



FOLEY HOAG LLP
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INSIDER TRADING POLICIES AND PRACTICAL COMPLIANCE TIPS

Overview

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2. Insider Trading Policies and Procedures
3. Insider Trading Concerns in SEC Exams
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I – Legal Background

Insider Trading Compliance Program



- Investment Advisers Act of 1940 (“Advisers Act”) Section 204A
 - Every SEC-registered investment adviser (an “Adviser”) must establish, maintain, and enforce written policies and procedures reasonably designed to prevent violations of the federal securities laws through the misuse of material, nonpublic information (“MNPI”) by
 - The Adviser, or
 - Any person associated with the Adviser
- Advisers Act Section 204A-I (the “Code of Ethics Rule”)
 - Every Adviser must establish, maintain, and enforce a written Code of Ethics that requires the Adviser’s “access persons” (defined below) to
 - Periodically report their securities transactions and positions, and
 - Obtain preapproval for direct or indirect investments in initial public offerings and limited offerings (i.e., private placements)
 - Requires the Adviser to review personal securities transactions and holdings
 - Requires supervised persons to comply with federal securities laws

Adviser's Potential Liability



- Advisers may be liable for insider trading violations of traders and other persons under their control
- Implementation, maintenance and enforcement of written insider trading policies and procedures that are designed to prevent the misuse of MNPI by the Adviser and persons associated with the Adviser may provide a good faith defense to controlling person liability by enabling the Adviser to demonstrate that it
 - Acted in good faith, and
 - Did not directly or indirectly induce the act(s) constituting the securities law violation
- Adviser can be held liable if one employee is in possession of MNPI and another employee not in possession trades
 - Under Securities and Exchange Act of 1934 Rule 10b5-1, Adviser not deemed to have engaged in insider trading if
 - The individual who actually made the investment was unaware of any MNPI at the time of the trade, and
 - The Adviser had implemented reasonable policies and procedures to ensure that persons making investment decisions do not possess MNPI



2 – Insider Trading Policies and Procedures

Developing Policies and Procedures



- Advisers Act Section 204A expressly requires the adviser to:
 - Take into consideration the nature of its business, and
 - Design policies and procedures that are focused on detecting and preventing insider trading
- Periodically review and fine tune policies and procedures designed to prevent the misuse of MNPI to take into account business, industry, and regulatory developments
 - Perform forensic testing to evaluate the effectiveness of the adviser's policies and procedures and to identify any weaknesses
- Adviser's duty of care also requires that it safeguard sensitive MNPI

Policy Prohibiting Insider Trading



- Adopt a policy statement regarding the Adviser's prohibition against insider trading, prohibiting:
 - Persons associated with the Adviser (including but not limited to shareholders, partners, members, officers, directors, employees, consultants and independent contractors) from trading
 - either personally, or
 - on behalf of others, including client accounts managed by the Adviser in any security or security-based derivative position on the basis of MNPI
 - Persons associated with the Adviser from communicating material, nonpublic information to any person (including Adviser personnel) in violation of the law (“tipping”)
- Applies to the Adviser and to persons associated with the Adviser, and extends to activities within and outside of their duties at the Adviser
- Informs employees of the severe sanctions imposed by the Adviser and by regulators for violations

Procedures to Prevent Insider Trading



- Tailored to meet the specific operations and organization of the Adviser
 - Employee training program addressing insider trading
 - At least annually; if high risk, conduct additional session(s) with legal counsel
 - Document attendance
 - Use of restricted and watch lists
 - Restricted list of securities that Access Persons are prohibited from trading
 - Watch list of securities that Access Persons may trade with pre-approval
 - Monitor employees' personal securities trading
 - Require pre-approval for trading securities or prohibit trading of certain securities
 - Require post-trade reporting of trades pre-approved
 - Use of information barriers (“Chinese Wall”)
 - Restrictions on (i) communications and (ii) access to information
 - Internal enforcement
 - Investigate reported breaches of insider trading policies and procedures
 - Provide meaningful discipline when investigation confirms a violation

