

**Part 2A of Form ADV: Firm Brochure**

**FALMOUTH INVESTMENT COMPANY, INC.**

**20820 Chagrin Blvd, Suite 300  
Shaker Heights, OH 44122**

**Telephone (216) 491-3990  
Fax (216) 491-3995**

**FORM ADV PART 2A**

**MARCH 28, 2016**

This brochure provides information about the qualifications and business practices of Falmouth Investment Company, Inc. Registration as an Investment Advisor does not imply that Falmouth Investment Company, Inc. or anyone associated with Falmouth Investment Company has achieved any level of skill or training.

If you have any questions about the contents of this brochure, please contact Falmouth Investment Company, Inc. at (216) 491-3990.

The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority.

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

**Item 2      Material Changes**

Falmouth Investment Company, Inc. has experienced no material changes since the last annual update of our brochure on March 30, 2015.

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**Item 4      Advisory Business**

Falmouth Investment Company, Inc (“Falmouth”) is a registered investment advisor founded in 1997, with its principal place of business in Shaker Heights, Ohio. Terence C. Sullivan and Christine L. Jemison are the owners of Falmouth.

Falmouth acts as the manager member to investment funds (pools) primarily offered to families who are clients of a related party, Paragon Advisors, Inc. Falmouth provides investment advisory services to these investment funds. Falmouth charges fees to each fund for providing the investment advisory services. Such services include formation and organization of the funds, drafting offering and subscription documents, performing due diligence on investment managers to be utilized by each pool, ongoing monitoring and performance evaluation of the managers, and annual accounting for each fund.

Falmouth manages approximately \$368,000,000 of assets as of January 1, 2016 on a discretionary basis.

## Item 5 Fees and Compensation

Fees charged to the funds for Falmouth's advisory services may vary, depending on the type and structure of each fund. The fee for each pool is based upon the amount of anticipated involvement that Falmouth may have in the investment.

- In all cases, Falmouth charges a fee for the organization of each pool, typically around \$20,000.
- Falmouth then charges an annual asset management fee ("AMF"), paid quarterly in advance, for the ongoing services provided to each fund, as described in Item 4. The annual AMF ranges from 0.4% to 0.8% of the net asset value of the individual investment funds. In some instances, this fee is calculated based on capital committed to the individual funds.
- In some cases, Falmouth may defer fees until the entity has achieved profitability in a given year. This fee will not be incurred for funds which do not achieve appreciation in net asset value.
- For certain funds, Falmouth charges a distribution fee when cash distributions exceed capital commitments. Once investors receive distributions equal to their capital commitment, all future distributions are split between the investors and Falmouth, with 2-2.5% of distributions going to Falmouth. The distribution fee replaces the AMF, which terminates when the distribution fee becomes effective.

Fees are billed to the funds in advance, and the fee agreement for each individual investment fund is disclosed in the respective funds' private placement memorandum ("PPM"), which is provided to an investor before an investment is made.

In addition to the AMF paid to Falmouth, the managers of the underlying investment funds will charge advisory and/or incentive fees to the funds in which Falmouth pools are invested. This results in investors paying two levels of advisory fees for the management of their assets in these pooled funds, one directly to Falmouth and one indirectly to the underlying investment fund manager

Paragon Advisors, Inc. ("Paragon"), an affiliate of Falmouth, also receives fees for the preparation of the tax returns for each entity and receives reimbursement for the out-of-pocket expenses incurred directly related to each investment fund's activities. Paragon receives compensation for tax return preparation and expense reimbursement after the services are performed or expenses incurred. Paragon's services are provided at a cost at or below what a comparable third party would charge for similar services.

Fees received in advance would be prorated and refunded in the event Falmouth no longer provided investment advisory services.

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

Falmouth charges management fees based upon capital commitments or assets under management, as described in the investment funds respective PPM. Please see item 5 for a detailed description of the asset management fees charged for its funds. Certain partnerships defer payment of this asset management fee until years in which profits are achieved. In these instances, the deferred amounts accumulate until profits are attained. Falmouth is allocated income from the respective investment fund in years when the investment fund realizes profit. Fees under this method will not be collected for unprofitable investment funds.

**Item 7      Types of Clients**

Falmouth Investment Company's clients are investment funds (pools) generally set up as LLCs or partnerships primarily offered to clients of Paragon Advisors, Inc, a related company.

