March 15, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0506

Re: Investment Adviser Codes of Ethics (File No. S7-04-04)

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to express its views on the Commission's proposed new rule, Rule 204A-1 under the Investment Advisers Act of 1940.[2] The proposed rule would require all registered investment advisers to adopt codes of ethics. Advisers would be required to set forth in their codes of ethics: standards of conduct for advisory personnel; provisions reasonably designed to prevent access to material nonpublic information; and a requirement that access persons of the adviser report their personal securities transactions and holdings, including transactions in any mutual fund managed by the adviser.

The Commission and the industry have considered issues relating to personal investing activities on several occasions during the past 10 years.[3] Recent events involving personal

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,625 open-end investment companies ("mutual funds"), 611 closed-end investment companies, 124 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $7.457 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 234 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

[2] SEC Release Nos. IA-2209 and IC-26337 (January 20, 2004) [69 FR 4040 (January 27, 2004)] ("Proposing Release").

[3] *See, e.g., Report of the Advisory Group on Personal Investing* (May 9, 1994) (report issued by a committee of senior industry officials and unanimously endorsed by the Institute's Board of Governors recommending that the investment company industry adopt a series of substantive restrictions on personal investing activities and certain compliance procedures to implement these restrictions); Division of Investment Management, Securities and Exchange Commission, *Personal Investment Activities of Investment Company Personnel* (September 1994) (report containing the findings and recommendations regarding a staff study of Rule 17j-1 under the Investment Company

investing activities of certain industry participants indicate that it is timely and prudent to revisit these issues. The Institute agrees that, in light of these events, further measures to reinforce the duty to place investors' interests first are necessary. As a preliminary step, last October, the Institute urged its members to amend or clarify their codes of ethics to include oversight of transactions by senior fund personnel in shares of funds offered or sponsored by the company. The Commission's proposal, in part, would codify the Institute's recommendation. This and the other aspects of the Commission's proposal should promote the protection and confidence of investors.

The Institute generally supports the proposal. We have several specific comments that are intended to harmonize personal trading reporting obligations under the proposed rule with those under Rule 17j-1,[4] and to respond to questions posed in the Proposing Release.

In summary, the Institute's comments are as follows.

- The Institute supports requiring each investment adviser code of ethics to set forth a standard of business conduct that the adviser requires of all its supervised persons.

- The Institute recommends revising the proposal to require that each code of ethics include provisions reasonably designed to prevent *misuse* of material nonpublic information about the adviser's securities recommendations and client securities holdings and transactions (rather than provisions reasonably designed to prevent *access* to material nonpublic information about the adviser's securities recommendations and client securities holdings and transactions by persons who do not need such information to perform their duties).

- The Institute recommends revising the proposal to make the reporting obligations of directors, officers, partners, and employees of investment advisers more consistent with reporting obligations under Rule 17j-1.

- The Institute supports the Commission's proposal to impose reporting obligations with respect to holdings and transactions in certain affiliated mutual funds.

- The Institute supports requiring each supervised person to acknowledge receipt of the code of ethics and suggests permitting such acknowledgements to be in electronic form (as an alternative to written form, as proposed).

- The Institute generally supports the proposed recordkeeping requirements with respect to personal securities transactions but opposes requiring advisers to keep records of access persons' personal securities reports (and duplicate brokerage

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Act of 1940); SEC Release Nos. 33-7728, IC-23958, IA-1815 (August 20, 1999) [64 FR 46821 (August 27, 1999)] (adopting amendments to Rule 17j-1); Letter from Thomas M. Selman, Associate Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated November 13, 1995 (commenting on the proposed amendments to Rule 17j-1).

[4] Rule 17j-1 requires registered investment companies and their investment advisers and principal underwriters to adopt codes of ethics.

confirmations or account statements in lieu of those reports) electronically in an accessible computer database because the costs of such a requirement would greatly outweigh its benefits.

- The Institute recommends that the Commission provide for a compliance date ranging from 9 to 12 months after adoption of proposed Rule 204A-1, depending on the nature of the new requirements.

Each of these comments is discussed more fully below.

