

**PRUDENTIAL  
FIXED INCOME**

## Form ADV Part 2A

### **Prudential Fixed Income**

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**This brochure provides information about the qualifications and business practices of Prudential Fixed Income. If you have any questions about the contents of this brochure, please contact us at (973) 367-6089 or [james.hartmann@prudential.com](mailto:james.hartmann@prudential.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (SEC) or by any state securities authority.**

**Additional information about Prudential Fixed Income is also available on the SEC's web site at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

Prudential Fixed Income is a unit within Prudential Investment Management, Inc., an investment adviser registered with the SEC. Registration of an investment adviser does not imply any level of skill or training.



**Item 2—Material Changes**

We are required to update this brochure each year within 90 days of the end of our fiscal year. If our updated brochure contains material changes, we will deliver a summary of such changes to our clients in accordance with SEC rules.

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## Item 4—Advisory Business

### Our Firm

Prudential Fixed Income is the public fixed income unit within Prudential Investment Management, Inc. (PIM). PIM is an SEC-registered investment adviser organized as a New Jersey corporation. When we use the terms “we,” “us” and “our” in this brochure, we are referring to Prudential Fixed Income. In addition, any references to “our employees” or “our officers” mean PIM officers or employees who work in the Prudential Fixed Income unit.

In addition to Prudential Fixed Income, the other units within PIM are Prudential Real Estate Investors (a provider of real estate investment advisory services) and Prudential Capital Group (a private fixed income investment adviser). Each of these units has a separate brochure that has been filed with the SEC and provides information about its advisory business.

PIM was formed in June 1984 and was registered with the SEC as an investment adviser in December 1984. PIM's predecessor companies began managing fixed income portfolios for affiliates in 1875 and for unaffiliated institutional clients in 1928. In addition to being a registered investment adviser, PIM is also registered as a commodity trading advisor (CTA) and is a member of the National Futures Association. PIM is an indirect, wholly-owned subsidiary of Prudential Financial, Inc. (Prudential Financial), a publicly held company (NYSE Ticker "PRU"). Prudential Financial, Inc. is not affiliated in any manner with Prudential plc, a company incorporated in the United Kingdom.

### Our Advisory Services

As a global fixed income manager, we offer a range of fixed income strategies and products.

Our fixed income investment strategies fall under four general categories:

- broad market strategies
- sector-specific strategies
- long duration strategies
- alternative strategies

#### **Broad Market Strategies**

- *U.S. Broad Market*

We manage a range of U.S. fixed income strategies that seek an excess return over broad-based U.S. investment grade benchmarks. These strategies invest primarily in U.S. treasury securities, mortgage-backed securities, corporate bonds and structured product. These strategies take various levels of active risk versus the relevant benchmark ranging from **core conservative** (least active risk) to **core plus** (most active risk).

- *Global Broad Market*

Our global broad market strategies target an excess return over a broad-based global fixed income benchmark. The strategies employ different levels of active risk ranging from a **global credit** strategy that invests in investment grade, developed market fixed income securities to a **global total return** strategy that invests in investment and non-investment grade securities of both developed and emerging markets issuers.

### **Sector-Specific Strategies**

- *Investment Grade Corporate Bond*

We manage **U.S., European and global corporate bond** strategies against a variety of benchmarks. These strategies are also available with short and intermediate duration targets.

- *High Yield Bond*

We manage a range of high yield bond strategies with different risk and geographic parameters, including **higher quality high yield, broad market high yield, European high yield, and global high yield** strategies. We also manage **U.S. and European bank loan** strategies.

- *Emerging Markets Debt*

We manage a wide range of **emerging markets debt** strategies, including a broad emerging markets debt strategy that invests in a mix of sovereign bonds, local currency instruments, and corporate bonds. We also manage **sovereign, local currency, and Asian fixed income** strategies, as well as a **blended emerging markets debt** strategy that invests approximately half of its assets in U.S. dollar denominated issues and half in local currency issues.

- *Structured Product*

As an active manager of structured credit across many different client portfolios, we have significant experience analyzing and managing a broad range of non-agency residential mortgage-backed securities, commercial mortgage-backed securities, and consumer and commercial asset-backed securities. We also have experience in structured credit securities, including collateralized loan obligations and synthetic corporate credit.

- *Municipal Bond*

We manage several municipal bond portfolios that seek to maximize current income that is exempt from federal income taxes.

- *Money Markets*

We manage a number of taxable money market portfolios that seek to maximize current income consistent with stability of capital.

### **Long Duration Strategies**

We have decades of experience in developing and managing liability-driven strategies and portfolios to help institutions solve pension liability challenges. We offer a range of **long duration fixed income** strategies, including long duration corporate, long duration government/credit, and long duration custom portfolios.

### **Alternative Strategies**

- *Hedge Strategies*

We believe that hedge strategies permit the fullest expression of our long-standing expertise in bottom-up research and individual security selection by permitting portfolio managers to pursue both long and short investment opportunities. Our hedge strategies include a strategy that invests in the U.S. government and agency markets and a strategy that invests in emerging market debt.

- *Collateralized Loan Obligations (CLOs)*

We believe that CLO management is a natural outgrowth of our expertise in global credit and structured transactions. We currently manage CLO assets across a broad range of sectors, including

U.S. and European bank loans, high yield bonds, and investment grade corporate bonds. We manage CLOs within both cash and synthetic structures.

### ***Our Securities Lending Services***

In addition to our investment advisory services, we also provide securities lending services to affiliates, institutional accounts, commingled trust funds, and mutual funds. We lend U.S. government and agency securities, corporate bonds, domestic and foreign equities, and foreign fixed income securities. Companies and institutions borrow securities for various reasons, including short selling, arbitrage, and to avoid settlement problems.

### ***Customization of Our Advisory Services***

We seek to accommodate the individual needs of our clients in providing our advisory services. Our investment management or similar agreements with clients, which include investment guidelines, are negotiated to incorporate mutually acceptable terms. Under these agreements, clients may impose limitations on our investment discretion, including restrictions regarding the investment in certain securities or types of securities. (See Item 16 below for more information regarding limitations on our investment discretion imposed by our clients.)

### ***Participation in Wrap Fee Programs***

We provide non-discretionary advisory services using our intermediate government strategy to an affiliate, Jennison Associates LLC (Jennison), with respect to certain strategies that Jennison manages for wrap fee programs of affiliated and unaffiliated sponsors. The program sponsor pays a portion of the fee it receives to Jennison who is responsible for managing the portfolios. We receive a fee from Jennison for our non-discretionary advisory services.

## **Our Assets Under Management**

As of December 31, 2011, our assets under management were as follows:

- Discretionary: \$333,092,100,000
- Nondiscretionary: \$2,220,500,000

Note that we do not include assets managed by other persons based on non-discretionary models provided by Prudential Fixed Income.

## **Item 5—Fees and Compensation**

### **Advisory Fees**

We negotiate fees with our clients individually. Fees paid by clients vary based on the type of advice provided and other factors, including the size of the client account, the investment strategy, the relationship with the client and the required level of service. Fees may also differ based on account type. For example, fees for commingled vehicles, including those that we subadvise, may differ from fees for single client accounts. Since fees are negotiable, clients with similar investment objectives or strategies may pay different fees.

We are generally compensated for our advisory services under asset-based fee schedules or performance-based fee schedules. On occasion, at our discretion, we may agree to charge a fixed fee. Our asset-based fees are customarily offered in tiered schedules with breakpoints linked to the amount of assets in the account, so that the fee rate decreases as the assets increase. In circumstances where we manage multiple accounts for a single client (or group of affiliated clients), we may, at our discretion,

aggregate the client's assets across accounts with similar strategies to enable the client to benefit from a lower fee tier. (See also our discussion in Item 6 below of asset-based fees and performance-based fees.)

We may enter into arrangements with investment managers or advisers under which the assets of the manager and one or more clients of such manager are aggregated in order to obtain a lower fee schedule. Such clients will pay lower fees than some other clients as a result of this lower fee schedule.

