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INVESTMENT ADVISER ASSOCIATION

BEST PRACTICES FOR INVESTMENT ADVISER CODES OF ETHICS

On July 2, 2004, the Securities and Exchange Commission adopted a new rule and rule amendments under Section 204 of the Investment Advisers Act of 1940 that require all registered investment advisers to adopt codes of ethics. The codes of ethics must set forth standards of conduct expected of advisory personnel and address conflicts that arise from personal trading by advisory personnel. The rule and rule amendments are intended to promote compliance with fiduciary standards by advisers and their personnel. The SEC also adopted conforming amendments to rule 17j-1 under the Investment Company Act.

The IAA strongly supports the fundamental requirement that all investment advisers adopt and implement written codes of ethics. Since 1937, the IAA has endorsed standards and principles that have emphasized an investment adviser's fiduciary duty. The IAA's current standards state that investment advisers are fiduciaries and thereby have the responsibility to render professional, continuous, and unbiased investment advice. Fiduciaries owe their clients a duty of honesty, good faith, and fair dealing. As a fiduciary, an adviser must act at all times in the client's best interests and must avoid or disclose conflicts of interests. Codes of ethics emphasize and implement these fundamental principles within each firm.

In 1995, the IAA encouraged its member firms to adopt a Code of Ethics that would address, among other things, personal trading, gifts, the prohibition against the use of inside information, and other situations where there is a possibility for conflicts of interest. At that time, the IAA issued guidelines to assist its members in addressing the personal trading aspects of such codes. Guidelines on Personal Investing (February 15, 1995). We understand that many of our members have followed these guidelines in establishing a code of ethics and personal trading policies and procedures.

In light of recent events, including the SEC's new rule and ongoing investigation of abusive practices involving advisers to mutual funds, the IAA has concluded that our guidelines should be expanded and updated. The IAA has prepared this Best Practices for Investment Adviser Codes of Ethics ("Best Practices") based on an extensive review of the current codes of ethics and policies and procedures of many investment advisers, and numerous discussions with IAA members and investment management professionals. These Best Practices are intended to provide guidelines and suggest best practices for an adviser seeking to update, revise or construct its own code of ethics appropriate to the nature and size of its particular advisory business and the types of clients it serves. The Best Practices also address all of the provisions required by the SEC's new rule.

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INTRODUCTION

An investment adviser's code of ethics should set the tone for the conduct and professionalism of the adviser's employees, officers, and directors. Because the ethical culture of a firm is of critical importance and must be supported at the highest levels of the firm, a firm's code of ethics should be approved or endorsed by senior management. For fund advisers, the code must also be approved by boards of funds advised by the firm. In addition, the president or chief executive of an adviser may wish to append a cover letter to the code when circulated to employees to emphasize his or her views regarding the importance of ethical conduct.

A code of ethics should be designed to:

- Protect the firm's clients by deterring misconduct;
- Educate employees regarding the firm's expectations and the laws governing their conduct;
- Remind employees that they are in a position of trust and must act with complete propriety at all times;
- Protect the reputation of the firm;
- Guard against violation of the securities laws; and
- Establish procedures for employees to follow so that advisers may determine whether their employees are complying with the firm's ethical principles.

Because of the educational component of a code of ethics, firms should strive to draft their codes in plain English. The more readable a code is, the more likely it is that employees will be able to understand and comply with its precepts. In addition, the firm should provide training and readily available resources for its employees to assist them in understanding what conduct is or is not permissible.

It is vitally important that firms tailor their codes of ethics to the business, structure, clientele, and nature of their own firms. No single "off-the-shelf" set of provisions will be appropriate for every adviser. In addition, the restrictions set forth in the code should be reasonable and not create an unnecessary burden on employees.

A code of ethics should establish the firm's expectations for its personnel and set forth principles and standards for them to follow. Specific procedures related to these standards may be included in the code itself or in a compliance manual. Some firms strongly prefer a short, simple code focused on core conduct, while other advisers prefer very comprehensive codes including or cross-referencing a wide range of compliance policies and procedures. Each firm should assess its own structure and compliance system in determining whether to include various policies and procedures in the code or in its compliance manual or other documents. While advisers may structure their codes of ethics to best fit their organizations, an adviser that puts various required provisions of the code into multiple documents should ensure that all parts are integrated and

understandable so that it is clear to employees that these documents together constitute the firm's code of ethics.

We set forth below the SEC's required topics for an adviser's code of ethics, additional IAA- recommended best practices for a code and related policies and procedures, and discussion of other provisions that firms may wish to consider including in their codes where appropriate. The required topics we cover focus solely on the requirements under Investment Advisers Act rule 204A-1 and Investment Company Act rule 17j-1. These provisions are indicated by a (**Required**) notation. This document does not, and is not intended to, cover code of ethics requirements imposed by the Sarbanes-Oxley Act of 2002.

We recognize that there is enormous diversity within the investment advisory profession and that every firm has unique characteristics and practices. Accordingly, this document is not intended to set forth a "one-size-fits-all" set of provisions that all firms should implement. Instead, this document should be used as a set of guidelines that firms may consider in crafting codes of ethics that serve their needs and fit their particular circumstances.

PART 1. GENERAL PRINCIPLES

The IAA recommends that an adviser's code of ethics include a general statement of principles or the firm's philosophy regarding ethics. These principles should emphasize the adviser's overarching fiduciary duty to clients and the obligation of firm personnel to uphold that fundamental duty.

The general principles should at a minimum include:

1. The duty at all times to place the interests of clients first;

2. The requirement that all personal securities transactions be conducted in such a manner as to be consistent with the code of ethics and to avoid any actual or potential conflict of interest or any abuse of an employee's position of trust and responsibility;

3. The principle that investment adviser personnel should not take inappropriate advantage of their positions;

4. The fiduciary principle that information concerning the identity of security holdings and financial circumstances of clients is confidential; and

5. The principle that independence in the investment decision-making process is paramount.

In addition, some firms use the general principles to discuss the importance of the firm's reputation, as well as principles of honesty, integrity, and professionalism. We

recommend that firms also emphasize to all directors, officers, and employees that the general principles discussed in this section govern all conduct, whether or not the conduct also is covered by more specific standards and procedures set forth below.