I. Standards of Conduct

Proposed Rule 204A-1(a)(1) would require each code of ethics adopted under the rule to set forth a standard of business conduct that the adviser requires of all its supervised persons. The standard would be required to reflect the adviser's fiduciary obligations and those of its supervised persons and to require compliance with applicable federal securities laws. The Institute supports the proposed requirement.

We recommend one technical change to the proposed requirement. The Commission should make clear that, in the case of investment advisers that do not advise investment companies, "applicable federal securities laws" means the Investment Advisers Act of 1940 and the rules adopted thereunder and not the other statutes and rules included in Rule 204A-1's proposed definition of federal securities laws.[5] Our recommended approach would make Rule 204A-1 more consistent with the Commission's recently adopted rule that requires each registered investment adviser to adopt and implement compliance policies and procedures.[6]

With regard to the standard of conduct requirement, the Proposing Release requests comment on whether the code of ethics should require supervised persons to comply with all applicable laws and regulations, rather than only the federal securities laws. We do not believe that this would be necessary or appropriate. Requiring employees to comply with all applicable laws and regulations would cover many areas that have no relevance to the Commission's objectives in proposing Rule 204A-1 (*e.g.*, employment laws, Occupational Safety and Health Administration regulations, Fair Credit Reporting Act). In addition, such a requirement could cause adviser codes to be unnecessarily lengthy and difficult to administer.

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[5] The proposed definition would include the Securities Act of 1933, Securities Exchange Act of 1934, Sarbanes-Oxley Act of 2002, Investment Company Act of 1940, Investment Advisers Act of 1940, Title V of the Gramm-Leach-Bliley Act, any rules adopted by the Commission under any of these statutes, the Bank Secrecy Act as it applies to funds and advisers, and any rules adopted thereunder by the Commission or the Department of Treasury.

[6] *See* SEC Release Nos. IA-2204 and IC-26299 (December 17, 2003) [68 FR 74714 (December 24, 2003)]. Rule 206(4)-7 under the Advisers Act requires registered advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons. By contrast, Rule 38a-1 under the Investment Company Act requires registered investment companies to adopt and implement written policies and procedures reasonably designed to prevent the fund from violating the "federal securities laws," defined in that rule in substantially the same way as in proposed Rule 204A-1. The fund's board of directors must approve the fund's compliance policies and procedures, as well as those of each investment adviser of the fund. Such approval must be based on a finding by the board that the policies and procedures are reasonably designed to prevent the fund and each investment adviser from violating the federal securities laws. Accordingly, a broader standard for advisers to investment companies is appropriate.

The Proposing Release also asks whether the Commission should specify a particular standard of conduct that all codes of ethics must incorporate and, if so, what standard should be adopted. We do not believe that it would be appropriate for the Commission to specify such a standard. Rather, we believe that each investment adviser should have the flexibility to articulate a standard of business conduct that best suits its business model.

II. Protection of Material Nonpublic Information

Proposed Rule 204A-1(a)(3) would require that each code of ethics include provisions reasonably designed to prevent access to material nonpublic information about the adviser's securities recommendations and client securities holdings and transactions by persons who do not need such information to perform their duties. The Proposing Release explains that tight controls on access to sensitive client information are the first line of defense against misuse of that information. The Proposing Release requests comment on whether the Commission should use an alternative formulation.

The Institute supports the objective of the proposed requirement to limit access to those who "need to know," but we are concerned that this approach would be too restrictive for many advisory firms. For example, in smaller advisory firms, all employees may be located on the same floor and share the same computer system. It may not be possible to physically segregate the individuals who "need to know" from those who do not, and it may not be cost-effective to have a separate computer system for client account-related information. In addition, some firms have an "open" corporate culture in which research and data are shared. These firms may have determined that preventing the flow of information is detrimental to the investment process and thus not the best way to achieve the ultimate goal of preventing misuse of material nonpublic information.[7]

We believe that each advisory firm should determine how best to protect material nonpublic information with the goal being to prevent *misuse* of that information. Having specific procedures to prevent access to this information is not the only way to achieve that goal. For example, an advisory firm that chose to permit greater access to material nonpublic information could deem a broader universe of employees to be access persons, thus requiring them to report, and the adviser to monitor, their personal securities transactions and holdings. In addition, such a firm could have a robust educational program geared toward informing access persons of their duties with respect to material nonpublic information. Accordingly, the Institute recommends revising the proposal to require that each code of ethics include provisions reasonably designed to prevent *misuse* of material nonpublic information about the adviser's securities recommendations and client securities holdings and transactions.[8]

The Proposing Release requests comment on whether computer files containing nonpublic information should be required to be identified and segregated. We do not believe

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[7] In addition, even where a person does not need to know particular information (*e.g.*, a research report) to perform his or her job, an advisory firm may determine that it would be beneficial for that person to have access to that information in performing his or her responsibilities.

