Standard IV: Duties to Employers

Ethical and Professional Standards

1 Three duties to an employer

- Standard IV(A): loyalty to the employer
- Standard IV(B): additional compensation arrangements
- Standard IV(C): responsibilities of supervisors
- Cases turn on dates, consent and what a supervisor did

IN THE LESSON

- Think about the people you trust most at work.
- You trust them to do the job, to keep the firm's secrets, and not to quietly work for a rival.
- Standard four is that trust, written down.
- It has three parts.
- Part A is loyalty: act for the benefit of your employer and do not harm it.
- Part B is additional compensation arrangements: do not accept outside pay that could clash with your employer's interests unless everyone agrees in writing.
- Part C is the responsibilities of supervisors: if you manage people, you must make reasonable efforts to stop them breaking the rules.
- Most exam cases turn on one of these three.

2 Loyalty, in plain words

- Do not harm the employer; do not take its property
- Records count in any form, paper or electronic
- Client and market duties come first
- Key question: is the person still employed?

IN THE LESSON

- Loyalty does not mean obeying every order.
- It means that you do not use your position to hurt the firm, and you do not take what belongs to it.
- That covers client lists, research, files and trade secrets, in any form: paper, email, a memory stick or your own head if you write it down.
- But the duty has limits.
- Loyalty to your employer never excuses a breach of the duty to clients or markets.
- And the duty runs only while you are employed.
- That one fact, when employment actually ends, decides a large share of the cases, so we start with it.
- Keep the question in mind: is this person still employed?

3 How to work any ethics case

Four steps for every case

Facts and dates → Name the Standard → Breach? Why? → Action to take

IN THE LESSON

- Before the cases, here is a routine you can use on every vignette.
- Step one, find the facts: who did what, and on which date.
- Step two, name the Standard and the subsection.
- Is it loyalty, outside pay or supervision?
- Step three, decide whether there is a breach, and say why in one sentence.
- Many cases contain several acts, and some are fine.
- Step four, if something is wrong, name the action that puts it right.
- In the exam, the wrong answers are usually well meant, such as a warning where an investigation was needed.
- Reading calmly, in this order, protects you from being swept along by a sympathetic story.

4 The line is the last day, not the notice

Resigning: the duty runs to the last day

Gives notice → Notice period → Last day → After it ends

What is allowed

Still loyal → Prepare, no soliciting → Duty ends here → Compete, no records

IN THE LESSON

- Let's draw the one date that matters.
- Follow the boxes from the left.
- First, the person gives notice.
- Nothing has changed yet: they are still employed and still owe full loyalty.
- Next, the notice period.
- Even if they are on paid leave and told to stay at home, they are still employed.
- They may prepare to compete, for example by renting an office or registering a company in their own time, using none of the firm's resources.
- But they must not solicit clients.
- Then comes the last day, when employment actually ends.
- After that, the duty of loyalty has ended, though firm records still cannot be used.

5 Case 1: Nadia Rao leaves Harbour Bank

Portfolio manager; resigns 1 March, last day 31 March

Registers a company, own time	no firm resources	**No breach**
Names her new firm to a client	allowed after notice	**No breach**
Emails 10 clients her new number	solicits while employed	**Breach**
Copies the client spreadsheet	firm records, any form	**Breach**
April calls from a public list	employment has ended	**No breach**

IN THE LESSON

- Case one.
- Nadia Rao is a portfolio manager at Harbour Bank.
- She resigns on the first of March and works her notice until the thirty first of March.
- During March she registers a company in her own time.
- A client asks where she is going, and she names her new firm.
- She then emails ten clients her new number.
- She also copies the client spreadsheet.
- In April she makes calls from a public list.
- Registering the company is fine.
- Naming the new firm is fine.
- The email is solicitation while still employed, so it is a breach.
- Copying the spreadsheet is a breach.
- The April calls are fine.

