Registered investment adviser compliance in a hedge fund environment

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Abstract

Purpose – *The purpose of this article is to explore what the author believes to be some of the key challenges facing hedge fund managers that are preparing for registration with the Commission under the Investment Advisers Act of 1940 (''Advisers Act'').*

Design/methodology/approach – *Discusses marketing issues, including promotional use of track records from predecessor firms, use of target returns, use of selected investment performance, explicit or implicit promises of low volatility, and promises of specific fund characteristics. Discusses protection and proper use of fund assets, including asset safeguarding policies and procedures, and allocating expenses to funds. Discusses managing material, non-public information; valuation of fund assets; side letters; and compliance program requirements.*

Findings – *The impacts of the new requirements will be significant for many hedge fund managers. Unregistered hedge fund managers will soon become subject to the full scope of the Advisers Act, including detailed compliance program requirements, obligations, and restrictions with respect to marketing, affiliated transaction prohibitions and restrictions, custody requirements, books and records creation and retention obligations, and a broad array of other standard and situational requirements. The organizations that meet these challenges successfully will be those that understand their risk profiles, foster top-down ''cultures of compliance,'' and dedicate sufficient human and other resources to develop appropriate compliance programs and to monitor and continuously evaluate their exposures to potential compliance issues.*

Originality/value – *Provides a useful discussion of what the author believes to be some of the most important regulatory concerns and challenges faced by hedge fund advisers as they prepare for a new regulated environment.*

Keywords *Financial management, Legislation, Financial markets*

Paper type *Technical paper*

Introduction

On October 26, 2004, the US Securities and Commission (''SEC'' or ''Commission'') adopted a rule and rule amendments that require advisers to certain hedge funds to register with the Commission under the Investment Advisers Act of 1940 (''Advisers Act''). Hedge fund managers affected by the requirements must be registered as advisers with the SEC no later than February 1, 2006[1].

The impacts of the new requirements will be significant for many hedge fund managers. Unregistered hedge fund managers will soon become subject to the full scope of the Advisers Act, including detailed compliance program requirements, obligations, and restrictions with respect to marketing, affiliated transaction prohibitions and restrictions, custody requirements, books and records creation and retention obligations, and a broad array of other standard and situational requirements.

Beyond the pure regulatory requirements, hedge fund advisers that are not yet registered with the SEC will soon be subject to direct examination scrutiny. In the course of such scrutiny, they will find that very few of their business or client records are outside the scope of the SEC's purview. They will also find that the SEC focuses not only on the technical requirements of the Advisers Act, but also on broader concepts regarding conflicts of interests and other anti-fraud issues.

This article explores what the author believes to be some of the key challenges facing hedge fund managers that are preparing for registration. In discussing these challenges, the author draws upon his experiences as a former SEC examiner, a former chief compliance officer for a major hedge fund adviser, and as a regulatory consultant to a number of entities that are either registered or preparing for registration.

It is important to note that the topics discussed below are not intended to constitute a comprehensive list of all of the regulatory concerns and/or key challenges facing hedge fund managers, but do comprise what the author believes may be common stress points for a number of hedge fund advisers as they cope with preparing for a regulated environment.

Marketing

Marketing is a difficult topic under the best of circumstances. Investment advisers operate in an extremely competitive marketplace, and the pressures faced by each firm to put forth a positive and successful image are enormous. These pressures are perhaps even more pronounced for hedge fund advisers. Prospective hedge fund investors often hold high expectations when reviewing the historical performance of a hedge fund. These expectations, coupled with the short operating histories of many hedge funds, may lead to marketing practices that must be carefully assessed in light of upcoming registration requirements and associated regulatory scrutiny.

The following is a discussion of selected marketing practices that should be closely considered in light impending registration requirements:

Use of track records from predecessor firms

Given the relatively short track records of many hedge funds, it is a common practice for hedge fund advisers to include, or refer to, the predecessor track records of one or more key portfolio managers and/or principals. In doing so, however, it is important to remember that the SEC has placed significant restrictions upon the use of predecessor performance in marketing materials.