Advisers may also wish to emphasize at the outset that failure to comply with the firm's code of ethics may result in disciplinary action, including termination of employment.

PART 2. SCOPE OF THE CODE

Understanding which compliance-related topics will be included in an adviser's code and which of the adviser's officers, directors, and employees will be covered by all or part of the code is essential to developing an appropriately structured code of ethics.

A. **Topics Addressed in the Code**

In drafting its code of ethics, an adviser needs to decide which topics should be included in the code and which will be covered by other policies or procedures included in the firm compliance manual/policies, employee handbook, or elsewhere. In general, broad principle-based concepts addressed to the firm's employees and emphasizing fiduciary duty are appropriate for the code. In addition, the code is required to encourage employees to comply with applicable federal securities laws, while the requirements for an adviser's compliance procedures focus on the firm's compliance with the Investment Advisers Act and regulations thereunder.

The vast majority of codes that we reviewed address securities-related conduct and focus principally on fiduciary duty, personal securities transactions, insider trading, gifts, and conflicts of interest. Some of the other provisions that a few firms included are: antitrust; anti-money laundering; compliance with copyright laws; corporate responsibility; drug free workplace; employment of former government employees; employment practices; financial reporting; health and safety in the workplace; illegal payments (Foreign Corrupt Practices Act); NASD regulations (for dual registrants); past and current litigation; press and media dealings; Sarbanes-Oxley code of ethics; sexual harassment; speaking engagements; and termination of employment. We understand that most firms, however, address these non-securities-related issues in their employee handbooks or in other policy and procedure compilations.

B. **Persons Covered by the Code**

An investment adviser must designate the categories or sub-categories of persons covered by an adviser's code or portions of its code. Rule 204A-1 requires the code to cover an adviser's "supervised persons." A subset of these supervised persons, "access persons," are required to comply with specific reporting requirements. (**Required**)

Supervised Persons include:

- Directors, officers, and partners of the adviser (or other persons occupying a similar status or performing similar functions);
- Employees of the adviser; and
- Any other person who provides advice on behalf of the adviser and is subject to the adviser's supervision and control.

An adviser may wish to specify additional categories of persons as supervised persons or persons otherwise subject to the code, including:

- Temporary workers;
- Consultants;
- Independent contractors;
- Certain employees of affiliates; or
- Particular persons designated by the chief compliance officer.

Similarly, an adviser, where appropriate, may also wish to clarify which persons or types of persons are *not* subject to the code.

Access Person includes any supervised person who:

- has access to nonpublic information regarding any clients' purchase or sale of securities, or nonpublic information regarding the portfolio holdings of any fund the adviser or its control affiliates manage; or
- is involved in making securities recommendations to clients, or has access to such recommendations that are nonpublic.

If a firm's primary business is providing investment advice, all of the firm's directors, officers, and partners are presumed to be access persons.

Access Persons for Mutual Funds. A code of ethics for an adviser that manages a mutual fund must cover a slightly different universe of individuals, including:[1]

- Directors, officers, and general partners of the adviser; and
- "Advisory persons" – employees and certain control persons (and their employees) who make, participate in, or obtain information regarding fund securities transactions or whose functions relate to the making of recommendations with respect to fund transactions.
- Fund advisers may exempt from certain reporting provisions of the code fund directors who are not employees of the adviser and do not have access to confidential information regarding client securities transactions or recommendations.

[1] We have assumed for purposes of this code that the investment advisory firm is primarily in the business of providing investment advice. For fund advisers not primarily in the business of advising funds or advisory clients, "access persons" only include directors, officers, general partners, or advisory persons who make, participate in, or who obtain information regarding fund transactions or whose functions relate to the making of any recommendations with respect to a fund transaction.

Accordingly, fund advisers should determine which persons employed by control affiliates may have access to fund information and either designate those employees as access persons or develop policies that prevent such control affiliate employees from obtaining confidential fund information.

Some firms choose to treat all employees as access persons, particularly where the nature or philosophy of the firm tends to expose a large range of employees to client information. Firms may also consider extending compliance procedures to some group of employees broader than access persons, or to all employees.

Family Members. For purposes of personal securities reporting requirements, an adviser should ensure that terms such as "employee," "account," "supervised person," and "access person" are defined to also include the person's immediate family (including any relative by blood or marriage living in the employee's household), and any account in which he or she has a direct or indirect beneficial interest (such as a trust). Some firms also include any other individuals living in the employee's household. Advisers may wish to consider whether the scope of code provisions other than those related to personal securities transactions should extend beyond employees to their family members.

Investment Personnel. These Best Practices include a few provisions that would apply to a subset of access persons (*e.g.*, IPOs, private placements). Accordingly, we recommend that advisers define an additional category of personnel in their codes who make investment decisions for clients (*i.e.*, portfolio managers), who provide information or advice to portfolio managers, or who help execute and/or implement the portfolio manager's decision. Such "investment personnel" could include, for example, portfolio managers, portfolio assistants, securities analysts, and traders. This definition is needed only if the adviser chooses not to apply these more restrictive provisions to all access persons.

C. **Securities Covered by the Code**

The IAA recommends that firms include a definition of "covered securities" in their codes. The definition clarifies for employees what types of securities are covered by various provisions of the code. For example, the definition may read:

Covered Security means any stock, bond, future, investment contract or any other instrument that is considered a "security" under the Investment Advisers Act. The term "covered security" is very broad and includes items you might not ordinarily think of as "securities," such as:

- Options on securities, on indexes, and on currencies;
- All kinds of limited partnerships;
- Foreign unit trusts and foreign mutual funds; and
- Private investment funds, hedge funds, and investment clubs.

Covered Security does not include[2]:

- Direct obligations of the U.S. government (e.g., treasury securities);
- Bankers' acceptances, bank certificates of deposit, commercial paper, and high quality short-term debt obligations, including repurchase agreements;
- Shares issued by money market funds;
- Shares of open-end mutual funds that are not advised or sub-advised by the firm (or certain affiliates, where applicable); and
- Shares issued by unit investment trusts that are invested exclusively in one or more open-end funds, none of which are funds advised or sub-advised by the firm (or certain affiliates, where applicable).

