

**A**  
**4-STEP RISK ASSESSMENT**  
**FOR INVESTMENT ADVISERS**

by  
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## INTRODUCTION

Effective compliance rests on a foundation of effective risk management. Effective risk management begins with an effective risk assessment.

Investment advisers are not required by law to conduct a risk assessment. However, SEC Staff expect advisers to do one<sup>1</sup> and at least some consider it is a key task:

“My advice to compliance professionals is that they should consider their internal risk assessments to be one of the more important and serious elements of their responsibilities....”  
(John Walsh, OCIE Associate Director and Chief Counsel)<sup>2</sup>

A risk assessment can provide obvious practical benefits, enhancing the efficiency and effectiveness of a compliance program. A risk assessment can also provide regulatory benefits, helping to demonstrate that a compliance program is “reasonably designed” to prevent violations of the Advisers Act, as SEC rules require it to be.<sup>3</sup> Aside from a few procedures advisers are specifically required to adopt,<sup>4</sup> advisers are left largely on their own to determine which procedures they must adopt to meet that “reasonably designed” standard. Consequently, it is crucial for them to have an effective process to (1) identify risks within their organizations that make them vulnerable to violations, and (2) assess those risks as to their significance, so scarce resources can be focused on those areas posing greater risk.

This paper offers one method advisers might use to conduct a risk assessment, comprised of four basic steps.<sup>5</sup> Many advisers find using a risk matrix helpful in organizing and documenting each step. A sample risk matrix appears in Appendix A. Whatever style of documentation is used, advisers would be wise to make sure it is clear and complete, since SEC Staff is likely to review it on inspection.<sup>6</sup>

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<sup>1</sup> See, for example, Compliance Programs of Investment Companies and Investment Advisers; Final Rule, Rel. Nos. IA-2204 and IC-26299, 74716 (Dec. 17, 2003) (the “Adopting Release”) (stating that advisers should “identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm’s particular operations, and then design policies and procedures to address those risks”); and Lori A. Richards, Director, OCIE, Remarks before the National Society of Compliance Professionals 2004 National Membership Meeting – Instilling Lasting and Meaningful Changes in Compliance (Oct. 28, 2004) (stating that all firms must be proactive in identifying risk areas and in endeavoring to mitigate or eliminate those risks).

<sup>2</sup> John H. Walsh, Associate Director - Chief Counsel of the SEC’s Office of Compliance Inspections and Examinations, *Update on the SEC Examination Program: Risk Assessments and the Selection of Firms for Review*, Practical Compliance & Risk Management for the Securities Industry, Vol. 1, No. 1 (March–April 2008) at 21 (emphasis added).

<sup>3</sup> Rule 206(4)-7 under the Investment Advisers Act of 1940 (the “Advisers Act”).

<sup>4</sup> For example, all registered advisers are required to adopt a Code of Ethics (see Rule 204A-1 under the Advisers Act) and procedures aimed at preventing misuse of material non-public (“inside”) information (see Section 204A of the Advisers Act). Advisers that store records electronically (likely to be all advisers these days) must also adopt procedures relating to the maintenance and safeguarding of those records (see Rule 204-2(g)(3) under the Advisers Act). There are other rules that require advisers to adopt specific procedures, but only if the adviser is involved in certain activities, for example:

- If an adviser has “customers” (as defined), it must have privacy procedures under Reg. S-P.
- If an adviser exercises proxy voting authority, it must have proxy voting procedures under Rule 206(4)-6.
- If an adviser is a publicly traded company, it must have a Sarbanes-Oxley code of ethics and disclosure/reporting controls under the Sarbanes-Oxley Act.
- If an adviser places brokerage for a registered investment company client with a broker that sells the fund’s shares, the adviser (or the fund) must have procedures to avoid those share sales from being taken into consideration when brokers are selected to execute fund trades, under Rule 12b-1(h)(2)(ii) of the Investment Company Act of 1940.

<sup>5</sup> These particular steps are not required by SEC rules, nor are they the only steps that could be used to conduct a risk assessment. They are offered merely as one possible alternative.

<sup>6</sup> The SEC’s “core initial request” list for adviser examinations indicates that the Staff will likely request to inspect: “Information about the compliance risks that the firm has identified (e.g., an inventory of compliance risks) and the written policies and procedures the firm has established and implemented to address each of those risks to provide an understanding of the firm’s compliance risks and corresponding controls.” The “core initial request” list is posted on the SEC’s website at <http://www.sec.gov/info/cco/requestlistcore1108.htm>.

## STEP 1: PREPARE A RISK INVENTORY

- Start by preparing a comprehensive list or “inventory” of risks posed by the adviser’s business.
- Include risks that are pertinent to the adviser’s particular business model, including its organization, clientele, personnel, strategies, products and services offered and methods of operation.
- Consider the risk of regulatory violations occurring, as well as the risk of breaching contracts or failing to adhere to client mandates.
- Also consider the risk of conflicts of interest arising which could lead to legal violations if not avoided or properly disclosed.
- Gather ideas for what to include on the risk inventory from publicly available sources<sup>7</sup> and other industry sources, such as colleagues at similarly situated firms.
  - Ideas can also be gathered from the sample inventory of risks included in Appendix B of this paper.
- Involve key adviser personnel in the process, soliciting from them ideas on what risks are posed in their particular areas of operation.
  - Larger firms may choose to set up a risk committee comprised of key personnel from all the major departments to undertake the risk management process on an on-going basis.
- At a minimum, include the 10 areas the SEC said advisers should consider when designing a compliance program:<sup>8</sup>
  - Portfolio management processes
  - Trading practices
  - Proprietary and personal trading
  - Disclosures
  - Safeguarding client assets (custody)
  - Books & records
  - Marketing/solicitors
  - Valuation
  - Privacy
  - Business continuity plans
- Add any other areas that are pertinent to that particular adviser.
- Consider the SEC’s “core initial request” list<sup>9</sup> for other risk areas that might be applicable.
- Include any risks or deficiencies that have been identified in the adviser’s prior SEC inspections.
- Consider adding risks posed by laws and activities outside the securities laws, to the extent applicable to the adviser, such as:<sup>10</sup>
  - ERISA
  - Tax
  - Issues of import to the adviser’s affiliates (such as funds, banks, brokers, other financial organizations)

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<sup>7</sup> For example, the Investment Adviser Association has posted on its website a useful Risk Assessment Guide, Questionnaire and Chart at: <http://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=PubDoc-RiskAssesment>. The SEC has also posted a risk matrix of sorts on its website for adviser CCOs at: [http://www.sec.gov/info/cco/cco\\_matrixguide.pdf](http://www.sec.gov/info/cco/cco_matrixguide.pdf).

