

# **F-Squared Alternative Investments, LLC**

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## **Form ADV Part 2A Brochure**

July 2015

This brochure provides information about the qualifications and business practices of F-Squared Institutional Advisors, LLC (hereinafter “F-Squared”). If you have any questions about the contents of this brochure, please contact us at 866-288-7657 or [info@f2inv.com](mailto:info@f2inv.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the “SEC”) or by any state securities authority.

Additional information about F-Squared is available at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Registration with the SEC does not imply that F-Squared or any person associated with F-Squared has achieved a certain level of skill or training.

## Item 2: Summary of Material Changes

F-Squared's last annual update to its disclosure brochure on Form ADV Part 2A was filed on March 31, 2015. Since then, F-Squared has made the following material changes to its brochure:

- Item 18 – Financial Information. On July 8, 2015, the Firm filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in conjunction with a Section 363 asset sale. See *In re F Squared Investments, Inc.*, Case No. 15-11469 (petition filed in the United States Bankruptcy Court for the District of Delaware).

F-Squared is seeking Court authorization to pursue the sale process on an expedited basis under Section 363 of the U.S. Bankruptcy Code. The proposed agreement with Broadmeadow Capital contemplates a Court-supervised auction process, which is designed to achieve the highest or otherwise best offer for the Company's assets. The agreement with Broadmeadow Capital sets the floor, or minimum acceptable bid, and is subject to Bankruptcy Court approval and certain other conditions. A final sale approval hearing is anticipated to take place shortly after the auction with the anticipated closing contingent on the approval of the Court and the consent of F-Squared's clients.

- As of May 31, 2015, F-Squared and its affiliated registered investment adviser entities maintained over \$7.4 billion in assets under management or maintained by unaffiliated third parties pursuant to F-Squared's Index Provider Services.
- As a result of the above, F-Squared has reduced its number of employees as needed.

Other changes have been made to the brochure in an effort to clarify the disclosure contained herein, but F-Squared does not consider these changes to be material.

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## **Item 4: Advisory Business**

### ***Description of our Firm***

F-Squared Alternative Investments, LLC (hereinafter “F-Squared”) is a privately-held, SEC registered investment management firm based in Wellesley, Massachusetts. F-Squared commenced operations as an investment adviser in 2011. F-Squared is a wholly-owned subsidiary of F-Squared Investment Management, LLC. No single person owns more than 25% of F-Squared Investment Management, LLC.

### ***Types of Services We Offer***

F-Squared provides various index products (the “Index Provider Services”) on a non-discretionary basis to unaffiliated third parties, and, separately, provides discretionary investment advisory services (the “Advisory Services”) based on those index products to pooled investment vehicles.

#### **Index Provider Services**

An affiliate of F-Squared has created and licensed a series of specialty indexes (the “AlphaSector Indexes”) covering a range of asset classes. The AlphaSector Indexes are based on sector rotation strategies that use quantitative models programmed to measure the volatility and price movements of exchange-traded funds (“ETFs”) as criteria for inclusion and weighting in the Indexes. There are numerous AlphaSector Indexes (including both standard and customized versions). F-Squared sub-licenses the right to use the AlphaSector Indexes to unaffiliated third parties but has no discretion over the assets that are to be managed by the third-party manager pursuant to the Index.

#### **Advisory Services**

F-Squared also provides investment advisory services on a discretionary basis to F-Squared U.S. Sector Opportunities Fund, L.P., a privately-offered pooled investment vehicle (the “Private Fund”), and may provide such services to additional private funds in the future.

The investment objective of the Private Fund is to achieve capital appreciation through both long and short investments in exchange-traded funds (“ETFs”). Long and short investments will be determined using F-Squared’s proprietary “AlphaSector” model (the “Model”). The Model identifies industry sectors that are predicted to have positive or negative price movement, and the Partnership’s investment portfolio will be positioned with long and short sector exposures accordingly. The Partnership’s portfolio will also use dynamic leverage to seek to increase long exposure when the Model predicts that a majority of sectors will have positive performance. The Investment Manager will also utilize a proprietary methodology which will seek to remove all short exposure in the Partnership’s portfolio when the market is predicted to have strong upward movement. The Investment Manager will utilize additional proprietary technology as an overlay on the Partnership’s portfolio which will seek to remove long or short exposure depending on the strength of the Model’s sector determinations.

### ***Wrap Fee Programs***

F-Squared does not currently participate in any wrap fee programs.

