers and others to borrow money against a pledge of an account's assets in order to employ leverage, when we deem such action appropriate. We may also cause the accounts to employ shorting, options, swap agreements and other derivatives for investment and/or hedging purposes if, when and as we deem appropriate. We are not required to employ any minimum level of portfolio hedging for the accounts.

Subject to the accounts' primary investment objective, we endeavor to manage the assets of our onshore funds employing our primary strategies, to the extent we deem appropriate, in a manner that will reduce and/or defer the taxable income for U.S. taxable investors arising in connection with their investments in the funds. Our determination as to whether or not, and to what extent, such funds should invest in a particular security or other investment will periodically take into account the expected income tax implications that such action will have for U.S. taxable investors. Further, the timing of specific purchase and disposition transactions may be determined in part based upon the expected income tax implications for U.S. taxable investors. As a result, the funds' portfolio holdings and investment transactions may vary from what they would be if such tax considerations were not taken into account and, consequently, the funds' performance may be impacted. There can be no assurance that this (or any) aspect of our investment strategy will be effective.

Prospective investors should be aware that accounts employing our primary strategies and their investors will incur all of the risks inherent in discretionary investments involving the securities and instruments referenced above. The various investment techniques we employ on behalf of the accounts such as, without limitation, the use of derivatives, investments in restricted securities, the use of leverage, short selling, *etc.* may increase the accounts' risk of loss. The accounts' portfolios will not necessarily represent a broad diversification of investments among particular issuers, industries, industry sectors, or types of securities or investments.

We utilize a variety of ongoing risk management policies and practices in the management of the accounts' portfolios, including, but not necessarily limited to, monitoring and adjustment of portfolio exposure, the selective use of hedging instruments against certain market risks, and the use of real-time portfolio evaluation tools. Notwithstanding these risk management practices, our investment strategies

inherently involve certain significant risks (certain of which are described below). Moreover, there can be no assurance that our risk management practices will necessarily be applied in all cases, or if applied, will successfully limit risk to acceptable levels.

### *Co-Investment Strategy*

The general investment objective of our co-investment strategy is to hold securities of a single or a limited number of issuers. A security becomes a co-investment opportunity (i) only if the position is or is intended to be held in some or all of the primary strategy accounts; (ii) the position reaches its desired allocation (in the discretion of the portfolio managers) in the primary strategy accounts and there is still available capacity in the name to make additional investments on behalf of co-investment clients.

The investment objective may vary for each co-investment account and each co-investment position. It is intended that the assets of each co-investment position will be held until we determine to exit the position (a “Liquidity Event”). Following a Liquidity Event, the applicable position will generally be sold and the net proceeds will be distributed to the relevant client or fund investors.

While the co-investment strategy involves investing primarily in common stocks of public companies, the accounts may be authorized to invest in common stocks of private companies and any other securities, instruments, derivatives we deem appropriate. The positions to be held will not be limited by industry or sector.

There can be no assurance that any account or co-investment position will achieve its investment objective.

We anticipate that each co-investment opportunity will have limited capacity, and such opportunity will not be offered during the time that such capacity is filled. Upon identifying a co-investment opportunity, we shall make the opportunity available to clients that have expressed an interest in this strategy and can meet the minimum requirements of a separate account. If capacity is still available in the opportunity, we shall establish a new class of shares and offer the opportunity to other qualified fund investors through our co-investment fund.

Any securities of a co-investment position shall be acquired, held and disposed of at the same time and on the same terms and conditions for all funds/accounts that holds such position except as may be necessary to (i) fund an account’s redemptions, withdrawals or terminations; (ii) deploy new capital received in any account; or (iii) maintain adherence to any guidelines or restrictions imposed on any account.

### *General*

There can be no assurance that any account will achieve its investment objective.

The foregoing description of our investment objectives and strategies represents our present intentions in view of current market conditions and other factors. We have the right under the relevant account documents to vary the foregoing investment objectives and strategies to the extent we determine that doing so will be in the interests of an account.

### **Risks Associated with Our Investment Strategies**

Our investment programs are speculative and entail substantial risks. There can be no assurance that the investment objective of an account will be achieved or that an account will not incur losses, and investment results may vary substantially over time. In fact, the investment techniques which we may employ for the accounts from time to time can, in certain circumstances, adversely impact the accounts’

investment performance. Accordingly, an account's activities could result in substantial losses under certain circumstances. An investment in an account is suitable only for persons who are willing and able to assume the risk of losing their entire investment.

Prospective investors in a fund or separate account for which we employ our strategies should carefully consider the risks involved in an investment in an account, including, but not limited to, those certain risks discussed below. Prospective investors should consult their own legal, tax and financial advisors as to all of these risks and an investment in an account generally. Prospective investors in a fund should review the applicable offering documents which describe all identified risks concerning the funds and Basswood. Material risks involved in our strategies are described below.

**Risks of Investments in Securities Generally.** All securities investments risk the loss of capital. No guarantee or representation is made that any account's program will be successful. An account's investment program may at times involve, without limitation, risks associated with lack of or limited diversification, leverage, interest rates, currencies, volatility, tracking risks in hedged positions, security borrowing risks in short sales, credit deterioration or default risks, counterparty default risks, systems risks and other risks inherent in the account's activities. Certain investment techniques we may employ can, in certain circumstances, magnify the impact of adverse market movements to which an account may be subject. In addition, an account's investments in securities and other investments may be materially affected by conditions in the financial markets and overall economic conditions occurring globally and in particular countries or markets where the account may invest its capital.

Our methods of minimizing such risks may not accurately predict future risk exposures. Risk management techniques are based in part on the observation of historical market behavior, which may not predict market divergences that are larger than historical indicators. Information used to manage risks may not be accurate, complete or current, and such information may be misinterpreted. Further, we may apply such risk management techniques on a selective or other periodic basis rather than at all times.

**Equity Risks.** Our strategies include investments in equity and equity derivative securities. The value of these securities generally will vary with the performance of the issuer and movements in the equity markets. As a result, an account may suffer losses if it invests in equity securities of issuers whose performance diverges from our expectations or if equity markets generally move in a single direction and the account has not hedged against such a general move. To the extent an account invests in equity derivatives and private placements activities, the account will be exposed to risks that issuers will not fulfill their contractual obligations to the account, such as delivering marketable common stocks upon conversions of convertible securities and registering restricted securities for public resale.

**Concentration Risks.** As an account employing our financial sector strategy will invest primarily in the financial services sector, the investment portfolio of such an account will be concentrated in such sector. Moreover, there will not be any fixed limitations as to investing in a particular industry within the financial services sector or segments within a sector or industry (such as banks or insurance companies). An account's investment portfolio may, as a result, be regarded as concentrated as to sectors, industries and segments thereof. Our general strategy may also be concentrated at times with respect to a particular sector, industry or segment thereof. In our view, such concentration offers a greater potential for capital appreciation as well as increased risk of loss. Such concentration could have the affect of increasing the volatility of the account's investment portfolio.

