INVESTMENT ADVISER ASSOCIATION

Newsletter

Issue Number 170 February 1, 2007

IAA to Cosponsor NRS Compliance Program

The Investment Adviser Association and National Regulatory Services recently announced that the IAA will cosponsor the NRS Investment Adviser Compliance Certificate Program[sm]. "We are proud to associate our organization's name and reputation with the highly regarded certification program that NRS has developed for investment adviser compliance professionals," said David Tittsworth, IAA Executive Director. "Working together, we believe that we can build on the success of this excellent program."

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>
> *David Tittsworth*
> *IAA Executive Director*

NRS, a division of SourceMedia, is a leading national compliance consulting firm that provides compliance, registration services, software solutions and training for investment advisers, broker-dealers, investment companies, and insurance institutions.

"We are very pleased that the IAA will be helping us in our endeavor to promote knowledge among investment adviser compliance professionals through the NRS Center for Compliance Professionals[sm]," said John Gebauer, NRS President. "We are convinced that this partnership will help us to achieve our goal of advancing compliance as a profession."

NRS announced the establishment of the Center for Compliance Professionals and the IACCP program on October 11, 2004 – the first program of its kind. The stated purpose of the Center for Compliance Professionals is "to advance the compliance profession and to acknowledge the heightened role of compliance professionals in today's environment."

The IACCP is a professional education program that consists of five primary requirements: (1) education (in general, requiring the successful completion of 60 hours of course work); work experience (in general, requiring two years of full-time professional work experience); (3) passing the certifying examination; (4) adhering to the program's Code of Ethics; and (5) fulfilling continuing education requirements to maintain the Investment Adviser Certified Compliance Professionalsm (IACCPsm) designation.

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In This Issue:

IAA Annual Conference – Register Today!
Austin, Texas – April 25-27, 2007

The Investment Adviser Association will hold its 2007 annual conference at the Four Seasons Hotel in Austin, Texas on April 25-27. "Our blue-ribbon planning committee from Texas has arranged a first-rate program," said IAA Executive Director David Tittsworth. "We strongly encourage every member to make plans to participate in what promises to be one of the best conferences we have ever sponsored."

Featured speakers will include Richard W. Fisher, President & CEO of the Federal Reserve Bank of Dallas Texas; The Honorable Paul Atkins, SEC Commissioner; Dr. George Friedman, an internationally recognized expert on geopolitics and intelligence; Matthew Simmons, chairman and founder of Simmons & Company International, a specialized energy investment banking firm, author, and leading authority on energy issues; Dr. Michael Brandl, Senior Lecturer in the Finance Department in the McCombs School of Business at The University of Texas at Austin; Nancy B. Rapoport, Professor of Law at the University of Houston Law Center; and Dr. James T. Willerson, President of the University of Texas Health Science Center at Houston.

In addition to the Thursday-Friday program, the conference will feature a half-day optional workshop on Wednesday, April 25, dealing with succession planning issues.
The conference includes breakout sessions for all participants, a reception, dinner, and entertainment at the One World Theatre in the hills of West Austin, a Western dinner/dance at The Four Seasons Hotel, an interesting and entertaining spouse program on Thursday, and more.

The conference brochure and registration forms are available on the IAA web site (www.investmentadviser.org). Please contact Lisa Gillette, IAA Director of Meetings and Events (lisa.gillette@investmentadviser.org) with any questions.

IA Compliance Best Practices Summit
March 22-23, 2007 -- Washington, DC

The 9th annual IA Compliance Best Practices Summit, co-sponsored by the Investment Adviser Association and *IA Week*, will be held March 22-23, 2007 at the Renaissance Hotel in Washington, DC. The conference presents sessions addressing the latest developments regarding compliance issues, including soft dollars, annual reviews, code of ethics, privacy and data disclosure, and best execution and trading practices.

Featured speakers include Andrew Donohue, Director of the SEC's Division of Investment Management; Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations; and Linda Thomsen, Director of the SEC's Division of Enforcement. Attendees will hear from many other regulators including Investment Management Division officials Robert Plaze, David Blass, Liz Osterman, Jennifer Sawin, Dan Kahl, Market Regulation's Jo Anne Swindler, Office of Compliance Inspections and Examination's John Walsh and Gene Gohlke, NASAA's Patricia Struck, and Department of Labor's Andrew Auerbach. Other speakers include CCOs and in-house counsel from a broad range of advisory firms and counsel and partners from leading law firms.

