

# SANDERS MORRIS HARRIS

## Investment Advisory Services Brochure

March 10, 2021

Sanders Morris Harris LLC  
600 Travis Street, Suite 5900  
Houston, TX 77002  
713.224.3100  
[www.smhgroup.com](http://www.smhgroup.com)

*This brochure provides information about the qualifications and business practices of Sanders Morris Harris LLC ("SMH"). If you have any questions about the contents of this brochure, please contact the Compliance Department at the above telephone number. 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.*

*SMH is a registered investment adviser. Registration of an investment adviser does not imply any level of skill or training. The oral and written communications of an investment adviser provide you with information from which you determine to hire or retain an investment adviser.*

*Additional information about Sanders Morris Harris LLC also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). Our firm CRD number is 20580.*

## **2 MATERIAL CHANGES**

The purpose of this page is to inform you of any material changes since the last annual amendment submitted March 2021.

At this time, we have no material changes to report.

We review and update our brochure at least annually to make sure that it remains current. If you would like to receive a copy of the most recent version of our ADV Part 2 Brochure, please call us at (713) 224-3100.

### 3 TABLE OF CONTENTS

|            |  |           |
|------------|--|-----------|
| <b>2.</b>  | <b>Material Changes.....</b>   | <b>2</b>  |
| <b>3.</b>  | <b>Table of Contents.....</b>  | <b>3</b>  |
| <b>4.</b>  | <b>Advisory Business .....</b>   | <b>4</b>  |
| 4.1        | <i>History of Sanders Morris Harris LLC .....</i>  | <i>4</i>  |
| 4.2        | <i>Investment Supervisory Services .....</i>   | <i>4</i>  |
| 4.2.1      | <i>Wrap Fee Programs .....</i>   | <i>4</i>  |
| 4.2.2      | <i>Advisor Directed Platforms.....</i>   | <i>8</i>  |
| 4.2.3      | <i>Financial Planning .....</i>  | <i>8</i>  |
| 4.2.4      | <i>Seminars .....</i>  | <i>9</i>  |
| <b>5.</b>  | <b>Fees and Compensation.....</b>  | <b>9</b>  |
| 5.1        | <i>Wrap Fee Programs.....</i>  | <i>9</i>  |
| 5.1.1      | <i>Wrap Fee Programs Offered by SMH .....</i>  | <i>9</i>  |
| 5.1.2      | <i>Wrap Fee Programs Offered But Not Sponsored by SMH .....</i>                                    | <i>12</i> |
| 5.2        | <i>Retirement Program Investment Management .....</i>  | <i>12</i> |
| 5.3        | <i>General Advisory Agreement Fees .....</i>   | <i>12</i> |
| 5.4        | <i>Financial Planning Fees .....</i>   | <i>13</i> |
| 5.5        | <i>Seminar Fees .....</i>  | <i>13</i> |
| <b>6.</b>  | <b>Performance Based Fees and Side by Side Management .....</b>                                    | <b>13</b> |
| <b>7.</b>  | <b>Types of Clients.....</b>   | <b>13</b> |
| <b>8.</b>  | <b>Methods of Analysis, Investment Strategies and Risk of Loss .....</b>                           | <b>13</b> |
| <b>9.</b>  | <b>Disciplinary Information .....</b>  | <b>14</b> |
| <b>10.</b> | <b>Other Financial Industry Activities and Affiliations.....</b>                                   | <b>15</b> |
| 10.1       | <i>Broker Dealers .....</i>  | <i>15</i> |
| 10.1.1     | <i>Sanders Morris Harris LLC, registered Broker Dealer (CRD No. 20580).....</i>                    | <i>15</i> |
| 10.2       | <i>Investment Advisers .....</i>   | <i>15</i> |
| 10.2.1     | <i>Related Persons: Tectonic Advisors, LLC ("TA").....</i>   | <i>15</i> |
| 10.3       | <i>Insurance Agency.....</i>   | <i>15</i> |
| 10.3.1     | <i>Related Persons: HWG Insurance Agency LLC .....</i>   | <i>15</i> |
| <b>11.</b> | <b>Code of Ethics, Participation or Interest in Client Transactions and Personal Trading .....</b> | <b>16</b> |
| <b>12.</b> | <b>Brokerage Practices.....</b>  | <b>17</b> |
| 12.1       | <i>Client Securities Transactions .....</i>  | <i>17</i> |
| 12.2       | <i>Trade Errors .....</i>  | <i>17</i> |
| 12.3       | <i>Soft Dollars .....</i>  | <i>18</i> |
| 12.4       | <i>Directed Brokerage Arrangements.....</i>  | <i>18</i> |
| 12.5       | <i>Trade Aggregation.....</i>  | <i>18</i> |
| <b>13.</b> | <b>Review of Accounts.....</b>   | <b>18</b> |
| <b>14.</b> | <b>Client Referrals and Other Compensation .....</b>   | <b>19</b> |
| <b>15.</b> | <b>Custody .....</b>   | <b>19</b> |
| <b>16.</b> | <b>Investment Discretion .....</b>   | <b>19</b> |
| <b>17.</b> | <b>Voting Client Securities .....</b>  | <b>19</b> |
| <b>18.</b> | <b>Financial Information .....</b>   | <b>19</b> |

## 4 ADVISORY BUSINESS

### 4.1 HISTORY OF SANDERS MORRIS HARRIS LLC

Sanders Morris Harris LLC (“SMH”) is an investment adviser firm registered with the United States Securities and Exchange Commission (“SEC”), File No. 801-66300, under the Investment Advisers Act of 1940 (“Advisers Act”). SMH is also an SEC-registered broker dealer, CRD No. 20580, and member of the Financial Industry Regulatory Authority (“FINRA”) and the Securities Investor Protection Corporation (“SIPC”).

The firm was formed in January 2000 as the result of a merger between Sanders Morris Mundy Inc. and Harris Webb & Garrison, Inc. SMH was wholly owned by Summer Wealth Management, LLC from September 2012 to February 2017.

In February 2017, Sanders Morris Harris LLC (“SMH”) was acquired by Tectonic Holdings, LLC (“Tectonic”). Tectonic in acquiring SMH also acquired its subsidiary HWG Insurance Agency LLC (“HWG”) a subsidiary of SMH, and Miller-Green Financial Services LLC (“MGFS”). SMH and HWG are now wholly owned by Tectonic, HWG Insurance Agency, LLC, is an insurance agency registered with the Texas Department of Insurance (“HWG”). MGFS was an investment adviser as defined by the Investment Advisers Act of 1940 and was registered with the Securities and Exchange Commission. On March 21, 2018, the Board of Managers of SMH and MGFS respectively approved the merger of MGFS into SMH with the resulting entity to be SMH. The merger was complete on January 31, 2019, and MGFS filed to withdraw its registration as an investment adviser.

Effective May 13, 2019, Tectonic Holdings LLC merged with and into Tectonic Financial Inc. Tectonic Financial Inc. indirectly also owns T Bank N.A., a national bank.

SMH’s Investment Adviser Representatives (“IARs”) responsibilities range from providing back office support and administration of advisory services to providing investment advice for our clients.

As of December 31, 2020, SMH managed approximately \$601,996,254. Of this amount, approximately \$600,681,643 was managed on a discretionary basis, and \$1,314,611 was held in client advised accounts on a non-discretionary basis.

SMH provides investment advisory services primarily through wrap fee programs, some of which are also sponsored by SMH or its affiliates. In a wrap fee program, services such as investment advice, investment research and brokerage services are bundled together. In this type of arrangement, a client pays a single fee, based on the percentage of assets under management, rather than transactional charges. The wrap fee is intended to provide payment for all of the direct

services the client receives (such as commissions or transaction charges on the purchase and sale of securities), as well as the administrative costs incurred by the investment adviser firm.

From time to time, investment advisory services are also made available outside of a wrap fee program. In these instances, commonly referred to as advisor directed platforms, the services provided by the Representative in exchange for a stated fee are detailed in the advisory services agreement.

Other advisory services, such as financial planning, seminars, and referral activities, are also made available by SMH.

In addition to investment advisory services, SMH primarily provides brokerage, asset management, and similar services to individuals, high net worth families and individuals, pension and profit-sharing plans, trusts, estates, and corporations and other business entities.

Investment advice is tailored to meet a client’s needs based on the client’s financial condition, need for liquidity, time horizon, risk tolerance, and investment objective. Clients may impose restrictions on investing in certain securities or types of securities.

### 4.2 INVESTMENT SUPERVISORY SERVICES

SMH primarily provides portfolio management services through wrap fee programs. These programs may be managed on either a discretionary or non-discretionary basis and may often involve the use of a third-party Portfolio Manager (“Portfolio Manager”). Ownership of all cash, securities and other instruments in the account is retained by the client. As compensation for its services, SMH may receive all of the fees and in some SMH receives a portion of the client fees. Wrap programs are generally utilized with actively traded accounts where asset-based fees may be (but are not always) lower than the potential transaction charges associated with a commissionable account.