<sup>8</sup> Adopting Release (cited above in note 1), at Section II.A.1.

<sup>9</sup> See the SEC’s “core initial request” list cited above in note 6.

<sup>10</sup> Although covering the risk of violations outside the Advisers Act and rules is not required in order to satisfy the basic requirements of Rule 206(4)-7, advisers aiming to manage risks on an enterprise-wide basis would be wise to identify and address other risks as well.

- Client relations
- “Corporate” status and housekeeping
- Insurance
- Financial strength and reporting
- Competitive risks
- Reputational risks

## STEP 2: ASSIGN A “RATING” TO EACH INVENTORIED RISK

- Assess each risk on the inventory list as to how significant it is to the adviser.
  - Consider both how likely the risk is to occur and how harmful it would likely be to the adviser or its clients if the risk were to occur.
- Assign a “rating” to each risk on the basis of that assessment.
  - This allows risks to be prioritized, so greater attention and resources can be focused on higher risk areas.
- Use a rating system that reflects the level of risk posed by each identified item, for example:
  - Higher “policy level” risks vs. lower rated risks<sup>11</sup>
  - High, medium or low rated risks
  - Color-coded risks, such as red (danger/prohibitions), yellow (cautionary/restrictions) or green (little or no risk/no restrictions)
  - Scale of 1 to 10 (least to greatest risk posed)
- Caveat: A rating system that belies the practical ability to distinguish one risk category from another is not the most useful.<sup>12</sup>
- Decide what the consequences will be if a risk is assigned to one rating category versus another.
  - In particular, decide where the line should be drawn between those risks that are significant enough to warrant adopting formal written procedures to address the risk versus those risks that are less significant and can be effectively addressed by other means.

## STEP 3: “MAP” RISKS TO PROCEDURES

- For each risk significant enough to warrant being addressed by written procedures, correlate or “map” the risk to the appropriate procedure by identifying the procedure and where it appears.
  - For example, if an adviser has determined that the risk of personnel front running client trades is significant enough to warrant written procedures, the adviser might “map” that risk to the personal trading restrictions in its Code of Ethics that help to address that risk.
- For each risk assigned a rating that indicates it is not significant enough to warrant written procedures, identify any informal procedures or firm practices in place to address the risk.
  - Alternatively, if the risk is inapplicable to the adviser altogether, indicate why it is inapplicable.
- Where the analysis reveals gaps -- that is, areas where procedures are warranted but have not yet adopted -- procedures or controls should be developed.
  - In the development process, involve key personnel who will be expected to comply with the procedures, in order to minimize the prospect of adopting procedures that will not or cannot be followed in practice.
  - When developing procedures:
    - First – Consider the root causes of the risk.

<sup>11</sup> This is the rating system used on the accompanying sample risk matrix in Appendix A.

<sup>12</sup> For example, on a 10-point scale, can a risk rated “6” be realistically discerned from one rated “7”?

For example, is the risk caused by the possibility that the adviser's computers might crash? Is the risk caused by the fact that only one person in the firm knows how to accomplish a key task and that person might be absent for a long period? And so on...

- Second – Consider the goals the procedures are intended to achieve and the adviser's acceptable risk tolerances.

For example, if an adviser's risk tolerance requires it to have up-time of at least 99% on its computerized trading systems, what procedures and back-ups are necessary to achieve that goal? If the adviser's goal is to have personnel available to perform identified key tasks every day the firm is open, what personnel measures are required to achieve that goal with reasonable certainty? Keep in mind that even the best procedures cannot eliminate risk entirely and that the adviser's procedures are required to be "reasonably designed," not "perfect."

- Third – Consider what procedures or controls are feasible to address those risks (that is, to eliminate or mitigate them).

Possible controls run the gamut from prohibitions, pre-approvals, independent verifications, reconciliations, reviews, audits, direct oversight, built-in redundancies and the like. For example, having computer back-ups is a control aimed to address the risk posed by a computer crash. Cross-training personnel to cover multiple areas might address the risk posed by long absences of key personnel.

- Fourth – Consider whether affordable technology can be leveraged to help.

Almost every area of compliance today has automated tools commercially available that can assist in avoiding problems. Many automated tools are becoming increasingly affordable even for the smallest firms. Automated solutions can be the most cost-effective, particularly when the labor cost of manual systems is factored in, along with the potential cost of human error.

- Include provisions in the procedures for functional separation, that is, avoid tasking individuals who have a vested interest in the outcome with the responsibility for overseeing that function.<sup>13</sup> Instead, checks and balances should be introduced so that even if interested or conflicted parties are involved in performing a function, objective oversight is provided by other individuals.
- Carefully consider the level of detail necessary in written procedures to achieve clarity and effective compliance, without introducing unnecessary details that might themselves cause violations.
- Any commercially available procedures adopted ("canned" procedures or "off the shelf" manuals) should be tailored to the adviser's own needs before use.<sup>14</sup>

## STEP 4: REVIEW AND UPDATE

- The risk management process should be "iterative," meaning on-going in a cycle that repeats itself over and over.

