



Legal Risk Management Tip September 2006

Codes of Ethics

This is the fifth of five risk management tips addressing the process of building internal controls. To recap, when we began this series, we focused on those areas that continue to be the “hot topics” of the financial industry. We discussed, among other things, internal controls related to:

- Sales Practices;
- Performance Advertising and Marketing;
- Anti-Money Laundering; and
- Best Execution and Soft Dollars.

Our final internal control tip will focus on **Codes of Ethics** and compliance's role of maintaining integrity in the marketplace.

For years broker-dealers have adopted personal trading written supervisory procedures to protect its clients against abuses such as market timing and front running. On July 2, 2004, the SEC adopted Rule 204A-1 of the Investment Advisers Act of 1940 to require register investment advisers to address not only personal trading, but also to adopt standards of business conduct, including provisions that require compliance with federal securities laws. In addition, investment advisers must provide a summary of its Codes of Ethics (Code) in their Form ADV Part II or similar disclosure brochure to ensure that clients are aware of these standards adopted by the firm.

Since the adopting release, investment advisers and broker-dealers have taken a proactive approach to adopt ethical standards for their organization(s). But adoption of the standards is not enough. Ethical principles must be embraced from the top down. The key for having a principled firm begins with the heads of the business units who set expectations for all associated persons. To help facilitate and strengthen the firm's Code, consider implementing the following.

1. Introduce the firm's Code to new personnel during their orientation program. Integrity is one of the cornerstones for maintaining and growing a successful enterprise. The Code should be presented with paramount importance, if possible, by a senior manager of the organization.
2. Train the firm's senior management team about the significance of the Code and the importance of their role in maintaining its principles. In addition, be sure that your Code is discussed with all personnel each year during the firm's annual meeting. If you have an intranet site, have a link to the Code appear on your home page.
3. Focus your Code on those areas that you have the highest risk of potentially jeopardizing the integrity of the firm. For example, if your marketing team is responsible for presenting grandiose statements within requests for proposal (RFPs), develop a Compliance Committee (composed of sales/marketing, compliance, operations and portfolio management staff) to review new responses prior to dissemination.
4. The Investment Advisers Codes of Ethics rule was adopted to help further mitigate actual and potential conflicts of interest. As conflicts of interest may occur in each of the firm's functional areas, establish a Conflicts Committee to discuss internal controls and their adequacy in maintaining the firm's integrity for its clients.
5. Embrace your role as Compliance Officers. Your position, role and responsibility serves as the foundation for ensuring integrity in the market place. But be careful not to have the compliance role be solely your own. Compliance is every associated person's responsibility. In addition, the duty to implement and enforce Codes of Ethics, WSPs and firm internal controls should be shared by the entire senior management staff.

Training and reviewing your Code with associated persons and senior management will help to maintain and build upon the integrity and safeguards to your internal controls. In addition, pro-actively reinforcing that “good compliance is good business” will go a long way in furthering your firm’s Codes of Ethics and will serve your clients’ best interest by mitigating conflicts of interest within your organization.

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