[8] The recommended formulation is consistent with Section 204A of the Advisers Act, which requires advisers to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the *misuse* of material nonpublic information by the adviser or any of its associated persons.

that the Commission should adopt such a requirement. Rather, as stated above, each individual advisory firm should have the flexibility to determine the most appropriate means for protecting material nonpublic information, tailored to its own individual circumstances.

III. Personal Securities Trading

A. Persons Subject to the Reporting Requirement

Proposed Rule 204A-1(d) would require the code of ethics to call for the adviser's "access persons" to periodically report their personal securities transactions and holdings to the adviser's chief compliance officer. Under the proposal, "access person" is defined to mean: (A) any of the adviser's "supervised persons" (1) who has access to nonpublic information regarding any clients' purchase or sale of securities, or information regarding the portfolio holdings of any reportable fund,[9] or (2) who is involved in making securities recommendations to clients, or who has access to such recommendations that are nonpublic; and (B) if the adviser's primary business is providing investment advice, all of its directors, officers and partners are presumed to be access persons.[10]

The Proposing Release requests comment on whether there is a significant need for Rule 204A-1 and Rule 17j-1 to be as uniform as possible. The Institute believes that there is such a need. Uniformity is important in order to make administration of codes of ethics requirements more straightforward for investment advisers that advise both investment companies and other clients and to diminish the potential for confusion and errors on the part of personnel in such organizations with respect to their reporting of personal securities holdings and transactions. Our comments are intended, in part, to promote uniformity between the requirements of Rule 17j-1 and those of proposed Rule 204A-1 with respect to the reporting obligations of the directors, officers, partners, and employees of investment advisers.

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[9] The Institute recommends that the Commission add the word "nonpublic" before the phrase "information regarding the portfolio holdings of any reportable fund" to clarify that the reporting requirement is *not* triggered when a person subject to the reporting requirement has access to *public* information about a reportable fund's portfolio holdings (*e.g.*, information in the fund's shareholder report or information posted on the fund's Internet website). We believe this change would be consistent with the Commission's intent. Requiring reporting when an access person has access to public information about a reportable fund's portfolio holdings would appear to go well beyond the purpose of the proposed reporting obligation.

[10] The Institute is pleased that the Commission recognizes that employees of other organizations would not be subject to the adviser's code of ethics. *See* Proposing Release at 4043 (stating that "employees of other organizations, including affiliated organizations such as broker-dealers, custodians, and banks that may acquire information about client securities transactions in the course of their duties, would not be subject to reporting requirements") (footnote omitted). The Commission's approach avoids several problems. Requiring advisers to monitor the personal securities trading of employees of other firms would be very difficult, given that these persons are not subject to the supervision and control of the investment adviser. Further, we do not believe that it would be reasonable or appropriate to require employees of outside firms to submit to the adviser's reporting requirements. In addition, to the extent that any of these individuals are themselves employees of other investment advisers, such as subadvisers to a fund, they would be subject to the code of ethics of the investment adviser who employs them (and should not also be subject to a second code of an outside adviser). Consistent with this approach, our recommended definition of advisory person, discussed *infra*, does not include an employee of a company in a control relationship to the investment adviser, notwithstanding the fact that Rule 17j-1 defines "advisory person," in part, as any employee of any company in a control relationship to the Fund or investment adviser.

The Institute recommends revising certain aspects of the proposed definition of "access person" to more closely track the definition of that term in Rule 17j-1 and to more precisely identify, and require reporting of personal securities transactions and holdings by, those advisory employees who have information about clients' securities transactions that they potentially could use for their own benefit. In particular, we recommend, among other things, eliminating the term "supervised persons" and instead using (and defining) the term "advisory person." Our proposed definition of "advisory person" would contain several elements of Rule 17j-1's definition of that term, as discussed below.

