

Statement of Michael S. Miller Managing Director The Vanguard Group, Inc.

Before the United States Senate Committee on Banking, Housing, and Urban Affairs

Oversight Hearing on Specific Issues:
Joint Management of Mutual Funds and Other Accounts

March 2, 2004 Washington, D.C.

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, my name is Michael Miller. I am a Managing Director at The Vanguard Group, based in Valley Forge, Pennsylvania, where I am responsible for Planning and Development. An important part of my responsibilities is managing our Portfolio Review Group, which selects and oversees third-party investment advisory firms that manage assets for our funds.

Vanguard understands that in the wake of fund trading scandals there is some interest in imposing a direct ban on the ability of an individual to manage both hedge funds and mutual funds. Congress is properly considering this and other issues relating to the operation and regulation of mutual funds. Vanguard appreciates the opportunity to testify on the issue of joint management of mutual funds and other accounts.

While Vanguard does not manage or offer hedge funds, Vanguard is very concerned that a ban on side-by-side management will eliminate a substantial number of investment professionals and investment advisory firms that would ordinarily be available to its mutual fund shareholders. Like Congress, Vanguard is concerned about protecting the interests of mutual fund shareholders. We believe there are ways to effectively protect the interests of multiple clients without taking the extraordinary, and potentially damaging, step of an outright ban on managing both hedge funds and mutual funds.

I. The Vanguard Group

The Vanguard Group is the world's second largest mutual fund family, with more than 17 million shareholder accounts and approximately \$725 billion of investments in

our U.S. mutual funds. Vanguard offers 126 funds to U.S. investors and over 35 additional funds in foreign markets. The Vanguard Group has a unique structure within the mutual fund industry. At Vanguard, the mutual funds, and therefore indirectly the fund shareholders, own The Vanguard Group, Inc., which provides the funds with all management services "at cost." Under this structure, all "profits" of The Vanguard Group are returned to our fund shareholders in the form of reduced expenses.

Given Vanguard's mutual ownership structure, all of our management policies, practices, and personal incentives are designed to ensure the growth, safety, and well being of our fund shareholders' assets. In addition, Vanguard has long maintained a philosophy of fair dealing with our shareholders, and we believe our current investment, business, and disclosure practices are designed to protect their interests. As an industry leader, we are pleased to contribute to the discussions about proposed fund initiatives, and we support appropriate and meaningful reforms at the federal level to restore investor trust in mutual funds.

Approximately 70% of Vanguard's assets are managed by investment professionals employed by The Vanguard Group, Inc. These professionals manage equity index funds, actively managed quantitative equity funds, actively managed and indexed bond funds, and money market funds. The remaining 30% of Vanguard's assets, or roughly \$220 billion, include actively managed equity and fixed income portfolios that are managed by third-party investment advisory firms, which are hired and overseen by the funds' boards of trustees with substantial assistance from Vanguard's professional investment staff. In all, 37 of our funds receive portfolio management services from 21 independent advisory firms. We have been selecting and overseeing independent advisory firms for more than 25 years. There are substantial benefits for investors from our approach of using both internal and outside managers:

- <u>Diversity of thought</u>. Vanguard funds and shareholders benefit from the diversity of thought that a variety of external advisers bring to the asset management process. We are able to engage portfolio managers with distinct investment strategies and cultures that would not otherwise be available to mutual fund investors. Investment styles and strategies in fund offerings across the Vanguard complex are distinct.
- <u>Larger pool of investment talent</u>. Vanguard funds and shareholders benefit from the additional investment talent that outside managers represent. Vanguard is able to consider a wider range of potential managers for a specific investment mandate and is not limited by geographic or other constraints.
- <u>Capacity to grow</u>. Vanguard funds and shareholders benefit from the flexibility to absorb new investments by engaging additional subadvisers, without a fund's larger size diluting the effectiveness of existing managers. Introducing new managers can increase a fund's capacity to grow and provide greater economies of scale without diminishing potential investment returns.
- <u>Diverse investment offerings with consistent compliance and service standards</u>. Vanguard funds offer diverse investment styles and strategies by using independent advisory firms. Importantly, Vanguard fund shareholders also

benefit from a consistent level of compliance oversight and service that a single management company can provide.

