

Review of Key Concepts in 2007 L2 Ethics

Soft dollar standards

1. General

- Seek to obtain best execution
- Minimize transaction costs
- Required: An investment manager may not allocate a client's brokerage based on the amount of client referrals the investment manager receives from a broker

2. relationship with clients: disclose the SD arrangement before doing so

3. Selection of brokers: solely consider the capabilities (best execution)

4. evaluation of research

III level analysis: Level 1/本質原則; Level 2/受益原則; Level 3/部分自負

5. client-directed brokerage

Two examples:

- 以整體付一部分: a non-ERISA institutional investor in XYZ's hedge fund has requested that XYZ direct a portion of the hedge fund's brokerage to Broker ABC to compensate Broker ABC for research services provided to the institutional investor (not permissible)
- 以一部份付整體: the SEC-registered investment companies have requested that XYZ directed a portion of the equity fund's Brokerage to Broker ABC in return for credits to be used to reduce or eliminate all of the registered investment companies' custodian fees (not permissible)

6. disclosure: whether it will use the research to benefit other clients

7. record keeping

ROS (required)

1. policy: a formal written policy and attest annually

2. public appearance: disclose the conflicts to the host and audience

3. R&AB: supervisory analyst, review committee

4. IB: segregation; no influence or approval from I/B or CF departments

5. compensation: tied to the quality of the research

6. relationships with companies

7. personal investing: no front running, no opposite action, no participation of IPO

8. timeliness

9. compliance and enforcement: disciplinary sanctions

10. disclosure

11. rating system

- useful
- consideration of suitability

ROS (recommended)

1. policy
2. public
3. R&AB
4. IB: quiet period, -30 for IPO and -10 for SPO
5. compensation
6. relationships with companies
7. personal investing: -30 and +5 before issuing buy/sell report
 - holding at least 60 days
8. timeliness: final report needed if an analyst needs to uncover the stock
9. compliance and enforcement
10. disclosure
 - receive fees from a subject company in previous 12 months or expected to receive in the next 36 months
 - the author has received gifts from the covered company in the previous 12 months
 - the brokerage holds more than 1% of the subject company's common shares
11. rating system
 - 1) recommendation or rating categories
 - 2) time horizon categories
 - 3) risk categories

The Glenarm Company

Key points: : loyalty to employer, disclosure of conflicts; 亂邦不居

- Standard 4A:
- Standard 4B: additional compensation arrangements
- Standard 6A:
- Standard 1B:

Preston Partners:

Key points: allocation procedures, fair dealing; supervisory responsibility

- Standard 3B:
- Standard 3C:

- Standard 4C:
No violation of 5A and 2A

Super selection

Key points: loyalty to clients, portfolio suitability, disclosure of conflicts, diligence and reasonable basis

- Standard 4C: responsibilities of supervisors
- Standard 5A:
- Standard 3A:
- Standard 3C:
- Standard 6B: priority of transactions
- Standard 4B
- Standard 6A
- Standard 1B

Trade allocation: fair dealing and disclosure

- 3B: allocate new issues by client assets on a pro-rata basis
- 3A:

Changing Investment Objectives

- 3C2: stick to the mandate unless clients agree to change
- 5B1:

Prudence in Perspective

- New prudent investor rule:
 1. Five principles: 1) diversification 2) Risk and return 3) avoid unjustified expenses 4) impartiality 5) delegation
- Differences from old prudent man rule:
 1. judge the prudence in the portfolio context vs. isolated basis
 2. risk and return (total return approach) vs. focus on realized income
 3. active risk management vs. avoid speculation
 4. delegation if necessary vs. forbid delegation (no mutual funds)