



**HEARTLAND ADVISORS**  
AMERICA'S VALUE INVESTOR®

# **BROCHURE (ADV PART II)**

March 13, 2014

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This Brochure provides information about the qualifications and business practices of Heartland Advisors, Inc. If you have any questions about the contents of this Brochure, please contact us at 414-347-7777. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (SEC) or by any state securities authority.

Additional information about Heartland Advisors, Inc. is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Registration as an investment adviser with the SEC does not imply a certain level of skill or training.

**Item 2: MATERIAL CHANGES**

There were no material changes to the last version of Heartland Advisors, Inc.'s last brochure dated October 1, 2013.

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#### Item 4: ADVISORY BUSINESS

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Heartland Advisors, Inc. (“Heartland”) is an investment advisory Firm that provides investment management services to separate account clients, mutual fund portfolios, and other advisors. Heartland’s predecessor was organized in 1983 in Wisconsin as an investment advisory subsidiary of a regional brokerage firm, The Milwaukee Company, owned in part by William (“Bill”) J. Nasgovitz. In 1984, Mr. Nasgovitz purchased a majority interest of the investment advisory subsidiary from his partners and started managing Heartland’s first mutual fund, the Heartland Value Fund. In 1988, Mr. Nasgovitz and his partners sold The Milwaukee Company to Dain Bosworth, and in the same transaction Mr. Nasgovitz acquired the remaining shares of the investment advisory subsidiary and changed its name to Heartland Advisors, Inc. In 2000, Heartland was reorganized into a wholly owned subsidiary of Heartland Holdings, Inc., but remains an independent Firm 100% owned by its employees, with Mr. Nasgovitz as the principal shareholder.

Heartland’s advisory services are typically provided on a discretionary basis. From time to time, Heartland may manage client accounts on a non-discretionary basis or provide non-discretionary services to clients, such as banks, broker-dealers, or other financial intermediaries, using a model portfolio based on one of its strategies. Heartland’s discretionary investment authority may be limited by conditions imposed by clients in their stated investment objectives or guidelines, or by other instructions provided to Heartland. Heartland generally requires that all clients approve the investment objectives and restrictions applicable to their account by agreeing to the guidelines applicable to a particular strategy or by providing special instructions. Please see *Item 16: Investment Discretion* for more information on how Heartland tailors its services to the individual needs of its clients.

Heartland uses a composite to report performance, which contains multiple portfolio managers who manage client portfolios in a similar investment strategy. Within the composite, some portfolios may be managed more or less conservatively subject to individual client restrictions. In addition, the management style of these managers may differ, which may result in performance differences between portfolios in the same composite.

Heartland may also provide investment management services through programs sponsored by unaffiliated broker/dealers or other financial intermediaries (“Program Sponsors”) that typically offer a combination of brokerage, custody, and investment advisory services (“wrap programs”) to various clients. In other cases, Heartland may provide a model portfolio to Program Sponsors who then execute trades on behalf of the program clients. For model Program Sponsors clients, Heartland is not responsible for trade execution, trade timing, broker selection, recordkeeping, or any other aspects of client service. In the wrap programs, the client may enter into an investment advisory agreement with the Program Sponsor, and in turn, the Program Sponsor may enter into a sub-advisory agreement or other arrangement with Heartland. Heartland generally is paid a portion of the combined program fee by the Program Sponsor. The fees paid to Heartland may vary from the schedule of fees stated in *Item 5: Fees and Compensation* and between different wrap or model portfolio programs. In addition, clients participating in a wrap or model portfolio program may not be subject to Heartland’s minimum account size that may otherwise apply to other separately managed accounts.

Clients participating in a wrap program, generally with assistance from the Program Sponsor, select Heartland to provide investment advisory services to their account (or a portion thereof), subject to the oversight of the Program Sponsor. In determining the suitability of Heartland’s investment management style selected by a wrap program client to the individual needs and financial situation of such client, Heartland relies on the information regarding each prospective client that is provided to Heartland by the Program Sponsor. Ordinarily, a wrap program arrangement may be terminated by the Program Sponsor, the client, or by Heartland. Wrap programs that Heartland currently participates in are identified in Heartland’s Form ADV Part 1A.

As of December 31, 2013 Heartland managed \$6,056,191,759 in client assets on a discretionary basis and \$0 in client assets on a non-discretionary basis.

## Item 5: FEES AND COMPENSATION

Heartland's current standard fee schedule for separately managed accounts is based on a percent of assets under management, as follows:

		Account Size	Annual Rate
<b>Small Cap Value Strategy</b>	First	\$ 5,000,000	1.00%
	Next	10,000,000	0.85
	Above	15,000,000	negotiable
<b>Small Cap Value Plus Strategy</b>	First	\$ 5,000,000	1.00%
	Next	10,000,000	0.85
	Above	15,000,000	negotiable
<b>Opportunistic Value Equity Strategy (Also known as the Multi Cap Relative Value Strategy)</b>	First	\$ 5,000,000	1.00%
	Next	10,000,000	0.85
	Above	15,000,000	negotiable
<b>Mid Cap Value Strategy</b>	First	\$ 5,000,000	1.00%
	Next	10,000,000	0.85
	Above	15,000,000	negotiable
<b>Core Plus Strategy</b>	First	\$ 10,000,000	0.75%
	Next	15,000,000	0.50
	Above	25,000,000	negotiable

From time to time, Heartland has had other fee schedules, which provide for fees that were higher or lower than those currently in effect. As new fee schedules were put into effect, they were generally only made applicable to new clients and the fee schedule applicable to any existing client was generally not affected by the new schedules. Therefore, some clients pay different fees than those shown above.

At its discretion, Heartland may negotiate fees with a particular client, on an account of any size depending upon certain factors, including, but not limited to, investment objectives, investment restrictions, the nature and extent of the relationship with the client and other business factors. The fees noted above may be waived or reduced when, for example, a new account is expected to grow rapidly in size, a relationship exists with a current client of Heartland, or for other reasons at Heartland's discretion.

Heartland also provides investment advisory services to wrap fee and model portfolio programs offered by Program Sponsors. Fees and features of each program will vary and fees for Heartland's services may be less than the fee schedule set forth above.