Each of the following fee schedules is representative of single client advisory account fees and may apply to one or more portfolios:

	Fee Schedule
<b>Core Conservative Fixed Income</b>	12 basis points on the first \$200,000,000 10 basis points on the next \$200,000,000 8 basis points thereafter
<b>Core Fixed Income or Government/ Credit Fixed Income or Government/Agency Fixed Income</b>	28 basis points on the first \$50,000,000 22 basis points on the next \$100,000,000 20 basis points on the next \$100,000,000 15 basis points thereafter
<b>Core Plus Fixed Income</b>	30 basis points on the first \$50,000,000 28 basis points on the next \$100,000,000 25 basis points on the next \$100,000,000 20 basis points thereafter
<b>Investment Grade Corporate Fixed Income</b>	30 basis points on the first \$100,000,000 25 basis points on the next \$100,000,000 22 basis points on the next \$100,000,000 15 basis points thereafter
<b>High Yield Fixed Income</b>	50 basis points on the first \$25,000,000 40 basis points on the next \$50,000,000 30 basis points thereafter
<b>Senior Secured Loans</b>	55 basis points on the first \$25,000,000 45 basis points on the next \$50,000,000 35 basis points thereafter
<b>Emerging Markets Fixed Income</b>	70 basis points on the first \$25,000,000 60 basis points on the next \$25,000,000 45 basis points thereafter
<b>Global Aggregate Plus</b>	32 basis points on the first \$100,000,000 25 basis points on the next \$100,000,000 22 basis points on the next \$100,000,000 15 basis points thereafter
<b>Asian Fixed Income</b>	55 basis points on the first \$25,000,000 50 basis points on the next \$25,000,000 40 basis points thereafter
<b>Inflation Protected Fixed Income</b>	20 basis points on the first \$25,000,000 15 basis points on the next \$25,000,000 10 basis points on the next \$50,000,000 5 basis points thereafter
<b>Structured Product</b>	28 basis points on the first \$50,000,000 22 basis points on the next \$100,000,000 20 basis points on the next \$100,000,000 15 basis points thereafter
<b>Municipal Bond</b>	28 basis points on the first \$50,000,000 22 basis points on the next \$100,000,000 20 basis points on the next \$100,000,000 15 basis points thereafter

	Fee Schedule
<b>Structured Maturity Fixed Income</b>	35 basis points on the first \$10,000,000 25 basis points on the next \$40,000,000 20 basis points thereafter
<b>Money Market</b>	15 basis points on all assets
<b>Absolute Return Fixed Income</b>	45 basis points on all assets
<b>Relative Value Fixed Income</b>	125 basis points base fee plus Incentive Fee: 20% of net return** over 3 month LIBOR, subject to a loss carryforward, calculated annually
<b>Emerging Markets Long/Short</b>	150 basis points base fee plus Incentive Fee: 20% of net return** over 3 month LIBOR, subject to a loss carryforward, calculated annually
<b>CLOs</b>	20 basis points on all assets senior fee 45 basis points on all assets subordinated fee Incentive fee: 20% of return over a 10% internal rate of return

\*\*Gross return less base fee and account expenses.

## Payment of Fees

Depending on the client's preference, we either bill a client for our fees or deduct fees from the client's account. Asset-based fees are typically payable either monthly or quarterly in arrears. Performance-based fees, if earned, are payable after the calculation period for such fees.

We do not require or solicit clients to pay advisory fees in advance. If a client were to pay advisory fees in advance and the client's advisory contract were to terminate before the end of a billing period, any prepaid fees would be refunded on a pro rata basis.

## Conflicts Related to Valuation and Fees

When client accounts hold illiquid or difficult to value investments, we face a conflict of interest when making recommendations regarding the value of such investments since our management fees are generally based on the value of assets under management. We believe that our valuation policies and procedures mitigate this conflict effectively and enable us to value client assets fairly and in a manner that is consistent with the client's best interests.

## Other Amounts Payable by Clients

Our advisory fees are the only amounts payable by clients to Prudential Fixed Income (unless we also provide securities lending services to the client). Clients are generally responsible for other fees and expenses related to their accounts, including custodial fees, brokerage fees and other transactions costs. (See Item 12 below for a discussion of our policies regarding the selection of broker-dealers.)

## Securities Lending Fees

We are compensated for our securities lending services by receiving a portion of the proceeds generated from our lending activities.

The type of proceeds earned from securities lending depends on the collateral provided by the borrower. Borrowers may provide collateral consisting of cash, securities or a letter of credit. For loans collateralized by securities or a letter of credit, client accounts receive a fee from the borrower for the borrower's use of the loaned securities. If a loan is collateralized with cash, we invest the cash in short-term funds that we manage. For these loans, the proceeds from securities lending is equal to the difference between the interest rate earned from investing the cash collateral and the interest returned to the borrower (which is commonly referred to as the "rebate rate").



## Conflicts Related to Securities Lending Fees

When we manage a client account and also serve as securities lending agent for the account, we could be considered to have the incentive to invest in securities that would yield higher securities lending returns. This conflict is mitigated by the fact that our advisory fees are generally based on the value of assets in a client's account. In addition, our securities lending function has a separate reporting line to our chief operating officer (rather than our chief investment officer).

## Other Compensation

We do not receive any compensation related to the sale of securities or other investment products. Our supervised persons do not receive any compensation directly related to the sale of securities or other investment products, but the sale of our advisory services or interests in funds we manage may be considered in determining the compensation of our sales personnel. Any such compensation would be payable by Prudential Fixed Income and not our clients or investors in the funds.

## Item 6—Performance-Based Fees and Side-By-Side Management

### Performance-Based Fees

As previously described in Item 5, we negotiate fees with our clients individually. While the majority of our fees are asset-based, we do accept performance-based fees in some of our strategies. Asset-based fees are calculated based on the value of a client's portfolio at periodic measurement dates or over specified periods of time. Performance-based fees are generally based on a share of the capital appreciation of a portfolio and may offer greater upside potential to us than asset-based fees, depending on how the fees are structured. Most of our performance-based fees are derived from the percentage by which we outperform the benchmark against which the client's portfolio is measured. We will generally be entitled to be paid a portion of that percentage, although the formulas and specifics of these negotiated fees vary. Our performance-based fees also customarily include an asset-based component, which we collect regardless of the performance of the account.

### Side-by-Side Management of Accounts and Related Conflicts of Interest

We manage accounts with asset-based fees alongside accounts with performance-based fees. This side-by-side management may be deemed to create an incentive for us and our investment professionals to favor one account over another. Specifically, we could be considered to have the incentive to favor accounts for which we receive performance fees, and possibly take greater investment risks in those accounts, in order to bolster performance and increase our fees.

Other types of side-by-side management of multiple accounts can also create conflicts of interest. Examples are detailed below, followed by a discussion of how we address these conflicts.

- *Proprietary accounts*—we manage accounts on behalf of our affiliates as well as unaffiliated accounts. We could be considered to have an incentive to favor accounts of affiliates over others.
- *Large accounts*—large accounts typically generate more revenue than do smaller accounts and certain of our strategies have higher fees than others. As a result, a portfolio manager could be considered to have an incentive when allocating scarce investment opportunities to favor accounts that pay a higher fee or generate more income for us.
- *Long only and long/short accounts*—we manage accounts that only allow us to hold securities long as well as accounts that permit short selling. We may, therefore, sell a security short in some client accounts while holding the same security long in other client accounts. These short sales

could reduce the value of the securities held in the long only accounts. In addition, purchases for long only accounts could have a negative impact on our short positions.

- *Securities of the same kind or class*—we may buy or sell for one client account securities of the same kind or class that are purchased or sold for another client at prices that may be different. We may also, at any time, execute trades of securities of the same kind or class in one direction for an account and in the opposite direction for another account due to differences in investment strategy or client direction. Different strategies effecting trading in the same securities or types of securities may appear as inconsistencies in our management of multiple accounts side-by-side.
- *Financial interests of investment professionals*—our investment professionals may invest in investment vehicles that we advise. Also, certain of these investment vehicles are options under the 401(k) and deferred compensation plans offered by Prudential Financial. In addition, the value of grants under our long-term incentive plan is affected by the performance of certain client accounts. As a result, our investment professionals may have financial interests in accounts we manage or related to the performance of certain client accounts. (See description in Item 11 of our compensation of investment professionals.)
- *Non-discretionary accounts or models*—we provide non-discretionary investment advice and non-discretionary model portfolios to some clients and manage others on a discretionary basis. Trades in non-discretionary accounts could occur before, in concert with, or after we execute similar trades in our discretionary accounts. The non-discretionary clients may be disadvantaged if we deliver the model investment portfolio or investment advice to them after we initiate trading for the discretionary clients, or vice versa.

### How We Address These Conflicts of Interest

We have developed policies and procedures designed to address the conflicts of interest with respect to our different types of side-by-side management described above.

- The head of Prudential Fixed Income and our chief investment officer periodically review and compare performance and performance attribution for each client account within our various strategies. (See Item 13 for more information regarding these reviews.)
- In keeping with our fiduciary obligations, our policy with respect to trade aggregation and allocation is to treat all of our accounts fairly and equitably over time. Our trade management oversight committee, which generally meets quarterly, is responsible for providing oversight with respect to trade aggregation and allocation.
  - We have compliance procedures with respect to our aggregation and allocation policy that include independent monitoring by our compliance group of the timing, allocation and aggregation of trades and the allocation of investment opportunities. In addition, our compliance group reviews a sampling of new issue allocations and related documentation each month to confirm compliance with our allocation procedures. Our compliance group reports the results of its monitoring processes to our trade management oversight committee.
  - Our trade management oversight committee reviews forensic reports of new issue allocation throughout the year so that new issue allocation in each of our strategies is reviewed at least once during each year. This forensic analysis includes such data as the:
    - number of new issues allocated in the strategy;
    - size of new issue allocations to each portfolio in the strategy; and
    - profitability of new issue transactions.

- The results of these analyses are reviewed and discussed at our trade management oversight committee meetings.
- Our trade management oversight committee also reviews forensic reports to analyze the allocation of secondary issues.
- The procedures above are designed to detect patterns and anomalies in our side-by-side management and trading so that we may assess and improve our processes.
- We have policies and procedures that specifically address our side-by-side management of long/short and long only portfolios. These policies address potential conflicts that could arise from differing positions between long/short and long only portfolios. In addition, lending opportunities with respect to securities for which the market is demanding a slight premium rate over normal market rates are allocated to long only accounts prior to allocating the opportunities to long/short accounts.