For a complete description of the Wrap Fee Programs listed below, a client should refer to the Wrap Fee Program Brochure (Part 2A Appendix 1 of Form ADV) prepared by the sponsor of the respective program.

#### 421 Wrap Fee Programs

SMH offers two primary wrap-fee programs through which it offers investment advice: (1) FOCUS Asset Management Program (“FOCUS”) and (2) Managed Asset Program (“MAP”). These programs are offered to individuals who have a need for fee-based services or could benefit from fee-based pricing over that of a traditional commission-based brokerage arrangement. In FOCUS and MAP, a client’s assets are invested in various securities including equities and fixed income securities, publicly traded real estate investment trusts or REITs, exchange traded funds or ETFs, no load mutual

funds or load funds purchased at net asset value (“NAV”), publicly traded closed-end funds, options, cash and money market funds and certain alternative investments. SMH invests clients’ assets in securities that it deems to be consistent with the client’s stated investment objectives.

#### *4.2.1.1 FOCUS Asset Management Program*

FOCUS is a flexible wrap fee advisory program that offers the client the choice of discretionary, non- discretionary, and third-party portfolio manager platforms as selected by the client. When a discretionary arrangement is selected, the Representative selects investments and executes transactions without further consultation with the client. In a non-discretionary arrangement, client authorization must be received prior to executing any transactions in the investments selected by the Representative. In this type of arrangement, the Representative may also execute transactions in securities selected by the client. When a Portfolio Manager platform is utilized, the third-party Portfolio Manager is granted discretion over the account.

SMH serves as the investment adviser for all FOCUS accounts and does not select other portfolio managers or investment advisers to manage client accounts and in some cases SMH utilizes outside managers albeit SMH is the adviser.

Management services in FOCUS are provided by a Representative selected by the client on either a discretionary or non-discretionary basis. These services include, but are not limited to, portfolio reviews and recommendations with respect to various investments and various administrative services.

A client also has the option to establish a dual contract wrap fee account whereby the client directs SMH to engage the third-party Portfolio Manager(s) selected by the client to invest the account assets on a discretionary basis. SMH assumes no responsibility for the selection of the Portfolio Manager or the suitability of the recommendations made by the Portfolio Manager.

No minimum investment is required to participate in FOCUS; however, minimum requirements may be established by any third-party Portfolio Manager selected by the client.

#### *4.2.1.2 Managed Asset Program (MAP)*

MAP is a multi-platform wrap fee advisory program where services are provided by a Representative and may include the services of third-party Portfolio Managers.

SMH has engaged Lockwood Advisors, Inc. (“Lockwood”), an SEC-registered investment adviser, as a third-party vendor to provide managed account services and the technology infrastructure for MAP. These services, administered through the Lockwood Managed Account Command technology,

include portfolio tools and reporting, calculation and collection of account fees on SMH’s behalf and the processing, pursuant to SMH’s instructions, of deposits to and withdrawals from the account.

The client may participate in one or more of five separate platforms within MAP. For all MAP platforms, neither Lockwood nor Pershing LLC (“Pershing”) assists clients in selecting SMH, Portfolio Managers, or investment objectives or in determining the suitability of any product or platform selected in MAP.

#### *Elite*

The Elite Choice platform (“Elite Choice”) is a wrap fee arrangement where the client selects a Portfolio Manager to manage the assets in the account. There is no minimum account value required to participate in Elite Choice, but a third-party Portfolio Manager selected by the client may establish minimum requirements. Although SMH does not perform due diligence on the Portfolio Managers in the Elite Choice platform, Lockwood makes “Scorecards” available for certain Portfolio Managers. These Scorecards, available to the Representative in the Lockwood Workstation are Lockwood’s proprietary diligence and should not be construed as investment advice or recommendations by either Lockwood or SMH.

The Representative’s services provided within Elite Choice include formulation of investment objectives, portfolio reviews, recommendations with respect to selection of Portfolio Managers, and various administrative services.

The Portfolio Manager selected by the client is responsible for the selection and suitability of recommendations. The Portfolio Manager will invest and reinvest the securities, cash and/or other investments held in the account in accordance with client’s investment objectives and other information provided by client to SMH at account opening or in subsequent documentation.

Some Portfolio Managers may choose not to participate in MAP. If the Portfolio Manager declines to participate in the program, the client must select another adviser.

In the event that a Portfolio Manager terminates from the program for any reason, SMH will assign a new Portfolio Manager, approved by the client to the account.

#### *Elite Choice*

The Elite Choice platform (“Elite Choice”) is a wrap fee arrangement where the client selects a Portfolio Manager to manage the assets in the account. There is no minimum account value required to participate in Elite Choice, but a third-party Portfolio Manager selected by the client may establish minimum requirements. Although SMH does not perform due diligence on the Portfolio Managers in the Elite

Choice platform, Lockwood makes “Scorecards” available for certain Portfolio Managers. These Scorecards, available to the Representative in the Lockwood Workstation are Lockwood’s proprietary diligence and should not be construed as investment advice or recommendations by either Lockwood or SMH.

The Representative’s services provided within Elite Choice include formulation of investment objectives, portfolio reviews, recommendations with respect to selection of Portfolio Managers, and various administrative services.

The Portfolio Manager selected by the client is responsible for the selection and suitability of recommendations. The Portfolio Manager will invest and reinvest the securities, cash and/or other investments held in the account in accordance with client’s investment objectives and other information provided by client to SMH at account opening or in subsequent documentation.

Some Portfolio Managers may choose not to participate in MAP. If the Portfolio Manager declines to participate in the program, the client must select another adviser.

In the event that a Portfolio Manager terminates from the program for any reason, SMH will assign a new Portfolio Manager, approved by the client to the account.

#### *Elite Trade*

The Elite Trade platform (“Elite Trade”) is an advisory wrap fee account in which the Representative manages and invests the assets in the account on either a discretionary or non-discretionary basis. The services of the Representative within Elite Trade include formulation of investment objectives, creation of tailored asset allocations using the Investment Questionnaire, portfolio reviews, and various administrative services. Based on the investment objectives selected, the client may choose from equity, balanced and fixed income style investing. There is no minimum account value required to participate in Elite Trade.

Should a client elect a discretionary arrangement, the Representative will have trading authorization with respect to the account. As such, the Representative in his or her sole discretion and at the client’s risk, can purchase, sell, exchange, convert, and otherwise trade the securities and other permitted investments in the account in accordance with client’s investment objectives and other information provided at account opening or in subsequent documentation.

If a client elects a non-discretionary arrangement with the Representative, the Representative will obtain client consent prior to execution of any transaction in the account and will obtain client approval of any asset allocation proposal. The Representative will have no

investment or other discretion with respect to account assets and will not perform any discretionary acts including, but not limited to, advice as to the voting of proxies.

In Elite Trade, transactions will generally be executed through SMH and cleared through Pershing.

#### *Elite Lockwood Investment Strategies*

The Elite Lockwood Investment Strategies platform (“Elite LIS”) is a discretionary multi-disciplined managed account product housed in a single portfolio. The minimum investment required to establish an Elite LIS account is \$250,000. Lockwood serves as the Portfolio Manager for all Elite LIS accounts.

The services of the Representative within Elite LIS include, but are not limited to, formulation of investment objectives, portfolio reviews, recommendations with respect to selection of investment models or strategies and various administrative services.

Within Elite LIS, a client may select an investment model from among five core models or strategies, which include allocations to traditional asset classes, and four alternative models or strategies, which include exposure to non-traditional asset classes. As a result of the underlying allocations into varying asset classes, the risk/reward potential and inherent volatility vary among the models.

The five traditional strategies, ranging from conservative to aggressive, are: Model I - Current Income; Model II - Growth & Income; Model III - Conservative Growth; Model IV - Moderate Growth; and Model V - Growth.

The four alternative strategies, ranging from conservative to aggressive, are: Model II - Growth & Income; Model III - Conservative Growth; Model IV - Moderate Growth; and Model V - Growth. (Model I intentionally excluded.)

As Portfolio Manager, Lockwood determines the asset allocation of the available investment models and selects Sub-Managers and specific investment vehicles for each investment style based on its proprietary modeling strategies, as well as its macroeconomic outlook and investment and research disciplines. Tax consequences are taken into consideration in the portfolio management process of Elite LIS. For complete details regarding the investment philosophy and methodology used by Lockwood for the traditional and alternative models, clients should refer to Lockwood’s Form ADV and/or other disclosure documentation made available by Lockwood.

