

FIXED INCOME DISCOUNT ADVISORY COMPANY

Form ADV Part 2, March 30, 2012

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**Item 1 – Cover Page**

FIXED INCOME DISCOUNT ADVISORY COMPANY

1211 AVENUE OF THE AMERICAS

29<sup>TH</sup> FLOOR

NEW YORK, NY 10036

212-696-0100

[www.fidacadvisors.com](http://www.fidacadvisors.com)

[info@fidacadvisors.com](mailto:info@fidacadvisors.com)

March 30, 2012

This Brochure provides information about the qualifications and business practices of Fixed Income Discount Advisory Company (“FIDAC” or “ADVISER”). If you have any questions about the contents of this Brochure, please contact us at 212-696-0100 and/or [info@fidacadvisors.com](mailto:info@fidacadvisors.com). The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

FIDAC is a registered investment adviser. Registration of an investment adviser does not imply any level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. Additional information about FIDAC is also available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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## **Item 2 – Material Changes**

This Brochure dated March 31, 2012 is an annual update document prepared according to the SEC's new requirements and rules. This is the first annual update after the new format was introduced and the first update since the March 31, 2011 brochure. While there are no material changes to FIDAC's advisory services, the brochure has been drafted to reflect FIDAC's focus on managing pools of assets, no longer managing individual or separately managed accounts.

In the future, this Item 2 will discuss only specific material changes that are made to the Brochure and provide clients with a summary of such changes. We will also reference the date of our last annual update of our Brochure.

Pursuant to SEC rules, we will ensure that you receive a summary of any materials changes to this and subsequent Brochures within 120 days of the close of our business' fiscal year. We may provide other ongoing disclosure information throughout the year about material changes where required.

We will further provide you with a new Brochure as necessary based on changes or new information, at any time, without charge. Currently, our Brochure may be requested by contacting Carol Denahan at 212-696-0100 or [info@fidacadvisors.com](mailto:info@fidacadvisors.com).

Additional information about FIDAC is also available via the SEC's web site [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The SEC's web site also provides information about any persons affiliated with FIDAC who are registered, or are required to be registered, as investment adviser representatives of FIDAC.

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## Item 4 – Advisory Business

### FIRM DESCRIPTION

Formed in 1994, Fixed Income Discount Advisory Company (“FIDAC”) is a SEC registered investment advisor specializing in managing pools of assets using credit and interest rate sensitive investment strategies, including residential and commercial loans and other mortgage backed securities, CDO liquidations and other financial services. FIDAC is a wholly-owned subsidiary of Annaly Capital Management, Inc. (NYSE:NLY), a publicly traded real estate investment trust (REIT).

### SERVICES PROVIDED

FIDAC is a SEC registered investment adviser, managing a very limited client base as described in Item 7. FIDAC manages pools of assets for a fee, focusing on credit and interest rate sensitive investment strategies, including residential and commercial loans and other mortgage backed securities, CDO collateral management and other financial services and real estate management services

FIDAC’s services are limited to investments that utilize its team’s expertise in analyzing opportunities and executing strategies in interest rate and credit-sensitive debt transactions. This expertise extends to both the asset and liability sides of client accounts, as well as collateral management services. FIDAC’s advisory strategy involves the use of U.S. Government and Agency securities (collectively, “U.S. Government Securities”) in conjunction with leverage to capitalize on the creation of opportunities within this market. FIDAC’s strategy also utilizes investments in residential mortgage loans, private label residential mortgage-backed securities, real estate and real estate-related securities, commercial mortgage loans, commercial real estate debt, commercial mortgage backed securities and other debt and asset-backed securities. FIDAC does not generally offer advice on equity securities. Under certain circumstances, FIDAC may use derivatives, interest rate caps and/or swaps in its recommended investment strategy for achieving the client’s investment objectives.