Some firms may not want to use this definition of "covered security" with respect to every provision in the code because it includes within its scope funds advised or sub-advised by the firm. For example, the new rule requires that access persons submit reports with respect to transactions in mutual funds advised or sub-advised by the firm, but a firm that voluntarily requires pre-clearance of transactions may decide not to include shares of mutual funds it advises or sub-advises in such procedures. In that case, the firm should include two separate definitional terms in this section (*e.g.,* "covered securities," which would exclude all open-end mutual funds, and "reportable securities" or "reportable funds" for use in sections applicable to transactions in funds advised or sub-advised by the firm). Firms that advise many funds, or whose employees will have to report regarding funds advised by affiliates, may wish to attach a list of such funds to assist employees in understanding their obligations.

In addition, advisers often include in their codes a broader glossary of important terms used in the code, such as "accounts," "beneficial interest," "covered funds," "access persons," "supervised persons," "investment persons," and "investment control." Advisers that include such a broader glossary should consider placing it at the back of the code so that employees are not immediately confronted by a daunting list of legalistic terms. Finally, some firms include a provision in their code regarding application of the various personal securities transaction rules to the firm's own retirement plan, subject to any ERISA considerations.

PART 3. STANDARDS OF BUSINESS CONDUCT

The new rule 204A-1 requires codes to include standards of business conduct that the firm requires of its supervised persons, which must reflect the firm's and its supervised persons' fiduciary obligations. (**Required**) This section sets forth potential categories of topics that could be included in an adviser's business conduct standards. These categories combine legal requirements with suggested practices that may not be necessary or appropriate for all advisory firms. Firms should tailor any policies to their own unique characteristics and clientele.

[2] These exceptions from the term "covered security" are expressly excluded from the reporting requirements of new rule 204A-1. These exceptions are also permitted by Investment Company Act rule 17j-1.

A. **Compliance with Laws and Regulations.** The code should provide that supervised persons must comply with applicable federal securities laws. (**Required**)

1. As part of this requirement, the code should specify that supervised persons are not permitted, in connection with the purchase or sale, directly or indirectly, of a security held or to be acquired by a client:

    a. To defraud such client in any manner;

    b. To mislead such client, including by making a statement that omits material facts;

    c. To engage in any act, practice or course of conduct which operates or would operate as a fraud or deceit upon such client;

    d. To engage in any manipulative practice with respect to such client; or

    e. To engage in any manipulative practice with respect to securities, including price manipulation.

2. Advisers should consider whether to specifically discuss other federal securities laws that may be applicable to their supervised persons.

    a. *Note*. Regulation S-P (privacy requirements) and anti-money laundering requirements imposed on mutual funds and proposed for investment advisers are considered to be federal securities laws.

B. **Conflicts of Interest.** The code should provide that, as a fiduciary, the firm has an affirmative duty of care, loyalty, honesty, and good faith to act in the best interests of its clients. Compliance with this duty can be achieved by trying to avoid conflicts of interest and by fully disclosing all material facts concerning any conflict that does arise with respect to any client. In addition, firms may wish to impose a higher standard by providing that individuals subject to the code must try to avoid situations that have even the *appearance* of conflict or impropriety.

1. *Conflicts Among Client Interests*. Conflicts of interest may arise where the firm or its supervised persons have reason to favor the interests of one client over another client (*e.g.*, larger accounts over smaller accounts, accounts compensated by performance fees over accounts not so compensated, accounts in which employees have made material personal investments, accounts of close friends or relatives of supervised persons). The IAA recommends that the code specifically prohibit inappropriate favoritism of one client over another client that would constitute a breach of fiduciary duty. Advisers should include in the code or elsewhere procedures designed to address such conflicts.

2. *Competing with Client Trades*. The IAA recommends that the code prohibit access persons from using knowledge about pending or currently considered securities transactions for clients to profit personally, directly or indirectly, as a result of such transactions, including by purchasing or selling such securities. Conflicts raised by personal securities transactions also are addressed more specifically in section D below.

3. *Other Potential Conflicts Provisions.* Advisers may wish to consider the following additional types of conflicts provisions:

    a. *Disclosure of personal interest.* Many advisers prohibit investment personnel from recommending, implementing or considering any securities transaction for a client without having disclosed any material beneficial ownership, business or personal relationship, or other material interest in the issuer or its affiliates, to an appropriate designated person (*e.g.*, the chief investment officer or, with respect to the chief investment officer's interests, another designated senior officer). If such designated person deems the disclosed interest to present a material conflict, the investment personnel may not participate in any decision-making process regarding the securities of that issuer.

        1) *Note*. This provision would apply in addition to the firm's quarterly and annual personal securities reporting requirements.

        2) *Research Analysts*. If a research analyst has a material interest in an issuer, the firm may wish to assign a different analyst to cover the issuer.

    b. *Referrals/Brokerage*. Although already addressed in separate policies and procedures, advisers may wish to include in the code itself a provision requiring supervised persons to act in the best interests of the firm's clients regarding execution and other costs paid by clients for brokerage services. As part of this principle, the code would remind supervised persons to strictly adhere to the firm's policies and procedures regarding brokerage (including allocation, best execution, soft dollars, and directed brokerage). Such policies and procedures generally are too detailed to be included in the code, but may be cross-referenced.

    c. *Vendors and Suppliers.* Some advisers include a provision in their codes requiring supervised persons to disclose any personal investments or other interests in vendors or suppliers with respect to which the person negotiates or makes decisions on behalf of the firm. Firms with this type of provision in their code generally prohibit supervised persons with such interests from negotiating or making decisions regarding the firm's business with those companies.

d. *No Transactions with Clients.* A few advisers include a provision specifically stating that supervised persons are not permitted to knowingly sell to or purchase from a client any security or other property, except securities issued by the client.

C. **Insider Trading.** Codes of ethics should include a provision prohibiting supervised persons from trading, either personally or on behalf of others, while in possession of material, nonpublic information. The provision should also prohibit personnel from communicating material nonpublic information to others in violation of the law. The code should either include the firm's insider trading policies and procedures or cross-reference these policies and procedures.

1. *Penalties.* Advisers that have separate insider trading policies and procedures may wish to include a discussion of potential insider trading penalties in the code itself, including civil injunctions, permanent bars from employment in the securities industry, civil penalties up to three times the profits made or losses avoided, criminal fines, and jail sentences. Advisers may also wish to emphasize that although access persons are most likely to come in contact with material nonpublic information, the prohibition on insider trading and potential sanctions apply to all employees, officers, and directors.