With respect to our primary strategies, aside from the financial services sector concentration for our financial sector strategy, there are no fixed limits to our primary strategies regarding concentration as to industries, companies or types of investments. Furthermore, except for the limitation on investment in non-public and restricted securities and other assets that are subject to legal or other restrictions on transfer, there is no limitation in the size of any single position as a percentage of an account's assets.

Accordingly, an account's portfolio may be expected to be concentrated from time to time or at all times. Although concentration may increase the possibility of achieving significant investment return, concentration of investments in a limited number of issuers, industries or sectors is generally regarded as increasing both relative investment risk and potential portfolio volatility. In addition to issuer, industry or market risk by reason of concentration, an account may be exposed to potentially significant losses by reason of adverse developments affecting one or more of such limited number of portfolio companies. A loss in any such position could materially reduce an account's performance or asset base, to the extent not offset by other gains.

As each co-investment account will only hold securities of a single or a limited number of issuers, each such account may, as a result, be regarded as highly concentrated. In our view, such concentration offers a greater potential for capital appreciation as well as increased risk of loss. Such concentration could have the effect of increasing the volatility of the co-investment accounts' investments.

**Co-Investment Risks.** The acquisition and holding of the securities in a co-investment account may be expected to enhance the value of such securities held by primary strategy accounts. We may have an incentive to use the co-investment accounts to advantage the primary strategy accounts and which may provide us with greater performance-based compensation than the co-investment accounts. The primary strategy accounts will have investment priority over the co-investment accounts with respect to certain positions with limited availability. Since more than one co-investment account may hold the same position, situations may occur where a co-investment account could be disadvantaged because of the investment activities conducted by the other accounts.

**Competition; Availability of Investments.** Certain markets in which the accounts may invest are extremely competitive for attractive investment opportunities and, as a result, there may be reduced expected investment returns. There can be no assurance that we will be able to identify or successfully pursue attractive investment opportunities in such environments. Among other factors, competition for suitable investments from other pooled investment vehicles and other investors may reduce the availability of investment opportunities. There has been significant growth in the number of firms organized to make such investments, which may result in increased competition to the accounts in obtaining suitable investments.

**Investor Activism.** The accounts may invest in securities of publicly-traded or private companies that we, either at the time of investment or subsequent thereto, believe are improperly managed by the companies' executives and/or inadequately governed by the companies' board of directors. We will often communicate with management and other stakeholders of the issuing company regarding the possibility of, or seeking to influence the management of the issuing company with respect to, business strategies, mergers, recapitalizations, sales of assets, negotiated or open-market stock repurchases or other extraordinary corporate transactions. We may consider a variety of different alternatives to maximize the value of the accounts' activist investments, including negotiated transactions, tender offers, proxy contests, consent solicitations, or other actions.

In addition, we may become involved in other legal contests and complaints relating to the accounts' activist investment and related efforts to influence issuing companies' management and/or corporate governance. Such activities may be more expensive and time-consuming than so-called passive investing, and may result in legal claims or proceedings against the accounts and/or Basswood that may result in significant legal and court costs or judgments that will be borne, at least in part, by the accounts. There can be no assurance that we will necessarily be successful when seeking to achieve changes in the companies with respect to such activist investments.

**Short Selling.** Our strategies generally include short positions. Short selling involves selling securities which may or may not be owned and borrowing the same securities for delivery to the purchaser, with an

obligation to replace the borrowed securities at a later date. Short selling allows the investor to profit from a decline in the price of a particular security to the extent that such decline exceeds the transaction costs and the costs of borrowing the securities. A short sale creates the risk of a theoretically unlimited loss, in that the price of the underlying security could theoretically increase without limit, thus increasing the cost to the account of buying those securities to cover the short position. There can be no assurance that the security necessary to cover a short position will be available for purchase. Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss.

**General Economic and Market Conditions.** The investment activities of the accounts will be affected by general economic and market conditions, such as interest rates, availability of credit, inflation rates, economic uncertainty, changes in laws (including laws relating to taxation of the accounts' investments), and national and international political circumstances (including wars, terrorist acts or security operations). These factors may affect the level and volatility of securities prices and the liquidity of an account's investments. Volatility or illiquidity could impair an accounts' profitability or result in losses. The accounts may maintain substantial trading positions that can be adversely affected by the level of volatility in the financial markets; the larger the positions, the greater the potential for loss.

**Debt Securities.** The accounts may invest in debt securities and instruments. Certain of the debt instruments in which the accounts invest may be unrated, and whether or not rated, the debt instrument may have speculative characteristics. The issuers of such instruments may face significant ongoing uncertainties and exposure to adverse conditions that may undermine the issuer's ability to make timely payment of interest and principal. In addition, an economic recession could severely disrupt the market for these securities and may have an adverse impact on the value of such instruments. It is also likely that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default for such securities.

**ETFs.** The accounts may also invest in ETFs, or exchange traded funds, which are publicly traded investment vehicles that hold passively managed portfolios of stocks. As a result, the risk associated with a particular ETF corresponds closely to the risk of the asset subclass that the ETF is tracking. ETFs typically track an index, such as the Dow Jones Industrial Average or the S&P 500. The purpose of ETFs is to give investors liquid ways of trading indices or groups of stocks. ETFs are traded like common stocks on major stock exchanges.

**Illiquid Investments.** Our primary strategies include the investment of up to 5% of an account's assets (based on cost at the time such a security is purchased) in securities that, at the time of acquisition, are not publicly traded or are subject to restrictions on transfer (which restriction will not apply to "convertible preferred" securities or restricted securities that are to be filed for registration with the SEC within a reasonable period after acquisition). In addition, we may also cause an account to invest in securities that are thinly traded. The market prices, if any, for restricted and illiquid securities tend to be volatile and may not be readily ascertainable and the accounts may not be able to sell them when we desire for them to do so, or to realize what we perceive to be their fair value in the event of a sale. The sale of such securities often requires more time and results in higher brokerage charges or dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in the over-the-counter markets or that are otherwise liquid. The accounts may not be able to readily dispose of illiquid investments and, in some cases, may be contractually prohibited from disposing of such investments for a specified period of time. Restricted securities may sell at a price lower than similar securities that are not subject to restrictions on resale.