## ***Assets under Management***

As of May 31, 2015, the total assets under management<sup>1</sup> for F-Squared were as follows:

<b><i>Discretionary:</i></b>	\$ 14,200,000
<b><i>Non-Discretionary:</i></b>	0
<b><i>Total:</i></b>	\$ 14,200,000

## **Item 5: Fees and Compensation**

### ***Fee Schedule***

#### ***Index Provider Services***

In connection with the licensing of its AlphaSector Indexes, F-Squared is entitled to receive a fee based on the market value of the assets managed by the third party using the AlphaSector Indexes. F-Squared generally receives this fee on a monthly or quarterly basis, typically in arrears. The rates for such fee generally range from 10 to 80 basis points. Such fees may be negotiable. Third party unaffiliated entities that license the use of the AlphaSector Indexes may charge fees and expenses with which F-Squared has no involvement. Such entities may employ fee and expense structures, as well as timing, that differ from F-Squared's. In addition, F-Squared's base subadvisory fee to a registered investment company (the "Fund") is subject to a performance adjustment. F-Squared's base subadvisory fee is adjusted by adding or subtracting 0.10% (10 basis points) for each 1.00% of absolute performance by which the Fund's performance exceeds or lags that of the S&P 500® Index. The performance adjustment is measured over the most recent 36-month period.

#### ***Advisory Services***

##### ***Private Fund***

With respect to the Private Fund, F-Squared receives a quarterly management fee, payable in advance, calculated at an annual rate of 1.5% of the total net assets of the Private Fund (the "Private Fund Management Fee"). The Private Fund Management Fee is adjusted to reflect contributions and withdrawals made during a quarter. The Private Fund Management Fee is negotiable. An affiliate of F-Squared is also entitled to performance-based compensation from the Private Fund in the form of an incentive allocation, which is compensation that is based on a share of capital gains or capital appreciation of the Private Fund's assets. This compensation is generally equal to 20% and is subject to a non-cumulative hurdle rate of 8%. Investors in the Private Fund should refer to the Fund's Confidential Private Offering Memorandum, Limited Partnership Agreement, and other governing documents for more information on the Private Fund's fee structure.

### ***Payment of Fees***

Both Index Provider Services and Advisory Services clients may choose to be billed for the services provided or have their fees automatically deducted from the assets subject to the Strategy by the client's custodian. Clients will be charged (whether by billing or deduction method) on either a monthly or quarterly basis.

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<sup>1</sup> In addition, as of May 31, 2015, unaffiliated third parties maintained \$24,800,000 in assets subject to an Index as part of F-Squared's Index Provider Services.

### ***Other Types of Fees or Expenses***

In addition to the management fees and performance-based compensation described above, Index Provider Services and Advisory Services clients may incur additional fees and expenses, including: (i) any sales or other taxes that may be assessed, (ii) commissions, brokerage fees or similar transactional charges that may be incurred in connection with executing trades in securities, (iii) custodial, administrative, accounting, legal and other fees that may be charged other unaffiliated financial intermediaries and service providers, and (iv) any other extraordinary expenses (such as expenses relating to litigation).

The Private Fund will also pay certain additional fund-specific expenses, including partnership organizational expenses; investment expenses such as research fees and expenses; interest on indebtedness; borrowing charges on securities sold short; custodial fees; bank service fees; partnership-related insurance costs (including D&O and E&O insurance); and any other expenses related to the purchase, sale or transmittal of Partnership assets.

See Item 12 which describes F-Squared's brokerage practices and the process for reviewing and selecting a broker-dealer for Advisory Service clients' transactions in applicable situations.

### ***Prepayment of Fees***

Where an Advisory Services client is required to pay F-Squared's fees in advance, F-Squared will refund a prepaid fee in the event an advisory contract is terminated or a withdrawal is made from an account before the end of a billing period.

### ***Compensation for Sales of Securities or other Investment Products***

F-Squared employees that sell AlphaSector Indexes to Index Provider Service clients and/or Strategies to Advisory Services clients receive additional compensation from F-Squared. F-Squared pays this additional compensation from the management fee received from the client; it is not an additional charge that the client bears. This compensation practice could present a conflict of interest in that it gives the employee an incentive to recommend the Index and/or the Strategy based on the compensation received, rather than on a client's needs. It is important to note, however, that the employees do not sell other products to the clients. Further, clients do not have the option to purchase the AlphaSector Indexes and Strategies from other agents unaffiliated with F-Squared.

