INVESTMENT ADVISER
ASSOCIATION

January 15, 2009

Via Electronic Filing

Jonathan J. Stokes
Director, Standards of Practice
CFA Institute Centre for Financial Market Integrity
CFA Institute
560 Ray C. Hunt Drive
Charlottesville, VA 22903-2981

Re: Proposed Risk Management Requirements for Investment Advisers

Dear Mr. Stokes:

The Investment Adviser Association[1] appreciates the opportunity to comment on the risk management requirements that the CFA Institute Centre for Financial Market Integrity has proposed adding to its Asset Manager Code of Professional Conduct ("CFA Code").[2] In particular, the CFA Centre has proposed amending the Compliance and Support section of the CFA Code to require investment advisers and other asset managers to include the following principle, "Establish a risk management process that identifies, monitors, and analyzes the risk position of the Manager and its investments, including the sources, nature and degree of risk exposure," as well as related guidance ("Risk Management Proposal"). The IAA supports the principle of establishing risk management processes, but does not believe that such processes appropriately belong in the CFA Code. Should the CFA Centre proceed with incorporating the risk management principle into its Code, we have a number of specific comments regarding the guidance accompanying the principle.

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[1] The IAA is a not-for-profit association that exclusively represents the interests of investment adviser firms registered with the SEC. Founded in 1937, the Association's membership consists of investment advisory firms that manage assets for a wide variety of institutional and individual clients, including pension plans, trusts, investment companies, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org.

[2] *See CFA Institute Centre Proposes New Risk Management Requirements for Asset Managers*, available at http://www.cfainstitute.org/aboutus/press/release/08releases/20081111_02.html, and *Appendix A: Addendum to the AMC relating to Risk Management*, available at http://www.cfainstitute.org/centre/codes/asset/pdf/proposed_risk_management_addendum.pdf.

Background

In 2005, the IAA provided extensive comments in response to the CFA Centre's draft Asset Manager Code of Professional Conduct.[3] At that time, we expressed concern that development of a code for a particular category of employers of CFA Institute members (*e.g.* investment advisers) was unnecessary for firms that are already subject to detailed regulatory requirements regarding codes of ethics. We noted that the scope of the Institute's membership makes developing a code for a particular category of employers somewhat impractical as some members work for firms already regulated in the relevant areas and others do not. As an alternative, we suggested that the CFA Centre develop and issue a research paper on approaches to codes of ethics and conduct issues in various jurisdictions.

In addition, we suggested that if the CFA Centre were to proceed with its Code, it should make clear that the Code is voluntary, and that investment advisers, as employers of CFA Institute members, are not obligated to adopt it; that it acknowledge the competing obligations of firms to comply with the requirements of regulatory authorities in their governing jurisdictions to develop codes of ethics that reflect the expectations and practices of that jurisdiction; and that the scope of the code should be limited to broad principle-based concepts that emphasize the firm's fiduciary duty and address fundamental ethical concepts related to the firms' employees. In response to these comments and follow-up discussions, the CFA Centre addressed a number of our concerns in the final version of the CFA Code and additional guidance and interpretations published later that year.[4] We appreciate the CFA Centre's willingness to engage in dialogue on these issues and look forward to continued discussions in this regard.

Purpose and Scope of the CFA Code

Effective risk management is an important component of an investment adviser's investment management process, operations, and compliance program. The IAA supports the premise that investment advisers should establish a risk management process that identifies, monitors, and analyzes risk and exposure. Addressing risk management in the CFA Code, even in light of the current market situation, however, is misplaced. Consistent with our prior comments to the CFA Centre, we continue to believe that the CFA Code should focus on broad principle-based concepts that emphasize a firm's fiduciary duty and address fundamental ethical concepts related to a firm's employees.[5] Specific compliance and

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[3] *See* Letter to the CFA Centre for Financial Market Integrity, from Caroline Schaefer, Associate General Counsel, IAA, dated January 5, 2005, available at http://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Archived_Comments_Statements/letterscompendium-2005.pdf .

[4] These interpretations are available at: http://www.cfainstitute.org/centre/codes/asset/pdf/interpretive_memo.pdf.

[5] The Risk Management Proposal would be added to the Compliance and Support section of the Code. That section currently includes general principles pertaining to the development

operational considerations are not conducive to treatment in an ethical code, particularly one that the Centre seeks to apply globally to its members who are associated with firms subject to a wide range of regulation and oversight.