**Non-U.S. Investments.** The accounts employing our primary strategies may invest in financial instruments of non-U.S. corporations and governments. Investing in the financial instruments of

companies (and, from time to time, governments) outside of the United States involves certain considerations not usually associated with investing in financial instruments of U.S. companies or the U.S. government, including political and economic considerations, such as greater risks of expropriation, nationalization, confiscatory taxation, limitations on the removal of assets and general social, political and economic instability; the relatively small size of the securities markets in such countries and the low volume of trading, resulting in potential lack of liquidity and in price volatility; the evolving and unsophisticated laws and regulations applicable to the securities and financial services industries of certain countries; fluctuations in the rate of exchange between currencies and costs associated with currency conversion; and certain government policies that may restrict the accounts' investment opportunities. In addition, accounting and financial reporting standards that prevail outside of the U.S. generally are not as high as U.S. standards and, consequently, less information is typically available concerning companies located outside of the U.S. than for those located in the U.S. As a result, we may be unable to structure the accounts' transactions to achieve the intended results or to mitigate all risks associated with such markets. It may also be difficult to enforce the accounts' rights in such markets. For example, financial instruments traded on non-U.S. exchanges and the non-U.S. persons that trade these instruments are not subject to the jurisdiction of the SEC or U.S. Commodity Futures Trading Commission ("CFTC") or the securities and commodities laws and regulations of the U.S. Accordingly, the protections accorded to the accounts under such laws and regulations are unavailable for transactions on foreign exchanges and with foreign counterparties.

**Derivative Instruments in General.** We may cause the accounts to use various derivative instruments, including options, forward contracts, swaps and other derivatives which may be volatile and speculative. Certain positions may be subject to wide and sudden fluctuations in market value, with a resulting fluctuation in the amount of profits and losses. Use of derivative instruments presents various risks, including the following:

- *Tracking Risk* — When used for hedging purposes, an imperfect or variable degree of correlation between price movements of the derivative instrument and the underlying investment sought to be hedged may prevent an account from achieving the intended hedging effect or expose the account to the risk of loss.
- *Liquidity Risk* — Derivative instruments, especially when traded in large amounts by a small number of counterparties, may not be liquid in all circumstances, so that in volatile markets an account may not be able to close out a position without incurring a loss.
- *Leverage Risk* — Trading in derivative instruments can result in large amounts of leverage. Thus, the leverage offered by trading in derivative instruments may magnify the gains and losses experienced by the accounts and could cause the accounts' net asset values to be subject to wider fluctuations than would be the case if the accounts did not use the leverage feature in derivative instruments.
- *Hedging Risk* — When a derivative is used as a hedge against an opposite position that the account also holds, any loss generated by the derivative should be substantially offset by gains on the hedged investment, and vice versa. While hedging can reduce or eliminate losses, it can also reduce or eliminate gains.
- *Investment Risk* — When an account uses derivatives as an investment vehicle to gain market exposure, rather than for hedging purposes, any loss on the derivative investment will not be offset by gains on another hedged investment. The account will therefore be directly exposed to the risks of that derivative. Gains or losses from derivative investments may be substantially greater than the derivative's original cost.

- **Availability Risk** — Derivatives may not be available to the accounts upon acceptable terms. As a result, the accounts may be unable to use derivatives for hedging or other purposes.
- **Counterparty Credit Risk** — When an account uses derivatives, it is subject to the risk that the other party to the agreement (the counterparty) will not be able to perform. It is possible that, in the event of a counterparty default, the account may not be able to recover all or a portion of its investment in such derivative instrument and may be exposed to additional liability (*i.e.*, the obligations associated with what has become an unhedged position).

**Call Options.** There are risks associated with the sale and purchase of call options. The seller (writer) of a call option that is covered (*e.g.*, the writer holds the underlying security) assumes the risk of a decline in the market price of the underlying security below the purchase price of the underlying security less the premium received, and gives up the opportunity for gain on the underlying security above the exercise price of the option. The seller of an uncovered call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The securities necessary to satisfy the exercise of an uncovered call option may be unavailable for purchase, except at much higher prices, thereby reducing or eliminating the value of the premium. Purchasing securities to cover the exercise of an uncovered call option can cause the price of the securities to increase, thereby exacerbating the loss. The buyer of a call option assumes the risk of losing the entire premium investment in the call option.

**Put Options.** There are risks associated with the sale and purchase of put options. The seller (writer) of a put option which is covered (*e.g.*, the writer has a short position in the underlying security) assumes the risk of an increase in the market price of the underlying security above the sales price (in establishing the short position) of the underlying security plus the premium received, and gives up the opportunity for gain on the underlying security if the market price falls below the exercise price of the option. The seller of an uncovered put option assumes the risk of a decline in the market price of the underlying security below the exercise price of the option. The buyer of a put option assumes the risk of losing the entire investment in the put option.

**Stock Index Options.** The accounts may also purchase and sell call and put options on stock indices listed on securities exchanges or traded in the over-the-counter market for the purpose of realizing their investment objectives or for the purpose of hedging their portfolios. A stock index fluctuates with changes in the market values of the stocks included in the index. The effectiveness of purchasing or writing stock index options for hedging purposes will depend upon the extent to which price movements in the accounts' portfolios correlate with price movements of the stock indices selected. Because the value of an index option depends upon movements in the level of the index rather than the price of a particular stock, whether an account realizes gains or losses from the purchase or writing of options on indices depends upon movements in the level of stock prices in the stock market generally or, in the case of certain indices, in an industry or market segment, rather than movements in the price of particular stocks. Accordingly, successful use by the accounts of options on stock indices will be subject to our ability to correctly predict movements in the direction of the stock market generally or of particular industries or market segments.

**Forward Trading.** The accounts may enter into forward contracts. Forward contracts and options thereon are not traded on exchanges and are not standardized; rather, banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward and "cash" trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. The principals who deal in the forward markets are not required to continue to make markets in the currencies or commodities they trade, and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have refused to quote prices for certain currencies or commodities or have quoted prices



with an unusually wide spread between the price at which they were prepared to buy and that at which they were prepared to sell. Disruptions can occur in forward markets due to unusually high trading volume, political intervention or other factors. The imposition of controls by governmental authorities might also limit such forward trading to less than that which we would otherwise recommend, to the possible detriment of the accounts. Market illiquidity or disruption could result in significant losses to the accounts.

**Credit Default Swaps.** The accounts may invest in credit default swaps. A credit default swap is a contract between two parties which transfers the risk of loss if a company fails to pay principal or interest on time or files for bankruptcy. In essence, an institution which owns corporate debt instruments can purchase a limited form of default protection by entering into a credit default swap with another bank, broker-dealer or financial intermediary. Upon an event of default, the swap may be terminated in one of two ways: (i) by the purchaser of credit protection delivering the referenced instrument to the swap counterparty and receiving a payment of par value, or (ii) by the parties pairing off payments, with the purchaser of the protection receiving a payment equal to the par value of the reference security less the price at which the reference security trades subsequent to default. The former way is the more common form of credit default swap termination.

In the manner described above, credit default swaps can be used to hedge a portion of the default risk on a single corporate bond or a portfolio of bonds. Credit default swaps can be used to implement our view that a particular credit, or group of credits, will experience credit improvement. In the case of expected credit improvement, we may cause the accounts to sell credit default protection in which they receive a premium to take on the risk. In such an instance, the obligation of the accounts to make payments upon the occurrence of a credit event creates leveraged exposure to the credit risk of the referenced entity. The accounts may also “purchase” credit default protection even in the case in which they do not own the referenced instrument if, in our judgment, there is a high likelihood of credit deterioration.