<sup>13</sup> For example, the person with ultimate responsibility for valuing portfolio securities should not be the portfolio manager who selected the securities and whose compensation and track record are tied to the portfolio's performance, which is exactly what occurred in at least one prior SEC enforcement action. See *In the Matter of Western Asset Management Co. and Legg Mason Fund Adviser, Inc.*, Advisers Act Release No. 1980 (September 28, 2001)(settled) (adviser failed to have adequate procedures to prevent portfolio manager from overstating the value of a fund's securities). Similarly, see *In the Matter of Mitchell Hutchins Asset Management, Inc.*, Advisers Act Release No. 1654 (September 2, 1997)(settled) (adviser had no procedures to detect inappropriate portfolio manager overrides of custodian provided prices) and *In the Matter of Van Kampen American Capital Asset Management, Inc.*, Advisers Act Release No. 1525 (September 29, 1995)(settled) (firm practices gave portfolio manager too much control over pricing with no oversight and no independent verification).

<sup>14</sup> The SEC has enforced against advisers and their CCOs for adopting "pre-packaged" procedures that were not properly adapted to the adviser's own business. See, for example, *In the Matter of Consulting Services Group, LLC and Joe D. Meals*, Advisers Act Release No. 2669 (October 4, 2007)(settled).

- As such, any circumstances that arise suggesting an adviser’s risk assessment has become inadequate or out-of-date should cause the adviser to review and update it.
- Circumstances that might trigger a review of the risk assessment are the same as those that might trigger a review of the adviser’s compliance program as a whole (or pertinent elements), including:
  - Any compliance matters that arose since the last review.  
Examples might be:
    - Breaches, exceptions, deviations, failure, violations, glitches, confusion or close calls experienced in the adviser’s operations or with respect to a client account.
    - Results of any compliance monitoring and testing conducted by the adviser throughout the year or in conjunction with an annual review.
    - Deficiency letters received from the SEC or other regulatory body following inspection.
    - Employee warnings, sanctions or disciplinary actions.
    - Client complaints or lawsuits or enforcement actions implicating compliance.
  - Any changes in the business activities of the adviser or its affiliates.  
Examples might be:
    - Acquisitions, divestitures or restructurings that changed the scope or nature of the adviser’s business, the scope or nature of its clientele or the ownership or affiliations of the adviser.
    - Business lines, products or services added to or dropped from the adviser’s operations.
    - Changes in the adviser’s key personnel, offices or infrastructure (such as computer systems).
  - Any changes in the law or regulatory developments that might suggest a need to revise the policies or procedures.  
Examples might be:
    - New SEC rules or new guidance issued by the SEC on regulatory issues.
    - Public speeches and statements from the SEC Staff and Commissioners (available on the SEC’s website) addressing compliance-related issues.
    - Common areas of deficiency identified by the SEC Staff in a “ComplianceAlert” letter (also available on the SEC’s website).
    - Tips or guidance made available by the SEC Staff at national and regional CCO outreach seminars.
    - Recent SEC and state enforcement proceedings suggesting areas of particular compliance and enforcement concern, such as custody (i.e., Madoff), insider trading, Ponzi schemes, senior investor fraud, etc.
- Regardless of interim events, an adviser’s risk assessment should be reviewed and updated at least annually, just like (and often undertaken as part of) the adviser’s entire compliance program.<sup>15</sup>
  - Any records documenting an adviser’s annual review of compliance procedures are considered “required records” under the adviser books and records rule.<sup>16</sup>
  - Accordingly, advisers that integrate their risk assessment update into their annual compliance program review should maintain and preserve documentation of it in an easily accessible place for not less than 5 years from the end of the fiscal year during which the last entry was made on the record, and during the first 2 years, in an appropriate office of the adviser.<sup>17</sup>

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<sup>15</sup> Under Advisers Act Rule 206(4)-7(b), an adviser’s compliance procedures are required to be reviewed not less frequently than annually.

<sup>16</sup> See Advisers Act Rule 204-2(a)(17)(ii).

<sup>17</sup> See Advisers Act Rule 204-2(e)(1).

## **CONCLUSION**

Advisers can follow these four basic steps to conduct a risk assessment, a key starting point for building a successful compliance program. The sample risk matrix and risk inventory on the following pages can also help advisers document the process and demonstrate that their compliance programs are “reasonably designed” as required.

## APPENDIX A

# SAMPLE RISK ASSESSMENT MATRIX

*Caveat: This is a single page excerpted from a sample risk assessment matrix for a hypothetical advisory firm. This matrix and the accompanying list of risks are neither comprehensive nor tailored. Not every item is legally required. As such, they may be over-inclusive or under-inclusive (or both) for any particular adviser. They are intended for illustration only, to be used as a "starting point" for advisers to build their own risk management process. This matrix and accompanying list were created in January 2010. Legal and other requirements change frequently. Every item should be checked independently and updated before use.*

| <b>HYPOTHETICAL ADVISORY FIRM LLC</b>  |  |   |  |  |
|--|--|---|--|--|
| <b>Risk Assessment Matrix</b>  |  |   |  |  |
| <b>January 2010</b>  |  |   |  |  |
| Risk Inventory (1)   | Higher<br>"Policy<br>Level"<br>Rated<br>Risk (2) | Lower<br>Rated<br>Risk or<br>No Risk<br>(N/A) (2) | Risk Addressed by Policy / Procedure (3)   | Follow-Up (4)  |
| <b>PORTFOLIO MANAGEMENT PROCESSES</b>  |  |   |  |  |
| <b>Supervision and Review</b>  |  |   |  |  |
| Accounts are reviewed periodically   | X  |   | Compliance Manual Section 1 – Account Opening Procedures and Account Reviews   |  |
| Advisory personnel are supervised appropriately  | X  |   | Compliance Manual Section 10 – Personnel Matters; Organizational Chart in Appendix to Compliance Manual; weekly staff meetings |  |
| Any sub-advisory relationships are overseen appropriately  |  | X   | N/A -- Firm currently has no sub-advisory relationships  | CCO will monitor on-going negotiations with proposed sub-adviser for new Small Cap strategy. |
| <i>[and so on...continue matrix by adding risks identified under all the major areas applicable to the adviser.]</i> |  |   |  |  |

