CHAPTER 42

CODE OF ET…FOR STANDARDS I – VII(A) (B)

1. (A) both the use of the holiday home and his sister's options.

Explanation

According to Standard IV(A), Loyalty to Employer, Valley must inform Advisors of his outside consultation even if it is not for monetary compensation. According to Standard VI(A), Disclosure) of Conflicts, Valley must also disclose possible conflicts of interest, and his sister's position qualifies.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

2. (A) Beckworth is in violation of Standard VII(A), but her assistant is not in violation.

Explanation

Beckworth is in violation of Standard VII(A), Conduct as Participants in CFA Institute Programs. Beckworth compromised the integrity of the exam by offering her assistant an advance copy. Beckworth's assistant is allowed to express his opinion without violation of any Standards.

(Module 43.10, LOS 43: VII(A))

Related Material

SchweserNotes - Book 5

3. (C) not a violation of his duty to employer.

Explanation

O'Donnell is required to obtain consent from his employer if he is attempting to practice in competition with his employer. Merely undertaking preparations to leave, which do not violate a duty, is not a violation of the Code and Standards.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

4. (B) **in violation standard IV(B) "Additional Compensation Arrangements."**

Explanation

Dalby is in violation of Standard IV(B) "Additional Compensation Arrangements." Nonmonetary compensation may still create a conflict of interest.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

5. (C) **reveal to the prospects by Smith that he performs services for Smith, along with the estimated value of those services.**

Explanation

According to VI(C), Referral Fees, as a member of CFA Institute, Towers must tell his clients about the payment in kind to Smith along with an estimate of the value of those services.

(Module 43.9, LOS 43: VI(C))

Related Material

SchweserNotes - Book 5

Michael Pennington Case Scenario

Michael Pennington is Senior Vice President of equity investments at Alpha Investment Advisors, Inc. (AIA). He manages a team of analysts and portfolio managers and is responsible for maintaining and developing client relationships. AIA is located in Belgium and provides investment management services to high net worth individuals. Pennington is also a Level III Candidate in the CFA Program.

One of Pennington's clients is the Flanders family. Pennington had a long relationship with Helmut Flanders. Before Flanders's untimely death, he gave Pennington full discretion over his portfolio based on an investment policy statement that had been refined continuously over the years.

- Flanders was the president of a publicly traded manufacturing company, Allux, and 20% of his portfolio's assets were invested in Allux equity. His contract with Allux prohibited selling his Allux shares while he was employed.
- Flanders had little liquidity needs. His children were grown, and his salary at Allux was sufficient to cover his annual expenditures as well as contribute to his investment portfolio.
- A former accountant, Flanders had been extremely knowledgeable and comfortable with the investment decision-making process.
- Pennington owns 10,000 shares of Allux and serves on Allux's board and is part of the board's audit committee. Pennington came to know about some aggressive accounting choices made by Allux's CFO.

- Pennington played golf with Flanders on a regular basis and, with Flanders's help, developed many client relationships from these outings.

AIA has an agreement with a local brokerage firm, First Brokerage, owned by Pennington's sister to place all AIA trades through First Brokerage.

- Flanders agreed in writing that all trades in his portfolio would be directed to First Brokerage.
- Pennington purchased new carpets for his office with soft dollars. He believes that his managers make better investment decisions when their environment is pleasant and comfortable.
- Pennington attended an industry conference in the Bahamas with soft dollars. The program is devoted to improving management of the investment advisory firm. He believes that a well-run firm makes better investment decisions.
- Pennington consistently uses soft dollars to purchase research reports from an independent research firm that does in-depth analysis of a company's financial reporting. Several of his managers have commented on the quality and usefulness of these reports to their analysis and decision making.
- After Flander's death, Pennington decided to sell all of his and his clients' holding of Allux shares.

Pennington has an appointment to meet with Flanders's widow, Elise, who, as an artist, left management of their financial assets to her husband. She is meeting with Pennington to better understand her financial position.

6. (B) **Standard III(C), Suitability.**

Explanation

Standard III(C), Suitability, is most relevant for Pennington's meeting with Elise. This Standard requires Pennington to make a reasonable inquiry into Elise's financial situation, investment experience, and investment objectives prior to making any recommendations about her portfolio. Pennington must also consider the appropriateness of the existing portfolio and investment policy statement for Elise. Standard III(A) also has some relevance since Pennington is in a position of trust with respect to Elise, and Pennington must ensure that his and AIA's goals do not conflict with Elise's.

(Module 43.5, LOS 43.a)

Related Material

SchweserNotes - Book 5

7. (C) **Pennington played golf with Helmut Flanders on a regular basis and developed client relationships from those golf outings.**

Explanation

Pennington playing golf with Elise's husband Helmut Flanders is not a conflict with respect to his relationship with Elsie and he need not disclose to her that he played golf with Flanders. Flanders was his client at the time and there was full disclosure that Pennington developed new client relationships. Al the other matters must be disclosed.

(Module 43.9, LOS 43.a)

Related Material

SchweserNotes - Book 5

8. (C) **research reports is an allowable use of soft dollars.**

Explanation

Brokerage is commission generated from trades and is an asset of the client not the investment manager. Soft dollars is the use of brokerage to purchase research services that benefit the client in the investment decision-making process. The investment manager has an ongoing responsibility to seek to obtain best execution, minimize transaction costs, and use client brokerage to benefit clients. Consequently, contingent on disclosure of a soft dollar arrangement to clients whose portfolios might be affected, the CFA Institute Standards permit client brokerage only to be used to purchase research; that is, goods and services, the primary use of which directly assists the investment manager in the investment decision making process and not in the management of the firm.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

9. (A) **Standard II, Integrity of Capital Markets.**

Explanation

As a director and member of Allux's audit committee, Pennington possesses material nonpublic information about a tender offer. Therefore, Pennington must be particularly concerned about complying with Standard II(A), Material Nonpublic Information.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

10. (C) **No, because it is a statement of fact.**

Explanation

The statement is not a violation because it is a fact. However, the member must not go on to claim superior performance.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

11. (A) **inform the clients of the changes and tell them it is based upon an opinion and not a fact.**

Explanation

According to Standard V(B), the analyst must inform the clients of the change and tell them it is based upon an opinion and not a fact. Making an identical change in two portfolios may be a violation of this standard if the needs of the clients are not identical.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

12. (C) **violated CFA Institute Standards of Professional Conduct because she misrepresented the optimism by turning it to certainty.**

Explanation

Standard V(B), Communication with Clients and Prospective Clients. Members must distinguish between fact and opinion in the presentation of a research report or investment recommendation. Wise violated the standard because she misrepresented management's enthusiasm by turning it into certainty.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

13. (C) **incorporate a professional conduct evaluation as part of the performance review only for the three CFA charterholders.**

Explanation

Green should incorporate a professional conduct evaluation as part of his review of all eight analysts under his supervision, not just the three CFA charterholders.

(Module 43.7, LOS 43: IV(C))

Related Material

SchweserNotes - Book 5

14. (A) loyalty.

Explanation

Standard IV(A) Loyalty requires members and candidates who are leaving an employer to act in their employer's interest until their departure takes effect.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

15. (C) both his supervisor in the organization and his regular place of work.

Explanation

An employee/employer relationship does not necessarily mean monetary compensation for services. If the analyst is performing services for the organization, then the analyst must treat the position as if he were an employee and obtain consent from both his supervisor in the organization and in his regular place of work.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

16. (C) make clear buy or sell recommendation on the securities covered in research reports.

Explanation

There is no obligation to make buy or sell recommendations on securities that are covered by research reports.-

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

17. (B) distribute a detailed research report to clients with any recommendation.

Explanation

Recommendations can be made in various contexts. For example, an analyst's firm may issue a list of buy recommendations or a brief recommendation that does not contain all the relevant details of the analysis, but clients must be informed that a full analysis supporting the recommendation is available. The other actions are required by the Standards.

(Module 43.8, LOS 43: V(C))

Related Material

SchweserNotes - Book 5

Mary Montpier, CFA, is an equity analyst located in the Malaysia office of World Class Advisers. The firm provides investment advice and financial-planning services globally to institutional and retail clients. The Malaysia office was opened last year to provide additional international investment opportunities for U.S. clients. Montpier covers small-cap stocks in the region. Montpier's supervisor, Rick Reynolds, CFA, works in New York.

Jim Taylor is an analyst in New York who works at World Class Broker-Dealer, a sister company of World Class Advisers. Taylor covers healthcare and biotech stocks for the firm. Taylor recently completed Level I of the CFA examination and is registered for the Level II examination next year. Taylor works for John James, CFA.