#### *Elite Lockwood Asset Allocation Portfolios*

The Elite Lockwood Asset Allocation Portfolios platform (“Elite LAAP”) is a discretionary multi-disciplined managed

account product housed in a single portfolio. Portfolio construction within LAAP is limited to mutual funds and exchange-traded funds (“ETFs”). The minimum investment required to establish an Elite LAAP account is \$50,000. Lockwood serves as the Portfolio Manager for all Elite LAAP accounts.

The services of the Representative within Elite LAAP include, but are not limited to, formulation of investment objectives, portfolio reviews, recommendations with respect to selection of investment models or strategies and various administrative services.

Within Elite LAAP, a client may select an asset allocation model from among five models or strategies. These models invest in mutual funds and exchange-traded funds exclusively. As a result of the underlying allocations into varying asset classes, the risk/reward potential and inherent volatility vary among the models.

The five asset allocation models, ranging from conservative to aggressive, are: Model I - Current Income; Model II - Growth & Income; Model III - Conservative Growth; Model IV - Moderate Growth; and Model V - Growth.

As Portfolio Manager, Lockwood determines the asset allocation of the available investment models and specific investment vehicles for each investment style based on its proprietary modeling strategies, as well as its macroeconomic outlook and investment and research disciplines. Tax consequences are not taken into consideration during the portfolio management process of Elite LAAP. For complete details regarding the investment philosophy and methodology used by Lockwood for the traditional and alternative models, clients should refer to Lockwood's Form ADV and/or other disclosure documentation made available by Lockwood.

#### *Lockwood Portfolio Design Services*

Lockwood Portfolio Design Services are available at no additional cost within the Elite Choice, Elite LIS and Elite LAAP platforms. The Lockwood Portfolio Design Team provides guidance to Representatives and, by extension, their clients and prospects, on constructing a portfolio of multiple Portfolio Managers and/or managed account options available in the Lockwood platforms.

The proposals, investment solutions, portfolio construction guidance and any type of analysis or research opinions generated by Lockwood's Portfolio Design Team are not reviewed, approved, or endorsed by SMH. A client should assess his/her own investment needs based on his/her own financial circumstances and investment objectives.

#### MAP Program Features by Platform

|                     | Portfolio Manager (PM)                       | Discretionary Management | Due Diligence on Money Manager                     | Product Types Included   | Portfolio Design Services | Minimum Account Value |
|---------------------|--|--------------------------|--|--|---------------------------|-----------------------|
| <b>Elite</b>        | 3rd Party selected by client from Focus List | Yes                      | Yes, conducted by SMH                              | Broad list of exchange traded securities, mutual funds and options | No                        | Varies by PM selected |
| <b>Elite Choice</b> | 3rd Party selected by client                 | Yes                      | No, but Lockwood research is available on some PMs | Broad list of exchange traded securities, mutual funds and options | Yes                       | Varies by PM selected |
| <b>Elite Trade</b>  | Rep  | Client election          | No   | Broad list of exchange traded securities, mutual funds and options | No                        | None                  |
| <b>Elite LIS</b>    | Lockwood                                     | Yes                      | Yes, conducted by SMH                              | Mutual funds and ETFs only   | Yes                       | \$250,000             |
| <b>Elite LAAP</b>   | Lockwood                                     | Yes                      | Yes, conducted by SMH                              | Mutual funds and ETFs only   | Yes                       | \$50,000              |

#### *4.2.1.3 Wrap Fee Programs Offered by SMH*

Certain SMH clients participate in various wrap fee programs that are sponsored by an independent firm. For complete details of each program, clients should obtain the Wrap Fee Program Brochure (Part 2A Appendix 1 of Form ADV) prepared by the program's Sponsor from their Representative.

#### *Investnet Asset Management Program*

SMH offers the Private Wealth Management Program, a wrap fee program sponsored by Investnet Asset Management, Inc. (“Investnet”), an investment adviser firm registered with the SEC.

Within this program, Investnet delivers a multi-product online platform which includes Managed Account Solutions with Manager Blends and Mutual Funds, Unified Managed Accounts, PMC Multi- Manager Accounts, PMC Select Mutual Fund Solutions, Sigma PMC Mutual Fund Solutions, PMC ETF Solutions, PMC Tactical ETF Solutions, Alternative Investment Solutions, Advisor as Portfolio Manager and Third Party Strategist Program. Based upon the product selected, Investnet may also serve as a Portfolio Manager with full discretionary authority to invest and reinvest portfolio assets.

The services of the Representative within this program include formulation of risk tolerance and investment objectives, and investment strategy. The Representative, on a non-discretionary basis, is responsible for the selection and suitability of product, investment vehicles, and sub-managers that are used to implement the client's investment strategy.

#### *Morningstar Managed Portfolios Program*

SMH offers a wrap fee program sponsored by Morningstar Investment Services, Inc. (“Morningstar”), an investment adviser firm registered with the SEC. Within this program, Morningstar offers multiple portfolios intended for a range of

clients based on such factors as age, time horizon, risk tolerance, return objectives and any reasonable restrictions the client may place on the account. Morningstar provides discretionary investment services such as constructing the portfolios by analyzing a universe of available investments using qualitative and quantitative analyses and continuously monitoring the portfolios within the program, rebalancing and/or reallocating when deemed necessary.

Representatives utilize the program questionnaire, proposal system and other tools provided by Morningstar to make a suitable portfolio recommendation for the client. SMH currently utilizes the following mutual fund strategies available within the program: Asset Allocation Series, Retirement Income Series, and Focused Allocation Series. In addition to mutual fund strategies, clients may participate in the ETF Strategy. The Representative also provides ongoing analysis and reviews on a non-discretionary basis throughout the client's participation in the program.

#### *4.2.1.4 Termination of Wrap Fee Programs*

In wrap fee programs sponsored by SMH, either the client or SMH may terminate an advisory agreement upon a thirty-day written notice to the other. For programs not sponsored by SMH, the standard is generally the same. Specific termination parameters can be found in the advisory agreement and/or the Wrap Fee Program Brochure for the applicable program.

## **422 Advisor Directed Platforms**

#### *4.2.2.1 FOLIOfn*

SMH has an agreement with FOLIOfn Investments, Inc. ("FOLIOfn"), a registered broker/dealer and member of FINRA, to administer advisory accounts on behalf of SMH. Under this arrangement, the Representative will provide investment advisory services and will direct, on a discretionary basis, FOLIOfn to execute transactions on the client's behalf.

FOLIOfn provides clearance, custodial functions, and reporting services, in addition to order execution through online folios, accessed through their proprietary website.

#### *4.2.2.2 Retirement Program Investment Management*

SMH Representatives may make services available to plan sponsors ("Plan Fiduciaries") of 401(k), profit-sharing and retirement plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA") under a Retirement Program Investment Management Agreement. SMH is appointed to provide non-discretionary investment management services for the Plan Fiduciary which may include: (i) Defining investment-related goals and objectives and assisting with the development of an Investment Policy Statement; (ii) Providing advice to the Plan Fiduciary about asset classes and investment alternatives available to the Plan in accordance

with the plan's investment policies and objectives; (iii) Assisting in the selection of qualified default investment alternatives from a variety of open-end registered investment companies ("Mutual Funds") and exchange-traded funds ("ETFs"); (iv) Monitoring investment options and meeting with the Plan Fiduciary on a periodic basis to discuss the performance of the investment options; (v) Assisting in the education of the plan participants about general investment principals and the investment options; (v) Assisting in group enrollment meetings designed to increase plan participation among employees and investment and financial understanding by the employees; and/or (vi) Providing periodic reports for the Plan Fiduciary. Such services are provided to the Plan Fiduciary as the client.

The investment options selected and approved by the Plan Fiduciary shall be offered as investment options to plan participants who individually direct the investment of an account or sub-account under the plan. Notwithstanding any recommendations made by SMH, the selection, approval or removal of any investment options under the Plan shall be made by the Plan Fiduciary, in its sole discretion.

#### *4.2.2.3 General Advisory Agreement*

SMH from time to time permits the use of a general advisory agreement that establishes an arrangement between SMH and a client to participate in an asset management program. This agreement, however, is not specific to any particular platform.

Under the general agreement, the client and the Representative determine if the Representative is granted the authority to execute transactions on a discretionary basis, name the account custodian, and establish a fee schedule.

Individual asset management programs may provide that a client's assets are invested in various securities including equities and fixed income, publicly traded real estate investment trusts or REITs, exchange traded funds or ETFs, no load mutual funds or load funds, publicly traded closed-end funds, options, cash and money market funds.

## **423 Financial Planning**

Representatives of SMH may conduct financial planning for a fee. As selected by the client, financial planning advisory services may include: financial plan preparation, income and estate tax review and recommendations, estate planning, retirement planning, educational planning, planned giving, portfolio evaluation, risk management, investments, asset allocation, cash flow analysis, financial options, life and disability insurance evaluation, and/or review of employee benefits. In exchange for these services, a client pays a total fee based upon the Representative's disclosed hourly rate, based on a fee schedule or a flat fee, as agreed upon by the client and the Representative. The frequency and schedule for payment are determined at the time the client enters into the financial planning agreement. Fees may be either in advance



or arrears. Either party may terminate the agreement upon written notice to the other party. If the agreement is terminated prior to completion of services, the fee amount to be charged to the client is at the discretion of the Representative and SMH based upon the time and resources expended prior to termination.