## **Item 6: Performance-Based Fees and Side-By-Side Management**

As discussed above in Item 5, a direct wholly owned subsidiary of F-Squared receives a performance-based fee for its work as general partner to the Private Fund. In addition, F-Squared serves as an investment adviser to a mutual fund account (an Index Provider Services client) for which it receives a performance-based fee. F-Squared believes that its clients are best served by the combined expertise and operational efficiencies of a central trading desk responsible for the trading activities of F-Squared and its affiliates. The potential for F-Squared and its affiliates to receive different levels of compensation from its clients creates a potential conflict of interest with respect to the allocation of investment opportunities, because F-Squared and its affiliates may have an incentive to allocate investments or trades in favor of the client that pays a more favorable performance fee.

F-Squared believes that this potential conflict is largely mitigated through the nature of the Advisory Services it provides. The AlphaSector Indexes are generated through quantitative models, and the client portfolios managed by F-Squared invest primarily in a limited universe of publicly-traded ETFs. Additionally, F-Squared's quantitative models that generate the investment decisions for accounts which F-Squared receives performance fees, and the models that generate the investment decisions for accounts which F-Squared and affiliates do not receive performance fees, operate independently of each other. As such, the opportunities for F-Squared to favor one client over another are relatively limited. Moreover, F-Squared only has investment discretion with respect to the Private Fund. In addition, the Private Fund has different investment objectives and strategies than the mutual fund account and is not vying for the same set of investments at the same time. Nevertheless, it is F-Squared's policy to prohibit front-running of trades in performance fee-based accounts by applying the model decisions intended for non-performance fee-based accounts. F-Squared performs periodic monitoring of performance fee-based accounts in its effort to ensure compliance with this policy.

To further mitigate the potential conflict of interest, F-Squared maintains a Trade Allocation and Aggregation of Orders Policy, which is designed to ensure the equitable allocation of investment opportunity among all clients. It is F-Squared's policy to allocate trades fairly and not favor certain performance-based or other client accounts, both in terms of times traded or with investment opportunities deemed to be limited in supply. In addition, F-Squared prohibits allocating profitable or unprofitable trades that would disproportionately favor certain clients or accounts. F-Squared may not manage a proprietary account in a favorable manner over client accounts. If investments are deemed to be in limited supply resulting in partial allocations, F-Squared allocates trades on a pro rata basis based upon order size. In the interest of efficient and effective execution, each F-Squared trade desk aggregates multiple client accounts' trade orders for the same security as one or more "block" trades. All transaction costs are shared by each participating account on a "pro rata" basis, based on each account's participation in the trade. To ensure compliance with this Policy, on a periodic basis F-Squared runs a test designed to identify trade executions that may have been excluded from the "block" order on the same day, for the same security and transaction side. Any deviations from the Policy must be flagged for Compliance, and documentation must be supplied to support why the trade order(s) were excluded from the accompanying block order on the same day.

It is also F-Squared's policy to review trade execution practices at a minimum on a quarterly basis. F-Squared maintains a Trade Management Oversight Committee (TMOC) to review, amongst other things, the trade execution quality obtained on behalf of the firm's clients, executing broker relationships, and the results from testing for compliance with F-Squared's Trading Policies. TMOC meeting documentation is maintained by F-Squared's Compliance team.

## **Item 7: Types of Clients**

### ***Index Provider Services***

F-Squared may provide Index Provider Services to third party unaffiliated entities, including investment advisers and mutual funds. F-Squared may have requirements for entering into an index provider relationship, including limiting the provision of Index Provider Services related to Indexes using leverage or shorting to Qualified Clients, as provided in Rule 205-3 of the Investment Advisers Act of 1940.

### ***Advisory Services***

F-Squared provides Advisory Services to the Private Fund. Investors in the Fund include individuals, trusts, and other types of business entities. The minimum investment in the Private Fund is \$5,000,000. However, F-Squared reserves the right to waive the minimum investment requirement in its sole discretion.

## **Item 8: Method of Analysis, Investment Strategies and Risk of Loss**

### ***Method of Analysis***

The AlphaSector Indexes are generally based on sector rotation strategies that seek to provide downside protection in falling markets and upside participation in rising markets. Each AlphaSector Index utilizes clearly defined portfolio construction rules and a proprietary quantitative model for investment decision-making in various ETFs or equivalent baskets of securities. The critical process, executed on a monthly or weekly cycle within each strategy, is the model's decision to include or exclude each of the sector- or geographic region-based ETFs. The decisions are generated through a sophisticated analytical engine that evaluates volatility and price trends. This output is a binary decision. If a sector receives a positive signal for investing, it is included. If a sector receives a negative signal, it is removed. A customized version of this process is applied to each of the AlphaSector Indexes. In each case, the algorithm is designed to address risk while providing exposure to normal, rising markets. Each Index has the flexibility to reduce risk on an incremental base or to reposition more dramatically, partly or wholly to a cash alternative ETF if suggested by the model.