Through her interaction with other analysts in Malaysia, Montpier learns that the use of material, nonpublic information is common practice in analyst research reports and recommendations, which is not prohibited by law in Malaysia. Montpier has acquired material, nonpublic information on the research pipeline of Circuit Secrets, a Malaysian semiconductor company. The nonpublic information makes the company seem like a fine investment. After extensive research through traditional means, Circuit Secrets appeared to be fully valued relative to its growth potential until Montpier found the nonpublic informations.

Montpier is proud of her CFA charter. In fact, she often boasts that she is one of the elite members of the CFA Institute that passed all three exams consecutively without failing. Taylor is also proud of the CFA program. He told his friends and family the CFA designation is globally recognized in the field of investment management and research. Furthermore, Taylor states that he believes the program will enhance his portfolio management skills and further his career development.

In her free time, Montpier has begun consultation for members of a local investment club. The club is in the process of developing an appropriate compensation package for her services, which to date have included financial-planning activities and investment research. Montpier informs the investment club that she has a full-time job at World Class Advisers, which offers similar services. The investment club gave Montpier written permission to consult for them despite her full-time work.

To gain insight on biotech stocks, Taylor registers for an upcoming asthma study conducted by Breakthrough Corp., through which he and others will be the subject of testing for the efficacy of several new drugs. On his application, longtime asthma sufferer Taylor indicates that he has the appropriate medical condition for the study and signs a confidentiality agreement. During the study, a researcher shows Taylor a spreadsheet detailing the progress of Breakthrough's research pipeline. Two of the new drugs on which Breakthrough is awaiting regulatory approval have serious negative side effects in patient testing. This information confirms suspicions Taylor had developed after extensive research and conversations with company executives regarding nonmaterial, nonpublic information, though he was not certain about the names of the drugs until he saw the spreadsheet. At the conclusion of the study, Taylor releases a report detailing the drugs' side effects and recommends that clients "sell" Breakthrough Corp.

Over the next two weeks, Breakthrough releases information that the drugs in question have been held up by a regulatory agency pending additional investigation. The stock plunges more than 30% on the news.

18. (B) **Reynolds approves Montpier's report on Circuit Secrets immediately, but tells his traders to wait a week before buying the stock themselves.**

Explanation

An immediate approval of Montpier's report implies that Reynolds did not check the facts or talk to Montpier about the recommendation, which was dependent on the use of insider information. Reynolds violated the Standard relating to supervisory responsibilities. Side work that is not in competition with the intern's firm is not a violation unless the side job interferes with her work for World Class. The statement on Taylor's resume is appropriate, and James' plans to help Taylor are well within the requirements of the Standards.

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

19. (C) **only Taylor is in compliance.**

Explanation

Both Montpier, as a CFA charterholder, and Taylor, as a CFA candidate, are subject to the Standards. Montpier violated Standard VII(B) by exaggerating the implications of passing the exam in three years. Taylor's comments comply with the Standards.

(Module 43.1, LOS 43.a)

Related Material

SchweserNotes - Book 5

20. (C) **Despite getting written permission from her clients to consult, Montpier is not in compliance with the Standard.**

Explanation

Montpier needs to get permission from both the client and her employer before she can begin to consult; since she has not received permission from World Class, she is not in compliance. Neither Taylor's use of rivals' research nor his participation in a medical study violate the Standard. Standard IV(A) addresses outside income, not research methods. And while the medical-study payment is certainly income, it is not in competition with his firm, and as such does not violate the Standard.

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

21. (A) **violate standard II(A) - Material Nonpublic Information because the information because he was not in the public domain.**

Explanation

Taylor's use of the material nonpublic information provided to him in confidence by a researcher is a clear violation of Standard II(A). The professional-misconduct Standard prohibits actions that reflect negative on "professional reputation, integrity, or competence." Since Taylor has signed a confidentiality agreement, his violation of the agreement definitely says something about his honesty. Thus, he is in violation of Standard I(D). Standard IV(A) only applies to work in competition with the employer.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

22. (A) **Halpert can make his report in person, by telephone, or by computer on the internet.**

Explanation

A report can be made via any means of communication, including in-person recommendation, telephone conversation, media broadcast, and transmission by computer such as on the internet.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

23. (C) **Spraetz, as the chief compliance officer, must set policy in clear terms and monitor the actions of the employees. In case of violations, she should investigate thoroughly, initiate disciplinary action, and issue guidelines that must be followed in order to prevent future violations. She must not only detect violations through a continuous monitoring process but also provide guidance for proper conduct consistent with the firm/s policy manual.**

Explanation

Since Spraetz has the authority to hire, fire, reward, and punish Jackson, Spraetz has supervisory duties in addition to being the chief compliance officer of Superior Selection. She must investigate Jackson and report her findings to her superiors and possibly the board. If no action is taken, Spraetz must consider resigning under the CFA Institute Code and Standards. Spraetz is also responsible for setting the policy, preventing and detecting violations, and putting into place reasonable procedures to monitor employees' actions. Her role as the chief compliance officer requires her to take disciplinary actions in order to deter further violations.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

24. (C) **Standard V(C) Record Retention.**

Explanation

Standard V(C) Record Retention requires analysts to develop and maintain "...records to support their investment analysis, recommendations...with clients and prospective clients." The analyst is unable to document the over-allocation with respect to the benchmark; this is most likely a violation of Standard V(C).

(Module 43.8, LOS 43: V(C))

Related Material

SchweserNotes - Book 5

25. (A) **My earning the CFA designation indicates my superior ability.**

Explanation

A CFA charterholder may not make claims about how earning the designation proves superior capabilities. Saying "my earning the CFA designation indicates my desire to maintain high standards" is allowed because it is a factual statement.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

26. (A) **If a subordinate violates a securities law, her supervisor is in violation Standard IV(C).**

Explanation

Standard IV(C) Responsibilities of Supervisors requires members to make a reasonable effort to ensure compliance with applicable laws, regulations, and rules by their subordinates. Violations by subordinates do not necessarily mean the supervisor has violated this Standard if the supervisor has made reasonable efforts to detect and prevent violations.

(Module 43.7, LOS 43: IV(C))

Related Material

SchweserNotes - Book 5

27. (B) **Both Bolt and Delvecco violated the standard.**

Explanation

Standard VI(A), Disclosure of Conflicts, requires that Bolt inform Dupree of his involvement with Midwest University given that Bolt's new role can be expected to be time consuming and possibly affect his responsibilities at Dupree. Delvecco is required to disclose her ownership of Aveco stock before conducting the research report because such ownership could bias her objectivity in making a recommendation. She should have discussed owning the stock with her supervisor before beginning to write the research report on Aveco.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

28. (C) **violating the Standard by not having a reasonable and adequate basis for his investment recommendation.**

Explanation

The ad hoc model is not part of the formal research process and does not formulate an adequate basis for a recommendation.

(Module 43.8, LOS 43.b)

Related Material

SchweserNotes - Book 5

29. (B) **Only Toffler has violated the Code of Standard.**

Explanation

The Code and Standards permit an individual to state that he or she is a candidate for the CFA designation as long as the person is registered for the next CFA exam. The same individual may state the fact that he or she has passed Level I or II of the CFA program. There is no partial designation, such as CFA II.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

30. (C) **No. because Bellow received no compensation for his services.**

Explanation

Standard IV(A) Loyalty requires members and candidates to disclose to their employers any independent practice for compensation. In this case, Bellow did not receive any compensation for his advice and therefore did not engage in independence practice.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

31. (B) **a violation of Standard I(D) concerning professional misconduct.**

Explanation

This is a violation because even though it does not necessarily compromise the integrity of the next exam, it does violate Standard VII(A) Conduct as Members and Candidates in the CFA Program. At the beginning of the CFA examination, all candidates are required to sign a statement saying they will not divulge any information regarding the exam to anyone. In this question the Code of Ethics was violated because it requires CFA candidates and CFA Institute members to act in an ethical manner.

(Module 43.10, LOS 43: VII(A))

Related Material

SchweserNotes - Book 5

32. (A) **that he is being considered for a job at Paulsen.**

Explanation

The possibility of employment with Paulsen creates a potential conflict of interest which Flome must disclose. Standard VI(A) Disclosure of Conflicts does not require disclosure of his brother-in-law's ownership of Paulsen stock.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

33. (A) **contact industry regulators.**

Explanation

See Standard IV(A) "Loyalty." Frost should begin by reviewing the company's policies and procedures for reporting ethical violations and provide her supervisor with a copy of the Code and Standards to highlight the high level of ethical conduct she is required to follow.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

34. (B) **not violated the Standards.**

Explanation

He must disclose any compensation to his employer if it conflicts with his employers/clients interests. However, this relationship does not likely represent any conflict of interest.

(Module 43.9, LOS 43.a)

Related Material

SchweserNotes - Book 5

35. (B) **make written disclosure to all parties involved before she accept this offer.**

Explanation

Standard IV(B), Additional Compensation Arrangements, applies in this situation. Standard IV(B) states, "No gifts, benefits, compensation, or consideration are to be accepted with may create a conflict of interest with the employer's interest unless written consent is received from all parties."