We recommend that proposed Rule 204A-1 define "advisory person" to encompass, among other persons, any employee who, *in connection with his or her regular functions or duties,* obtains nonpublic information regarding any clients' purchase or sale of securities, or nonpublic information regarding the portfolio holdings of any reportable fund.[11] Our proposed definition (particularly the italicized language) would permit an adviser to identify those employees who, as part of their day-to-day responsibilities, obtain non-public information.[12] These are the employees who are in a position to use this information to their own advantage and so these are the employees whose securities transactions should be reported to, and monitored by, their investment adviser-employer.

This portion of our proposed definition of "advisory person" would refer to persons who *obtain* (rather than have access to) non-public information. This recommended change is based on the premise that only when a person actually obtains non-public information could he or she potentially use it in a way that would run counter to the interests of a fund or other advisory client. By designing the definition to capture those employees who actually obtain non-public information that could be used in such a harmful way, we believe that advisers will be better able to focus their monitoring efforts toward those employees who potentially pose the most risk.[13]

The Institute also recommends amending Rule 17j-1 to incorporate a legal presumption (as in proposed Rule 204A-1) that, if an advisory firm's primary business is providing investment advice, then all of its directors, officers, and partners are access persons. As noted in the Proposing Release, Rule 17j-1 has special rules for advisory firms that are "primarily engaged" in a business other than advising funds or advisory clients, and uses a revenue-based

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[11] We assume that in the case of an adviser to a fund, the "client" would be the fund, not the fund's shareholders. This assumption is based on the way funds are treated for other regulatory purposes under the Advisers Act. For example, as a matter of practice in the disclosure context, fund advisers provide disclosures to the fund's board of directors to satisfy requirements under the Advisers Act to make disclosures to their clients. *See, e.g.*, Section 206(3) of the Advisers Act (requiring disclosure to clients regarding principal transactions); Rule 206(3)-2 under the Advisers Act (requiring disclosure to clients regarding agency cross transactions). Thus, for example, under proposed Rule 204A-1, a fund adviser's customer service representatives would not be deemed to be access persons merely because they receive information about fund purchase and redemption transactions in dealing with fund investors. (Those investors would not be the fund adviser's "clients.") This information would not be susceptible to the types of abuses the proposed rule seeks to address.

[12] We have modeled the italicized language on Rule 17j-1.

[13] We have imported the term "obtain" from Rule 17j-1, which provides, in part, that an advisory person is an employee of the Fund or investment adviser who, in connection with his or her regular duties or functions, makes, participates in, or *obtains* information regarding the purchase or sale of Covered Securities by the Fund.

test to establish the advisory firm's primary business.[14] The Proposing Release asks if Rule 17j-1 should be amended to replace the current revenue-based test for determining an adviser's primary business with a legal presumption as in proposed Rule 204A-1. The Institute believes that it should. The recommended approach should simplify efforts to comply with Rule 17j-1 and make the two rules more consistent.

Definitions of "access person" and "advisory person" for purposes of Rule 204A-1 that reflect the foregoing recommendations are set forth in the attached appendices.[15]

B. Personal Trading Procedures

The Commission has recognized the need to give advisers flexibility to adopt codes appropriate for their businesses and, therefore, it has not proposed any specific provisions regarding personal trading (with one exception).[16] The Institute believes that it is essential for each advisory firm to have the latitude to craft a code and procedures that are most effective in light of its particular business structure and operations and, therefore, strongly supports the proposed approach.[17]

C. Reportable Securities and Beneficial Ownership

Proposed Rule 204A-1(e)(9) would exempt from reporting requirements money market instruments, direct obligations of the United States government, money market fund shares, and shares of other types of mutual funds where the adviser or a control affiliate does not act as the investment adviser or principal underwriter for the fund. The Proposing Release explains that these securities would be exempt from the rule's reporting requirements because they appear to present little opportunity for abuse. The Institute agrees with the Commission's assessment and supports the proposed approach.

