

**SEC ADOPTS A RULE TO REQUIRE REGISTERED INVESTMENT ADVISERS TO
ESTABLISH CODES OF ETHICS AND AMENDS INVESTMENT COMPANY
CODES OF ETHICS RULE**

The Securities and Exchange Commission (the “SEC”) recently adopted and amended final rules¹ that require all registered investment advisers to develop codes of ethics. In addition, the SEC adopted amendments to Rule 17j-1 under the Investment Company Act of 1940, which requires advisers to registered investment companies to adopt codes of ethics. Under the new rules, an adviser’s code of ethics should:

- Reflect the adviser’s fiduciary obligations and those of its supervised persons;
- Set forth standards of conduct and require compliance with federal securities laws; and
- Require advisory personnel to report their personal securities holdings and transactions, including those in affiliated mutual funds, and to obtain pre-approval of certain investments.

Other key components of the rules are:

- Each adviser must keep copies of its code of ethics and records relating to the code; and
- An adviser must describe its code of ethics in Form ADV.

The SEC also made amendments to Rule 17j-1 to conform certain provisions to the new rules. Additionally, if, as expected, the SEC requires hedge fund advisers to register, those advisers will need to adopt a code of ethics.²

I. Compliance Date

The adopted rule and amendments take effect on August 31, 2004. Advisers must comply with the adopted rule and amendments by January 7, 2005. By this compliance date, each adviser must:

- Have adopted its code of ethics and be prepared to maintain and enforce it;
- Have an initial holdings report from each access person; and
- Arrange for the submission of quarterly transaction reports.

¹ SEC Release Nos. IA-2256, IC-26492 (July 6, 2004).

² On July 20, 2004, the SEC released a proposed rule that would require many private fund managers to register as investment advisers with the SEC.

II. Code of Ethics Requirements³

1. Standards of Conduct and Compliance with Laws.

Each adviser's code of ethics must set forth a standard of business conduct that the adviser requires for all its supervised persons. The SEC's adopted rule establishes only a minimum requirement. The SEC stated that the adviser's chosen standard, however, must reflect the adviser's fiduciary obligations and those of its supervised persons, and must require compliance with federal securities laws. The SEC urged advisers to take great care in preparing their codes of ethics, and hopes that each adviser's code of ethics sets forth ideals premised on fundamental principles of openness, integrity, honesty and trust.

2. Personal Securities Trading.

Each adviser's code of ethics must require an adviser's "access persons"⁴ to periodically report their personal securities transactions and holdings to the adviser's chief compliance officer or other designated persons. Further, the code of ethics must require the adviser to review those reports.

Personal Trading Procedures. The SEC believes that all advisers should consider the following elements when crafting their code of ethics procedures for employees' personal securities trading:

- Prior written approval before access persons can place a personal securities transaction;
- Maintenance of lists of issuers of securities that the advisory firm is analyzing or recommending for client transactions, and prohibitions on personal trading in the securities of those issuers;
- Maintenance of "restricted lists" of issuers about which the advisory firm has inside information, and prohibitions on any trading (personal or for clients) in securities of those issuers;
- "Blackout periods" when client securities trades are being placed or recommendations are being made and access persons are not permitted to place personal securities transactions;
- Reminders that investment opportunities must be offered first to clients before the adviser or its employees may act on them, and procedures to implement this principle;
- Prohibitions or restrictions on "short-swing" trading and market timing;

³ See Rule 204A-1 under the Investment Advisers Act of 1940 ("Advisers Act").

⁴ An access person is a supervised person who has access to nonpublic information regarding clients' purchases or sales of securities, is involved in making securities recommendations to clients, or has access to such recommendations that are nonpublic. A supervised person who has access to nonpublic information regarding portfolio holdings of affiliated mutual funds is also an access person. The SEC's rule also contains a presumption that if the firm's primary business is providing investment advice, then all of its directors, officers and partners are access persons.

- Requirements to trade only through certain brokers, or limitations on the number of brokerage accounts permitted;
- Requirements to provide the adviser with duplicate trade confirmations and account statements; and
- Procedures for assigning new securities analyses to employees whose personal holdings do not present apparent conflicts of interest.

Initial and Annual Holdings Reports. Each adviser's code of ethics must require a complete report of each access person's securities holdings, at the time the person becomes an access person and at least once a year thereafter.

Quarterly Transaction Reports. Each adviser's code of ethics must require quarterly reports of all personal securities transactions by access persons, which are due no later than thirty days after the close of the calendar quarter. An adviser's code of ethics does not have to require access persons that had no personal transactions during the quarter to submit a report confirming the absence of transactions.