The credit default swap market in high yield securities is comparatively new and evolving compared to the credit default swap market for more seasoned and liquid investment grade securities. Swap transactions dependent upon credit events are priced incorporating many variables including the pricing and volatility of common stock, potential loss upon default and the shape of the U.S. Treasury Yield curve, among other factors. As such, there are many factors upon which market participants may have divergent views. We may also cause the accounts to enter into credit default swap transactions, even if the credit outlook is positive, if we believe that participants in the marketplace have incorrectly valued the components which determine the value of a swap.

**Asset-Backed Securities (“ABS”), Collateralized Debt Obligations (“CDO”) and Mortgage-Backed Securities (“MBS”).** The accounts may invest in structured finance products, including ABS, CDO and MBS. The investment characteristics of ABS, CDO, MBS and other structured finance products differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, usually semi-annually, quarterly or monthly, and that principal may be prepaid at any time because the underlying mortgage loans or other assets generally may be prepaid at any time. The collateral supporting ABS is of shorter maturity than mortgage loans and is less likely to experience substantial prepayments.

Structured finance products are subject to credit, liquidity, market value, interest rate, operations, structural, legal and certain other risks. Structured finance products are generally privately placed and offer less liquidity than other investment grade or non-investment grade corporate debt. They are also generally issued in structured transactions with risks different from regular corporate debt. In addition, concentrations of structured finance products of a particular type, as well as concentrations of structured finance products issued or guaranteed by affiliated obligors, serviced by the same servicer or backed by

underlying collateral located in a specific geographic region, may subject the accounts to additional risk. A portion of the accounts' portfolios may consist of structured finance products that are subordinate in right of payment and rank junior to other securities that are secured by, or represent an ownership interest in, the same pool of assets. In addition, certain transactions have structural features that divert payments of interest and/or principal to more senior classes when the delinquency or loss experience of the pool exceeds certain levels. As a result, such securities have a higher risk of loss as a result of delinquencies or losses on the underlying assets. In certain circumstances, payments of interest may be reduced or eliminated for one or more payment dates.

**Contracts for Differences.** The accounts may enter into contracts for differences. In these transactions, an account and another party assume price positions in reference to an underlying security or other financial instrument. The "difference" is determined by comparing each party's original position with the market price of such securities or financial instruments at a pre-determined closing date. Each party will then either receive or pay the difference, depending on the success of its investment. Financial markets for the securities or instruments which form the subject of a contract for differences can fluctuate significantly. Parties to a contract for differences assume the risk that the markets for the underlying securities will move in a direction unfavorable to their original positions. In addition, these contracts often involve considerable economic leverage. As a result, such contracts can lead to disproportionately large losses as well as gains and relatively small market movements can have large impacts on the value of the investment.

**Other Derivative Instruments.** The accounts may enter into swap agreements and other derivative instruments. We may take advantage of opportunities with respect to certain other derivative instruments that are not presently contemplated for use or that are currently not available, but that may be developed, to the extent such opportunities are both consistent with the investment objective of the accounts and legally permissible. The specific risks inherent in such investments cannot be determined until these instruments are developed. Certain swaps, options and other derivative instruments may be subject to various types of risks, including market risk, liquidity risk, the risk of nonperformance by the counterparty, including risks relating to the financial soundness and creditworthiness of the counterparty, legal risk and operations risk.

**Counterparty Risk.** The accounts may effect transactions through over-the-counter or "interdealer" markets. The participants in such markets are generally not subject to as stringent credit evaluation and regulatory oversight as are members of "exchange based" markets. The accounts may also enter into other contracts and arrangements that expose the accounts to the creditworthiness and performance of one or more counterparties. This exposes the accounts to the risk that a counterparty will not settle a transaction in accordance with its terms and conditions because of a dispute over the terms of the contract (whether or not bona fide) or because of a credit or liquidity problem, thus causing an account to suffer a loss. Such "counterparty risk" is accentuated for contracts with longer maturities where events may intervene to prevent settlement, or where an account has concentrated its transactions with a single or small group of counterparties. The accounts are not restricted from dealing with any particular counterparty or from concentrating any or all of their transactions with one counterparty. Although we intend to cause the accounts to enter into transactions only with counterparties that we believe to be creditworthy and will attempt to reduce exposure by obtaining collateral in appropriate cases, there can be no assurance that a counterparty will not default and that an account will not sustain losses on a transaction as a result. In addition, concentration of transactions with a limited number of counterparties could increase the potential for losses by the accounts. The ability of the accounts to transact business with any one or more counterparties, the lack of any meaningful and independent evaluation of such counterparties' financial capabilities and the absence of a regulated market to facilitate settlement may increase the potential for losses by the accounts.

The assets of the accounts may be held by non-United States brokers or any other entities or counterparties of the accounts (including, but not limited to, sub-custodians). Such assets of the accounts may be available to the creditors of those non-United States brokers, entities and counterparties. These relationships expose the accounts to credit risks and involve the risk that the counterparties may become insolvent.

Because securities of an account held by broker-dealers are generally not held in the account's name, a failure of a broker-dealer may have a greater adverse impact on the account than if such securities were registered in the account's name.

**Currency Exchange Exposure.** We may invest a portion of the assets of each account in the securities of non-U.S. issuers and other instruments denominated in non-U.S. currencies, the prices of which are determined with reference to currencies other than the U.S. dollar. The accounts, however, value their securities and other assets in U.S. dollars. We may or may not seek to hedge the non-U.S. currency exposure of the accounts by entering into currency hedging transactions, such as treasury locks, forward contracts and cross-currency swaps. There can be no guarantee that instruments suitable for hedging currency or market shifts will be available at the time when we wish to use them for the accounts, or that hedging techniques we employ on behalf of the accounts will be effective. Furthermore, certain currency market risks may not be fully hedged or hedged at all.

To the extent unhedged, the value of an account's positions in non-U.S. investments will fluctuate with U.S. dollar exchange rates as well as the price changes of the investments in the various local markets and currencies. In such cases, an increase in the value of the U.S. dollar compared to the other currencies in which the accounts make their investments will reduce the effect of any increases and magnify the effect of any decreases in the prices of the accounts' securities in their local markets and may result in losses to the accounts. Conversely, a decrease in the value of the U.S. dollar will have the opposite effect on the accounts' non-U.S. dollar investments.