Fees are generally payable monthly or quarterly after services are rendered, based on a valuation of the account at the end of the period, as provided in the advisory agreement. Assets of related accounts may be aggregated to determine if a lower fee applies. Heartland generally does not allow clients to prepay fees. In addition, fees may be billed to the client or deducted directly from the client account, depending on the client's preference.

The client or Heartland may terminate any advisory contract upon 30 days' prior written notice. In the event of termination, any fees outstanding are charged on a pro-rata basis based on the number of days that the account was open during the applicable period. In circumstances where prepaid or unapplied fees exist, such fees will be refunded to the client. Termination of an advisory agreement will not affect transactions that Heartland has initiated on the client's behalf prior to the effective date of such termination.

Clients may incur additional fees outside of what Heartland charges, including but not limited to, custodian, brokerage, and transaction costs. For more information on these types of fees, please see *Item 12: Brokerage Practices*.

Heartland also provides investment management services for an open-end registered investment company, Heartland Group, Inc. and its underlying series funds (the "HGI Funds" or "Mutual Funds").

The Mutual Funds and management fees charged to each Mutual Fund are described in each Mutual Fund's prospectus. The management fees charged are also summarized below.

Heartland Select Value Fund (a series of HGI Funds)

- 0.75% on the average daily net assets up to \$1 billion; and
- 0.70% on the average daily net assets in excess of \$1 billion

Heartland Value Plus Fund (a series of HGI Funds)

- 0.70% on the average daily net assets

Heartland Value Fund (a series of HGI Funds)

- 0.75% on the average daily net assets

Heartland International Value Fund (a series of HGI Funds)

- 0.85% on the average daily net assets

Heartland also acts as a subadvisor to a sub-portfolio of the Clearwater Core Equity Fund (hereinafter included in the defined term, the "Mutual Funds"), a series of another open-end registered investment company, for which it receives an annual fee (paid monthly by the Clearwater Core Equity Fund's advisor) based on the average daily net assets of the portion of the Clearwater Core Equity Fund it advises.

When Heartland determines to invest part or all of a discretionary account in a Mutual Fund, the account will pay the Mutual Fund fees and expenses, but not Heartland's investment management fee as described in the fee schedule listed above for that portion of the account invested in the Mutual Fund. Heartland may also invest in unaffiliated open-end and closed-end funds, unit investment trusts, exchange-traded funds ("ETFs"), or similar investments on behalf of client accounts. Clients whose assets are invested in such securities will pay both a direct fee to Heartland and the proportionate share of the fund's expenses, including the investment management fees to the fund's investment advisor. Please refer to the respective fund's prospectus for more information. See *Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading* for more information regarding Heartland's participation in such transactions.

Other than advisory fees disclosed above, neither Heartland nor its supervised persons receive compensation from clients for the sale of securities or other investment products.

Please see *Item 6: Performance-Based Fees & Side-by-Side Management* for information regarding performance fees.

## **Item 6: PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

From time to time, clients may pay Heartland for services by means of a combination of performance and asset-based fees as permitted by applicable federal and state regulations, including SEC Rule 205-3. Performance fee arrangements may create an incentive for Heartland to make investments that are riskier or more speculative than would be the case in the absence of a performance fee. In addition, performance fee arrangements may create an incentive for Heartland to favor those accounts in the timing of trades, security selection, or similar methods. Also, Heartland may receive increased compensation with regard to unrealized appreciation as well as realized gains. Heartland has established procedures reasonably designed to address such conflicts; these include, but are not limited to, compliance review of account documentation, Brokerage Committee review of trade rotation procedures and audits, and Investment Policy Committee review of account performance.

## **Item 7: TYPES OF CLIENTS**

Heartland generally provides investment advice to clients such as individuals, institutions, trusts, estates and charitable organizations, corporations and other business entities, pensions and profit sharing plans, and investment companies.

Heartland may also provide investment advice to banks, broker-dealers, or other financial intermediaries using a model portfolio based on one of its strategies.

Heartland generally does not accept new accounts of less than \$1,000,000 for the Small Cap Value Strategy, Small Cap Value Plus Strategy, and the Mid Cap Value Strategy and \$500,000 for the Opportunistic Value Equity Strategy and the Core Plus Strategy.

Strategy	Account Minimum
Small Cap Value	\$ 1,000,000
Small Cap Value Plus	1,000,000
Mid Cap Value	1,000,000
Opportunistic Value Equity	500,000
Core Plus	500,000

At its discretion, Heartland may accept an account of any size depending upon certain factors, including, but not limited to, investment objectives, investment restrictions, the nature and extent of the relationship with the client, and other business factors.

In order to open an account with Heartland, a client must complete the proper paperwork and must appoint a qualified custodian, such as a bank, trust company, or broker-dealer, to custody the account's assets.

Heartland reserves the right, in its sole discretion, to decline any new account, or consistent with the applicable client's advisory agreement, to resign as investment advisor to an account after initiation of the investment advisory relationship.

## **Item 8: METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

### **Methods of Analysis**

Heartland's investment process relies upon fundamental research to actively select securities for client accounts. Heartland's investment team evaluates each security through a set of criteria known as Heartland's 10 Principles of Value Investing™. These criteria are designed to identify stocks that Heartland finds to be priced at a discount to their fundamental, intrinsic value and that are consistent with the "value" style of investing.

Heartland's investment team uses several methods to target securities for this in-depth fundamental analysis. For example, periodic screens of a relevant universe are used to identify securities that meet quantifiable aspects of the 10 Principles of Value Investing™. Ideas may be generated from industry conferences, trade journals, broker research, company disclosures or presentations and from discussions with company management, or other professionals. The investment team also develops ideas by monitoring macroeconomic, regulatory, and geopolitical developments.

All securities selected for purchase must weigh favorably, in totality, against the 10 Principles of Value Investing™, listed below:

1. Catalyst for recognition
2. Low price-to-earnings
3. Low price-to-cash flow
4. Low price-to-book value
5. Financial soundness
6. Positive earnings dynamics
7. Sound business strategy
8. Capable management and insider ownership
9. Value of the company
10. Positive technical analysis

These principles form the basis of Heartland's security research framework. Research is generated to fully support an analyst's rating on each of the ten criteria. This may include building analytical assessments of financial statements, projections or models, or subjective assessments of the quality of corporate management's business strategy and capability. Research is summarized into a 10-point grid, an output of the investment process that is used as a basis for discussion at research team meetings. All aspects of the investment thesis may be probed and challenged by members of the investment team. If the investment team believes a security is fundamentally attractive, it will be added to the watch list.