## Item 7—Types of Clients

### Types of Clients

We provide investment advisory services to a variety of affiliated and unaffiliated institutional clients located in both the U.S. and abroad. Our clients include pension and profit-sharing plans, public employee retirement systems, sovereign wealth funds, corporations, registered investment companies and their investment managers, insurance companies, commingled trust funds, Taft-Hartley plans, charitable institutions, foundations, endowments, municipalities, CLO trusts, and private investment funds. Minimum account sizes vary by investment strategy. Single client accounts typically have higher minimums than investments in commingled funds that we manage.

Affiliated clients and certain other clients may have different or greater needs for information, reporting, operational support, training or our other resources than our clients generally. For example, representatives of Prudential Financial, the general account of The Prudential Insurance Company of America (PICA) and accounts of other affiliates that are responsible for monitoring Prudential Financial's enterprise investment risk have access to information about our assets under management, including for third parties that is not made available to unaffiliated clients. This information does not include specific unaffiliated client identifying information or portfolio information for clients that have prohibited us from sharing such information with affiliates.

## Item 8—Methods of Analysis, Investment Strategies and Risk of Loss

### Our Methods of Analysis and Investment Strategies

We believe that research-driven security selection is the most consistent strategy for adding value to client portfolios. We complement this base strategy with active sector rotation, duration/yield curve/currency management and a focus on trade execution.

Our research-based investment process integrates credit research, quantitative research and risk management. Our portfolio managers are divided into six sector specialist teams:

- corporate
- leveraged finance and high yield
- emerging markets

- global rates and securitized products (including, U.S. and developed market sovereign, mortgage-backed securities, asset-backed securities and structured product)
- municipal
- money markets

In addition, a separate team is dedicated to securities lending activities.

## Our Investment Process

We generally use the following portfolio construction process:

### Develop Top-Down Investment Outlook

- Quarterly, we formulate a market outlook that assesses economic, interest rate, and fixed income sector scenarios. This top-down outlook is prepared with input from a cross-functional group consisting of our chief investment officer, chief risk officer, chief economist, chief investment strategist, head of credit research, head of quantitative research, head of structured product research, senior portfolio managers for each strategy and heads of each of our sector teams.
- The market outlook plays a role in helping to determine the level and types of risk to assume in our client portfolios. We update this market outlook on a weekly basis throughout the quarter.

### Develop Portfolio Strategy

- The senior portfolio manager for each strategy develops portfolio strategy, seeking excess return over the portfolio's benchmark by establishing risk exposures within a pre-established risk budget.
- As discussed below, we use risk budgets to manage expected portfolio tracking error.
- Each strategy team meets periodically to discuss portfolio strategy, positioning and attribution.

### Security Selection

- For multi-sector portfolios, the senior portfolio manager for the applicable strategy conveys the overall portfolio strategy to the applicable individual sector teams.
- Individual securities are selected by the applicable sector team based on:
  - fundamental research;
  - quantitative relative value modeling; and
  - technical and relative value analysis and trading expertise in the applicable markets.
- The senior portfolio manager for each strategy is ultimately responsible for all investment decisions and portfolio positioning.

### Portfolio Monitoring

- On a daily basis, each portfolio's risk characteristics and positioning versus its benchmark are reported and reviewed by both the portfolio manager for the account and a separate risk manager.
- Credit meetings are held each morning at which credit analysts discuss industry and individual issuer developments and events while portfolio managers discuss the market environment, trading technicals, and spread levels. A portfolio's positions in an issuer may change as a result of these meetings. Throughout the day, analysts and portfolio managers interact informally on specific news-related issues as they arise. Periodically, sector teams meet formally and informally and conduct comprehensive subsector reviews.

## Our Macroeconomic Research Process

We conduct in-house economic and strategic research to develop views on economic, policy, and market trends to support the fixed income investment process. Our chief investment strategist, chief economist, and members of our portfolio analysis group continually evaluate incoming economic data as well as monetary and fiscal policy developments in real time. We supplement our internal research with third party research that focuses on economic and policy analysis. The portfolio analysis group also analyzes market supply and demand trends from a range of sources, including Federal Reserve flow of funds reports, investor sentiment indices, retail mutual fund subscriptions and redemptions, and reports on gross and net debt issuance across sectors.

Our chief investment strategist and chief economist interact with the sector portfolio managers and research teams to integrate their top-down macroeconomic analysis with the sector teams' bottom-up fundamental views. Each Monday, the senior investment team meets to discuss economic and market developments, and investment opportunities across the fixed income sectors. The following day, the chief investment officer hosts a weekly sector allocation meeting to translate the macroeconomic research and sector views from the Monday meeting into tangible strategic themes and portfolio rebalancing decisions. As discussed above, we summarize our macroeconomic views each quarter in a quarterly market outlook. This document includes not only our macroeconomic and interest rate outlook, but also an outlook for each fixed income sector.

## Our Credit Research Process

### Corporate, High Yield and Municipal Bond

We have a team of credit analysts who are each responsible for a group of credits within an industry sector or group of industry sectors. To initiate coverage on an issuer, the analyst will develop a spreadsheet earnings model and derive an internal rating and outlook on the issuer. The rating and outlook will be determined based on a complete review of the financial health and trends of the issuer, which will include a review of the composition of revenue, revenue trends, profitability margins and trends, cash flow margins and trends, and leverage and coverage trends. In addition, the analyst will review the issuer's business strategy, financial policies and position within its industry. The analyst will also determine the creditor rights and ranking of the security or securities being proposed for purchase.

Once a security is purchased for a portfolio, the analyst will monitor the performance of the issuer on an ongoing basis by reviewing its financial statement and other disclosures, as well as ratings changes, relevant sell-side research and other news about the issuer using a variety of data services and news feeds. The analysts may listen to management conference calls detailing business results, attend industry conferences to learn about trends affecting issuers in their coverage universe, and meet directly with issuer management.

At any time an analyst determines that events, business results, a change in financial policy or strategic direction, or other developments warrant a change in our internal rating, the analyst will notify the portfolio managers and make the change in our credit database, where our ratings, outlooks and other credit related information is maintained. These changes appear on a dashboard of most recent updates to the database that is available on the desktop of all the portfolio managers and analysts. The analysts are also responsible for using our internal watch list categories to signal potential changes in the credit profile of the issuer.

### Structured Product

Our research approach to structured credit employs a combination of collateral, structure, macro-economic and issuer analysis for underwriting and monitoring. We use our structured finance research capabilities to identify securities that we believe to be mispriced. Our analysts rate all securities and evaluate the effective spread of each security (including any option adjustments). Our analysts also

maintain comprehensive views on the credit profiles and trends in each subsector, as well as views on the generic spreads appropriate for the risks of each subsector in the marketplace. Creditworthiness is regularly monitored while a security is held in any portfolio.

### Emerging Markets

We closely follow emerging market sovereign, quasi-sovereign, and corporate issuers across a range of countries. Given our emphasis on country selection during the investment process, much of the emerging markets credit research we do is focused on the fundamental analysis of the quantitative and qualitative factors driving sovereign credit risk. We also perform relative value and technical research on sovereign issuers, and we identify key risk factors that could cause a particular sovereign to outperform or underperform over a base case scenario. Our fundamental, technical and relative value views are combined to form a specific country recommendation.

This process helps us to incorporate research findings into actual portfolio construction by providing a framework for translating a research-based stand-alone country recommendation into a risk-adjusted country allocation within an overall portfolio.

### Our Quantitative Modeling Process

Our quantitative research team develops proprietary quantitative models to support relative value trading and asset allocation for portfolio management as well as various risk models to support risk management. Models include the:

- Arbitrage-free interest rate model- used for the relative value analysis of government bonds in developed and emerging markets as well as interest rate swap markets in all major currencies.
- Agency mortgage-backed securities prepay model and market implied option adjusted spread model- used to estimate the fair value and relative values for our mortgage positions, as well as interest rate sensitivity.
- Commercial mortgage-backed security (CMBS) model- used to estimate the fair value and interest rate risk of various tranches of CMBS.
- Single-name credit model- a structural model of corporate defaults, used to analyze the relative value of corporate bonds and credit default swaps.
- CLO model- leverages our single name credit model to project the default behavior of a portfolio of syndicated leveraged loans that have been securitized into a collateralized loan obligation, facilitating valuation and risk analysis.
- Tracking error risk model- used to measure systematic expected tracking risk of our client portfolios relative to their benchmarks.
- Asset allocation model- provides portfolio managers with a “strawman” fixed income sector allocation based on a risk-return optimization framework.
- Stress index- utilized weekly to estimate the level of stress in the fixed income markets, attempting to indicate when credit risk is elevated and market liquidity is constrained.

### Our Investment Risk Management Process

The risk management team develops risk budgets for each client portfolio, with certain limited exceptions. The risk budgets guide and monitor the allocation of a portfolio's overall risk capacity across the range of available investment opportunities. Our risk management team sets discrete thresholds for monitoring systematic and non-systematic risks.



Our proprietary risk management system incorporates a tracking error model designed to estimate the systematic risk of a portfolio's active positioning versus its benchmark resulting from yield curve, currency and spread movements. This model forms the basis for monitoring systematic risk in our portfolios. We supplement our tracking error model with short-term spread risk measures and with scenario analyses derived from actual historical events. Non-systematic risk (issuer, industry and country exposures) is addressed by applying market-value based thresholds and using custom stress-tests. Our risk management system is used by risk managers and portfolio managers to analyze portfolio risk, monitor portfolio positioning relative to pre-established risk budgets, and perform detailed performance attribution.