### ***Investment Strategies***

#### **Long/Short Strategy**

The investment objective of the Long/Short Strategy is to provide both long and short exposure to the U.S. Equity asset class. Utilizing F-Squared's proprietary Model, the Long/Short Strategy employs a systematic approach to construct a portfolio of ETFs with varying degrees of exposure. The portfolios are rebalanced to weight toward those ETFs that are priced at the largest discount for long positions and those that are priced at the largest premium for short positions, as determined by the Model. The objective is to achieve capital appreciation through both long and short investments in ETFs. The Model identifies industry sectors that are predicted to have positive or negative price movement, and the Strategy portfolio will be positioned with long and short sector exposures accordingly. The portfolio also uses dynamic leverage to seek to increase long exposure when the Model predicts that a majority of the sectors will have positive performance.

The portfolio also utilizes a proprietary methodology which seeks to remove all short exposure in the Strategy portfolio when the market is predicted to rebound.

The portfolio also utilizes a proprietary technology to filter out weak long and short signals from the Model, allowing the portfolio to maintain neutral positions with respect to certain sectors as identified by the Model.



## ***Risk of Loss***

All investments in securities include a risk of loss that clients should be prepared to bear.

The principal risks of the AlphaSector Indexes and Strategies are as follows:

- *Market Risk:* The risk that the value of the securities in which the Strategies invest may drop in reaction to tangible and intangible events and conditions, independent of a security's particular underlying circumstances. For example, political, economic, and social conditions may cause a change in the value of the securities. Price changes may be temporary or may last for extended periods.
- *Equity Securities Risk:* The risk that events or circumstances at a particular industry, or a particular company within an industry will impact the value of the stocks and ETFs held by the Strategy and thus, the value of an investment over short or extended periods.
- *Interest-Rate Risk:* The risk that fluctuations in interest rates may cause investment prices to fluctuate and impact the value of fixed income securities or ETFs held by the Strategy. For example, when interest rates rise, yields on existing bonds become less attractive causing their market values to decline.
- *Credit Risk:* The risk that a fixed income security issuer will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that fixed income security to decline.
- *ETF Risk:* The risk that the value of an ETF in which a Strategy invests will be more volatile than the underlying portfolio of securities the ETF is designed to track, or that the costs to the fund of owning shares of the ETF will exceed those the fund would incur by investing in such securities directly.
- *Leveraged and Inverse ETF Risk:* For some of its Strategies, F-Squared may invest in "leveraged" or "inverse" ETFs. Leveraged ETFs use borrowed capital to increase their buying power and magnify their investment returns. Although the use of leverage may increase returns in times when investment performance is positive, leverage can also magnify losses in times when investment performance is negative. Inverse ETFs use a variety of investment techniques (such as short sales, buying put options or selling futures) to gain short exposure to the securities markets by moving in the opposite direction to the index or other benchmark the inverse ETF is based on. Inverse ETFs may also be leveraged. The use of these leveraged and inverse ETFs in some of F-Squared's Strategies may increase the volatility of these Strategies and the risk that a client may suffer a significant loss.
- *Sector Concentration Risk:* The risk that events negatively affecting an industry or market sector in which the Strategy invests will cause the overall value of the Strategy to decline. To the extent that some of the Strategies invest significant portions of their portfolio in ETFs representing particular markets or sectors (such as Energy, Healthcare, Real Estate, etc.) or in an ETF representing U.S. Treasuries, the Strategy is more vulnerable to conditions that negatively affect such sectors as compared to an investment strategy that is not significantly invested in such sectors.