A security on the watch list is monitored on its stock price and its valuation relative to its peer group and its own history. If recent market conditions or developments are supportive, the portfolio manager may initiate a position in the security.

The investment team evaluates existing holdings against the same criteria used to evaluate purchases – the 10 Principles of Value Investing™. This framework allows the team to assess whether or not a security is still meeting the original investment thesis. Securities that no longer remain attractive are sold from the portfolio.

### Investment Strategies

Heartland, as part of its investment strategy in pursuing the investment objectives of its clients, may (but is not obligated to) use the ownership interest in a portfolio company to seek to change or influence control of the company's management. For example, Heartland may

- (a) actively support, oppose, or influence a company's decision-making;
- (b) seek changes in a company's management or board of directors;
- (c) effect the sale of all or some of a company's assets;
- (d) vote to participate in or oppose a takeover of a portfolio company or an acquisition by a portfolio company; or
- (e) serve as lead plaintiff in a matter related to a portfolio company.

Heartland would engage in such activities in an effort to protect and maximize the value of an investment on behalf of its clients when it deems such action to be appropriate. The extent to which Heartland may seek to change or influence control of management would depend, among other things, on facts and circumstances specific to the company, as well as general market conditions. Engaging in such activities would restrict Heartland's ability, on behalf of its clients, to engage in certain transactions with regard to the company's securities and could require additional regulatory filings.

### Risk of Loss

Investing in securities involves a risk of loss. Heartland does not offer any products or services that guarantee rates of return on investments for any time period to any client. All clients assume the risk that investment returns may be negative or below the rates of return of other investment advisors, market indices, or investment products.

Heartland primarily recommends common stocks defined by value-style characteristics. In certain limited circumstances, Heartland may also engage in transactions in financial futures contracts in connection with its investment management services. On occasion, when permissible in a client account, and only to a limited extent, Heartland may engage in covered call/put writing in connection with its investment management services. Options transactions will be used for the purpose of bona fide hedging or for income generation. Depending on a client's strategy, Heartland may also recommend fixed income securities.

There are some risks inherent in these types of securities:

#### *Common Stock Risk*

Common stocks are susceptible to market fluctuations and to volatile increases and decreases in value as investors' confidence in and perceptions of their issuers change. Investments in common stocks are subject to the risk that in the event of a company's liquidation, the holders of preferred stock and creditors will be paid in full before any payments are made to holders of common stock.

#### *Small-Cap Risk*

Investing in securities of small-cap companies generally involves a higher degree of risk than investing in securities of larger companies. The prices of securities of smaller companies are generally more volatile than those of larger companies, and they generally will have less market liquidity. These risks generally increase as the size of the company decreases.

#### *Value Investing Risk*

Value stocks can perform differently from the market as a whole and from other types of stocks. Value investments are subject to the risk that their intrinsic value may not be recognized by the broad market.

### *Foreign Investing Risk*

Foreign markets can be more volatile than the U.S. market due to increased risks of adverse political, social, regulatory, and economic developments. Foreign security prices can be affected by exchange rate and foreign currency fluctuations, less publicly available information, and different accounting, auditing, legal, and financial standards. Foreign investments may also be less liquid than investments in U.S. issuers. This risk may be heightened in emerging or developing markets.

### *Options and Futures Risk*

Successful use of options and futures depends upon Heartland's ability to predict movements of the overall securities markets, which requires different skills than predicting changes in the prices of individual securities. Heartland may be incorrect in its expectations as to the extent of market movements or the time span within which the movements take place, which, may result in the strategy being unsuccessful. Lack of a liquid secondary market for an option or future may result in losses to a client, as may premiums paid by Heartland on a transaction.

### *Fixed Income Risk*

Debt securities, such as notes and bonds, are subject to credit risk and interest rate risk. Credit risk is the possibility that an issuer of an instrument will be unable to make interest payments or repay principal when due. Changes in the financial strength of an issuer or changes in the credit rating of a security may affect its value. Interest rate risk is the risk that interest rates may increase, which tends to reduce the resale value of certain debt securities.

## **Item 9: DISCIPLINARY INFORMATION**

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The following legal proceedings have been resolved:

On January 25, 2008, Heartland, William J. Nasgovitz (Chairman of Heartland, President and a director of Heartland Group, Inc. (the "Funds") and a portfolio manager), Paul T. Beste (Chief Operating Officer of Heartland and Vice President and Assistant Secretary of the Funds), and Kevin D. Clark (Senior Vice President of Heartland) (Heartland, Nasgovitz, Beste, and Clark collectively referred to herein as the "Respondents") and certain others no longer associated with the Funds, reached a settlement with the SEC that resolved the issues resulting from the SEC's investigation of Heartland's pricing of certain bonds owned by the Heartland High-Yield Municipal Bond Fund and the Heartland Short Duration High-Yield Municipal Fund (collectively the "HY Bond Funds"), and Heartland's disclosures to the Funds' Board of Directors and investors concerning Heartland's efforts to evaluate bond issuers in connection with the operation of the HY Bond Funds during calendar year 2000. The Respondents do not admit or deny any wrongdoing and the settlement does not establish wrongdoing or liability for purposes of any other proceeding. The SEC's administrative order involves, among other things: (i) findings by the SEC that the Respondents violated certain

federal securities laws; (ii) a cease and desist order against the Respondents; (iii) a censure of the Respondents; (iv) payment by the Respondents of disgorgement of \$1; and (v) civil money penalties against the Respondents as follows: Heartland and Mr. Nasgovitz, jointly and severally, \$3.5 million; Mr. Beste, \$95,000; and Mr. Clark, \$25,000. In connection with this administrative settlement, the SEC's civil complaint against the Respondents was dismissed.