With hundreds of attendees, the Best Practices Summit presents excellent networking opportunities with other compliance professionals. Plan to attend. For registration information, go to http://www.iaweek.com/conferences/spring07/. Investment Adviser Association members save $200.

Legal & Regulatory Update

SEC Sanctions Dually Registered IA/BD for Understating Total Fees Charged for Managing Five Mutual Funds

The SEC alleged that a dually registered investment adviser and broker-dealer understated the publicly disclosed advisory fee of 1 percent of assets under management for five managed mutual funds. The adviser/broker-dealer did not include in its management fee the substantial brokerage commissions that in the context of providing advice to mutual funds would be deemed advisory services. The SEC deemed the disclosures misleading and claimed that the commissions had the effect of obscuring from mutual fund shareholders the full cost of the investment advisory services. The misleading disclosures prevented investors from making a fair comparison with fees charged by other mutual funds.

On January 18, 2007, the SEC entered an order instituting administrative and cease and desist proceedings, and accepted a settlement where the registered investment company would be censured, fined $100,000, and ordered to comply with undertakings to hire an independent consultant to review its advisory fees and options commissions at the end of its most recent fiscal year. The consultant will review the activity for compliance with rules and regulations governing commissions and fees as well as best execution obligations. The SEC noted cooperation of the respondent and brought proceedings against no individuals.

See In Re Kelmoore Investment Company Inc. IA Rel. No. 2581 (Jan. 18, 2007), File No. 3-12541 available at http://www.sec.gov/litigation/admin/2007/33-8774.pdf

SEC Staff Issues No-Action Letter on Commission Sharing Arrangements

The SEC's Division of Market Regulation issued a no-action letter on January 17, 2007 to outside counsel for a large brokerage firm stating that if the brokerage firm formed a separate program that pays service providers for research services, those service providers would not need to register as broker-dealers provided certain conditions are met. This interpretation is helpful because under the "program," service providers are paid from a commission pool set apart as part of a commission-sharing arrangement under Section 28(e) of the Exchange Act. Paying service providers for research services from a pool of accumulated commissions could, depending on circumstances, raise a question of whether the service providers would be receiving "transaction-based compensation," a condition that often leads to a conclusion that the service provider should be deemed subject to broker-dealer registration. This letter provides a set of conditions under which that service provider would not need to register as a broker-dealer. See the SEC's no-action letter *In Re Goldman Sachs* (Jan. 17, 2007) and incoming letter, both available at http://www.sec.gov/divisions/marketreg/mr-noaction/2007/goldmansachs011707-15a.pdf

SEC Brings and Settles Administrative Proceeding against CEO of Large Investment Adviser Firm

On January 9, 2007, the SEC entered an administrative order instituting and settling cease and desist proceedings, making findings, and imposing remedial sanctions against the former CEO of an investment adviser firm that advised over 70 mutual funds. The adviser had arranged with over 60 brokerage firms to direct fund brokerage commissions to pay for preferred marketing arrangements or "shelf space." In exchange for the marketing preferred treatment, the adviser placed the funds' securities buy and sell orders with these brokers. The SEC alleged that by using fund assets to compensate the brokers, the adviser helped protect the assets of the adviser and its complex of companies. At the same time, the CEO repeatedly assured the funds' boards of trustees that there were no agreements for commissions used for compensating brokers who sold fund shares but only targets were set and no firm amounts

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of commissions were promised to the brokers. The advisory firm did not adequately disclose to the funds' boards of trustees that the adviser was directing fund brokerage commissions to over 60 brokers to pay for the preferred marketing arrangements and the related potential conflicts of interests. The SEC found that the CEO had willfully aided and abetted and was the cause of the adviser firm's violation of the Advisers Act anti-fraud provisions. As a result, the SEC accepted the offer of settlement, ordered the CEO to cease and desist from committing or causing any future violations of the anti-fraud rules, and ordered the CEO to pay a civil money penalty of $75,000. See *In Re Lawrence J. Lasser*, SEC Rel. No. IA-2578, File No. 3-12527 (Jan. 9, 2007), available at http://www.sec.gov/litigation/admin/2007/ia-2578.pdf.