### INVESTMENT MANAGEMENT AGREEMENT (“IMA”)

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FIDAC generally manages assets pursuant to an IMA. Fees and investment guidelines are outlined in the IMA, which the FIDAC and the client sign before services begin. While FIDAC often follows its own defined strategies, clients are permitted to impose restrictions on investing in certain securities or types of securities, which must be detailed in writing.

FIDAC is not permitted to assign an IMA without client consent. The client or FIDAC are generally permitted to terminate an IMA at-will upon thirty to sixty days written notice. Fees will be charged through the date service is terminated.

As of December 31, 2011, FIDAC calculates approximately \$112,128,022,287<sup>1</sup> in assets for six clients. Of this:

\$ 13,349,584,586 is managed on a discretionary basis.

\$ 98,778,437,701 are owned by Annaly.

### **Item 5 – Fees and Compensation**

#### **FEE SCHEDULE**

All fees are subject to negotiation.

The specific manner in which fees are charged by FIDAC is established in a client's written agreement with FIDAC. FIDAC generally bills its fees on a quarterly basis, but certain clients may elect to be billed in advance or arrears each calendar quarter. Clients may also elect to be billed directly for fees or to authorize FIDAC to directly debit fees from client accounts. Fees may be prorated for each capital contribution and withdrawal made during the applicable calendar quarter (with the exception of de minimis contributions and withdrawals). Accounts initiated or terminated during a calendar quarter will be charged a prorated fee.

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<sup>1</sup> This total includes assets owned by Annaly Capital Management, Inc. ("Annaly"), which are not managed by FIDAC, but have historically been included in the total AUM, under direction of its primary regulator.

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Upon termination of any account, any prepaid, unearned fees will be promptly refunded, and any earned, unpaid fees will be due and payable. The client has the right to terminate an agreement without penalty within five business days after entering into the agreement.

FIDAC's fees are exclusive of brokerage commissions, transaction fees, and other management related costs and expenses which shall be incurred by the client. Clients may incur certain charges imposed by custodians, brokers, third party investment and other third parties such as fees charged by managers, custodial fees, deferred sales charges, odd-lot differentials, transfer taxes, wire transfer and electronic fund fees, and other fees and taxes on brokerage accounts and securities transactions. Such charges, fees and commissions are exclusive of and in addition to FIDAC's fee, and FIDAC shall not receive any portion of these commissions, fees, and costs.

FIDAC has an affiliated broker-dealer, RCap Securities, Inc. ("RCap"). While FIDAC generally does not engage in any securities transactions with RCap, FIDAC does reserve the right to use RCap to perform administrative services or engage in transactions for FIDAC clients. Any contemplated transaction may incur fees which will be assessed in compliance with any applicable rules and regulations. Certain transactions between FIDAC clients and RCap may require written client permission from clients prior to settlement of the transaction.

Clients are permitted to engage in any recommended transaction with the broker of their choosing, including brokers or agents that are not affiliated with FIDAC.

#### **Item 6 – Performance-Based Fees and Side-By-Side Management**

FIDAC does not currently charge any performance-based fees (fees based on a share of capital gains on or capital appreciation of the assets of a client). FIDAC has in the past and does reserve the right to charge performance-based fees in the future if warranted and FIDAC will structure any performance or incentive fee arrangement subject to Section 205(a)(1) of the Investment Advisors Act of 1940 (The Advisors Act) in accordance with the available exemptions thereunder, including the exemption set forth in Rule 205-3. When measuring clients' assets for the calculation of performance-based fees, FIDAC may include realized and unrealized capital gains and losses. Performance based fee

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arrangements may create an incentive for FIDAC to recommend investments which may be riskier or more speculative than those which would be recommended under a different fee arrangement. Such fee arrangements also create an incentive to favor higher fee paying accounts over other accounts in the allocation of investment opportunities. FIDAC has procedures designed and implemented to ensure that all clients are treated fairly and equally, and to prevent this conflict from influencing the allocation of investment opportunities among clients.