II. Side-by-Side Management

At many investment advisory firms, including Vanguard and all of the third-party advisers we use, individual portfolio managers manage multiple accounts for multiple clients. In addition to mutual funds, these other accounts may include separate accounts (assets managed on behalf of institutions such as pension funds, insurance companies, endowments, and foundations), bank common trust accounts, collective trusts and other unregistered investment companies. Although, as stated earlier, Vanguard does not manage or offer hedge funds, many asset management firms, including a number of our subadvisory firms, do. A growing number of mutual fund families hire independent subadvisers to manage one or more funds. These subadvisers have other clients, including, in some cases, hedge funds.

While the structure of asset management firms may vary widely, managing money for multiple clients is, and has always been, an inherent feature of a successful asset management firm. Vanguard, for example, has never had a subadviser that managed money solely for Vanguard. Importantly, any firm that manages mutual fund assets is a registered investment adviser and, as such, should have substantive policies and procedures that help ensure that the investment professionals manage multiple accounts in the interest of all clients. The law and an adviser's role as a fiduciary demand no less.

III. Current Practices to Protect Mutual Fund Shareholders

- **A.** Vanguard's Approach. Vanguard's external investment advisers are subject to multiple controls and regulations to help ensure that Vanguard fund shareholders are protected. Among these are:
 - <u>Careful Selection.</u> In the selection of fund advisers, Vanguard carefully evaluates the people, philosophy, process, and performance of a prospective investment management firm. In our view, the integrity and ethics of an advisory firm's investment professionals are as critical as experience and talent.
 - <u>Close Supervision.</u> Vanguard works closely with our advisers to ensure that they
 are employing talented and experienced investment personnel as well as devoting
 the necessary research and compliance resources in the management of our funds.
 In addition, the investment professionals in our Portfolio Review Group
 continually review the performance and portfolio characteristics of our funds.
 The practices and policies of our advisers are also subject to periodic audits by
 Vanguard.
 - <u>Federal Regulation and Fiduciary Obligation.</u> Under the Investment Advisers Act of 1940, all investment advisers are required to perform as fiduciaries and must

- place the interests of their clients above their own at all times. Advisers also have a fiduciary obligation to treat all clients fairly and equitably.
- <u>Codes of Ethics.</u> Each of our advisers has long maintained a strict code of ethics that requires them to conduct their business in a completely ethical manner and adhere to the highest standards of professional behavior. Accordingly, all managers representing Vanguard are expected to act for the benefit of fund shareholders. Vanguard regularly reviews each adviser's code of ethics and its procedures and efforts to assure compliance with its code.
- <u>Internal Compliance Policies and Procedures.</u> In addition to the various laws and regulations that govern investment management firms, our advisers maintain formal compliance procedures and policies that are consistent with SEC regulations and designed to address potential conflicts of interest. These safeguards help to assure us that Vanguard funds are not being disadvantaged by any of the firm's other investment activities.
- **B.** Federal Regulation. All investment advisers who manage mutual funds are required by law to be registered with the Securities and Exchange Commission under the Investment Advisers Act. Therefore, all investment advisers whose business models include side-by-side management of mutual funds and other accounts are also required to be registered under the Advisers Act. All registered investment advisers are subject to the SEC's jurisdiction, inspection, and enforcement powers for all of their business, including the side-by-side management of mutual funds and hedge funds. The SEC's oversight of the investment adviser extends to all of its management activities, regardless of whether the investment activity is otherwise regulated. This provides the SEC with enhanced insight into unregulated investment activity, a degree of transparency that is not present when the unregulated funds or accounts are not managed jointly with mutual funds.

Under the Advisers Act, a registered investment adviser has a fiduciary duty to recognize and disclose potential investment conflicts and carefully manage them through appropriate policies and oversight. For example, a portfolio manager might hypothetically have an incentive to allocate well-priced trades to a client paying higher fees and more expensive trades to a client paying lower fees. As another example, a manager might hypothetically have an incentive to benefit one client by "trading ahead" of the trading strategies of another client. As noted previously, these potential conflicts are not unique to advisers who provide investment management to a mutual fund and a hedge fund. They exist *whenever* a portfolio manager advises two accounts that differ in any way, potentially even when a manager runs two different mutual funds simultaneously.

C. Compliance Policies and Procedures. Investment firms typically manage potential conflicts, whether involving hedge funds or other types of accounts, through allocation policies and procedures, internal review processes, and oversight by directors and independent third parties. Investment advisers develop trade allocation systems and controls to ensure that no one client—regardless of type—is intentionally favored at the expense of another. Allocation policies are designed to address potential conflicts in

situations where two or more clients' accounts participate in investment decisions involving the same securities, which happens frequently. In our experience, there are four core elements of a strong compliance program.¹ These elements are:

- Assigning one average price per security for all trades in that security executed for multiple clients;
- When supply of a security is insufficient to satisfy all clients, apportioning the available supply according to equitable, predetermined rules;
- Periodic reviews of the trading activity of portfolio managers for anomalous trading patterns involving multiple accounts; and
- Independent review of the internal controls relating to the management of accounts, including controls on trade allocation.