- (1) Each adviser should list its own inventory of risks in this column, based on the risks posed by its particular business model. See the accompanying sample inventory of risks (in Appendix B) that advisers might consider including, among others.
- (2) Advisers should assess and assign a "rating" to each inventoried risk, taking into account how likely the risk is to occur and how much harm could result if it were to occur. In this sample matrix, risks are rated either as higher "policy level" risks, or as lower rated risks posing little or no concern. In this hypothetical example, higher rated risks are those the adviser considers significant enough to warrant being addressed by formal written procedures. Lower rated risks are not considered significant enough to warrant formal written procedures, but may be managed by informal practices or other appropriate means.
- (3) This column can be used to "map" or correlate higher rated risks to compliance policies and procedures adopted by the adviser to address those risks. Procedures are identified by where they appear in the adviser's compliance documentation (shown in this hypothetical example as particular sections in the adviser's Compliance Manual). For lower rated risks, this column can be used to explain what informal practices are used to address the risk or why the risk is lower rated or not applicable and therefore does not warrant a formal written procedure.
- (4) This column can be used to task individuals with follow-up responsibilities in the risk assessment process. In this hypothetical example, the CCO is tasked with the responsibility of monitoring on-going negotiations the adviser is having with another advisory firm to hire as a potential sub-adviser. If negotiations are concluded successfully, the adviser should consider whether the risk posed by that new sub-advisory relationship warrants adopting written procedures for sub-adviser oversight.

## APPENDIX B

# SAMPLE INVENTORY OF RISKS<sup>18</sup>

*Caveat: As part of its risk assessment process, each adviser should prepare its own inventory of risks based on the risks posed by its particular business. The following list is neither comprehensive nor tailored. Not every item on the list is legally required. As such, the list may be over-inclusive or under-inclusive (or both) for any particular adviser. It is intended for illustration only, to be used as a "starting point" for advisers to build their own risk management process.*

|                                |
|--------------------------------|
| PORTFOLIO MANAGEMENT PROCESSES |
|--------------------------------|

### Supervision and Review

- Accounts are reviewed periodically
- Advisory personnel are supervised appropriately
- Any sub-advisory relationships are overseen appropriately
- Oversight extends to personnel or contractors in branch offices and/or remote locations

### Allocation of Investments

- Conflicts of interest in managing investments are identified and addressed and adequately disclosed
- Allocations of investment opportunities among clients are fair and equitable
- Allocations are consistent with disclosures

### Compliance with Restrictions

- Information is gathered regarding each client's financial and family circumstances, investment objectives and restrictions, and risk tolerance
- Information regarding clients is updated periodically
- Consistency of portfolios with clients' investment objectives, guidelines and restrictions is checked periodically
- Risk in client accounts is managed appropriately
- Consistency of investments with SEC and IRS requirements is monitored

### Illiquid Securities

- Investments in illiquid securities (restricted securities, Rule 144A securities and 4(2) securities) comply with investment policies and SEC requirements

### Credit Quality

- Credit quality is maintained within applicable restrictions/limits for each account
- Investments in unrated securities are determined to be of credit quality equivalent to that permitted in account restrictions

### Repurchase Agreement Guidelines

- Investments in repos or reverse repos comply with account restrictions
- Creditworthiness of repo counterparties is monitored

### Investments in Securities-Related Businesses

- For fund clients, investments in securities-related businesses comply with Rule 12d3-1 under 1940 Act

### Lending Procedures

- Securities lending program complies with applicable SEC requirements
- For fund clients, interfund lending program complies with SEC exemptive order

### Consistency with Disclosures

- Procedures exist for ensuring that portfolio management processes are consistent with ADV, fund client prospectus disclosure, shareholder reports and marketing materials (including website)

### Borrowing Procedures

- Client account/fund borrowings comply with applicable 1940 Act requirements and SEC guidance

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<sup>18</sup> Note that this list reads more like an "Inventory of Goals" than an "Inventory of Risks," since the items on the list are worded in the affirmative, for example, that "IPOs are allocated among clients fairly and consistently." However, each item on the list represents the risk that the opposite of what is stated is in fact occurring, for example, the risk that "IPOs are not allocated among clients fairly and consistently."

#### Segregation Procedures

- Segregation of assets for collateral is undertaken and monitored in accordance with requirements

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| TRADING PRACTICES AND PLACEMENT OF BROKERAGE |
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#### Bunched Trades

- Adviser has process for determining which accounts will be allowed to participate in which types of trades
- Decision on which accounts will participate is made before order is placed for execution, along with initial allocation decision
- Transaction orders are bunched when appropriate, consistent with best execution, terms of advisory agreements and disclosure to clients
- Methodology for bunching is defined and disclosed as appropriate
- Any trades for proprietary or personal accounts bunched with client trades are done consistently with Code of Ethics, other disclosures, SEC interpretive guidance and other applicable guidance (such as ERISA, if applicable)

#### Trade Allocations

- Fair and consistent system for allocating bunched trades is in place
- Conflicts of interest in allocating trade orders are identified and addressed and adequately disclosed
- Any changes made to initial allocation decisions are fully supported by documentation and audit trail

#### IPO Allocations

- IPOs are allocated among clients fairly and consistently

#### Trade Sequencing

- Methodology exists for sequencing trades in accounts trading in the same security at the same time, if trades are not bunched
- Sequencing methodology, and conflicts inherent in methodology, are disclosed

