

December 22, 2003

Memorandum to Our Investment Management Clients

Compliance Programs of Registered Investment Advisers

On December 3, 2003, the Securities and Exchange Commission (“Commission”) adopted new rules¹ under the Investment Advisers Act of 1940 (“Advisers Act”) that require each investment adviser registered with the Commission to (i) adopt and implement compliance policies and procedures, (ii) annually review them, and (iii) designate a chief compliance officer.² The new rules are intended to address, in part, the Commission’s concerns with registered advisers’ systems of internal controls. Advisers must comply with the new rules by October 5, 2004.

Compliance Policies and Procedures

The new rules make it unlawful for a registered adviser to provide investment advice unless the adviser has adopted and implemented written policies and procedures (“Compliance Procedures”) reasonably designed to prevent violations of the Advisers Act by the adviser and its supervised persons.³ Although the new rules do not prescribe specific elements that an adviser should include in its Compliance Procedures, the Compliance Procedures should be designed to *prevent* and *detect* violations of the Advisers Act and *correct* promptly any violations. To the extent relevant to an adviser, the Commission expects that the adviser’s Compliance Procedures will address:

- Portfolio management processes (*e.g.*, allocation of investment opportunities, compliance with investment objectives and policies and regulatory requirements);
- Trading practices (*e.g.*, best execution obligations, soft dollar arrangements and trade allocation policies);
- Proprietary trading and personal trading of supervised persons;
- Disclosures to clients (*e.g.*, account statements and advertisements);

¹ The Commission adopted new rule 206(4)-7 under the Advisers Act and amendments to existing rule 204-2 under the Advisers Act. The new rules do not apply to unregistered hedge fund advisers or advisers registered only with a particular state, but will if such advisers are required to register with the Commission.

² The Commission also adopted new rules under the Investment Company Act of 1940 that require registered investment companies, among other things, to adopt and implement written compliance policies and procedures and designate a chief compliance officer. The new rules under the Advisers Act and the Investment Company Act of 1940 were made available on December 17, 2003.

³ A supervised person includes any partner, officer, director, or employee of the adviser, or other person who provides investment advice on behalf of the adviser and is subject to the supervision and control of the adviser.

- Custody of client assets;
- Creation, maintenance and protection of required records;
- Marketing of services, including the use of solicitors;
- Safeguards for the privacy protection of client records and information;
- Security valuations; and
- Business continuity plan, including steps to protect client interests in the event of a natural disaster or, in the case of smaller advisers, the death of an owner or key personnel.

The extent of an adviser's Compliance Procedures should reflect the size and nature of the adviser's business. The Commission expects that smaller advisers without conflicting business interests will have simpler Compliance Procedures than larger advisers with multiple conflicting business interests.

The new rules require an adviser to review its Compliance Procedures no less frequently than annually to determine their adequacy and the effectiveness of their implementation. The annual review should include a review of any matters that might require a revision to the adviser's Compliance Procedures, such as:

- any compliance matters that arose during the previous year;
- any changes in the adviser's business activities; and
- any changes to the Advisers Act or applicable regulations.

Chief Compliance Officer

The new rules require that an adviser designate a chief compliance officer who is responsible for administering the adviser's Compliance Procedures.⁴ The chief compliance officer should be knowledgeable regarding the Advisers Act and empowered with full responsibility and authority to develop and enforce the adviser's Compliance Procedures. Smaller advisers may designate a principal or current employee to serve as chief compliance officer, provided such person is qualified to serve as chief compliance officer. The chief compliance officer is required to have a position of sufficient seniority and authority *within* the adviser's organization to compel others to adhere to the adviser's Compliance Procedures. Accordingly, an adviser may not contract with a third party to serve as chief compliance officer.

Recordkeeping Requirements

The new rules require an adviser to maintain a copy of its Compliance Procedures and any records documenting the adviser's annual review of its Compliance Procedures. These records must be maintained and preserved in an easily accessible place for a period of at least five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the adviser.

⁴ The new rules require that the adviser identify its chief compliance officer in its Form ADV.

We are in the process of preparing sample Compliance Procedures that will be available in the near future. If you have any questions regarding the new rules or need assistance in preparing Compliance Procedures, please contact an attorney in the Investment Management Group at Seward & Kissel. In addition, the new rules may be accessed at www.sec.gov.

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