Ethics for Advisers: Compliance with Fiduciary Standards Spotlight on Code of Ethics Requirements

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Rule 204A-1 under the Investment Advisers Act of 1940 (the "Advisers Act"), also known as the Code of Ethics Rule, is a long-standing Securities and Exchange Commission ("SEC") rule that governs the activities and ethics of associated persons of investment advisers. The SEC adopted Rule 204A-1 to promote compliance with fiduciary standards by advisers and their personnel. At the time, there had been an increasing number of enforcement actions involving violations of fiduciary duties to clients, leading in turn to rulemaking.

Rule 204A-1 specifically requires investment advisers to adopt a code of ethics that sets forth standards of conduct expected of advisory personnel and addresses conflicts that arise from personal trading by advisory personnel. One of the policy goals of Rule 204A-1 is to prevent the possibility of fraud by reinforcing fiduciary principles that govern conduct of investment adviser firms and their personnel. Therefore, as the SEC's pronouncements on fiduciary principles has evolved through the years, Rule 204A-1 compliance benefits from greater guidance.[2] To this end, we also briefly address in this summary the 2019 Commission Interpretation Regarding Standard of Conduct for Investment Advisers to provide further context relevant to Rule 204A-1 compliance.[3] Furthermore, as with all aspects of long-standing Advisers Act compliance, advisers should review and update code of ethics requirement to respond to both regulatory and market developments. This includes both developments like the Interpretation and emerging areas, such as crypto.[4]

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[1] This material is provided for informational purposes only and does not constitute legal advice or create an attorney-client relationship. This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.

[2] The scope of this summary is generally limited to code of ethics requirements. There are other components to fiduciary duties that are important to consider when developing, implementing, and enforcing a code of ethics. For further discussion *see* A.Valerie Mirko and Margaret Mudd, *Fiduciary Obligations for Identifying, Managing, and Disclosing Conflicts of Interest* (Sept. 1, 2023) ("2023 Conflicts Outline").

[3] *Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser*, Investment Advisers Act Release No. 5249, 84 FR 33681 (Jul. 12, 2019) ("Interpretation"). Note that the Commission intended this to be a restatement of existing fiduciary principles.

[4] *See* 2024 Examination Priorities Report, SEC Division of Examinations (Oct. 16, 2023), available at https://www.sec.gov/files/2024-exam-priorities.pdf. In our experience, code of ethics deficiencies are often

1. Rule 204A-1 Overview and Code Requirements

Under federal law, investment advisers must have policies and procedures in place reasonably designed to prevent the misuse of material nonpublic information by investment advisers and persons associated with the investment adviser.[5] Specifically, Rule 204A-1 requires that all investment advisers registered or required to be registered with the SEC adopt, maintain and enforce a written code of ethics reflecting the adviser's fiduciary duties to its clients. At a minimum, an adviser's code of ethics must contain the following:[6]

- A standard (or standards) of business conduct that the investment adviser requires of supervised persons,[7] which must reflect both the investment adviser's fiduciary obligations and the supervised persons' fiduciary obligations.
- Procedures requiring supervised persons to comply with applicable federal securities laws.
- Procedures that require all access persons to report,[8] and the investment adviser to review, all personal securities transactions and holdings periodically.
- Procedures requiring supervised persons to report any violations of the code of ethics promptly to the Chief Compliance Officer ("CCO") or, provided the CCO also receives reports of all violations, to other persons designated in the code of ethics.
- Procedures for distributing copies of the code of ethics and any amendments to each supervised person and requiring supervised persons to provide written acknowledgement of their receipt of the same.

Several provisions of Rule 204A-1 are modeled after Rule 17j-1 under the Investment Company Act. Like its Advisers Act counterpart, Rule 17j-1 requires funds and each investment adviser and principal underwriter of a fund to "adopt a written code of ethics containing provisions necessary to prevent" certain persons affiliated with the fund, its investment adviser or its principal underwriter from engaging in fraudulent, manipulative, and deceptive actions with respect to the fund.[9] Rule 17j-1 further requires that investment companies use reasonable diligence and institute procedures reasonably necessary to prevent violations of the code.[10] Any access person who acquires direct or indirect beneficial ownership of any security as defined in the rule is required to

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addressed in the SEC exam context, though we note in this document certain recent enforcement actions and key takeaways on those.