- *Turnover Risk:* The risk that frequent trading will result in increased brokerage and other transaction-related costs, as well as less favorable tax treatment of short-term capital gains that can negatively impact an investor's overall investment as compared to investments in strategies with low turnover.
- *U.S. Government Securities Risk:* The risk that U.S. Government securities in a Strategy will be subject to price fluctuations, or that an agency or instrumentality will default on an obligation not backed by the full faith and credit of the United States.
- *Quantitative Risk:* The risk that the effectiveness of the quantitative model used for the strategy can dissipate over time as similar Strategies are adopted and as the market becomes more efficiently priced.
- *Input Data Risk:* The risk that the information and data supplied by third party vendors ("Data") is subject to input and quality errors. F-Squared's quantitative models depend on the accuracy and reliability of Data supplied by third party vendors, and the quantitative models may not function properly if Data proves to be incorrect or incomplete, or is input incorrectly.
- *Programming / Modeling Risk:* F-Squared's research and modeling process is extremely complex and the results of that process must then be translated into computer code. Although F-Squared seeks to hire individuals skilled in each of these functions and to provide appropriate levels of oversight, the complexity of the individual tasks, the difficulty of integrating such tasks, and the limited ability to perform "real world" testing of the end product raises the chances that the finished model may contain an error; one or more of such errors could adversely affect a client's portfolio.
- *System Risk:* F-Squared relies extensively on computer programs and systems in its proprietary modeling to evaluate securities, to monitor its portfolio, and to generate reports that are critical to oversight of its activities. In addition, certain systems are operated by third parties, including counterparties and service providers. F-Squared may not always be in the best position to verify the risks or reliability of such third-party systems. These programs or systems, whether operated by a third party or not, may be subject to certain defects, failures or interruptions, including, but not limited to, those caused by computer "worms," viruses and power failures. Any such defect or failure could have a material adverse effect on F-Squared's activities. For example, such failures could cause settlement of trades to fail, lead to inaccurate accounting, recording or processing of trades, and cause inaccurate reports, which may affect F-Squared's ability to monitor its investment portfolios and its risks.
- *Operational Risk:* F-Squared has developed systems and procedures to control operational risk. Operational risks arising from mistakes made in the trading confirmation or settlement of transactions, from transactions not being properly booked, evaluated or accounted for or other similar disruption in F-Squared's operations may cause F-Squared to suffer financial loss; the disruption of its business; liability to Clients or third parties; regulatory intervention; or reputational damage. F-Squared relies heavily on its financial, accounting and other data processing systems.

- *Swaps and Derivatives Risk:* F-Squared may make use of swaps and other forms of derivative contracts. In general, a derivative contract (including options) typically involves leverage, i.e., it provides exposure to potential gain or loss from a change in the level of the market price of a security, currency or commodity (or a basket or index) in a notional amount that exceeds the amount of cash or assets required to establish or maintain the derivative contract. Consequently, an adverse change in the relevant price level can result in a loss of capital that is more exaggerated than would have resulted from an investment that did not involve the use of leverage inherent in the derivative contract. Depending on the Strategy, many of the derivative contracts used by F-Squared may be privately negotiated in the over-the-counter market. These contracts also involve exposure to credit risk, since contract performance depends in part on the financial condition of the counterparty or the counterparty's guarantor. These transactions may also involve significant transaction costs and may expose a portfolio to counterparty risk.
- *Short Selling Risk:* A short sale involves the sale of a security that a portfolio does not own in the expectation of purchasing the same security (or a security exchangeable therefore) at a later date at a lower price. To make delivery to the buyer, the portfolio must borrow the security, and the portfolio is obligated to return the security to the lender, which is accomplished by a later purchase of the security by the portfolio. In some cases, the lender may rescind the loan of securities and cause the borrower to repurchase shares at inflated prices, resulting in a loss. When a portfolio makes a short sale in the United States, it must leave the proceeds with the broker and it must also deposit with the broker an amount of cash or marketable securities sufficient under current margin regulations to collateralize its obligation to replace the borrowed securities that have been sold. If short sales are affected on a foreign exchange, such transactions will be governed by local law. A short sale involves the risk of a theoretically unlimited increase in the market price of the security. The extent to which a portfolio will engage in short sales depends upon the particular Strategy and perception of market direction. In addition, global regulatory prohibitions on short sales may impair F-Squared's ability to implement its investment process. Bans may add additional constraints to a Strategy, which may increase transaction costs as well as the time required to monitor compliance with the restrictions.
- *Leverage Risk:* Certain Strategies utilize varying amounts of leverage, which involves the borrowing of funds and may also be embedded in financial instruments, including short sales, over-the-counter derivatives, options, swaps, and forwards, which enable investors to gain exposure to assets whose value exceeds the amount of capital necessary to obtain such exposure. The use of leverage allows F-Squared to increase its exposure to assets, such that total assets may be greater than capital invested. However, the use of leverage may also magnify the volatility – or the likelihood of short-term changes in value – of any portfolio. The effect of the use of leverage in a portfolio may result in losses to the portfolio that exceed losses to the portfolio if such portfolio did not utilize leverage.