### **Item 7 – Types of Clients**

FIDAC provides portfolio management services to a small number of clients comprised of pooled investment vehicles. FIDAC is the external manager for two publicly traded REIT's, Chimera Investment Corporation (Chimera) (NYSE:CIM) and CreXus Investment Corp. (CreXus) (NYSE:CXS). FIDAC also advises private funds, including an appointment as sub-adviser to an offshore private liquidity fund which is administered and sold by third parties. FIDAC also acts as collateral manager to two private fund CDO's. FIDAC does not manage accounts for individuals.

### **CONDITIONS FOR MANAGING ACCOUNTS**

FIDAC doesn't seek out traditional advisory clients; rather it manages pools of assets that are publicly traded or privately issued and sold and administered by others. As such, FIDAC doesn't have established account minimums.

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

#### **INVESTMENT STRATEGIES**

Most FIDAC clients provide their own risk disclosures and other informational documents to their investors directly specific to their investments in the pools. FIDAC's objective is to provide attractive risk-adjusted returns to our clients' pools over the long-term, primarily through interest income and secondarily through capital appreciation. We intend to achieve this objective by investing in a diversified investment portfolio of RMBS, residential mortgage loans, real estate-related securities and various other asset classes. Depending on

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specific account guidelines, the RMBS, ABS, CMBS, collateralized debt obligations and other asset classes we purchase may include investment-grade and non-investment grade classes, including the BB-rated, B-rated and non-rated classes.

FIDAC makes investment decisions based on various factors, including expected cash yield, relative value, risk-adjusted returns, current and projected credit fundamentals, current and projected macroeconomic considerations, current and projected supply and demand, credit and market risk concentration limits, liquidity, cost of financing and financing availability, as well as maintaining the stated account or fund guidelines. Over time, we will modify our investment allocation strategy as market conditions change to maximize the returns for an investment portfolio. We believe this strategy, combined with our experience, will enable us to create interest income and achieve capital appreciation throughout changing interest rate and credit cycles and provide attractive long-term returns to investors.

### SOURCES OF INFORMATION

FIDAC reviews available information relating to an investment, including prospectuses, term sheets, trading history and public research and commentaries. FIDAC also obtains information from and relies on government generated and private sector reports on economic and government activity. FIDAC also utilizes contacts in the professional investment community to gather information relevant to investment advisory activities.

### METHODS OF ANALYSIS

The FIDAC investment process is designed in such a way that allows the investment team to be flexible and responsive to changes in the markets. We rely on our expertise in identifying assets within our target asset classes and, over time, we will modify our investment allocation strategy as market conditions change to seek to maximize the returns for an investment portfolio. The investment team will only acquire those assets that it believes it has the necessary expertise to evaluate and manage and which are consistent with the investment guidelines and risk management objectives. In general, among the asset choices available to the investment team, the team will acquire those assets which it believes will generate the highest returns on capital invested, after considering:



- The stated objective and limitations of the client or investment fund;
- The amount and nature of the anticipated cash flows from the asset;
- Current and projected credit fundamentals
- Current and projected macroeconomic considerations
- The ability to pledge the asset to secure collateralized borrowings; and
- The cost of financing, hedging, and the general management of the asset.

A decision to sell generally begins with a recommendation from an investment team member. A discussion among team members would take place with the goal of reaching consensus on the best course of action. The FIDAC investment team monitors and evaluates holdings on a daily basis and will consider a sale under any of the following circumstances:

- Change in credit opinion or market valuation
- Increased loss or default assumptions
- Operating results/financial condition
- Change in collateral performance
- Change in credit quality ratings by NRSRO's
- Shift in market supply/demand balance
- Trading rich versus similar available investment opportunities
- Declining in price for no known reason - (difficult subjective call)
- Change in capital markets
- Change in prepayment expectations
- Change in funding terms for the asset
- Change in accounting or tax treatment for the asset
- Changes in government regulations

Based on the work of the investment team, which includes FIDAC's portfolio managers, each client's or investment fund's portfolio is constructed. Before negotiating the purchase of the security, FIDAC first does a portfolio 'needs assessment'. FIDAC reviews each portfolio's exposure to the market sector and the specific security in question. FIDAC

determines whether the duration impact and credit impact of adding the security would be acceptable within the context of the firm's overall portfolio strategy and the accounts' investment guidelines. Rather than employ a trading oriented strategy, most purchases are made with a willingness to hold securities to maturity based on intrinsic value. Final portfolio characteristics are guided by each client's or investment fund's objectives and benchmarks.