[5] 15 U.S.C. § 80b–4a.

[6] 17 C.F.R. § 275.204A-1(a).

[7] "Supervised person" means: (i) a partner, officer, director (or other person occupying a similar status or performing similar functions); (ii) an employee of an investment adviser; or (iii) a person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser. 15 U.S.C. § 80b–2(a)(25).

[8] Rule 204A-1 defines "access person" as any supervised persons who either (A) have access to nonpublic information regarding clients' purchase or sale of securities, or (B) are involved in making securities recommendation to clients or have access to such recommendations that are nonpublic. Directors, officers and partners of an investment adviser whose primary business is giving investment advice are presumed to be access persons. 17 C.F.R. § 275.204A-1(e)(1). *See* p. 3 for further discussion.

[9] 17 C.F.R. § 270.17j-1.

[10] 17 C.F.R. § 270.17j-1(c)(2).

report such transaction to their investment company adviser or underwriter.[11] Additional details on each of the Advisers Act code of ethics requirements are set forth below.

(a) Standard of Conduct Considerations

The code must set forth a minimum standard of conduct for all supervised persons.[12] While Rule 204A-1 does not require a particular standard, the SEC stated in the adopting release – at the time, in 2004 – that a "good code of ethics should effectively convey to employees the value the advisory firm places on ethical conduct and should challenge employees to live up not only to the letter of the law, but also to the ideals of the organization."[13] This means that the code must be consistent with the firm's fiduciary obligations to clients and "premised upon the fundamental principles of openness, integrity, honesty and trust."[14]

Furthermore, pursuant to Rule 204A-1 text adopted in 2004, investment advisers should consider specifying that supervised persons are not permitted, in connection with the purchase or sale, directly or indirectly, of a security held or to be acquired by a client to:

- Defraud clients in any manner.
- Mislead clients (including an omission of material facts).
- Engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon clients.
- Engage in any manipulative practice with respect to clients.
- Engage in any manipulative practice with respect to securities (including price manipulation).[15]

In adopting Rule 204A-1, it is clear that the SEC intentionally drafted the rule broadly enough so as to provide advisers the flexibility to tailor their code to existing trading policies and varied business models. At the time, the 2019 Interpretation was 15 years away and the SEC had not been as active in specifying the contours of Advisers Act fiduciary principles as it subsequently became. Over the years we have seen exam deficiencies, enforcement settlements and ultimately the Interpretation.

It is helpful and instructive to read the above requirements of Rule 204A-1 in conjunction with the Interpretation. The Interpretation consolidated many – but not all – principles of Advisers Act fiduciary duty in a single Commissioner-approved release. To this end, the Interpretation provides a discussion of both the duty of care and the duty of loyalty, as well as the overarching duty to act in the best interest of clients. The duty of care discussion focuses largely on (i) the duty to provide advice that is in the best interest of the client, (ii) the duty to seek best execution of a client's

[11] 17 C.F.R. § 270.17j-1(d).

[12] 17 C.F.R. § 275.204A-1(a)(1).

[13] *Investment Adviser Code of Ethics*, Advisers Act Release No. 2256 (July 9, 2004) (hereinafter "Adopting Release") at Section II.A, available at https://www.federalregister.gov/documents/2004/07/09/04-15585/investment-adviser-codes-of-ethics.

[14] *Id*.

[15] *See* 17 C.F.R. § 270.17j-1(b).

transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship.[16] The duty of loyalty discussion in the Interpretation is instructive with regard to conflict disclosure and mitigation.[17]

The Interpretation purported to consolidate and reaffirm aspects of the fiduciary duty investment advisers owe their clients under Section 206 of the Advisers Act, while at the same time highlighting that it is not intended to be the sole authority on fiduciary duty. Rule 204A-1 is one of those additional authorities on fiduciary duty and among the reasons the Interpretation cannot be the sole authority. Therefore, Rule 204A-1 should be read in conjunction with the Interpretation – particularly the section on conflicts – when an adviser seeks to update its code of ethics program. Advisers should tread carefully to ensure their practices, procedures, and policies outlined in their codes of ethics align with standard of care developments as well as their business model. We note that the Interpretation's discussion on the duty of loyalty and conflicts management is particularly relevant to a code of ethics analysis.