In a number of no-action letters, the SEC has allowed the use of predecessor performance within the contexts of advisers that wished to market the performance of predecessor firms[2]. The SEC has also allowed a mutual fund adviser to use the predecessor performance of a fund manager in its fund marketing materials[3]. In both contexts, however, the SEC has set forth stringent guidelines around the use of predecessor performance by an adviser, the substance of which is summarized as follows:

- the person(s) to which the predecessor performance is attributed was(were) the person(s) primarily responsible for achieving the prior performance results;
- the accounts/funds managed at the predecessor entity are so similar to the accounts currently under management that the performance results would provide relevant information to prospective clients/investors;
- all accounts/funds that were managed in a substantially similar manner are included in the predecessor performance calculation unless the exclusion of any such accounts/funds would not result in materially higher performance;
- the presentation is consistent with other staff interpretations with respect to the presentation of performance results;
- the presentation piece includes all relevant disclosures, including that the performance results were from accounts/funds managed at another entity; and
- the organization presenting the predecessor performance has sufficient back-up documentation to support the predecessor performance figures.

Of these criteria, perhaps the most difficult challenge facing hedge fund advisers that use predecessor performance is the availability of supporting documentation. It is, however, a critical component, and the absence of such documentation may quickly lead to problems under SEC anti-fraud provisions. Organizations that present, or refer to, predecessor performance must maintain sufficient documentation to support the performance numbers.

Also of note is the requirement that the individual(s) to which predecessor performance is attributed must have been the individual(s) primarily responsible for the results. If, for example, a portfolio manager was part a team or committee that made investment decisions, the hedge fund adviser should carefully consider whether the circumstances fit the requirements set forth by the SEC for use of predecessor performance[4].

Use of target returns

A practice that is somewhat common in the hedge fund arena is the use of so-called ''target returns.'' This practice, while perhaps even expected in some hedge fund circles, is largely unseen in the world of registered investment advisers that manage separate accounts and other products. This is due, in large part, to the tremendous amount of scrutiny that target return figures receive during SEC examinations. While the presentation of target returns is not prohibited by the Advisers Act *per se*, it is often viewed by field examiners as an implicit promise of future results.

While this has not yet been a significant focus area of SEC enforcement, the use of target returns in hedge fund marketing materials has recently drawn scrutiny from the National Association of Securities Dealers (''NASD''). In two recent NASD actions, broker-dealers were fined and censured for, among other things, distributing hedge fund marketing materials that included target returns without providing a sound basis for evaluating the targets[5]. Further, once the bulk of unregistered hedge fund advisers become registered on or before February 1, 2006, it is expected that this practice will also be one of a number of marketing focus points for SEC examiners.

A hedge fund adviser that uses a target return should clearly disclose the limitations inherent in the target, including the possibility that the return may not be achieved and the fact that an investment in the fund may lose value. A hedge fund adviser that uses a target return should also carefully consider whether the target is reasonably achievable and should continuously evaluate the target return figure over time, particularly in light of actual fund performance.

Use of selected investment performance

It is a common practice for hedge fund advisers to distribute informational letters (so-called, ''investor letters'') on a monthly and/or quarterly basis to apprise current and prospective investors of fund performance, portfolio characteristics, and other relevant data points. These investor letters also often include information regarding specific investments held during their respective periods, and in some instances may include performance information pertaining to individual investments.

Similarly, a number of hedge fund advisers utilize investment-specific case studies as a means of highlighting their investment management processes and philosophies to prospective investors. As with investor letters, these case studies, in some instances, may include investment-specific performance information along with other key statistical information regarding highlighted investments.

Rule 206(4)-1(a)(2) of the Advisers Act generally states that a marketing piece may not refer, directly or indirectly, to past specific recommendations that were or would have been profitable to any person, unless an adviser provides information regarding all of its recommendations for the past year or longer, along with specified data points and the inclusion of certain cautionary information[6].

