



# Sigma Summaries

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## ***COMPLIANCE IS GOOD BUSINESS***

*Beginning with the Enron scandal back in 2000, it seems that the financial news outlets are punctuated on an almost daily basis with reports of unsavory business practices. Currently, insurers are under the spotlight. Confronted with this environment, we at Sigma Investment Counselors felt a need to share some practices at our firm that are designed to protect the interests of clients. While we rely on the character and integrity of our people to "do what is right," we recognize that a specific framework helps to focus attention on carrying out this mission.* - Bob Bilkie, CFA

As a registered investment advisory firm, Sigma Investment Counselors is regulated by the Securities and Exchange Commission (SEC) and therefore, governed by the Commission's rules and regulations. Due to a heightened number of scandals in the securities and mutual fund industries in recent years, the Commission has not only adopted new rules to protect investors, they are also increasing their enforcement of these policies to minimize abuses.

The combination of increased scrutiny by the SEC and recognition that many investment advisory firms did not have written policies and procedures, the SEC imposed a rule change to the Investment Advisers Act of 1940. This Rule became effective on February 5, 2004 and imposed a deadline of October 5, 2004 for investment advisors to be in compliance.

This Rule mandated that each investment advisory firm designate a Chief Compliance Officer; adopt written policies and procedures that satisfy the requirements of the new Rule, and complete annual audits of

its policies and procedures on an ongoing basis.

In response to this Rule, we formally recognized Cheryl Kotlarz as our Chief Compliance Officer in 2003. However, the role of compliance officer is not new to Cheryl, as she has served in this capacity for over 10 years, both at Sigma as well as at another investment advisory firm. This responsibility necessitates ongoing training and education as the rules are constantly changing and there are gray areas of the law that regularly need interpretation.

It is perhaps safe to say that our work in this area is never completed. Nevertheless, the purpose of this Sigma Summary is to highlight a number of the safeguards that we have introduced to protect the interests of our clients.

### **Best Execution**

Sigma has a fiduciary and fundamental duty to seek best execution for client transactions. Best execution does not necessarily mean the lowest commission but the best overall qualitative execution in

a particular circumstance. Nevertheless, we have witnessed a significant decline in commission rates over the past several years.

Other factors that may dictate which broker we use to initiate the purchase or sale of a security includes our subjective assessment of a firm's order handling ability, error support and correction experience, ability to limit market impact, block trading capabilities and availability of a dedicated service team.

Recently, we elevated Tony DiGiovanni to oversee our fixed income efforts. Not only should this provide Sigma's clients with a more unified and uniform fixed income approach, it has also allowed us, in certain circumstances, to bundle trades in an effort to increase the yield on our fixed income investments. In addition, we have asked a majority of our fixed income related clients to sign a Prime Broker Agreement. This agreement allows us to access a significantly broadened inventory of fixed income securities and introduce a higher level of competitive bidding among our multiple trading partners.

### **Disaster Recovery**

Since the terrorist activities of 9/11/2001, all advisory firms need to establish written disaster recovery and business continuity plans for the firm's business. For Sigma, we are undertaking steps such that in the event that we are denied access to our office, computer system or telecommunication service due to a disaster such as a bombing, fire, flood, earthquake or power failure, a backup plan goes into effect. In this way, we can meet our responsibilities in managing our client assets as well as meet our regulatory requirements.

We have developed a Disaster Recovery and Contingency Plan. As a result of this planning, we now backup our computer files on a nightly basis and archive the files at an offsite location. Moreover, we are in the process of scanning all of our critical paper-based client files as paper files are considered less secure and can be easily destroyed by fire, water damage, etc. We have also established multiple off-site locations that can function as a remote office for mission critical personnel. In the event of a power outage, we have secured the use of a generator to support our computer systems. For a loss of traditional land based communications, we have a cell-based calling tree allowing us to contact a majority of our staff at a moment's notice. These are but a few of the action steps that we have undertaken as a result of our Disaster Recovery initiative.