There is no one size fits all solution to a code of ethics and an adviser should adopt a code that properly reflects its respective business and fiduciary obligations. In failing to include the required provisions or tailoring to the scope of the business, an adviser runs the risk of costly—and potentially reputationally embarrassing—disciplinary action. For example, in a recent action, the order specifically focused on why advisers cannot just over-rely on a code of ethics template. The order noted that this investment adviser had adopted a code of ethics, word for word, from an outside trade organization with no applicability to the firm's own business.[18] According to the order, "[the firm's] Code of Ethics, as *adopted wholesale* from the Professional Organization's Code of Ethics. . . failed to include any. . . requirements." The order goes on further to say that "in adopting this *off-the-shelf* code of ethics from the Professional Organization's Code of Ethics, [the firm] failed to meet the requirements of Section 204A and Rule 204A-1 thereunder." A key takeaway is that advisers are expected to be deliberate and thoughtful in implementing a code of ethics.

(b) Reporting Requirements for Access Persons

A code of ethics must address personal trading and require access persons to periodically report their personal securities holdings and transactions to the CCO or other designated persons.[19] In evaluating who is an access person, Rule 204A-1 defines "access person" to include supervised persons who either (i) have access to nonpublic information regarding clients' purchase or sale of securities, (ii) are involved in making securities recommendations to clients, or (iii) have access to recommendations that are nonpublic.[20] This includes clerical, accounting, and information technology personnel who have access to client recommendations.

[16] *Id*. at 33672-33674.

[17] *See* 2023 Conflicts Outline for additional detail.

[18] *See In the Matter of Two Point Cap. Mgmt., Inc., & John B. Mcgowan*, Advisers Act Release No. 6199 (Dec. 5, 2022), available at https://www.sec.gov/files/litigation/admin/2023/ia-6413.pdf (emphasis added).

[19] *Id*.

[20] 17 C.F.R. § 275.204A-1(e)(1).

On the other hand, access persons do not generally comprise employees of service providers or related persons, even though they may have access to such information. In such situations, however, advisers should consider access and level of risk.[21] Directors, officers and partners of an investment adviser whose primary business is giving investment advice are presumed to be access persons.[22]

i. Holdings Reports

Access persons must submit a securities holdings report no later than ten days after becoming an access person and once a year thereafter.[23] All information submitted in the reports must be current as of a date no more than 45 days prior to the individual becoming an access person (with respect to the first report) or not more than 45 days prior to the date the report is submitted (with respect to subsequent reports).

At a minimum, each holdings report must contain the following:

- The title and type of security, the exchange ticker symbol or CUSIP number (as applicable), the number of shares, and principal amount of each reportable security[24] in which the access person has any direct or indirect beneficial ownership;[25]
- The name of any broker, dealer or bank with which the access person maintains an account in which any securities are held for the access person's direct or indirect benefit; and
- The date the access person submits the report.

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[21] Note that the SEC has found violations where the investment advisers did not properly establish or maintain policies and procedures for identifying whether outside consultants involved in portfolio management should be subject to the adviser's policies or procedures, including the code of ethics. *See In the Matter of Federated Global Investment Management Corp.*, Advisers Act Release No. 4401 (May 27, 2016), available at: https://www.sec.gov/litigation/admin/2016/ia-4401.pdf.

[22] 17 C.F.R. § 275.204A-1(e)(1); *see also* 17 C.F.R. § 270.17j-1(a)(1) ("If an investment adviser's primary business is advising Funds or other advisory clients, all of the investment adviser's directors, officers, and general partners are presumed to be Access Persons of any Fund advised by the investment adviser. All of a Fund's directors, officers, and general partners are presumed to be Access Persons of the Fund.").