The Rule also does not necessarily prohibit an adviser from publishing selected past specific recommendations if the purpose in providing the recommendations is informational and if the data is not intended to indicate past or future profitability. When providing past specific recommendations, however, a registered adviser is required to:

- use objective, non-performance-based criteria to select the specific securities that it will list and discuss;
- use the same selection criteria for each [period] for each particular investment category;
- not discuss, directly or indirectly, the amount of the profits or losses, realized or unrealized, of any of the specific securities; and
- maintain, and make available to Commission staff upon request, records that evidence information regarding the complete list of securities recommended in the preceding year, along with the criteria used to select specific securities used in marketing materials[7].

It is expected that the use of investment-specific information in hedge fund marketing materials will sharply diminish as a larger number of hedge fund advisers are subjected to regulatory examinations. For hedge fund advisers that continue to present investment-specific information, the keys to avoiding regulatory difficulties will lie in ensuring that such information is selected and presented pursuant to the provisions set forth in the paragraph above.

Explicit or implied promises of low volatility

A core goal of many hedge fund strategies is to reduce fund exposure to general market and, in some instances, industry volatility, in an effort to isolate the strengths and weaknesses of specific investments. A number of methods may be employed in pursuing this result, including so called ''long/short'' strategies, the use of credit default swaps as a hedging tool, and a variety of other approaches.

It is important for hedge fund advisers to tread carefully when addressing fund volatility in marketing materials. It is quite tempting to market a fund using terms such as ''low volatility,'' but it is also perilous to do so. There is no guarantee that a particular hedging strategy will succeed, and it is indeed possible to lose value on both a primary investment and a corresponding hedging position. Further, many hedge funds employ leverage, which magnifies both gains and losses, and in fact may make some funds more volatile than the overall markets in which they invest.

Hedge fund advisers need to include full and fair disclosure when discussing volatility in marketing materials. In particular, hedge fund marketing materials and offering documents should clearly disclose that hedging strategies may not work as intended and that future volatility may be greater than historical and/or target measures. Hedge fund offering and marketing documents should also clearly disclose the potential impact of leverage, including the potential magnification of losses that may be associated with the use of leverage.

Promises of specific fund characteristics

Hedge fund offering and governance documents are often designed to provide their respective advisers with wide latitude in managing the funds. In cases where a fund's offering and governance documents include specific guidelines and restrictions, they are often ''soft'' guidelines and restrictions, allowing the adviser to deviate from them as deemed appropriate.

Because of the flexibility generally built into most fund offering and governance documents, fund marketing documents are often used to define the intended goals and strategies of a particular fund more clearly. In using fund marketing documents to provide more specificity to fund objectives and characteristics, however, it is important that fund managers do not unwittingly create functional fund guidelines and limitations that they may subsequently be forced to adhere to, or worse, communicate objectives and characteristics about the fund that may not hold true in future practices.

A hedge fund adviser must carefully consider how a fund is described in its marketing materials. When describing fund goals and characteristics, fund marketing materials should clearly state that such information may not always hold true, and that the fund goals and characteristics are ultimately determined pursuant to fund offering and governance documents. Fund managers should also carefully monitor the actual composition and direction of a fund over time against the historical information provided to prospective investors to determine whether updated disclosures should be provided to legacy fund investors.

Protection and proper use of fund assets

Asset safeguarding policies and procedures

Every registered investment adviser is required to develop and maintain written compliance policies and procedures[8]. As part of this requirement, each adviser is expected to have policies and procedures reasonably designed to safeguard client assets from theft or inappropriate use by advisory personnel[9].

Hedge fund advisers must carefully consider their control environments to ensure that investor assets are protected from theft or misappropriation. While it is understood that the best policies and procedures would have been unlikely to prevent the types of activities that the SEC alleges occurred in the Bayou Funds, where the founder and the CFO of the funds' adviser are alleged to have colluded to defraud investors and misappropriate fund assets[10], such policies and procedures can and should be reasonably designed to prevent less egregious problems at the next tier of the organizational chart. For example, hedge fund advisers may wish to address the following topics in their asset-safeguarding policies and procedures:

