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# Practical tips for an investment adviser code of ethics

**Nov 30 2011** Kris Gruben and Michelle L. Jacko

The underlying principle of an adviser's Code of Ethics is the fiduciary standard of care. Investment advisers owe their clients the highest duty of loyalty and must ensure that their clients' interests are put ahead of their own.

Federally-registered investment advisers should adopt a Code of Ethics to address not only personal trading, but also standards of business conduct, including provisions that require compliance with federal securities laws. (SEC Rule 204A-1 of the Investment Advisers Act of 1940.)

To that end, the following is provided as guidance on the substance of what a Code of Ethics must include:

> The standard of business conduct that the investment adviser requires of its supervised persons, including guidance on the firm's fiduciary obligations and those of its supervised persons;
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> Provisions requiring the adviser's supervised persons to comply with applicable federal securities laws;
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> Clear definition of who is an "access person" and protocols for such access persons to report personal securities transactions and holdings to the firm;
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> Provisions requiring supervised persons to report any violations of the adviser's Code of Ethics promptly to the firm's Chief Compliance Officer or, to other qualified designated person;
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> Stipulations on when the Code of Ethics is to be provided to each supervised person, including delivery of periodic amendments to the Code, and any requirements for completing a written acknowledgement indicating receipt by the supervised person of the new Code provisions; and
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> Standards for pre-approval of certain securities, including initial public offerings (IPOs), secondary offerings or private placements.

Generally, a Code of Ethics requires all persons who have access to non-public information regarding client's transactions, to be subject to the Code of Ethics. These "access persons" have certain reporting obligations and must adhere to the higher standards set forth by the Code.

The CCO must review all personal trading reports and other specified Code of Ethics and maintain them as part of the firm's books and records. When reviewing these reports, compliance should take into consideration its role as being the gatekeeper to protect the interest of the adviser's clients by checking for front running, market timing abuses or improper use of non-public information.

Essentially, monitoring should be conducted with a view to identify any conflict of interest between the firm's access persons and its clientele.

Many firms' Code of Ethics provide for disciplinary provisions for access persons who violate the Code. Examples include re-reading and re-acknowledging the firm's Code of Ethics, fines, bars on personal trading and even termination. Each violation should be investigated with due care. Dependent upon the circumstance, you may wish to seek guidance from senior management prior to assessing a penalty.

In addition, all employees should be encouraged to confidentially report any suspected violation of the Code of Ethics to the CCO immediately.

Finally, it is important for investment advisers to train and educate their employees on an annual basis to ascertain their knowledge and understanding of the Code's requirements. Records of this training, including employee acknowledgements, should also be maintained in the firm's books and records.

The most important asset of a firm is its relationship with its clients and employees, and its professional reputation. Establishing and adhering to a practical Code of Ethics can help keep these relationships in good standing.

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