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

Falmouth does not employ any one particular method of evaluating investments. Its evaluation techniques depend upon the investment being examined. The following are techniques that may be used to evaluate individual opportunities:

- Research reports from investment banking firms
- Research reports from brokerage firms
- General investment publications
- Meetings with money managers
- Meetings with general partners, sponsors or developers
- Meetings and phone calls with references for the sponsors of an investment (such as lawyers, accountants, bankers, etc.)
- Site and office visits
- Review and research regarding prior performance
- Discussions with contacts (developed in over 25 years in the financial advisory business) to evaluate the timelines and viability of an investment
- Continuing education required to maintain CPA designation
- Use of analytical software, such as Pertrac Analytic Platform and Reporting Studio

Falmouth's investment strategy varies by each investment fund. Each investment fund will invest in a selection of managers based upon the fund's investment strategy as noted in its private placement memorandum. Certain investment funds are classified as hedge funds, which are funds of funds which invest in strategies including long- short US equity, international long-short equity, market neutral and global macro strategies. Falmouth also has private equity funds of funds which employ various strategies including Middle Market Buyout, Real Estate, Technology/Venture, Mezzanine, Energy and Distressed investment strategies. The performance of these funds cannot be guaranteed and past performance is not indicative of future results.

Investing in securities involves a risk of loss to the client which the client should be ready to bear.

Investments in private equity funds are subject to restrictions on the re-sale of such investments. These investments are illiquid and may have no readily available market price. Contract terms of these vehicles may provide restrictions on when the underlying investments may be sold. These terms or other market or operating conditions on the underlying managers may cause the investments to be sold at lower prices than desirable due to liquidity needs, response to economic events or other factors.

Hedge Fund investments cannot ensure that a particular hedge strategy is appropriate, or that the risk is measured properly. These hedging transactions may result in poorer performance than non-hedge transactions, and could increase risk to investors.

Investors or prospective investors can learn more about the risks involved with the investment funds by referencing the investment funds PPM. These are available upon request by calling our office.



**Item 9      Disciplinary Information**

Falmouth Investment Company has no history of disciplinary action.

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

As described in Item 5, Falmouth is related to Paragon Advisors through common ownership of both entities by Terence Sullivan and Christine Jemison. Paragon, a registered investment advisor, is a fee-based multi-family office and financial advisory firm specializing in comprehensive and confidential management of family wealth. Paragon provides tax preparation and consulting services to its clients in addition to its financial advisory services.

Falmouth's investment funds are primarily offered to families who are clients of Paragon.

Paragon also provides professional and administrative staff to Falmouth in support of Falmouth's investment advisory service and is compensated for its services to Falmouth's funds. These services are considered extraordinary and beyond the compensation paid by Paragon clients as part of the Core and other services.

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

### **Code of Ethics**

Falmouth does not have any employees. Falmouth uses employees of Paragon Advisors, Inc. to perform its advisory services. Falmouth has adopted Paragon's Code of Ethics (the "Code") that obligates Paragon, and Paragon's employees, to have a fiduciary duty to place the interest of clients ahead of their own and the Company's interests. This Code of Ethics applies to all employees of Paragon working on Falmouth advisory clients. Employees must avoid activities, interests and relationships that might interfere with making decisions in the best interest of Advisory Clients.

As fiduciaries, all employees must at all times:

- Place the interest of Advisory Clients first;
- Avoid taking inappropriate advantage of their position;
- Conduct all personal securities transactions in full compliance with the Code, including both pre-clearance and reporting requirements;
- Refrain from revealing information relating to the investment intentions, activities or portfolios of Advisory Clients except to persons whose responsibilities requires knowledge of such information;
- Abide by the provisions for accepting and giving gifts, and abstain from soliciting gifts of any size under any circumstance;
- Not take any personal advantage of any opportunity properly belonging to any Advisory Client or the Company;
- Refrain from using undue influence to cause or attempt to cause any Advisory Client to purchase, sell or hold any security in a manner calculated to create any personal benefit to such employee.

Clients or prospective clients may obtain a copy of the Code by contacting Susanne M. Powers, Chief Compliance Officer, by email at [spowers@paragnadvisors.net](mailto:spowers@paragnadvisors.net) or by telephone at 216-491-3990.

### **Participation or Interest in Client Transactions and Personal Trading Procedures**

Falmouth acts as manager member of investment funds formed to facilitate client investments in certain offerings that, due to size limitations, would not otherwise be accessible to Paragon clients. Paragon employees and affiliates of Paragon may invest in pools alongside clients. Terry Sullivan and Christine Jemison and some other employees have invested their own money along the same economic terms as client investors. For the services provided to these pools, Falmouth will be compensated and will enjoy appreciation of its income to the same extent as the client. Paragon, its affiliates and its employees are prohibited from taking commissions or other compensation from the sponsors of investments in the funds. However, Paragon will make an effort to have the sponsors reimburse Paragon for the funds' out of pocket and other expenses incurred during the due diligence process.

