

Adviser Code of Ethics

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Speaker Bio

Steve Stone is a partner in the Securities Industry and Investment Management practices at Morgan Lewis and serves as Managing Partner of the Washington office. Steve's practice focuses on broker-dealer and investment manager regulation and enforcement defense and regulation of the securities markets. Steve has extensive experience in all aspects of broker-dealer and investment management regulation, representing major investment banks, broker-dealers and investment managers in a broad range of matters. He frequently advises trading desks of both broker-dealers and investment managers on a range of issues.

Mr. Stone holds a B.A. from Bates College and a J.D. from George Washington University National Law Center.

Speaker Bio

Chris Menconi is an associate in the Investment Management Practice Group. His practice focuses on the regulation of investment companies, investment advisers and broker-dealers. In particular, Mr. Menconi handles matters involving mutual funds and variable insurance products arising under the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Act of 1933 and the Securities Exchange Act of 1934.

Mr. Menconi holds a B.A. from JD Catholic University of America and a J.D. from Catholic University of America, Columbus School of Law.

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

- By February 1, 2005, each adviser must
 - Adopt or revise its 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
 - Update 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