6 Cases 2 and 3: paid leave and a kind copy

Reyes on full-pay notice leave; Menon is leaving too

Reyes rents an office, own money	preparing to compete	**No breach**
Reyes advises two firm clients	on paid leave, still employed	**Breach**
Menon emails himself client files	kind motive, firm's records	**Breach**
Menon hands over to his manager	firm decides next step	**No breach**

IN THE LESSON

- Case two.
- Tomas Reyes gives notice and is told to stay at home on full pay for his notice period.
- He rents an office with his own money, which is fine, but he also advises two of the firm's clients.
- He is paid, so he is still an employee, and this is a breach.
- Case three is a well meant breach.
- Dev Menon wants a smooth handover, so he emails himself the client files.
- His motive is kind, but the files belong to the firm, and the answer is still a breach.
- What he should do is give the handover to his manager and let the firm decide who tells the clients what.

7 Whistle-blowing: when loyalty gives way

- Loyalty can be overridden to protect clients or markets
- Motive decides: protection, never personal gain
- Raise it inside the firm first where you can
- Taking records for private use is still a breach

IN THE LESSON

- Now a harder situation.
- You discover that your employer is doing something wrong, and you are the only one who knows.
- Do you owe silence?
- Not always.
- Loyalty to the employer can be overridden when the purpose is to protect clients or the integrity of markets.
- The word purpose matters.
- If you report to protect clients, that is acceptable.
- If you report to get money, to settle a score, or to win a job at a rival, it is not.
- The sensible route is to raise it inside the firm first, then go outside if the firm does nothing.
- Remember that the exam asks about motive, so read why the person acted.

8 Case 4: two people who spot wrongdoing

Head of desk favours some accounts; different motives

Clarke reports it to compliance	raises it inside first	**No breach**
Clarke tells the regulator later	firm did nothing, clients first	**No breach**
Fallon demands a payout	personal gain	**Breach**
Fallon takes files to a rival	records, private use	**Breach**

IN THE LESSON

- Case four.
- Imogen Clarke notices that her head of desk is sending the best trades to favoured accounts.
- She reports it to compliance.
- Months pass and nothing happens.
- She then tells the regulator, to protect clients.
- That is not a breach of loyalty.
- Compare Greg Fallon.
- He finds the same problem and demands a payout from the firm.
- He also takes files to a rival.
- The threat for personal gain is a breach, and so is taking the files.
- Same facts, different motive, different answer.

9 Additional compensation arrangements

- Outside pay that could conflict with the employer's interest
- Needs written consent from all parties involved
- An email counts as written; a chat does not
- Get consent before accepting, not afterwards

IN THE LESSON

- Now part B.
- Compensation means pay, gifts and benefits.
- Your employer pays you, and that pay is meant to be your reward for the work.
- Suppose someone else also pays you, a client, a company, or another firm, for services that relate to your job.
- The risk is a split loyalty: you may start working for whoever pays extra.
- So the rule is simple.
- If the outside pay could conflict with your employer's interests, you must get written consent from your employer and from every other party involved, before you accept.
- Written includes an email.
- A quiet chat in the corridor does not.
- A verbal approval is the classic wrong answer.

10 Outside pay: the consent chain

Before accepting any outside pay

Could it conflict? → Ask in writing → Written consent → Then accept

IN THE LESSON

- Here is the chain for outside pay, drawn left to right.
- First, ask yourself whether the arrangement could conflict with your employer's interests.
- If it plainly cannot, such as an unpaid seat on a charity board, there is nothing to ask.
- If it could, the second box is to ask in writing, describing the arrangement and who pays.
- The third box is the answer: written consent from the employer and from the other parties involved.
- An email reply is enough.
- Only then, in the fourth box, do you accept the pay.
- If consent is refused, you decline.
- Notice that the order never changes: ask, get it in writing, and then accept.

11 Cases 5 to 7: bonus, board seat, rival

Bonus: 10% of 150,000 excess (3% of 5,000,000) = 15,000

Client bonus, no written consent	favours one client	**Breach**
Same bonus, email consent from all	everyone agreed in writing	**No breach**
Unpaid charity board seat	no conflict with employer	**No breach**
Paid writing for a rival firm	may compete, no consent	**Breach**

IN THE LESSON

- Case five.
- A client offers a manager a private bonus of ten per cent of her excess return.
- Her fund holds five million, and it beats the benchmark by three per cent.
- That is a hundred and fifty thousand of excess return, and a bonus of fifteen thousand.
- The temptation is to favour that client over the others, so without written consent it is a breach.
- Once everyone agrees in writing, by email, it is fine.
- Case six, an unpaid charity board seat, creates no conflict, so no breach.
- Case seven, paid writing for a rival firm, could conflict and needs consent.