The key words here are "written consent" - members must obtain written consent because such arrangements may affect loyalties and objectivity and create potential conflicts of interest.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

Rolf Lindquist, a CFA charterholder, is a portfolio manager at Midwestern Investment Management, a firm catering to high-net-worth individual clients. Lindquist has worked in the investment industry for 10 years, the first four years with KMGR and the last six with Midwestern. In advertising material, Lindquist reports his investment performance over the last 10 years without identifying the first four years as being achieved at KMGR.

Lindquist sits on the board of directors of Western Inns, a hotel chain. In return for his services on the board, he receives free lodging from Western when he travels for business and pleasure. He currently holds no Western stock in any of his clients' portfolios, although in the recent past some of these portfolios have included Western. Lindquist discusses his Western directorship with his supervisor, but because he does not receive any monetary compensation, he does not formally disclose this arrangement in writing to his employer or his clients.

Lindquist manages the portfolio of Martha Olson. Last year, Lindquist beat the benchmark portfolio for Olson by 180 basis points. In appreciation for that performance, Olson gives Lindquist two third-row tickets to the NCAA basketball championship. Lindquist discloses this gift to his employer. Lindquist also receives a two-week, expense-paid trip to Paris from Boston and Co., a brokerage firm, in return for providing Boston with business during the year.

Lindquist also manages the portfolio of Jerry Chandler, a conservative investor with a low tolerance for risk. Lindquist recommends the purchase of equity index put options on the equity portion of Chandler's portfolio. Lindquist educates Chandler on the risks and rewards of such a strategy, including the risk that equity prices will increase and that this would cause the value of the put options will fall.

Midwestern has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Midwestern model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research—an aspect that is disclosed to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. Lindquist modifies the model on an experimental basis by adding factors he reads about in the financial press, but does not back test the results. When making trading decisions, he applies his own version of the model, which is occasionally in conflict with the Midwestern model. Lindquist discloses his use of this experimental model to his own clients, but not to his supervisor.

36. (B) cannot accept the gift under any circumstances.

Explanation

According to Standard I(B) concerning independence and objectivity, Lindquist cannot accept gifts that reasonably could be expected to compromise his independence and objectivity. Acceptance of such a gift would call into question his independence and objectivity; his first obligation is to his clients, not to Boston and Co.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

37. (B) neither Standard III(C): Suitability, nor Standard III(A): Loyalty, Prudence, and Care.

Explanation

Lindquist's actions conform to Standard III(C): Suitability, Standard V(A): Diligence and Reasonable Basis, and Standard III(A): Loyalty, Prudence, and Care. Lindquist must take into account the risk level of the portfolio in its entirety, not individual securities within the portfolio. Although purchasing index put options is, by itself, inherently risky, in the context of a diversified portfolio it may well conform to a conservative client's risk tolerance by hedging some of the risk of owning equities. Lindquist may rightly determine that such a strategy is consistent with Chandler's investment policy statement. If properly constructed originally and properly explained to the client, no change in the investment policy statement is needed.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

38. (B) **Standard VI(A): Disclosure of conflicts, and Standard IV(B: Additional Compensation Arrangements.**

Explanation

Under Standard IV(B), Lindquist is required to disclose in writing to his employer any benefits (monetary or non-monetary) he receives for services that are in addition to compensation or benefits provided by his employer. An informal discussion with his supervisor does not conform to the requirement that the notice be in writing. Under Standard VI(A), he is also required to disclose the arrangement to his clients because a directorship is a conflict of interest that could reasonably be expected to impair his objectivity. He must do so even if he currently holds no shares of Western in his clients' portfolios because it may impair his objectivity in recommending the stock for inclusion in clients' portfolios in the future. Lindquist violated Standard I(B) because clients could reasonably assume his objectivity is in question.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

39. (B) **Standard V(A): Diligence and Reasonable Basis.**

Explanation

Lindquist's experimental model is not part of the formal research process and has not been adequately researched or tested. So, Lindquist does not have a reasonable basis for his recommendations. Lindquist's supervisor is required to make reasonable efforts to detect and prevent violations of applicable laws and the Code and Standards, but cannot be held responsible for all of Lindquist's actions when there is deliberate deceit involved. Plagiarism is not relevant here, because Lindquist has permission to use the model, and is not misrepresenting the work of others as his own work.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

40. (A) Violate Standard III(D): Performance Presentation.

Explanation

Lindquist failed to conform to Standard III(D) by releasing misleading information concerning his historical performance at Midwestern. KMGR may use a different management style than Midwestern, rendering historical performance of little value to Midwestern clients. Claiming compliance with CFA Institute GIPS would only compound the problem. Misrepresenting performance results as occurring at one firm when they actually occurred at a previous employer is a violation of the presentation standards.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

41. (C) Informing his employer's sufficient.

Explanation

Lindquist may accept this gift from a client for past performance as long as he informs his employer.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

42. (C) refuse supervisory responsibility.

Explanation

According to Standard IV(C), Responsibilities of Supervisors, if the member cannot discharge supervisory responsibilities because of a poor or nonexistent compliance system, the member should decline in writing to accept supervisory responsibility until the firm adopts an adequate system.

(Module 43.7, LOS 43: IV(C))

Related Material

SchweserNotes - Book 5

43. (A) require to seek the authorization from Wright to copy the spreadsheets, acknowledge Wright for developing the initial model but is not required to acknowledge Moody's Investors Service as the source of the data.

Explanation

To comply with Standard I(C) Misrepresentation, Olson should have gotten the authorization from Wright to copy the spreadsheets. The prohibition against plagiarism requires that Olson identify Wright as the source of the initial model. However, the Standard permits publishing factual information from Moody's Investors Service without acknowledgment because Moody's is recognized as a source of factual materials.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

44. (B) Ackert: Yes. Brown: No.

Explanation

The second statement is not consistent with Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program. Regarding the first statement, using "CFA" as a noun is no longer a violation of the Code of Standards. No designation exists for someone who has passed Level I of the CFA examination. Thus, Brown's statement saying that he "holds a CFA Level I designation" represents incorrect use. A correct statement would be: "Chris Brown passed Level I of the CFA examination in 2001."

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

45. (A) may invest in the stocks because the analyst would not purchase the stock for the bond portfolio he manages.

Explanation

The problem says the analyst "came across" the speculative stock investment. We do not know if the analyst neglected his duties. Since such an investment is clearly not appropriate for a high-grade bond fund, the analyst may invest in the stock without any restrictions relating to the fund.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

46. (A) Hire a full discretionary power or blind trust manager for his portfolio.

Explanation

Burgin followed Standard VI(A) and informed his employer about the potential conflict of interest. He needs to follow the CFA Institute Standards in the best interest of his employer. To prevent any future problems with conflict of interest, his best option is to discontinue the active management of his personal portfolio and use a blind trust.

(Module 43.9, LOS 43.a)

Related Material

SchweserNotes - Book 5

47. (B) **Soprano is violating the Standards by not disclosing the fundamental research aspect of the investment process.**

Explanation

Soprano is violating the Standard on portfolio investment recommendations and actions by excluding relevant factors of the investment process. The fundamental research aspect is highly relevant to the process and should be disclosed to clients. It is acceptable for Melfi to use two investment processes that may be in conflict with each other and to use a process that was not developed by her.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

48. (B) **may generally exclude more basic facts.**

Explanation

According to Standard V(B), an analyst can use reasonable judgment regarding the exclusion of some facts and should include more basic facts for reports to wider audiences. The key issue is that analysts should tailor their reports to the intended audience.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

49. (C) **There are no exceptions in this list.**

Explanation

Standard III(E) allows an analyst to reveal information about a client to CFA Institute since CFA Institute will keep the information confidential. If the analyst is reasonably certain a law has been violated, an analyst may have an obligation to report the activities to the appropriate authorities. Therefore, neither of the listed actions are exceptions from the analyst's options.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

50. (C) **disclose the nature of the free arrangement to the client before entering into a formal agreement.**

Explanation

According to Standard VI(C), the nature as well as the value of the fee must be disclosed to the client before entering into a formal agreement. The compliance officer and/or the employee's supervisor should be contacted for consultation.