## **5 FEES AND COMPENSATION**

### **5.1 WRAP FEE PROGRAMS**

SMH offers a number of wrap fee programs to clients. The fees and the manner in which they are charged by SMH for these programs vary. The fee schedule is established in a client's written agreement applicable to the advisory service selected by the client. For a complete description of the compensation structure of the programs, clients should refer to the Wrap Fee Program Brochure (Part 2A Appendix 1 of Form ADV) prepared by the respective program sponsor of the programs in which the client is interested.

The client should be aware that lower fees for comparable services may be available in other SMH programs or from other sources.

A portion of the Advisory Fee is paid to the Representative. The Advisory Fee earned may be more or less than what SMH or its Representatives might earn from other programs available in the financial services industry or if the services were purchased separately. Therefore, SMH and its Representatives may have a financial incentive to recommend one program over other programs or services.

Please refer to the Other Financial Industry Activities and Affiliations section below, in particular the subsection "Broker Dealers" Sanders Morris Harris LLC, for important disclosure as the receipt of certain fees and commissions by the Representative and the conflicts resulting therefrom.

For accounts that contain mutual funds or ETFs, each mutual fund or ETF bears its own fees and expenses (none of which are shared with SMH or its affiliates) as disclosed in the applicable prospectus or product description. The Advisory Fee does not cover fees or expenses charged by any mutual fund or ETF held in the account.

For accounts that utilize margin, the Advisory Fee does not include margin interest. The use of margin could increase the fees in your account, as the market value of your investment portfolio increases. Utilizing margin as a strategy creates a conflict of interest since SMH stands to receive increased

advisory fees and SMH will receive margin revenue. SMH is credited a percentage of the interest assessed on margin accounts by Pershing. This credit creates a conflict of interest since SMH receives additional compensation beyond the advisory fees collected on accounts custodied at Pershing.

In addition, the Advisory Fee does not include debit balances, wire transfer fees, overnight check fees, margin interest, account transfer fees, IRA and retirement plan fees, SEC fees, 12b-1 fees for certain money market funds, or other fees or taxes required by law.

Please refer to the "Brokerage Practices" section below, which further describes the factors that SHMI considers in selecting or recommending broker dealers for client transactions and determining the reasonableness of their compensation (e.g., commissions).

### **5.1.1 Wrap Fee Programs Offered by SMH**

#### **5.1.1.1 FOCUS Program**

The Total Program Fee for FOCUS includes the Advisor Fee, which is shared by SMH and the Representative, and the Program Administrative Fee paid to the sponsor, administrator, or custodian of the program.

The negotiable Advisor Fee compensates SMH and the Representative for investment advisory services provided, pursuant to the Focus Asset Management Program Agreement. This fee covers the management and other account related services provided by SMH and the Representative, such as investment advice, investment selection, and the allocation and reallocation of investments. The Advisor Fee may be discounted at the discretion of the Representative.

The non-negotiable Program Administrative Fee compensates SMH and Pershing, the program's custodian, for the cost of execution, clearance and custody, fee calculation and deduction, and performance reporting.

The Total Program Fee is payable quarterly and may be deducted either in advance or in arrears using the following formula:

$$\frac{\text{Account Value} \times \text{Fee Schedule} \times \# \text{ of days in the billing cycle}}{365 \text{ (366 if leap year)}}$$

The account value for fee calculation purposes is based on the market value of the securities held in the account. The calculation excludes illiquid investments such as private placements, non-traded REITs, annuities, investments that include a publicly disclosed selling concession such as underwritten offerings, and any other securities previously designated by the client. The calculation follows a blended (or "not retroactive") schedule where the fee schedule for each asset level is

calculated using the relevant formula above. The fee for each asset level will then be added together to determine the total fee due for the specified period. Under certain circumstances, fees may be negotiated.

When advance billing is selected, the initial Total Program Fee is due in full on the effective date of the advisory agreement. The effective date is defined as the date when the account is accepted by SMH, and the fee is based on the account value on that date. The fee calculation is prorated if the account has been added to the billing system at any time other than the beginning of a billing cycle. Subsequent quarterly fees are determined on the first day of each calendar quarter based on the total value of the account as of the close of business on the last business day of the previous quarter and are due the following day. In the event that the advisory agreement is terminated prior to the end of a period for which a quarterly fee has been paid, fees are recalculated based on the length of service and unearned fees are returned to the client.

When arrears billing is selected, the Total Program Fee is deducted from the account at the end of the calendar quarter. When selecting arrears billing, the client must also elect if billing is to be based upon either the account value on the last day of the calendar quarter or the average daily account value.

If the client elects to be billed in arrears based on account value on the last day of the calendar quarter, subsequent quarterly fees are determined on the last day of each calendar quarter based on the total value of the account as of the close of business on the last business day of the quarter and are due the following day. Accounts added to the billing system during the billing period are charged a pro rata fee at the end of the period.

If average daily balance billing in arrears is elected, fees are charged at the end of the billing period. Daily account value is based on the previous market close. Fees calculated using this method are always final, and no adjustments will be made for any billing period.

In the event the advisory agreement is terminated prior to the end of a period for which an arrears quarterly fee is due, the fee is prorated and is due immediately.

If the account does not maintain sufficient cash or money market balances to cover the Total Program Fee, the client may deposit additional funds by the due date. If no deposit is made, SMH may liquidate securities in the account in amounts sufficient to cover such fees. Any liquidation may cause the client to incur taxes and other costs. For each addition to or withdrawal from the account of \$1,000 or more, the fee is adjusted in the next billing period.

The fee schedule for FOCUS is as follows:

| Total Assets      | Maximum Total Program Fee<br>as a % of Asset Value |
|-------------------|--|
| First \$100,000   | 3.00%  |
| Next \$200,000    | 2.25%  |
| Next \$200,000    | 1.90%  |
| Next \$500,000    | 1.70%  |
| Above \$1,000,000 | Negotiable   |

#### 5.1.1.2 Managed Asset Program (MAP)

The Total Program Fee for MAP is payable quarterly in advance and is calculated based on the market value of the securities held in the account on the last day of the calendar quarter. The Total Program Fee compensates SMH, the Representative and Lockwood for their services. Complete information regarding these services is set forth in the MAP Enrollment Document Agreement.

The portion of the Total Program Fee payable to SMH and the Representative is negotiable; however, the Lockwood portion of the fee is non-negotiable.

All fees are deducted from the account by Pershing and are noted on account statements sent to the client.

The initial Total Program Fee is due in full on the effective date of the advisory agreement. The effective date is defined as the date when the account is accepted by SMH, and the fee is based on the account value on that date. The fee calculation is prorated if the account has been added to the billing system at any time other than the beginning of a billing cycle. Subsequent quarterly fees are determined on the first day of each calendar quarter based on the total value of the account as of the close of business on the last business day of the previous quarter is due the following day.

If the account does not maintain sufficient cash or money market balances to cover the Total Program Fee, client may deposit additional funds by the due date. If no deposit is made, either the Portfolio Manager or the Representative may liquidate securities in the account in amounts sufficient to cover such fees. Such liquidation may cause client to incur taxes and other costs. For each addition to or withdrawal from an account of \$25,000 or more (Elite or Elite Choice) or \$10,000 or more (all other MAP platforms), the Total Program Fee is adjusted in the next billing period.

The Total Program Fee schedule for Elite, Elite Choice, Elite LIS and Elite LAAP is as follows:

| Total Assets     | Maximum Total Program Fee<br>as a % of Asset Value |
|------------------|--|
| First \$500,000  | 3.00%  |
| Next \$500,000   | 2.25%  |
| Next \$1,000,000 | 1.90%  |
| Next \$2,500,000 | 1.70%  |

|                   |       |
|-------------------|-------|
| Above \$5,000,000 | 1.50% |
|-------------------|-------|

The Total Program Fee schedule for Elite Trade is as follows:

| Total Assets      | Maximum Total Program Fee<br>as a % of Asset Value |
|-------------------|--|
| First \$500,000   | 2.50%  |
| Next \$500,000    | 2.25%  |
| Next \$1,000,000  | 2.00%  |
| Above \$2,000,000 | 1.50%  |

Generally, Portfolio Manager fees (if applicable) are not included in the Total Program Fee for MAP. In the Elite LIS and Elite LAAP platforms where Lockwood serves as the Portfolio Manager, the Lockwood fees are included in the Total Program Fee. The fee schedules for the Lockwood portion of the Total Program Fee are detailed below.