12 Mistakes on loyalty and outside pay

- 1. Loyalty runs to the last day, not the notice date
- 2. Paid leave: still employed, still loyal
- 3. Kind motives do not excuse taking firm records
- 4. Whistle-blowing: client or market protection only
- 5. Outside pay needs written consent, not a chat

IN THE LESSON

- Let's stop and list the traps from the first half.
- One.
- Treating the notice date as the end of loyalty.
- Duty runs to the last day of employment.
- Two.
- Believing that being on paid leave means being free.
- Pay means still employed.
- Three.
- Thinking a well meant act is acceptable.
- Kind motives do not make taking firm records right.
- Four.
- Allowing whistle-blowing for any reason.
- Only protecting clients or markets overrides loyalty, never personal gain.
- Five.
- Accepting verbal permission for outside pay.
- You need written consent from all parties, and an email counts.
- Hold on to these five as we move to supervisors.

13 Supervisors: the duty to prevent

- Supervisor: make reasonable efforts to prevent breaches
- Judged on the system set up and the response to warnings
- Not guilty merely because someone broke a rule in secret
- Adequate procedures plus a proper response

IN THE LESSON

- Now part C, the duty of supervisors.
- Think of a head lifeguard.
- She cannot swim every lap for every swimmer, but she must make sure the pool has rules, trained lifeguards and someone watching.
- Standard four C says a supervisor must make reasonable efforts to see that everyone under her supervision follows the laws, rules and the Code and Standards.
- The test is reasonable efforts, not perfection.
- A supervisor is judged on what she set up and what she did when she heard something.
- She is not automatically guilty because an employee broke a rule in secret.
- Two questions decide the case: were the procedures adequate, and did she respond properly?

14 What an adequate compliance system holds

From a code to a working system

Code of ethics → Written procedures → Training and incentives → Followed and reviewed

IN THE LESSON

- So what makes a compliance system adequate?
- Walk along the boxes.
- The first is a code of ethics.
- It is a start, but a code alone is only a statement of principles.
- The second is written procedures, fitted to the size and business of the firm.
- A small advisory shop and a global bank need different rules.
- The third is communication and training, plus incentives that reward ethical conduct, so that pay does not quietly reward what the rules forbid.
- The fourth is that the procedures are actually followed and periodically reviewed.
- A binder on a shelf that nobody opens does not count.
- Miss any box, and the system is not adequate.

15 A code alone versus an adequate system

Does the firm have this? What the Standard expects

Feature of the firm	Expectation
Code of ethics	Not enough
Written procedures	Fitted
Training and incentives	Reward ethics
Followed and reviewed	Yes

IN THE LESSON

- Let's turn the same idea into a checklist you can use when a vignette describes a firm.
- Does it have a code of ethics?
- That is necessary, but not enough on its own.
- Does it have written procedures?
- They must be fitted to the firm's size and business.
- Is there training, and do incentives reward ethical conduct?
- Without that, rules stay on paper.
- Are the procedures followed in practice?
- A rule that people ignore protects no one.
- And are they reviewed from time to time as the business changes?
- In the exam, if a firm only has a code and tells staff to use good judgement, the answer is that its system is inadequate.

16 Case 8: Fiona Wells and the doubtful trader

Wells, head of trading: trader denies it, promises

Accepts his promise	does not change his access	**Breach**
Warns him, tells compliance	not enough on its own	**Breach**
Investigates promptly	personal vs client tickets	**Required**
Limits or monitors meanwhile	preclear every trade	**Required**

IN THE LESSON

- Case eight.
- Fiona Wells is head of trading.
- She hears that a trader may be placing personal orders ahead of client orders.
- She asks him, and he denies it and promises it will never happen again.
- She accepts his word.
- That is not enough.
- A promise does not change what he is able to do tomorrow.
- Warning him and passing the matter to compliance is also not enough on its own.
- What she must do is investigate promptly, comparing personal tickets with client tickets.
- And while the investigation runs, she must limit or closely monitor his activity, for instance by requiring preclearance of every trade he makes.