#### Principal Trades, Agency Cross Trades and Cross Trades

- Principal transactions (including riskless principal trades) comply with Advisers Act Section 206(3) and SEC guidance
- Agency cross transactions comply with Advisers Act Rule 206(3)-2 and, for fund clients, Rule 17a-7
- Cross trades are done only in accordance with SEC guidance and, for fund clients, client's own policies
- All client consent requirements are met for principal trades under 206(3), agency cross and cross trades under 206(3), Rule 206(3)-2, 17a-7 and (ERISA) PTCE 86-128, to the extent applicable
- Conflicts of interest in principal, agency cross and cross trades are identified, monitored and disclosed

#### Best Execution

- Broker-dealers used to place trades are periodically evaluated as to performance
- Conflicts among clients relating to execution of trade orders are addressed and adequately disclosed
- Post-trade analysis of trades is conducted to assess whether best execution was achieved
- Periodic evaluations are made to determine adherence to best execution policies
- Criteria used to select brokers is defined and disclosed as appropriate, and updated as necessary

#### Monitoring for Inappropriate Trading

- Portfolio personnel are not engaged in "churning"
- Advisory personnel are not engaged in "window dressing" or "portfolio pumping"
- Turnover is analyzed to ensure within acceptable range

#### Trade Error Correction

- Trade errors are caught and corrected in a timely way
- Client accounts are adjusted appropriately and promptly
- Soft dollars are not used to correct trade errors

#### Directed Brokerage

- Client instructions to direct brokerage are in writing and are indicated on each client's/fund's trade ticket
- Adviser discloses its duties and responsibilities in directed brokerage arrangements, including the limitations on adviser's ability to seek best execution, negotiate commissions and aggregate directed trades with others
- No directed brokerage is used to pay for or reward fund share sales (Rule 12b-1(h))

Soft Dollars / Uses of Client Brokerage to Obtain Goods/Services

- If required by advisory contract, disclosures or client relationship (such as with an ERISA or mutual fund client), soft dollars are done only in accordance with Section 28(e)
- Determinations as to reasonableness of commissions are made and documented per Section 28(e), where applicable
- Any other uses of client brokerage are identified, potential conflicts disclosed and actions monitored
- Any soft dollars done outside of Section 28(e) are analyzed beforehand for compliance with all applicable laws and fiduciary obligations
- All required disclosures on uses of brokerage are made
- Consideration is given to arrangements that may involve "inadvertent" or unintended ("unavoidable") soft dollars using a "follow the money" approach
- Commission-sharing arrangements (CSAs) and client commission arrangements (CCAs) are undertaken only in accordance with applicable SEC guidance

List of Approved Trading Personnel

- Trades are executed only by approved advisory personnel

Trade Settlement Procedures

- Trades are processed on a timely basis and trade settlement is monitored effectively

Other Trading Issues

- Any short sales/trades are placed consistently with applicable SEC and exchange regulations, such as Regulation SHO and Regulation M
- Levels of initial and maintenance margin are monitored and maintained per Regulation T
- Any trades in derivatives or otherwise creating leverage are "covered" to the extent required by law or client parameters
- Trades on margin are consistent with client requirements and regulatory parameters
- Monitoring is done for any special treatment or favoritism in trading given to client accounts who provide adviser with client referrals, such as reduced fees, reduced commissions or favorable allocations, etc.
- Monitoring is done for any special treatment or favoritism in trading given to client accounts of persons with personal relationships to adviser or its personnel (family, friends, related accounts, etc.)
- Monitoring is done for trading inconsistent with any restricted trading lists

PROXY VOTING

Voting Procedures

- Proxies are voted in accordance with policies and in the best interest of client
- How clients can obtain voting record is disclosed to clients
- Copies of proxy voting procedures are provided upon request
- Proxy voting information is made available to service providers responsible for filing Form N-PX on behalf of fund clients
- Form ADV discloses summary of proxy voting procedures

CLASS ACTIONS / PROOFS OF CLAIM / CORPORATE ACTIONS

Tracking Claims/Actions

- To the extent handled by adviser, class action lawsuits and other corporate actions (e.g. bankruptcies) relating to securities held in client accounts are monitored, proofs of claim are filed and tracked and pay-outs are directed to proper client accounts

Disclosure

- Disclosure in ADV, any related client disclosures and investment advisory agreement provisions regarding adviser's obligation to file proofs of claim or take other corporate actions on behalf of client accounts is clear and accurate

PROPRIETARY AND PERSONAL TRADING / CODE OF ETHICS / "PAY TO PLAY"

Code of Ethics

- Access persons report holdings and transactions quarterly and annually in a timely fashion
- Reports/duplicate confirms and statements are reviewed for improprieties in a timely fashion
- Exemptions/waivers are approved and documented, and do not involve waivers of any provisions required by statute or regulation
- Adviser provides copies of Code to supervised persons
- Initial and periodic acknowledgments are required from covered persons
- Supervised persons are required to report any violations of Code promptly to CCO
- Records are kept of any non-compliance with Code of Ethics by adviser personnel

- Consideration is given to inclusion of contract employees and temporary employees under Code as "access persons"

List of Access Persons

- List is maintained and updated as necessary

Trading in Fund Shares

- Personnel trade in client fund shares only as permitted under Code of Ethics

Personal Trading

- Appropriate restrictions, bans and pre-clearances are established for access persons
- Personal trading is monitored for any taking by adviser personnel of opportunities that should be offered to clients

Gifts

- Gifts are given and received only in accordance with policies and/or Code of Ethics
- Adviser is aware of and complies with any DOL requirements concerning LM-10 filings (relating to gifts, gratuities or other payments made to union officials)

"Pay to Play" Restrictions

- Appropriate restrictions are imposed on ability of adviser and personnel to make political contributions and solicitation payments in violation of SEC "pay to play" rules (MSRB Rules G-37 and G-38 and [proposed] Rule 206(4)-5)
- Similar appropriate restrictions are imposed on contributions as necessary to comply with any applicable city, state or other local requirements
- Contributions/payments are monitored periodically

Directorships in Companies

- Prohibitions on or pre-clearance requirements for directorships, creditor committee appointments, etc., are monitored
- When directorships or creditor committee appointments are permitted, securities of subject company are not acquired or potential conflicts are monitored and disclosed