The FIDAC research and investment process has two general aspects: bottom-up and top-down.

The bottom-up process focuses heavily on issuer and issue analysis. For structured products, the issuer analysis includes a review and assessment of loan underwriting and documentation procedures, servicing capability, back-up servicer capability, reputation in the industry, parent support, financial strength and performance of prior deals in the market. The issue-level analysis is highly quantitative, and includes a review of the nature and amount of credit enhancement, a thorough review of the cash-flow waterfall and collateral performance triggers, a review of historical collateral performance versus previous issues from the same issuer and other peer-group issuers and extensive stress-testing under a wide range of potential economic and interest rate conditions and loss scenarios. This initial review is supported by a rigorous, proprietary surveillance process to identify upgrade/downgrade candidates, identify trends in the underlying collateral and focus relative value discussions between sectors.

The top-down facet of FIDAC's investment process involves ongoing asset allocation discussions. These discussions are ongoing and include input from the entire investment team and executive management. FIDAC reviews relative value opportunities, valuation metrics and technical market factors in all sectors including corporate debt, government issued securities, and asset backed securities and mortgages.

## LEVERAGE

FIDAC often employs leverage to increase the potential returns to investors. Leverage involves borrowing funds in an effort to multiply gains. Account guidelines, along with the credit quality, general risk of an asset, availability of funds as well as the cost of borrowing

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as compared to the possible benefits the portfolio expects to achieve, determine the appropriate amount of leverage utilized. The use of leverage will magnify losses as well as gains in the value of a portfolio's investments. Money borrowed by a portfolio will be also subject to interest costs on the borrowed amount which may or may not exceed the income from the investments made with the proceeds of such borrowing. Amounts borrowed may be secured by a pledge of securities or otherwise. If loans to a portfolio are collateralized with portfolio securities which decrease in value, the portfolio may be obligated to pledge additional collateral to a lender in the form of cash or securities to avoid liquidation of the pledged securities. The rights of any lenders to the portfolio to receive payments of interest on and repayments of principal of such borrowings will be senior to those of the investors, and the terms of borrowings may contain provisions which limit certain activities of a portfolio, including the payment of dividends to investors in certain circumstances. Interest payments and fees incurred in connection with borrowings will reduce the amount of net income available for payment to investors.

FIDAC may, from time to time, utilize derivative financial instruments to hedge all or a portion of the interest rate risk associated with our borrowings; however, perfect hedges are impossible. Should interest rates move in an unexpected direction, a portfolio may not achieve the anticipated benefits of leverage and thus would be in a worse position than if leverage had not been used. While borrowings are outstanding, a portfolio might be forced, in order to meet redemption or margin requests, to sell portfolio securities at what FIDAC considers to be a disadvantageous time due to the client's inability to borrow additional funds to pay redemption proceeds or meet margin requirements.

FIDAC may access leverage through the multitrillion dollar repurchase agreement market. A repurchase agreement is a current sale of a security and a contemporaneous agreement to repurchase the security at a price reflective of the cost of funds for the term until the repurchase date and is functionally equivalent to a collateralized borrowing. The Federal Reserve Bank uses repurchase agreements to manage adjustments in bank reserves. The major dealers in this market include firms designated as "Primary Dealers" in U.S. Government Securities and a number of money center banks. Such dealers include Goldman Sachs, Bank of America, Citigroup, UBS, and others. The principal risk to a portfolio in its use of repurchase agreements (other than the risks typically associated with the use of leverage) is the possibility of a delay in the return of collateral beyond the

repurchase date in the event the dealer defaults or becomes insolvent. Such a delay could disrupt a portfolio's investment program and adversely affect a portfolio's investment return. A default could result in the portfolio losing money that it may not recover.