Falmouth is currently invested in several private equity funds in which one of the General Partners is a Paragon client.

From time to time, Terry Sullivan may serve on the Board of Directors of certain privately-held companies owned by entities in which Falmouth's investment pools are invested. Mr. Sullivan does receive compensation for his position on such boards. Currently, he serves on the Board of Directors of

Spartan Food Holding Company, a privately held company owned by Linsalata Capital Partners V, LP, a private equity entity owned by two of Falmouth's investment funds.

Paragon employees may recommend to clients securities or investments that they own, purchase or sell for their own accounts. In addition, Terry Sullivan and Christine Jemison and other Paragon employees may invest in the same funds recommended by Falmouth to its advisory clients.

As part of Paragon's Code of Ethics, all employees are required to disclose such investments and all reportable transactions to the Chief Compliance Officer (CCO). The CCO reviews and monitors these transactions on a regular basis in order to detect and prevent breaches of fiduciary duty, and to avoid potential conflicts of interest in connection with employees' personal trading activities. Furthermore, Paragon's Code of Ethics requires that employees obtain pre-approval from the CCO before purchasing any security of which an advisory client is considered an insider, or any security in a private placement, including investments in investment funds managed by Falmouth.

If the CCO determines that an employee has committed a violation of the Code, the Company may impose sanctions and take other actions as it deems appropriate, including a letter of caution or warning, suspension of personal trading privileges, suspension or termination of employment or monetary fine.

## **Item 12            Brokerage Practices**

Falmouth has the discretionary authority to invest each fund's assets in managers which it deems appropriate in achieving the goals of each fund. In most cases, Falmouth discloses in advance what managers it expects to utilize in achieving its objectives. However, the final determination of the managers is made by Falmouth. In addition to selecting the managers, Falmouth determines how much of each fund's capital is allocated to the respective managers. Finally, in certain circumstances, Falmouth may select brokers and negotiate commission rates for transactions made within each fund based upon competitive commission rates Falmouth has negotiated with other brokers. Falmouth will select brokers best suited to the advisory client's needs based on the size of account, services provided and competitiveness of commissions.

Falmouth's affiliate, Paragon, does recommend brokers to clients where appropriate. Paragon will recommend a broker best suited to the client's needs based on the size of account, breadth of services provided and available investment products, reputation, financial strength and stability, and competitiveness of commissions.

One such broker and qualified custodian that Paragon often recommends to clients is Charles Schwab & Co., Inc. (Schwab), a registered broker-dealer, member SIPC. Paragon and Falmouth are independently owned and operated and not affiliated with Schwab. While Paragon may recommend that clients use Schwab as custodian/broker, the client will decide whether to do so and will open an account with Schwab by entering into an account agreement directly with them. Paragon does not open the account for the client, although we will assist clients in doing so.

### **Brokerage Costs**

For Paragon client accounts maintained in its custody, Schwab generally does not charge separately for custody but is compensated by account holders through commissions or other transaction-related fees for security trades that are executed through Schwab or that settle in Schwab accounts. In addition to commissions and transaction-based fees, Schwab charges a flat dollar amount as a "prime broker" or "trade away" fee for each trade executed by a different broker-dealer but where securities bought or the funds from the securities sold are deposited (settled) in a Schwab account. These fees are in addition to the commissions or other compensation paid to the executing broker-dealer. Because of this, in order to minimize trading costs, Paragon uses Schwab to execute trades in client Schwab accounts. Having Schwab execute the trades is consistent with Paragon's duty to seek "best execution" of client trades. Best execution means the most favorable terms for a transaction based on all relevant factors.

### **Products and services available from Schwab**

Schwab Advisor Services is Schwab's business serving independent investment advisory firms like Paragon. They provide us and our clients with access to its institutional brokerage services (trading, custody, reporting and related services), many of which are not typically available to Schwab retail customers. Schwab also makes available various support services. Some of these services help Paragon manage or administer clients' accounts, while others help us manage and grow our business. Schwab's support services are generally available on an unsolicited basis and at no charge to Paragon. Following is a more detailed description of Schwab's support services:

### *Services that benefit clients*

Schwab's institutional brokerage services include access to a broad range of investment products, execution of securities transactions, and custody of client assets. The investment products available through Schwab include some to which Paragon might not otherwise have access or that would require a significantly higher minimum initial investment by clients.