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| ACCURACY AND TIMELINESS OF DISCLOSURES / FORM ADV |
|---|

Form ADV

- Annual amendment to Form ADV is filed timely
- Interim amendments to Form ADV are made when required
- Form ADV Part II is delivered to clients at inception as required
- Form ADV Part II is offered or delivered to clients annually as required

Form 13-F

- EDGAR access codes are obtained and maintained in order to permit necessary 13-F filings
- Accurate and timely 13-F filings are made
- Coordination with affiliates / sub-advisers is undertaken to ensure all 13(f) securities are covered in appropriate 13-F filings

Client/Fund Disclosures / Government Filings

- Steps are taken to ensure accurate and timely client or fund disclosures as a result of account holdings, including Schedules 13D/G; Forms 3/4/5; Hart-Scott-Rodino filings

Dissemination of Materials via Electronic Means

- Any regulatory materials (e.g. Form ADV) sent to clients electronically is sent in compliance with applicable SEC guidance on use of electronic means and E-SIGN Act consent requirements

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| SAFEGUARDING CLIENT ASSETS (CUSTODY) |
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Asset Custody

- Client funds and securities are held in custody with "qualified" custodian, to the extent required by Rule 206(4)-2
- If adviser acts as the qualified custodian for its own clients' assets, or opens omnibus accounts with custodians and performs the client-level sub-accounting, appropriate custodial controls are in place over areas such as client account setup and maintenance, processing of client transactions, processing of income and corporate action transactions, reconciliations to custodians and client reporting
- If adviser has "custody" as defined in custody rule (Rule 206(4)-2), adviser obtains acknowledgement from custodians that they send account statements directly to clients not less than quarterly and/or obtains from custodians copies of statements sent to clients
- If adviser has "custody" under custody rule, accounts are subjected to annual "surprise exam" if required by Rule 206(4)-2

- If adviser or a related person is the qualified custodian for client assets, an annual internal control report on custody controls is obtained
- Independent accountant performing surprise exam and/or internal control report is PCAOB-registered and inspected if required by Rule 206(4)-2
- Funds or securities inadvertently received are returned to sender promptly, but in any case within 3 business days of receiving them, to the extent required by Rule 206(4)-2
- Investment advisory agreement contains appropriate clauses pertaining to custody

Independent Verification

- Assets in client accounts are verified with independent third parties (e.g. independent custodians, DTCC)

Reconciliation

- Custodial statements are reconciled on a timely basis to adviser's records of client's holdings and cash

List of Control/Authorized Personnel

- List is maintained of persons authorized to give instructions to move fund and client assets in custody

Fidelity Bond/Insurance

- Adviser maintains adequate fidelity bond coverage, if required (e.g. for mutual fund and/or ERISA clients)
- Adviser maintains adequate D&O and E&O coverage
- Adviser maintains adequate general liability insurance
- Any joint bond and insurance/premium arrangements between adviser and fund clients is in writing and approved by fund board each year

**CONFLICTS OF INTEREST**

Identification of Conflicts

- Adviser undertakes on-going and systematic identification of potential conflicts between adviser and clients and among clients
- Example: conflicts in investment advice to various clients, such as telling one client to sell a security and another to buy it
- Example: financial self-interest to trade in client accounts at levels that might be inappropriate, such as commission-based fees
- Example: financial self-interest to take more risk in an account than might be appropriate, such as performance fees
- Example: financial incentives for personnel to recommend to clients securities that are not suitable for them or are not in their best interest, such as employee-level "pay-outs" or compensation that varies by product
- Example: financial incentives to not seek best execution on behalf of a client, such as benefits obtained from soft dollars or placing trades with an affiliated broker-dealer
- Example: cherry-picking of favorable trades for favored accounts over less favored accounts, such as proprietary accounts or accounts that pay a performance fee
- Example: scalping, meaning the illegal practice of recommending that clients purchase a security and secretly selling the same security in a personal or proprietary account contrary to the recommendation for the client
- Example: "side letters" or other side agreements with some clients or investors to provide them with different or favored terms that are not made available to other clients or investors
- Example: providing investment advice regarding securities of affiliates or other companies with which adviser or its personnel has a business relationship (including personnel sitting on Boards, creditor committees, etc.)
- Example: financial incentives created by investing client assets in proprietary vs. non-proprietary products or in products with different fees
- Example: side-by-side management of accounts with hedge fund or other pooled vehicles in which adviser has ownership stake and/or performance fee interest
- Example: referral or revenue sharing arrangements with solicitors, pension consultants, fund administrators/distributors and others
- Example: deals to waive transfer fees, loads, redemption fees or trading windows (such as "sticky" asset deals)
- Example: preferential treatment given to "value added" clients and investors (clients or investors who are, for example, sell side brokers, investment banking research analysts, brokerage employees, hedge funds, employees of unaffiliated investment advisers to hedge funds, senior executives of public companies, or paid consultants) that may imply a hidden "quid pro quo" or other improper relationship
- Example: conflicts inherent in the process of advisers or their personnel pricing assets or "fair valuing" assets where market prices are not available

Disclosure

- Steps are taken to ensure that material, relevant conflicts are disclosed to clients in an adequate and timely way

**BOOKS AND RECORDKEEPING**

Required Records

- Adviser personnel are aware of books and records required to be created and preserved under Rule 204-2 of Advisers Act

- Adviser personnel are aware of its role relative to books and records required to be created and preserved under Rules 31a-1 and 31a-2 of Investment Company Act for any fund clients
- Records can be retrieved and/or produced upon request within required regulatory time frames

#### Preserving Integrity

- Data is captured and recorded in a timely and accurate manner
- Records/data are protected from unauthorized access or alteration
- Records/data are protected from unintentional destruction
- Electronic records are kept in accordance with SEC rules pertaining to "micrographic and electronic storage" (Rule 204-2(g) and parallel Investment Company Act provisions)
- Email and other electronic communications are preserved in accordance with same requirements (if substance of communication is record required to be created or preserved)