2. *Special Procedures.* Advisers must tailor their insider trading policies to the circumstances of their firm, their employees, and their clients. For example, a firm that permits employees to serve on the boards of public companies or on creditors committees may require special procedures. Similarly, firms with clients that are publicly traded companies or clients who are insiders at public companies may need additional cautionary provisions in their codes. Advisers should consider information provided not only by insiders, but also by paid consultants and other third parties in drafting their policies and procedures.

3. *Material Nonpublic Information.* Advisers should note the SEC's position that the term "material nonpublic information" relates not only to issuers but also to the adviser's securities recommendations and client securities holdings and transactions.

D. **Personal Securities Transactions.** Codes of ethics should include a provision requiring all access persons strictly to comply with the firm's policies and procedures regarding personal securities transactions. Some firms maintain a separate personal securities transactions policy. Others include the policy within the code of ethics. The IAA recommends the following provisions for a firm's personal securities transactions policy:

1. *Initial Public Offerings – Prohibition*. The IAA recommends that codes of ethics prohibit *investment personnel* from acquiring any securities in an initial public offering, in order to preclude any possibility of their profiting improperly from their positions with an adviser.

    a. *Note*. The SEC's rule requires pre-clearance of an *access person's* participation in IPOs. (**Required**) For simplicity, a firm may wish to prohibit all access persons from participating in IPOs, rather than requiring pre-clearance for access persons who are not also investment personnel.

    b. *Sole Proprietors*. The SEC rule exempts firms with only one access person from the IPO pre-clearance requirement.

2. *Limited or Private Offerings – Pre-Clearance.* The rule mandates that codes of ethics require express prior approval of any acquisition of securities by access persons in a limited offering (*e.g.*, private placement). (**Required**) The IAA recommends that this prior approval take into account, among other factors, whether the investment opportunity should be reserved for clients, and whether the opportunity is being offered to an individual by virtue of his or her position with the adviser.

    a. The IAA further recommends that investment personnel who have been authorized to acquire securities in a private placement should be required to *disclose* that investment when they play a part in any client's subsequent consideration of an investment in the issuer; and

    b. In such circumstances, the decision to purchase securities of the issuer for the client should be made either by another employee or, at a minimum, should be subject to an independent review by investment personnel with no personal interest in the issuer.

    c. The new rule exempts firms with only one access person from the pre-clearance requirement for limited offerings.

3. *Blackout Periods.* The IAA recommends that codes of ethics prohibit any access person from executing a securities transaction on a day during which any client has a pending "buy" or "sell" order in the same (or a related) security until that order is executed or withdrawn. The IAA recommends that advisers consider an additional prohibition on purchase or sale by access persons or investment personnel of a security within a so-called "blackout" period, *i.e.*, a prescribed number of calendar days before and after a client trades in that security.

    a. The IAA recognizes that policies on "blackout" periods, the length of such periods, and the persons or categories of persons to whom they apply will vary to meet the particular nature and practices of individual firms.

b. Some firms provide exemptions from the blackout period for certain types of transactions that do not present the potential for conflicts of interest, including those set forth in Part 4, section A.3 below.

c. Some firms have a separate blackout period that applies when an analyst changes his or her recommendation.

4. *Short-Term Trading.* The IAA recommends that advisers restrict short-term trading by investment personnel. Any profits realized on prohibited short-term trades should be required to be disgorged.

   a. *Duration*. The duration of a ban on short-term trading is a policy matter for each firm. Common durations for non-fund advisers are 30 days and 60 days.

   b. *Persons Covered*. Depending on the size and nature of the firm, the adviser may wish to consider extending this prohibition to access persons or all supervised persons.

   c. *Securities Covered*. Some advisers prohibit short-term trading only with respect to securities held in client accounts.

   d. *Fund Advisers*. The IAA recommends that investment advisory firms that advise or sub-advise mutual funds either (a) define the securities transactions covered by the code to include transactions in mutual funds advised by the adviser or certain affiliates or sub-advised by the adviser; (b) expressly prohibit access persons from engaging in short-term trading in mutual funds advised by the firm or its affiliates or sub-advised by the firm; or (c) require pre-clearance of access persons' redemptions or exchanges of the adviser's funds or sub-advised funds within 30 days of purchase.

      1) *Note*. This type of provision is recommended to deter and/or monitor for any market timing by fund adviser employees, in addition to the reporting requirements set forth in Part 4.A below.

5. *Miscellaneous Restrictions.* Advisers may wish to consider some of the following additional restrictions:

   a. *Margin Accounts.* Some advisers discourage or prohibit their personnel from purchasing securities on margin.

   b. *Short Sales.* Some advisers generally prohibit their personnel from selling any security short, except for short sales "against the box." Alternately, some advisers prohibit short sales in any security that is owned by any client of the firm.

   c. *Options and Futures.* Options and futures are covered securities subject to all sections of the code. Some advisers impose additional restrictions on

transactions involving puts, calls, straddles, options, or futures either generally or with respect to options or futures related to securities held by clients of the firm.

d. *Limit Orders.* Some firms prohibit access persons from placing a "good until cancelled" order or any limit order other than a "same-day" limit order.

e. *Significant Holdings.* A few firms prohibit their investment personnel from holding more than a specified percentage of the outstanding securities of one company without (a) disclosure; or (b) approval by the chief compliance officer or other designated person.

f. *Restricted List.* Some firms maintain a list of securities that the firm is analyzing or considering for client transactions, and prohibit their access persons from personal trading in those securities.

g. *Frequent Trading.* In addition to prohibiting short-term trading in the same security, some firms explicitly discourage frequent trading in general because it may be a potential distraction from servicing clients.

E. **Gifts and Entertainment.** The IAA recommends that codes of ethics contain the following types of provisions regarding gifts and entertainment.

1. *General Statement.* A conflict of interest occurs when the personal interests of employees interfere or could potentially interfere with their responsibilities to the firm and its clients. *The overriding principle is that supervised persons should not accept inappropriate gifts, favors, entertainment, special accommodations, or other things of material value that could influence their decision-making or make them feel beholden to a person or firm.* Similarly, supervised persons should not offer gifts, favors, entertainment or other things of value that could be viewed as overly generous or aimed at influencing decision-making or making a client feel beholden to the firm or the supervised person.

   a. *Note*. This general principle applies in addition to the more specific guidelines set forth below.