(Module 43.9, LOS 43: VI(C))

Related Material

SchweserNotes - Book 5

51. (A) **must inform her employer of the arrangement because it provides her with additional compensation.**

Explanation

Members are required to disclose to their employer in writing all monetary compensation or other benefit they receive in addition to the employer's compensation. The discounting of West's commissions is a benefit that must be disclosed.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

52. (A) **in violation of Standard IV(A) "Loyalty" for failing to follow the employer's policies and procedures related to notifying clients of his departure.**

Explanation

Kline is in violation of Standard IV(A) "Loyalty" for failing to follow the employer's policies and procedures related to notifying clients of his departure.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

53. (B) **violation both Standard VII(B) and Standard I(C).**

Explanation

Arnold violated Standard VII(B). The CFA designation should not be referred to as a degree. Arnold also violated Standard I(C) because her claim that she graduated "with honors" is not true.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

54. (C) **current clients, former clients, and prospects.**

Explanation

According to Standard III(E), Preservation of Confidentially, an analyst must preserve the confidentiality of information communicated by clients, former clients, and prospects.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

55. (A) **A member or candidate may not solicit current clients away from their current employer.**

Explanation

A member or candidate may not solicit current clients away from their current employer under Standard IV(A) "Loyalty."

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

56. (A) **Karen Wright received her CFA charter in 1980. In 2001, she stopped paying her annual CFA Institute dues. During her retirement speech in 2002, Wright said, “Although I am no longer an active CFA charteholder, I was awarded the right to use the CFA designation in 1980 and maintained in 1980 active membership in CFA Institute for 20 years.”**

Explanation

Wright's statement did not violate Standard VII(B). Her right to use the CFA designation was suspended when she stopped paying dues but her statement is a matter of fact. Cabell's violated Standard VII(B) because he improperly used the CFA designation on his business card. Proper usage of the CFA designation on his business card would be: John Cabell, CFA or John Cabell, Chartered Financial Analyst. Latrell violated Standard VII(B) by misstating the requirements for obtaining a charter. There is no requirement of passing the three levels of the CFA program over three years. The CFA mark must be used as an adjective. Latrell could have stated, "I was awarded the CFA charter in 1995."

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

57. (C) **neither the firm nor the charterholder are required to comply with GIPS.**

Explanation

Adoption of GIPS is voluntary for firms. GIPS apply to firms, not individuals.

(Module 43.6, LOS 43.b)

Related Material

SchweserNotes - Book 5

58. (A) **Long violated Standard III(E) Short did not violate Standard III(E).**

Explanation

Long violated Standard III(E) because he did not preserve the confidentiality of information communicated by clients. Short did not violate Standard III(E) because this standard does not prevent members from cooperating with an investigation by CFA Institute's Professional Conduct Program. Thus, Short can forward confidential information to the PCP.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

59. (A) **provided that the analyst has a reasonable basis for his or her actions.**

Explanation

According to Standard V(B), the analyst must use reasonable judgment in identifying relevant factors when communicating with clients and prospects. The Mosaic theory does not apply here.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

60. (A) **Offshore is an OTC market maker for Burch Corporation stock.**

Explanation

Standard VI(A), Disclosure of Conflicts, requires members to disclose to their employer all matters, including beneficial ownership of securities, that reasonably could be expected to interfere with their duty to their employer or ability to make unbiased and objective recommendations. Disclosure of an employer's own involvement with the security is not necessary in this instance. If the report had been for external use, it would have been necessary to make all of the disclosures given as choices.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

Glenarm Case Study (Refer to CFA Institute Standards of Practice Casebook for details.

Peter Sherman, CFA, has recently joined Glenarm Company after spending 5 years at Pearl Investment Management. He is responsible for identifying potential Latin American investments. Previously, Sherman held jobs as a consultant for many Latin American companies and had plans to continue such consulting jobs without disclosing anything to Glenarm.

After resigning, but before leaving his employment at Pearl, Sherman had encouraged Pearl customers to move their accounts to Glenarm. He contacted accounts Pearl had been soliciting for business. He also contacted potential clients that Pearl had rejected in the past as too small or incompatible with the firm's business. Furthermore, he convinced several of Pearl's clients and prospects to hire Glenarm after he joined Glenarm. He also identified materials from Pearl to take with him, such as:

1. Sample marketing presentations he had prepared.
2. Computer program models for stock selection.
3. Research materials on companies he had been following.
4. A list of companies recommended by Sherman for potential investment which were rejected by Pearl.
5. News articles for potential research ideas.

61. (A) **Sherman did not violate Standard IV(A) by soliciting clients that were rejected by Pearl either because they were too small or unsuitable as long as winning their business did not adversely affect Pearl.**

Explanation

Standard IV(A) addresses Loyalty to the Employer and depriving the employer of profit opportunities is a violation of this standard. Because Pearl had no interest in rejected clients and had turned their profit potential down already, soliciting them is not a violation.

Taking away news articles and computer program models is a violation of Standard IV(A) because Sherman took away employer property, which could be used by Pearl or Sherman's replacement. Engaging in independent consulting practice is a violation IV(A) because Sherman not only compromised his independence and objectivity, but also did not obtain explicit written consent of his new employer, Standard IV(B), Additional Compensation Arrangements.-

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

62. (A) **a violation of Standard IV(A) because it undermined Pearl's business and its profit opportunities and caused damage to Pearl's business.**

Explanation

An attempt, successful or not, to lure away existing clients of the current employer is a violation of Standard IV(A) as it causes damage to the employer's business.

Others are incorrect because: "After hours" solicitation is not an excuse if it damages the employer's business; the fact that Pearl's clients were agreeable does not absolve Sherman of Standard IV(A) violation; even if Pearl's clients would have followed Sherman to his new employer anyway, Sherman, by soliciting such clients, damaged his employer's business. The focus is on Sherman's actions.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

63. (A) **Consent from the employer necessary to permit independent practice that could result in compensation or other benefits in competition with the member's employers.**

Explanation

Members are not prohibited from making arrangements or preparations to go into competitive business before terminating their relationship with their employer.

CFA Institute members are not prohibited from undertaking independent practice in competition with their employer provided they have consent from their employer. Members must provide notification to their employer describing the types of services to be rendered, the expected duration, and compensation for the services.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

64. (A) **decline supervisory responsibilities in writing until the company adopts an adequate compliance system.**

Explanation

According to Standard IV(C) Responsibilities of Supervisors, if Crane believes the company's compliance procedures are not adequate, Crane should decline supervisory responsibilities in writing until an adequate system is adopted.

(Module 43.7, LOS 43: IV(C))

Related Material

SchweserNotes - Book 5

65. (B) **Both of these statements must be disclosed to clients.**

Explanation

Both of these items are explicitly listed in the discussion of Standard VI(A), Disclosure of Conflicts.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

66. (A) **does not require Parsons to notify Malloy or preparing to undertake independent practice under the current conditions.**

Explanation

Standard IV(A), Loyalty to Employer, requires that Parsons obtain written consent only from her employer before she undertakes independent practice that could result in compensation or other benefit in competition with Malloy. It is not required to get permission from your employer when only preparing to go into independent practice.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

67. (A) Chang.

Explanation

Consistent with Standard VII(B), members must use the CFA marks in a proper manner. Members may indicate "CFA" or "Chartered Financial Analyst" after their names, but the designation should not be given more prominence than that used in printing the name itself. Also, periods should not be used to separate the letters.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

68. (A) must disclose the terms of the lease arrangement.

Explanation

Standard VI(C), Referral Fees, requires members to disclose to clients and prospects any consideration or benefit received by the member or delivered to others for the recommendation of any services to the client or prospect. Florence has delivered a benefit (free rent) to Rigs, which must be disclosed to the clients referred by Rigs. Florence must not rely on Rigs to make the disclosure.

(Module 43.9, LOS 43: VI(C))

Related Material

SchweserNotes - Book 5

69. (B) Toby's clients and his parent's account equal priority, followed by his employer, and then his personal account.

Explanation

According Standard VI(B) Priority of Transactions, Duval should give transactions for clients and employers priority over his personal transactions. Because his parent's retirement account represents a client account at Toby, Duval should treat this account just like any other firm account. His parent's retirement account should neither be given special treatment nor disadvantaged because of an existing family relationship with Duval. If Duval treats his parent's retirement account differently from other accounts at Toby, he would breach his fiduciary duty to his parents.

(Module 43.7, LOS 43.b)

Related Material

SchweserNotes - Book 5

70. (A) **Brenan has violated both Standard of Professional Conduct III(D), Performance Presentation, and Standard I(C), Misrepresentation.**

Explanation

Brenan violated Standard of Professional Conduct III(D) by using only one portfolio's results to create a false impression of all the portfolios, and Brenan violated Standard of Professional Conduct I(C) by creating the impression that a certain return was assured (he should have used the words "might" or "could" instead of "can").

(Module 43.6, LOS 43.b)

Related Material

SchweserNotes - Book 5

Joan Platt, CFA, operates an investment firm in New York, but maintains an office in Xania. Platt's firm invests on its clients' behalf in both domestic and international stocks and bonds. Platt's employees include two analysts, Paula Linstrom, CFA, and Hershel Wadel, a member of the CFA Institute. Both analysts report to Platt directly. Thorvald Knudsen, CFA, manages the international bond portfolio.