## RISK OF LOSS

As with most investments, clients must be prepared to risk the loss of some, or all, of their money.

All investment programs have certain risks that are borne by the investor. Given FIDAC's fixed income focus, the firm's investment approach constantly keeps the risk of loss in mind. Clients face the following investment risks:

- **Interest-rate Risk:** Fluctuations in interest rates may cause investment prices to fluctuate. For example, when interest rates rise, yields on existing bonds rise, causing their market values to decline.
- **Market Risk:** The price of a security or bond may drop in reaction to tangible and intangible events and conditions. This type of risk is caused by external factors independent of a security's particular underlying circumstances. For example, political, economic and social conditions may trigger market events.
- **Inflation Risk:** When any type of inflation is present, a dollar today will not buy as much as a dollar next year, because purchasing power is eroding at the rate of inflation.
- **Reinvestment Risk:** This is the risk that future proceeds from investments may have to be reinvested at a potentially lower rate of return (i.e. interest rate). This primarily relates to fixed income securities.
- **Business Risk:** These risks are associated with a particular industry or a particular company within an industry. For example, oil-drilling companies depend on finding oil and then refining it, a lengthy process, before they can generate a profit. They carry a higher risk of profitability than an electric company, which generates its income from a steady stream of customers who buy electricity no matter what the economic environment is like.

- **Liquidity Risk:** Liquidity is the ability to readily convert an investment into cash. Generally, assets are more liquid if many traders are interested in a standardized product. For example, Treasury Bills are highly liquid, while real estate properties are not.
- **Credit Risk:** Excessive borrowing to finance a business' operations or a consumer's consumption increases the risk of profitability and solvency, because the company or consumer must meet the terms of its obligations in good times and bad. During periods of financial stress, the inability to meet loan obligations may result in principal losses, bankruptcy and/or a declining market value.
- **Extension & Prepayment Risk:** During periods of rising interest rates, the average life of certain types of securities is extended because of slower than expected principal payments. This may lock in a below market interest rate, increase the security's duration and reduce the value of the security. During periods of declining interest rates, the issuer of a security exercises its option to prepay principal earlier than scheduled, forcing the Fund to reinvest in lower yielding securities. To the extent an account invests significantly in asset-backed and mortgage-related securities, its exposure to prepayment and extension risks may be greater than other investments in fixed income securities.
- **Counterparty Risk:** The institutions, including brokerage firms and banks, with which the firm (directly or indirectly) does business, or to which securities have been entrusted for custodial purposes, may encounter financial difficulties that impair the operational capabilities to trade security positions.
- **Regulatory Risk:** Recently there has been increased governmental, as well as self regulatory, scrutiny of the securities industry in general. It is impossible to predict what, if any, changes in regulations will result from these developments, but any regulations which restrict the ability of the manager to employ, or broker and other counterparties to extend, credit in their trading (as well as other regulatory changes which result) could have a material adverse impact on the profit potential.
- **Leverage risk:** As discussed above, leverage involves the use of various financial instruments or borrowed capital, to increase the potential

return of an investment. Although the use of leverage may create an opportunity for increased return, it also results in additional risks and can magnify the effect of any losses. If the income and gains earned on the securities and investments purchased with leverage proceeds are greater than the cost of the leverage, the return will be greater than if leverage had not been used. Conversely, if the income and gains from the securities and investments purchased with such proceeds does not cover the cost of leverage, the return will be less than if leverage had not been used. Reverse repurchase agreements are also subject to the risks that the market value of the securities sold by the Fund may decline below the price of the securities the Fund is obligated to repurchase, and that the securities may not be returned to the Fund. There is no assurance that a leveraging strategy will be successful.

#### **Item 9 – Disciplinary Information**

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that would be material to your evaluation of FIDAC or the integrity of FIDAC's management. At least annually, FIDAC employees are required to certify if they have any matters that require disclosure. FIDAC has no matters that require disclosure.