2. *Gifts.* No supervised person may receive any gift, service, or other thing of more than *de minimis* value from any person or entity that does business with or on behalf of the adviser. No supervised person may give or offer any gift of more than *de minimis* value to existing clients, prospective clients, or any entity that does business with or on behalf of the adviser without pre-approval by the chief compliance officer.

3. *Cash.* No supervised person may give or accept cash gifts or cash equivalents to or from a client, prospective client, or any entity that does business with or on behalf of the adviser.

4. *Entertainment.* No supervised person may provide or accept extravagant or excessive entertainment to or from a client, prospective client, or any person or entity that does or seeks to do business with or on behalf of the adviser. Supervised persons may provide or accept a business entertainment event, such as dinner or a sporting event, of reasonable value, if the person or entity providing the entertainment is present.

5. *Additional Provisions.* Some firms include provisions that provide additional specificity regarding gifts and entertainment. Firms may wish to consider including some of the following types of provisions in their code where appropriate:

    a. *Specific De Minimis.* Advisers may wish to delineate a *de minimis* value for gifts or entertainment in their codes of ethics. The specific amount may vary depending on the nature and location of the firm and its clients. Firms that are dual registrants sometimes use a $100 gift *de minimis* for all employees based on NASD rules.

    b. *Pre-Clearance.* Some firms require pre-clearance of business entertainment events exceeding a specified amount in value, or of a certain type (*e.g.*, offer of travel expenses or hotel accommodations), or to certain categories of persons (*e.g.*, government officials).

    c. *Reporting.* Some firms require quarterly reporting of gifts and entertainment received by certain categories of personnel. Some firms also keep logs of gifts and entertainment provided and received.

    d. *Solicited Gifts.* Some firms expressly prohibit employees from soliciting for themselves or the firm gifts or anything of value. Some policies express this concept in terms of a prohibition on a supervised person's using his or her position with the firm to obtain anything of value from a client, supplier, person to whom the employee refers business, or any other entity with which the firm does business.

    e. *Appropriate Circumstances.* Some firms specifically list acceptable types of gifts and entertainment and/or specify that receipt of entertainment is acceptable if the expenses would have been paid as a firm business expense. Some firms clarify that discounts and rebates on merchandise or services are appropriate only where they do not exceed those available for other customers.

    f. *Referrals.* Some policies include a provision that supervised persons may not make referrals to clients (*e.g.*, of accountants, attorneys, or the like) if the supervised person expects to benefit in any way.

    g. *Government Officials.* Firms that engage in certain types of business, such as managing state or municipal pension funds, may want to include special

provisions regarding government officials. For example, the code may make employees aware that certain laws or rules in various jurisdictions may prohibit or limit gifts or entertainment extended to public officials. *See also* subsection 5.b above.

F. **Political and Charitable Contributions.** The IAA recommends that any investment adviser that provides investment supervisory services to government entities, or that seeks to provide such services, prohibit employees from making political contributions for the purpose of obtaining or retaining advisory contracts with government entities. In addition, an adviser should prohibit its supervised persons from considering the adviser's current or anticipated business relationships as a factor in soliciting political or charitable donations. For more information, *see* IAA's *Best Practice Pay-to-Play Guidelines for Adviser Codes of Ethics* (May 15, 2000).

G. **Confidentiality.** All confidentiality provisions should start with the basic fiduciary premise that information concerning the identity of security holdings and financial circumstances of clients is confidential.

1. *Firm Duties.* The IAA recommends that codes include a provision stating that the adviser must keep all information about clients (including former clients) in strict confidence, including the client's identity (unless the client consents), the client's financial circumstances, the client's security holdings, and advice furnished to the client by the firm.

2. *Supervised Persons' Duties.* As part of or in addition to insider trading procedures, an adviser should prohibit supervised persons from disclosing to persons outside the firm any material nonpublic information about any client, the securities investments made by the firm on behalf of a client, information about contemplated securities transactions, or information regarding the firm's trading strategies, except as required to effectuate securities transactions on behalf of a client or for other legitimate business purposes.

    a. *Disclosure of Holdings.* Some firms include a provision in their code that governs the timing of the firm's disclosure of fund or model portfolio holdings to clients, consultants, or prospective clients upon request. Such a provision is designed to ensure that some clients are not able to receive such information earlier than other clients and to ensure that the information is no longer material in the sense of affecting the firm's trading strategies. A firm may also require consultants to abide by a confidentiality agreement and stipulation not to trade on the information provided.

3. *Internal Walls.* Depending on the size and nature of the firm, a firm may wish to prohibit access persons from disclosing nonpublic information concerning clients or securities transactions to non-access persons within the firm. Similarly, a firm with affiliates may include a provision prohibiting supervised persons from

sharing information with persons employed by affiliated entities, except for legitimate business purposes.

4. *Physical Security.* A few firms discuss the physical security of nonpublic information in this section. For example, a policy might state that files containing material nonpublic information should be sealed and access to computer files containing such information should be restricted.

5. *Regulation S-P.* A few firms also expressly cross-reference their Regulation S-P privacy policy under the confidentiality section. Such a provision would mandate that supervised persons comply with the firm's privacy policy, which the firm could attach to or reference in the code.

    a. *Note*. Regulation S-P covers only a subset of an adviser's confidentiality standards. Regulation S-P applies only to natural persons and only to personal information. An adviser's fiduciary duty to keep client information confidential extends to *all* of the firm's clients and information.

H. **Service on a Board of Directors.** The IAA recommends that codes of ethics set out the circumstances under which investment personnel may serve on boards of directors of publicly traded companies. Because of the high potential for conflicts of interest and insider trading problems, such situations should be carefully scrutinized and subject to prior approval. In the relatively small number of instances in which board service is authorized, investment personnel serving as directors normally should be isolated, through information barriers or other procedures, from those making investment decisions regarding the issuer.

1. *Ban.* Some advisers state more strongly that they prohibit supervised persons from serving as directors of public companies and state that exceptions will be made only when in the best interests of the firm and its clients.

2. *Private Company Going Public.* Some firms include a provision that a director of a private company may be required to resign, either immediately or at the end of the current term, if the company goes public during his or her term as director.