Xania recently established a stock market, which is not very efficient. None of the Xanian stocks trade in the U.S. market. Xania legally permits the use of material inside information. Platt believes that using inside information would help her compete against other Xanian investment advisers, and also help some of her Xanian clients reach their investment objectives.

Platt instructs Wadel to write a research report on Gamma Company. Wadel's wife inherited 500 shares of Gamma Company from her father when he died five years ago. Gamma stock currently sells for $35 a share. Wadel does not believe that informing Platt about his wife's inheritance is necessary.

Doris Black, one of Wadel's long-time clients, verbally promised Wadel that he could use her vacation home in Aspen, Colo., for a week during skiing season if the return on her portfolio exceeded its benchmark by two percentage points during the next year. Black also promised to reimburse Wadel for his travel expenses. Because Wadel is the sole manager of Black's portfolio, he says nothing to Platt about his arrangement with Black.

Platt instructs Linstrom to write a research report on Delta Enterprises. Delta's stock is widely held by institutional and individual investors. Linstrom does not own any Delta shares, though one of her friends owns 100 shares of Delta. Linstrom does not believe that informing Platt about her friend's ownership of Delta shares is necessary.

Platt suspects that one of the firm's unpaid interns has violated a federal securities regulation.

71. (B) **Wadel violated Standard VI(A) – Disclosure of conflicts and Linstrom did not violate Standard VI(A).**

Explanation

Wadel violated Standard VI(A) by not disclosing his wife's holdings. Linstrom is not in violation of the Standard because a friend's ownership of the shares should not be expected to impair her ability to make objective decisions.

(Module 43.9, LOS 43.a)

Related Material

SchweserNotes - Book 5

72. (A) **Wadel must disclose the arrangement to Platt but is not required to disclose the arrangement to his other clients.**

Explanation

Wadel is required to disclose the arrangement between him and Black under Standard IV(B)-Additional Compensation Arrangements, regardless of whether or not the compensation is cash or noncash. Under Standard I(B)—Independence and Objectivity, members may accept bonuses or gifts from clients, so long as they disclose them to their employers, because gifts in a client relationship are deemed less likely to affect a member's objectivity and independence than gifts in other situations. Token gifts need not be disclosed.

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

73. (A) **Initiate an investigation and place limits on the intern's activities pending the outcome.**

Explanation

Platt must initiate an investigation, and must also take steps to ensure that additional violations do not occur during the investigation. The investigation could be handled internally by the firm's compliance officer, or could involve outside legal counsel. Simply instructing the intern to stop the conduct is not sufficient—the Standards require a more proactive response. Reporting the intern to the authorities is not appropriate because Platt is not sure the intern is violating the law. The fact that the intern is not paid does not absolve Platt or her company from liability for the intern's actions.

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

74. (B) **not use material inside information when trading in Xania.**

Explanation

Standard II(A)—Material Nonpublic Information does not allow the use of material nonpublic information in investment decisions. Platt is bound by the law of the land if it is stricter than the Standards, and by the Standards if they are stricter than the law. Since the Standards are stricter than Xanian law, Platt's Xanian operations are governed by the Standards. Thus, she cannot use material nonpublic information under any circumstances.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

75. (B) **in violation of the Standard concerning disclosure of investment processes.**

Explanation

Standard V(B) Communication with Clients and Prospective Clients requires members to disclose "general principles and investment processes" to clients and to "promptly disclose any changes that might significantly affect those processes." Under the Standard, Midland management is required either to:

1. rebalance the portfolio in a timely manner so as to maintain compliance with the investment policy or
2. communicate an intended change in that policy well in advance of the actual change so as to afford investors time to act prior to the change in investment policy taking place.

Midland is in violation of the Standard.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

Vera Sandro recently joined Seamark Securities as a portfolio manager. Sandro also recently took the Level III examination in the Chartered Financial Analyst program, but has not yet received her results. Seamark is a medium-sized firm that employs many CFA Institute members.

Sandro has been asked by her supervisor, Ledia Ferrazzo, CFA, to write a brief biography to be included in the promotional brochure Sandro hands out to prospective clients. Sandro included the following sentences in her biography: "Vera Sandro, a Chartered Financial Analyst Level III candidate, has focused educational and investment experience in the small-cap stock market. She has consistently achieved better-than-average market returns and expects to do so in the future as well." The brochure was printed and is being used by Sandro as a marketing tool.

Soon after joining Seamark, Sandro attended a conference at which Liam Wright presented several computerized spreadsheets that he had developed to value high-tech stocks. During the presentation, Sandro copied the spreadsheets on her laptop computer. Later, Sandro made major changes to Wright's initial model. After testing the new model, Sandro was impressed with the results. Wright used Standard & Poor's data as inputs for the model, but Sandro used data supplied by Moody's Investors Service. Sandro wrote a research report describing the revised model and its results in detail and sent the report to her biggest client, along with some stock picks selected by the model.

Ferrazzo, the head portfolio manager for Seamark, often meets corporate executives in the course of her evaluation of potential investments. A week ago, Ferrazzo had lunch with Ralph Henderson, a senior vice president of Kellogg Industries, a maker of luxury linens. Ferrazzo told Henderson that she was looking for an appropriate investment in the fabric industry for her large client, Parker Jones. Henderson responded that he thought his company was well-positioned in the market, though he admitted to underestimating the demand for silk sheets in the region. After lunch, Ferrazzo read a research report that said all of Kellogg's silk plants were running at capacity, and the company might have trouble meeting the long-term demand. Two days later, Ferrazzo observed another senior vice president of Kellogg at a restaurant having dinner with the chief financial officer of Bradley Textiles, a maker of various kinds of silk fabrics. It is widely known in the market that Bradley is seeking a potential merger partner, as the founder and CEO is ready to retire.

Ferrazzo did additional research and concluded that Kellogg Industries and Bradley Textiles had complementary product lines in several areas and similar management cultures. She also remembered reading in Forbes a story in which Kellogg's CFO was quoted as saying the company had the financial wherewithal for a merger and an interest in expansion.

Ferrazzo's research indicated that Bradley's market value exceeded its intrinsic value, suggesting that Kellogg was unlikely to pay a high merger premium. Nonetheless, Ferrazzo proceeded to purchase stock in Bradley on behalf of her clients. Six months later, Kellogg acquired Bradley and paid a 40 percent premium over market price.

Sandro shares a workspace with Don Wilson, a CFA charterholder. Wilson recommends that one of his clients buy Alpha Co. shares based upon detailed research conducted by a Seamark analyst. Sandro recommends that one of her clients sell Alpha Co. shares based upon comprehensive research conducted by another brokerage firm.

Seamark has evaluated prospective brokers to execute trades on behalf of its investment-management clients. The findings are as follows:

- White Brokerage Co. offers best price and execution, charges an average of $99 for a typical trade, and provides generous soft dollars.
- Green Brokers Inc., offers good price and execution, charges an average of $59 for a typical trade, and provides moderate soft dollars.
- Blue Brokerage Services Inc., offers best price and execution, charges an average of $79 for a typical trade, and provides moderate soft dollars.

76. (A) Standard V(A): Diligence and Reasonable Basis, but not standard II(A): Material Nonpublic Information.

Explanation

Ferrazzo's disclosure of the name of her client, Parker Jones, to Henderson violated Standard III(E): Preservation of Confidentiality. Ferrazzo used the mosaic theory to determine that Kellogg was pursuing an acquisition and did not violate Standard II(A): Material Nonpublic Information. The purchase of Bradley violated Standard V(A): Diligence and Reasonable Basis, because Ferrazzo had reason to believe that even if Bradley was going to be acquired, the premium was likely to be low. The fact that she got lucky and guessed right does not satisfy the Standard.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

77. (C) Providing basic information about technology stocks in the research report.