## **Item 10: OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

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Certain employees of Heartland are registered representatives of ALPS Distributors, Inc., an unaffiliated broker-dealer that acts as distributor for Heartland Group, Inc. (an open-end registered investment company), for which Heartland serves as investment advisor. These employees may offer such investment products to advisory clients of Heartland.

Without conceding that the registrant is a "related person" of the Mutual Funds, Heartland furnishes investment advice and certain administrative and compliance services to Heartland Group, Inc., an open-end investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act"). Certain of Heartland's executive officers and employees may also serve as officers or directors of Heartland Group, Inc., and Heartland pays the salaries, fees, and expenses of all Heartland Group, Inc.'s officers and those directors who are affiliated with Heartland. The officers and employees who serve in multiple capacities for Heartland and the HGI Funds at times may face inherent conflicts of interest in allocating their time and in serving the interest of the Firm's clients, fund shareholders, and Heartland's financial and other interests. However, Heartland monitors these conflicts through its Code of Ethics, Business Conduct Rules, and other policies and procedures, including oversight by HGI Funds' independent directors, to ensure that the interest of fund shareholders and clients are placed first. Please see *Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading* for more information.

## **Item 11: CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING**

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### **Code of Ethics and Personal Trading**

Heartland has adopted comprehensive Business Conduct Rules pursuant to SEC Rule 204A-1 and 17j-1 of the 1940 Act, which include a Code of Ethics, and Insider Trading, Gift and Outside Activities policies. The Business Conduct Rules require that, when conducting business activities on behalf of Heartland, all Heartland employees must:

- (1) act with integrity, competence, and dignity, adhere to the highest ethical standards, and deal fairly with and act in the best interests of all Heartland clients;

- (2) comply with applicable federal securities laws; and
- (3) promptly disclose to Heartland's Legal/Compliance Team circumstances that may create an actual or potential conflict with the interests of a Heartland client.

The Code of Ethics governs, among other things, the personal securities transactions of all Heartland employees. Heartland or its employees may purchase or sell for their own accounts securities that are recommended to clients or placed in discretionary accounts. However, Heartland and its employees generally are prohibited from purchasing or selling for their own accounts in anticipation of (1) a purchase or sale in an account as to which Heartland exercises investment discretion, or (2) a recommendation of a purchase or sale to a client. The Code of Ethics provides an exception to these personal trading prohibitions for common stocks (and convertible preferred stocks convertible into such common stocks) of companies with market capitalizations of \$5 billion or more if consistent with Heartland's policies governing insider trading. Certain investment personnel are restricted from personally trading in a security for seven calendar days prior or subsequent to that security's purchase or sale for a client account if the investment person is either (i) the portfolio manager for such account or (ii) the investment analyst for such security. In addition, Heartland generally prohibits employees from profiting in the purchase and sale, or the sale and purchase of the same (or equivalent) securities within 60 calendar days. The Code of Ethics requires, among other procedures, prior approval and pre-clearance of most purchases and sales of securities in which Heartland's employees have a beneficial interest and prohibits most purchases of equity securities of issuers with market capitalizations of less than \$2 billion. The Code of Ethics also requires prior approval and pre-clearance of most purchases and sales by Heartland employees of shares in any Mutual Fund for which Heartland serves as investment advisor.

All employees are required to provide copies of trade confirmations and account statements for all personal securities transactions covered by the Code of Ethics to the Legal/Compliance Team. In addition, employees are required to report, on a quarterly basis, securities transactions in accounts in which they have a beneficial interest. These reports are reviewed to determine if there have been any violations of the Code of Ethics.

A copy of Heartland's Code of Ethics is available upon request by calling Heartland at 1-888-505-5180, visiting [www.heartlandadvisors.com](http://www.heartlandadvisors.com), or writing to Heartland at 789 North Water Street, Suite 500, Milwaukee, Wisconsin 53202.

#### Participation or Interest in Client Transactions

Heartland's goal is to treat each client fairly and equitably, consistent with its fiduciary duties and obligations under applicable federal and state regulations, including Section 206 of the Investment Advisers Act of 1940, as amended, and relevant provisions of Section 17 of the Investment Company Act of 1940, as amended.

Heartland performs investment advisory services for various clients and may give advice, and take action in the performance of its duties, with respect to any one client which may differ from advice given or action taken with respect to any other client. Provided that over a period of time, to the extent practical, it allocates investment opportunities to each client in a manner that it reasonably believes is fair and equitable relative to other similarly-situated clients. Heartland has no obligation to purchase or sell a security for a client that Heartland, its principals, employees, or affiliates (to the extent permitted by Heartland's Code of Ethics) may purchase or sell for its or their own accounts, or for the account of any other client, if in the sole and absolute discretion of Heartland, it is deemed not appropriate to purchase or sell such security for that client.

From time to time, Heartland may invest in securities of an issuer and also provide investment advisory services to that issuer, or to a member of the issuer's management. In each such situation, Heartland considers various factors, which may include, as applicable, the existing business relationship with the issuer or management of the issuer; the existing advisory relationship with the issuer or a member of management of the issuer; the current holdings of the issuer that are held by other Heartland clients; and any pending new security offering of the issuer. Taking into consideration the applicable factors, Heartland may have a conflict of interest and has established procedures reasonably designed to address such conflicts, which may include monitoring percentage of ownership and reviewing procedures for voting proxies related to such issuers.

Heartland may recommend that its discretionary clients purchase shares of the Mutual Funds and such purchases may increase Heartland's aggregate fee revenue. Where shares of the Mutual Funds are purchased with assets of a client's advisory account, Heartland makes certain fee adjustments to prevent receipt of advisory fees from both the client and the Mutual Funds with respect to assets so invested. The marginal fee rate paid by the Mutual Funds to Heartland may exceed the marginal investment advisory fee rate applicable to the client's account, in which case, a purchase of the Mutual Funds' shares from the assets of the client's account will result in an increase in Heartland's total fee revenue, notwithstanding the fee adjustments referred to in *Item 5: Fees and Compensation*. See *Item 5: Fees and Compensation* for more information.