Furthermore, the accounts may incur costs in connection with conversions between various currencies. Non-U.S. currency exchange dealers realize a profit based on the difference between the prices at which they are buying and selling various currencies. Thus, a dealer normally will offer to sell currency to the accounts at one rate, while offering a lesser rate of exchange should the accounts desire immediately to resell that currency to the dealer. The accounts conduct their currency exchange transactions either on a spot (*i.e.*, immediate cash) basis at the rate prevailing in the currency exchange market, or through entering into forward or commodity options contracts to purchase or sell non-U.S. currencies. Most of the accounts' currency exchange transactions occur at the time securities are purchased and are executed through the local broker or custodian acting for the accounts.

**Leverage and Borrowing Risks.** The accounts have the power to borrow funds and we expect them to do so when we deem appropriate, including to enhance the accounts' returns and meet withdrawal requests that would otherwise result in the premature liquidation of investments. The accounts will borrow funds from brokers, banks and other lenders to finance their trading operations. The use of such leverage can, in certain circumstances, magnify the losses to which the accounts' investment portfolios may be subject. Such leverage, which may be substantial, may be achieved through, among other methods, purchases of securities on margin and the use of options, forward contracts, repurchase and reverse repurchase agreements, swap agreements and other derivative instruments. The access to capital could be impaired by many factors, including market forces or regulatory changes. If the accounts were unable to borrow, they may need to liquidate assets in order to meet their liabilities.

The use of margin and short-term borrowings creates several risks for the accounts. If the value of an account's securities falls below the margin level required by a broker, additional margin deposits would be required. If the account is unable to satisfy any margin call by a broker, then the broker could liquidate

the account's position in some or all the financial instruments that are in the fund's account or the separate account at the broker and cause the account to incur significant losses. The failure to satisfy a margin call, or the occurrence of other material defaults under margin or other financing agreements, may trigger cross-defaults under the account's agreements with other brokers, lenders, clearing firms or other counterparties, multiplying the adverse impact to the account. In addition, because the use of leverage allows the accounts to control positions worth significantly more than their investment in those positions, the amount that an account may lose in the event of adverse price movements is high in relation to the amount of its investment.

In the event of a sudden decrease in the value of an account's assets, the account might not be able to liquidate assets quickly enough to satisfy its margin requirements. In that event, the account may become subject to claims of financial intermediaries that extended "margin" loans. Such claims could exceed the value of the assets of the account. The banks and dealers that provide financing to the accounts can apply essentially discretionary margin, haircut, financing and collateral valuation policies. Changes by banks and dealers in any of the foregoing may result in large margin calls, loss of financing and forced liquidations of positions at disadvantageous prices. There can be no assurance that an account will be able to secure or maintain adequate financing, without which the account may not continue to be viable.

The purchase of options, forward contracts, repurchase agreements, reverse repurchase agreements and other derivative instruments generally involves little or no margin deposit and, therefore, provides substantial leverage. Accordingly, relatively small adverse price movements in these financial instruments may result in immediate and substantial losses to an account.

**Volatility Risk.** Our investment program may involve the purchase and sale of derivatives, which are frequently valued based on implied volatilities of such derivatives compared to the historical volatility of their underlying securities. Fluctuations or prolonged changes in the volatility of the underlying securities, therefore, can adversely affect the value of derivative positions held by the accounts.

**Hedging Transactions.** Our strategy may utilize a variety of financial instruments, such as short sales, options, swap agreements, caps and floors and forward contracts and similar derivatives, both for investment purposes and for risk management purposes. While we may cause the accounts to enter into hedging transactions to seek to reduce risk, such transactions may not be fully effective in mitigating the risks in all market environments or against all types of risk (including unidentified or unanticipated risks), thereby causing the accounts to incur losses. In addition, such hedging transactions may result in an inferior overall performance for an account than if it had not engaged in any such hedging transactions. Moreover, we may not necessarily endeavor to hedge an account portfolio whatsoever. In the event we utilize hedging, we will employ it, in general, solely as a technique to limit certain market risks. As a general matter, the accounts' portfolios will still be exposed to basic issuer risk and other risks attendant to our investment strategy and to particular positions, which risks will not be generally hedged.

**Execution of Orders.** Our trading strategy depends on our ability to establish and maintain an overall market position in a combination of securities and other investments we select. An account's trading orders may not be executed in a timely and efficient manner due to various circumstances, including, without limitation, systems failures or human error attributable to the account or to the account's brokers, agents or other service providers. In such event, an account might only be able to acquire some, but not all, of the components of such position, or if the overall position were to need adjustment, the account might not be able to make such adjustment. As a result, the account would not be able to achieve the market position we selected, and might incur a loss in liquidating its position.

## **Item 9. Disciplinary Information**

Basswood and the persons affiliated with Basswood have not been involved in any legal or disciplinary events that would be material to the evaluation or the integrity of our advisory business.

## **Item 10. Other Financial Industry Activities and Affiliations**

### **Material Financial Industry Affiliations of the Firm**

Basswood Capital Management, L.L.C. is under common ownership with Basswood Partners, L.L.C. and Basswood Enhanced Long Short GP, LLC each of which serves as the general partner of certain of the private investment funds for which Basswood Capital Management, L.L.C. serves as investment adviser.

We currently serve as investment adviser to the following private funds:

- Basswood Opportunity Partners, L.P.
- Basswood Opportunity Fund, Inc.
- Basswood Financial Fund, L.P.
- Basswood Financial Fund, Inc.
- Basswood Financial Long Only Fund, L.P.
- Basswood Financial Long Only Fund, Ltd.
- Basswood Co-Investment Fund (SPC), Ltd.
- Basswood Co-Investment Fund, Ltd.
- Basswood Co-Investment Partners, Ltd.

We also serve as investment adviser to other private investment funds formed for the purpose of separately managed accounts for certain institutional investors.

We also act as sub-advisor to the American Beacon Grosvenor Long/Short Fund, an investment company registered under the Investment Company Act of 1940.

From time to time, the portfolio managers or senior investment professionals may be appointed, nominated and/or elected to serve on the board of directors of companies in which the funds and accounts and other persons affiliated with Basswood are investors. As of the date of this brochure, a Basswood senior investment professional serves on the board of Regional Management Corp.

Additionally, the principals of the firm are managing members and/or general partners to limited liability companies and limited partnerships that serve as vehicles for managing assets of the principals and their family members.

### **Conflicts of Interest**

Basswood and its principals, officers and employees will devote as much of their time to the activities of each account as they deem necessary and appropriate in their discretion. The firm, its affiliates, and their respective principals, officers and employees, are not restricted from engaging in other business activities of any kind. Basswood and such other persons may provide investment management services to additional investment funds and client separate accounts, as well as proprietary accounts of the firm, its principals, their family members, and their respective affiliates. The existence of such accounts necessarily creates a number of potential conflicts of interest, and may involve substantial time and resources of the firm, its affiliates, and their respective principals, officers and employees.