### **Privacy**

As a registered investment advisor, Sigma Investment Counselors must comply with SEC Regulation S-P,

which requires registered advisors to adopt policies and procedures to protect nonpublic personal information. Nonpublic personal information is information that is not publicly available but that is required to facilitate your relationship with us. In an effort to protect the information you provide to us to service your account, we have adopted procedures to safeguard that data. To prevent identity theft or fraudulent attempts to obtain client information we have undertaken procedures such as locking rooms and file cabinets where paper records are kept, password protecting our internal network and changing those passwords periodically.

### **Custody of Assets**

Effective November 5, 2003, the SEC adopted new rules to modernize the custody rules to protect clients' assets. The custody rule under the Investment Advisor' Act of 1940 now defines custody as "holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them". This rule also requires Sigma to maintain client funds and securities with a "qualified custodian."

As an Advisor, Sigma can assist our clients in the opening of brokerage accounts and the forwarding of funds or securities as long as the client is present. However, a client cannot leave certificates in our possession or forward them to us by mail. We are required to return them to you within three days of receipt, rather than forward to your custodian on your behalf. In addition, a check made payable to Sigma Investment Counselors, for anything other than payment of management fees, will

be returned to the client. We realize that these rules can seem cumbersome but any hint of impropriety would be devastating to our clients as well as our firm.

### **Adoption of a Code of Ethics**

On July 2, 2004 the SEC adopted a rule under Section 204 of Investment Advisors Act of 1940 requiring advisors to adopt a code of ethics. Advisors must be in compliance by February 1, 2005. Sigma Investment Counselors adopted a code of ethics in 1997, which has guidelines for avoiding prohibited acts and eliminating potential conflicts of interest.

As a fiduciary we must accept certain limitations on financial interest and place client interest ahead of our own. The Code of Ethics places restrictions against front running (trading our own personal account ahead of clients), insider trading and the appearance of actual conflicts of interest. Among other matters, the ethics rules forbid any employee from trading, either personally or on behalf of others, on material non-public information or communicating material non-public information to others in violation of the law. The code of ethics sets forth sanctions for violations of these policies. In addition, the code of ethics sets forth restrictions on receipt of gifts, outside employment, maintenance of brokerage accounts, and other matters. Sigma provides orientation on ethics rules to new employees and meets, at least annually, with all employees to review the current policies.

**Soft Dollar Arrangements**

The use of the term “soft dollars” generally refers to an arrangement between a discretionary investment advisor and a broker-dealer or third party provider whereby research and research related services can be paid for with commissions that are generated from the accounts of the firm’s clients.

For example, an investment firm may be able to negotiate a competitive commission rate of \$15 per trade under normal circumstances but instead, negotiates a commission schedule of \$20 per trade. This \$5 premium, in effect, allows the firm to receive research or research related services from the broker or third party vendor at no additional cost. In reality, the costs of these services are simply paid by the clients in the form of a higher commission.

It is important to note that these arrangements are deemed legal under Section 28(e) of the Securities Exchange Act of 1934.

**Nevertheless, Sigma has made a business decision not to engage in soft dollar arrangements.** Not only does the use of soft dollars open itself up for potential abuse, we also feel a fiduciary responsibility to negotiate a competitive commission rate for each of our clients and be prepared to absorb any research related expenses ourselves.

**Trade Errors**

In the event any error occurs in the handling of a client transaction due to Sigma’s actions or inactions, or actions of others, Sigma’s policy is to seek to identify and correct these errors as promptly as possible without disadvantaging the client. If the error is the responsibility of

Sigma, any client transaction will be corrected and we will be responsible for any client loss resulting from an inaccurate or erroneous order.

**Summary**

The policies and procedures highlighted above only scratch the surface on the rules and regulations that impact our business. Suffice it to say that staying within the letter and the spirit of the law is a rigorous undertaking that demands constant attention. If you have any questions regarding any of our practices or procedures, we invite you to contact us for a more in-depth discussion.

Written by:  
Christopher J. Kress, CFA

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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives.