- *Frequent cash and securities reconciliations*. Frequent reconciliation processes are critical to catching problems in their early stages. Ideally, these reconciliations are conducted by individuals other than those who are responsible for processing cash and securities transactions.
- *Separation of duties.* Separating key responsibilities significantly decreases the likelihood that one individual may misappropriate investor assets and subsequently hide the activity for an extended period of time. For example, such separations may include a requirement that different individuals initiate and approve expense payments and/or cash transfers, or a requirement that a person who processes investor redemptions does not also engage in fund accounting activities.
- *Authorized signatory requirements.* Hedge fund advisers should maintain clear authorized signatory procedures and communicate these procedures to custodians holding fund assets. Such procedures may include tiered signature lists requiring senior management approval for larger transactions and dual or multiple signature requirements for certain types of transactions.
- *Special procedures for large cash transfers and expense payments.* Hedge fund complexes should consider instituting special confirmation procedures for cash transfers and expense payments exceeding specified amounts. In many organizations, cash transfers and expense payments exceeding certain amounts require telephonic confirmation from a principal, partner, or other senior manager in addition to requiring the multiple authorized signatures as noted above.

Of course, the controls outlined above are not all-inclusive. Each adviser must tailor its asset safeguarding procedures to its specific operational circumstances. For example, a hedge fund complex that maintains fund accounting, administration, and transfer agency activities internally may require more rigorous procedures than one that uses independent third parties to perform these functions. The one constant, however, is that the SEC will very carefully scrutinize these policies and procedures, as well as cash movements involving transfers and expense payments, during regulatory examinations.

Allocating expenses to funds

Determining which expenses should be charged to a fund and which should be borne by the adviser can be a difficult exercise. While most fund offering and governance documents provide broad latitude in charging expenses to their respective funds, hedge fund advisers need to consider carefully which expenses properly belong to the funds and which should be borne by the advisers.

It is a certainty that the SEC will review expense allocations very carefully when it examines newly registered hedge fund advisers. In particular, expenses related to marketing, travel, employee compensation, facilities and equipment, and certain other expenses will draw heavy scrutiny during an SEC examination. Further, broad, generic disclosures in a fund's offering documents and the fund adviser's Form ADV are not necessarily sufficient protection from potential anti-fraud actions. Hedge fund complexes should include explicit disclosures in their offering documents and Forms ADV regarding the types of expenses that may be borne by their respective funds.

Moving beyond the pure anti-fraud considerations, however, hedge fund complexes should carefully consider the costs versus the benefits in charging certain types of expenses to funds. Hedge fund advisers that are viewed by the SEC as expansive in charging expenses to their funds will likely face difficult and prolonged examinations. Similarly, such advisers will also likely attract more frequent and lengthy visits from SEC examination teams during future examination cycles.

Managing material, non-public information

Hedge funds are major players in the bank debt market and are becoming increasingly active in private equity markets. In the course of analyzing bank debt and private equity investments, hedge fund managers often gain access to private information regarding the investments and their issuers. While access to this level of information is often necessary in order to evaluate these investments, such access may create concerns for hedge fund managers that also manage investments in public securities.

Managing potential conflicts of interests relating to non-public information access can pose a significant challenge for hedge fund advisers, particularly in circumstances in which such advisers invest in both the private and public securities of a given issuer. Non-public information may come from a number of sources, including commonly used deal information platforms such as Intralinks and Syndtrak, meetings with company management and advisers, participation on formal and ad hoc creditors committees, and through a variety of other sources. Consequently, it is important that hedge fund advisers understand when they may be in possession of material, non-public information that may restrict them from trading in public securities.

The issue of managing access to private information in the context of public securities activities is nothing new in the securities industry as a whole. Larger brokerage firms that conduct both investment banking and public trading typically maintain significant controls to clearly separate and define public and private activities, often including electronic access controls to prevent public trading arms from gaining access to private information, separate physical locations for investment banking (and other private activities) and public trading operations, and document control groups (based in either compliance or operations departments) to filter information going to public trading desks.

In the hedge fund environment, however, the issue of managing access to, and utilization of, non-public information becomes more problematic. Most hedge fund advisers maintain relatively small operations with centralized physical locations and shared server access. Also, in many hedge fund complexes, the same portfolio manager is likely to be involved in analyzing the merits of, and executing transactions in, all of the securities for a given issuer. Consequently, ensuring that that trades are not executed while in possession of material, non-public information can be a challenging exercise.