[23] 17 C.F.R. § 275.204A-1(b)(1); *see also* 17 C.F.R. § 270.17j-1(d)(i).

[24] Rule 204A-1 treats all securities—as broadly defined in Section 202(a)(18) of the Advisers Act—as "reportable securities" though it specifically excludes from its purview: (i) transactions and holdings in direct obligations of the U.S. government; (ii) certain bank instruments, commercial paper and agreements; (iii) shares of money market funds; (iv) transactions and holdings in shares of other types of mutual funds, unless the adviser or a control affiliate acts as the investment adviser or principal underwriter for the fund; and (v) transactions in units of a unit investment trust if the unit investment trust is invested exclusively in unaffiliated mutual funds. *See* 17 C.F.R. § 275.204A-1(e)(10); Adopting Release, *supra* note 13 at Section II.C.6. Note, Rule 17j-1 requires access persons of investment companies to report holdings or transactions in securities held or to be acquired by the investment company, but it does not require access persons to report holdings or transactions in shares of open-end funds, including mutual funds they manage.17 C.F.R. § 270.17j-1(a)(4)(iii).

[25] Beneficial ownership is defined by reference to Rule 16a-1(a)(2) under the Exchange Act, which presumes an access person to have beneficial ownership of securities held by his or her immediate family members residing in the same household. 17 C.F.R. § 275.204A-1(e)(3). Thus, these securities holdings must be reported as well. Immediate family members include any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, brother-in-law, or sister-in-law, and adoptive relationships. 17 C.F.R. § 240.16a-1(e).

ii. Transaction Reports

An adviser's code of ethics must require that access persons submit quarterly transaction reports of all personal securities transactions no later than 30 days after the end of the calendar quarter.[26] Each report must contain, at a minimum, the following information about each transaction involving a reportable security in which the access person had, or acquired, any direct or indirect beneficial ownership:

- The date of the transaction, the title, and as applicable the exchange ticker symbol or CUSIP number, the interest rate and maturity date, number of shares, and principal amount of each reportable security involved;
- The nature of the transaction (i.e., purchase, sale or any other acquisition or disposition);
- The execution price of the security;
- The name of the broker, dealer or bank by or through which the transaction was executed; and
- The date the access person submits the report.

iii. Exceptions to Reporting Requirements

Rule 204A-1 permits three exceptions to reporting personal securities. First, access persons are not required to submit reports with respect to securities held in accounts over which the access person had no direct or indirect influence or control.[27] Before relying on this exception, the SEC has recommended that investment advisers take steps to establish a reasonable belief that an access person actually had no direct or indirect influence or control, as opposed to a third-party manager simply having discretionary investment authority. In doing so, the SEC suggests an investment adviser consider, for example:

- obtaining information about a trustee or third-party manager's relationship to the access person;
- obtaining periodic certifications by access persons and their trustees or discretionary third-party managers regarding the access persons' influence or control over the account;
- providing access persons with the exact wording of the reporting exception and a clear definition of "no direct or indirect influence or control" that the investment adviser consistently applies to all access persons; and
- on a sample basis, requesting reports on holdings and/or transactions made in the account to identify transactions that would have been prohibited pursuant to the adviser's code of ethics, absent reliance on the reporting exception.[28]

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[26] 17 C.F.R. § 275.204A-1(b)(2); *see also* 17 C.F.R. § 270.17j-1(d)(1)(ii).

[27] 17 C.F.R. § 275.204A-1(b)(3)(i); *see also* 17 C.F.R. § 270.17j-1(d)(2)(i).

[28] *See* Investment Management Guidance Update, Personal Securities Transactions Reports by Registered Investment Advisers: Securities Held in Accounts Over Which Reporting Persons Had No Influence or Control, No. 2015-03 (June 2015), available at https://www.sec.gov/investment/im-guidance-2015-03.pdf.