These systems can also be, and typically are, examined by the SEC staff during their inspections of registered investment advisers.

The SEC has very recently adopted new rules that will raise industry-wide standards for addressing these potential conflicts for the protection of all investors. The new rules require each mutual fund, and each registered investment adviser, to have written compliance policies and programs administered by a designated chief compliance officer. Fund boards must approve not only the policies and programs of the fund but also of the fund's adviser. Fund chief compliance officers will report directly to fund directors. These changes will enhance the transparency and accountability of fund investment advisers and also require fund directors to review these activities very closely to determine that fair and equitable allocation policies are in place and are being followed.

D. Fiduciary Duties of Investment Advisers. Many investment advisers have adopted practices such as those described previously regarding joint management in order to meet the fiduciary duties that have been required of them by Congress. All investment advisers (whether registered or not) are subject to Section 206 of the Advisers Act, which generally makes it unlawful for an investment adviser to engage in fraudulent, deceptive, or manipulative conduct. Congress enacted the Advisers Act upon declaring that the public interest was adversely affected "when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients."

An investment adviser has a fiduciary duty to exercise good faith and to disclose all material facts fully and fairly, as well as an affirmative obligation "to employ reasonable care to avoid misleading" its clients.⁴ As a fiduciary, an adviser owes its

² SEC Rel. No. IA-2204, "Final Rule: Compliance Programs of Investment Companies and Investment Advisers" (Dec. 17, 2003).

¹ A detailed list of compliance procedures is included in the Appendix.

³Investment Trusts and Investment Companies: Hearings on S. 3580 Before the Subcomm. of the Comm. On Banking and Currency, 76th cong., 3d Sess. 202(1940).

⁴ Id. at 194. See also, In re Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948).

clients more than honesty and good faith alone. Rather, an adviser has an affirmative duty to act solely in the best interests of the client and to make full and fair disclosure of all material facts, particularly where the adviser's interests may conflict with the client's. Pursuant to this duty, "an investment adviser must at all times act in its clients' best interests, and its conduct will be measured against a higher standard of conduct than that used for mere commercial transactions." 5

IV. Effects of Banning Side-by-Side Management

Banning individual portfolio managers from managing mutual funds and hedge funds would disadvantage mutual fund shareholders and fail to protect them fully.

A. Access to Investment Talent. Allowing side-by-side management of mutual funds and other accounts, including hedge funds, affords mutual fund investors access to top investment firms and investment professionals. Based on our experience, there is a limited supply of exceptional investment advisory firms and investment professionals. It is important that all investors, including mutual fund investors and 401(k) plan participants (who largely invest through mutual funds), be afforded access to the same universe of investment expertise as may be otherwise available to large institutions or high-net-worth individuals.

Many mutual funds with strong long-term performance records are managed by portfolio managers who also manage other accounts, including in some cases, hedge funds. These professionals have a range of options open to them regarding where they commit their time and talent. Hedge funds can be an attractive option because they allow for a broader range of investment techniques and provide an opportunity to earn higher fees based on performance. Banning the joint management of mutual funds and hedge funds would simply force these managers to choose between mutual funds and hedge funds. The unfortunate and undesirable result would be a reduction in the pool of managers available to mutual fund investors.

B. Management Continuity and Stability. Such a ban would hurt fund investors in other ways as well. Mutual funds will experience higher portfolio manager turnover, whether the fund is managed by an individual manager or a team, as investment professionals move on to manage other accounts not subject to such a ban.

Allowing management of different types of investment accounts also enhances the ability of investment management firms to retain their best portfolio managers. By managing a wide variety of accounts, investment firms and individual portfolio managers are able to diversify their client bases, as many businesses rationally seek to do. Moreover, the diversity of clients can give a top-quality investment firm greater balance and the ability to better attract and retain talented professionals. This stability benefits

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⁵ Thomas P. Lemke & Gerald T. Lins, Regulation of Investment Advisers, at 2-34 (1999).

mutual fund investors because, in our experience, the continuity and quality of an investment organization is one of the key determinants of long-term investment success for the firm's clients, including mutual fund clients.