SEC Issues Final and Proposed Rules Regarding Use of Internet Accessible Proxy Materials

The SEC adopted a final rule that after July 1, 2007 will permit corporations to provide notice to its shareholders electronically that the reporting company's proxy materials are available on a web site. That notice is to be sent at least 40 days before the shareholder meeting. The SEC also proposed for comment a rule that would *require* all companies to make available this "notice and access" model some time in the future. As the SEC voted to approve the rules, the SEC staff emphasized that in every instance, any shareholder electing to receive only paper or only electronic notices would not need to take any further action to always receive paper or electronic notices from those companies, as they may elect. The SEC states that the proposed amendments are intended to provide all shareholders with the ability to choose the means by which they receive proxy materials, to expand use of the Internet to ultimately lower the costs of proxy solicitations, and to improve shareholder communications. Commenters on the proposed rule have 60 days after publication in the *Federal Register* to submit their comments. For final rule, see SEC Rel. No. 34-55146, File No. S7-10-05 (Jan. 22, 2007), available at http://www.sec.gov/rules/final/2007/34-55146.pdf. For proposed rules, *see* SEC Rel. No. 34-55147, File No. S7-03-07, (Jan. 22, 2007), available at http://www.sec.gov/rules/proposed/2007/34-55147.pdf.

SEC Bars Former Chairman of Investment Adviser on Fraud and Money Laundering Charges

On January 16, 2007, the SEC barred the former chairman of an investment adviser from the industry based on his guilty plea to conspiracy to commit fraud and money laundering charges. The bar comes on the back of a 2004 order issued by the Commission, in which the respondent had pleaded guilty to conspiracy to commit fraud and money laundering. The crux of the commission's investigations into the alleged wrongdoing centered on the fact that the investment adviser had invested client funds in unauthorized, highly leveraged and extremely risky investments, contrary to its representations that the funds would be "primarily invested in safe, secure investments." In addition the Commission found that the investment adviser had grossly misrepresented the true value of the client investments in monthly account statements and created a complex web of affiliated offshore entities to disguise the true nature of the investment activities.

The Commission concluded that the previous criminal conviction and injunction provided a basis for the sanction and that it was in the public interest to bar the respondent for his misconduct. The SEC found that his actions constituted "an egregious abuse of the trust placed in him as a securities professional." The SEC said that he represents a significant risk to the public and should be prevented from acting as a securities professional in the future. *See In Re Jose P. Zollino*, SEC Rels. IA-2579; File No. 3-11536, available at *http://sec.gov/litigation/opinions/2007/34-55107.pdf*

Hedge Fund Advisers Indicted on Criminal Charges in Alleged $190 Million Scam

The SEC recently announced that on December 15, 2006, the US Attorney for the Southern District of Florida obtained indictments against several individuals and three hedge fund advisers on 35 counts of committing and conspiring to commit wire and mail fraud and money laundering while orchestrating a massive hedge fund fraud. According to the criminal charges, the defendants touted to investors through quarterly mailings and website

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postings that one of the corporate defendants was a hugely successful family of hedge funds. In reality, however, the funds lost millions of dollars, and allegedly paid old investors with new investors' funds. The indictment, further, alleges that the respondents used counterfeit documents, including false account statements, reporting false annualized returns of 125 to 150 percent gains for the investors. *See* SD FL US Attorney Litigation Rel. No. 19399 (Sept. 29, 2005), available at http://www.usdoj.gov/usao/fls/PressReleases/070110-02.html

The SEC had filed its securities fraud action on March 2, 2005 and obtained permanent injunctions against certain of the defendants. The SEC alleged that from approximately 1999 to March 2005, the defendants raised tens of millions of dollars from investors nationwide by boasting false annualized returns of 125 to 150 percent, when in actuality the hedge funds were suffering tremendous trading losses. *See SEC v. Jung Bae Kim, a.k.a. "John Kim," Won Sok Lee, Yung Bae Kim, KL Group, LLC, KL Florida, LLC, KL Triangulum Management, LLC, and Shoreland Trading, LLC*, SEC Litigation Rel. No. 19967 (Jan. 12, 2007), available at http://sec.gov/litigation/litreleases/2007/lr19967.htm.