Lockwood's fee schedule for LIS (part of the above Total Program Fee) is as follows:

| Total Assets       | Maximum Total Program Fee<br>as a % of Asset Value |
|--------------------|--|
| First \$500,000    | 0.75%  |
| Next \$500,000     | 0.55%  |
| Next \$4,000,000   | 0.40%  |
| Next \$5,000,000   | 0.35%  |
| Above \$10,000,000 | 0.30%  |

Lockwood's fee schedule for LAAP (part of the above Total Program Fee) is as follows:

| Total Assets       | Maximum Total Program Fee<br>as a % of Asset Value |
|--------------------|--|
| First \$500,000    | 0.40%  |
| Next \$500,000     | 0.35%  |
| Next \$4,000,000   | 0.30%  |
| Next \$5,000,000   | 0.25%  |
| Above \$10,000,000 | 0.20%  |

#### Other FOCUS and MAP Fees:

The Total Program Fee for MAP and FOCUS does not include any fees charged by the third-party Portfolio Manager selected by the client, if any. The Portfolio Manager Fee varies per Manager selected by the client. For specific information regarding the fees charged by the Portfolio Manager, the client should refer to the Portfolio Manager's Form ADV. The Portfolio Manager Fee, if any, is reflected as a separate line item on the client account statement.

The Total Program Fees also do not include certain charges associated with securities transactions that may be imposed by regulatory authorities or by broker dealers other than SMH, including commissions charged by broker dealers other than SMH, dealer markups or markdowns in principal transactions by or agency transactions with broker dealers other than

SMH, American Depository Receipts (ADRs) agency processing fees, odd-lot differentials, SEC and exchange fees and transfer taxes, and any other charges imposed by law.

In addition to the Total Program Fees described above, each mutual fund or exchange traded fund in which the client may invest also bears its own fees, including but not limited to short-term redemption fees, and expenses. Complete details of fees can be found in the applicable mutual fund or exchange traded fund prospectus. Other fees, such as SEC fees, Individual Retirement Account custodial fees or other taxes as required by law, may be incurred.

Certain mutual funds may be subject to deferred sales charges. Neither SMH nor the Representative recommends the transfer of such funds into advisory accounts. Should the client choose to transfer such funds into the account, the client may incur deferred sales charges upon the redemption of the shares.

Clients may invest in certain mutual funds that make payments to broker dealers (such as SMH) pursuant to a 12b-1 distribution plan or pursuant to another arrangement as compensation for distribution or administrative services and may be paid out of the fund's assets.

Mutual funds with 12b-1 fees are generally more expensive than those funds without such fees. There is a conflict of interest when we recommend these products or services since they result in increased compensation to SMH. To mitigate this conflict of interest, SMH credits back to your account an amount equal to the 12b-1 fees collected in connection with your advisory assets, except for 12b-1 fees generated through the default sweep money market mutual funds available on the Pershing platform, which Pershing remits to SMH and SMH retains. This revenue sharing creates a conflict of interest as the increased revenue generated from the default money market funds is paid to SMH. Because SMH receives and retains these amounts, SMH has an incentive to recommend accounts offering sweep money market funds paying 12b-1 fees, which in turn will negatively impact the amount you earn on cash in your account.

The cost of the services provided through wrap fee programs may be more or less than if each service was purchased separately. For example, the cost of services provided separately may be less for accounts with infrequent trading activity. Conversely, the cost of services provided separately may be more for an account with more frequent trading activity. Similarly, Representative compensation for advisory accounts may be more than what the Representative would receive if the client participated in other available programs or paid separately for advice, brokerage, and other services and, therefore, the Representative may have a financial incentive to recommend these programs over other programs and services.

## 512 Wrap Fee Programs Offered But Not Sponsored by SMH

In addition to the wrap fee programs sponsored by the firm, SMH utilizes or has the ability to use certain wrap fee programs sponsored by other investment advisory firms. The program fees and the manner in which they are charged vary based upon the program selected. The fee schedule is established in a client's written agreement applicable to the advisory services selected by the client.

SMH and its Representatives are compensated for their services in programs sponsored by other investment advisory firms.

The Total Program Fees would not exceed the amounts provided below:

| Total Assets      | Maximum Total Program Fee<br>as a % of Asset Value |
|-------------------|--|
| First \$500,000   | 3.00%  |
| Next \$500,000    | 2.25%  |
| Next \$1,000,000  | 1.90%  |
| Next \$2,500,000  | 1.70%  |
| Above \$5,000,000 | 1.50%  |

For a complete description of the compensation structure of the programs sponsored by other investment advisers, the client should refer to the Wrap Fee Program Brochure (Part 2A Appendix 1 of Form ADV) prepared by the respective program sponsor.

## 5.2 RETIREMENT PROGRAM INVESTMENT MANAGEMENT

For its services provided under the Retirement Program Investment Management Agreement, SMH is paid an Advisory Fee of .50% of the total assets of the Plan per year (.0125% per quarter). The Advisory Fee, which is shared with the Representative, does not include any brokerage commissions and other transactions costs, redemption fees, wire transfer fees, overnight check fees, account closing fees or any other charges or expenses imposed by Mutual Funds or ETFs in which the Plan may invest. In addition, the Plan's administrator, custodian, or other service provider may charge a separate fee to cover the administrative and other recordkeeping costs associated with the Plan and plan accounts.

The Advisory Fee is payable quarterly, in arrears, to SMH. The Advisory Fee shall be based on the balance of the total assets in the plan accounts as of the end of each calendar quarter. The first payment shall be prorated for assets that are placed in the plan accounts during a calendar quarter. Subsequent fees shall be determined on the last day of each quarter. The Advisory Fee shall be payable to SMH no later than the 30th day after the end of each quarter, in arrears. Unless otherwise agreed to by the parties, the Plan Fiduciary

will cause the Plan's administrator, custodian, or other applicable service provider to deduct the quarterly Advisory Fee from the plan assets and to remit such amounts to SMH prior to the due date for such quarterly Advisory Fee.

SMH will receive no other form of compensation for its services other than the Advisory Fee. Some mutual funds selected by the Plan Fiduciary may pay directly or indirectly, as administrative expenses of the mutual fund or pursuant to a written plan described in SEC Rule 12b-1, fees or other compensation ("fees") to the Plan's Record-keeper in recognition of recordkeeping and shareholder services provided by the Record-keeper. Such fees, which are described in the prospectus or other disclosure material, are used to offset the Record-keeper's fees and to the extent that there is excess revenue sharing after the Record-keeper's fees have been paid, the remaining dollars will be used to offset the Advisory Fee paid to SMH with the remainder deducted from Plan assets.

## 5.3 GENERAL ADVISORY AGREEMENT FEES

Under the general agreement, the client and the Representative determine if the Representative is granted the authority to execute transactions on a discretionary basis, name the account custodian, and negotiate and establish a fee schedule. The fee, which is shared with the Representative, can be calculated in advance or in arrears as established by the agreement. This fee covers the management and other account related services provided by SMH, execution of trades, and clearance and custody costs. Other fees, such as SEC fees, Individual Retirement Account custodial fees, margin interest or other taxes as required by law, may be incurred and are not included in the fee.

For accounts that utilize margin, the Advisory Fee does not include margin interest. The use of margin could increase the fees in your account, as the market value of your investment portfolio increases. Utilizing margin as a strategy creates a conflict of interest since SMH stands to receive increased advisory fees and SMH will receive margin revenue. SMH is credited a percentage of the interest assessed on margin accounts by Pershing. This credit creates a conflict of interest since SMH receives additional compensation beyond the advisory fees collected on accounts custodied at Pershing.

Clients may invest in certain mutual funds that make payments to broker dealers (such as SMH) pursuant to a 12b-1 distribution plan or pursuant to another arrangement as compensation for distribution or administrative services and may be paid out of the fund's assets. Mutual funds with 12b-1 fees are generally more expensive than those funds without such fees. There is a conflict of interest when we recommend these products or services since they result in increased compensation to SMH. To mitigate this conflict of interest, SMH credit's back to your account an amount equal to the 12b-1 fees collected in connection with your advisory assets,

except for 12b-1 fees generated through the default sweep money market mutual funds available on the Pershing platform, which Pershing remits to SMH and SMH retains. This revenue sharing creates a conflict of interest as the increased revenue generated from the default money market funds is paid to SMH. Because SMH receives and retains these amounts, SMH has an incentive to recommend accounts offering sweep money market funds paying 12b-1 fees, which in turn will negatively impact the amount you earn on cash in your account.

#### **5.4 FINANCIAL PLANNING FEES**

In exchange for the planning services detailed in the financial planning agreement, the client will pay a total fee based upon the Representative's disclosed hourly rate or a flat fee, as negotiated and agreed upon by the client and the Representative. The frequency and schedule for payment are determined at the time the client enters into the agreement.