Moreover, access persons are not required to submit a transaction report (1) with respect to transactions effected pursuant to an automatic investment plan, or (2) if the report would duplicate information contained in broker trade confirmations or account statements that are received no later than 30 days after the end of the applicable quarter.[29]

iv. Report Reviews

Once submitted, securities transactions and holding reports must be reviewed by the CCO or other designated person to identify potential conflicts of interests and prevent misconduct.[30] The SEC has stated that such person should, among other things, "compare the personal trading to any restricted lists" and "assess whether the access person is trading for his own account in the same securities he is trading for clients, and if so whether the clients are receiving terms as favorable as the access person takes for himself."[31]

(c) Pre-Clearance Requirements

An investment adviser's code of ethics must also include a requirement that its access persons obtain prior authorization before investing in an initial public offering ("IPO") or private placement, which would include most investments in hedge funds or other private funds.[32] Because most people do not have the opportunity to invest in IPOs or private placements, the issues that often arise with respect to an access person's purchase of these securities include whether the employee should have first offered the opportunity to clients, or whether a portfolio manager is receiving a personal benefit for directing client business.[33]

Beyond this base-level requirement, many advisers may wish to adopt policies requiring that its access persons obtain prior approval for all personal securities transactions and that duplicate confirmations for personal securities transactions be provided to and reviewed by a designated senior person (some advisers require all access persons to trade through designated firms that automatically provide the adviser with duplicate confirmations). The SEC strongly recommended too that such policies and systems provide for automated or computerized analysis of trading patterns.[34] According to the SEC, this practice aims to prevent gaming the restrictions, such as placing personal trades on the day before or after "blackout" periods begin or end. Advisers with robust policies and procedures around preclearance – as opposed to a more bare minimum framework – further mitigate their enforcement risk by showing a reasonable, thoughtful and thorough effort to meet the rule's requirements. Demonstrating such an effort is helpful in an exam and enforcement setting, and can have significant impact on the adviser's liability in the event of

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[29] 17 C.F.R. § 275.204A-1(b)(3)(ii)-(iii). No-action relief has been provided to permit an investment adviser not to treat an access person's transactions and holdings in a 529 Plan as reportable securities if the adviser or its control affiliate does not manage, distribute, market, or underwrite the 529 Plan or the investments and strategies underlying the 529 Plan. Wilmer Hale, LLP, SEC No-Action Letter (July 28, 2010), available at https://www.sec.gov/divisions/investment/noaction/2010/wilmerhale072810.htm.

[30] 17 C.F.R. § 275.204A-1(a)(3*)*; *see also* 17 C.F.R. § 270.17j-1(d)(3).

[31] Adopting Release, *supra* note 13 at Section II.G.

[32] 17 C.F.R. § 275.204A-1(c); *see also* 17 C.F.R. § 270.17j-1(e).

[33] *See* Adopting Release, *supra* note 13 at n.50.

[34] *See* Adopting Release, *supra* note 13.

an employee engaging in fraudulent and deceitful conduct by intentionally concealing transactions and falsifying internal reports.[35]

2. Reporting Violations and Maintaining the Code of Ethics

A code of ethics must require all supervised persons to promptly report any violations of the code to the investment adviser's CCO or other designated person.[36] Should an investment adviser designate someone other than the CCO to receive reports of violations, the adviser must still have procedures requiring that the CCO receives periodic reports of all violations. Furthermore, all violations of the code of ethics should be handled appropriately and consistently across all staff. This includes the imposition of fines or other similar sanctions for repeated violations.

In its adopting release, the SEC cautioned investment advisers that it is the adviser's responsibility to foster an environment in which individuals feel comfortable and encouraged to report violations.[37] Safeguards should be in place to protect and prevent retaliation against supervised persons who report violations. For example, advisers may choose to permit anonymous reporting, or decide that retaliation constitutes a further violation of the code.[38]

(a) Adviser Enforcement of the Code of Ethics

An investment adviser's code of ethics should be maintained, enforced, and frequently reviewed. The authority to enforce the code often lies with the CCO, or others designated under his or her authority.