Exceptions From Reporting Requirements. There are three exceptions to the personal securities reporting requirement. No reports are required:

- For transactions effected pursuant to an automatic investment plan;
- For securities held in accounts over which the access person has no direct or indirect influence or control; or
- For an advisory firm that has only one access person, so long as the firm maintains records of holdings and transactions.

Reportable Securities. Access persons must submit holdings and transaction reports for "reportable securities" in which the access person has, or acquires, any direct or indirect beneficial ownership. An access person is presumed to be a beneficial owner of securities that are held by his or her immediate family members sharing the access person's household. All securities are treated as reportable securities with five exceptions:

- Transactions and holdings in direct obligations of the government of the United States;
- Money market instruments, including bankers' acceptances, bank certificates of deposit, commercial paper, repurchase agreements and other high-quality short-term debt instruments;
- Shares of money market funds;

- Transactions and holdings in shares of other types of mutual funds, unless the adviser or a control affiliate⁵ acts as the investment adviser or principal underwriter for the fund; and
- Transactions in units of a unit investment trust if the unit investment trust is invested exclusively in unaffiliated mutual funds.

Thus, each adviser's code of ethics must require access persons to report shares of mutual funds advised by the access person's employer or an affiliate, and must be designed to help advisers identify abusive trading by personnel with access to information about a mutual fund's portfolio.

3. Initial Public Offerings and Private Placements.

Each adviser's code of ethics must require that access persons obtain the adviser's approval before investing in an initial public offering or private placement. Advisory firms with only one access person are not required to have that access person pre-clear these investments.

4. Reporting Violations.

Each adviser's code of ethics must require that all supervised persons promptly report any violations of the code by any other person. Violations must be reported to the adviser's chief compliance officer or to other persons designated in the code of ethics. The SEC urged advisers to create an environment that encourages and protects supervised persons who report violations.

5. Educating Employees and Clients About the Code of Ethics.

Each adviser's code of ethics must require the adviser to provide each supervised person with a copy of the code of ethics and any amendments, and each supervised person must acknowledge, in writing, receipt of those copies. Although not required, the SEC suggested that advisers hold periodic orientation or training sessions with new and existing employees to remind them of their obligations under the code. Additionally, advisers are required to describe their codes of ethics to clients in Form ADV Part II, and, upon request, to furnish clients with a copy of the code of ethics.⁶

6. Protection of Material Nonpublic Information.

The final rules, as adopted, do not require an adviser's code of ethics to prevent access to material nonpublic information about the adviser's securities recommendations and client securities holdings and transactions by individuals who do not need the information to perform their duties. The SEC reminded advisers, however, that they are already required to maintain

⁵ Transactions and holdings in shares of closed-end investment companies would be reportable regardless of affiliation. The exception extends only to open-end funds registered in the United States. Thus, transactions and holdings in offshore funds are reportable.

⁶ See Item 9 of Form ADV Part II (as amended).

and enforce policies and procedures to prevent the misuse of material nonpublic information under Section 204A of the Advisers Act.

7. Adviser Review and Enforcement.

The adviser's chief compliance officer, or persons under his or her supervision, must have primary responsibility for enforcing the adviser's code of ethics.

III. Recordkeeping

An adviser is required to keep copies of its code of ethics, records of violations of the code and actions taken as a result of the violations, and copies of its supervised persons' written acknowledgement of receipt of the code and any amendments to it.⁷ Advisers are also required to keep a record of the names of their access persons, the holdings and transaction reports made by access persons, and records of decisions approving access persons' acquisition of securities in initial public offerings and limited offerings.⁸ The final rules require advisers to retain books and records for five years, in an easily accessible place, the first two years in an appropriate office of the adviser.

IV. Amendments to Rule 17j-1

The SEC made conforming changes to Rule 17j-1 under the Investment Company Act of 1940 to the extent that it differed from Rule 204A-1, as adopted.⁹ The changes are as follows:

- No report is required under Rule 17j-1 to the extent that the report would duplicate information required under the Advisers Act recordkeeping rules;
- The information in initial and annual holdings reports must be current as of a date no more than forty-five days prior to the individual's becoming an access person;
- Quarterly transaction reports are due no later than thirty days after the close of the quarter;¹⁰
- Quarterly transaction reports need not be submitted with respect to transactions effected pursuant to an automatic investment plan;
- The term "access person" now includes an advisory person of a fund or its investment adviser; and
- Directors, officers and general partners are presumed to be access persons if the firm's primary business is investment advisory.¹¹

⁷ See Rule 204-2(a)(12) (as amended).

⁸ See Rule 204-2(a)(13) (as amended).

⁹ See Rule 17j-1 (as amended).

¹⁰ Previously, reports were due ten days after the close of the quarter.

¹¹ This standard replaces a revenue-based test.

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