## Item 9: Disciplinary Information

On December 22, 2014, pursuant to an offer of settlement proffered by F-Squared Investments, Inc. ("F-Squared Investments"), an affiliate of F-Squared, the SEC issued an administrative order (the "Order") against F-Squared Investments. In the Order, F-Squared Investments admits to certain findings of fact set forth in the Order, and acknowledges that it violated certain federal securities laws in connection with F-Squared's use of marketing materials advertising the performance of the AlphaSector Indexes for

the period April 2001 to September 2008. The performance track records for this period were removed from all of F-Squared Investments' advertising and marketing materials in October 2013.

F-Squared Investments and its former CEO calculated the index performance track record for the period from April 2001 through September 2008 based on buy and sell signals F-Squared Investments acquired in September 2008 from a data provider that was related to a private wealth adviser. Certain of F-Squared Investments' advertisements stated that the signals had been used by the private wealth adviser to make investment decisions for private client accounts from April 2001 to September 2008. F-Squared Investments converted the signals it acquired into an index performance track record by applying index construction rules. The Order finds that the advertising materials were inaccurate because the private wealth adviser did not use the signals before October 2008 to manage actual client assets and because a performance calculation error in the index conversion resulted in a material overstatement of the historical index performance. The Order censured F-Squared Investments and required F-Squared Investments to cease and desist from violating the federal securities laws in the future. F-Squared Investments was also required to disgorge \$30 million, pay a civil monetary penalty of \$5 million, and undertake to continue to retain an independent compliance consultant it voluntarily hired at the beginning of 2014, and to implement the independent compliance consultant's recommendations.

The Order resolves the SEC's investigation with respect to F-Squared Investments.

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

### ***Broker-Dealer Affiliations***

Neither F-Squared nor any of its management persons is registered or has an application pending to register as a broker-dealer.

### ***Futures/Commodities Affiliations***

Neither F-Squared nor any of its management persons is registered, or has an application pending to register, as a futures commission merchant, commodity pool operator, commodity trading advisor, or an associated person of the foregoing entities.

### ***Investment Company Affiliations***

F-Squared and certain affiliates serve as a sub-adviser to several mutual funds managed by unaffiliated investment advisers. For its services, F-Squared receives a fee based on a percentage of the applicable fund's net assets.

### ***Investment Adviser Affiliations***

F-Squared is a subsidiary of F-Squared Investment Management, LLC. Other registered investment adviser subsidiaries of F-Squared Investment Management, LLC include F-Squared Investments, Inc., F-Squared Retirement Solutions, LLC, F-Squared Alternative Investments, LLC, and F-Squared Capital, LLC. F-Squared does not recommend or select any of the above affiliates, or any other investment adviser, for its clients.

### ***ETF Providers***

As noted above, a key element of F-Squared's investment strategy involves investing in ETFs. F-Squared maintains significant relationships with ETF providers by virtue of trading their instruments or advising clients to trade their instruments. These relationships create potential conflicts of interest to the extent that F-Squared may be incented to invest client assets in one provider's ETFs over another's for reasons unrelated to the best interests of F-Squared's clients. F-Squared seeks to mitigate this conflict through internal policy requiring documented review and approval, prior to the use of any ETF in F-Squared's Strategies, by the voting body of F-Squared's Investment Committee.

### ***Pooled Investment Vehicle Affiliations***

A wholly-owned subsidiary of F-Squared serves as a general partner to the Private Fund, and may service as general partner to additional private funds in the future. For its services, F-Squared receives a fee based on a percentage of the fund's net assets, and an affiliate of F-Squared may receive performance fees based on different rates, performance targets or other terms and conditions.

## **Item 11: Code of Ethics, Participation in Client Transactions and Personal Trading**

F-Squared has adopted a Code of Ethics (the "Code") which sets forth high ethical standards of business conduct for our employees and governs a number of potential conflicts of interest that we may encounter when providing investment advisory services. The Code is based on the principle that F-Squared owes a fiduciary duty to the investors for which we serve as an adviser. In adherence with the Code, F-Squared and its employees must avoid activities, interests and relationships that might interfere or appear to interfere with making decisions in the best interests of our clients. The Code seeks to place the interests of F-Squared clients over the interests of the firm and any of its employees, and to comply with the applicable Federal securities laws and other applicable law.