I. **Other Outside Activities.** In addition to addressing service on boards of publicly traded companies, many firms have provisions addressing the following issues:

1. *General.* The firm may discourage supervised persons from engaging in outside business or investment activities that may interfere with their duties with the firm. Some firms prohibit supervised persons from maintaining any outside business affiliations, including directorships of private companies, consulting engagements, or public/charitable positions, without the prior written approval of the appropriate officer at the firm.

2. *Fiduciary Appointments.* Firms often require that supervised persons obtain firm approval before accepting an executorship, trusteeship, or power of attorney, other than with respect to a family member. With respect to fiduciary appointments on behalf of family members, some firms require disclosure at the inception of the relationship.

3. *Creditors Committees.* Some firms prohibit a supervised person from serving on a creditors committee except as approved by the firm as part of the person's employment duties.

4. *Disclosure.* Regardless of whether an activity is specifically addressed in the code, supervised persons should disclose any personal interest that might present a conflict of interest or harm the reputation of the firm.

J. **Marketing and Promotional Activities.** The IAA recommends that the code include a provision reminding supervised persons that all oral and written statements, including those made to clients, prospective clients, their representatives, or the media, must be professional, accurate, balanced, and not misleading in any way. Firms may wish to cross-reference the advertising section of their compliance manuals. Many advisers also require pre-clearance for promotional materials, either in their codes or in separate compliance policies and procedures.

PART 4. COMPLIANCE PROCEDURES

The IAA suggests the following compliance procedures to implement firms' codes of ethics. Some firms may include these provisions in the code itself, while others may wish to include them in a separate compliance policies and procedures. Firms may wish to consider extending these procedures to some group of employees broader than access persons, or to all employees.

A. Personal Securities Transaction Procedures and Reporting.

1. *Pre-Clearance Procedures.* The IAA recommends that access persons be required to obtain pre-clearance for transactions in covered securities (as defined by the firm). The pre-clearance requirements and associated procedures should be reasonably designed to identify any prohibition or limitation applicable to a proposed investment. Pre-clearance procedures typically include:

   a. A standard form to be submitted by the requesting access persons, containing all relevant information about the proposed transaction;

   b. The time that pre-clearance expires (*e.g.*, same business day, 48 hours, etc.). Note that advisers with non-U.S. offices may find that pre-clearance needs to be extended to accommodate the different hours of non-U.S. markets;

c. Designation of chief compliance officer or other person to authorize requested transactions;

d. Designation of individual responsible for authorizing transactions of the chief compliance officer or other person that authorizes transactions; and

e. Documentation of the authorization, including time and signature of authorizing individual.

Procedures should include monitoring of personal investment activity of access persons and others who have been granted pre-clearance. For example, post-trade reports or duplicate confirmations should be checked against the log or file of pre-clearance approvals.

2. *Reporting Requirements.*

a. *Holdings Reports.* The code must require access persons to submit to the chief compliance officer (or other person designated in the code) a report of all holdings in covered/reportable securities within 10 days of becoming an access person and thereafter on an annual basis. (**Required**) The holdings report must include: (i) the title and exchange ticker symbol or CUSIP number, type of security, number of shares and principal amount (if applicable) of each reportable security in which the access person has any direct or indirect beneficial ownership; (ii) the name of any broker, dealer or bank with which the access person maintains an account in which any securities are held for the access person's direct or indirect benefit; and (iii) the date the report is submitted. (**Required**)

1) *Note*. Most firms supply their access persons with initial and annual holdings report forms indicating the information required, in lieu of specifying the content of the reports in the code itself. These forms often include certifications as to the completeness and accuracy of the information provided.

2) *Current information*. The information supplied must be current as of a date no more than 45 days before the annual report is submitted. For new access persons, the information must be current as of a date no more than 45 days before the person became an access person.

3) *Account identifier.* In addition to the required items listed above, some firms require their access persons to include specific account numbers or identifiers in their holdings reports.

b. *Quarterly Transaction Reports.* The code must require access persons to submit to the chief compliance officer (or other person designated in the code) transaction reports no later than 30 days after the end of each calendar quarter covering all transactions in covered/reportable securities during the quarter.

(**Required**) The transaction reports must include information about each transaction involving a reportable security in which the access person had, or as a result of the transaction acquired, any direct or indirect beneficial ownership. The reports must include: (i) the date of the transaction, the title and exchange ticker symbol or CUSIP number, the interest rate and maturity date (if applicable), the number of shares and the principal amount (if applicable) of each reportable security involved; (ii) the nature of the transaction (*e.g.*, purchase, sale); (iii) the price of the security at which the transaction was effected; (iv) the name of the broker, dealer, or bank with or through which the transaction was effected; and (v) the date the report is submitted. (**Required**)

1) *Note*. Again, most firms provide access persons with quarterly transaction report forms in lieu of listing the required content of the reports in the code. Some firms require this information on a monthly basis.

c. *Quarterly Brokerage Account Reports.* Fund advisers must include in their codes a provision requiring access persons to disclose the following information about any account opened during the quarter containing securities held for the direct or indirect benefit of the access person: (i) the name of the broker, dealer or bank with whom the access person established the account; (ii) the date the account was established; and (iii) the date the report is submitted. (**Required for fund advisers**).

1) *Note*. The IAA recommends that non-fund advisers require access persons to disclose all securities accounts to the chief compliance officer or other designated person.

d. *Confidentiality of Reports.* Some firms include a provision assuring access persons that their transactions and holdings reports will be maintained in confidence, except to the extent necessary to implement and enforce the provisions of the code or to comply with requests for information from government agencies.

3. *Exempt Transactions*

a. *Reporting Exemptions.* Under the rule, an adviser's code need not require an access person to submit:

1) Any report with respect to securities held in accounts over which the access person has no direct or indirect influence or control;

a) *Note*. With respect to access persons who have accounts managed by investment advisers on a discretionary basis, firms may wish to require reporting (but not pre-clearance) for monitoring purposes.

2) A transaction report with respect to transactions effected pursuant to an automatic investment plan;

a) *Note*. This exemption includes dividend reinvestment plans.