In order to manage potential information-access concerns, some hedge fund managers have instituted processes to better filter and manage information access. Such processes have included mandatory filtering of information from private sources through compliance or operations employees and stringent procedures requiring that all issuers for which these firms have access to non-public information be placed on a restricted list, thereby preventing traders from executing transactions in the public securities of the issuers. Some organizations also monitor access to third-party information platforms to ensure that employees are not accessing material, non-public information for issuers in which the firm wishes to remain unrestricted – i.e. able to trade in public securities. Anecdotal evidence suggests, however, that the practices regarding information access vary considerably, and that some firms may still have significant ground to cover in properly monitoring this area.

It is expected that, as the SEC gains greater access to hedge funds through adviser registration requirements, it will pay significant attention to this issue. Further, as many hedge funds expand their scope of investment activities to other countries, this becomes a truly global issue as many foreign regulatory authorities also maintain rigorous restrictions around the use of material, non-public information. Consequently, as hedge fund advisers both move forward with SEC registration and continue to expand to other marketplaces, a vital element of a successful compliance program will be a strong control regimen over access to, and the use of, material, non-public information.

Valuation of fund assets

This can be a difficult area for some hedge fund managers. A number of hedge funds hold, and indeed are established to invest in, assets that are illiquid in nature and very difficult to value, including bank debt, private equity holdings, and so called ''hard assets,'' such as real estate and airplanes. The proper valuation of hedge fund investments, however, is as critical as it is difficult, as the results of these valuations ultimately drive not only the management fees that are paid to hedge fund advisers, but also the calculations of what can be significant incentive fees.

Historically, the SEC has carefully scrutinized the valuation practices of pooled investment vehicles and has instituted a number of enforcement actions where egregious valuation problems have been discovered[11]. When reviewing valuation practices during examinations, the SEC carefully scrutinizes, among other things, the reasonableness of valuations and valuation methodologies, the consistency with which such methodologies are applied, instances in which advisers provide ''fair value'' prices for investments or override prices provided by third-party pricing services, and the sufficiency of, and compliance with, disclosures provided to fund investors. Problems in these areas can quickly lead to deficiency comments and, in extreme cases as noted above, enforcement actions.

Pursuant to the compliance program requirements, every adviser is expected to maintain written valuation policies and procedures[12]. Given the examination focus points noted above, hedge fund advisers need to carefully consider the manner in which such points are addressed in their control processes. Additionally, such advisers should carefully review fund offering documents and their Forms ADV to ensure that they have adequately disclosed their valuation practices to investors, particularly where special or non-standard valuation methodologies are employed.

Side letters

It is a common practice for hedge fund managers to enter into special term arrangements (so-called ''side letters'') with larger, institutional investors. In a typical side letter, the hedge fund adviser often agrees to special terms such as more favorable liquidity provisions, reductions in management fees, and so-called ''favored nation'' status whereby the adviser informs the investor of, and allows the investor to participate in, more favorable terms if such are made available to another investor. In some instances, investors may also require an adviser to make representations guaranteeing that a fund will not deviate beyond certain parameters, such as specified leverage ratios or industry and/or issuer concentrations.

There are certain considerations that must be taken into account when entering into, or maintaining, a side letter, including, but not limited to, the following:

- Whether the adviser is truly capable of complying with all the provisions of the side letter;
- Whether the side letter places stricter limitations upon a fund than those included in the fund's offering and/or governance documents;
- Whether the availability of preferential arrangements has been disclosed to prospective investors in fund offering documents and in the adviser's Form ADV, if applicable; and

- Whether preferential treatment for a given investor creates a new functional share class that must be separately monitored for ERISA plan asset testing[13].

It is important to note that the SEC will carefully review side letter arrangements against the actual activities of funds. Consequently it is important that each hedge fund adviser maintain a complete inventory of all side letter arrangements and carefully monitor actual practices against provisions set forth in those agreements. Failure to a meet the cumulative conditions of all applicable side letter provisions may expose a hedge fund adviser to significant regulatory and investor liability.