As mentioned above, part of enforcing the code includes an adviser reviewing access persons' personal securities reports. The CCO or designated person should, among other things: (1) review whether the access person followed proper internal procedures, such as pre-clearance; (2) periodically analyze the access person's trading for patterns that may indicate abuse, including market timing; and (3) investigate any substantial disparities between the percentage of trades that are profitable when the access person trades for his or her own account and the percentage that are profitable when he or she places trades for clients.[39]

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[35] *See In re Geoffrey Brod*, Advisers Act Release No. 2673 (Oct. 24, 2007).

[36] 17 C.F.R. § 275.204A-1(a)(4). Whether the reviews are conducted by the CCO or other designated person generally depends on the size of the investment adviser.

[37] Adopting Release, *supra* note 13 at Section II.E.

[38] Section 21F of the Securities Exchange Act of 1934 and Rules 21F-1 through 21F-17 thereunder are designed to protect whistleblowers by creating incentives for investment adviser employees to report violations of the federal securities laws. While outside the scope of this outline, some investment advisers incorporate such rules into their codes of ethics, prohibiting advisers and their personnel from deterring, or retaliating against, an employee who reports. Note, in September 2023, the SEC brought an enforcement action against an investment adviser for requiring employees to sign agreements that prohibited them from disclosing "Confidential Information" to anyone outside of the firm unless authorized by the firm or required by law, without any exception for voluntary communications with the SEC concerning possible securities laws violations. *See In the Matter of D.E. Shaw & Co, L.P.*, Exchange Act Release No. 98641 (Sept. 29, 2023), available at https://www.sec.gov/files/litigation/admin/2023/34-98641.pdf.

[39] Adopting Release, *supra* note 13 at Section II.G.

(b) Educating Employees About the Code of Ethics

An adviser's code of ethics must require that each supervised person is provided a copy of the codes of ethics and any amendments.[40] The code must also require each supervised person to acknowledge, in writing, his or her receipt of those copies.[41]

Though not required, many advisers provide periodic employee training to highlight the types of conflicts of interest that may arise. The SEC recommends that investment advisers train employees on the principles and procedures of their codes, in addition to holding sessions with new and existing employees to remind them of their obligations under the code.[42]

Procedures such as requiring supervised persons to annually certify that they have read and understood the code and providing annual hands-on trainings help to reinforce the code's principles. Moreover, it provides supervised persons with an opportunity to ask questions and to gain a better understanding for the consequences of non-compliance. The point is to make the trainings meaningful. For example, advisers should explain the rationale behind the rules and use real-life scenarios and fact patterns to make it memorable for the employees. Advisers can additionally ask employees to bring to the training any ethical dilemmas they have experienced.

3. Recordkeeping Requirements

An adviser's code of ethics must require that the adviser keep copies of the code, records of violations of the code, and any actions taken against violators of the code. Advisers must also maintain copies of each supervised person's acknowledgement of receipt of a copy of the code and any amendments.[43] Moreover, Rule 204-2(a)(13) requires investment advisers to keep a record of the names of their access persons, the holdings and transaction reports made by access persons, and records of decisions approving access persons' acquisition of securities in IPOs and limited offerings.[44]

The standard retention period required for most records is five years. The records must be kept in an easily accessible place, and the first two years of which the records must be in an appropriate office of the investment adviser.[45] The five years is measured per the following:

- Codes of ethics must be kept for five years after the last date they were in effect.
- Supervised person acknowledgements of the code must be kept for five years after the individual ceases to be a supervised person.
- The list of access persons must include every person who was an access person at any time within the past five years, even if some of them are no longer access persons of the investment adviser.

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[40] 17 C.F.R. § 275.204A-1(a)(5).
[41] *Id*.
[42] Adopting Release, *supra* note 13 at Section II.F.
[43] 17 C.F.R. § 275.204-2(a)(12); *see also* 17 C.F.R. § 270.17j-1(f).
[44] 17 C.F.R. § 275.204-2(a)(13).
[45] 17 C.F.R. § 275.204-2(e).

