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Client Alert

Current Issues Relevant to Our Clients

July 1, 2015

SEC Issues Guidance On Exception To Personal Securities Transaction Reporting For Certain Accounts Where Reporting Person Has No Influence or Control

The staff of the Securities and Exchange Commission's (the "SEC") Division of Investment Management recently published guidance on investment adviser Code of Ethics exceptions to personal securities transaction reporting for securities transactions occurring in certain types of trusts or investment management accounts where the beneficiary or account holder has limited or no discretionary investment authority. A copy of the staff's guidance is available here.

Background

Under Section 204A of the Investment Advisers Act of 1940, as amended (the *"Advisers Act"*), registered investment advisers are required to maintain and enforce written policies and procedures reasonably designed to prevent the firm or its employees from misusing material nonpublic information. Under Advisers Act Rule 204A-1, an adviser's Code of Ethics must require its directors, officers and partners and its supervised persons who have access to nonpublic information regarding securities transactions, referred to as "access persons", to report their personal securities holdings and transactions. Rule 204A-1 also provides certain exceptions to the personal securities reporting requirements, including for securities holdings or transactions in trusts or accounts over which the access person had no direct or indirect influence or control.

Division of Investment Management Guidance

As a result of numerous questions regarding the above mentioned exception, the staff recently issued guidance to inform the public of its views regarding the application of Rule 204A-1 in the context of certain trusts and third-party discretionary accounts. The staff stated its view that blind trusts (typically an arrangement where a trustee manages funds for the benefit of another who has no knowledge of the specific management actions taken by the trustee and no right to intervene in the trustee's management) can be established such that an access person would have no direct or indirect influence or control. However, the staff believes that an access person providing a trustee with management authority over a trust for which he or she is grantor or beneficiary, or providing a third-party manager discretionary investment authority over his or her personal account is not by itself sufficient for an adviser to reasonably believe that the access person had no direct or indirect influence or control over the trust or account for purposes of the reporting exception. Such arrangements leave open the possibility of the access person influencing decisions regarding the purchase, sale or allocation of investments. Furthermore, while an access person's discussions with a trustee or third-party manager that simply summarize, describe or explain account activity to an access person would not implicate influence or control by the access person over the account, other types of discussions concerning account holdings may reflect direct or indirect control or influence in certain circumstances.

The staff believes that an adviser may be able to implement additional controls to establish a reasonable belief that an access person actually had no direct or indirect influence or control over the trust or account. The staff provided several policies and procedures for advisers to consider including obtaining information about a trustee or third-party manager's relationship to the access person; obtaining periodic certifications by access persons and their trustees or discretionary third-party managers regarding the access persons' influence or control over trusts or accounts; providing access persons with the exact wording of the reporting exception and a clear definition of "no direct or indirect influence or control"; and requesting reports on holdings and/or transactions made in the trust or discretionary account to identify transactions that would have been prohibited pursuant to the adviser's Code of Ethics absent reliance on the reporting exception. The staff noted that obtaining more general certifications alone would likely be insufficient to establish that an access person did not exercise direct or indirect influence or control. Instead, the staff suggested obtaining specific certifications from the access person regarding the access person's activities relating to specific trusts or accounts during specified timeframes.

What Should I Do Now?

Advisers should consider the staff's guidance when assessing their own Code of Ethics and compliance with the advisory personnel reporting requirements under Rule 204A-1.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.