Explanation

To comply with Standard I(C): Misrepresentation, Sandro should have gotten permission from Wright to copy the spreadsheets. The Standard also requires that Sandro identify Wright as the source of the initial model despite the fact that she made major changes to it. The plagiarism standard permits publishing factual information from Moody's and S&P without acknowledgment, but the use of different data sources could affect the performance of the model, and should be disclosed to satisfy Standard V(B): Communication with Clients and Prospective Clients. Because the report is going to an individual client, Sandro need not provide basic information about technology stocks, according to Standard V(B): Communication with Clients and Prospective Clients.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

78. (A) **Standard IV(C): Responsibilities of Supervisors, but nor standard VII(B): Reference to CFA Designation, and the CFA Program.**

Explanation

Sandro's description of her CFA standing is truthful in this case because she is still technically a CFA candidate. Sandro is not allowed to imply that she can continue to produce superior returns, and as such violated the misrepresentation standard. Ferrazzo, in her supervisory role, should have prevented the violation but did not. Standard IV(A): Loyalty to Employer refers to independent practice, and is not relevant to this situation.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

79. (C) **White and Blue only.**

Explanation

The CFA Institute Soft Dollar Standards dictate members must always seek best price and execution. Soft-dollar arrangements must provide a benefit to clients, be disclosed, and be reasonable in relation to the research and execution services provided. Because both White and Blue provide best price and execution, it is within Ferrazzo's discretion to pay more for White's services as long as the research benefit is reasonable. Both White and Blue may be used.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

80. (C) **Sandro has breached a fiduciary duty or her client.**

Explanation

The use of a comprehensive research report is reasonable basis for a buy or sell recommendation. The fair-dealing standard has not been violated, as neither client was put at a disadvantage by the advice, even though the analysts' advice was contradictory. The fair-dealing standard requires the notification of clients who trade in opposition to the firm's official recommendation, so the trade should not be executed until the client is told about the firm's buy rating. While Sandro's advice differs from that of her colleague and is based on a competitor's research, she did not necessarily breach a fiduciary duty, if the investment made sense for the client. There are numerous investments that are appropriate for certain types of clients and inappropriate for others.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

81. (B) **Sandro can begin using the CFA designation as soon as she receivers her exam results.**

Explanation

Just because Sandro receives her results from CFA Institute, she still must satisfy all of the requirements before she can use the designation. The standard governing use of the CFA mark states that there is no acceptable term for a partial designation. According the Standards of Practice Handbook, 9th Edition, delivering a copy of the Code and Standards is no longer required. Standard VI(A): Disclosure of Conflicts, requires the disclosure of all security ownership that might interfere with a member's duties. While the stock is thinly traded, it still might be of interest to Seamark clients, and Sandro must disclose her ownership. In addition, if she holds a position in the company or on the board that could take up some of her time, Standard IV(A): Loyalty to Employer, also comes into play.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

82. (A) **Harrow must disclose both his relationship with Miracle and his ownership of shares in Wonder.**

Explanation

Standard VI(A) Disclosure of Conflicts requires that Harrow disclose matters that reasonably could be expected to interfere with his independence and objectivity. Both Harrow's relationship with Miracle and his ownership of Wonder's shares represent potential conflicts of interest and must be disclosed prominently and in clear language in the research report, giving clients the ability to weigh the possible effects of these potential conflicts on his analysis and conclusions.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

83. (B) **Hiring a company outside the firm to perform the task.**

Explanation

According to Standard III(E), an analyst should limit the number of persons who have access to clients' personal information. Allowing a company outside the firm to send birthday cards could be a violation. Sending a birthday card is not a violation, nor is sending a gift of reasonable value.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

84. (C) **No. as long as she does not indicate she currently has the designation.**

Explanation

Stades is allowed to state that she earned the designation as long as she does not infer that she currently has the designation.

(Module 43.1 0, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

85. (A) **member or candidate provide (on request) additional detail information which supports the abbreviated presentation.**

Explanation

See Standard III(D). When presentations are brief, additional detail which supports the abbreviated presentation information must be provided on request. Best practice dictates that the member or candidate should make reference to the abbreviated nature of the presentation.

(Module 43.6, LOS 43: III(D))

Related Material

SchweserNotes - Book 5

86. (A) **may be a violation despite the client's approval.**

Explanation

Just because the clients know of a practice does not make it right. The analyst must put the clients first. It is a violation for the analyst to participate in a "hot new issue" which can lower the allocation to any given client below what that client would prefer. This is tantamount to putting the analyst's interests ahead of the clients' interests.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

87. (A) **not a violation of any Standard.**

Explanation

The fact that the firm is seeking the mandate does not preclude the research department from performing analytical work on the security. As long as the final recommendation is based upon reasonable facts, not the desire to obtain the mandate, there is no violation.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

88. (A) **not violating the Standard by applying his version of the model, but is violating the standard by not disclosing it to clients, Brisco is not violating the Standard.**

Explanation

Because the research is thoroughly conducted, and Logan has authority to make individual security selection decisions, Logan is not violating the Standards by applying his model. However, Logan is violating the Standard on communication with clients and prospective clients by excluding relevant factors of the investment process. The use of his model is an important aspect of the investment process and should be disclosed to clients. Brisco is not violating the Standards by not considering Logan's research.

(Module 43.8, LOS 43.b)

Related Material

SchweserNotes - Book 5

89. (B) **making arrangements to go into a competitive business before terminating her relationship with Nationwide.**

Explanation

Standard IV(A) permits Thompson to make preparations to go into a competitive business before terminating her relationship with Nationwide provided that such preparations do not breach her duty of loyalty.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

90. (A) **Coleman violated the Standard because she failed to separate opinion from fact in her research report.**

Explanation

Coleman is required to distinguish between facts and opinions in her research reports. Her statement that Union will decrease its dividend from $2 to $1 a share is a prediction, not a fact, and therefore should be distinguished clearly as an opinion.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

91. (C) **the relationship of the historical beta and return only.**

Explanation

Using reasonable judgment, an analyst may exclude certain factors from research reports. Since the report will be delivered to clients with well-diversified portfolios, total risk is not as important as beta. Given that the total risk has been only commensurate with historical return, furthermore, then the analyst is not negligent by not mentioning it.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

92. (B) **Standard VI(B). Priority or Transactions.**

Explanation

Standard VI(B), Priority of Transactions, applies. If an analyst decides to make a recommendation about the purchase or sale of a security, he must give his customers or employer adequate opportunity to act on this recommendation before acting on his own behalf. Personal transactions include those made for the member's own account and family accounts. Here, McKinney violated Standard VI(B) by acting on his mother-in-law's behalf and then waiting until the end of the day to act on his employer's behalf.

Explanations for other responses:

- Standard IV(A), Loyalty to Employer, does not apply. This standard concerns a member competing with his/her employer (independent practice), for example a member who engages in outside consulting.
- Standard II(A), Material Nonpublic Information, does not apply. The question does not indicate that the information is not public.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

93. (B) **Standard V(A), Diligence and Reasonable Basis, and Standard V(B), Communication with Clients and Prospective Clients.**

Explanation

The analyst should verify that the research department has interpreted the chairman's speech correctly. The analyst must make it clear that the statement concerning inflation is only an opinion. No one knows if that is true or not at any point in time. Based upon the given information, we cannot say that the analyst is violating only one standard. The analyst may also be violating plagiarism in accordance with Standard 1(C), Misrepresentation. Hence, the answer citing the two standards and not limiting violations to just those two standards is the best answer.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

94. (A) **do both of these.**

Explanation

Both of these are explicitly required by Standard V(A).

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

95. (A) **decline in writing to accept supervisory responsibility until Allegheny adopts reasonable producers to allow her adequately exercise such responsibility.**

Explanation

If Kirby clearly cannot discharge supervisory responsibilities because of an inadequate compliance system, she should decline in writing to accept supervisory responsibility until Allegheny adopts reasonable procedures to allow her to adequately exercise such responsibility.

(Module 43.7, LOS 43: IV(C))

Related Material

SchweserNotes - Book 5

96. (C) **violated the Code and Standard by not including the insider trading information in her report.**

Explanation

Standard V(B), Communication with Clients and Prospective Clients, requires analysts to use reasonable judgment regarding the inclusion or exclusion of relevant factors in their research reports. It would not be unreasonable to exclude the temporary credit downgrade from 3 years earlier.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

97. (A) **may not satisfy the Standard if such information is only provided after the receivers of the information have become clients.**

Explanation

Standard VI(C) says that a member must reveal information both on fees she receives for referring clients to other professionals and those she pays for having clients referred to her before a prospect becomes a client. This allows the prospect to evaluate any partiality of a recommendation and the full cost of the services.

(Module 43.9, LOS 43: VI(C))

Related Material

SchweserNotes - Book 5

98. (A) **both disclose the position on the board to his supervisor and described his responsibilities on the board.**

Explanation

Valley could be affected by his position on the board because he may tend to favor investments in firms that do cancer research. To comply with Standard VI(A), Disclosure of Conflicts, Valley must inform his supervisor of this relationship and describe his responsibilities on the board. Even if his supervisor does not find the relationship troublesome, any subsequent action that could lead to a conflict of interest should be discussed with the firm's compliance officer.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

99. (B) **insist that the supervisor change the earnings forecast or remove his (the analyst's) name from the report.**

Explanation

According to Standard V(A), Diligence and Reasonable Basis, the analyst must exercise diligence, independence, and thoroughness when performing investment analysis, making a recommendation, or taking investment action. The analyst should document the difference in opinion including any request to remove his or her name from the report.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

100. (B) **Consent from the employer is necessary to permit independent practice that could result in compensation or other benefits in competition with the member's employer.**

Explanation

There is no blanket prohibition against independent practice in competition with a member's employer. The member must obtain permission from the employer. Members may make preparations to go into a competitive business, but may not solicit clients of the employer as long as members are still employed by the employer.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

101. (B) not violated the Standards.

