

Adviser Code of Ethics

CFA Institute/IAA Hedge Fund Compliance Conference

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Adviser Code of Ethics

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Background

- As fiduciaries, advisers generally owe clients a duty of undivided loyalty
- SEC has become concerned that advisers have lost sight of this duty
- Existing SEC rules lacked a thematic approach
- The SEC's new rule is designed to prevent fraud by more thematically reinforcing principles to govern the conduct of advisory firms and their personnel

Code - Required Provisions

- Codes must contain minimum provisions
 - But advisers can tailor their codes to best fit the structure, size and nature of their business
- Standards of business conduct for supervised persons
 - Reflect the fiduciary obligations of the adviser and its supervised persons
 - “Set out ideals for ethical conduct premised on fundamental principles of openness, integrity, honesty & trust”
 - Require compliance with federal securities laws
 - Require all “access persons” to report, and the CCO or delegate to review, personal securities trades and holdings

Access Person Concept

- Access person is any “supervised person” who
 - Has access to nonpublic information about any client’s purchase or sale of securities
 - Has access to nonpublic information about the portfolio holdings of any affiliated mutual funds
 - Is involved in making securities recommendations to clients
 - Has access to such recommendations that are nonpublic
- If providing investment advice is the adviser’s primary business, all directors, officers and partners are presumed access persons

Holdings Reports

- Access persons are required to report current securities holdings
 - Within 10 days of becoming an access person
 - At least annually thereafter
- Reports must reflect holdings as of a date not more than 45 days before the date
 - The person become an access person (initial report) or
 - The report is submitted (annual report)
- An access person can satisfy holdings report requirements by confirming in writing the accuracy of previously provided confirms & statements If
 - He or she previously provided them for all trades
 - The adviser kept them

Content of Holdings Report

- Title and type of security
- Exchange ticker symbol or CUSIP
- Number of shares and principal amount
- The name of the broker-dealer or bank with which the account is maintained
- The date the report is submitted

Transaction Reports

- Access persons are required to submit quarterly reports of transactions
 - Involving a “reportable security”
 - In which the access person had, or as a result of a transaction acquired, any direct or indirect beneficial ownership
- Transaction reports must be submitted no later than 30 days after the close of the calendar quarter
- Access persons with no personal securities transactions during the quarter are not required to submit a report confirming the absence of transactions

Content of Transaction Reports

- Date of each transaction
- Title of security
- Exchange ticker symbol or CUSIP
- Number of shares and principal amount (interest rate and maturity date, if applicable)
- Nature of transaction (i.e., purchase or sale)
- Price at which transaction was effected
- The name of the broker-dealer or bank through which the transaction was effected
- The date the report is submitted

Reportable Securities

- Reportable securities includes all securities except
 - Direct U.S. government obligations
 - Certain bank instruments and short-term debt instruments, including repurchase agreements
 - Shares issued by money market funds
 - Shares issued by other types of mutual funds
 - Unless the adviser or a control affiliate acts as the investment adviser or principal underwriter for the fund
 - Interests in variable insurance contracts funded by insurance company separate accounts that invest exclusively in unaffiliated mutual funds
- Transactions and holdings of affiliated mutual funds, closed-end funds, and offshore funds are not exempt from reporting

Reporting Exceptions

- Access persons are not required to submit any report:
 - For securities held in accounts over which the person had no direct or indirect influence or control
 - For transactions effected pursuant to an automatic investment plan
 - That duplicates information in trade confirmations or account statements the adviser holds in its records
 - If the adviser has receives them no later than 30 days after the close of the calendar quarter when the transaction takes place

Beneficial Ownership

- An access person must submit holdings and transaction reports for reportable securities in which he has, or acquires, direct or indirect beneficial ownership
- An access person is presumed to be a beneficial owner of securities held by his immediate family members sharing the same household

Pre-Clearance Procedures

- Access persons must obtain approval before directly or indirectly acquiring beneficial ownership in an
 - IPO
 - Private placement

Reporting Violations

- Supervised persons are required to report violations of the code to the CCO
- Advisers should foster an environment that encourages and protects supervised persons who report violations

Informing Employees

- An adviser is required to provide each supervised person with a copy of the code (and any amendments)
- Supervised persons are required to provide written acknowledgment of receipt (which may be electronic)
- SEC expects advisers to provide training on the principles and procedures of their codes

Review & Enforcement

- Advisers are required to maintain and enforce their codes
- Enforcement includes reviewing access persons' reports
 - Assess whether the access person followed procedures
 - Compare personal trading to any restricted lists
 - Assess whether the access person is trading for his own account in the same securities he trades for clients (and if so whether clients are receiving terms as favorable)
 - Periodically analyze the access person's trading patterns for possible abuse, including market timing
 - Investigate any substantial disparities between the performance the access person achieves for his own account and that he achieves for clients
 - Investigate any substantial disparities between the percentage of profitable trades when the access person trades for his own account and the percentage when he places trades for clients

Recordkeeping

- Advisers are required to keep
 - Copies of their codes
 - Records of violations and actions taken
 - Copies of supervised persons' written acknowledgment of receipt
 - Certain records about access persons:
 - Names
 - Holdings and transaction reports
 - Records of decisions approving acquisition of securities in IPOs and private placements

Form ADV Disclosure

- Advisers are required to
 - Describe their codes to clients
 - Furnish a copy to clients on request
- Advisers that materially deviate from policies and procedures disclosed in Form ADV could run afoul of anti-fraud provisions

SEC Recommendations

- Pre-clear personal securities trades by access persons
- Restricted lists of securities the adviser is analyzing or recommending for client transactions (or about which the firm has inside information)
- Blackout periods when client securities trades are being placed or recommendations are being made
- Reminders that investment opportunities must be offered first to clients and procedures to implement this principle
- Restrictions on short-swing trading
- Requirements to trade only through certain brokers
- Requirements to provide the adviser with confirms and account statements

SEC Recommendations

- Procedures for assigning new securities analyses to employees whose personal holdings do not present apparent conflicts
- Limits on acceptance of gifts
- Limits on accepting outside directorships of public companies
- Detailed identification of who is considered an access person
- Procedures for the firm and compliance personnel to periodically review the code and any reports made pursuant to it
- Discussion of specific penalties for violating the code of ethics
- Ensuring that employees receive adequate training about the principles, provisions and procedures of the code

Action Items for New Advisers

- Each adviser must:
 - Adopt a code and be prepared to maintain and enforce it
 - Identify all “access persons”
 - Provide a copy of the code to each “supervised person” and have received his or her acknowledgment
 - Have received an initial holdings report from each access person
 - Arrange for the submission of quarterly transaction reports by access persons
 - Disclose relevant information in the firm’s Form ADV

Sources of Information

- New Rule 204A-1
- Amended Rules 204-2 & 17j-1
- SEC Adopting Release
- ICAA Best Practices for Investment Adviser Codes of Ethics
- CFA Institute Revised Code of Ethics and Standards of Professional Conduct (effective January 2006)
- CFA Institute Asset Manager Code of Professional Conduct

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