Additional Recommended Procedures



- Initial efforts to screen employees for past bad behavior, including in-depth background checks and initial and annual conduct questionnaires
- Identify a person to whom employees can turn with questions relating to insider trading (compliance/legal)
- Prohibit employees from personal trading in securities in which the Adviser may invest
 - Most extreme position – limit employee trading to mutual funds
- Require employees to provide the Adviser with duplicate trade confirmations and account statements
- Require employees to execute acknowledgements as to their knowledge of and compliance with the Adviser's insider trading policy
 - Annually or quarterly, depending on risk
- Monitor electronic communications between the Adviser's investment personnel or traders and third parties for potential misuse of MNPI
 - Quarterly compliance attestation in lieu of monitoring, depending on risk

Additional Recommended Procedures



- Requirements to trade only through certain broker(s) or limits on the number of brokerage accounts permitted
- Impose “blackout periods” when client securities trades are being placed or recommendations are being made
 - Employees are not permitted to place personal securities transactions during the blackout period
- Require preapproval of an employee’s outside employment as an officer or director of a company, or as a member of company’s creditors committee
- Have a written policy regarding dissemination of rumors and trading based upon rumors
- Back-test to identify any insider trading
- Utilize a “10b5-1 plan”
- Prohibitions or restrictions on “short-swing” profits

Identifying MNPI and Response Procedure



- Employees should ask the following questions:
 - Is this information that a reasonable investor would consider important in making an investment decision?
 - Is this information that would materially affect the market price of a stock if generally disclosed?
 - To whom was this information provided?
 - Has the information been effectively communicated to the market place by being published in *The Wall Street Journal* or another publication of mass circulation, appearing on wire services or electronic media, or has it otherwise been made available to the public?
- An employee who believes that he has been exposed to MNPI should
 - Report the matter promptly to the CCO
 - Refrain from recommending, purchasing or selling securities, for himself or for the account of others, with respect to such information
 - Refrain from communicating the information within or without the Adviser, other than to the CCO/Chief Legal Officer

Personal Securities Trading



- The Code of Ethics Rule requires an Adviser to enact and enforce policies and procedures regarding personal trading by “Access Persons”
 - Any of the registered Adviser’s “supervised persons”
 - Officers, partners, directors (or other persons occupying a similar status or performing similar functions), or employees, or any other person who provides investment advice on the Adviser’s behalf and is subject to the adviser’s supervision or control
 - Who has access to nonpublic information regarding any clients' purchase or sale of securities, or nonpublic information regarding the portfolio holdings of any fund, or
 - Who is involved in making securities recommendations to clients, or who has access to such recommendations that are nonpublic
 - All directors, officers and partners are presumed to be Access Persons
- Preapproval of purchases of new issues (IPOs) or private placements
- Identification of Access Persons’ personal trading accounts and reporting of trades therein
- Ongoing process to review personal trading by the Adviser’s Access Persons for potential insider trading



3 – SEC Exam Concerns

Exam Concerns Regarding Insider Trading



- The Office of Compliance Inspections and Examinations (“OCIE”) continues to conduct “Presence Examinations” of investment advisers registered as a result of the implementation of the Dodd-Frank Act
 - Examinations are similar for older registrants
- Areas of concern related to insider trading include the following:
 - “Consultants” or “researchers” who share office space with the Adviser and who are paid only if a specific recommendation becomes profitable
 - Include consultant or researcher as an “Access Person” subject to the Adviser’s Code of Ethics
 - Advisory boards
 - Include advisory board members as “Access Persons” subject to the Adviser’s Code of Ethics
 - “Value-Added Investors”
 - Provide industry expertise in addition to investment dollars; often senior officers or directors at public companies in which the Adviser’s fund(s) may invest
 - Potential conflicts if Adviser’s employees transact for their own accounts, or on behalf of the Adviser’s client(s), in companies affiliated with Value-Added Investors
 - Guidelines or restrictions relating to communications between the Adviser’s personnel and Value-Added Investors