Although not expressly required in the rules, the SEC has stated that investment advisers also will likely need to maintain electronic records of access persons' personal securities reports in order to meet their obligations with respect to reviewing the records and monitoring compliance with their codes of ethics.[46]

While some may find recordkeeping burdensome, the goal is to ensure that all documentation or other output generated substantiates the adviser's efforts in obtaining all related information in a timely, accurate, and complete manner.

4. Common Compliance Issues and SEC Division of Examination Observations

We acknowledge that the provisions of Rule 204A-1 are not overtly complicated, but note that in our experience, in practice the details may get lost in the shuffle of day-to-day firm operations. An adviser's code of ethics, however, is one of the initial documents the SEC will request and review during a typical examination of an adviser.[47] Noncompliance with the code of ethics is thus a quick and easy area for the SEC to uncover possible violations.

Pursuant to a Risk Alert issued on April 26, 2022 (the "2022 Risk Alert"),[48] staff from the Division of Examinations noted the following recurrent deficiencies associated with Rule 204A-1 during the Exams process:

- Identification of Access Persons. Advisers failed to identify and supervise certain employees as access persons in accordance with Rule 204A-1. Moreover, many codes of ethics did not properly define "access persons" or accurately identify which employees were access persons.
- Pre-Clearance for Certain Investments. Access persons failed to obtain the requisite pre-approval before purchasing direct or indirect ownership in IPOs and private offerings, and codes failed to include such requirements.
- Personal Securities Transactions and Holdings. Access persons failed to report personal securities transactions and holdings, and ones that did contained deficiencies. For example, some advisers: (1) failed to produce evidence of supervisory review of holdings and transaction reports; (2) did not assign to another employee or officer the review of a CCO's reporting, thereby permitting the CCO to self-review his or her own reports; and (3) did not include in their codes provisions requiring access persons to submit reports, or include in such reports all of the information required by Rule 204A-1, such as private placements.
- Written Acknowledgment of Receipt of Code. Advisers failed to provide supervised persons with a copy of the code or amendments to the code, and in turn, supervised persons failed to provide written acknowledgement of the same.

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[46] Adopting Release, *supra* note 13 at Section II.H.

[47] *See* Division of Examinations Risk Alert, Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents (Sept. 6, 2023), available at https://www.sec.gov/files/risk-alert-ia-risk-and-requesting-documents-090623.pdf.

[48] *See* Division of Examinations Risk Alert, Investment Adviser MNPI Compliance Issues (Apr. 26, 2022), available at https://www.sec.gov/files/code-ethics-risk-alert.pdf.

- Trading Investments on Restricted List. Employees traded in securities of issuers that were on the adviser's restricted securities list.
- Allocation of Investment Opportunities. Employees failed to follow policies and procedures regarding the allocation of investment opportunities (e.g., an adviser or its employee purchased securities at a better price, or ahead of the adviser's clients and in contravention of the adviser's own code of ethics).

The 2022 Risk Alert serves as a reminder that advisers should consistently and meaningfully review their practices, policies, and procedures regarding the topics listed above to ensure they comply with the Advisers Act and the rules thereunder. First and foremost, advisers should review their codes to confirm that they provide for all elements required by Rule 204A-1. All relevant definitions should be consistent with the rule and all records or lists should be up to date and accurately reflect the current status and activities of the adviser. Policies and procedures for regularly updating the code and relevant materials should also be in place and routinely followed.

The 2022 Risk Alert also notes that "advisers should consider incorporating procedures to ensure that investment opportunities must first be offered to clients before the adviser or its employees may act on them."[49] This observation concerns potential breaches of an adviser's fiduciary duties and reinforces the notion that compliance personnel must remain vigilant when preclearing employee trades involving securities that may relate to existing investor or fund strategies.

Furthermore, advisers should remind access persons of their obligations to: (1) submit transaction and holdings reports; (2) submit written acknowledgements on a timely basis and otherwise in accordance with the code; and (3) obtain pre-approval prior to making IPO and limited offering purchases. Advisers should also evaluate whether their recordkeeping procedures are sufficient to demonstrate that transaction and holdings reports are reviewed and that any omissions or violations by access persons are addressed appropriately.