#### Item 12: BROKERAGE PRACTICES

##### Broker Selection

Heartland may select and establish securities accounts and process transactions through one or more securities brokerage firms. Heartland selects brokers and/or dealers (collectively, "brokers") to execute transactions for the purchase or sale of portfolio securities based upon a judgment of the broker's professional capability to provide the service. The primary

consideration is to have brokers execute transactions at best price and execution. Best price and execution refers to many factors, including the price paid or received for a security, the commission charged, the promptness and reliability of execution, the confidentiality and placement accorded the order, and other factors affecting the overall benefit obtained by the accounts in the transactions.

When determining the reasonableness of compensation paid to a broker, Heartland considers competitive rates in the market, complexity of the transaction, promptness and reliability of services, and other similar factors. Heartland's Brokerage Committee is responsible for reviewing, on at least a quarterly basis, Heartland's commission levels for reasonableness. This review includes analyzing Heartland's trading costs relative to other investment managers.

Allocation of portfolio brokerage transactions, including their frequency, to various brokers is determined by Heartland, in its best judgment, based on the professional capabilities of the brokers, and in a manner deemed fair and reasonable to clients. The primary consideration in selecting brokers is prompt and efficient execution of orders in an effective manner at the most favorable price, but a number of other judgmental factors may enter into the decision. These factors may include, for example: knowledge of negotiated commission rates and transaction costs; the nature of the security being purchased or sold; the size of the transaction; historical and anticipated trading volume in the security and security price volatility; and broker operational capabilities and financial conditions. Among the brokers that may be used are electronic communication networks (ECNs), which are fully disclosed agency brokers that normally limit their activities to electronic execution of securities transactions. While commission rates are a factor in Heartland's analysis, they are not the sole determinative factor in selecting brokers.

Heartland does not consider, when selecting or recommending brokers, whether the broker refers clients to Heartland.

### Soft Dollar Transactions

As permitted by the Securities Exchange Act of 1934, as amended, Heartland engages in the long-standing investment management industry practice of paying higher commissions to brokers who provide brokerage and research services ("research services") than to brokers who do not provide such research services, if such higher commissions are deemed reasonable in relation to the value of the services provided. Heartland uses these research services in its investment decision-making processes. These types of transactions are commonly referred to as "soft dollar transactions."

Three different types of research services are typically acquired through these transactions:

- (i) proprietary research services offered by the broker executing a trade;

- (ii) other research services offered by third parties through the executing broker; and
- (iii) proprietary or third party research services obtained through client commission arrangements (as discussed below).

Heartland also may receive soft dollars on riskless principal transactions in accordance with applicable regulatory requirements.

During the past fiscal year, Heartland has obtained research services through soft dollar transactions including, but not limited to:

- economic, industry or company research reports or investment recommendations;
- subscriptions to certain financial publications or research data compilations;
- compilations of securities prices, earnings, dividends, and similar data;
- certain computerized databases, quotation services, research or analytical computer software and services;
- certain trade related services; and
- services of economic and other consultants concerning markets, industries, securities, economic factors, and trends and portfolio strategy.

Research services so received enable Heartland to supplement its own research and analysis used in connection with providing advice to its clients as to the value of securities; the advisability of investing in, purchasing or selling securities, and the availability of securities or purchasers or sellers of securities; the furnishing to clients of analyses and reports; and the effecting of securities transactions and performing functions incidental thereto (such as clearance and settlement) on behalf of clients. To the extent that Heartland uses client transactions to obtain research services that Heartland could otherwise purchase for cash, Heartland may have an incentive to place more orders or pay higher commissions than would otherwise be the case. However, Heartland, through its Legal/Compliance Team and Brokerage Committee, monitors this potential conflict of interest by continually monitoring soft dollar commissions paid to each broker. In addition, HGI Funds' Board of Directors complete an annual review and quarterly monitoring of Heartland's soft dollar usage.

Soft dollar transactions are not effected pursuant to any binding agreement or understanding with any broker regarding a specific dollar amount of commissions to be paid to that broker. However, Heartland does in some instances request a particular broker to provide a specific research service, which may be proprietary to that firm or produced by a third party and made available by that firm. In such instances, the broker, in agreeing to provide the research service, frequently will indicate to Heartland a specific or minimum amount of commissions, which it expects to receive by reason of its

provision of the particular research service. Although Heartland does not agree to direct a specific or minimum commission amount to a firm in that circumstance, Heartland does maintain an internal procedure to identify those brokers who provide it with research services and the value of such research services, and endeavors to direct sufficient commissions to ensure the continued receipt of research services Heartland believes are useful in managing client accounts.

In a few instances, Heartland receives products or services from brokers that it uses both for investment research and for administrative, marketing, or other non-research or brokerage purposes. Heartland has a policy of not allocating brokerage business in return for products or services other than brokerage or research services in accordance with the provisions of Section 28(e) of the Securities Exchange Act of 1934, as amended. In such instances, Heartland makes a good faith effort to determine the relative portion of its use of such product or service that is for investment research or brokerage, and that portion of the cost of obtaining such product or service may be paid through brokerage commissions generated by client transactions, while the remaining portion of the costs of obtaining the product or service is paid directly by Heartland. In making such allocations, Heartland has a conflict of interest because it is deciding how much the Firm will pay directly versus client brokerage commissions, and has established procedures reasonably designed to address such conflicts. Heartland's Chief Compliance Officer and Director of Equity Trading determine together what proportion of a product is paid with soft dollars or directly by Heartland. This determination is reviewed by the Brokerage Committee and the HGI Funds' Board of Directors.

Research or brokerage products or services provided by brokers may be used by Heartland in servicing any or all of its clients, and such research products or services may not necessarily be used by Heartland in connection with client accounts which paid commissions to the brokers providing such product or service. In recognition of these factors, clients may pay higher commissions to brokers than might be charged if a different broker had been selected, if, in Heartland's opinion, this policy furthers the objective of obtaining best price and execution. In addition, Heartland does not modify or reduce its fees based on the amount of brokerage or research services it receives from soft dollar transactions.