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C. Consistent Investor Protection. Importantly, a ban against the side-by-side management of mutual funds and hedge funds would not address potential conflicts that may arise with the management of accounts other than hedge funds. As explained above, such a ban would not prevent a portfolio manager from managing investments for pension funds and hedge funds, or separate accounts and mutual funds, or, for that matter, multiple mutual funds. In any of these instances, the fee structure could be higher for one account than another for a variety of reasons, just as the investment objectives, strategies, and risk characteristics will differ to meet client needs. The potential conflicts of interest that arise in these situations are the same and should be treated consistently to maximize investor protection. Multiple compliance regimes for similar circumstances would introduce complexity and confusion, and would likely weaken rather than strengthen industry wide compliance around these issues. A better way to address concerns about conflicts of interest is to demonstrably strengthen compliance procedures, reporting, and oversight.

V. Oversight and Compliance Evaluation by Fund Independent Directors

A better approach than banning side-by-side management of mutual funds and hedge funds is to require mutual fund directors to review and approve stringent procedures to address conflicts of interest and to review the adviser's performance under those procedures. As mentioned earlier, at Vanguard the funds' independent directors monitor the independent advisory firms that manage money on behalf of the Vanguard funds. Our approach involves careful screening and selection, close supervision and evaluation of each firm's compliance policies and codes of ethics, and continuous review of its performance under those policies. We believe that advisers should be required to demonstrate to mutual fund boards that they have successfully followed all procedures and, when appropriate, to inform the board how the firm's procedures can be improved.

While mutual fund directors have long been charged with overseeing the performance and compliance of the fund's adviser, due to recent events, Congress and regulators have demanded more specific protections. As mentioned earlier, the SEC recently strengthened the position of fund directors in this regard by requiring that every mutual fund have a chief compliance officer reporting directly to the directors. Each investment adviser must now have written policies and procedures, administered by its own chief compliance officer. These policies and procedures must address a number of issues, including allocation of trades among multiple clients. Fund boards must approve the policies and procedures of their advisers, and funds must oversee the performance of

⁶ SEC Rel. No. IA-2204, "Final Rule: Compliance Programs of Investment Companies and Investment Advisers" (Dec. 17, 2003).

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their advisers under these procedures. This new regulation makes mandatory what "best practice" investment firms have long required.

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In addition, to the extent that fund directors require special experts to assist with their analysis of an adviser's performance, the SEC has recently proposed that mutual funds be required to explicitly authorize their independent directors to hire employees or other experts to help them fulfill their fiduciary duties. We support this authority for independent directors (the independent directors of Vanguard funds have long had this authority) and hope that this aspect of the proposal is adopted in the final rule.

We believe that the combined effect of enhanced compliance obligations and additional support for independent directors will sufficiently protect investors from potential conflicts of interest present in the side-by-side management of mutual funds and hedge funds, as well as other investment accounts. In our view, this approach will benefit mutual fund investors and protect their interests at the same time. Accordingly, we believe that imposing an outright ban on the management of mutual funds and hedge funds is a drastic solution that does not appear to be necessary at this time, particularly in light of the SEC's recent adoption of more stringent compliance requirements for funds and advisers. To do so could well deprive mutual fund shareholders of the widest available universe of investment management talent—surely an unintended but severe consequence that should be avoided.

Thank you. We appreciate the opportunity to testify before the Committee on issues of importance to mutual fund investors.

⁷ SEC Rel. No. IC-26323, "Proposed Rule: Investment Company Governance" (Jan. 15, 2004).

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Appendix <u>Management of Multiple Accounts</u> <u>Compliance Policies and Procedures</u>

In Vanguard's experience, investment advisory firms have developed effective policies and procedures to address the conflict of interest potentially present to an advisory firm or its personnel managing simultaneously mutual fund and other accounts, including the accounts of hedge funds. Those policies and procedures are typically and appropriately tailored to reflect an advisory firm's business operations and other specific characteristics. Vanguard believes that acknowledging "one size does not fit all" is crucial to the development of workable and effective compliance procedures in the area of joint management. In particular, policies may differ for equity and fixed income securities. Nonetheless, in Vanguard's view, certain types of compliance procedures and policies having core elements can be effective in dealing with the conflicts present in joint management of hedge funds and mutual funds. The policies and procedures adopted for this purpose by firms Vanguard has hired fall into three categories: procedures, both general and specific, for the allocation of securities among different clients; specialized allocation procedures for securities offered through public offerings and other limited offerings; and oversight mechanisms. Examples of the three categories of policies and procedures follow bellow:

Allocation Policies and Procedures

- One way in which investment advisory firms seek to address the potential that an individual portfolio manager responsible for managing hedge fund and mutual fund accounts could favor the hedge fund in allocating securities positions is by adopting specific policies and procedures that require orders for the purchase or sale of the same securities on behalf of multiple clients made on the same day to be aggregated. The central elements of these policies and procedures include:
 - assigning the same price per securities to all clients participating in the aggregated trade, even if multiple trades are needed to fulfill the entire aggregated order;

- executing trades in accordance with a defined and objective rotation system in which all clients participate on the same basis;
- distributing costs among clients participating in the aggregated trade on a proportionate basis;
- allocating trades at, or immediately after, execution, and entering trades into client accounts promptly after execution and in accordance with the allocation policy; and
- in cases when the supply of securities is insufficient and the full amount of an aggregated trade cannot be filled, allocating on a proportionate basis to the original order or in some other objective manner that is consistently applied.
- A second general way in which an investment advisory firm seeks to deal with allocation of securities when managing mutual funds and hedge funds is by only aggregating a purchase or sale order if the aggregated order is in the best interests of each individual client participating in the order and consistent with the firm's best execution policies.
- A third general way of addressing joint management conflicts by an investment
 advisory firm with a trading department is by having the trading department
 aggregate orders in the same securities, even when the orders are originated by
 different portfolio managers, if aggregation provides clients with better, cheaper
 and more efficient execution.
- Other specific policies and procedures Vanguard has observed that an
 investment advisory firm adopts in light of its business operations and other
 factors, in seeking to ensure that mutual fund clients are not disadvantaged by
 the firm's joint management activities include some of the following:
 - executing at the same time all the transactions undertaken by a portfolio manager employed by the firm in the same securities during the day;
 - o requiring consistent trading activity among all funds having similar investment strategies, such as mandating that transactions on behalf of

- mutual funds be entered by a portfolio manager when the portfolio manager has entered into a transaction for a hedge fund that is deemed suitable for the mutual fund;
- prohibiting a portfolio manager from maintaining different positions in the same securities on behalf of mutual funds and hedge funds that generally follow the same principal investment strategy;
- allowing a portfolio manager to undertake a securities transaction for one client while not contemporaneously entering into the same transaction for other clients, only if the portfolio manager determines and documents that the securities are or the transaction is not appropriate for the other clients:
- precluding a portfolio manager from purchasing securities for a mutual fund that have been sold recently by a hedge fund managed by the same manager, unless the manager obtains approval for the transaction from the investment advisory firm's chief investment officer or a compliance officer;
- prohibiting a portfolio manager from assuming a long position in equity securities on behalf of one client while simultaneously selling short the same securities on behalf of another client;
- establishing an order of trade execution priority for short and long transactions, giving general preference to long transactions;
- separating hedge fund short sales from mutual fund sale orders when they involve the same securities, and assigning trade execution priority on the basis of the time each of these transaction requests was received by the investment advisory firm's trading desk;
- prohibiting cross trades between the accounts of hedge funds and any other client;
- limiting cross trades between or among client accounts to liquid securities for which market quotations are readily available;

- requiring that the price used for cross transactions be the same as the last independent trade on a recognized market, and that the transactions conform to the investment advisory firm's overall trading policies and regulations; and
- restricting cross trades among specific types of accounts, such as trades involving accounts of employee benefit plans subject to the requirements of the Employee Retirement Income Security Act of 1974, as amended.

Allocation of Initial Public Offerings Securities and Other Limited Issues

- Vanguard has observed many investment advisory firms that seek to address the
 conflicts of interest presented by simultaneous management of hedge funds and
 mutual assets by adopting specialized rules covering securities purchased
 through initial public offerings and other limited issues. Misallocation of IPO
 securities has been at the center of a number of Securities and Exchange
 Commission enforcement cases. In some of these cases, hedge funds, but not
 other clients, were allocated IPO securities believed by an investment advisory
 firm to have the potential for strong returns. In seeking to preclude such
 inappropriate allocations, advisory firms, in Vanguard's experience, have
 adopted some or all of the following policies and procedures:
 - o apportioning IPO securities and other securities available through limited offerings according to equitable, predetermined rules, such as for example, by apportioning securities to all clients on a proportionate basis when the supply of a particular securities position is insufficient to satisfy all clients:
 - pre-determining clients that are eligible for securities offered through specific types of IPOs;
 - dividing IPOs into categories according to size and investment strategies furthered by holding the securities offered through the IPOs, and allocating IPO securities among all clients that have similar investment strategies on the basis of market capitalization of the issuers of the securities; and

 prohibiting portfolio managers and other fund personnel from participating in IPOs through hedge funds.