Compliance program requirements

Compliance policies and procedures

Every registered adviser is required to adopt policies and procedures designed to prevent compliance violations from occurring, detect violations that have occurred, and correct promptly any violations that have occurred[14]. These policies and procedures should include, at a minimum, coverage of the following areas[15]:

- Portfolio management processes, including allocation of investment opportunities among clients and consistency of portfolios with clients' investment objectives, disclosures by the adviser, and applicable regulatory restrictions[16];
- Trading practices, including procedures by which the adviser satisfies its best-execution obligation, uses client brokerage to obtain research and other services (''soft dollar arrangements''), and allocates aggregated trades among clients;
- Proprietary trading of the adviser and personal trading activities of supervised persons[17];
- Accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements;
- Safeguarding of client assets from conversion or inappropriate use by advisory personnel;
- Accurate creation and maintenance of required records in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction;
- Marketing advisory services, including the use of solicitors;
- Processes to value client holdings and assess fees based on those valuations;
- Safeguards for protecting the privacy of client records and information; and
- Business continuity plans.

It is important to note that each adviser's policies and procedures should be functional and tailored to the manager's operations[18]. Also, each adviser's compliance policies and procedures must be reviewed at least annually to evaluate their adequacy and the effectiveness of their implementation[19].

Hedge fund advisers face somewhat unique challenges in developing appropriate compliance programs. While many are relatively small in size from a personnel perspective, they often execute sophisticated investment strategies, manage relatively esoteric and/or illiquid investments, and interact with investors that have significant performance and other expectations. Hedge fund advisers also face a number of other challenges, including those set forth in preceding portions of this article.

In the challenging environment in which hedge fund advisers operate, a crucial element in the successful development of each adviser's compliance program is, and will continue to be, strong support from senior management. In supporting a successful compliance program, senior management will need to embrace, and actively promote, the formalization of certain compliance and operating processes. Senior management will also need to carefully consider compliance resource needs, both internally and in terms of whether external resources are needed.

Finding a qualified chief compliance officer

Each registered adviser is required to designate an individual responsible for administering its compliance policies and procedures[20]. In the adopting release, the Commission indicated that the designated chief compliance officer (''CCO'') should be competent and knowledgeable regarding the applicable federal securities laws and should be authorized to develop and enforce appropriate policies and procedures[21].

In discussing this issue, it is important to note that, in the adopting release to the compliance program requirements, the SEC indicated that the new rule requirements are not intended to mandate the hiring of additional compliance personnel[22]. From a practical perspective, however, it will be difficult for some hedge fund advisers to meet their compliance requirements without strong internal support, particularly in light of the challenges highlighted in preceding portions of this article.

Anecdotal evidence suggests that finding a qualified CCO has become a difficult and costly affair. This problem started in the months leading to October 5th, 2004, when all registered advisers and mutual funds were required to implement comprehensive compliance programs, and has since been exacerbated by the requirement that hedge fund advisers register with the SEC.

In an effort to cope with the shortage of qualified compliance officers in the marketplace, some hedge fund advisers have started to manage compliance risks using a combination of internal resources and external expert support. Additionally, many hedge fund advisers have turned to intensive compliance training for their designated CCOs as a means of bolstering their in-house compliance skill sets. Whatever route a hedge fund adviser chooses, however, the challenges facing hedge fund advisers necessitate the use of knowledgeable compliance resources in managing, and mitigating, compliance risks.

Conclusion

As highlighted in this article, hedge fund advisers face many challenges in preparing to operate in a regulated environment. The organizations that will meet these challenges successfully will be those that understand their risk profiles, foster top-down ''cultures of compliance,'' and dedicate sufficient human and other resources to develop appropriate compliance programs and to monitor and continuously evaluate their exposures to potential compliance issues.

As hedge fund advisers that have already registered with the SEC are well aware, instituting the changes necessary to operate in a regulated environment can be difficult. Further, some of these changes ultimately may need to take place on a broader, industry-wide basis. For example, individual firms will be hesitant to change potentially problematic marketing practices if, in doing so, they perceive the changes as placing them at a competitive disadvantage with respect to their peers. Similarly, the implementation of rigorous compliance programs may require greater formalization of certain processes than has historically been the case in some hedge fund complexes. Nonetheless, these and other changes, some of which are noted in this article, are critical to successfully managing the regulatory exposures faced by a registered investment adviser.

