



## Taking the Initiative

### Asset Manager Code gives hedge funds a chance to meet a higher standard

BY CRYSTAL DETAMORE-RODMAN

When regulators took steps to protect investors following the recent scandals that rocked Wall Street, hedge funds were thrust into the regulatory spotlight. Following an exhaustive investigation that culminated with certain hedge fund managers having to register with the US Securities and Exchange Commission (SEC) by February 2006, many worried it was only the beginning of tighter regulatory control for an industry that traditionally enjoyed a great deal of autonomy.

It's not surprising that some see this as a critical juncture for the hedge fund industry. Many argue it's time to take a proactive stance to ward off future regulatory action, starting with industrywide adoption of professional standards governing ethical conduct.

The newly released Asset Manager Code of Professional Conduct (AMC) offers just that — global ethical and professional standards for firms managing assets as separate accounts or pooled funds, including hedge funds and mutual funds. Developed by the CFA Centre for Financial Market Integrity, with input from investment professionals in the United States, Europe, and Asia, it provides investors with a “checklist” to gauge the ethical behavior of individual asset managers.

“It's long overdue for the industry,” says Jason Bell, CFA, an associate at Legacy Capital Management in Roseville, Calif., a privately owned money management firm that started a hedge fund a year and a half ago. “When we started our discussions to launch a hedge fund, we wanted to have something that was transparent, to have a clear investment process, to have industry standard per-

formance reporting, best practices client reporting — basically what we were doing on our managed account side for so many years but applying it to this new vehicle. This Code essentially raises the bar for all the industry participants, and when you can do that, everybody looks better in the eyes of the constituents, the clients, and the regulators.”

In fact, the Managed Funds Association has included the AMC as an appendix to its 2005 Sound Practices for Hedge Fund Managers as a checklist for important items that should be included in a code of ethics for the firm.

Russell Investment Group also has expressed its support of the new AMC as a means of promoting ethical conduct and transparency among money managers worldwide. “Russell fully supports and applauds the principles of responsibility and ethical practices being advanced in the new Asset Manager Code,” says Chris Phillips, director of public relations for the global investment services firm. “This Code will help keep the investment management industry focused on ethical obligations and operational integrity. Russell has long maintained a code of ethics, policies, and procedures which are substantially consistent with the CFA proposal, and now, Russell will be looking for opportunities to incorporate some of the CFA Institute thinking. This Code represents an opportunity for the money management industry to adhere to a clear and common standard involving ethical, operational, and communications issues globally. The end result for investors will be greater consistency in the way our industry's policies, procedures, and conduct are measured.”

Jonathan Boersma, CFA, director of standards of practice at the CFA Centre, says hedge fund managers adopting the AMC will not only send a message to reg-

#### KEY POINTS

- The newly released AMC offers global ethical and professional standards for firms managing assets as separate accounts or pooled funds, including hedge funds and mutual funds.
- The Managed Funds Association has included the AMC as an appendix to its 2005 Sound Practices for Hedge Fund Managers as a checklist for important items that should be included in a code of ethics for the firm.
- The AMC can help hedge funds to demonstrate their commitment to ethical behavior and putting client interests first — and may reduce the need for further regulation in that sector.
- Anecdotal evidence suggests that accredited investors are already conducting more due diligence on investment opportunities.

ulators that they're serious about ethical practices but also may demonstrate that the industry can enforce professional behaviors without regulatory oversight. “Although hedge funds will soon fall under SEC registration in the United States, many hedge funds are changing their structure, such as moving to a two-year lock up, which will exempt them from the registration requirement,” he says. “The AMC is a useful tool for hedge funds to demonstrate their commitment to ethical behavior and putting client interests first — and may reduce the need for further regulation in that sector.”

Attorney George Mazin, a partner in the financial services group at Dechert LLP in New York City, agrees: “The SEC has said publicly that the registration initiative is not the first step toward further regulation of the hedge fund industry. I think many in the industry are understandably skeptical of those claims. But certainly the best defense is a good offense. Demonstrating to the SEC a willingness to adopt high principles governing the conduct by hedge fund managers and following that up by having the SEC do some examinations of firms and finding, in fact, there are not significant compliance problems is the way to demonstrate that to the SEC.”