Explanation

Based on the information here, Hill has done nothing wrong. He took a call at his home, presumably on his own time, and the client made it clear that he would never be a client of Advisors. Therefore, there was no breach of loyalty to Advisors by Hill, nor is there a conflict of interest.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

102. (C) Robert Hopkins, Chartered Financial Analyst.

Explanation

The CFA designation should always be capitalized and shown without periods. The CFA designation should not be referred to as a degree. Placing the designation "CFA" or "Chartered Financial Analyst" after one's name on a resume, business card, brochure, or other published material is appropriate.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

103. (C) updating disclosures when the policy change is implemented.

Explanation

Standard VI(A) "Disclosures of Conflicts" recognizes this policy as a potential conflict of interest as members and candidates could be incentivized to favor short-term trading gains over long-term value creation. Best practices dictate updating disclosures when the policy change is implemented. The long-term investors should know how members and candidates are compensated, especially when there is the potential for conflicts of interest.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

104. (C) not violate the Code and Standards by revealing the names, financial condition and investment objectives of his clients to PCP.

Explanation

Standard III(E) requires members to preserve client confidentiality. An exception to this standard is a PCP investigation. Because PCP will also keep the clients' information confidential, members are expected to fully cooperate with PCP investigations.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

105. (C) **Advisors' research department recommends a stock.**

Explanation

Smith will be in violation if he acts solely on the basis of what he read in the periodical. Use of information within the firm can be relied upon unless the Smith has reason to believe the source lacks a sound basis.

(Module 43.6, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

106. (B) **Stating his past performance as long as it is fact.**

Explanation

There is no evidence that he's lying about his past performance. He is in violation for implying that he can guarantee performance, for using short-term performance, and for imputing the manager's past performance to future performance.

(Module 43.6, LOS 43: III(D))

Related Material

SchweserNotes - Book 5

107. (C) **Lim violated the Standard, but Bland did not.**

Explanation

There is no designation for someone who has passed Level I, Level II, or Level III of the CFA examination. Candidates may state, however, that they have completed Level I, II, or III, as the case may be, in the CFA Program. Thus, Lim violated the Standard, but Bland did not.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

108. (C) **violated the Standards by not including all of the relevant factors in the research report, but not by making patriotic statements.**

Explanation

By not mentioning the increased risk of the market, Brooks has violated the Standard on using a research report. However, the patriotic statements do not violate the Standards.

(Module 43.8, LOS 43: b)

Related Material

SchweserNotes - Book 5

109. (B) **in violation of Standard V(C) Record Retention.**

Explanation

Hurst is most likely in violation of Standard V(C) Record Retention because the supporting documentation is unavailable. He needs to recreate the supporting records based on information gathered through public sources or the covered company. He may have a reasonable basis for his recommendations and have been diligent in his analysis, but must reconstruct the records of this analysis before issuing the reports.

(Module 43.8, LOS 43: V(C))

Related Material

SchweserNotes - Book 5

110. (A) **Tripp may delegate some or all of his supervisory duties to Brown, even though Brown is not subject to the Standards.**

Explanation

Standard IV(C) Responsibilities of Supervisors permits Tripp to delegate supervisory duties to Green, Brown, or both, but such delegation does not relieve Tripp of his supervisory responsibility.

(Module 43.7, LOS 43: IV(C))

Related Material

SchweserNotes - Book 5

111. (B) **I passed Level II of the CFA Program in 2003.**

Explanation

Candidates may refer to the CFA level(s) passed and the associated dates as long as a partial designation is not implied. They may not guarantee or promise a given level of return.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

112. (B) **There must be monetary compensation for an employer/employee relationship to exist.**

Explanation

Monetary compensation is not a requirement of the employee/employer relationship.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

113. (C) describe to his employer in detail the activities related to this consulting arrangement.

Explanation

According to the Standards of Professional Conduct, Jones must disclose to his employer all outside compensation arrangements, describe to his employer in detail the activities that give rise to outside compensation, and obtain written permission from his employer in advance.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

114. (A) complied with the Standards.

Explanation

Members and candidates may reasonably rely on their firms' research departments for analysis and remain in compliance with Standard V(A) Diligence and Reasonable Basis.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

115. (C) Saul must obtain written consent from Savage Bank and Fairway Enterprises if he decides to accept the offer to serve on the Board of Directors.

Explanation

Standard IV (B) requires that member obtain written consent from all parties involved before accepting monetary compensation or other benefits that they receive for their services that are in addition to compensation or benefits conferred by a member's employer. The phrase "all parties" is referring to Saul's employer and Fairway's Board of Directors.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

116. (A) The sanctions imposed by the Professional Conduct staff are final and conclusive.

Explanation

In the event of misconduct by a member or candidate the CFA Institute Professional Conduct staff decides whether a violation occurred and what action to take. If the Professional Conduct staff decides a disciplinary sanction is appropriate the member or candidate may decide to reject the sanction. In this case the matter is referred to a panel of Disciplinary Review Committee members comprised of volunteer CFA charterholders. The panel decides whether a violation of the Code and Standards occurred and what sanction should be imposed.

(Module 43.10, LOS 43: VII(A))

Related Material

SchweserNotes - Book 5

LMS Securities is a boutique broker-dealer specializing in private placements for technology companies. The firm also provides aftermarket support for the companies that go public after private rounds of financing. This support includes market making and research coverage.

Susan Jones, CFA, is an analyst at LMS Securities. She is responsible for a subset of the companies for which LMS offers research coverage. She recently received her annual CFA Institute Professional Conduct statement, but has not yet filled it out and turned it in. Steve Brown is an analyst who directs the due diligence process for LMS Securities' private placements. Brown passed the Level II exam five years ago, and has registered for the Level III exam every year since then, but has never taken it. He is registered for the Level III CFA exam next June, but nobody at the office believes he will actually take the test.

Sunrise Technologies is a longtime client of LMS Securities. LMS arranged four levels of private financing, for Sunrise, providing in-depth business consulting as well as handling all of the private placements. Sunrise went public 90 days ago and is currently trading at $14 per share.

Kenneth Karloff, CEO of LMS Securities, instructed Jones to write a favorable research report on Sunrise Technologies right before the company went public, setting a price target of at least $30 per share. Jones has developed a number of alternative cash flow projections for Sunrise Technologies. She picks an optimistic scenario to justify a $30 price target and issues a positive report using those projections.

After Sunrise Technologies has gone public, Karloff decides to help Jones to write a more-detailed research report on the company. Karloff provides Jones with information about the product pipeline and sensitive patent litigation that was given to him in confidence by Sunrise executives while the company was private. Given the product pipeline and legal outlook, Jones revises her cash flow models to reflect greater growth, then writes a positive report and advises LMS's clients to buy the stock.

117. (A) **submit her completed Professional Conduct Statement and pay applicable membership dues.**

Explanation

To remain an active member, Jones must agree to abide by the Code and Standards and the Professional Conduct Program. This is accomplished by completing the Professional Conduct Statement on an annual basis. In addition, Jones must pay annual membership dues. Continuing education is encouraged but not required to remain an active member.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

118. (A) **Jones is in compliance with the objectivity Standard because she made her recommendation based facts, not conjecture; Karloff has violated the Standard regarding the use of material nonpublic information.**

Explanation

Jones' second research report made reference to hard facts, and her analysis and revision of the cash flow projections seems thorough and reasonable. This time, Karloff did not press her to express a certain opinion, and she found the information about the company compelling. She projected higher growth in cash flow for Sunrise, but nowhere is it said that she guaranteed a hard target. Jones is in compliance with the misrepresentation, objectivity, reasonable-basis, and research-report Standards. Karloff violated the insider-trading Standard because the information was given to him in confidence. He may also have violated his fiduciary duty to Sunrise, which probably kept the information private for a reason.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

119. (A) **Disclose to all clients whether different levels of service are offered**

Explanation

Jones must disclose different levels of service to all clients. Jones must inform clients about new buy recommendations and advise them not to sell, but she cannot disregard the order if the client still wishes to sell. Family-owned accounts should be handled in the same way as other accounts, and cannot be made to wait until everyone else has acted. The Standard allows for the fact that it is impossible to notify everyone at the same time.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

120. (A) **If I pass the Level III test, I may be eligible for my CFA charter late next year.**

Explanation

This statement is quite literally correct, and complies with the Standards. "Level III CFA" is not an acceptable use of the CFA mark. Candidates should not offer a prediction about the time they will earn their charter. While Brown is not likely to take the test, as long as he is registered, he may refer to himself as a candidate.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