Certain of the accounts have investment objectives and policies that are similar or identical to those of other accounts. We expect there to be differences at times between and among the accounts with respect to investment objectives, investment strategies, investment parameters and restrictions, portfolio

management personnel, tax considerations, liquidity considerations, legal and/or regulatory considerations, asset levels, timing and size of investor capital contributions and redemptions, cash flow considerations, market conditions, existing exposure to an investee company or security, and other criteria we deem relevant (the nature and extent of the differences may be expected to vary from one account to another). Notwithstanding these differences, there are circumstances where accounts participate in parallel investment transactions, on a pro rata basis, at the same time and on the same terms; this is the case most commonly with respect to accounts that have similar investment objectives and investment strategies. However, this will not always be the case. There may be expected to be circumstances where:

- only some of the accounts participate in parallel investment transactions;
- the level of participation between and among the accounts in parallel investment transactions is not on a pro rata basis;
- the terms of parallel investment transactions vary between and among the accounts;
- accounts effectively engage in opposite transactions with respect to a particular investment (for instance, if an account acquires a long position in a security while one or more of the other accounts sell or short the security); and/or
- investment transactions by the accounts vary in other respects.

Such non-parallel and/or non-pro rata investment transactions between and among the accounts will be made in our discretion: (i) when we deem appropriate given the differences between the accounts involved; (ii) to adjust the portfolio holdings of one or more accounts so as to rebalance the portfolio composition we determine suitable; and/or (iii) when we deem otherwise to be in the best interests of the accounts involved. It is our general policy that no account may receive inappropriate preferential treatment or otherwise be treated unfairly, and we seek to uphold such policy when making decisions regarding investment allocations and transactions; however, it is possible that the activities of other accounts could, from time to time, have an adverse impact on the market value of the portfolio holdings of an account and, consequently, the account's performance.

Allocations among accounts of equity securities issued in initial public offerings ("new issues") will be made only to "eligible accounts", based on the principles described above for allocations generally. Eligible accounts are determined by us based on the amount of account assets and/or fund investors that are eligible to participate in the net profits or net losses of new issues. Investors in the funds that, under applicable rules, are "restricted persons" with respect to new issues will not be allocated any net profits or net losses with respect to any new issue investments made by the funds.

We may provide personnel to sit on the board of directors or to serve in any other capacity with respect to a company or banking institution in which an account is invested or intends to invest. In return for such services, Basswood, its partners, affiliates and officers, directors and shareholders of such affiliates may earn fees directly from such company or banking institution. In addition, a company or banking institution may pay management fees or directors' fees directly to Basswood or any of our affiliated entities as payment for management services rendered or for serving on the board of directors. Such fees may take the form of cash, securities of the company or banking institution or the right to acquire securities in the company or banking institution on a basis more favorable than that available to the accounts. In these circumstances, we will either (i) allocate the fees pro rata across the applicable accounts; or (ii) offset the amount of the fees received against future management fees receivable from the applicable accounts by the same amount.

We have an obligation to accurately value the securities held by the funds and separate accounts. This process is critical for determining the net asset value of the clients' accounts which affects, among other things, the calculation of the fees paid to the firm and the calculation and reporting of the performance

returns of the clients' accounts. Securities that are listed on national securities exchanges and securities traded over the counter which are freely transferable will be valued at their last sales price on the date of determination or, if no sales occurred on the date of determination, such securities will be valued at the arithmetic mean of the bid and asked price on the date of determination. All other securities and investment instruments held by a client account will be valued in the manner determined by the firm or its designee (such as the Administrator) to reflect their fair market value. The accounts may hold certain illiquid securities or investment instruments for which there is no readily available pricing. Such securities or investment instruments are valued either by an independent third-party or at the firm's discretion - in which case the valuations are generally based upon an internal valuation analysis, in which presents a potential conflict of interest. Accordingly, we (i) strive to reasonably determine that such securities and investment instruments reflect their fair market value; (ii) work with the fund's administrator and independent auditors to verify the reasonableness of the valuations; and (iii) maintain valuation policies and procedures that are reasonably designed to assist in mitigating this potential conflict of interest.

Basswood and persons affiliated with Basswood have investments in the funds and/or may elect to make subsequent investments in the funds or in other accounts managed by the firm. We generally waive the management fee and incentive fee/allocation for such investors.

Other present and future activities of Basswood and its affiliates may give rise to additional conflicts of interest. While none of Basswood, or its directors, officers, employees or affiliates is obligated to resolve any conflicts in favor of any account, we will endeavor to ensure that any conflict of interest is resolved fairly.

### **Trade Error Policy**

We have adopted a policy for the purpose of addressing trade errors that may arise, from time to time, with respect to the securities transactions of clients. An example of a trade error is the sale of a security when it should have been purchased. Pursuant to the policy, we will seek to identify and correct any trade errors in an expeditious manner without disadvantaging any client in any way. Any losses as a result of trade errors caused by us will be reversed, with Basswood being responsible to make the affected client accounts whole. Gains caused by trade errors will be credited to the affected account and may not be used to offset losses from other or additional trade errors. We will not use "soft dollars" or "client commissions," either directly or indirectly, to correct trade errors. We will document each trade error with appropriate supervisory approval and maintain a trade error file. The determination of whether or not a trade, or series of trades, has been made in error shall be in our sole discretion.

## **Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **Code of Ethics**

We have established and maintain a Code of Ethics intended to satisfy our obligations in connection with Rule 204A-1 under the Investment Advisers Act of 1940, as amended ("Advisers Act") and Rule 17j-1 under the Investment Company Act of 1940. All Basswood employees, principals and any other affiliated persons, as determined by the firm's Chief Compliance Officer (together, "supervised persons"), are required to comply with and acknowledge receipt of the Code of Ethics. The purpose of our Code of Ethics is to identify the ethical and legal framework in which we and our supervised persons are required to operate and to highlight some of the guiding principles and mechanisms for upholding our standard of

business conduct. Our Code of Ethics is designed to ensure that all supervised persons are aware of and adhere to our policies and procedures. Our Code of Ethics covers the following topics:

- standards of business conduct;
- fiduciary duties and principles;
- prohibited conduct;
- conflicts of interest;
- personal trading;
- insider trading;
- privacy of client information;
- service as a director;
- outside business activities;
- certain reporting and certification requirements;
- reporting of violations of the code of ethics;
- training; and
- review and enforcement.

A complete copy of our Code of Ethics will be provided to clients and prospective clients upon request.

### **Interested Transactions**

We may, from time to time, recommend a security in which the firm or one of our related persons, directly or indirectly, has an interest. For instance, it may be expected that separate account assets will be invested in securities of issuers in which one or more other separate accounts or funds hold positions. In addition, fund assets may be invested in securities of issuers in which one or more other funds or separate accounts hold positions. Given the likely frequency of such occurrence, clients will not be provided with notification of such occurrences. This may represent a conflict of interest for us.