FinCEN Announces Cooperation with the SEC and a New Form for SARs Filings

On December 21, 2006, the SEC and Financial Crimes Enforcement Network (FinCEN) simultaneously announced that they have signed an information sharing agreement. The agreement permits for the routine exchange of examination and enforcement information relating to SEC-regulated firms' compliance with the Bank Secrecy Act (BSA). The agreement's goal is to assist in the identification, deterrence, and interdiction of terrorist financing and money laundering. The SEC regulated firms that are principally affected are broker-dealers and investment companies, both of which are required by law to have anti-money laundering programs. The agreement is reflected in a memorandum of understanding (MOU) that is similar to ones with the federal banking regulators and the Internal Revenue Service. See FinCEN Rel. Dec. 21, 2006, available at http://www.fincen.gov/new_release_info_sharing_agreement.pdf. *See* SEC Release Dec.21, 2006, available at http://sec.gov/news/press/2006/2006-217.htm.

Also on December 21, 2006, FinCEN and the federal banking agencies announced the introduction of a newly revised form SAR-DI, the form used for reporting suspicious activity by depository institutions. The revised form supports a new joint-filing initiative intended to reduce the number of duplicate SARs filed for a single suspicious transaction. As yet, investment advisers do not have to file SARs; however, when new anti-money laundering rules for investment advisers are issued in the future, investment advisers may be required to use this form or another similar form designed to minimize duplicate filings. The implementation date for the newly revised form is June 30, 2007. According to FinCEN, on this date, depository institutions will have the option of using either the existing or the revised SAR-DI format, with mandatory use of the new format beginning December 31, 2007. Financial institutions can review and download the PC fill-in version from the FinCEN website at http://www.fincen.gov/fincen_form111.pdf. For more information, see the FinCEN Release Dec. 21, 2006, available at http://www.fincen.gov/press_release_12212006.html.

SEC Enforcement Director Testifies about Insider Trading in Hedge Funds

On December 5, 2006, Linda Thomsen, the Director of the SEC's Division of Enforcement, testified before the US Senate Committee on the Judiciary about insider trading involving hedge funds. She stated that insider trading by hedge funds is an area of tremendous concern for the Division of Enforcement, and represents a significant focus of the SEC's current enforcement efforts. Director Thomsen identified three key requirements that must be met for the SEC to bring a civil insider trading case. These are: access to material, non-public information; scienter (or culpable intent); and breach of a duty to the source of the information. The director explained the individual challenges faced by the staff in investigating insider trading by hedge funds. She explained that due to the sheer volume of assets under management, hedge funds may place extremely large trades in many different securities on a daily basis that could appear to be unusual or suspicious. The SEC must determine whether such trades were the result of advance tips or someone's financial acumen, and the SEC would usually look to the fund's prime brokers for information needed to reach conclusions. The prime brokers usually provide the SEC with the necessary information about the various hedge funds they serve. This was Director Thomsen's second appearance before a

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Senate Committee to testify on insider trading. In September 2006, she appeared before the committee to testify on insider trading in general. For more information, *see Testimony of Linda Chatman Thomsen, Division of Enforcement, before the Committee on the Judiciary, US Senate*, (Dec. 5, 2006), available at http://sec.gov/news/testimony/2006/ts120506lct.pdf.

SEC Settles Fraud Case against Investment Adviser and Affiliates

On December 29, 2006, the SEC settled a fraud case with a registered investment adviser and several of its affiliates in a case where the adviser was alleged to have misappropriated client funds totaling more than $1.2 million from at least three of the client's bank or investment accounts. The Commission found that the respondents had fraudulently failed to disclose their vulnerable financial condition to their clients, maintain certain required books and records for investment advisers, maintain proper custody of client assets, and failed to maintain its registration as an investment adviser. Without admitting or denying the charges, the respondents agreed to the entry of an order that censured the adviser firms for their respective willful violations of the securities laws, and revoked one of the adviser's registrations as an investment adviser. Further, the affiliated individual has been ordered to cease-and-desist from committing or causing violations of various provisions of the securities laws, barred from association with any investment adviser and has been ordered to pay a civil monetary penalty in the amount of $120,000. For more information, *see SEC v Veritas Financial Advisors, LLC, Veritas Advisors, Inc., Patrick Cox and Rita White*, Rel. IA-2577; File No. 3-12355 (Dec. 29, 2006), available at http://sec.gov/litigation/admin/2006/34-55021.pdf.