Consistent with that approach, we recommend not including as a reportable security shares issued by short-term bond funds that offer check-writing privileges. Like money market fund shares, which are proposed to be exempt from the rule's reporting requirements, the value

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[14] Rule 17j-1(a)(1)(i)(A) provides that if an investment adviser is primarily engaged in a business or businesses other than advising Funds or other advisory clients, the term, "access person," means any director, officer, general partner or Advisory Person of the investment adviser that engages in certain activities with respect to the fund. Rule 17j-1(a)(1)(i)(B) provides that an adviser is primarily engaged in a business other than advising Funds or other advisory clients if, for each of the last three fiscal years (or for the period of time since its organization, whichever is less), the investment adviser derived, on an unconsolidated basis, more than 50 percent of its total sales and revenues and more than 50 percent of its income (or loss) from the other business or businesses.

[15] Appendix A contains the text of proposed Rule 204A-1(e) amended to reflect our recommendations, and Appendix B shows the same provision marked to highlight our recommended changes.

[16] The Commission has proposed requiring access persons to obtain the adviser's approval before investing in an initial public offering or private placement. We agree with the Commission's determination to require all adviser codes of ethics to include such a provision and note that the proposed approach is consistent with Rule 17j-1.

[17] In adopting Rule 17j-1, the Commission noted that the variety of employment and institutional arrangements used by different investment companies makes it impracticable to design a rule to cover all of the possibilities and that, as a result, it was better policy to allow each investment company complex to design its own code of ethics and related procedures. *See* SEC Release No. IC-11421 (October 31, 1980). This need for flexibility was explicitly recognized by Congress when it enacted Section 17(j) under the Investment Company Act. *See* SEC Release No. IC-21341, *supra* note 3, at n.7.

of these fund shares typically does not vary day-to-day and, therefore, such funds appear to present little opportunity for abuse. Because these funds often are used as an alternative to money market funds or checking accounts, it is likely that there would be numerous transactions to report. Given the lack of potential for abuse, any benefit associated with treating these securities as reportable securities is outweighed by the costs of doing so.[18]

The Proposing Release asks if transactions in index funds and investments in variable annuity contracts should be excluded from reporting obligations. The Institute believes that transactions in funds underlying variable annuity contracts should be covered to the same extent as other mutual funds, as they present the same risk of abuse as other funds. In addition, we believe that transactions in index funds should be subject to the rule's reporting obligations. Index funds may be sampled (*i.e.*, the fund may not purchase each and every security in the appropriate index). Therefore, their securities holdings may not be fully transparent and, thus, these funds could permit similar opportunities for abuse as other funds.

D. Reporting of Investment Company Shares

As discussed above, proposed Rule 204A-1 would require all advisers' codes of ethics to call for reporting of holdings and transactions in certain affiliated mutual funds. The Proposing Release asks whether reporting of holdings and transactions in *all* mutual fund shares should be required. The Institute supports the Commission's approach of limiting reporting requirements to certain affiliated funds.[19] We believe that trading in the shares of mutual funds that are not affiliated with the adviser pose little risk for the abuse the Commission seeks to address. Advisory personnel would not be in a position to have access to nonpublic information about the portfolio holdings of these funds and so requiring them to report on these holdings and transactions goes beyond the intent of the rule. To do otherwise would unnecessarily complicate an adviser's ability to comply with the rule.

Consistent with the approach of limiting reporting obligations to "access persons" who truly have access to nonpublic information, we recommend narrowing the definition of "reportable fund" to avoid imposing reporting requirements that are broader than necessary to achieve the objectives of the rule.[20] For example, many advisers that advise funds have affiliated advisers that do not advise funds. Under the proposal, an employee of Adviser A who has access to nonpublic information about a private client's purchase or sale of securities (but who does not have access to any nonpublic information regarding the portfolio holdings of any reportable fund) would be required to report any of its holdings in any fund whose adviser or principal underwriter controls Adviser A, is controlled by Adviser A, or is under common control with Adviser A. That person is not in a position to have access to nonpublic information

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[18] We also support exempting transactions effected pursuant to automatic investment plans from the reporting requirements for the reasons stated in the Proposing Release and believe that these transactions similarly should be exempted from reporting obligations under Rule 17j-1.