17 Supervisor who learns of a possible breach

The supervisor's path

Learns of possible breach →
Investigate promptly →
Limit or monitor meanwhile →
Act on the result

IN THE LESSON

- Let's draw what Fiona should have done, as a path.
- The first box, she learns of a possible breach.
- It does not need to be proven, a credible suspicion is enough.
- The second box, she investigates promptly, and the word promptly matters because delay lets harm continue.
- The third box, she limits or closely monitors the employee while the facts are found.
- Preclearing trades, blocking access to certain accounts, or putting a second person on the desk are all examples.
- The fourth box, she acts on the result, which might mean discipline or, if nothing happened, closing the matter and recording why.
- A warning or a promise is never the whole answer.

18 Cases 9 and 10: delegating, and no procedures

Wells delegates; Dunmore's firm has a code only

Wells delegates, gives no briefing	responsibility stays with her	**Breach**
Wells briefs the deputy first	what to look for	**No breach**
Dunmore urges fixes in writing	asks for preclearance, blackouts	**Required**
Declines to supervise, in writing	if clearly unable without them	**Acceptable**

IN THE LESSON

- Case nine.
- Wells hands the checking to her deputy but does not tell the deputy what to look for.
- She may delegate the work, but she stays responsible, so she must instruct the deputy on how to prevent and detect breaches.
- Doing nothing of the kind is a breach.
- Case ten.
- Rachel Dunmore joins a firm that has only a code of ethics.
- She writes to senior management asking for preclearance and blackout periods.
- If she clearly cannot supervise properly without them, she should decline supervisory responsibility, in writing, until reasonable procedures exist.

19 Case 11: a secret breach, a sound system

Haddad's firm has adequate procedures

Voss hides a personal account	she breaches, he did not know	**Voss: breach**
Procedures, training, review	reasonable efforts	**Adequate**
Haddad investigates and restricts	prompt response to the audit	**Correct**
Verdict for the supervisor	system sound, response prompt	**No breach**

IN THE LESSON

- Case eleven is a no breach case.
- Omar Haddad supervises analysts at a firm with written procedures, training and review.
- An analyst, Lena Voss, hides a personal account.
- Haddad finds out only when an audit catches her, and he acts at once: he investigates and restricts her.
- Lena has breached the Standards.
- Haddad has not, because his efforts were reasonable and his response was prompt.
- This shows why the exam rewards the supervisor who built a real system.
- Perfection is not the test.

20 Firm procedures that prevent breaches

- Written procedures on trading, outside work and gifts
- Preclearance, blackout periods and restricted lists
- Information barriers and a safe way to raise concerns
- Training, regular compliance reviews and ethical incentives

IN THE LESSON

- Now the practical part of this lesson: what does a firm put in place so breaches do not happen?
- Start with written procedures on the rules most likely to be broken: personal trading, outside work and gifts.
- Then preclearance of employee trades and blackout periods around research changes.
- Information barriers between departments, so that secrets stay where they belong.
- A restricted list of securities that staff may not trade.
- A safe, confidential channel for staff to report concerns, so that a whistle-blower can raise it inside the firm first.
- Regular compliance reviews and testing.
- And incentives that reward ethical conduct, because people do what they are paid to do.
- Think of the list as seatbelts, brakes and signs on the road.