Canadian Regulators Conduct Hedge Fund Review

On January 12, 2007, the Canadian Securities Administrators (CSA) announced the findings of a sample-based review of hedge funds in Canada. The CSA conducted the review in response to a growing interest in hedge fund regulation in Canada. The review was conducted through a combination of compliance reviews of fund managers and advisers and purported to show that certain areas of hedge fund regulation in Canada need improvement. One of the highlighted areas of concern was the registration and oversight of fund managers. The review found that the increased role of fund managers in establishing, promoting, and running investment funds necessitated their registration to help ensure proper supervision and compliance with investment laws. For more information, *see Canadian Securities Administrators' Staff Notice 81-316 – Hedge Funds*, available at *http://osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/csa_20070112_81-316_hedge-funds.jsp*

IAA posts a complete copy of each month's Legal and Regulatory column to the Members Only section of the IAA web site. Interested readers should consult that site for the complete version of this month's Legal and Regulatory column.

IAA To Change Members-Only Log-in Information

IAA is updating and enhancing its web site to serve you better! The IAA is developing an improved web site that will include enhancements for all users. IAA members will soon be accessing the password-protected Members Only area through a personalized login. *Your email address will be your new log-in name and will be required by the IAA system for entry*. You will then be able to assign your own password for entry.

In anticipation of this change, please update your email information with the IAA today.
Provide accurate and current email addresses for you and all authorized users at your firm.

Please contact the IAA office for member support at iaa@investmentadviser.org or (202) 293-4222.
Address your inquiries, questions, or comments directly to Garrett Honea by telephone or email (garrett.honea@investmentadviser.org).

Compliance Corner

Best Execution: Questions & Answers

By Lorna A. Schnase*

Best execution continues to concern clients, advisers and regulators alike since poor execution can negatively impact a client's returns, lowering the adviser's fees and raising red flags for regulators. This Q&A addresses some of the most fundamental questions about best execution and discusses some important undercurrents developing in this arena as well.

What is "best execution"?

There is no 'official' definition of best execution spelled out in the federal securities laws. However, courts and regulators have provided guidance on the meaning of best execution through various statements made over the years, which might be synthesized into the following working definition:

> "Best execution" is placing client trades so that the terms and net results for the trades are the most favorable under the circumstances.

Underpinning this definition is the notion that best execution is a process. This emanates from the now well-settled principle that an adviser has a fiduciary duty to <u>seek</u> best execution for client trades. Note that the principle is stated as the duty to seek best execution, not necessarily to <u>get</u> it, implying that the adviser's process for achieving the best terms and net results is key when determining whether an adviser has discharged its fiduciary duty.

I'm getting commission rates of less than 2¢ a share on all my client trades. Aren't I discharging my best execution obligations?

Maybe yes, maybe no. Best execution does not necessarily mean getting the lowest possible commission rate. Even advisers getting commission rates far below the old 5¢ or 6¢ a share standard aren't necessarily discharging their duty to <u>seek</u> best execution. Again, the adviser's process is key, and many other "qualitative" factors can affect the choice of broker or trading venue aimed at achieving the best net result. These might include, for example, the broker's speed; ability to maintain confidentiality of the client's trading program; trading expertise; reputation; integrity; trading infrastructure and facilities; responsiveness; financial stability and capability, including the availability of capital to commit in order to facilitate particular trades; access to IPOs and other offerings; access to a wide range of secondary markets; reliability; and fairness in resolving problems and disputes. Other relevant factors may include the availability of volume discounts and the availability of ancillary benefits, such as commission recapture or rebate programs.

All of these factors can affect the overall net result or "cost" of a trade just as the commission rate can. Thus, it is impossible to tell from the commission alone whether an adviser getting 2¢ a share or 1¢ a share is necessarily fulfilling its best execution obligations. But an adviser that does not have in place a <u>process</u> to take into consideration all the relevant factors when placing trades may well be viewed as not fulfilling its duty to <u>seek</u> best execution, no matter how low the overall commission rate is.