#### Disposal

- Procedures relating to destruction of records ensures that recordkeeping requirements to preserve and maintain records for regulatory periods are satisfied
- Any disposal of "consumer report information" is made consistent with Reg. S-P (on privacy)

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| PRIVACY PROTECTION |
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#### Protection of Information

- Customer/client records are safeguarded in compliance with SEC and any other applicable requirements
- Appropriate controls are in place restricting access of employees and unauthorized persons to physical locations where client and other confidential information is stored
- Appropriate electronic controls are in place restricting access to client and other confidential information
- Clients are notified of adviser's privacy policy at inception and at least annually

#### Data Security Breach

- When required by applicable federal or state law, notification is made to clients and/or governmental entities of any data security breach

#### Disposal

- Procedures relating to destruction of records ensure that recordkeeping requirements to preserve and maintain records for regulatory periods are satisfied
- Any disposal of "consumer report information" is made consistent with Reg. S-P (on privacy)

#### Transfers of Client Information

- Permitted transfers of client information (e.g. upon client's consent or at time of account transfer) are undertaken with appropriate safeguards

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| ADVERTISING / MARKETING |
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#### Guidelines

- Adviser advertisements are prepared in accordance with SEC requirements, including avoiding specific prohibitions in SEC rules
- Ads and other marketing materials are monitored to ensure adviser's actual practice is consistent with statements made in marketing materials and ads

#### Performance Calculations

- Calculations of adviser's client performance are done accurately and disclosed properly
- GIPS compliance is not stated or implied unless full GIPS compliance is achieved and verification obtained from outside auditor

#### Approval

- All ads and other marketing materials, or changes/additions to them (including website), are reviewed and approved by designated person at adviser

#### Filings

- Advertisements are filed in accordance with applicable SEC and/or FINRA requirements

#### Marketing of Fund Shares or Pooled Vehicles

- Adviser involvement in any marketing or selling of fund shares or interests in other pooled vehicles is undertaken in accordance with applicable restrictions (including any need to register as or associated with a broker-dealer)

#### Solicitors

- Any cash compensation paid to solicitors (employees or non-employee/third-party solicitors) is done only in accordance with SEC "cash solicitation" rule (Rule 206(4)-3)
- Use of any solicitors for client referrals is disclosed on Form ADV appropriately
- No fund portfolio brokerage commissions are used to reward client referrals to adviser
- Any other client commissions used to reward client referrals are only done consistent with all fiduciary, disclosure and other obligations

### VALUATION OF HOLDINGS / ASSESSMENT OF ADVISORY FEES

#### Calculation of Advisory Fee

- Adviser performs due diligence on methodology used by pricing services and others for determining values used in reporting to clients and calculating advisory fees
- Adviser uses appropriate "fair value" pricing methods for assets where objective market values are not available, in accordance with SEC guidance, and methodology is appropriately disclosed
- Adviser (or service provider) identifies and records corporate actions (stock splits, etc.) that impact valuations in a timely and accurate fashion
- Advisory fee calculation and assessment is consistent with each client's advisory agreement
- Advisory fee calculation and assessment is consistent with adviser and fund client fee disclosures
- If advisory contract is terminated, any fees owed as a refund are paid back in accordance with the contract

#### Performance-based Fees

- Any performance fees are consistent with SEC requirements (including clients meeting the standards set out in Section 205 and/or Rules 205-1, 205-2 and 205-3)
- Upside and downside "proportionality" in performance fee is recognized, per SEC guidance
- Conflicts involved in performance-based fees are fully disclosed

#### Commission-based or Transaction-based Fees

- Conflicts of interest involved in commission and transaction-based fees are fully disclosed

#### "Double Dipping"

- For ERISA accounts, if client assets are invested in advised funds, advisory fee is offset to avoid double dipping
- For non-ERISA accounts, if client assets are invested in advised funds, fee is offset to avoid double dipping or fiduciary duty is satisfied through other means where appropriate (full disclosure/consent)

#### Waivers/Reimbursements

- Fee waivers/expense reimbursements are approved by fund board, for fund clients
- Fee waivers/reimbursements made to advisory clients are made uniformly or in another fair manner
- Any fee reimbursements required (e.g., upon account termination) are made in a timely fashion

### BUSINESS CONTINUITY / DISASTER PLANNING

#### Planning

- Emergencies and disasters have been thought through and plans adopted to ensure safety and continuity of business operations
- Plans have been developed to provide for critical personnel and systems availability in case of emergency
- Annual review/update of plan is undertaken

#### Testing of Plan

- Plans include periodic "dry runs" or testing
- Adviser due diligence is conducted to ensure that business continuity plans are in place at critical third-party service providers

### ANTI-MONEY LAUNDERING

#### Adviser's Private, Separate Account Clients

- AML Customer ID Program (CIP) and related procedures are in place, and IDs of prospective clients are screened against the OFAC lists of designated persons to avoid OFAC violations
- AML Officer is designated to oversee AML program
- AML monitoring is part of overall compliance program

- Steps are taken to ensure proper filing of government reports such as FinCEN "suspicious activity reports," IRS and/or Customs reports of cash transactions in excess of \$10,000, OFAC Reports of Blocked Transactions and any other applicable similar reporting requirements

#### Delegation

- Any AML responsibilities delegated to or shared with broker-dealers or other custodians is done only after due diligence to ensure appropriate

### IDENTIFICATION OF AFFILIATED PERSONS

#### List Maintained

- Affiliates are identified and listed
- Affiliates are made aware of their status as "affiliates"