Oversight of Policies and Procedures

- Vanguard believes that crucial to effective compliance is a strong oversight of policies and procedures adopted to protect the interests of clients. Each investment advisory firm used by Vanguard must demonstrate it has established review processes and has retained the necessary oversight personnel to supervise trading activities and to ensure compliance with Vanguard's and the investment advisory firm's policies. An investment advisory firm should, as a starting point, have a compliance officer to review trading activity, monitor compliance with policies, and intervene in situations in which conflicts of interest are apparent. Other specific oversight mechanisms that Vanguard has observed investment advisory firms adopt with respect to joint management allocation policies and procedures include some or all of the following:
 - investment advisory firm personnel regularly on a periodic basis
 reviewing client transactions to identify potential conflicts of interest;
 - an investment advisory firm's portfolio managers, traders and/or compliance employees bringing transactions to the attention of a supervisor and/or an executive officer of the firm for closer review;
 - investment advisory firm compliance personnel reviewing representative samples of client transactions to assess overall compliance with the firm's trade allocation policies and procedures and to ensure fairness and equity in the operation of the firm's trading systems;
 - o an investment advisory firm's allowing for exceptions to the firm's policies and procedures only if the exceptions are properly documented and approved by a compliance officer employed by the firm;
 - o investment advisory firm personnel preparing and retaining separate documentation for each client participating in an aggregated order;

- investment advisory firm compliance officers' periodically reviewing past trade allocations to determine whether any client was systematically disadvantaged as a result of aggregated transactions;
- investment advisory firm compliance officers' reviewing portfolio manager determinations that trade aggregation provides all clients with the opportunity to achieve more favorable execution;
- an investment advisory firm's identifying instances in which a portfolio manager has deviated from the firm's allocation policy, and if so, whether the portfolio manager has identified a legitimate reason for the allocation;
- an investment advisory firm's requiring portfolio managers to document the reasons for entering into different or opposite positions on behalf of multiple clients, and requiring a compliance officer of the firm to review portfolio manager explanations at least every quarter;
- investment advisory firm personnel automatically time-stamping, at multiple stages of transactions, all records of transactions undertaken on behalf of all clients;
- o an investment advisory firm's allowing short selling of securities by a hedge fund that are held long by a mutual fund advised by the portfolio manager of the hedge fund only if the manager receives approval for the short sale from the firm's compliance department and if this policy is properly disclosed to all clients involved, including the mutual fund;
- an investment advisory firm's permitting cross trades subject to the condition that they be monitored by compliance officials charged with identifying trading patterns of cross trades between or among mutual funds and hedge funds;
- investment advisory firm compliance personnel simultaneously reviewing hedge fund trading and mutual fund trading;
- o an investment advisory firm's compliance personnel reviewing daily hedge fund transaction reports to identify transactions executed on behalf

- of hedge funds by portfolio managers who executed transactions on behalf of mutual funds within seven days before or after the hedge fund transactions;
- o an investment advisory firm's requiring portfolio managers to sign quarterly trading reviews for each hedge fund and mutual fund they manage, certifying that all trading was in compliance with each fund's investment strategy and that all clients were treated fairly and equally;
- an investment advisory firm's requiring portfolio managers to explain to oversight officials the investment rationale for proposed transactions on behalf of hedge funds that appear to be inconsistent with transactions undertaken on behalf of mutual funds;
- an investment advisory firm's establishing hedge fund review and oversight groups to provide specific fiduciary oversight for hedge fund transactions and to ensure that policies and procedures relating to hedge fund management are followed;
- an investment advisory firm's reviewing IPO allocation procedures and allocations at least annually;
- an investment advisory firm's having its compliance officer or an investment committee review prospective allocation of IPO securities prior to execution of the transaction in the securities;
- an investment advisory firm's requiring written explanations of the investment rationale underlying hedge fund transactions;
- o an investment advisory firm's disclosing the potential conflicts of interest presented by simultaneous management of client accounts in the appropriate regulatory forms and offering materials; and
- an investment advisory firm's reviewing and updating compliance policies and procedures and related disclosures to ensure accurate representation to all actual and prospective clients of potential conflicts of interest.