Fees may be payable either in advance or in arrears. The fee does not cover compensation for services rendered to the client by the representative outside the scope of the arrangement, such as for services performed in the representative's capacity as a registered representative, or insurance agent.

#### **6. PERFORMANCE- BASED FEES AND SIDE- BY-SIDE MANAGEMENT**

SMH will charge a performance-based fee (fee based on a share of capital gains on or capital appreciation of the assets of a client) only to those clients who satisfy the requirements of Section 205 of the Investment Adviser Act permitting the payment of such fees. SMH does not engage in side-by-side management.

#### **7. TYPES OF CLIENTS**

SMH may provide advisory services to individuals, high net worth individuals, pooled investments, plan sponsors, trusts, estates, corporations, institutions, and other businesses.

There is no minimum asset requirement to become a client of SMH. However, certain products, wrap fee programs and platforms may require minimum asset values.

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

SMH and its Representatives use a wide variety of methods, including charting, fundamental analysis, quantitative, qualitative analysis and technical analysis to determine investment strategies for clients. The primary sources of information used to conduct these types of analysis are financial newspapers and magazines, inspections, research prepared by third parties, independent sources and affiliated entities, ratings services, press releases, and annual reports, prospectuses and other filings with the SEC. The implementation of these strategies varies based upon the individual client.

Each client's account is managed on the basis of the client's financial situation, sophistication and knowledge, investment objectives (e.g. suitability) and instructions. The Representative works with the client to obtain sufficient information to provide individualized investment advice and is reasonably available to consult with the client on an ongoing basis. Clients are permitted to impose reasonable restrictions on the management of the account.

A quarterly custodial statement, containing a description of all account activity is provided to the client, in electronic or paper form at the direction of the client. The Representative reviews the overall performance of each account on a periodic basis in order to ensure that transactions are suitable based on the client's investment objectives, meet quality expectation of the client and comply with any investment restrictions requested by the client.

Clients who choose a third-party Portfolio Manager are advised to review carefully and should carefully review the third-party firm's Form ADV Part 2 for information on their investment strategy. Investment strategies vary by the Portfolio Manager selected.

Investing in any type of security involves risk of loss that clients should be prepared to bear. SMH does not guarantee the performance of an account or any specific level of performance. Market values of the securities in the account will fluctuate with market conditions. When the account is liquidated, it may be worth more or less than the amount invested.

Some strategies incorporate allocations to alternative investments, including mutual funds or ETFs invested in real estate investment trusts, master limited partnerships, managed futures, commodities, covered calls, long/short strategies, and other non-traditional investments. Investment strategies also include allocation to international/global investments.

Investment in a portfolio that includes alternative investments presents additional risks which the client should consider when making an investment decision. These risks may include adverse market conditions risk, counterparty risk,

currency exchange risk, derivatives risk, emerging markets risk, high portfolio turnover, leverage risk, and other risks depending on the investment. Alternative investments are frequently asset classes that are referred to as non-correlated (investments that move contrary to, or without influence from, broader markets). While including non-correlated assets may result in smoother portfolio performance with less volatility, there are no assurances that non-correlated assets will not decline in value.

International investments are subject to risks not associated with domestic investing. In addition to the risks generally associated with domestic investments, international investing is subject to currency, political, economic and social risks.

## 9. DISCIPLINARY INFORMATION

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that would be considered material to your evaluation of SMH or the integrity of SMH's management.

SMH is a broker/dealer in addition to its activities as a registered investment adviser. In connection with its broker/dealer business, SMH has been the subject of certain regulatory actions, some of which SMH has determined to be immaterial. Others are summarized below:

On January 8, 2008, SMH entered into a letter of Acceptance, Waiver and Consent ("AWC") with the NASD (predecessor to FINRA) where SMH neither admitted nor denied the allegations that during the period July 2000 until December 2005, SMH (1) failed to establish, maintain, and enforce adequate procedures and systems that were tailored to ensure that its hedge fund, prime brokerage services, and soft dollar activities were in compliance with federal securities laws and rules, and pertained to supervision of its employees who provided services to funds utilizing the prime brokerage services divisions' platform; (2) allowed improper payment of \$325,000 in soft dollars to one hedge fund manager; and (3) lacked adequate procedures concerning the contents of hedge fund sales materials prepared and disseminated by SMH and distributed sales literature that did not adequately disclose material investment risks to potential investors in accordance with NASD Notice to Members 03-07. During the period January 2003 until December 2004, SMH (1) failed to retain certain e-mails and instant messages sent to and received by certain employees in the prime brokerage services division and (2) permitted an unregistered employee of the prime brokerage services division to engage in activities that required registration. In 2002, SMH modified certain brokers' compensation structure so that they shared in the prime brokerage services profit pool, derived in part from commissions earned on the fund's trading. As a result, contrary to restrictions, from April 2002 to June 2004, the brokers shared indirectly in the commissions SMH earned in the fund's trading but did not amend the fund's offering

document to accurately depict the sharing arrangement. SMH was censured, paid a fine in the amount of \$450,000, and entered into an undertaking to have an independent consultant review SMH's systems and procedures.

On June 16, 2008, SMH entered into an AWC with the NASD where SMH neither admitted nor denied the allegations that, during the period December 2002 until April 2004, SMH failed to establish, maintain or enforce a supervisory system and procedures reasonably designed to detect and prevent market timing activities and that SMH failed to take supervisory action against a Representative who appeared to be market timing. SMH was censured and paid a fine in the amount of \$45,000.

On November 20, 2008, SMH consented to the entry of an Order brought by the Texas State Securities Board ("TSSB") that alleged the firm failed to require two agents of an independent investment adviser within SMH's network to be appropriately registered to conduct business in the State of Texas. The TSSB found that SMH failed to enforce a system reasonably designed to supervise the activities of its agents and also found that one of SMH's agents failed to disclose an outside advisory business activity. The firm was reprimanded and paid a fine in the amount of \$30,000.

On August 7, 2012 SMH entered into an AWC with FINRA where SMH neither admitted nor denied the allegations that (1) failed to reasonably supervise a registered representative who was under a heightened supervision plan, (2) failed to supervise the options trading at a branch office, (3) failed to establish and maintain an adequate AML compliance program and (4) failed to accurately calculate its net capital requirement due to a proposed credit agreement between a bank and SMH's parent company that pledged its assets, causing inaccurate reporting for more than 18 months. SMH was censured and paid a fine of \$150,000.

On January 2, 2015 SMH entered into an AWC with FINRA which alleged that on December 28, 2012, as a result of an inaccurate deferred tax balance calculation, SMH inaccurately calculated its excess net capital. Based on that, on December 28, 2012 SMH's board of directors authorized a distribution to its owners, in connection with which it filed with FINRA a notice of withdrawal of equity capital on January 2, 2013.

SMH failed to properly accrue this capital distribution as a liability, instead reflecting it as an expense when the distribution occurred on January 4, 2013. When SMH later provided FINRA with an estimated net capital calculation that reflected the correct value for the deferred tax asset and distribution, it showed a net capital deficiency until February 28, 2013. Additionally, from October 1, 2012 to February 28, 2013 SMH failed to maintain books and records that properly reflected the book basis amounts for partnership interests sold in October 2012. Consequently, SMH filed inaccurate FOCUS reports for periods ending October, November and

December 2012, as well as January and February 2013. SMH was censured and paid a fine of \$85,000.

## **10. OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

SMH is wholly owned by Tectonic Financial Inc. (“Tectonic”). As such, SMH is managed by the SMH Managers of Tectonic who have the requisite FINRA licenses to manage a SEC registered Investment Adviser and Broker-Dealer. However, SMH exercises its own independent investment and voting discretion in accordance with its investment philosophy, fiduciary duties, client guidelines and policies and procedures as a broker dealer and an investment adviser. In addition to advisory services, SMH offers a broad range of financial services to clients. Currently, the majority of SMH’s revenues are generated by brokerage activities, with the remaining revenues being advisory services and fee-based business. SMH is also registered as a broker dealer and is affiliated with another investment adviser, Tectonic Advisors, LLC, and an insurance agency, HWG Insurance Agency LLC, as described below.

### **10.1 BROKER DEALERS**

#### **10.1.1 Sanders Morris Harris LLC, registered Broker Dealer (CRD No. 20580)**

As a result of the dual registration of SMH as an investment adviser and broker dealer, Representatives, principal executive officers and other related employees of SMH may also be Registered Representatives, managers, and/or officers of the SMH registered broker dealer and FINRA member. SMH may perform and receive compensation for, among other things, brokerage, asset management, underwriting of syndicate and secondary As a result of the dual registration of SMH as an investment adviser and broker dealer, Representatives, principal executive officers and other related employees of SMH may also be Registered Representatives, managers, and/or officers of the SMH registered broker dealer and FINRA member.