Heartland may obtain proprietary and third party research through client commission arrangements. In a client commission arrangement, Heartland agrees with a broker effecting trades for Heartland's client accounts that a portion of the commissions paid by the accounts will be credited to purchase research services either from the executing broker or another broker, as directed from time to time by Heartland. The client commission arrangements, as well as the research provided in connection with such arrangements, are intended to comply with Section 28(e) of the Securities Exchange Act of 1934, as amended, and the SEC's related interpretative

guidance. Participating in client commission arrangements enables Heartland to consolidate payments for research services through one or more channels using accumulated client commissions. Such arrangements also help to facilitate Heartland's receipt of research services and ability to provide best execution in the trading process. Heartland also believes such research services are useful in its investment decision-making process by, among other things, providing access to resources that might not be available to Heartland absent such arrangements.

Heartland may engage in "step-out" brokerage transactions subject to best price and execution. Generally, in a "step-out" transaction, Heartland directs a trade to a broker with an instruction to execute the transaction, but "step-out" a portion of the transaction to a second broker who clears and settles that portion of the trade. Each broker in a step-out transaction receives a commission based on the portion of the transaction that it clears and settles. Heartland engages in step-out transactions primarily to satisfy directed brokerage arrangements for its client accounts and/or to pay commissions to brokers who supply research or brokerage services. Heartland may have an incentive to engage in step-out transactions to generate additional commissions or soft dollars, which may create a conflict of interest. Heartland has established procedures reasonably designed to address such conflicts, including review of step-out transactions by its Brokerage Committee.

#### **Investment Opportunity Allocation and Aggregation**

In general, Heartland allocates investment opportunities on a random or pro rata basis, with available cash being a major consideration, among discretionary clients that have comparable investment objectives and positions where sufficient quantities or trading volumes of a security exist. However, because many of the securities owned by Heartland's clients have a limited trading market, it may not be possible to purchase or sell a sufficient quantity of a security at a particular time to allocate among all clients that have comparable investment objectives and positions. In other instances, because of the nature of the markets for securities with lower volume, it may take a significant period of time to accumulate or dispose of a position in such securities at a price deemed acceptable by Heartland. In such cases, the price of the security may fluctuate over time and it may be desirable to allocate trades to a particular client or group of clients in order to accumulate or dispose of a position of reasonable size in relation to the size of the account with as little disruption of the market as possible. There also may be situations where an investment opportunity, in particular a new idea, is only allocated to those accounts that the portfolio manager reasonably believes have sufficient size and diversification.

To assure that clients, including model portfolio clients, are treated fair and equitably, Heartland utilizes a rotation process, as necessary, when placing trades for clients. There are many

factors used to determine when trade rotation is necessary. Among them, but not exclusive to the decision making process, is order size, liquidity, and price sensitivity. The inclusion of model portfolio clients in Heartland's trade rotation may result in Heartland competing against the model Program Sponsor when executing securities transactions. Heartland has adopted policies and procedures reasonably designed to minimize the impact of such simultaneous trading.

In order to seek the fair treatment of all clients, while recognizing the inherent need for flexibility, especially in the micro-cap and small-cap markets and the markets for certain fixed income securities, it is Heartland's policy to allocate investment opportunities, purchases, and sales among clients on a basis that considers the characteristics and needs of the clients, including their respective investment objectives, current securities positions, cash available for investment or their cash needs, and similar factors based on the portfolio manager's best judgment under the circumstances. See *Item 16: Investment Discretion* for additional information regarding Heartland's investment allocation procedures.

Heartland may, when appropriate, aggregate purchases or sales of securities and allocate such trades among two or more clients. By so doing, Heartland reasonably believes that over time it may be able to decrease brokerage and transaction costs to its clients through volume discounts, reduce brokerage commissions through negotiations not available to purchasers or sellers of smaller volumes of securities and/or obtain better pricing than is possible for smaller trades. In general, an aggregated purchase or sale order that is only partially filled will be allocated on either a random or pro rata basis among the clients participating in the order.

Generally, clients participating in aggregated trades will receive the same average execution price on any given aggregated order on a given business day and transaction costs will be shared pro rata based on each client's participation in the transaction.

### **Directed Brokerage**

Heartland permits clients to direct transactions to a certain broker ("directed brokerage"). If a client requires Heartland to direct transactions to a certain broker, Heartland may be unable to achieve best execution for those transactions because it is unable to direct the transaction based on costs and broker capabilities. Directed brokerage may cost clients more money. For example, in a directed brokerage account, the client may pay higher brokerage commissions because Heartland may not be able to aggregate orders to reduce transaction costs or the client may receive less favorable prices.

Where a client has a directed brokerage arrangement and/or negotiated a separate commission rate with that broker (which includes most clients receiving investment management services from Heartland through a wrap program), trades for that client may or may not be included in an aggregated trade.

When not aggregated, trades for the account may be executed before or after aggregated orders for other clients, which could result in different prices with different trading costs. Among other things, client-directed brokerage may result in (a) Heartland being unable to seek best price and execution by placing transactions with other brokers and (b) the client foregoing benefits from savings on execution costs that might otherwise be obtained from aggregation of brokerage orders for clients. As a result, client-directed accounts may have performance that is different from that of comparable, non-directed client accounts.

Generally, Heartland will execute all securities transactions for wrap fee accounts through the broker-dealer sponsoring the wrap fee program because the commission charge is included in the wrap fee payable to the program sponsor. Accordingly, trades affected through the broker-dealer sponsoring the program avoid additional transaction costs to the client. Similar to directed brokerage transactions discussed above, trades for wrap fee accounts may be executed before or after aggregated orders for other clients. Heartland has adopted procedures reasonably designed to ensure that clients are treated fairly and equitably in the execution of orders for wrap fee accounts. In order to ensure clients are treated fairly and equitably, Heartland allocates investment opportunities on a random or pro rata basis, including those for wrap fee accounts. In addition, the Brokerage Committee reviews on a quarterly basis a trade rotation report which shows the order in which certain trades, including directed brokerages, were filled.

### **Trade Errors**

Heartland has adopted Trading Policies and Procedures (the "Trading Policy"), as may be amended from time to time, to address potential conflicts of interest and trading issues related to providing investment advisory services to its clients. The Trading Policy sets forth the policies and procedures that Heartland follows when addressing a trade error in a client account. Heartland considers a trade error to be an unintentional mistake, such as purchasing instead of selling a security, purchasing (or selling) an incorrect amount of a security, or purchasing (or selling) a security in contradiction of an applicable guideline. Heartland's Brokerage Committee is responsible for ensuring that any such trade error is corrected in accordance with procedures reasonably designed to ensure that such error is promptly identified, corrected, and documented. In correcting a trade error, Heartland will generally reimburse a client's account for any losses arising from the error and any profits related to the error will generally remain in the client's account.