[19] We note that under the Commission's proposal, access persons of investment advisers would not be required to report shares held or acquired by them in unaffiliated investment companies organized outside of the United States. We recommend that the Commission make a conforming change to Rule 17j-1.

[20] "Reportable fund" is proposed to be defined as (i) any fund for which the adviser serves as investment adviser or (ii) any fund whose investment adviser or principal underwriter controls the adviser, is controlled by the adviser, or is under common control with the adviser.

about the portfolio holdings of any of these funds and so requiring them to report on these holdings and transactions goes beyond the intent of the rule. Accordingly, we urge the Commission to refine the definition of "reportable fund" as set forth in Appendix A (attached).

E. Timing of Personal Securities Reports

Proposed Rule 204A-1 would require each access person to report his or her securities holdings at the time the person becomes an access person and the information reported would be required to be current as of the date the person becomes an access person. We are concerned that the proposed currentness requirement would require access persons to manually develop a list of their holdings, which is more burdensome and more susceptible to errors than permitting access persons to provide their most recent account statement showing their securities holdings. Accordingly, we recommend permitting each access person to report his or her securities holdings at the time the person becomes an access person and requiring the information reported to be current as of a date no more than 45 days prior to the date the report is submitted.[21] We recommend a 45-day period because we believe that this is the amount of time needed to allow an access person to use his or her most recently received account statement. Under our recommended approach, for example, if a person becomes an access person on June 1st of a given year, he or she would be required to provide an account statement(s) for the period ended April 30th (and not the statement for the period ended May 31st, which the person would not yet have received).[22]

Proposed Rule 204A-1(b)(1)(ii) would require access persons to report their securities holdings at least once each 12-month period after their initial holdings report. The Institute recommends that the proposal be modified to require access persons to submit holdings reports "annually" rather than "once each 12-month period." The recommended change would provide some flexibility for advisory firms regarding what month during any given year its access persons would be required to report their holdings while still assuring that access persons report their holdings once during any given calendar year. We also note that the change would make this provision consistent with the annual holdings report requirement under Rule 17j-1.[23]

The proposed rule also would require access persons to make quarterly reports of all personal securities transactions no later than ten days after the close of the calendar quarter. An access person would not be required to submit a transaction report if the report would duplicate information contained in broker account statements so long as the statement is received no later than ten days after the end of the applicable calendar quarter. The Proposing Release requests comment on the required timing of these reports.

It is our understanding that, in practice, it takes approximately three weeks for advisers to receive monthly statements regarding their access persons' personal securities transactions

[21] To promote consistency, we recommend that a conforming change be made to Rule 17j-1(d)(1), which does not currently require initial holdings reports to be current as of any particular date.

[22] For the same reasons, we recommend that proposed Rule 204A-1(B) and Rule 17j-1(d)(1)(iii) be modified to require the information in annual reports to be current as of a date no more than 45 days prior to the date the report was submitted (rather than 30 days, as is proposed under Rule 204A-1 and currently required under Rule 17j-1).

[23] *See* Rule 17j-1(d)(1)(iii).

when these securities are held in external brokerage accounts. As a result, for securities held in this type of account, it is possible to comply with the ten-day requirement for the first two months of a quarter, but not for the last month of any given calendar quarter. In recognition of this, the Institute recommends that the proposal be changed to require that broker account statements (in lieu of quarterly reports) be submitted as soon as reasonably practicable, but in no event later than 30 days after the end of each calendar quarter. For the same reasons and to promote consistency, we recommend that a conforming change be made to Rule 17j-1.

IV. Reporting of Violations

Proposed Rule 204A-1(a)(5) would require supervised persons to promptly report any violations of the code to the adviser's chief compliance officer or another person designated in the code. The Institute recommends permitting the reporting of any code violations to the adviser's chief compliance officer or *one or more* other persons designated in the code. The recommended approach would allow each advisory firm to designate the most appropriate person or persons, given its particular structure.[24] We also support the Commission's proposed approach of requiring reporting of any violations rather than requiring codes of ethics to call for reporting of "apparent" violations. Requiring the reporting of apparent violations would establish an overly vague standard, resulting in difficulties in monitoring and enforcement.