#### **Item 10 – Other Financial Industry Activities and Affiliations**

##### **AFFILIATIONS**

FIDAC has relationships with, and may utilize, suggest or recommend its own services or those of affiliated entities under the parent company Annaly in connection with its activities. The particular services involved will depend on the types of services offered by the affiliate. Certain of FIDAC's trading, advisory and other activity for advisory clients may be delegated to affiliated entities at FIDAC's discretion. These arrangements will generally involve sharing or joint compensation related to each entity's responsibilities for the client, subject to the requirements of applicable law.

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RCap Securities, Inc. ("RCap")

RCap is a wholly owned, FINRA member, broker-dealer subsidiary of FIDAC's parent Annaly. RCap was established in part to provide broker-dealer and administrative support services for Annaly, FIDAC, as well as non-FIDAC clients. It is expected that RCap will receive commissions or commission equivalents in connection with the execution of transactions for advisory accounts when acting as broker-dealer. To the extent that the services of RCap are utilized for FIDAC clients, clients will be charged and RCap and its employees will generally receive compensation for customary fees paid by the client in addition to advisory fees paid to FIDAC. Customary fees may take the form of commissions, markups, markdowns, fees or other commission equivalents, or the retention of spreads or markups on principal transactions. Generally, RCap will earn compensation for principal transactions in addition to the agreed upon advisory fee, but the compensation will be reasonable and customary, and would otherwise be paid to a third party if transacting with a non-affiliate. Information about RCap is available at [www.rcapsecurities.com](http://www.rcapsecurities.com) and through FINRA's BrokerCheck portal at [www.finra.org](http://www.finra.org).

FIDAC currently utilizes RCap in connection with a limited amount of its advisory business and most transactions are executed through unaffiliated third party broker-dealers. FIDAC and/or RCap may engage in principal transactions with advisory clients in compliance with applicable rules and regulations. FIDAC will not engage in principal transactions with clients without disclosing to such client in writing before the completion of such transaction the capacity in which FIDAC and/or RCap is acting, and obtaining the consent of the client for each transaction.

Merganser Capital Management, Inc. ("Merganser")

FIDAC is also affiliated with Boston, MA based Merganser, also a federally registered investment adviser. Merganser is a wholly owned subsidiary of Annaly, and was acquired in 2008. Merganser is also a fixed income advisor, but Merganser is a separate legal entity, which is operationally independent and subject to its own policies and procedures which are distinct from FIDAC. FIDAC and Merganser do not share clients. Merganser does not execute any transactions through RCap or otherwise receive services from them. Information about Merganser is available on their website at [www.merganser.com](http://www.merganser.com), or you

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can email the Chief Compliance Officer Jeff Addis at [jca@merganser.com](mailto:jca@merganser.com). Finally, additional information about Merganser is also available via the SEC's web site [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The SEC's web site also provides information about any persons affiliated with Merganser who are registered, or are required to be registered, as investment adviser representatives of Merganser.

With respect to accounts managed by FIDAC or its affiliates, execution of transactions is effected in accordance with FIDAC's policies and procedures with respect to best execution, selection of broker-dealers and aggregation of trades. In addition, FIDAC may receive record keeping, administrative and support services from RCap including analyses, reports and other services that FIDAC in its advisory capacity from time to time and may choose to obtain from them.

### OTHER ACTIVITIES

FIDAC from time to time also acts as a third-party auction agent for liquidations of CDO's and other mortgage portfolios. FIDAC is compensated through fees paid by the trustees for serving as auction agent. Less than 5% of FIDAC's time is dedicated to the auction agent business.

### Item 11 – Code of Ethics

FIDAC has adopted a Code of Ethics for all supervised persons of the firm describing its high standard of business conduct, and fiduciary duty to its clients. The Code of Ethics is available to any client or potential client upon request and includes standards of business conduct, avoiding conflicts of interest, a prohibition on insider trading, and personal securities trading procedures, among other things. FIDAC employees must acknowledge the terms of the Code of Ethics annually, or as amended.