### **Item 13: REVIEW OF ACCOUNTS**

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Heartland's Investment Policy Committee monitors client accounts on at least a quarterly basis. Portfolio structure, selection, and execution for an account are reviewed by the applicable Portfolio Manager on an ongoing basis, usually several times a week.

On a periodic basis, Heartland's Operations and Legal/Compliance Team review accounts and performance calculations, and perform tests on process controls, as necessary.

Clients receiving investment management services typically receive written reports at least quarterly, showing current account size, investment performance for the current quarter and year-to-date, and the investment performance of one or more relevant benchmarks. With respect to wrap program arrangements, reporting may be carried out by the program sponsor.

#### **Item 14: CLIENT REFERRALS AND OTHER COMPENSATION**

Heartland does not currently compensate any person who is not a supervised person and Heartland does not receive compensation or other economic benefit from someone who is not a client. From time to time, Heartland may compensate employees who introduce clients to various products for which Heartland serves as investment advisor.

#### **Item 15: CUSTODY**

Heartland does not act as custodian for any clients; however Heartland may be deemed to have custody to the extent it may deduct advisory fees directly from a client's account. Please see *Item 5: Fees and Compensation* for more information regarding fees. All clients must appoint a qualified custodian, such as a broker/dealer, bank, or trust company (a "custodian"), to maintain custody over their assets. All Heartland clients should receive quarterly accounts statements directly from their custodian. Heartland advises its clients to compare the information in Heartland's client statements with the information in statements provided by the custodian. From time to time, a client may need to establish a new custodial relationship in order to obtain Heartland's investment management services. Under these circumstances, the client may ask Heartland to suggest an appropriate custodian for the client's account. When suggesting a custodian, Heartland will generally consider the execution, clearance, settlement, and other services offered by a custodian. In addition, Heartland may suggest an unaffiliated custodian who frequently provides custodial services for other clients of Heartland. There may be a conflict of interest when Heartland suggests such a custodian. Although Heartland may suggest a possible custodian to a client, the client must independently choose the custodian and setup a relationship/account with the custodian. Clients must also receive independent communications from their chosen custodian. Custodians do not compensate Heartland in any way for suggesting a client use them as a custodian.

#### **Item 16: INVESTMENT DISCRETION**

Clients may choose to retain Heartland as investment advisor with or without granting investment discretion. Where a client chooses to grant investment discretion, Heartland performs its advisory services by exercising full discretionary authority. In granting full discretionary authority to Heartland, there is no limitation on Heartland's authority to select securities, or the amount of securities to purchase or sell, except as set forth in the account's investment objectives and any applicable guidelines. Where a client does not choose to grant investment discretion to Heartland, Heartland makes investment recommendations to the client as to which securities are to be purchased or sold, and the amounts to be purchased or sold. Upon approving the recommended transactions, the client may request that Heartland direct the execution of purchase or sale orders to implement the recommended transactions for the client's account; however, the client retains discretion over the transaction.

Heartland's authority may be subject to client-imposed restrictions, for example, where the client restricts or prohibits transactions in certain types of securities. These restrictions may affect the performance of the client's account relative to comparable accounts. In addition, Heartland's authority may also be limited in cases where a client directs or otherwise suggests that securities transactions be effected through a specific broker. See *Item 12: Brokerage Practices* for more information.

With respect to its services as an advisor to institutional clients, such as pension/profit sharing plans and endowment funds, Heartland provides these services to most accounts on a fully discretionary basis, subject to the overall review by the fiduciaries of these accounts. This authority is subject to specific investment restrictions and requirements of the various accounts. See *Item 7: Types of Clients* for information regarding the requirements for establishing an account and providing authority.

#### **Item 17: VOTING CLIENT SECURITIES**

Unless a client specifically reserves the right to vote proxies, Heartland will use its best efforts to vote the shares owned by a client in accordance with Heartland's Statement of Policy Regarding Proxy Voting ("Proxy Statement"). Even if a client gives Heartland the right to vote proxies, the client may direct Heartland's vote in a particular solicitation. Heartland's Proxy Statement is subject to change as necessary to remain current with applicable rules and regulations, and internal policies and procedures. In general, Heartland votes proxies in a manner designed to maximize the value of a client's investment. With respect to each proxy proposal, Heartland will consider, among other factors, the period of time that the

particular security is expected to be held for an account, the size of the holding, the costs involved with the proxy proposal, the existing corporate governance structure, and the current management and operations for the particular company. As corporate governance standards, disclosure requirements and voting mechanics vary greatly among markets, especially in foreign markets, there may be instances in which Heartland elects not to vote. Typically, Heartland votes proxies in accordance with management's recommendations. However, in situations where Heartland believes that management is acting on its own behalf or acting in a manner that is adverse to the rights of the company's shareholders, Heartland will not vote with management. For example, Heartland may not vote with management regarding:

- (1) poison pill proposals;
- (2) proposals that Heartland believes are attempts by management to insulate itself from accountability;
- (3) proposals that deter potential interests in an acquisition or other corporate transactions at a fair price; or
- (4) proposals that represent less than fair value for the company.

In addition, Heartland may withhold votes or vote against management as a means of communicating Heartland's dissatisfaction with management's performance. Heartland also generally votes against significant compensation increases or compensation not tied to company performance where Heartland believes that a company is underperforming and/or management has not added value to the company.

Heartland considers and votes, or abstains from voting, all proxy proposals on an individual basis. Subject to the oversight of its Investment Policy Committee, Heartland designates a proxy administrator responsible for monitoring and voting proxies, either electronically through Glass Lewis & Co.'s electronic delivery platform ("Glass Lewis") or directly with the appropriate company. The proxy administrator reviews proxy proposals and provides all relevant information to the applicable Heartland analyst responsible for determining how Heartland will vote a particular proxy. For each proxy, Heartland also considers whether there are any specific facts and circumstances that may give rise to a material conflict of interest on the part of Heartland in voting the proxy. If it is determined that a material conflict of interest may exist, the proxy will be referred to Heartland's Investment Policy Committee to decide if Heartland may vote the proxy or if the proxy should be forwarded to the client to vote. All instances where Heartland determines a material conflict of interest may exist are resolved in the best interest of the applicable client.