V. Acknowledgement of Receipt of the Code

Proposed Rule 204A-1(a)(6) would require an adviser to provide each of its supervised persons with a copy of the code of ethics and any amendments thereto, and each supervised person to acknowledge, in writing, receipt of the code. The Proposing Release explains that an adviser's procedures for informing its employees about its code are critical to obtaining good compliance and avoiding inadvertent violations of the code. The Institute supports the proposed requirement but requests that the final rule permit acknowledgements to be in either written or electronic form. This change would ease compliance efforts for advisers and their personnel while providing a record for advisers and the Commission regarding employees' receipt of the code. Further, in response to the Commission's request for comment, we do not believe that the rule should require codes to contain procedures for educating employees about the code and to inform employees about changes made to the code. Advisory firms currently use various means to educate their employees about their ethical and reporting obligations. Because there is a range of appropriate choices, we believe decisions like these should be left to individual advisory firms, not mandated by Commission rule.

VI. Recordkeeping

Rule 204-2(a)(13) under the Advisers Act would require advisers to keep copies of their codes, their supervised persons' written acknowledgements of receipt of the code, records of violations of the code, and records of actions taken as a result of violations. In addition, advisers would be required to keep a record of the names of their access persons, holdings and transaction reports made by access persons, and records of decisions approving access persons'

[24] Proposed Rule 204A-1(b)(ii)(B)(2) would mandate that codes of ethics require access persons to submit quarterly transaction reports to the adviser's chief compliance officer. We request that, consistent with our recommendation regarding reporting of violations, the Commission permit access persons to submit quarterly reports to the adviser's chief compliance officer or to *one or more* other persons designated in the code.

acquisitions of securities in IPOs and limited offerings. The Institute supports these proposed recordkeeping requirements.

Under the proposal, advisers would be required to keep records of access persons' personal securities reports (and duplicate brokerage confirmations or account statements in lieu of those reports) electronically in an accessible computer database. The Proposing Release states the Commission's understanding that requiring electronic records to be kept would not be costly or burdensome and specifically requests comment on this point.[25] The Institute has serious concerns regarding the adoption of an electronic recordkeeping requirement. It is our understanding that such a requirement would involve a significant economic undertaking for most, if not all, investment advisory firms. Some investment advisers receive electronic feeds of information regarding their access persons' personal securities reports from broker-dealers. However, brokers are not required to, and many do not, provide this information electronically. In addition, not all advisers are set up to receive this information electronically. Advisers may find it necessary to hire an additional employee (or dedicate existing staff) to enter data received on paper into the adviser's computer system solely for the purposes of this new requirement. For those advisers that do not have a system in place for receiving this information, there would be the additional cost of building a system to receive the information that is available electronically from brokers. For all of these reasons, we recommend that the Commission delete from proposed Rule 204-2(a)(13)(i) the phrase "to be maintained electronically in an accessible computer database."

VII. Amendments to Form ADV

The Commission has proposed amending Form ADV to require advisers to describe their codes of ethics and, upon request, to furnish clients with a copy of the code. The Proposing Release requests comment on whether a general disclosure requirement is adequate. The Institute believes that such a general disclosure requirement is adequate and recommends that the Commission permit any adviser to make its code accessible to clients by posting it on the adviser's website as an alternative to furnishing clients with a copy upon request.[26] The recommended approach will ease costs for advisers without depriving clients of the benefit of access to the adviser's code.[27]

VIII. Compliance Date

The Commission has not proposed a transition period in connection with the proposed requirements. The Institute recommends that the Commission provide for a compliance date ranging from 9 to 12 months after adoption, depending on the nature of the new requirements.

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[25] The Proposing Release states that a small advisory firm may satisfy the proposed recordkeeping requirement by maintaining a spreadsheet of its employees' trades and that a larger firm may do so by opening up "client" accounts for each employee so that the firm's existing portfolio analysis programs can track the employees' trades.

[26] Of course, any adviser that chose to post its code on its website would be required to include disclosure in its Form ADV so alerting clients.