#### Avoiding Transactions with Affiliates

- Steps are taken to avoid sales and purchases between affiliates and clients
- Steps are taken to avoid affiliates borrowing assets from clients
- Steps are taken to avoid other transactions between affiliates and clients
- Steps are taken to ensure compliance with Rule 17a-6 for transaction involving any fund client and a "portfolio affiliate"
- For fund clients, steps are taken to ensure any merger of affiliated funds is consistent with 17a-8
- For fund clients, steps are taken to ensure any "joint enterprises" and "profit sharing plans" comply with 17d-1
- For fund clients, affiliated transactions are reported to fund board

#### Affiliated Underwriters

- For fund clients, fund portfolio securities involving affiliated underwriters meets 10f-3 and does not involve "cherry picking"
- For fund clients, affiliated underwriter transactions are reported to fund board

#### Affiliated Brokers

- Steps are taken to ensure use of affiliated brokers for non-fund clients is properly disclosed (including conflicts)
- Steps are taken to ensure use of affiliated brokers for fund clients meets 17e-1 and fund policies
- For fund clients, commissions paid to fund affiliated brokers are reported to fund board

#### Other Fund/Affiliate Transactions

- Steps are taken to ensure fees paid to fund affiliates are proper
- Steps are taken to ensure there are no improper joint transactions (including loans) between fund clients and affiliates

### PROTECTION OF NON-PUBLIC / CONFIDENTIAL INFORMATION (INSIDER TRADING)

#### Insider Trading Prevention and Detection

- Steps are taken to ensure material, non-public information is not misused by adviser or its directors, officers or employees
- Personal securities transactions of reporting personnel are monitored for insider trading issues

#### Internal Information Protection

- Steps are taken to ensure material, non-public information is not disclosed to unauthorized internal personnel
- Measures are in place to avoid inadvertent disclosure of non-public or confidential information to unauthorized outside personnel (visitors, on-site service providers, persons sharing offices, etc.)

#### Portfolio Information Disclosure

- Portfolio holdings information is disclosed to a third party only in accordance with client's and adviser's policies
- Steps are taken to ensure there is no unauthorized disclosure of pending transactions and trading strategies to third parties

#### Outside Employment, Directorships & Other Business Activities

- Considerations (confidentiality, insider trading, etc.) posed by outside employment, directorships, dual appointments and other arrangements are identified and addressed

#### Communications with the Media

- Steps are taken to ensure only authorized persons respond to inquiries from public and the media

## COMPLIANCE PROGRAM

### Program Design

- Corporate culture of compliance / "tone at the top" is established
- General fiduciary and adviser obligations are acknowledged
- Compliance program is aimed at meeting Advisers Act Rule 206(4)-7
- Steps are taken to ensure that personnel cannot override control systems and to maintain best reasonably available independent oversight and checks and balances
- On-going monitoring and testing is conducted in key areas ("transactional," "periodic" and "forensic" testing)
- Organizational chart is maintained
- Compliance manual is maintained

### Annual Review

- Review of adequacy and effectiveness of compliance policies and procedures is undertaken at least annually
- Risk assessment is updated at least annually
- Conflicts of interest are reconsidered at least annually
- Potential need for interim reviews is acknowledged and steps are taken to ensure they occur

### SEC Regulatory Oversight

- SEC contacts, visits, examinations, etc. are managed by appropriate personnel
- Commitments made in deficiency letter responses and other SEC communications are implemented as committed

### Training/Continuing Education

- CCO and other personnel receive appropriate training and continuing education

## CORPORATE, REGULATORY AND PERSONNEL MATTERS

### Registration and Other Periodic Filings

- Adequate account balance is maintained in the IARD system to cover fees for necessary federal and state IARD filings
- Adviser is "notice-filed" via IARD system in states where required
- Periodic Secretary of State and other state filings are made in a timely fashion
- IRS and other tax filings are made in a timely fashion

### Contracts

- Fully signed, current copies of advisory and other key corporate contracts are maintained

### Internal Corporate Matters

- Directors/managers are elected periodically if required
- Officers are elected/appointed as required
- Minutes and other records of corporate actions are maintained as required

### Regulatory Personnel Matters

- In hiring process, adviser checks to ensure candidates are not "disqualified" (under SEC rules) for the position
- Personnel are licensed/registered as IARs (investment adviser representatives) in states where so required
- Personnel are licensed/registered as registered representatives of a broker-dealer with SEC and/or states where so required, if they are involved in fund share sales or other activities involving the sale of securities
- All required U-4 and U-5 filings are made of registered personnel
- Monitoring under any anti-nepotism policy is in place at adviser
- Any outside activities by adviser personnel (such as directorships) are approved and monitored by adviser and disclosed as appropriate

### Regulatory History

- Steps are taken to stay within any special SEC-imposed parameters applicable to adviser, conditions appearing in any applicable SEC Order conditions, conditions in any no-action letters on which adviser is relying, etc.
- Steps are taken to maintain current disclosure regarding anything of that similar regulatory nature

## FINANCIAL MATTERS AND RISKS

### Internal Financial Management

- Steps are taken to monitor and maintain adviser's financial soundness

- Steps are taken to maintain any subsidiary support relationship with a parent company

Financial Disclosure

- Steps are taken to ensure compliance with requirements of Rule 206(4)-4 to disclose to clients/prospective clients financial conditions reasonably likely to impair ability of adviser to meet contractual commitments and legal/disciplinary events material to evaluation of adviser's integrity or ability to perform contract
- Steps are taken to include adviser's balance sheet with Form ADV if required -- for SEC-registered advisers, required if adviser requires prepayment of more than \$500 in fees per client and 6 or more months in advance; for state-registered advisers, also required if adviser has custody of client funds or securities

Cost Sharing

- Steps are taken to monitor any allocations of costs between adviser and clients, among clients or between adviser and outside parties (e.g., office sharing)

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| CLIENT RELATIONS / OTHER |
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Client Relations

- Client complaints are logged and responses followed to conclusion
- Fee waivers and other special arrangements for clients are undertaken only consistent with fiduciary obligations (including fairness among clients) and with appropriate management approval
- Adviser monitors for loss of advisory clients / accounts and reasons therefor