### Primary Risks Associated with Our Methodology and Strategies

Investing in securities and other financial instruments involves risk of loss that clients should be prepared to bear. Investment strategies may not achieve their performance objectives and may result in losses. Summarized below are certain important risks for clients and prospective clients to consider.

#### General Risks Related to Fixed Income Investments

- **Market Risk.**
  - General. The value of securities and other investments may move up or down, sometimes rapidly and unpredictably. Securities markets are volatile. A client account may at any point in time be worth less than its initial value. Regardless of how well an individual investment performs, if financial markets decline, you could lose money.
  - Interest Rate Risk. Debt securities can lose value because of interest rate changes. For example, debt securities tend to decrease in value if interest rates rise. Debt securities with longer maturities generally are more sensitive to interest rate changes than those with shorter maturities. In addition, short-term and long-term interest rates do not necessarily move in the same direction or by the same amount. Changes in interest rates can also cause certain types of debt obligations to become subject to prepayment risk and extension risk. These include securities such as mortgage-backed securities and bonds with embedded call or put options.
  - Spread Risk. Portfolio returns are affected by changes in the spreads over risk-free rates of the underlying sectors and assets. In particular, a portfolio that is systematically overweighted in spread product would lose value if spreads widen. This systematic risk is dependent on the portfolio's exposure to various fixed income asset classes with varying degrees of spread risk.
  - Currency Risk. Assets in our client accounts may be denominated or quoted in currencies other than the base currency for the account. Accordingly, changes in currency exchange rates will affect the value of these client accounts. Generally, when the base currency of an account rises in value versus another currency, assets denominated in the non-base currency lose value because that currency is worth less than the base currency, and vice versa.
- Issuer-Specific and Industry Credit Risk. The issuer, the guarantor or the insurer of a fixed income security, or the counterparty to a contract, may be unable or unwilling to make timely principal and interest payments or to otherwise honor its obligations. Additionally, securities could lose value due to a loss of confidence in the ability of the issuer, guarantor, insurer or counterparty to pay back debt. The longer the maturity and lower the credit quality of an instrument, the more likely its value will decline as a result of such a loss of confidence. From time to time, several issuers in a given industry may experience such difficulties simultaneously, making it difficult for issuers in that industry to roll-over obligations, to repay creditors or to obtain liquidity in the market.

- *Liquidity/Valuation/Turnover Risk.* Assets in client accounts may, at any given time, include financial instruments that are thinly traded, for which no market exists, or that are not readily transferable under applicable securities laws. The sale of any thinly-traded or illiquid investments may be possible only at substantial discounts, if at all. Further, illiquid investments may be extremely difficult to value. Our investment strategies may include long-term purchases, short-term purchases, short sales or margin transactions. Frequent trading may result in higher transaction costs.
- *Model Risk.* Some of our investment strategies and risk management processes utilize proprietary mathematical models. There is a risk that we may select models that are not well-suited to prevailing market conditions. In addition, models that have been formulated on the basis of past market data may not be predictive of future price movements. Models may also have hidden biases or exposure to broad structural or sentiment shifts.
- *Foreign Securities and Sovereign Risk.* Investing in securities of non-U.S. issuers may involve more risk than investing in securities of U.S. issuers. Foreign political, economic and legal systems, especially in developing and emerging countries, may be less stable and more volatile than the corresponding U.S. systems. Foreign legal systems generally have fewer regulatory requirements than the U.S. legal system. Certain foreign countries may impose restrictions on the ability of their issuers to make payments of principal and interest or dividends to investors located outside the country, due to blockage of foreign currency exchanges or otherwise. Investments in foreign securities may be subject to non-U.S. withholding and other taxes. Investments in emerging markets are typically subject to greater volatility and price declines than investments in developed markets. In addition, investments in sovereign debt can involve a high degree of risk. A governmental entity's willingness or ability to repay principal and interest in a timely manner may be affected by, among other factors, its cash flow situation, the extent of its foreign reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the governmental entity's policy towards the International Monetary Fund and the political constraints to which a governmental entity may be subject.
- *Securitized Products Risk.* Securitized products are securities that are collateralized by, or linked to the performance of, pools of assets including commercial mortgage loans, residential mortgage loans, syndicated bank loans, credit card receivables, auto loans or other assets. Securitized products carry risks in varying degrees including credit risk, concentration risk, prepayment risk, interest rate risk, geographic concentration risk, the risk of poor performance due to adverse economic conditions, and price volatility. Securitized products are often not guaranteed by any governmental entity or other party.

#### **Risks Related to Our Strategies**

- *Leverage Risk.* Certain of our investment strategies employ various levels of leverage. The use of leverage exposes client accounts to additional levels of risk, including:
  - greater losses from investments than would otherwise have been the case if we had not borrowed to make the investments;
  - margin calls or interim margin requirements which may force premature liquidations of investment positions; and
  - losses on investments where the investment fails to earn a return that equals or exceeds the cost of borrowing such funds (including interest, transaction costs and other costs of borrowing).
- *Short Sale Risk.* The sale of securities not owned by a client (short sales) involves certain additional risks. There is the risk that securities sold by a client account could become scarce or



"special" in the financing markets. If a security becomes special, it may be very costly or even impossible to borrow in order to fulfill the delivery obligation of a short sale. A "short squeeze" could occur where an account might be compelled to purchase the shorted securities at a disadvantageous time, possibly at prices significantly in excess of the proceeds received in the earlier sale.

- **Derivatives Risk.** Derivatives can be volatile and may involve significant risks. Derivatives generally fall into two subcategories: exchange-traded and over-the-counter (OTC). Exchange-traded derivatives, such as futures contracts, are traded on an exchange regulated by the U.S. Commodity Futures Trading Commission, are guaranteed by a clearing corporation, and have standardized terms. OTC derivatives, such as swap agreements, are privately negotiated transactions, the terms of which are tailored to the specific needs of the parties. Derivatives are generally subject to credit risk, leverage risk and potentially currency risk. In addition, OTC derivatives are subject to liquidity risk.

The use of derivatives for hedging purposes involves correlation risk. If the value of the derivative moves more or less than the value of the hedged instrument, a client account will experience a gain or loss that will not be completely offset by movements in the value of the hedged instruments.

Futures, forward contracts, swaps, options and other derivative instruments contain inherent leverage in that they provide more market exposure than the amount paid on the initiation of the transaction. As a result, a relatively small adverse market movement can not only result in the loss of the entire investment, but may also expose a client to the possibility of a loss exceeding the original amount invested. In addition, many of these products are subject to variation or other interim margin requirements, which may force premature liquidation of investment positions.

- **Securities Lending Risk.** The primary risk of securities lending is the credit and market risk related to the re-investment of cash collateral. In addition, securities lending involves the risk that a counterparty will default on its obligation to return loaned securities, which is mitigated by the collateral posted by a counterparty.

#### **Risks Related to Regulation**

Laws and regulations affecting our business change from time to time, and we are currently operating in an environment of significant regulatory reform, both in the U.S. and globally. We cannot predict the effects, if any, of future legal and regulatory changes on our business or the services we provide.

#### **Risks Related to Conflicts of Interest**

Like other investment advisers, we are subject to various conflicts of interest in the ordinary course of our business. We strive to identify potential risks, including conflicts of interest, that are inherent in our business, and conduct formalized annual conflict of interest reviews. When actual or potential conflicts of interest are identified, we seek to address such conflicts through one or more of the following methods:

- elimination of the conflict;
- disclosure of the conflict; or
- management of the conflict through the adoption of appropriate policies and procedures.

Various conflicts of interest are discussed throughout this document. Please review this information carefully and contact us if you have any questions.

We follow Prudential Financial's policies on business ethics, personal securities trading by investment personnel, and information barriers. We have adopted a code of ethics (see Item 11), allocation policies and conflicts of interest policies, among others, and have adopted supervisory procedures to monitor

compliance with our policies. We cannot guarantee, however, that our policies and procedures will detect and prevent, or assure disclosure of, each and every situation in which a conflict may arise.

## Item 9—Disciplinary Information

Under Item 9, we are required to disclose all material facts regarding any legal or disciplinary events that would be material to an evaluation of us or the integrity of our management. There have been no material legal or disciplinary events related to Prudential Fixed Income that are required to be disclosed pursuant to Item 9.

## Item 10—Other Financial Industry Activities and Affiliations

### Our Staff's Broker-Dealer Activities

Certain of our management persons and other employees are registered representatives of Prudential Investment Management Services LLC (PIMS), an affiliated SEC-registered broker-dealer.

### Our Commodity Trading Activities

PIM is registered as a commodity trading advisor, and certain of our management persons are our associated persons when we act in that capacity.

### Our Relationships with Affiliates

As an indirect wholly-owned subsidiary of Prudential Financial, we are part of a diversified, global financial services organization. We are affiliated with many types of U.S. and non-U.S. financial service providers, including insurance companies, broker-dealers and other investment advisers. Some of our employees are officers of some of these affiliates.

- *Relationships with Affiliated Broker-Dealers*

PIMS provides marketing and administrative support in connection with the offer and sale of securities of certain commingled vehicles that we advise or subadvise. As noted above, some of our management persons and other employees are registered representatives of PIMS.