[27] The Commission recently recognized a fund's Internet website as an appropriate medium for making codes of ethics and other information available to fund investors. *See* SEC Release Nos. 34-47262 and IC-25914 (January 27, 2003) [68 FR 5348 (February 3, 2004)] (permitting any fund to make its Sarbanes-Oxley codes of ethics publicly available by posting it on the fund's website); SEC Release Nos. 33-8294, 34-48558, and IC-26195 (September 29, 2003) [68 FR 57760 (October 6, 2003)] (permitting any fund to disclose certain performance information on its website).

For example, as discussed above, many funds do not have the capability to keep records of personal securities transactions electronically and they would need sufficient lead-time to comply with such a requirement. The requested time period is consistent with the time provided by the Commission in other instances where advisers have been required to comply with significant new responsibilities under the federal securities laws.[28]

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The Institute appreciates the opportunity to comment on this significant proposal. If you have any questions or need additional information, please contact me at (202) 326-5824, Frances M. Stadler at (202) 326-5822 or Dorothy M. Donohue at (202) 218-3563.

Sincerely,

Amy B. R. Lancellotta
Acting General Counsel

Attachments

cc: Paul F. Roye, Director
Robert E. Plaze, Associate Director
Division of Investment Management

[28] *See, e.g.*, SEC Release No. IA-2204, *supra* note 6 (providing for a nine-month transition period in connection with adopting compliance rules for investment advisers and investment companies) and SEC Release Nos. 33-7728, IC-23958, and IA-1815 (August 20, 1999) [64 FR 46821 (August 27, 1999)] (providing for a transition period ranging from six months to twelve months in connection with adopting amendments to Rule 17j-1).

Appendix A

Amend Rule 204A-1(e) under the Investment Advisers Act of 1940 to read as follows:

(e) *Definitions.* For the purpose of this section:

(1) *Access person* means:

(i) Any of your directors, officers, general partners (or other person occupying a similar status or performing similar functions) or Advisory Persons.

(2) *Advisory Person* of an investment adviser means:

(i) any of your employees or any other person who provides investment advice on your behalf and is subject to your supervision and control who, in connection with his or her regular functions or duties:

(A) obtains nonpublic information regarding any clients' purchase or sale of securities, or nonpublic information regarding the portfolio holdings of any reportable fund, or

(B) makes, participates in, or whose functions relate to the making of securities recommendations to clients or who has access to information concerning such recommendations that are nonpublic.

(9) *Reportable fund* means:

(i) Any fund for which you serve as investment adviser as defined in section 2(a)(20) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(20)) (*i.e.,* in most cases you must be approved by the fund's board of directors before you can serve); or

(ii) Any fund whose investment adviser or principal underwriter controls you, is controlled by you, or is under common control with you; provided, however, that this paragraph shall apply only to your access persons who have access to nonpublic information about any fund described in this paragraph. For purposes of this section, *control* has the same meaning as it does in section 2(a)(9) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(9)).

Appendix B

Proposed Rule 204A-1(e) is marked to show changes that reflect the Institute's recommendations (deleted language is shown in brackets and new language is shown in bold text):

(e) *Definitions.* For the purpose of this section:

(1) *Access person* means:

[(i) Any of your supervised persons:]

(i) Any of your directors, officers, general partners (or other person occupying a similar status or performing similar functions) or Advisory Persons.

(2) ***Advisory Person*** **of an investment adviser means:**

(i) Any of your employees or any other person who provides investment advice on your behalf and is subject to your supervision and control who, in connection with his or her regular functions or duties:

(A) [who has access to] **obtains** nonpublic information regarding any clients' purchase or sale of securities or **nonpublic** information regarding the portfolio holdings of any reportable fund, or

(B) [who is involved in] **makes, participates in, or whose functions relate to the** making **of** securities recommendations to clients, or who has access to such recommendations that are nonpublic.

(9) *Reportable fund* means:

(i) Any fund for which you serve as investment adviser as defined in section 2(a)(20) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(20)) (*i.e.,* in most cases you must be approved by the fund's board of directors before you can serve); or

(ii) Any fund whose investment adviser or principal underwriter controls you, is controlled by you, or is under common control with you**; provided, however, that this paragraph shall apply only to your access persons who have access to nonpublic information about any fund described in this paragraph**. For purposes of this section, *control* has the same meaning as it does in section 2(a)(9) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(9)).