

# Compliance Issues for SMA Advisers

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MMI Fall Conference  
Managed Accounts Solutions 2005  
October 20, 2005

“Clients must be given an opportunity to impose reasonable investment restrictions on their accounts”

What the SEC said in adopting release:

“The ability of a client in an investment advisory program to place reasonable restrictions on the management of his or her account is a critical factor in determining whether individualized treatment is provided under the program.”

## SEC's examples:

- Prohibitions on the purchase of particular securities or types of securities.
- A program relying on rule 3a-4 need not provide clients with the right to direct the manager to purchase specific securities or types of securities.

“Whether a restriction would be reasonable depends on the facts and circumstances”

What is Unreasonable:

- Clearly inconsistent with the manager's investment philosophy or the client's investment objective
- Fundamentally inconsistent with the nature or operation of the program.

## What may be Unreasonable:

- How difficult is it to comply with the restriction
- How specific is restriction
- How many restrictions does the client want to impose.

What is not *per se* unreasonable:

- A restriction that simply places administrative burdens on the manager
- A restriction that could affect the performance of the account.

Clarke Lanzen case (1995):

“None of the agreements between CLS, the custodian and the MAAP II clients expressly permitted . . .the imposition of any restrictions on investments by MAAP II clients.”

How do managers decide whether to accept restrictions?

- Permit restrictions, but only with a CUSIP or a third party list defining the restricted stock (e.g. social indices)
- Permit restrictions, but only up to a percentage of the account's value

## How do managers accommodate restrictions?

- Substitute a similar security
- Reallocate the account among the unrestricted securities
- Invest the restricted portion of the account in an ETF that matches the account's style
- Invest the restricted portion of the account in cash

## SEC wrap manager sweep

Focus of the letter:

- How fee calculated and by whom
- Who decides whether program is suitable for client
- What client information manager receives
- Why sponsor thought manager was appropriate for program
- Why manager withdrew or was terminated in a program
- What are other relationships between sponsors and manager
- When does manager trade away, and how it analyzes executions
- How manager is marketed to sponsors and clients

## What would the SEC ask sponsors?

- How managers are selected and reviewed, and any payments for conferences
- How investment restrictions are accommodated, and how many clients have them
- Who decides whether program is suitable for client
- Any reviews of manager-supplied performance