- *Relationships with Affiliated Investment Vehicles*

*Insurance Company Separate Accounts.* We are the investment manager of the separate accounts of certain of our insurance company affiliates, including PICA, Prudential Retirement Insurance and Annuity Company (PRIAC) and Prudential Annuities Life Assurance Corporation (PALAC).

*Mutual Funds.* We serve as subadviser and may provide certain ancillary services to mutual funds managed or co-managed by our affiliate Prudential Investments LLC (Prudential Investments). These include certain funds in the Prudential Investments family of funds, the Prudential Series Fund and the Advanced Series Trust.

*Collective and Commingled Trust Funds.* Our affiliate Prudential Trust Company (Pru Trust), a trust company organized under the Pennsylvania Banking Code, is the trustee of the Prudential Trust Company Collective Trust and the Prudential Trust Company Master Commingled Investment Fund for Tax Exempt Trusts, as well as certain other Pru Trust trust assets. We provide investment advice and certain ancillary services to Pru Trust with respect to some of these accounts, and certain of our employees are officers and directors of Pru Trust.

### Hedge Funds and Other Private Funds.

- *Master-Feeder Funds.* We are the investment manager of three master-feeder hedge fund structures: the Pru Alpha funds, the Prudential Fixed Income Emerging Markets Long Short funds and the Prudential Fixed Income U.S. Relative Value funds. These structures have master funds that are domiciled in the Cayman Islands and both U.S. and non-U.S. feeder funds. Each feeder fund invests all or substantially all of its assets in a master fund. All of the directors of the funds that are organized as corporations are employees of PIM. Subsidiaries of PIM serve as the general partner of the funds that are organized as limited partnerships. In addition, one of our affiliates has invested in each of these funds.
- *Irish Qualifying Investor Funds.* We manage five sub-funds of Pramerica Fixed Income Funds plc (PFIF), an Irish domiciled investment company organized as a qualifying investor fund. All of the directors of PFIF are employees of PIM or an affiliate. In addition, an affiliate has invested in certain of the sub-funds.
- *Side Letters.* With respect to the hedge funds and other private funds listed above and that we may manage in the future, we or the funds may at times enter into side agreements with investors (including affiliated investors) that grant such investors terms and conditions that are more advantageous than other investors. For example, investors may have side letters granting more favorable redemption rights, reduced fees or expenses, or access to more frequent or detailed information regarding the fund's investments.

*Other Affiliated Foreign Funds.* We act as investment adviser to certain funds domiciled in Italy that are sponsored and organized by UBI Pramerica SGR S.p.A., a joint venture owned, in part, by our affiliate Prudential International Investments Corporation. We also act as subadviser to certain funds of UBI SICAV, which is domiciled in Luxembourg, through our affiliate Prudential International Investment Advisers, LLC. In addition, we act as investment subadviser to certain funds domiciled in Japan that are sponsored and organized by our affiliate Prudential Investment Management Japan Co., Ltd. Finally, we act as investment adviser to certain sub-funds of Worldwide Investors Portfolio, an investment company domiciled in Luxembourg for which Prudential Investments serves as manager.

*Collateralized Loan Obligations.* Certain of our affiliates hold equity and/or debt interests in the CLOs for which we serve as collateral manager. These CLOs may be considered affiliates of ours due to these investments. In addition, our affiliate, PIM Warehouse, Inc., may temporarily finance all or a portion of the assets purchased for CLO vehicles until the CLO bonds are issued. These assets may change in value from the time of purchase to the time of issuance of the CLO bonds. Any increase or decrease in the value of the assets may impact the value of the CLO bonds at the time of issuance.

Some of the insurance company separate accounts and mutual funds described above are investment options under Prudential Financial's 401(k) plan. In addition, employees that are eligible to participate in Prudential Financial's deferred compensation plan can choose to have all or a portion of their deferred amounts generate a return equal to the return of certain of the separate accounts or mutual funds described above.

- *Relationships with Affiliated Investment Advisers*
  - *General.* In addition to Prudential Investments which is described above, other affiliated investment advisers include Quantitative Management Associates LLC, Jennison, PICA, Pramerica Investment Management Limited (PIML), Prudential Investment Management Japan Co., Ltd., Pramerica Fixed Income (Asia) Limited (PFIA), Pru Trust, Prudential

International Investment Advisers, LLC and Global Portfolio Strategies, Inc. We provide subadvisory services with respect to certain accounts managed by these affiliates and certain of these affiliates provide subadvisory services with respect to accounts managed by us. We also have service agreements with some of these affiliates under which we or they may perform services.

- *PIML.* Members of some of our investment teams and certain sales/marketing personnel are employees of an affiliate that have been seconded to PIML. These personnel are located in London, England.
- *PFIA.* Members of our emerging markets team and certain client service/marketing and administrative personnel are employees of PFIA, an affiliate located in Singapore.
- *Relationships with Affiliated Insurance Companies*

We provide advisory services with respect to the general accounts of some of our affiliated insurance companies, including PICA (and certain of its subsidiaries), PRIAC and PALAC in the U.S.; and Gibraltar Life Insurance Co., Ltd. (and certain of its subsidiaries) in Japan. In addition, we provide subadvisory services with respect to accounts managed by PICA. We also provide advisory services with respect to the insurance company separate accounts described above. The PICA general account constitutes a material portion of our assets under management.

Because of the substantial size of PICA's general account, trading by PICA's general account, including our trades on behalf of the account, may affect market prices. Although we don't expect that PICA's general account will execute transactions that will move a market frequently, and generally only in response to unusual market or issuer events, the execution of these transactions could have an adverse effect on transactions for or positions held by other clients.

- *Affiliate Relationships with Limited Partnerships*

As described above, we serve as the investment manager of certain commingled investment vehicles, including limited partnerships, for which our affiliates serve as general partner.

- *Relationships with Affiliated Banks*

We provide investment advisory services to Prudential Bank and Trust, FSB, a federal savings bank with limited operations.

#### **Recommendation of Investment Advisers**

From time to time, we may refer a client to one of our affiliated investment advisers. The sales representative that makes such a referral may be entitled to receive compensation for such a referral pursuant to a cross-selling program and solicitation agreement applicable to certain of the U.S. investment management units of Prudential Financial.

#### **Conflicts Related to Affiliations**

- *Conflicts Arising Out of Legal Restrictions.* We may be restricted by law, regulation or contract as to how much, if any, of a particular security we may purchase or sell on behalf of a client, and as to the timing of such purchase or sale. These restrictions may apply as a result of our relationship with Prudential Financial and its other affiliates. For example, our holdings of a security on behalf of our clients may, under some SEC rules, be aggregated with the holdings of that security by other Prudential Financial affiliates. These holdings could, on an aggregate basis, exceed certain reporting thresholds unless we monitor and restrict purchases. In addition, we could receive material, non-public information with respect to a particular issuer and, as a result, be unable to execute transactions in securities of that issuer for our clients. For example, our bank loan team often invests in private bank loans in connection with which the borrower provides material, non-

public information, resulting in restrictions on trading securities issued by those borrowers. We have procedures in place to carefully consider whether to intentionally accept material, non-public information with respect to certain issuers. We are generally able to avoid receiving material, non-public information from our affiliates and other units within PIM by maintaining information barriers as described below in Item 11. In some instances, we may create an isolated information barrier around a small number of our employees so that material, non-public information received by such employees is not attributed to the rest of Prudential Fixed Income.

- **Conflicts Related to Outside Business Activity.**
  - From time to time, certain of our employees or officers may engage in outside business activity, including outside directorships. Any outside business activity is subject to prior approval pursuant to our personal conflicts of interest and outside business activities policy. Actual and potential conflicts of interest are analyzed during such approval process. We could be restricted in trading the securities of certain issuers in client portfolios in the unlikely event that an employee or officer, as a result of outside business activity, obtains material, nonpublic information regarding an issuer.
  - The head of Prudential Fixed Income serves on the board of directors of the operator of an electronic trading platform. We have adopted procedures to address the conflict relating to our trading on this platform. The procedures include independent monitoring by our chief investment officer and chief compliance officer and reporting on our use of this platform to the President of PIM.
- ***Conflicts Related to Investment of Client Assets in Affiliated Funds.*** We may invest client assets in funds that we manage or subadvise for an affiliate. We may also invest cash collateral from securities lending transactions in these funds. These investments benefit both us and our affiliate. We do not receive a management fee for advising these funds. We are only entitled to reimbursement of our costs and expenses for these services.
- ***Conflicts Related to Co-investment by Affiliates.*** Our affiliates may provide initial funding or otherwise invest in vehicles managed by us. When an affiliate provides "seed capital" or other capital for a fund, it may do so with the intention of redeeming all or part of its interest at a future point in time or when it deems that sufficient additional capital has been invested in that fund.
  - The timing of a redemption by an affiliate could benefit the affiliate. For example, the fund may be more liquid at the time of the affiliate's redemption than it is at times when other investors may wish to withdraw all or part of their interests.
  - In addition, a consequence of any withdrawal of a significant amount, including by our affiliate, is that investors remaining in the fund will bear a proportionately higher share of fund expenses following the redemption.
  - We could also face a conflict if the interests of an affiliated investor in a fund we manage diverge from those of the fund or other investors.

We believe that these conflicts are mitigated by our allocation policies and procedures, our supervisory review of accounts and our procedures with respect to side-by-side management of long only and long-short accounts.