While the costs and burdens associated with meeting the requirements of a regulated environment can be significant and often frustrating, the costs of inadequate compliance with these requirements can be catastrophic.

Notes

1. See Registration Under the Advisers Act of Certain Hedge Fund Advisers (SEC Release No. IA-2333).
2. See Horizon Asset Mgmt., LLC, SEC No-Action Letter, 1996 WL 554956 (September 13, 1996); see also Conway Asset Management Inc., SEC No-Action Letter, 1989 WL 245639 (January 27, 1989) and Fiduciary Management Association, Inc. SEC No-Action Letter, 1984 WL 48452 (March 5, 1984).

3. See Bramwell Growth Fund, SEC No-Action Letter, 1996 WL 450346 (August 7, 1996).
4. See Horizon Asset Management., LLC, SEC No-Action Letter, 1996 WL 554956 (September 13, 1996).
5. See NASD actions regarding Citigroup Global Markets, Inc (NASD Case # CAF040077) and UBS Financial Services, Inc (NASD Case # CAF040051).
6. See Advisers Act Rule 206(4)-1(a)(2) [17 C.F.R. §275.206(4)–1(a)(2)]. An adviser may advertise all of its recommendations for the past year or longer, provided that the advertisement:
   - States the name of each security recommended, the date and nature of each recommendation (e.g. whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each security as of the most recent practicable date; and
   - Contains the following legend on the first page in print or type as large as the largest print or type used in the body or text: ''It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list''.
7. See Franklin Management, Inc., SEC No-Action Letter, 1998 WL 853257 (December 10, 1998).
8. See Advisers Act Rule 206(4)-7(a) [17 C.F.R. §275.206(4)-7(a)].
9. See Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).
10. See SEC v. Samuel Israel III; Daniel E. Marino; Bayou Management, LLC; Bayou Accredited Fund, LLC; Bayou Affiliates Fund, LLC; Bayou No Leverage Fund, LLC; and Bayou Superfund, LLC, Litigation Release No. 19406 (September 29, 2005).
11. For recent examples of SEC Enforcement actions relating to fund portfolio valuation practices, see SEC v. Vincent Montagna and Christine Palmer, Litigation Release No. 19211 (May 2, 2005); Beacon Hill Asset Management LLC et al., Litigation Release No. 18745A (June 16, 2004); SEC v. Global Money Management, L.P., Litigation Release No. 18666 (Apr. 12, 2004); SEC v. Burton G. Friedlander, Litigation Rel. No. 18426 (Oct. 24, 2003); SEC v. Michael Lauer, Lancer Management Group, LLC, and Lancer Management Group II, LLC, Litigation Release No. 18247 (July 23, 2003); SEC v. David M. Mobley, Sr. et al., Litigation Release No. 18150 (May 20, 2003).
12. See Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).
13. See 29 U.S.C. § 2510.3-101. Generally, if, in the aggregate, 25 percent or more of a fund's share class, after excluding the ownership interest of the fund adviser and advisory affiliates, is held by ''benefit plan investors'', the fund may deemed to be ''plan assets'' and hence subject to the Department of Labor's plan asset regulations.
14. See Advisers Act Rule 206(4)-7(a) [17 C.F.R. §275.206(4)-7(a)] and Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).
15. See Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).
16. Proxy voting policy and procedure requirements also exist for advisers under Rule 206(4)-6 of the Advisers Act.
17. Policies and procedures, commonly referred to as ''insider trading policies and procedures,'' are also required for all investment advisers by Section 204A of the Advisers Act.
18. See Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).
19. See Advisers Act Rule 206(4)-7(b) [17 C.F.R. §275.206(4)-7(b)].
20. See Advisers Act Rule 206(4)-7(c) [17 C.F.R. §275.206(4)-7(c)].
21. See Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).
22. See Compliance Programs of Investment Companies and Investment Advisers [SEC Release No. IA-2204; IC-26299] (December 17, 2003).