Can I take into account research or other ancillary benefits when placing brokerage, consistent with best execution?

Yes, some ancillary benefits can and should be taken into account in seeking the best net result for a client's trade. For example, the availability of commission rebates or volume discounts that inure to the <u>client's</u> benefit

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should be considered in assessing the overall cost of a trade placed with one broker or venue relative to another.

On the other hand, taking into account research or other ancillary benefits that inure to the adviser's benefit is more problematic because of the conflicts of interest that arise. While it is true that an adviser acting within the parameters of Section 28(e) of the Securities Exchange Act of 1934 may cause an account to "pay up" (pay more than the lowest available commission) to obtain research that inures to the adviser's benefit or to the benefit of the adviser's other clients, it would not be consistent with the adviser's duty to seek best execution if it compromised the quality of execution (speed, reliability, confidentiality, etc.) on its trades in order to obtain research, even if a higher commission rate charged on those trades were fully justified under Section 28(e) by the value of the research obtained.

The availability of certain other ancillary benefits can no longer legally be considered when placing trades. For example, advisers are now prohibited from taking into consideration a broker's sale of fund shares when placing fund brokerage. In 2005, the SEC concluded that the potential for abuse inherent in allowing advisers to use fund commissions to reward brokers for selling fund shares was just too great and therefore adopted Rule 12b-1(h) under the Investment Company Act of 1940 banning that practice.

The SEC Staff continues to evolve its thinking on best execution and to struggle over the conflicts of interest that arise when advisers obtain personal benefits from placing client brokerage. This struggle was evident again in public remarks made last fall by the SEC's Director of the Division of Investment Management, who openly expressed concern over whether advisers are *truly* seeking best execution, or whether in certain instances other considerations may be influencing their decisions regarding the placement of client trades. In the Director's view, personal benefits or considerations should not be a motivating factor in an adviser's determination of how, where, when and with whom to place a client trade. He strongly urged advisers that are considering those factors to re-think their practices, disclosure and control structures.

This may foreshadow things to come from the SEC. In any event, the wise will heed the remarks about disclosures and controls as a warning that advisers obtaining personal benefits when placing client brokerage can expect to receive special scrutiny upon SEC inspection.

How might I go about setting up a best execution process?

The IAA has an excellent discussion of this under the Brokerage and Trading Practices section of its Online Compliance Guide, so I will simply mention here a few tips advisers should keep in mind:

- Agree firm-wide on a general statement of the firm's best execution policy and on the major steps that will be used to implement the policy. Assign specific individuals or departments responsibility for each step. The more operational areas that are involved in this effort, the better.

- Consider forming a brokerage committee with representatives from various areas (trading, operations, compliance, etc.) to continually monitor and evaluate the firm's execution. According to the SEC, advisers must periodically and systematically evaluate the quality of their execution. Setting up a brokerage committee charged with specific functions and obligations is one way to discharge that responsibility.

- Decide on the best method for evaluating how various brokers and trading venues are performing on trades. Some advisers do this by 'rating' or 'grading' brokers and venues in key areas (speed, responsiveness, expertise, etc.) on a quarterly basis. The CCO or other designated individual then reviews the ratings so that trades can continually be directed to the better-performing brokers and venues.

- Consider hiring an independent evaluator to analyze the adviser's execution. Independent evaluations can help the adviser not only in operations but can be used as a marketing or client relations tool as well.

- Ensure that appropriate documentation is being created and maintained to evidence each step in the firm's process.

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Although having a robust process is key to seeking best execution, process alone is not enough. In other words, even an elaborate process is unlikely to shield an adviser generating strikingly out-of-line results. However, an adviser with a reasonably designed and implemented process is far less likely to wind up in that position.

Do I have to be using ATSs or ECNs to fulfill my best execution obligations?

Not necessarily. Advisers generally do not have to be using one particular venue or broker to execute trades in order to fulfill their duty to seek best execution. Rather, advisers should have a process for analyzing which venue or broker is likely to achieve the most favorable net result for each trade, given the relevant factors. Alternative trading systems (ATSs) and electronic communications networks (ECNs) often offer very low commission rates among other advantages and therefore might represent best execution for certain types of trades. However, they may not be suitable for all trades due to their general lack of liquidity; potential for inadvertent cross trades; unclarity of who stands behind failed trades; general lack of capital to facilitate large block trades; and lack of control over the trade, which might be inappropriate for trades that would be accomplished more favorably if "worked" or guided by a human being.