- ***Conflicts Arising Out of Our Industry Activities.*** We and our affiliates have service agreements with various vendors that are also investment consultants. Under these agreements, we or our affiliates compensate the vendors for certain services, including software, market data and technology services. Our clients may also retain these vendors as investment consultants. The existence of these service agreements may provide an incentive for the investment consultants to favor us when they advise their clients. We do not, however, condition our purchase of services

from consultants upon their recommending us to their clients. We will provide you with information about services that we obtain from these consultants upon request.

## Item 11—Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

### Code of Ethics

We maintain a code of ethics as required by applicable SEC rules. Our code of ethics requires employees to conduct business in an honest and forthright manner in accordance with the highest of ethical standards. In addition, the code of ethics requires employees to put client interests ahead of our own and disclose actual and potential meaningful conflicts of interest. The code of ethics incorporates our information barrier and personal securities trading policies that are described in greater detail below. Our employees are required to report any violation of the code of ethics promptly to our chief compliance officer.

We will provide you a copy of our code of ethics upon request.

### Information Barrier Policy

PIM's information barrier policy is designed to prevent the communication of material, non-public information across the various Prudential U.S. asset management investment sectors. Under the policy, an employee of one investment sector, including Prudential Fixed Income, may not communicate material, non-public information to an employee of another investment sector without approval from each sector's compliance unit. The information barrier policy also restricts physical access to an investment sector's offices by employees of a different investment sector.

We maintain a restricted list of issuers about which we have material, non-public information. The restricted list is contained in an electronic database that can be viewed only by specified associates who have been granted access. The database is updated intra-day as changes are required. Restricted issuers are also added directly into the trading system so that our trading activities are screened on a pre-trade basis against our restricted list. Investment personnel must receive an override from our compliance unit prior to transacting for client accounts in the securities of any issuers that are restricted in the trading system.

### Personal Securities Trading Policy

We maintain a personal securities trading policy that governs the trading activities of our employees as well as their household members and dependents. Subject to certain limited exceptions, employees are required by the policy to:

- report personal securities transactions to our corporate compliance unit;
- pre-clear personal securities transactions (for employees considered to be "access persons" under SEC rules);
- maintain brokerage accounts only with certain approved brokers that report transaction information to our corporate compliance unit; and
- annually report securities holdings to our corporate compliance unit.

Our access persons and investment personnel are subject to additional restrictions under the policy, including the following:

- investment personnel are generally prohibited from purchasing securities in initial public offerings;



- access persons may not trade any security on the same day that we trade such security (or an equivalent security) for client accounts (other than in client accounts that replicate a broad-based index);
- investment personnel are prohibited from trading any security within seven days before or after we trade such security (or an equivalent security) for client accounts (other than in client accounts that replicate a broad-based index);
- Investment personnel who invest in proprietary and certain non-proprietary mutual funds must hold such investments for a period of at least 60 days;
- investment personnel must disgorge any profits from the purchase and sale (in whatever order) of the same security within 60 days; and
- access persons may not write naked call options or buy naked put options on a security held in a client account.

We monitor personal trading activity versus firm trading and restricted list content, and any matches are investigated by our compliance unit. An ethics committee meets regularly to consider possible violations and take disciplinary action where appropriate.

All employees receive annual training regarding our personal securities trading and information barrier policies. In addition, employees must annually confirm that they have read and understand our code of ethics, including the personal securities trading and information barrier policies.

### **Compensation of Our Investment Professionals**

#### *General*

An investment professional's base salary is based on market data relative to similar positions as well as the past performance, years of experience and scope of responsibility of the individual. Incentive compensation, including the annual cash bonus, the long-term equity grant and grants under our long-term incentive plan, is primarily based on such person's contribution to our goal of providing investment performance to clients consistent with portfolio objectives, guidelines and risk parameters and market-based data such as compensation trends and levels of overall compensation for similar positions in the asset management industry. In addition, an investment professional's qualitative contributions to the organization are considered in determining incentive compensation. Incentive compensation is not solely based on the performance of, or value of assets in, any single account or group of client accounts.

#### *Cash Bonus*

An investment professional's annual cash bonus is paid from an annual incentive pool. The pool is developed as a percentage of our operating income and is refined by business metrics, such as:

- business development initiatives, measured primarily by growth in operating income;
- the number of investment professionals receiving a bonus; and
- investment performance of portfolios relative to appropriate peer groups or market benchmarks.

#### *Long-Term Compensation*

Long-term compensation consists of Prudential Financial restricted stock and grants under our long-term incentive plan. Grants under our long-term incentive plan are participation interests in notional accounts with a beginning value of a specified dollar amount. The value attributed to these notional accounts increases or decreases over a defined period of time based, in part, on the performance of investment composites representing a number of our most frequently marketed investment strategies. An investment composite is an aggregation of accounts with similar investment strategies. Our long-term incentive plan

is designed to more closely align compensation with investment performance and the growth of our business. Both the restricted stock and participation interests are subject to vesting requirements.

#### *Conflicts Related to Long-Term Compensation*

The performance of many client accounts is not reflected in the calculation of changes in the value of participation interests under our long-term incentive plan. This may be because the composite representing the strategy in which the account is managed is not one of the composites included in the calculation or because the account is excluded from a specified composite due to guideline restrictions or other factors. As a result of the long-term incentive plan, our portfolio managers from time to time have financial interests related to the investment performance of some, but not all, of the accounts they manage. To address potential conflicts related to these financial interests, we have procedures, including trade allocation and supervisory review procedures, designed to ensure that each of our client accounts is managed in a manner that is consistent with our fiduciary obligations, as well as with the account's investment objectives, investment strategies and restrictions. For example, our chief investment officer reviews performance among similarly managed accounts with the head of Prudential Fixed Income on a quarterly basis.

#### **Conflicts Related to Financial Interests**

- **Conflicts Related to the Offer and Sale of Securities**

Certain of our employees may offer and sell securities of, and units in, commingled funds that we manage. Employees may offer and sell securities in connection with their roles as registered representatives of PIMS, officers of Pru Trust, agents of PICA or the role of an affiliate as general partner of investment partnerships. (See Item 10 for more information about these affiliations). There is an incentive for our employees to offer these securities to investors regardless of whether the investment is appropriate for such investor since increased assets in these vehicles will result in increased advisory fees to us. In addition, such sales could result in increased compensation to the employee. (See "Other Compensation" in Item 5).

- **Conflicts Related to Securities Holdings and Other Financial Interests.**

- *Securities Holdings.* Prudential Financial, PICA's general account, our proprietary accounts and accounts of other affiliates of ours (collectively, affiliated accounts) hold public and private debt and equity securities of a large number of issuers and may invest in some of the same companies as other client accounts but at different levels in the capital structure. These investments can result in conflicts between the interests of the affiliated accounts and the interests of our clients. For example:
  - Affiliated accounts can hold the senior debt of an issuer whose subordinated debt is held by our clients or hold secured debt of an issuer whose public unsecured debt is held in client accounts. In the event of restructuring or insolvency, the affiliated accounts as holders of senior debt may exercise remedies and take other actions that are not in the interest of, or are adverse to, other clients that are the holders of junior debt.
  - To the extent permitted by applicable law, we may also invest client assets in offerings of securities the proceeds of which are used to repay debt obligations held in affiliated accounts or other client accounts. Our interest in having the debt repaid creates a conflict of interest. We have adopted a refinancing policy to address this conflict.



We may be unable to invest client assets in the securities of certain issuers as a result of the investments described above.

- *Financial Interests.* We and our affiliates may also have financial interests or relationships with issuers whose securities we invest in for client accounts. These interests can include debt or equity financing, strategic corporate relationships or investments, and the offering of investment advice in various forms. For example, we may invest client assets in the securities of issuers that are also our advisory clients. In addition, we may invest client assets in securities backed by commercial mortgage loans that were originated or are serviced by an affiliate.

In general, conflicts related to the securities holdings and financial interests described above are addressed by the fact that we make investment decisions for each client independently considering the best economic interests of such client.

#### Conflicts Related to Our Trading

- *Personal Trading by Our Employees.* Personal trading by our employees creates a conflict when they are trading the same securities or types of securities as we trade on behalf of our clients. This conflict is mitigated by our personal trading policy and procedures described above.
- *Side-by-Side Management of Accounts.* See Item 6 for a description of conflicts of interest related to our side-by-side management of accounts.

## Item 12—Brokerage Practices

### Factors Used in Selecting or Recommending Broker-Dealers

#### Approved Counterparties

Transactions for client accounts must be made through approved counterparties. Counterparties are approved by our credit research group based on the same criteria used in our issuer credit analysis process. Criteria for approval include:

- profitability
- liquidity
- capital
- financial metrics
- economic factors
- size
- market presence

Our approval process considers both transactional risk and counterparty creditworthiness, with transaction approval divided into four ascending risk classes:

- Class A: U.S. delivery versus payment transactions;
- Class B: Securities lending and repurchase transactions;
- Class C: Nonstandard settling transactions and delivery versus payment trades with non-US counterparties; and

- Class D: Over-the-counter (OTC) derivatives transactions.