All personal securities transactions by the firm's supervised persons, in which they have or will have, as a result of the transaction, a direct or indirect beneficial interest, are subject to pre-approval by our Chief Compliance Officer before the supervised person may proceed with the transaction, except for transactions in certain categories of securities such as money market funds and U.S. government securities. Securities maintained or acquired by a supervised person are subject to specific holding periods and supervised persons are generally prohibited from trading any security issued by a company that is held in a client portfolio or that is otherwise deemed to be restricted by the firm.

We may permit a supervised person to invest in securities or related securities that a client account is also investing in, but subject to the requirement that such a transaction will not disadvantage any client account. In addition, all supervised persons are required to submit to the firm a list of all personal security holdings and other investments in which they have a direct or indirect beneficial interest, upon hire and annually; and arrange to have copies of trade confirmations and account statements of each personal investment account sent directly to us. The firm's Chief Compliance Officer reviews all information regarding a supervised person's personal trading activity. Our pre-approval procedure and the submission of supervised persons' personal trading information assist us towards our goal of ensuring that no personal trading of any supervised person will disadvantage any client account.



We may determine that it is in a client's best interest to execute a transaction between the client account and Basswood's own account or an affiliate account ("principal transaction"). In accordance with Section 206(3) of the Advisers Act, if we determine to execute a principal transaction, then we will provide applicable written disclosures to the client before the completion of such transaction, and obtain the client's consent.

In regards to the onshore funds, we appointed International Management Services, Inc. ("IMS") as an objective and disinterested third party that can approve, or disapprove, each transaction that may be deemed a principal transaction. Principal transactions involving the offshore funds are to be reviewed and approved by the fund's independent board members. As such, we will provide IMS or the fund's independent board members, as applicable, with the appropriate disclosures regarding these transactions and request their consent. Consistent with our fiduciary duty, we may execute principal transactions only if such transactions are in the best interests of the clients and are executed consistent with our duty to obtain best execution. In addition, we will not receive any remuneration for principal transactions and the funds will not be subject to any commission costs.

## **Item 12. Brokerage Practices**

### **Selection of Brokers**

Basswood has full investment discretion with respect to the initiation of all portfolio securities transactions for the accounts as well as full authority to select broker-dealers to execute such transactions. We have selected prime brokers for the funds. The prime brokers have certain administrative responsibilities, including the issuance of account statements and information with respect to securities transactions affected through other broker-dealers. The prime brokers are allocated a portion of the funds' securities transactions, subject to principles of best execution. The funds are not committed to continue their prime brokerage relationship with particular broker-dealers for any minimum period, and we may, in our sole discretion, select other or additional brokers to act as prime broker(s) of the funds at any time.

In addition to the prime brokers, we place transactions with other broker-dealers, which include the following:

- *Execution brokers* – brokers that provide execution only services;
- *Full service brokers* - brokers that provide both research and execution services; and
- *CSA brokers* – brokers subject to a commission sharing arrangement ("CSA") whereby the broker-dealer effecting the transaction generally retains a portion of the commission for the execution and allocates the balance to a third-party research firm or other vendor that has provided us research products or services eligible under Section 28(e) (as defined below).

We generally allocate an account's brokerage business to such brokers on the basis of certain considerations, which may include:

- amount of commission,
- quality and promptness of execution,
- reputation, experience and financial stability of the broker-dealer involved,
- expertise and quality of service,
- familiarity with the securities markets and investment techniques employed by the account,

- research and analytic services,
- clearing and settlement capabilities,
- soft dollar/client commission programs of the broker-dealer,
- block positioning or other special execution capabilities or
- other services provided to the account.

In allocating brokerage to the prime brokers or such other broker-dealers, the commissions the accounts will pay to such broker-dealers will not necessarily represent the lowest commission rates available, but will reflect our evaluation of the research and other brokerage-related services supplied by such broker-dealers and which benefit the accounts, either alone or together with the other accounts. Therefore, we may pay a commission to a broker-dealer, in recognition of the value of the brokerage and other products and services provided by the broker-dealer, which is greater than the commission another broker-dealer might have charged for effecting the same transaction. In doing so, we are receiving a benefit because the firm does not have to produce or pay for the research, products or services and accordingly, we may have an incentive to select a broker-dealer based on our interest in receiving the research or other products or services, rather than on our clients' interest in receiving most favorable execution. In each case, we will make a good faith determination that the amount of commission costs on account of such research or other services is reasonable relative to the value of services so provided.

Section 28(e) of the Securities Exchange Act of 1934 provides a "safe harbor" to investment managers who use commission dollars of their advisory accounts (so-called "soft-dollars") to obtain investment research, brokerage and other services that provide lawful and appropriate assistance to the investment managers in performing investment decision-making responsibilities, provided that the amount of any increased commission costs on account of such research or other services is reasonable relative to the value of the services so provided. Any such arrangement we enter into will be confined to the products or services that qualify as "research and brokerage services" within the meaning of Section 28(e) and that meet the other requirements of that Section. The research we receive under such an arrangement is both proprietary (prepared by the relevant broker/dealer) and may be created or developed by third parties.

We may place transactions with a prime broker or other broker-dealer that (i) provides us with the opportunity to participate in capital introduction events sponsored by the broker-dealer; (ii) provides us with other consulting services; or (iii) refers investors to the funds or other products we advise, if otherwise consistent with seeking best execution; provided, that we are not selecting the broker-dealer in recognition of the opportunity to participate in such capital introduction events, consulting services utilized or the referral of investors. We will be subject to a conflict of interest in determining whether to select such brokers-dealers to execute transactions on behalf of the accounts, because we will have an incentive to select or recommend a broker-dealer based on our interests, rather than on our clients' interest in receiving most favorable execution. We will manage any such conflict of interest appropriately and will not allocate business or effect transactions on behalf of the accounts with a broker-dealer in recognition of such incentives if such allocations or transactions would not be in the best interest of the accounts.

The research obtained through an account's brokerage allocations, whether or not directly useful to it, may be useful to us in connection with services we render to other accounts. Similarly, research we obtain for commissions paid to brokers in the course of managing other accounts, may be useful to an account. Since any particular research we obtain may be useful to any or all accounts, in considering the reasonableness of brokerage commissions paid by the accounts we will not attempt to allocate the relative costs or benefits of research as between the accounts, except in limited circumstances where we believe it to be appropriate to do so.

In our last fiscal year, the products and services for which we used soft dollars include: research reports or other information about particular securities, companies and industries; market and economic surveys and analyses; discussions with research analysts; recommendations as to specific securities and companies; attendance at certain seminars and conferences; meetings with corporate executives; financial publications; portfolio evaluation services; trading software; and data services and feeds. All of the services paid for with soft dollars were services the costs of which would have been paid for or reimbursed by the accounts if not paid for with soft dollars.

In general, any and all brokerage allocations will be subject to principles of best execution and the other allocation policies described above, as well as any restrictions imposed by applicable law.