For each proxy, Heartland maintains all related records as required by applicable law. A client may obtain a copy of Heartland's Statement of Policy Regarding Proxy Voting, or a copy of the specific voting record for the account,

by calling Heartland at 1-888-505-5180, or writing to Heartland at 789 North Water Street, Suite 500, Milwaukee, Wisconsin 53202.

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## Item 18: FINANCIAL INFORMATION

Heartland does not have any financial conditions reasonably likely to impair its ability to meet its contractual commitments to its clients.

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## Item 19: OTHER INFORMATION

### Privacy Policy

Heartland respects its clients' right to privacy. Heartland understands that the privacy and security of its clients' nonpublic personal information is important, and therefore, Heartland maintains safeguards reasonably designed to protect client data from unauthorized access. Heartland does not sell this information to anyone and only shares such information with others as permitted by law or for the purpose of serving clients' investment needs.

### *What Information Heartland Collects*

Heartland collects only information that is either required or necessary to provide personalized investment services to its clients. Any information a client chooses to provide is kept confidential and allows Heartland to:

- Service client accounts;
- Deliver products and services that may be of interest to clients;
- Prevent unauthorized access to client accounts;
- Improve client service; and
- Comply with legal and regulatory requirements.

Depending on the nature of a client's relationship with Heartland, nonpublic personal information such as name, address, Social Security Number, telephone number, and income may be collected from the following sources:

- Information Heartland receives from clients on applications or other forms, on Heartland's web site, or through other means;
- Information Heartland receives from clients through transactions, correspondence, and other communications with Heartland, Heartland affiliates, and others; and
- Information Heartland otherwise obtains from clients in connection with providing them a financial product or service.

### *What Information Heartland Shares*

Heartland does not share the information collected about its clients or former clients with any third parties, except as required or permitted by law or for the purpose of servicing

client needs. This means Heartland may disclose the information collected to companies who help maintain and service client accounts. For example, Heartland may share information with a transfer agent or clearing broker to process client securities transactions and update client accounts or to an external service provider so that client account statements can be printed and mailed. These companies are only permitted to use this information for the services for which Heartland hired them, and are not permitted to use or share this information for any other purpose. Heartland will share information with affiliates if the information is required to provide a product or service a client requested. Additionally, Heartland may share information with its affiliates about clients or client accounts in order to make clients aware of services and products which Heartland thinks may be of interest or value to them. Marketing from Heartland's affiliates may also include invitations to events sponsored by them. Affiliates are companies in the Heartland group of companies, such as Heartland Advisors and the Heartland Mutual Funds. Heartland may also disclose nonpublic personal information to government agencies and regulatory organizations when permitted or required by law.

#### *How Heartland Protects Your Information*

For your protection, Heartland restricts access to clients' nonpublic personal information to those individuals who need to know that information to provide products and services to a client. Heartland maintains physical, electronic, and procedural safeguards that are reasonably designed to comply with federal standards to maintain the confidentiality of client nonpublic personal information. The accuracy and protection of client personal information is important to Heartland.

#### *How to Contact Heartland*

Clients may limit Heartland's affiliates in the Heartland group of companies from marketing their products or services based on personal information that Heartland collects and shares with them. A client's choice to limit marketing offers from Heartland's affiliates will apply until a client requests a change to his/her choice. A client's choice to limit marketing offers from Heartland's affiliates will not affect their ability to receive marketing materials directly from Heartland. If a client has already made a choice to limit marketing offers from Heartland's affiliates, they do not need to act again. To limit marketing offers, contact Heartland at the telephone number listed below.

Clients can correct, update, or confirm their personal information and limit marketing offers from Heartland's affiliates by calling Heartland at 1-888-505-5180.

#### **Class Action Claims**

Upon initial authorization from a client, Heartland uses reasonable efforts to file a proof of claim or otherwise participate in class action lawsuits from time to time that involve securities held in the client's account. Heartland may impose a de minimis threshold before pursuing a specific

claim on behalf of clients. Participating in a class action may adversely affect the client's legal rights, including the client's ability to pursue other claims against the defendant(s) and the client's submission to the jurisdiction of a particular court. A client must notify Heartland in writing to revoke Heartland's authorization to act on the client's behalf in class action lawsuits. After termination of an advisory relationship, Heartland will use reasonable efforts to forward any class action notices that it receives to the client, or the client's authorized representative, and Heartland will be under no obligation to file proofs of claims or otherwise participate in class action lawsuits.

#### **Financial Intermediary Compensation**

From time to time, Heartland may compensate third party service providers, brokers, advisors, or other financial intermediaries for providing record keeping, sub-accounting, marketing or other administrative services to their clients in connection with an investment in the Mutual Funds. These fees may be in addition to any distribution, administrative, or shareholder-servicing fees paid by the Mutual Funds, out of the Mutual Funds' assets, to the financial intermediary. In addition, and in accordance with applicable law and Heartland's current Business Conduct Rules, Heartland may also provide non-cash compensation, such as gifts, meals, tickets or event sponsorship, to representatives of various intermediaries who offer Heartland services or refer clients to Heartland.

#### **Portfolio Holdings Disclosure**

From time to time, Heartland may make available to third parties current or historical information regarding the portfolio holdings of certain separate account clients and the Mutual Funds. These third parties may include rating agencies, industry trade groups, consultants, and financial publications. In compliance with applicable law and consistent with its fiduciary duties, Heartland will generally only release such information when it is otherwise publicly available, when there is a validly-executed agreement imposing a duty of confidentiality on the other party and covering the use of the information, or when Heartland reasonably believes that the release will not be detrimental to the best interests of the applicable client. With respect to the portfolio holdings of the Mutual Funds, such disclosures are also subject to the Mutual Funds' respective policy regarding disclosure of portfolio holdings.