SMH may perform and receive compensation for, among other things, brokerage, asset management, underwriting of syndicate and secondary securities offerings, and similar services. The advice given and the action taken with respect to such services may differ from advice given or the timing and nature of action taken with respect to advisory accounts.

Dual registration may present a conflict of interest to the extent that a Representative recommends the purchase of security, which results in commissions being paid to the Representative as a registered representative of the broker dealer. The commissions and fees charged by the broker dealer are in addition to SMH’s management fee and other fees and expenses of investment companies in which a client’s account may be invested.

SMH may purchase or sell securities in which SMH or its Representatives directly or indirectly have or may acquire a position or interest. In some circumstances SMH and its Representatives may receive customary compensation from mutual fund companies, including 12b-1 fees for performing certain administrative and/or shareholder servicing related tasks associated with SMH clients’ investments in such securities.

SMH and its Representatives may also be compensated for referral activity.

### **10.2 INVESTMENT ADVISERS**

#### **10.2.1 Related Persons: Tectonic Advisors, LLC (“TA”)**

Relationships and arrangements with related persons: Tectonic is under common ownership with SMH. Employees of Tectonic may also be Registered Representatives of SMH, the dual registrant. Those Registered Representatives may receive compensation from the sale of investment companies (mutual funds), insurance, and other investments and services to various clients. Certain officers and directors of Tectonic may also serve as officers and directors of SMH.

Through Tectonic Financial Inc., we are also affiliated with the following investment advisers and operating entities – Sanders Morris Harris LLC, Tectonic Advisors, LLC, HWG Insurance Agency, Inc., (insurance), as well as T Bank N.A., a national bank. Sanders Morris Harris LLC is both an investment adviser and a registered broker-dealer. Through common ownership of Tectonic Financial Inc. is also affiliated with Cain Watters & Associates, an SEC registered investment adviser.

### **10.3 INSURANCE AGENCY**

#### **10.3.1 Related Persons: HWG Insurance Agency LLC**

Relationships and arrangements with related persons: SMH Representatives may also be licensed insurance agents for HWG, a subsidiary of SMH. If a client elects to purchase an insurance product through an SMH employee or Representative, which may include life, accident, disability insurance and annuities, the Representative may receive a commission from those sales. This could present the appearance of or an actual conflict of interest to the extent that the Representative recommends the purchase of an insurance product resulting in a commission being paid to the Representative as an insurance agent.

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

SMH has adopted a Code of Ethics for all Representatives and employees of the firm describing its high standard of business conduct and its fiduciary duty to its clients. The Code of Ethics includes provisions relating to the confidentiality of client information, insider trading, gifts and entertainment, and personal securities trading, among other things. All Representatives and employees at SMH must acknowledge the terms of the Code of Ethics annually, or as amended.

SMH's Representatives and employees are required to follow SMH's Code of Ethics.

SMH's clients or prospective clients may request a copy of the firm's Code of Ethics by contacting us using the contact information on the cover page.

SMH anticipates that from time to time, SMH may recommend and effect the purchase or sale of securities in which SMH, its affiliates and/or clients, directly or indirectly, have a position of interest. As such, this could present the appearance of or an actual conflict of interest. Officers, directors and employees of SMH and its affiliates may trade for their own accounts in securities which are recommended to and/or purchased for SMH's clients. While permitted under the Code of Ethics and applicable laws, this does present a potential conflict of interest. The Code of Ethics is designed to ensure that the personal securities transactions, activities and interests of the employees of SMH will not interfere with: (i) making decisions in the best interest of advisory clients; and (ii) implementing such decisions while, at the same time, allowing employees to invest for their own accounts.

The Code of Ethics requires pre-clearance of certain transactions. As mentioned above, employees and other access persons may be permitted to invest in the same securities as clients. As a result, there is a possibility that employees might benefit from market activity by a client in a security held by an employee. Employee trading is monitored to reasonably prevent conflicts of interest between SMH and its clients.

Certain affiliated accounts may trade in the same securities with client accounts on an aggregated basis to obtain best execution and avoid price differential. In such circumstances, the affiliated and client accounts will share commission costs equally (if applicable) and transactions are executed on an average price basis.

SMH prohibits principal transactions that involve it or its representatives in advisory client accounts. Principal transactions are generally defined as transactions where an adviser, acting as principal for its own account or the account

of an affiliated broker dealer, buys from or sells any security to any advisory client. A principal transaction may also be deemed to have occurred if a security is crossed between an affiliated hedge fund and another client account.

Although occurring on an infrequent basis, SMH or its Representatives may execute transactions in which the client's securities are sold to or bought from an SMH brokerage customer (i.e., an agency cross transaction). Agency cross transactions are only executed for those clients who have provided written consent. Written consent is obtained only after the client has received full written disclosure that SMH or the Representative may act as broker, receive commissions from, and potentially have a conflicting division of loyalties and responsibilities regarding both parties to such transaction.

Client's written consent approving agency cross transactions may be revoked at any time by written notice to SMH. Each client will receive a written confirmation at or before the completion of each such transaction. The confirmation will include a statement of the nature of such transaction and the date the transaction took place. The confirmation must also contain an offer to furnish, upon request, the time the transaction took place and the source and amount of any other remuneration received or to be received by the SMH or the Representative in connection with the transaction. An annual disclosure statement identifying the total number of such transactions and the total amount of all commissions or other remuneration received in connection with such transactions during the period must also be provided.

Under no circumstances will SMH or a Representative make recommendations to parties on both sides of the transaction.

Representatives may buy or sell for themselves securities that they also recommend to clients. Securities purchased and sold for the account of a Representative or employee are purchased and sold on the same basis for the client according to the client's stated goals and investment objectives. In all instances, the positions would be so small as to have no impact on the pricing or performance of the security.

Representatives may hold positions in securities held by or recommended to clients but may not front-run or otherwise benefit from these positions. Internal procedures have been instituted to ensure that the client is treated fairly in execution of all trades.

To avoid conflicts of interest, SMH directors, officers or employees are prohibited from buying or selling securities for their personal portfolio(s) where their decision is substantially derived, in whole or in part, by reason of their employment unless the information is also available to the investing public on reasonable inquiry. No associated person of SMH shall place their own interests over those of the advisory client.

Further, all Representatives must comply with all applicable



federal and state regulations governing registered investment advisory practices.

## **12. BROKERAGE PRACTICES**

### **12.1 CLIENT SECURITIES TRANSACTIONS**

SMH, its Representatives, and/or third-party portfolio managers, if applicable, will invest and reinvest the securities, cash and/or other investments held in advisory accounts in accordance with client investment objectives, risk tolerance and other information provided by client to SMH at account opening or in subsequent documentation.

SMH may perform, among other things, research, brokerage, asset management, and similar services for other clients and receive fees for such services. The advice given and the action taken with respect to such clients may differ from advice given or the timing and nature of action taken with respect to advisory accounts. In managing advisory accounts, SMH may purchase or sell securities in which SMH or its Representatives directly or indirectly have or may acquire a position or interest.

Transactions within advisory accounts or in different accounts or for accounts of others with similar investment objectives may occur the same time or on different days. If the client elects a discretionary account, SMH and the Representative may utilize average pricing when transactions of the same security occur in the accounts of different clients within a reasonable timeframe.

Clients may impose reasonable restrictions on the management of accounts. SMH will restrict investment in client accounts subject to any limitations the client may impose in writing. Restrictions imposed by the client on the management of account assets, including any asset allocation percentages or maximums, may cause the Representative to deviate from investment decisions the Representative would otherwise make in managing the account, or the Representative may refuse to manage the account. Client-imposed restrictions and any changes to restrictions should be evidenced in writing and acknowledged by both the client and the Representative.

SMH may place securities transactions in its capacity as a broker dealer. The broker dealer may receive commissions and fees, including 12b-1 fees from investment companies (mutual funds), for securities recommended by Representatives of SMH.

Because SMH may provide the same or similar professional portfolio management services on a discretionary basis to a large number of advisory clients, SMH will comply with the following guidelines to ensure that each account is separately managed and to make certain that each client receives

individually tailored investment advice: (i) Each client's account is managed on the basis of the client's financial situation, investment objectives and instructions; (ii) SMH obtains sufficient information from the client to be able to provide individualized investment advice; (iii) SMH personnel are reasonably available to consult with the client when SMH is the sponsor or the portfolio manager of the account; (iv) The client is permitted to impose reasonable restrictions on the management of the account; (v) The client is provided with at least a quarterly custodial account statement containing a description of all account activity; and (vi) Each client maintains a separate account retaining indicia of ownership of all securities and funds in the account, although client securities may be held in nominee or street name.

Further, each client retains any and all rights afforded under the federal securities laws to proceed directly against the issuer of any underlying security in the client's account. In addition, each client may withdraw, hypothecate, vote, or pledge securities in their account upon written notice to SMH.