### *Services that may not directly benefit clients*

Schwab also makes available other products and services that benefit Paragon but may not directly benefit client accounts. These products and services assist us in managing and administering clients' accounts. They include investment research, both Schwab's own and that of third parties. Paragon may use this research to service all or a substantial number of clients' accounts, including accounts not maintained at Schwab. Schwab also makes available software and other technology that:

- Provide access to client account data (such as duplicate trade confirmations and account statements)
- Facilitate trade execution
- Provide pricing and other market data
- Facilitate payment of our fees from our clients' accounts
- Assist with back-office functions, recordkeeping, and client reporting

### *Services that generally benefit only Paragon*

Schwab also offers other services intended to help Paragon manage and further develop our business. These services include:

- Educational conferences and events
- Consulting on technology, compliance, legal and business needs
- Publications and conferences on practice management and business succession

Schwab may provide some of these services itself. In other cases, it will arrange for third-party vendors to provide the services. Schwab may also discount or waive its fees for some of these services or pay all or part of a third party's fees. Schwab may also provide Paragon with other benefits, such as occasional business entertainment of personnel.

### **Paragon's interest in Schwab's services**

The availability of these services from Schwab benefits us because we do not have to produce or purchase them. We do not have to pay for Schwab's services. We may have an incentive to recommend that clients maintain accounts with Schwab, based on our interest in receiving Schwab's services that benefit our business. This is a potential conflict of interest. We believe, however, that our selection of Schwab as custodian and broker is in the best interest of clients. Our selection is primarily supported by the scope, quality, and price of Schwab's services and not Schwab's services that benefit only us.

**Item 13     Review of Accounts**

Falmouth Investment Company, Inc. reviews the financial matters of the investment funds it manages at least quarterly. The review process includes monthly bank account reconciliation, and review of check registers cash balances, correspondence from the managers in which the investment funds are invested, and financial statements for each pool.

Each pool is supervised by several employees responsible for the monitoring and managing the funds. Mr. Sullivan (a Certified Public Accountant "CPA") is involved in the global monitoring of each fund and acts as chief investment officer. In addition, Paragon provides the services of two CPA's, an additional professional and administrative staff who spend a majority of their time providing ongoing monitoring of the funds managed by Falmouth, including accounting and administrative services.

Falmouth provides written reports on all funds it manages to investors as frequently as quarterly. In some circumstances, when information is not received in a timely manner from underlying investment managers, the reports are provided less frequently, but at least annually. Investors are provided with annual tax reporting (schedule K-1) and an annual audited financial statement is available for each investment fund.

**Item 14 Client Referrals and Other Compensation**

Falmouth receives no compensation for client referrals.

Falmouth does receive some benefit from Schwab in the form of the support products and services its makes available to us. These products and services, and how they benefit us have been described above, in Item 12.



**Item 15 Custody**

Falmouth Investment Company is the manager member for several investment partnerships in which Paragon clients invest. As manager member, Falmouth has custody of all assets held by the investment fund including cash, bank accounts and securities. As manager member, Falmouth has signature authority over client advisory accounts.

Falmouth is required to provide audited financial statements to investors in these funds by June 30<sup>th</sup> of each year.

Paragon Advisors, an affiliate of Falmouth, does not directly have custody of Falmouth's advisory client accounts. However, Paragon financial advisory clients are substantial investors in the funds managed by Falmouth. In some cases, Paragon is deemed to have custody of its financial advisory clients' accounts.

**Item 16 Investment Discretion**

Falmouth has the discretionary authority to invest each fund's assets in managers which it deems appropriate in achieving the goals of each fund. In most cases, Falmouth discloses in advance what managers it expects to utilize in achieving its objectives. However, the final determination of the managers is made by Falmouth. In addition to selecting the managers, Falmouth determines how much of each fund's capital is allocated to the respective managers. Finally, in certain circumstances, Falmouth may select brokers and negotiate commission rates for transactions made within each fund based upon competitive commission rates Falmouth has negotiated with other brokers. Falmouth will select brokers best suited to the advisory client's needs based on the size of account, services provided and competitiveness of commissions.

**Item 17 Voting Client Securities (“Proxy Voting”)**

As manager member, Falmouth does have authority to vote proxies on behalf of advisory clients. Falmouth is responsible for receiving and voting proxies on behalf of the investment funds. Falmouth always acts in the best interest of its clients in voting of proxies, and votes all proxies with the expectation of maximizing client value.

**Item 18 Financial Information**

Falmouth Investment Company, Inc. has no financial commitments that impair its ability to meet contractual and fiduciary commitments to clients.