5. Additional Considerations

Potential conflicts of interest may arise in other areas not enumerated in Rule 204A-1. As such, advisers have the option to implement higher ethical standards when developing and enforcing a code of ethics. In doing so, certain risks and advantages must be considered. For example, including additional content reduces the risk of noncompliance with other fiduciary obligations under the Advisers Act. At the same time, it broadens the possibility for violations and may increase the administrative burden with respect to documenting the same.

Nevertheless, common additions to a code of ethics are discussed in greater detail below.

(a) Outside Business Activities

While not required by the rule, many advisers include in their code of ethics provisions regarding other business activities of their supervised persons to prevent conflicts with such person's

[49] *Id*.

fiduciary duties. Supervised persons' conflicts may affect their ability to make proper decisions on behalf of clients and are attributed to the adviser.

Activities like serving on a nonprofit board, while common in the industry, can present potential conflicts that need monitoring. Other examples of potentially conflicted outside business activities include forming an entity for personal business activities or receiving compensation from a person or entity other than the adviser and its affiliates. Advisers could either prohibit such activities or implement policies requiring prior authorization.

(b) Gifts, Contributions, and Entertainment

Accepting gifts or entertainment may implicate other violations of the law outside of Rule 204A-1. Accordingly, the SEC has indicated that the receipt of gifts or entertainment by investment advisers should be addressed in the adviser's compliance manual or as a stand-alone policy. A properly implemented policy helps shield employees from improper influence and thus protects the interests of the adviser and its clients. When developing such a policy, advisers should consider requirements to report gifts given or received over a de minimis amount (an amount which should reasonably reflect the adviser and its clientele).

(c) Insider Trading

Beyond warning investment advisers to review their codes of ethics, the 2022 Risk Alert discussed above also noted the additional scrutiny on advisers for lacking appropriate policies concerning material nonpublic information ("MNPI").[50] Section 204A of the Advisers Act requires investment advisers to establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of MNPI by the adviser or any of its associated persons.[51] Many provisions required in a code of ethics may serve a dual purpose in preventing the receipt and misuse of MNPI, but they are likely insufficient, standing alone, and thus need to be supplemented.

(d) Anti-Bribery

Advisers may also wish to incorporate anti-bribery policies that address compliance issues related to the Foreign Corrupt Practices Act and doing business outside the United States.

6. Update on SEC Enforcement Actions

The last time there was a string of settlement orders focusing on Rule 204A-1 dates back to 2015. We note, however, based on recent orders, that the Division of Enforcement shows no signs of retreating. Furthermore, the more recent orders show that investigations and recommendations for resolution are following a consistent position similar to about a decade ago. Below is a sampling of settlement orders.

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[50] *Id*.

[51] 15 U.S.C. § 80b–4a.

- *In the Matter of Mortg. Indus. Advisory Corp.*, Advisers Act Release No. 6413 (Sept. 11, 2023). Despite receiving a deficiency notice during an examination in 2006, MIAC failed to properly establish, maintain, and enforce a written code of ethics until 2022—which was only after a subsequent 2021 examination raised the same issues.

- *In the Matter of Parallax Invs., LLC, John P. Bott, II, & F. Robert Falkenberg*, Advisers Act Release No. 4159 (Aug. 6, 2015). For two years after registration with the Commission, Parallax failed to adopt proper policies and procedures as well as perform annual reviews of the adequacy and effectiveness of such policies.

- *In the Matter of Du Pasquier & Co., Inc.*, Advisers Act Release No. 4004 (Jan. 21, 2015). Du Pasquier adopted a code of ethics but failed to indicate how personal transactions would be reviewed, and thus Du Pasquier did not assess whether a given access person had traded in his own account in the same security he was trading for clients.

- *In the Matter of Thomas E. Meade*, Advisers Act Release No. 3855 (June 11, 2014). As CCO of PCM, Inc., Thomas Meade failed to adequately collect and review required reports. Furthermore, Meade overly relied on other employees to self-report violations and failed to assess the adequacy or effectiveness of the firm's policies and procedures on an annual basis as required by said policies and procedures.