F-Squared distributes the Code to each employee at the time of hire and annually thereafter. Each employee is required to sign the Code acknowledging that they have read, understand, and will abide by the Code and its requirements. All employees receive training and are monitored for compliance with the Code.

F-Squared will provide a copy of our Code to any client or prospective client upon request.

Our Code includes, but is not limited to the following:

- Requirements on fiduciary duty
- Prohibitions on the acceptance of gifts and entertainment that exceed our policy standards
- Prohibitions on insider trading and communication of material non-public information
- Requirements on the handling of confidential information
- Requirements for pre-clearance of employees' personal securities transactions
- Identification and pre-clearance requirements on accounts where employees have beneficial interest
- Requirements for reporting applicable personal securities transactions

## ***Personal Securities Transactions Requirements***

All Access Persons (any employee of F-Squared and affiliated entities) may not engage, and may not permit any other person or entity to engage, in any purchase or sale of a Covered Security (defined as all securities other than Exempt Securities set forth below) in which such Access Person has, or by reason of the transaction will acquire any Beneficial Ownership (direct or indirect pecuniary interest), unless (i) the transaction is an Exempt Security (as defined below) or (ii) he/she has have complied with the provisions set forth below.

### ***Pre-clearance***

Access Persons must seek to obtain pre-clearance trading approval from the Chief Compliance Officer or designee to purchase or sell any Covered Security which has been placed on the “Restricted List” or the “Pre-Clearance List” for which the person has or will have by reason of the trade a Beneficial Ownership and that F-Squared actively engages in trading in, provides advisory services with respect to or performs research on such Covered Security.

In addition, Access Persons must seek to obtain pre-clearance trading approval from the Chief Compliance Officer or designee before directly or indirectly acquiring beneficial ownership in any security in an initial public offering or in a limited offering.

Finally, all employees of F-Squared are required to receive pre-clearance trading approval from the Chief Compliance Officer or designee to purchase or sell any security placed on the “Pre-Clearance List” or the “Restricted List.”

### ***Exempt Securities***

Access Persons are required to report all transactions in Covered Securities. The following are generally not considered Covered Securities:

- Direct obligations of the Government of the United States;
- Bankers’ acceptances, bank certificates of deposit, commercial paper and high quality short-term debt instruments, including repurchase agreements;
- Shares issued by money market funds;
- Shares issued by open-end funds except Reportable Funds (any Fund for which F-Squared serves as investment adviser or any fund whose investment adviser controls, is controlled by, or is under common control with F-Squared).

## **Item 12: Brokerage Practices**

### ***Index Provider Services***

Brokerage practices are not applicable with respect to F-Squared’s Index Provider Services.

### ***Advisory Services***

For Advisory Services clients, F-Squared is responsible for selecting broker-dealers to execute the trading of underlying securities. In those circumstances, F-Squared will use its best efforts to select a broker-dealer that F-Squared believes will provide the best services at competitive commission rates. When

reviewing a brokerage firm and the services they provide, our assessment includes, but is not limited to the following:

- Reputation/Stability of brokerage firm
- Ability to execute trades in a timely and efficient manner
- Ability to interface with client's custodian bank
- Competitive commission rates

F-Squared does not receive research or other products or services other than execution from a broker-dealer or a third party in connection with client securities transactions.

F-Squared will at all times seek to achieve best execution. F-Squared may utilize "step-out" trades if it believes such trades will help to obtain best execution. Step-out trades are trades in which a broker-dealer executes an order, but agrees to allocate the order for clearance and settlement by another broker-dealer. The executing broker-dealer clears and settles the portion of the order not stepped out, and may add a charge to the overall cost of the trade. Step-out trades may benefit clients by allowing F-Squared to find liquidity and execute trades with natural buyers and sellers on terms more favorable than might otherwise be available in the market. Trade confirmations with respect to "step-out" trades may reflect, within the price per share, applicable commission costs instead of reflecting this as a separate line item on the confirmation.

F-Squared does not consider, in selecting broker-dealers, whether it or one of its related persons receives client referrals from a broker-dealer or a third party. In addition, F-Squared does not routinely recommend, request or require that a client direct it to execute transactions through a specified broker-dealer nor does it permit a client to direct brokerage.

As stated previously, in the interest of efficient and effective execution, F-Squared aggregates multiple client accounts' trade orders placed by its separate trading desks for the same security as one or more "block" trades. All transaction costs are shared by each participating account on a "pro rata" basis, based on each account's participation in the trade.