“I think as investors become increasingly sophisticated in their analysis and investment decisions with respect to hedge funds, one of the questions investors will ask managers as they go through their due diligence process is whether they’ve adopted the Code or something approaching it.”

GEORGE MAZIN  
Partner  
Dechert LLP

Although a large number of hedge fund managers are adamantly opposed to the SEC’s registration plans, it’s worth noting that many are generally supportive of efforts to create a “compliant culture,” according to Mazin. “They don’t feel they need the SEC looking over their shoulder and telling them what to do and how to do it. They think the industry can be effective in policing itself and developing a compliant culture across the industry,” he observes. “I think this new Code will significantly help advance the process.”

For individual firms like Legacy Capital Management, the AMC provides a tangible way to communicate to clients and referral partners “how we conduct our business, the philosophies we embrace,” Bell discloses. “In addition to explaining to a prospective client, ‘Here’s how we feel, here’s how we do business,’ we can point to a document by a neutral third party and say, ‘Here, this is the code that we adhere to.’ It gives us a great level of comfort and confidence to be able to communicate that to prospective clients.”

Bell predicts that funds that already support open relationships with their investors will have less difficulty making the transition. “If an organization has or fosters a culture of transparency and openness with clients and vendors and so forth, then I think it’s going to have a much easier time adopting something like this. If a firm’s operational or investment process structure lacks visibility, then I think it would have a more difficult time.”

### Not Just for Hedge Funds

Although providing an ethical framework for hedge funds was a key motivation, other factors played into the development of the AMC, from the late trading and market timing scandals in the mutual fund industry that opened “a lot of eyes to the fact that abuses can take place in even well-regulated sectors,” says Boersma, to the need to provide the same level of ethical guidance to firms as traditionally offered to individuals. “A lot of our members have adopted the CFA Institute Code of Ethics and Standards of Professional Conduct for their firm. The Code and Standards, however, were developed to apply to individuals rather than firms. The AMC takes those principles and modifies them to apply to a firm,” he explains. “There are also certain processes or policies that firms should have in place that are simply not applicable to individuals, such as having a compliance officer.”

The recently enacted SEC rule requiring registered advisers to adopt a code of ethics to address personal trading by staff also was a motivating factor. “If all of the principles of the AMC, as well as the recommendations, were implemented, we feel confident that the manager would meet the SEC requirements for a code of ethics and also possibly the requirement for supervisory policies and procedures, a separate SEC requirement,” Boersma maintains.

The CFA Centre is working to educate not only the asset management industry but also investors about the

significance of the new AMC. “We are targeting investors themselves — they are the demand side of the equation,” says Boersma. “We hope that the demand for the AMC will be market driven — that is, clients will begin asking or demanding that their managers comply with the AMC.”

Mazin predicts that the new Code will take hold as investors gradually demand more transparency from hedge fund managers. “I think as investors become increasingly sophisticated in their analysis and investment decisions with respect to hedge funds, one of the questions investors will ask managers as they go through their due diligence process is whether they’ve adopted the Code or something approaching it,” he says. “If your competitor has adopted it and you haven’t, you’re going to have to explain to investors why you haven’t.”

Bell says anecdotal evidence suggests that accredited investors are already conducting more due diligence on investment opportunities. “Typically, these investors are investing large sums of money, and the returns in the hedge fund universe have been regressing to the mean. The returns are going down as more money and more assets are chasing this asset class, and so investors are becoming more discriminating, demanding a better investment process and more transparency — and certainly ethical behavior.”

He adds: “It gives us one more proof point to differentiate ourselves from the firm down the street by saying, ‘Here is something that we hold ourselves to voluntarily. Mr. and Mrs. Client, if you’re out there looking to invest your assets with a manager, these are the sorts of questions you should ask each and every manager. We might not be the right manager, but make sure you have this checklist when you’re interviewing prospective managers to manage your assets.’”

*Crystal Detamore-Rodman is a freelance journalist with a background in small business finance.*

### RECOMMENDED RESOURCES

“Asset Manager Code of Professional Conduct” ([www.cfainstitute.org/cfacentre/positions/pdf/asset\\_manager\\_code.pdf](http://www.cfainstitute.org/cfacentre/positions/pdf/asset_manager_code.pdf))