Nonetheless, as part of the best execution process, all advisers should document that they at least considered ATSs and ECNs as possible alternatives for their trades, even if they ultimately conclude that they are not appropriate for any of the trades they place. Advisers should also take into consideration other technological and industry advances and alternatives as they become available in order to ensure that they are continually seeking best execution in light of evolving circumstances.

I trade in fixed-income securities. How can I discharge my best execution obligations for those trades?

Best execution for fixed-income trading remains relatively uncharted territory. Even though best execution discussions tend to focus on equity securities, the SEC Staff has recently reiterated that an adviser's best execution obligations apply equally to fixed-income securities and other asset classes. While some best execution concepts carry over effectively from the equity markets, others do not since non-equity markets tend to be decentralized, dealer-driven markets lacking in transparency, available data (especially for illiquid securities) and benchmarks, making many of the familiar best execution concepts inapplicable or difficult to apply.

Slowly but surely, however, these difficulties are being addressed. Technological solutions are now offered by information providers (e.g., TradeWeb) that allow non-equity investor/subscribers to get live, executable prices from multiple dealers and markets simultaneously for various fixed-income and other non-equity products. These systems hold out the prospect of better speed, transparency, benchmarking and post-trade reporting, assisting advisers in meeting their best execution obligations and documenting their processes. Without doubt, new technological tools will continue to be innovated, addressing more of the problems that currently make best execution for non-equity products difficult. Indeed, the SEC Staff is publicly encouraging advisers, clients and dealers to continue to work to improve and perfect these tools. Among the challenges will be to ensure that the tools developed are available not only to larger, more active non-equity traders who can afford to subscribe to a particular service, but also to smaller and occasional traders who need the same tools at a justifiable cost.

In the meantime, many advisers will continue to approach best execution for fixed-income and other non-equity trades by obtaining as many quotations as they reasonably can from relevant dealers (often three, when three or more are available) consistent with the adviser's needs in terms of speed, availability and reliability. Documentation will be created manually or electronically by traders and their systems, recording real-time quotations and other relevant data when available for monitoring purposes and analysis after the fact.

** Lorna Schnase has been practicing corporate and securities law for over 20 years. Her independent law practice emphasizes investment management matters, primarily for registered mutual fund and investment adviser clients. She may be reached at lschnase@houston.rr.com or (713)741-8821. This information is provided strictly as a courtesy to readers for educational purposes. All facts and matters reflected in this article should be independently verified and should not be taken as a substitute for individualized legal advice.*

Welcome New Members

The IAA is pleased to announce that the following firms have joined the organization. Please join us in welcoming these firms to our membership.

1717 Capital Management Company, Newark, DE

Covington Capital Management, Los Angeles, CA

DHR Investment Counsel, Oakland, CA

EPG Inc., Boston, MA

Federated Investors, Inc., Pittsburgh, PA

Franklin Advisers, Inc., San Mateo, CA

Gateway Investment Advisers, L.P., Cincinnati, OH

H. M. Payson & Co., Portland, ME

Husic Capital Management, San Francisco, CA

Kochis Fitz, San Francisco, CA

Mill Creek Capital Advisors, LLC, Conshohocken, PA

Nuveen Asset Management, Chicago, IL

Oak Ridge Investments, LLC, Chicago, IL

Premier Asset Management, Chicago, IL

Pyramis Global Advisors, LLC, Boston, MA

Saracen Energy Advisors LP, Houston, TX

Shay Assets Management, Inc., Chicago, IL

Tealwood Asset Management, Minneapolis, MN

Third Street Advisors, LLC, Geneva, IL

Valley Forge Asset Management Corp., Valley Forge, PA

Westwood Global Investments, Boston, MA

IAA Distributes Educational Brochures to Member Firms

The IAA is asking its membership to help promote two educational brochures published by the Association. "We encourage all members to use these brochures to inform and educate their existing and potential clients – as well as policy makers, the media, and others – who have an interest in learning more about the investment advisory profession," said IAA Executive Director David Tittsworth.