4 – Working with Expert Network Groups

Procedures for Expert Network Groups



- Review and approval process to ensure that the expert network group being used by the Adviser employs reasonable practices and compliance efforts
 - Who approves of paid expert consultants?
 - Is a background check of the expert consultant performed?
 - Is the process documented?
 - What is the expert consultant's compensation?
- Screen the expert consultant
 - Basic background check (public search engine)
 - Prohibit use of expert consultants employed at a public company for a specific time frame (six-month to two-year range)
- Pre-approval of communication with expert consultant
 - Adviser's employees should obtain pre-approval from the CCO prior to communicating with an expert
 - Document the approval

Procedures for Expert Network Groups



- Employee communicating with paid expert consultant should document the call/meeting
 - Who participated?
 - What topics were discussed?
 - What is the basis of the expert consultant's knowledge?
- Limitations on employees' communication with any one expert consultant
- There should be no communication with the expert consultant after the scheduled call/meeting
 - Employees should not text or otherwise communicate with expert consultant without further preapproval
- Train staff to identify problematic answers and bring the matter to the attention of the CCO
- Ongoing surveillance
 - Forensic testing to identify trades made after an expert consultation and compare trades against publicly available information

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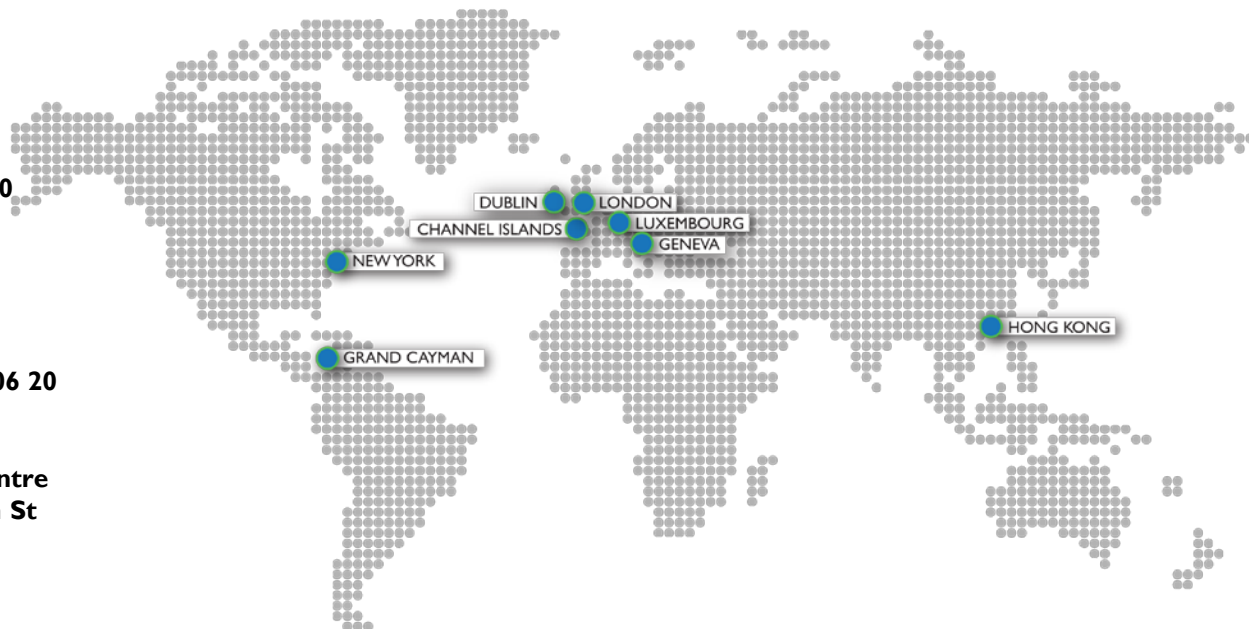
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