We approve counterparties for one or more of the transaction categories listed above. The classes are further broken down into tiers based on the credit quality of the counterparty. We set maximum dollar exposure limits for each counterparty approved for transactions in classes B and C. These dollar limits are determined based on the credit quality of the counterparty with consideration given to the counterparty's market presence. In addition, our risk management team monitors counterparty exposure in each third party account. If the exposure to any counterparty exceeds certain pre-established thresholds, the risk management team initiates a discussion with the applicable portfolio manager.

Our counterparty committee, which generally meets quarterly, is responsible for general oversight of the counterparty approval process. This committee reviews and monitors counterparty usage data, patterns (if any) relating to counterparty use, and other information relevant to our counterparty selection process. If any of the limits in the counterparty policy are exceeded, employees must escalate the matter to the counterparty committee.

#### **Execution of Trades**

We seek to execute transactions in client accounts at the most favorable total price reasonably attainable in the circumstances. Factors we may consider in selecting an approved counterparty to execute a particular transaction include:

- the nature of the portfolio transaction;
- the size of the transaction;
- the desired timing of the trade;
- the activity existing and expected in the market for the particular transaction;
- broker confidentiality (the broker not revealing details about our trades or trading patterns to other brokers or market participants);
- the availability of research and research related services provided through such counterparty (as discussed below); and
- administrative cooperation.

Given these factors, it is possible that our clients may pay transaction costs in excess of that which another firm might have incurred for executing the same transaction.

We manage foreign currency (FX) transactions through our approved counterparties or our clients' custodians. We will execute FX transactions through client custodians when directed by a client or when local market rules or settlement practices indicate this to be a more efficient method for settling our trade orders. Our portfolio managers monitor all FX transactions to review for best price and execution while considering factors such as available market quotations, liquidity, capability of our counterparties or local rules and practices.

#### **Soft Dollars and Research Services**

Currently, we do not enter into any third party or proprietary soft dollar arrangements where a broker-dealer provides research services in exchange for an expectation of receiving a certain dollar amount of commissions.

We receive a broad range of research from broker-dealers, including information on the economy, industries, groups of securities and individual companies, statistical information, market data, accounting and tax law interpretations, information regarding political developments, pricing and appraisal services, credit analysis, risk measurement analysis, performance analysis and other information regarding matters

that may affect the economy and/or security prices. We may receive research services in the form of written reports, periodicals, investment seminars, software, and electronic access to, and telephone contacts and personal meetings with, security analysts, economists, government representatives, and corporate and industry spokespersons. It also may consist of computer databases.

We use these research services in connection with our investment activities. Services obtained in connection with the execution of transactions for one client account may be used in managing other accounts, including accounts managed by PIM business units other than Prudential Fixed Income and the accounts of PICA and other affiliates.

Certain broker-dealers may also provide us with computer hardware and/or software as well as dedicated phone lines to be used to communicate trades.

We do not believe that the provision to us by broker-dealers of the research or other items and services described above results in higher transaction costs.

### Brokerage for Client Referrals

In selecting or recommending broker-dealers, we do not consider whether we or any of our related persons receive referrals from such broker-dealers or any other third parties.

We may from time to time retain broker-dealers as solicitors with respect to our advisory services or placement agents with respect to funds we manage. In addition, we or funds that we manage may participate in broker-dealer capital introduction programs.

### Directed Brokerage

We do not recommend, request or require that clients direct us to execute transactions through a specified broker-dealer.

We do permit clients to direct the use of a particular broker-dealer or futures commission merchant for their account. Any such direction must be in writing or evidenced in our clients' contracts with futures commission merchants or swap counterparties. If a client directs brokerage:

- The client may pay higher prices, depending on its arrangements with the broker-dealer or futures commission merchant and upon other factors such as trading volume, the market for the security, and market-making capabilities of that particular broker-dealer or futures commission merchant;
- The client may lose the possible advantage which non-directing clients derive from the aggregation of orders for multiple clients as a single "batch" transaction, where we would, in some instances, be in a better position to negotiate pricing if the brokerage were not directed; and
- The client would be responsible for monitoring the creditworthiness of the brokers or futures commission merchants it has selected.

ERISA accounts may be subject to additional requirements and restrictions with respect to directed brokerage.

You should evaluate the relative costs, advantages and disadvantages of directed brokerage when considering whether or not to direct us to use one or more specific brokers.

### Trade Aggregation and Allocation

Our policy with respect to trade aggregation and allocation is to treat all client accounts fairly and equitably over time.

Subject to the exception noted below, we aggregate and allocate all new issue orders among accounts with an appetite for the particular trade. While not required, we often aggregate secondary transactions. However, in many other cases, we may execute trades to meet the specific needs of a single account.

As stated above, our trade aggregation and allocation policy provides for the fair and equitable allocation of trading opportunities over time. However, a specific trade, when viewed in isolation, may have the effect of benefiting one account over another.

In determining individual account appetite, we may be influenced by numerous factors including:

- an account's cash or liquid asset availability;
- the benchmark weight of the security;
- maturity, quality, duration, or risk contribution represented by the security;
- existing holdings of each account;
- specific account and mandate objectives, guidelines and constraints;
- liquidity requirements;
- de minimis allocation considerations based on criteria such as round lot provisions, minimum percentage of NAV or minimum transaction size; or
- any other portfolio construction considerations.

In addition, preference may be given to accounts whose investment guidelines limit their universe of available securities.

Our aggregation and allocation policy exempts transactions in securities that are deemed to be both liquid and fungible. Examples of such securities are: eligible securities as defined by Rule 2a-7 under the Investment Company Act of 1940; U.S. government securities, including agencies and agency mortgage-backed securities; non-U.S. government securities issued in their native currency that we consider to be investment grade; exchange-traded futures and options; index credit default swaps; interest rate swaps; and foreign currency instruments.

Our general policy is that all aggregated orders will be allocated at the time of the transaction, or as soon as possible thereafter, on a basis equal to each account's appetite for the issue, including affiliated accounts. Order allocation is not based upon account performance, fee structure, or any proprietary interest that we or our affiliates may have in an account.

If less than an entire aggregated order is executed, each account may be cut back based on one of a number of methodologies approved by our compliance group and senior management, such as pro rata based on original order or position or duration weight relative to benchmark. In determining final allocations, we may also consider the factors described above with respect to the determination of individual account appetite.

Deviations from our aggregation and allocation policy must be approved in advance by a supervisor, and our compliance unit or law department must subsequently approve. Supervisors or their delegates review allocations for compliance with the policy.

#### **Aggregation/Allocation of Futures**

We seek to enter a single futures order for multiple client accounts that have appetite for the same instrument. This is commonly referred to as a "block order." Block orders may result in "split fills" (an execution of a block order at more than one price) or "partial fills" (an execution of a block order at less than specified quantities). We allocate block orders and any resulting split and/or partial fills in a non-preferential, predetermined and objective manner.

## Trade Error Policy

We maintain a trade and operational errors policy that is designed to ensure that corrections of trading and operational errors are processed promptly and in a manner that is fair and reasonable. To avoid potential errors, our policy provides that trades may, where appropriate, be cancelled or modified prior to settlement. If we cancel or modify a trade, we must be able to document that the trading counterparty will not suffer any loss. For daily valued accounts, we must also be able to document that such cancellation or modification will not change any net asset value of the account that is struck between the commission of the error and the date of cancellation. In addition, our policy provides that a trading error in one client's account involving a violation of law or of the account's investment guidelines may be corrected through a reallocation or other transfer of securities to another account, subject to certain conditions. These conditions are that the reallocation or other transfer must represent an appropriate investment decision on behalf of each account involved, and that the reallocation or other transfer is effected without loss to the transferee account.

Under our policy, an associate who becomes aware of errors or potential errors must bring the circumstances to the attention of a compliance officer promptly. The compliance officer will then contact appropriate supervisors to determine and document the corrective action.

## Item 13—Review of Accounts

### Periodic Review of Client Accounts

We hold various meetings at which we review client accounts, including:

- *Quarterly Strategy Reviews.* Each quarter, our chief investment officer meets with the senior portfolio manager and team responsible for the management of each of our investment strategies. At this meeting, the chief investment officer and strategy teams review and discuss the investment performance and performance attribution for each client account managed in the applicable strategy.
- *Quarterly Senior Management Investment Review.* Each quarter, our chief investment officer reviews the investment performance and performance attribution of each of our accounts and strategies with the head of Prudential Fixed Income. The heads of our distribution, credit, compliance and risk groups also typically attend this meeting.

### Risk Management Reviews

Our risk management team also conducts the following periodic reviews:

- *Daily Risk Reporting and Review.* On a daily basis, our risk management team reviews and monitors risk reports which indicate where active risk is taken relative to a portfolio's risk budget. A member of the risk management team will discuss potential risk issues with the portfolio managers of the applicable account.
- *Weekly Review.* Our chief risk officer conducts weekly meetings with our risk management team to discuss current risk positioning in client portfolios. At this meeting, our risk management team also discusses potential risk issues highlighted in the daily risk reporting process. When appropriate, issues are escalated by bringing them to the attention of our chief investment officer or, ultimately, to the head of Prudential Fixed Income.

### Commingled Account Reviews

We serve as subadviser to commingled accounts such as mutual funds, collective investment trusts and other pooled investment vehicles. For these subadvised accounts, we are also subject to the oversight of

the investment manager for the account and the governing body of the vehicle (such as the board of directors, trustee or investment committee of the vehicle).