Unless permitted by the Chief Compliance Officer, FIDAC employees are prohibited trading and investing in securities issued by the funds it manages, as well as in mortgage backed securities and derivatives of mortgage backed securities. FIDAC maintains a Restricted List of securities in which there is a conflict or non-public information known about an issuer of securities. FIDAC employees are prohibited from trading and investing in securities on the



Restricted List in unless permitted by the Chief Compliance Officer. The employees are required to report their transactions quarterly, and are required to have duplicate confirmations and account statements delivered to FIDAC for review for compliance purposes. The Code of Ethics is designed to assure that the personal securities transactions, activities and interests of the employees of FIDAC will not interfere with (i) making decisions in the best interest of advisory clients and (ii) implementing such decisions while, at the same time, allowing employees to invest for their own accounts. Under the Code certain classes of securities have been designated as exempt transactions, based upon a determination that these would materially not interfere with the best interest of FIDAC's clients. In addition, the Code of Ethics requires pre-clearance of many transactions. Nonetheless, because the Code of Ethics in some circumstances would permit employees to invest in the same securities as clients, there is a possibility that employees might benefit from market activity by a client in a security held by an employee. Employee trading is continually monitored under the Code of Ethics through the review of employee account confirmations and statements, in an effort to reasonably prevent conflicts of interest between FIDAC and its clients.

FIDAC's clients or prospective clients may request a copy of the firm's Code of Ethics by contacting the Chief Compliance Officer at 212-696-0100.

### **Item 12 – Brokerage Practices**

FIDAC does not enter in to soft dollar arrangements. FIDAC does not take in to consideration whether we or related persons receive client referrals from a broker-dealer or other third party.

A client may direct that FIDAC use a particular broker-dealer to execute transactions for its account under such term and arrangements as the client may negotiate with the particular broker-dealer. However, where the use of a particular broker-dealer is so directed, FIDAC may not be in a position to freely negotiate rates or spreads, or to select broker-dealers on the basis of best execution. Additionally, transactions for which FIDAC is directed to use a particular broker-dealer may not be comingled or batched for purposes of execution with the orders for the same securities for other accounts managed by FIDAC. Accordingly, the

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direction by a client of a particular broker-dealer to execute transactions for their account may result in greater spreads, or less favorable net prices than might be the case if FIDAC were empowered to freely negotiate rates or spreads, or to select broker-dealers on the basis of best execution.

Depending on the terms of the agreement with each client for whom it provides discretionary management, FIDAC may have the discretionary authority select the broker or dealer through whom securities and other assets are bought or sold, including accepting the commission rates at which transactions for client accounts are affected.

In arranging for the purchase and sale of clients' securities and other assets, FIDAC takes numerous factors into consideration, including any legal restrictions and any client imposed restrictions. Within these constraints, FIDAC employs or deals with members of the securities exchange and other brokers or dealers as may in its judgment implement the policy of obtaining best execution (i.e. prompt and reliable execution at the most favorable prices obtainable under the prevailing market conditions) with respect to the accounts' portfolio transactions.

In determining the abilities of a broker-dealer to obtain best execution of transactions, FIDAC will consider all relevant factors, including the execution capabilities required by the transactions, the ability or willingness of the broker-dealer to facilitate the transactions as well as cost to the client.

Transactions will generally be completed independently, except when decisions may be made to purchase or sell the same securities for a number of client accounts simultaneously. Such orders will be combined when possible to facilitate best execution and to negotiate more favorable brokerage commissions. In this event, the transactions will be averaged as to price and allocated as to amount in accordance with the daily purchase or sales orders actually placed for each client account.

In certain cases, FIDAC may from time to time represent both the buyer and seller of a particular security in a transaction. Although these transactions occur infrequently, FIDAC acknowledges the potential conflict of interest inherent in this type of transaction. FIDAC

has established procedures to ensure that transactions of this nature are executed in a manner that provides independent, fair valuation to both the buyer and seller.