## **Item 13: Review of Accounts**

Advisory Services accounts will be reviewed quarterly to help ensure that all transactions are in accordance with their Strategy. Accounts will also be reviewed by traders and operations staff on a daily basis and after any trading activity to help ensure proper trade execution and settlement. These accounts receive confirmation of activity reports post any trading activity and receive unaudited account statements on a quarterly and annual basis. The Co-Chair of the Investment Committee, the Chief Operating Officer, Chief Financial Officer, Chief Compliance Officer, and/or SVP of Operations conduct(s) the quarterly account reviews.

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

F-Squared does not receive cash or another economic benefit from someone other than the client in connection with its provision of advisory services to the client. In addition, F-Squared does not compensate any person (other than a supervised person) for client referrals to F-Squared. That said, F-Squared may, in the future, enter into such a compensation arrangement for client referrals and will comply with Rule 206(4)-3 under the Investment Advisers Act of 1940 to the extent such Rule applies to the arrangement.

## **Item 15: Custody**

F-Squared is deemed to have custody of the securities and other assets in the Private Fund because a related person of F Squared serves as the general partner of the Private Fund. F-Squared has established an account with the following qualified custodian to hold funds and securities on behalf of the Private Fund: Morgan Stanley & Co., LLC. In addition, audited financial statements for the Fund are prepared on an annual basis and delivered to investors in the Private Fund within 120 days of its fiscal year end.

## **Item 16: Investment Discretion**

### ***Index Provider Services***

F-Squared does not have investment discretion or manage client assets in connection with its Index Provider Services.

### ***Advisory Services***

F-Squared provides its Advisory Services on a discretionary basis. Before F-Squared can exercise discretion with respect to a client's assets, the client and F-Squared must execute an investment advisory agreement that contains a power of attorney granting F-Squared discretionary authority of the account's assets. The client, by selecting a particular Strategy, effectively limits F-Squared's discretionary authority to investment decisions that are in line with that Strategy.

## **Item 17: Voting Client Securities**

### ***Index Provider Services***

Proxy voting is not applicable to F-Squared's Index Provider Services business.

### ***Advisory Services***

The Private Fund invests exclusively in ETFs. Voting authority for all corporate actions of underlying security holdings of the ETF remain with the ETF provider. In rare instances where the actual ETF has a corporate action, the voting authority will remain with F-Squared and F-Squared will vote in accordance with its proxy voting policies and procedures.

Except when a client has retained proxy voting authority, F-Squared will vote proxies relating to securities held in Advisory Services client portfolios in accordance with its proxy voting policies and procedures. The proxy voting policies and procedures are designed and implemented in a way that is reasonably expected to ensure that proxies are voted in the economic best interests of clients. Material conflicts between F-Squared and the client in the voting of proxies are resolved in the best interest of the client.

Clients may receive a copy of these proxy voting policies and procedures upon request. Clients may also contact us at 866-288-7657 with any questions relating to how we voted their securities or how we may vote their securities in the future.

In cases where F-Squared does not have authority to vote client securities, proxies or other solicitations will generally be received by the client directly from the custodian or transfer agent. Clients are encouraged to contact their SMA platform manager or investment adviser or custodian with questions



related to proxies and solicitations. If clients need further assistance with this process, they may contact F-Squared at 866-288-7657 with any questions related.

## **Item 18: Financial Information**

On July 8, 2015, the Firm filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code in conjunction with a Section 363 asset sale. See *In re F Squared Investments, Inc.*, Case No. 15-11469 (petition filed in the United States Bankruptcy Court for the District of Delaware).

F-Squared is seeking Court authorization to pursue the sale process on an expedited basis under Section 363 of the U.S. Bankruptcy Code. The proposed agreement with Broadmeadow Capital contemplates a Court-supervised auction process, which is designed to achieve the highest or otherwise best offer for the Company's assets. The agreement with Broadmeadow Capital sets the floor, or minimum acceptable bid, and is subject to Bankruptcy Court approval and certain other conditions. A final sale approval hearing is anticipated to take place shortly after the auction with the anticipated closing contingent on the approval of the Court and the consent of F-Squared's clients.

In addition, as of May 31, 2015, F-Squared and its affiliated registered investment adviser entities maintained over \$7.4 billion in assets under management or maintained by unaffiliated third parties pursuant to F-Squared's Index Provider Services.

As a result of the above, F-Squared has reduced its number of employees as needed.