#### **Additional Ongoing Review of Accounts**

Control functions such as our compliance team also monitor and assess data and processes relating to our management and trading. They report results of these analyses independently to our senior management. Some examples of these independent reviews include:

- pre-trade compliance review of proposed transactions to monitor consistency with guideline restrictions (for absolute restriction-based rules such as prohibited securities or counterparties);
- post-trade compliance review, including manual review of calculation-based guidelines such as percentage limitations;
- periodic review of trading to examine allocation and trade errors; and
- periodic review by oversight committees of various investment and trading activities, including reviews by our:
  - trade management oversight committee;
  - pricing and liquidity committee;
  - risk operating committee; and
  - counterparty committee

#### **Reports to Clients**

We provide written reports regularly to all of our clients. In most cases we distribute these reports monthly, but may provide certain reports quarterly or annually. Our reports generally include:

- a list of all activity in the account during the applicable period;
- a list of positions;
- the market value of the positions in the account;
- a calculation of the account's return and the return of the applicable benchmark;
- a comparison of the characteristics of the account (such as industry, sector, issuer, credit quality and country weightings) versus the applicable benchmark; and
- a summary of performance attribution.

In addition, we send our clients a quarterly investment outlook that summarizes our current views regarding the fixed income markets in general.

We may agree with some clients to provide additional information in our reports or to provide some reports more frequently than monthly.

### **Item 14—Client Referrals and Other Compensation**

#### **Other Compensation**

Other than the research and brokerage-related services described in Item 12 under the caption "Soft Dollars and Research Services," we do not receive economic benefits from anyone who is not a client in connection with the advisory services we provide to our clients.

**Client Referrals**

We may, on occasion, have arrangements where we compensate, either directly or indirectly, affiliated and/or unaffiliated solicitors for client referrals. The manner and amount of compensation would typically be negotiated on a case by-case basis. We currently have agreements with certain affiliates and two unaffiliated entities under which we may provide compensation for client referrals. Our agreements with unaffiliated entities provide for the payment to an Australian company of a fixed fee as well as an additional fee based upon a percentage of the management fee we receive from clients introduced by such company, and payment to a United Kingdom company of a percentage of the management fee we receive as a result of our submission of responses to requests for proposals organized by such company. In addition, we will pay cross-selling commissions to marketing representatives of affiliates with respect to certain of our strategies and products pursuant to a cross-selling program and solicitation agreement applicable to certain of the U.S. investment management units of Prudential Financial, as noted in Item 10.

**Item 15—Custody**

We do not take physical custody of the assets of our clients. Client assets are generally held in custodial accounts with banks, broker-dealers or other qualified custodians retained by our clients under arrangements negotiated by them. Although we do not have possession of client assets, when our clients permit us to deduct our management fees directly from their custodial accounts, the SEC nevertheless deems us to have custody over the assets of those clients. There are certain other circumstances under which the SEC may deem us to have custody of client assets as well, such as when a PIM subsidiary serves as a general partner of an investment limited partnership.

Our clients will receive account statements from their custodians no less frequently than quarterly, and should carefully review those statements. Where our fees are deducted from the client's custodial account, the statements will show those deductions, among other information. As described in Item 13 above under "Review of Accounts: Reports to Clients," we also generally provide statements or reports to our clients. Some of the types of information we provide in those statements or reports are comparable to information in the account statements clients receive from their custodians. We urge our clients to compare the account statements they receive from their qualified custodians with those statements that they receive from us.

**Item 16—Investment Discretion**

We typically have the discretionary authority to purchase and sell assets for client accounts. This authority is granted pursuant to a written investment management or similar agreement between the client and PIM.

Our discretionary authority to manage client accounts is in all cases subject to the specific objectives, guidelines and limitations set forth in the applicable investment management agreement. Investment guidelines generally set forth the universe of eligible investments and issuers. Guidelines may also contain one or more of the following types of restrictions or limitations:

- a list of prohibited issuers or types of issuers;
- percentage limitations regarding the investment in certain issuers, groups of issuers or asset classes;
- limitations on the use of derivatives;
- percentage limitations regarding deviation from the holdings of the account's benchmark; and



- specifications regarding the credit quality of purchases for the account.

Certain regulated clients, such as U.S. mutual funds and ERISA accounts, are subject to additional investment, diversification and other limitations imposed by applicable law.

## Item 17—Voting Client Securities

### Proxy Voting

#### In General

We accept the authority to vote securities held in our clients' accounts when our clients wish to provide us with this authority. Our investment management agreements with our clients will generally specify whether or not we have the authority to vote proxies on their behalf. We do not receive a significant number of proxies since we primarily invest client assets in public debt securities.

#### Our Proxy Voting Policy and Procedures

Our policy is to vote proxies in the best economic interest of our clients. In the case of pooled accounts, our policy is to vote proxies in the best economic interest of the pooled account.

Our proxy voting policy contains detailed voting guidelines on a wide variety of issues commonly voted upon by shareholders. These guidelines reflect our judgment of how to further the best economic interest of our clients through the shareholder or debt-holder voting process. We generally vote with management on routine matters such as the appointment of accountants or the election of directors. From time to time, ballot issues arise that are not addressed by our policy or circumstances may suggest a vote not in accordance with our established guidelines. In these cases, voting decisions are made on a case-by-case basis by the applicable portfolio manager taking into consideration the potential economic impact of the proposal. If a security is held in multiple accounts and two or more portfolio managers are not in agreement with respect to a particular vote, our proxy voting committee will determine the vote.

Not all ballots are received by us in advance of voting deadlines, but when ballots are received in a timely fashion, we strive to meet our voting obligations. We cannot, however, guarantee that every proxy will be voted prior to its deadline.

With respect to non-U.S. holdings, we take into account additional restrictions in some countries that might impair our ability to trade those securities or have other potentially adverse economic consequences. We generally vote non-U.S. securities on a best efforts basis if we determine that voting is in the best economic interest of our clients. For non-U.S. holdings, we will generally vote in favor of the recommendations of management if such management has demonstrated a shareholder orientation (which vote may be contrary to our specific guidelines).

#### Client Direction of Voting

We will use our best efforts to implement any written client voting instructions with respect to a specific solicitation.

#### Conflicts of Interest in the Voting Process

Occasionally, a conflict of interest may arise in connection with proxy voting. For example, the issuer of the securities being voted may also be a client of ours. When we identify an actual or potential conflict of interest between our firm and our clients with respect to proxy voting, the matter is presented to senior management who will resolve such issue in consultation with the compliance and legal departments.



### Accounts for Which We Do Not Vote Securities

Some of our clients elect to retain voting authority for themselves. If a client has a question about a particular solicitation, the client may contact its client service representative and we will try to address the client's question. We will not, however, disclose how we intend to vote on an issue for other clients' accounts.

### How to Obtain Information Regarding Proxy Voting

Any client may obtain a copy of our proxy voting policy, guidelines and procedures, as well as the proxy voting records for that client's securities, by contacting the client service representative responsible for the client's account.

### Securities Lending and Proxies

Clients that participate in our securities lending program should be aware that when securities are on loan, they cannot be voted by us. Under certain circumstances, we may not recall loaned securities in order to vote, including if:

- we deem the benefit of exercising the vote to be outweighed by the economic benefit of keeping the securities on loan or the administrative burden of calling them back;
- it is impracticable to obtain the return of the securities from the borrower in time to vote; or
- we are not aware of a pending vote.

### Other Actions with Respect to Securities in Client Accounts

#### Corporate Actions and Class Actions

In addition to voting rights with respect to securities held in our clients' portfolios, there may be other rights associated with those securities, including the right or opportunity to participate in corporate actions and class actions.

With respect to corporate actions (such as an issuer's merger, tender offer, reorganization, etc.), we participate on behalf of clients unless instructed otherwise, taking such action as we deem to be in the best economic interest of the clients' accounts.

Where we have agreed to handle proof of claim filings for a client, we will generally seek and use our best efforts to file such notices in all class action lawsuits in which the client is eligible to participate. In so doing, we will not inquire into the particular circumstances of any client. As a result, we will not seek to determine on an individual basis whether facts and circumstances relevant to that client would suggest that non-participation in the class action is appropriate or more advantageous to that client. For example, a client on whose behalf a proof of claim is filed may, as a result of having joined the class, waive or relinquish other claims that it may have against the target of the class action. The client may also have an interest or position with respect to the nature of the class action claim that is adverse to that of the class of plaintiffs. We would generally not be aware of those circumstances. Had the client elected to handle class action lawsuits for itself, it might have determined not to file the proof of claim in such a class action. We do not provide any legal advice or services in connection with class actions.

## Item 18—Financial Information

We have no financial commitment that impairs our ability to meet contractual and fiduciary commitments to our clients.

## **Exhibit 1**

March 30, 2012

### **Prudential Fixed Income**

#### **Form ADV Part 2A—Summary of Material Changes**

We are required to update our brochure (Form ADV Part 2A) each year within 90 days of the end of our fiscal year.

The following is a summary of the material changes to our brochure since the annual update dated March 31, 2011:

- We have amended our trade aggregation and allocation policy (See Item 12 of the accompanying brochure for a current summary of this policy);
- We have adopted a new long-term incentive compensation plan (See Item 11 of the accompanying brochure for a summary of this plan); and
- The head of Prudential Fixed Income has accepted a position on the board of directors of the operator of an electronic trading platform.

Please note that this document only discusses those changes from our last brochure that we consider to be material.