Certain affiliated accounts may trade in the same securities with client accounts on an aggregated basis when consistent with FIDAC's obligation of best execution. In such circumstances, the affiliated and client accounts will share commission costs equally and receive securities at a total average price. FIDAC will retain records of the trade order (specifying each participating account) and its allocation, which will be completed prior to the entry of the aggregated order. Completed orders will be allocated as specified in the initial trade order. Partially filled orders will be allocated on a pro rata basis. Any exceptions will be explained on the Order.

### **Item 13 – Review of Accounts**

Accounts are generally reviewed daily. Accounts with little or no activity may be reviewed on a less frequent basis, but no less frequently than monthly where there is activity. Reviews of accounts include examination of asset purchases, financing arrangements, and alignment of account objectives with actual positions. Reviewers include Portfolio Managers, Vice Presidents, Assistant Vice Presidents, and accounting personnel, as well as external independent auditors. Reviewers are instructed to confirm the accuracy of the account position, performance, and alignment with account objectives. The Chief Investment Officer oversees all of the investment activity.

The nature and frequency of reporting on accounts is specific to the particular contractual agreement and goals of the account, but occurs at least monthly. FIDAC may arrange for independently reported account information or may produce reports internally. Reports may include, but are not limited to, a summary of the accounts position, a listing of the transactions occurring in that account, and various performance measures.

New York Stock Exchange listed pooled investment vehicles undergo independent audits of their financials on a quarterly and annual basis, historically by Deloitte & Touche LLP, and beginning in 2012 by Ernst & Young. Audited financials are submitted to the Securities and Exchange Commission and disseminated to the public as required by law. Private funds

engage their own auditors and disseminate their documents to their investors, who are not clients of FIDAC.

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

FIDAC does not compensate third parties for client referrals.

#### **Item 15 – Custody**

FIDAC is deemed to have custody of certain client assets, which is administered in compliance with applicable rules and regulations. Pooled vehicles generally undergo audits by independent accountants, which are hired by the pools and all reports are disclosed directly to investors.

#### **Item 16 – Investment Discretion**

FIDAC usually receives discretionary authority in writing from the client at the outset of an advisory relationship to select the identity and amount of securities to be bought or sold. In all cases, however, such discretion is to be exercised in a manner consistent with the stated investment objectives for the particular client account.

When selecting securities and determining amounts, FIDAC observes the investment policies, limitations and restrictions of the clients for which it advises. FIDAC's authority to trade securities may also be limited by certain federal securities and tax laws that require diversification of investments and favor the holding of investments once made. Investment guidelines and restrictions must be provided to FIDAC in writing.

#### **Item 17 – Voting Client Securities**

As a matter of firm policy and practice, FIDAC generally does not have any authority to and does not vote proxies on behalf of advisory clients. Clients retain the responsibility for receiving and voting proxies for any and all securities maintained in client portfolios. FIDAC may provide advice to clients regarding the clients' voting of proxies.

FIXED INCOME DISCOUNT ADVISORY COMPANY

Form ADV Part 2, March 30, 2012

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In very limited instances, clients may elect in writing to have FIDAC to engage in the voting of proxies or making decisions relating to other proposed actions on client securities on their behalf. FIDAC has adopted policies and procedures relating to voting proxies and other corporate actions which are designed to reasonably ensure that FIDAC votes proxies in the best interest of its advisory clients where requested, including notice to the client of any potential or actual conflict of interest that may arise. Clients may request a copy of our Corporate Action and Proxy Voting Policy, as well as a history of votes on their behalf by making a written request to the Chief Compliance Officer at the address set forth on the first page of this form.

**Item 18 – Financial Information**

Registered investment advisers are required in this Item to provide you with certain financial information or disclosures about FIDAC's financial condition. FIDAC has no financial commitment that impairs its ability to meet contractual and fiduciary commitments to clients, and has not been the subject of a bankruptcy proceeding.