3) A transaction report if the report would duplicate information contained in broker trade confirmations or account statements that the firm holds in its records so long as the firm receives the confirmations or statements no later than 30 days after the end of the applicable calendar quarter; and

4) Any transaction or holding report if the firm has only one access person, so long as the firm maintains records of the information otherwise required to be reported under the rule.

b. *Pre-Clearance Exemptions.* Firms that require pre-clearance of access persons' personal securities transactions include some or all of the following types of exemptions from pre-clearance (but not from reporting) requirements:

1) Purchases or sales over which an access person has no direct or indirect influence or control (the corollary of (a)(i) above);

2) Purchases or sales pursuant to an automatic investment plan (the corollary of (a)(ii) above);

3) Purchases effected upon exercise of rights issued by an issuer *pro rata* to all holders of a class of its securities, to the extent such rights were acquired from such issuers, and sales of such rights so acquired;

4) Acquisition of securities through stock dividends, dividend reinvestments, stock splits, reverse stock splits, mergers, consolidations, spin-offs, and other similar corporate reorganizations or distributions generally applicable to all holders of the same class of securities;

5) Open end investment company shares *other than* shares of investment companies advised by the firm or its affiliates or sub-advised by the firm;

6) Certain closed-end index funds;

7) Unit investment trusts;

8) Exchange traded funds that are based on a broad-based securities index;

9) Futures and options on currencies or an a broad-based securities index;

10) Transactions in certain types of debt securities (*e.g.*, municipal bonds) where the firm is an equity-only adviser or other similar circumstances where conflicts of interest would not arise;

11) Other non-volitional events, such as assignment of options or exercise of an option at expiration; or

12) *De minimis* transactions in large-cap securities.

a) The transaction parameters set forth by firms for these exemptions are varied. Most firms specify a market capitalization for issuers in conjunction with a specified limit on the number of shares involved in the transaction (*e.g.*, no more than 1,000 shares in a issuer with a market capitalization of $10 billion or greater, in a one-month period).

b) The *de minimis* parameters will vary depending on the size of the firm, the nature of its business, its investment strategy, and whether the size of client transactions involves market-moving potential.

c. *Other exemptions.* Many advisers use the pre-clearance exemptions listed above for other personal trading restrictions such as blackout periods and short-term trading restrictions. Some advisers that sponsor unregistered funds and that allow employees and principals to invest in those funds exempt trades in those unregistered funds from pre-clearance and other personal trading restrictions.

4. *Duplicate Brokerage Confirmations and Statements.* The IAA recommends that advisers' codes require access persons to direct their brokers to provide to the chief compliance officer or other designated compliance official, on a timely basis, duplicate copies of confirmations of all personal securities transactions and copies of periodic statements for all securities accounts. Firms may wish to permit their access persons to use such duplicate brokerage confirmations and account statements in lieu of submitting their quarterly transaction reports, provided that all of the required information is contained in those confirmations and statements.

5. *Designated Brokerage Accounts.* Some advisers, particularly larger firms, require their employees to maintain their personal brokerage and trading accounts with a firm-designated broker or limit the number of brokers employees may use. Other firms require employees to obtain permission or provide prior notice before opening a new account. Some fund advisers, where feasible, may wish to prohibit their access persons from buying shares of mutual funds advised or subadvised by

the adviser through omnibus accounts and requiring access persons to buy such shares directly from the fund's transfer agent.

6. *Monitoring of Personal Securities Transactions.* Advisers are required to review personal securities transactions and holdings reports periodically. (**Required**) The IAA recommends the following procedures to implement this requirement:

    a) The firm should designate an individual or position that is responsible for reviewing and monitoring personal securities transactions and trading patterns of access persons ("Reviewer").

    b) The firm should designate an individual or position that is responsible for reviewing and monitoring the personal securities transactions of the Reviewer and for taking on the responsibilities of the Reviewer in the Reviewer's absence.

    c) Advisers should consider including a written procedure for the Reviewer to follow should the Reviewer become aware of potential violations of the code.

    d) Advisers should consider excluding specific monitoring and reviewing procedures from the code itself. Overly specific detail regarding these procedures may provide an opportunity for wrongdoers to evade detection. However, the SEC has suggested that review of personal securities holding and transaction reports include:

        1) An assessment of whether the access person followed any required internal procedures, such as pre-clearance;

        2) Comparison of personal trading to any restricted lists;

        3) An assessment of whether the access person is trading for his or her own account in the same securities he or she is trading for clients, and if so, whether the clients are receiving terms as favorable as the access person takes for him or herself;

        4) Periodically analyzing the access person's trading for patterns that may indicate abuse, including market timing; and

        5) An investigation of any substantial disparities between the percentage of trades that are profitable when the access person trades for his or her own account and the percentage that are profitable when he or she places trades for clients.

B. **Pre-Clearance and Reporting of Gifts and Outside Activities.** Firms that choose to include pre-clearance procedures for gifts, entertainment, donations, outside directorships, or other activities should include procedures similar to those suggested

for personal securities transactions (*e.g.*, designation of authorizing individual/committee, documentation, and so forth). Similarly, firms that choose to require reporting of gifts, entertainment, and donations should provide forms or specifications for their employees, as well as guidance on frequency of reporting. Such firms should also set forth procedures for review and analysis of the reports received.

C. **Certification of Compliance**

1. *Initial Certification.* The firm is required to provide all supervised persons with a copy of the code. The IAA recommends that advisers require all supervised persons to certify in writing that they have: (a) received a copy of the code; (b) read and understand all provisions of the code; and (c) agreed to comply with the terms of the code. (**Acknowledgement of receipt of code required**)

2. *Acknowledgement of Amendments.* The advisory firm must provide supervised persons with any amendments to the code and supervised persons should submit a written acknowledgement that they have received, read, and understood the amendments to the code. (**Acknowledgement of receipt of amendments required**)

    a) *Note*. The SEC rule requires that supervised persons receive any amendments to the code. Accordingly, to avoid inundating employees, firms may wish to reserve technical amendments to include in the annual process or to include with any material amendments. In addition, firms may wish to use titles or positions instead of specific names in the code.

    b) *Attention to changes*. Rather than simply distribute the amended code, the adviser should bring important changes to the attention of employees.