Following is a brief description of each brochure:

- *IAA Standards of Practice*. The Association has always prescribed standards since its founding in 1937. Last year, the IAA Board approved revisions to the *Standards* that, among other things, underscore and spell out various aspects of an adviser's fiduciary duty. The *Standards* can help inform investors and others about the unique ethical responsibilities that govern the advisory profession.

- *Cutting Through the Confusion*. This brochure represents the collective work of the IAA, North American Securities Administrators Association (representing state securities regulators), Consumer Federation of America, CFA Institute, and Financial Planning Association. It explains the basic differences between investment advisers, brokers, and financial planners and identifies questions investors should ask before making a choice about who should manage their investments.

50 copies of each brochure have been mailed to each IAA member firm. Additional copies may be purchased from the IAA for a nominal fee. The brochures also are available in electronic format that may be emailed or posted to a web site. Please contact Glenda Henning (glenda.henning@investmentadviser.org) with any questions.

Welcome New Chartered Investment Counselors

The IAA Board of Governors is pleased to announce that the following individuals have completed the requirements prescribed for the Chartered Investment Counselor designation and have been awarded the CIC charter, effective October 1, 2006:

Paul R. Davis, CFA, CIC
Marble Harbor Investment Counsel, LLC

D. Brooke deBoutray, CFA, CIC
Zevenbergen Capital Investments LLC

John L. Furth, CFA, CIC
Klingenstein, Fields & Co., LLC

David D. Jumper, CFA, CIC
Deutsche Bank Trust Company Americas

Mark A. Keeling, CFA, CIC
Pillar Point Equity Management, LLC

Jean M. Kennedy, CFA, CIC
Heritage Investors Management Corporation

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IAA/SEI Tech/Ops Survey Report

Late last year, the IAA and SEI conducted a survey relating to technology and investment operations issues. A report analyzing the survey results will be published in the near future and copies will be delivered to all IAA member firms.
Following are some of the key findings of the survey report:

- Operational and technology capabilities are viewed as important enablers, rather than indicators, of business success.
- Most respondents say their IT budgets are currently focused on maintaining and upgrading existing systems and operating infrastructure.
- Asset managers are dealing with growing operational complexities (e.g., multiple outsourcing relationships, portfolio accounting systems, external data vendors, and trading applications).
- Legal, regulatory, and compliance concerns continue to drive IT spending higher.
- Responses point to continued growth in IT spending.

The survey report is posted on the IAA and SEI web sites: www.investmentadviser.org and www.seic.com/ims. Please contact IAA Executive Director David Tittsworth for additional information.

IAA to Cosponsor NRS Compliance Program

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"Compliance requirements for investment advisory firms have changed dramatically during the past few years," Tittsworth said. "Given the recent proliferation of SEC regulations, including the compliance program and code of ethics rules, there is a compelling need for an education and training protocol that is specifically designed to enhance the competency and professionalism of those who are charged with understanding and implementing effective compliance programs."

"We look forward to working with IAA to equip compliance professionals with the knowledge, skills, abilities and support system they need," Gebauer said.

Information about the IACCP program is available on the NRS web site (www.nrs-inc.com). Member firms are encouraged to contact Paul Glenn, IAA Counsel, for additional information about the program.

Neil Simon to join IAA Staff

Last month, the Investment Adviser Association announced that Neil Simon, a seasoned Washington lobbyist and former veteran congressional aide, will become the Vice President for Government Relations of the organization. He will begin his new job with the IAA in mid-February. For the past three years Simon has been the Director of Government Relations for the 28,000 member Financial Planning Association (FPA) in Washington, D.C.

"We are extremely pleased that Neil has agreed to join our professional team," said David Tittsworth, IAA Executive Director. "Neil's a great attorney, he has an excellent working knowledge of the financial services industry and the investment advisory profession, and he understands how to work with policy makers on Capitol Hill, the SEC, and other governmental agencies."

Prior to joining FPA, Simon was executive director of the National Franchise Council, a trade group that pioneered an innovative public-private partnership with the Federal Trade Commission, state attorneys general, and securities commissioners. While there, he focused primarily on compliance issues. Simon also served as a legislative director in the U.S. House of Representatives.

Simon received his law degree from Georgetown University in Washington, D.C. and a bachelor's degree in political science and international relations at Clark University in Worchester, Mass.

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