21 From weak spot to fix

A gap in the firm, and the practice that closes it

Only told to use good judgement	no written rules	**Preclearance rules**
Client files on personal laptops	records walk out	**Controlled storage**
Outside work never reported	no paper trail	**Consent log**
Leavers go unchecked	access stays on	**Exit checklist**
Delegated checks, no briefing	supervisor unclear	**Written briefing**

IN THE LESSON

- Let's turn the cases into fixes, which is how this part is asked: here is a weak firm, propose what to change.
- If the firm says to use good judgement about personal trading, the fix is written rules with preclearance.
- If staff keep client files on personal laptops, the fix is firm controlled storage and limits on copying.
- If outside work goes unreported, the fix is a written consent process with a log of approvals.
- If departures are unmanaged, the fix is an exit checklist: access cut on the last day, a return of all records, and a reminder of continuing duties.
- And if supervisors cannot see what staff do, the fix is regular monitoring with clear delegation instructions.

22 A member's own practices

- Know the code and the firm's procedures
- When unsure, ask compliance and get it in writing
- Keep records on firm systems; document every consent
- Leaving? No records, no soliciting, prepare in your own time
- Supervising? Write down what you delegated

IN THE LESSON

- Firms write the procedures, but you also have personal habits that keep you safe.
- First, learn the rules that apply to you, and read the code and procedures when you join.
- Second, when you are unsure, ask compliance and get the answer in writing.
- Third, keep client and firm records on the firm's systems, never on your own devices.
- Fourth, document every consent, whether it is for outside work or a gift.
- Fifth, if you plan to leave, make a short checklist: do not take records, do not solicit, and do your preparing in your own time.
- Sixth, if you supervise, write down what you delegated and how you checked.
- A paper trail is your best defence.

23 Mistakes on supervisors and procedures

- 1. A code alone is not an adequate system
- 2. Promise, warning, report: not enough; investigate
- 3. Delegating work does not delegate responsibility
- 4. Adequate system and prompt response: no breach
- 5. Inadequate procedures: escalate, or decline in writing

IN THE LESSON

- Here are the traps for the second half.
- One.
- Thinking that a code of ethics is a compliance system.
- Two.
- Thinking that a warning, a report to compliance, or the employee's promise is enough, when the duty is to investigate and limit activity meanwhile.
- Three.
- Believing that delegation passes the responsibility on.
- It does not; the supervisor must still instruct the delegates.
- Four.
- Assuming a supervisor is guilty whenever an employee breaks a rule.
- A supervisor with adequate procedures and a prompt response has made reasonable efforts.
- Five.
- Staying silent when procedures are inadequate.
- Raise it with senior management, recommend fixes, and decline supervision in writing if clearly unable.

24 Recap

- Loyal to the last day; prepare, never solicit
- Whistle-blow only to protect clients or markets
- Outside pay: written consent from all parties
- Supervisors: adequate system, investigate, limit

IN THE LESSON

- Let's pull it together.
- Loyalty runs until employment actually ends, not until notice is given, and paid leave is still employment.
- Before the last day you may prepare to compete in your own time, but you may not solicit clients or take firm records in any form.
- After notice, naming the new firm is fine, giving new contact details is not.
- Whistle-blowing can override loyalty only to protect clients or markets.
- Outside pay that could conflict needs written consent from all parties, and email counts.
- Supervisors need adequate, fitted, followed procedures, must investigate promptly and limit the employee meanwhile, must brief delegates, and must escalate or decline if procedures are missing.

25 Try three quick questions

1. On paid notice leave, an analyst signs a client for her new firm. Breach?
   Answer: Yes: still employed, so soliciting clients breaches IV(A).
2. A client bonus is approved verbally by the boss. Enough?
   Answer: No: written consent from all parties, and an email counts.
3. A supervisor warns a suspect trader and tells compliance. Enough?
   Answer: No: investigate promptly and limit or monitor meanwhile.

IN THE LESSON

- Now try three quick questions.
- Pause after each one.
- Question one.
- An analyst on paid notice leave signs on a new client to her future firm.
- Is this a breach?
- The answer is yes, because she is still employed and may not solicit.
- Question two.
- A manager is offered a bonus by a client for beating a benchmark, and gets verbal approval from her boss.
- Is that enough?
- The answer is no, because written consent from all parties is needed, though an email would be enough.
- Question three.
- A supervisor hears a trader may be trading ahead of clients, and warns the trader and tells compliance.
- Is that enough?
- The answer is no, since she must investigate promptly and limit his activity in the meantime.
- Well done.