For the managed accounts that are handled on a discretionary basis, with SMH acting as an attorney-in-fact for the client, the client retains the right to direct SMH in writing to purchase and or not to purchase certain types of securities for its managed account.

### **12.2 TRADE ERRORS**

SMH uses care in implementing investment decisions of behalf of clients. However, occasionally an error may occur in a client account. To the extent that an error occurs that is unique to the client, SMH will correct the error as soon as is practical and in such a manner that the effected client incurs no loss.

For any errors made by SMH personnel, the client's account value will be corrected. In the case of an aggregated order, errors will be corrected using the average price provided to all affected clients. The trade error will be settled via the error account. Any gains or losses in this error account will be the responsibility of SMH.

In the event an error is caused by a broker dealer or other third-party, SMH shall take reasonable steps to resolve the error and ensure that effected clients are made whole. However, under no circumstances may a third-party pay costs attributable to a trade error caused by SMH or any SMH personnel.

For any errors made by the client, SMH will correct the trade and any resulting monetary loss will be borne by the client. In the case of an error that results in a monetary gain, such error may be removed from the client account and may result in a financial benefit to SMH.

### 12.3 SOFT DOLLARS

Soft Dollars are a means of paying brokerage firms for their services through commission revenue. In the event that SMH wishes to enter into a soft dollar arrangement, the arrangement must be approved in advance by the Chief Compliance Officer, documented in a written agreement, and shall comply with the safe harbor provided by Section 28(e) of the Exchange Act.

### 12.4 DIRECTED BROKERAGE ARRANGEMENTS

Client directed Client directed brokerage refers to an arrangement where an Advisory Client instructs an investment adviser to direct some or all of its brokerage transactions for its account to one or more designated broker-dealers. SMH's policy does not allow client direct brokerage arrangements.

In rare situations, SMH has permitted Advisory Clients to direct SMH to effect securities transactions through a specific broker-dealer. Under such arrangements, the Advisory Client is responsible for negotiating the terms of their account directly with the broker-dealer, and SMH's inability to negotiate commissions or obtain volume discounts on the clients' behalf may result in best execution not being achieved for transactions in such accounts. SMH may only direct brokerage pursuant to specific written instructions that have been signed and dated by the Advisory Client.

SMH may refuse to accept direction from the client in those cases where it would be harmful or disruptive to the interests of the client or its other clients.

### 12.5 TRADE AGGREGATION

SMH's policies and procedures are designed so that over time, subject to individual client guideline or trade restrictions, all accounts are treated fairly and equitably. Different rules or practices do not exist for those accounts where SMH, an affiliate, or a parent company has some financial interest or for any account where any employee of SMH, an affiliate or its parent company may have some financial interest.

When applicable, portfolio transactions may be executed in an aggregated transaction as part of concurrent authorizations to purchase or sell the same security for numerous accounts managed by SMH, some of which may have similar investment objectives. In addition, SMH will aggregate trades for other accounts that may be considered "proprietary" accounts with trades for SMH clients.

SMH believes that aggregation of transactions may enable it, on average and over time, to obtain enhanced execution and lower brokerage commissions (although there is no certainty that such objectives will be achieved). In addition, SMH believes that coordination of such transactions is an effective

means of preventing the completion of orders in the marketplace. Accordingly, SMH may aggregate orders if it determines that aggregation is consistent with its duty of best execution. However, SMH is not obligated to aggregate orders into larger transactions.

## 13. REVIEW OF ACCOUNTS

SMH Representatives monitor investment strategies on a periodic basis. Changes affecting a particular investment strategy may trigger changes to all client portfolios following that strategy. Portfolios not following a particular strategy may also be reviewed periodically by the Representative for investment opportunities. In addition, not less than annually, accounts are reviewed with clients by Representatives to ensure that the strategy continues to meet the client's investment objectives and to determine if the client wishes to impose any new restrictions or revisions to the investment objectives on the management of the account.

The overall performance of each portfolio is reviewed on a periodic basis by the Representative. Portfolio transactions are reviewed to ensure that each transaction: (1) is suitable to the client's investment objectives, (2) meets the client's investment objectives, and (3) complies with the client's investment restrictions, if any.

The nature and frequency of reports to clients are determined primarily by the particular needs of each client. Generally, SMH issues quarterly reports detailing account holdings. Clients also receive account statements from the custodian at least quarterly detailing all activity in the client's managed account.

Clients may contact and consult with the Representative that is responsible for the client's account at any time.

Accounts are valued by the account custodian who utilizes a third-party pricing service. If third party pricing is unavailable, valuations are provided on at least a quarterly basis and are summarized in a portfolio performance report detailing assets, transactions, receipt and disbursement of funds, interest and dividends received and gain or loss by security and for the overall account. Illiquid investments, such as private placements, non-traded REITs, and annuities may be included at the client's election on custodial statements for informational purposes only where permitted by the custodian. Illiquid investments are valued by third parties, such as the issuer or others possessing the requisite knowledge of the investment of the security. Such values are provided for informational purposes only and are intended to reflect an estimate of the interest in the illiquid investment and the value may not be realized when liquidated.

Third party portfolio managers, if applicable, will also review and monitor accounts on a periodic basis. A detailed explanation of the portfolio manager's review can be found in the manager's Form ADV Part 2A.

#### **14. CLIENT REFERRALS AND OTHER COMPENSATION**

From time to time, SMH may enter into solicitation agreements with individuals or entities whereby investment advisory accounts or private fund investors are solicited by SMH and referred to another state or SEC-registered investment adviser. In these situations, SMH may be compensated for the referral activity.

Similarly, SMH may enter into solicitation agreements where investors are solicited by another individual or entity and referred to SMH. In these situations, the individual or entity may be compensated by SMH for the referral activity.

Solicitation agreements require the solicitor to perform his duties in accordance with the Investment Advisers Act of 1940 and appropriate state regulations. Under the agreement, the solicitor must also provide each prospective client with Part 2 of Form ADV for the firm receiving the referral and SMH's separate written disclosure document.

#### **15. CUSTODY**

Clients should receive at least quarterly statements from a broker dealer, bank or other qualified custodian (collectively referred to as "Custodian") that holds and maintains account assets. SMH urges the client to carefully review such statements and compare the official custodial records provided by the Custodian to the account statements provided by SMH, if any. SMH statements may vary from custodial statements provided by the Custodian based on accounting procedures, reporting dates, or valuation methodologies of certain securities.

For FOCUS and MAP, SMH has an arrangement with Pershing, a member of the New York Stock Exchange, to provide clearance and custody of Accounts. Pershing will (a) maintain custody of all account assets, (b) execute and perform clearance of all purchase and sale orders directed to SMH, and (c) perform all custodial functions customarily performed with respect to securities brokerage accounts, including but not limited to the crediting of interest and dividends on account assets. Unless otherwise directed by the client, Pershing will forward client account statements as well as confirmation of each purchase and sale to the client.

Pershing acts as the general administrator of the account, which will include charging and collecting account fees on SMH's behalf and processing, pursuant to SMH's instructions, deposits to and withdrawals from the account. Pershing does not assist clients in selecting SMH or any investment objective or in determining suitability. Ownership of all cash, securities and other instruments in an account is retained by the client.

In certain situations, clients may participate in wrap-fee programs that are not sponsored by SMH. In those situations,

clearance and custody of securities is determined by the program sponsor. Clients should refer to the sponsor's Form ADV Part 2A for complete details regarding those programs.

#### **16. INVESTMENT DISCRETION**

When the client grants SMH investment discretion, SMH, or a Representative, has the authority to determine, without specific client consent, the securities to be bought or sold, the amount of securities to be bought or sold, the broker or dealer to be used, and the commission rates to be paid. A client's election of a discretionary or non-discretionary relationship is made in the advisory agreement at the outset of the advisory relationship.

Discretion is exercised in a manner consistent with the stated investment objectives for the particular client account. When selecting securities and determining amounts, SMH observes the investment policies, limitations and restrictions placed by clients on client accounts.

Investment guidelines and restrictions must be provided to SMH in writing.

#### **17. VOTING CLIENT SECURITIES**

As a matter of firm policy and practice, SMH has no authority to take and therefore does not take action or render any advice with respect to voting proxies on behalf of advisory clients. Clients will receive proxies or other solicitations directly from the account custodian or transfer agent, not from SMH. Clients retain the responsibility for voting all proxies for securities maintained in client portfolios and the SMH Representative will not be available to assist with any questions about a particular proxy vote.

#### **18. FINANCIAL INFORMATION**

Registered investment advisers are required to provide clients with certain financial information or disclosures about its financial condition. Currently, SMH has no financial condition that is reasonably likely to impair its ability to meet contractual and fiduciary commitments to clients. SMH has not been the subject of any bankruptcy proceeding.