### **Aggregation of Orders**

When we deem the purchase or sale of securities to be in the best interest of more than one account, we may aggregate the securities to be purchased or sold by all such accounts in order to obtain more favorable execution and/or lower brokerage expenses. Each account that participates in the order shall do so at the average price and shall share in commissions or other transaction costs on a pro rata basis. In such events, allocation of the securities purchased or sold, as well as commissions and other expenses incurred in the transaction, will be made among the participating accounts by applying such considerations as we deem equitable, including:

- relative account size of such entities and clients,
- amount of available capital,
- size of existing positions in the same or similar securities,
- impact of leverage,
- investment objective and
- strategy considerations, including, without limitation,
  - concentration parameters,
  - tax considerations and
  - other factors.

As a result of such considerations, allocations among the accounts will not necessarily be pro rata. No account will be entitled to investment priority over another account and an account may not necessarily participate in every investment opportunity. Although we seek to allocate investment activities in a fair and equitable manner, situations may occur where an account could be disadvantaged because of the investment activities we conduct for other accounts.

### **Item 13. Review of Accounts**

One of our portfolio managers reviews all securities transactions on a daily basis. Each account is also subject to an overall review, no less frequently than weekly. Reviews generally consist of a review and analysis of all positions, risk analysis, performance to date in light of each account's investment objective and an evaluation of any appropriate changes to be implemented with respect to each portfolio.

After the end of each fiscal year, each investor in a fund is provided with audited financial information with respect to the financial statements of such fund, as well as information regarding the status of the investor's capital account and certain tax reporting information, where applicable. After the end of each

month, each investor in a primary strategy fund is provided with unaudited information for such period with respect to the performance of such fund and the investor's capital account balance.

Separate account clients will generally be provided with account statements by the account's prime broker or custodian on at least a monthly or quarterly basis, at the client's discretion. Notwithstanding the foregoing, separate account clients may be provided with additional or more frequent reports subject to negotiation between Basswood, the separate account client and the prime broker or custodian.

All fund and account information provided to our clients and fund investors, as described above, is in writing, and distributed either electronically or in hardcopy form.

#### **Item 14. Client Referrals and Other Compensation**

Basswood previously had a separate arrangement, which has since been terminated, pursuant to which Basswood agreed to make payments to a third party on behalf of certain fund investors, to satisfy payment obligations of such investors to the third party that arose in connection with advisory services provided by the third party to the fund investors relating to their investment in the funds. Although the arrangement has been terminated, Basswood continues to make payments to the third party on behalf of certain fund investors as required by the terms of the agreement. The funds do not bear any portion of such payments.

#### **Item 15. Custody**

We would be considered to have custody in the event Basswood directly or indirectly holds or has authority to take possession of client's funds or securities. Accordingly, we maintain all client funds and securities with unaffiliated banks and/or broker-dealers that are considered qualified custodians. However, where we act in any capacity (such as general partner of a limited partnership) that gives us, or our supervised persons, legal ownership of, or access to, a client's funds or securities, the firm is deemed to have custody. In such cases, the fund is subject to an annual audit and we distribute the audited financial statements to all investors in the fund. The audited financial statements are prepared by an independent auditing firm, in accordance with generally accepted accounting principles, and distributed to all investors in the fund within 120 days of the end of the fund's fiscal year.

Basswood may also be considered to have custody if we inadvertently receive a client's funds or securities. If we inadvertently receive client funds or securities, we will return or forward the funds/securities promptly, but in any case within five business days following receipt, to the client, former client, the client's qualified custodian, or the original sender, as appropriate and document the receipt and return of the funds/securities.

If we are deemed to have custody of the assets of a client account that is not a pooled investment vehicle, the client will be provided with an account statement by a third-party custodian no less than quarterly. These statements will be sent directly to the client by the account custodian. These statements list the account positions, activity in the account over the covered period, and other related information. Clients will also be sent confirmations following each brokerage account transaction unless receipt of confirmations has been waived by the client. We will generally not issue separate reports with respect to such clients. Clients should carefully review statements they receive from the account custodian.

## **Item 16. Investment Discretion**

Item 4 includes a description of the investment discretion that we exercise with respect to the funds and separate accounts. Fund investors generally do not have any ability to restrict the investment of the fund, although under limited circumstances we may agree with a particular investor that such investor will not participate in certain categories of investment made by the fund. Separate account investors have greater flexibility to impose restrictions on types of investments or investment strategies and under certain circumstances may be deemed to have shared discretion with us.

We generally exercise investment discretion with respect to accounts pursuant to a power of attorney that is granted by each fund or separate account client as part of the investment management agreement relating to each such account.

## **Item 17. Voting Client Securities**

We have authority to vote client securities for the funds and certain separate accounts. We have engaged a third-party proxy advisory and voting service provider (the “Proxy Adviser”) to assist us with the analysis, voting and record keeping of all proxies. The Proxy Adviser provides independent assessment and recommendations with regard to the proxy items for securities held by our clients.

We have adopted a written policy regarding the voting of client proxies that is designed to ensure that we fulfill our fiduciary obligation to our clients. It is our policy to generally vote proxies in accordance with the proxy voting recommendations and guidelines issued by the Proxy Adviser (“Proxy Guidelines”). The Proxy Guidelines are designed to address a wide range of common business and social issues often contained in proxy statements. Although the firm may rely on the recommendations provided by the Proxy Adviser, we retain final authority to determine how each proxy is voted. Items not specifically addressed in the policy will be addressed on a case-by-case basis by Basswood’s Chief Compliance Officer and the principals, with guidance, as deemed necessary, from the Proxy Adviser. We may base our proxy voting decisions on established policies or recommendations on individual proxy proposals developed by the Proxy Adviser, or may vote a proxy contrary to such policies or recommendations, if we determine that such action is in the best interest of our clients. Furthermore, we reserve the right to abstain from voting, or to not vote, proxies in certain situations or for certain clients, if we determine that such action is in the best interests of the clients.

We have included procedures in our proxy voting policy for dealing with known potential or actual conflict of interests. Each conflict of interest relating to a particular proxy proposal will be handled on a case-by-case basis, based on the particular facts and circumstances. If we are uncertain how to address a conflict relating to a particular proxy proposal, we will vote the proposal in accordance with the recommendation provided by the Proxy Adviser; or if no recommendation is provided by the Proxy Adviser, our Chief Compliance Officer may determine for the client to be notified of such conflict and will cause the proxy to be voted in accordance with the client’s instructions, or if no instructions are received, abstain from voting.

A client may obtain a copy of our proxy voting policy, as well as information regarding how we voted proxies for their account, by contacting our Chief Compliance Officer at (212) 521-9500.

## **Item 18. Financial Information**

We do not believe there to be any financial condition that is reasonably likely to impair our ability to meet contractual commitments in managing client accounts. We do not require or solicit prepayment of more than \$1,200 in fees from the accounts, six months or more in advance, and therefore are not required to include a balance sheet for our most recent fiscal year.