With respect to U.S.-based asset managers, for example, Rule 204A-1 of the Advisers Act requires all SEC-registered investment advisers to establish, maintain and enforce a written code of ethics that contains: (1) general standards of business conduct reflecting firms' fiduciary duties to their clients and provisions requiring compliance with the applicable federal securities laws; (2) a requirement that "access persons" report their personal securities holdings and securities transactions and pre-clear investments in initial public offerings and private placements; (3) a requirement that supervised persons of the adviser promptly report any violations of the code to a designated person; and (4) a requirement that the firm provide a copy of the code and any amendments to all supervised persons and obtain their written acknowledgement of receipt of those documents. The fiduciary nature of an investment adviser's obligations creates an ethical component to essentially all of the firm's activities. Nevertheless, an investment adviser's code of ethics typically addresses general ethical principles,[6] not specific policies and procedures, which are addressed as part of an adviser's compliance program.[7] This approach is consistent with language in the adopting release to Rule 204A-1 that states, "We urge advisers to take great care and thought in preparing their codes of ethics, which should be more than a compliance manual. Rather, a code of ethics should set out ideals for ethical conduct premised on fundamental principals of openness, integrity, honesty and trust."[8]

In contrast, the Risk Management Proposal goes beyond the scope of Rule 204A-1 and addresses a subject area not ordinarily included in advisers' codes of ethics. We appreciate the CFA Centre's guidance that a firm may claim compliance with the Code if it adheres to

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and maintenance of policies and procedures, the appointment of a compliance officer, the accuracy and completeness of portfolio information, the maintenance of records, the employment of qualified staff, and the establishment of a business continuity plan. In our 2005 comment letter, the IAA recommended against including specific topics such as business continuity and employee qualifications in a Code focused on broad ethical principles.

[6] For example, in addition to provisions addressing personal trading, the IAA recommends in its *Best Practices for Investment Adviser Codes of Ethics* that investment advisers may wish to consider including general provisions, as appropriate, regarding: (1) gifts and entertainment; (2) political and charitable contributions; (3) confidentiality; (4) service on boards of directors of publicly traded companies and other outside activities; (5) marketing and promotional activities; and (6) compliance policies and procedures related to the scope of the code.

[7] Except with respect to conflict of interest issues, policies and procedures pertaining to portfolio management, trading practices, disclosure, safeguarding client assets, and marketing usually are part of an adviser's compliance program, not its code of ethics.

[8] *Final Rule: Investment Adviser Codes of Ethics,* SEC Release Nos. IA-2256, IC-26492; File No. S7-04-04 (July 2, 2004) at 6, available at http://www.sec.gov/rules/final/ia-2256.htm.

the principles and provisions in the Code regardless of whether the principles are reflected in the firm's own code of ethics or in other policies and procedures. We are concerned, however, that adding the Risk Management Proposal to the CFA Code would force advisers to expend valuable time and resources repeatedly to explain to clients and potential clients why their risk management principles are not subsumed within their codes of ethics, but rather are covered as part of the firm's overall internal control structure.[9] In addition, for the reasons discussed below, the principles and guidance are of limited value. Accordingly, we urge that the Proposal not be added to the Code.

Proposed Guidance on Risk Management Processes

Should the CFA Centre nevertheless include the Risk Management Proposal in its Code, the IAA proffers the following specific comments regarding the proposed guidance accompanying the principle.

First, no uniform set of criteria is appropriate for risk management. Each firm should tailor its risk management process to the nature of its own business, clients, investment style, and investment team. We agree with the proposed guidance that "there is no single authoritative method or definitive model that can be universally applied to evaluate risk." For that reason, however, the guidance that follows is not particularly helpful to firms in developing an effective risk management process. For example, the focus on leverage and liquidity is inapplicable for a significant number of investment advisers in light of the nature of their businesses. In addition, depending on their businesses, investment advisers following best practices would not necessarily perform stress tests, scenario tests, and backtests as part of developing risk models.

Second, the proposed guidance states that "[r]isk management that is objective and independent of the portfolio management process is imperative to understanding and controlling these types of risk." However, risk management is an integral part of portfolio management. Many firms appropriately include in their risk management committees and process the portfolio managers with the most intimate knowledge of the risks involved in investment strategies they employ. Accordingly, the guidance should clarify that it may be appropriate for portfolio managers to be involved in the risk management process.

We appreciate that firms claiming compliance with the Code are encouraged, but not required, to adhere to the guidance accompanying each principle. Again, however, clients and potential clients may use the guidance as a source of questions and, potentially, requirements, in their due diligence of advisers. As a result, the guidance should be modified to broadly reflect the diversity of the investment advisory community and clarified to reflect that the examples provided are illustrative only and may not be applicable to all investment advisers.

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[9] Indeed, we understand that some clients may require investment advisers to comply with the specific terms of the CFA Code as a hiring condition, even though the CFA Centre has indicated that the Code is voluntary and that a firm may claim compliance with the Code if it adheres to the principles and provisions of the Code.

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The IAA appreciates your consideration of our comments on the Risk Management Proposal. Please do not hesitate to contact Karen Barr, IAA General Counsel, or me if we may provide additional information or assistance to you regarding these matters.

Respectfully,

/s/ Valerie Baruch

Valerie Baruch
Assistant General Counsel