3. *Annual Certification.* The IAA recommends that all supervised persons annually certify that they have read, understood, and complied with the code of ethics. In addition, firms may wish more specifically to require the certification to include a representation that the supervised person has made all of the reports required by the code and has not engaged in any prohibited conduct. Conversely, if the employee is unable to make such a representation, the firm should require the employee to self-report any violations.

    a) *Note*. As part of the annual code of ethics certification, a few firms also require supervised persons to certify annually that they are not subject to any of the disciplinary events listed in Item 11 of Form ADV, Part 1.

PART 5. RECORDKEEPING

Advisers may wish to include recordkeeping provisions relevant to the code in the code itself as well as in any separate recordkeeping policies and procedures in the firm's

compliance manual. If so, the code's recordkeeping provision should state that the firm will maintain the following records in a readily accessible place: (Required records)

1. A copy of each code that has been in effect at any time during the past five years;

2. A record of any violation of the code and any action taken as a result of such violation for five years from the end of the fiscal year in which the violation occurred;

3. A record of all written acknowledgements of receipt of the code and amendments for each person who is currently, or within the past five years was, a supervised person;

    a) These records must be kept for five years after the individual ceases to be a supervised person of the firm.

4. Holdings and transactions reports made pursuant to the code, including any brokerage confirmation and account statements made in lieu of these reports;

5. A list of the names of persons who are currently, or within the past five years were, access persons;

    a) Firms may wish to consider maintaining a list of investment personnel as well.

6. A record of any decision and supporting reasons for approving the acquisition of securities by access persons in limited offerings for at least five years after the end of the fiscal year in which approval was granted.

    a. *Note*. Firms that require pre-approval of access persons' investments in IPOs rather than prohibiting such investments would also be required to maintain records of such approvals.

    b. *Other approvals*. The IAA recommends that firms consider maintaining records of any decisions that grant employees or access persons a waiver from or exception to the code.

Fund advisers must also maintain:

1. A record of persons responsible for reviewing access persons' reports currently or during the last five years; and

2. A copy of reports provided to the fund's board of directors regarding the code.

PART 6. FORM ADV DISCLOSURE

The SEC's new rule requires advisers to include on Schedule F of Form ADV, Part II a description of the firm's code and to state that the firm will provide a copy of the code to any client or prospective client upon request. (**Required**) Advisers should take care to review and update the firm's Part II disclosure in connection with making amendments to the code.

PART 7. ADMINISTRATION AND ENFORCEMENT OF THE CODE

A. **Training and Education.** Advisers should consider designating the individual or position responsible for training and educating supervised persons regarding the code. Advisers should also consider stating in the code that training will occur periodically and that all supervised persons are required to attend any training sessions or read any applicable materials.

B. **Annual Review.** The code should require the chief compliance officer to review at least annually the adequacy of the code and the effectiveness of its implementation.

   1. *Note*. Because the code of ethics is part of a firm's overall compliance program, this review is required by Investment Advisers Act rule 206(4)-7 (the compliance program rule). Fund advisers should also coordinate this review with the compliance program review required by Investment Company Act rule 38a-1.

C. **Board Approval (Fund Advisers).** Fund advisers are required to have their codes approved by the board of directors of any mutual funds they advise or sub-advise. Any material amendments to the code must also be approved by the board. (**Required by Investment Company Act rule 17j-1**)

   1. *Note*. Fund advisers may wish to coordinate board approval of their codes with the compliance program approval required by Investment Company Act rule 38a-1.

D. **Report to Board (Fund Advisers).** Fund advisers are required to provide an annual written report to the board of the directors of the funds they advise or sub-advise that describes any issues arising under the code since the last report, including information about material violations of the code and sanctions imposed in response to such violations. The report must include discussion of whether any waivers that might be considered important by the board were granted during the period. The report must also certify that the adviser has adopted procedures reasonably necessary to prevent access persons from violating the code. (**Required by Investment Company Act rule 17j-1**)

   1. *Note*. Fund advisers may wish to coordinate this report with the annual compliance program report required by Investment Company Act rule 38a-1.

E. **Report to Senior Management (All Advisers).** Depending on the size and structure of the firm, an adviser should consider requiring the chief compliance officer to report to senior management regarding his or her annual review of the code and to bring material violations to the attention of senior management.

1. *Note*. If the chief compliance officer is a member of senior management, this provision may be less appropriate.

F. **Reporting Violations.** The code must require all supervised persons to report violations of the firm's code of ethics promptly to the chief compliance officer or other appropriate personnel designated in the code (provided the chief compliance officer also receives reports of all violations). (**Required**)

1. *Confidentiality.* Advisers may wish to state that such reports will be treated confidentially to the extent permitted by law and investigated promptly and appropriately. Similarly, advisers may permit reports to be submitted anonymously.

2. *Alternate Designee.* Advisers should consider designating an alternate person to whom employees may report violations in case the chief compliance officer or other primary designee is involved in the violation or is unreachable.

3. *Types of Reporting.* Advisers may also wish to illustrate for supervised persons the types of reporting required, such as: noncompliance with applicable laws, rules, and regulations; fraud or illegal acts involving any aspect of the firm's business; material misstatements in regulatory filings, internal books and records, clients records or reports; activity that is harmful to clients, including fund shareholders; and deviations from required controls and procedures that safeguard clients and the firm.

4. *Advice of Counsel.* Advisers may wish to encourage their supervised persons to seek advice from the legal department with respect to any action or transaction which may violate the code and to refrain from any action or transaction with might lead to the appearance of a violation.

5. *Apparent Violations.* Advisers may consider requiring supervised persons to report "apparent" or "suspected" violations in addition to actual or known violations of the code.

6. *Retaliation.* Advisers may wish specifically to state that retaliation against an individual who reports a violation is prohibited and constitutes a further violation of the code.

G. **Sanctions.** The IAA recommends that the code warn supervised persons that any violation of the code may result in any disciplinary action that a designated person or group (*e.g.*, chief compliance officer, compliance committee) deems appropriate,

including but not limited to a warning, fines, disgorgement, suspension, demotion, or termination of employment. In addition to sanctions, violations may result in referral to civil or criminal authorities where appropriate.

H. **Further Information Regarding the Code.** The IAA suggests that the code provide information about where supervised persons may turn for additional information about the code or any other ethics-related questions. Advisers may wish to provide names and contact information of individuals, such as the chief compliance officer or members of an ethics or compliance committee, or information about written resources.

July 20, 2004