121. (C) **Standard V(A): Diligence and Reasonable Basis because her research report was not thorough, and Standard I(B): Independence and Objectivity because of her obedience to her CEO.**

Explanation

Jones' research was not thorough, and her report did leave out salient facts. Thus, she violated Standards V(A) and V(B). Her objectivity was certainly in question, so she violated Standard I(B). She also has a fiduciary duty to the clients regardless of what the boss says, so she violated Standard III(A). No nonpublic information was used in this report, so Standard II(A) was not violated.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

122. (A) **Dawson: Yes, Hamilton: Yes.**

Explanation

Dawson violated Standard VI(A), Disclosure of Conflicts, by failing to inform Ascott of her involvement with Brightwood College. Dawson could reasonably be expected to be involved with investment policy decisions at Brightwood that could affect Ascott because Ascott manages a portion of Brightwood's endowment. Hamilton also violated Standard VI(A), because she ignored a directive of her employer. Her purchase of Horizon stock has an appearance of impropriety. Hamilton could discuss the purchase of Horizon stock with her firm's compliance officer and request an exception to the prohibition against personal trading in securities analyzed or recommended by Ascott.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

123. (C) **Standard V(A), Diligence and Reasonable Basis, if she does not first verify the data in the table is accurate.**

Explanation

Since the data in the table supposedly comes from Standard & Poor's, a recognized data source, the analyst does not have to cite the source of the data. However, the analyst needs to use reasonable care and verify that the data is accurate by going back to the source. Had the analyst printed the table prepared by her colleague without acknowledgement, the analyst would have violated Standard I(C), Misrepresentation.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

124. (B) **a violation because the advertisement implies the firm generated this return.**

Explanation

Reporting the historical returns of all assets now in the fund introduces a survivorship bias. Also, the advertisement is misleading because the fund just came into existence and has no historical record. Thus, the firm has misled the public as to their performance history.

(Module 43.6, LOS 43: III(D))

Related Material

SchweserNotes - Book 5

125. (B) **in violation of CFA Institute Standards concerning the disclosure of security selection and portfolio construction processes.**

Explanation

Clearly, the risk profile of this fund is much different from a typical balanced fund. In fact, it could be effectively described as a hedge fund if +200/-100 allocations are typical. BlueRock is in violation of the Standard concerning disclosure of security selection and portfolio construction processes.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

126. (A) **discussing the new methodology with the clients, in its entirety.**

Explanation

Standard V(B), Communication with Clients and Prospects, requires any change in the scope, valuation methodology, or focus of the portfolio to be discussed with clients.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

127. (B) **Capelli has a reasonable basis for his recommendation, but King does not.**

Explanation

Capelli appears to have exercised diligence and thoroughness in making his recommendation. King's recommendation is not based on thorough quantitative work because the period used in her study is only one year. Also, her recommendation does not consider the client's specific needs and circumstances.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

128. (A) **act on it on her own behalf as she sees fit.**

Explanation

The analyst's commodity futures trading is not a violation of Standard VI(B) Priority of Transactions because the investment is not suitable for her clients. If the analyst believes that none of her clients should trade commodity futures, she is not obligated to advise them of her own investments in them.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

Hunter Harrison, CFA, has recently been promoted to Chief Investment Officer (CIO) of Ironclad Investments, an investment adviser and pension consultant for medium and large corporate pension clients. Ironclad recently hired a compliance officer to update its compliance manual, which is consistent with the CFA Institute Code and Standards. Harrison serves as a director on several non-profit and corporate boards of directors, some of which have their pension assets managed by Ironclad. As part of his new job duties, Harrison will oversee Ironclad's research analysts and portfolio managers, including Michelle Myers, who passed the Level II CFA examination last year and is registered for the next exam. Myers is a portfolio manager who regularly meets with clients and prospects. Myers is also a partner in a software company that sells retirement and benefit administration services to institutional clients, some of which are also clients of Ironclad to whom Myers has recommended the software company. Myers has disclosed her partnership interest in the software company to Ironclad, including the potential for additional compensation and the possible conflicts of interest, but not to her clients.

One of Myers' software clients, Breakthrough Pharmaceuticals (Breakthrough), is a publicly traded corporation that is also held in many of Ironclad's client portfolios. In the course of their business relationship, Breakthrough's CEO informs Myers that the company has been having difficulty making retirement benefit payments, and its pension plan has recently gone from "overfunded" to "significantly underfunded" as a result of market conditions. Breakthrough's CEO indicates to Myers that he is attempting to source additional short-term financing to make retiree benefit payments and will disclose the significant "underfunded status" of the pension plan in the upcoming financial statements. Myers, concerned that Breakthrough's current pension troubles and short-term liquidity issues will negatively affect its earnings and consequently the performance of the company's stock, informs Harrison of the impending disclosure. Harrison allows Myers to sell 1,800,000 shares of Breakthrough stock for clients, causing the price to drop by 5%. When the pension troubles are later disclosed in the company's financial statements, Breakthrough's stock price drops an additional 18%.

Harrison, as CIO, is chairman of Ironclad's proxy voting committee. Myers is also a member of the committee. Ironclad, as a discretionary investment manager, votes proxies through the proxy voting committee on behalf of clients. Ironclad is currently reviewing proxies for several companies covered in research, including technology companies Advanced DSL (Advanced), InterConnect Inc. (InterConnect), Speedy Chip Technology (Speedy Chip), and Wavelength Digital (Wavelength). Each company's current proxy contains voting proposals pertaining to employee stock option expensing methods. This issue is particularly important to Ironclad because several of its investment personnel recently participated in an industry forum that supported increased disclosure for company stock options. The panel concluded that such disclosure will provide investors with a more complete estimate of corporate earnings. Ironclad, through its clients, owns approximately 4% of the outstanding shares of Advanced and InterConnect and approximately 6% of the outstanding shares of Speedy Chip and Wavelength.

Harrison serves on the board of directors for InterConnect and Wavelength, while Myers provides consulting services for Speedy Chip. Harrison receives cash compensation and stock options for his services, while Myers receives restricted stock and stock options. The investment bank that led the public offering of InterConnect and Speedy Chip and seven of nine sell-side analysts covering the companies have "sell" ratings on the stocks. Ironclad's analysts have also issued "sell" recommendations on the companies due to, among other issues, lack of earnings transparency and low earnings quality. Contrary to committee consensus, Harrison and Myers vote client proxies "against" the expensing of employee stock options for InterConnect, Wavelength, and Speedy Chip. Harrison increases his clients' positions in both InterConnect and Wavelength, citing "growth opportunities" and "consensus opinion." Neither Harrison nor Myers has disclosed these compensation arrangements to Ironclad.

129.		Partnership interest	Breakthrough sale
	(B)	Yes	Yes

Explanation

Standard VI(A) — Disclosure of Conflicts, is applicable since Myers is a portfolio manager with fiduciary responsibility for institutional clients of Ironclad who may also be clients of her software company, thereby potentially compromising her ability to make unbiased and objective investment recommendations. Myers should disclose the potential conflict to her clients and to Ironclad and abide by any restrictions imposed by the firm. Myers has not disclosed the conflict to clients and has therefore violated the Standard. Harrison has violated Standard IV(C) — Responsibilities of Supervisors by failing to prevent Myers from trading on material nonpublic information. He has a responsibility as a supervisor to make reasonable efforts to detect and prevent violations of the Standards by his employees.

(Module 43.9, LOS 43.a)

Related Material

SchweserNotes - Book 5

130. (A) Yes, because the information shared by Breakthrough's CEO was nonpublic.

Explanation

Although the information shared by Myers may have helped Ironclad's clients avoid losses in shares of Breakthrough, the information was material nonpublic information. Information is "material" if its disclosure would have an impact on the stock or if a reasonable investor would want to know the information prior to making an investment decision. Information is "nonpublic" until it has been generally disseminated to the marketplace and investors have had an opportunity to react to the information. The information about Breakthrough's pension difficulties was both material and nonpublic, as the stock dropped significantly upon disclosure of the information in the market. Therefore, Myers had a duty to keep the information confidential and not to trade or cause others to trade on the information. By sharing the information with Harrison and trading on that information, Myers violated Standard II(A) – Material Nonpublic Information.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

131.		Harrison's directorships	Myers' consulting arrangements
	(A)	Yes	Yes

Explanation

Standard IV(B) — Additional Compensation Arrangements, applies to both Harrison and Myers, as they both receive compensation for their respective outside services in the form of cash, stock, and stock options. There is no indication that either of them have disclosed their compensation arrangements to Ironclad, which constitutes a violation of Standard IV(B). Standard I(B) — Independence and Objectivity also applies to this situation, as both Harrison and Myers have outside activities that have the appearance of compromising their independence and objectivity regarding Ironclad's clients. Harrison's role on the boards of directors for InterConnect and Wavelength and Myers' role as a consultant for Speedy Chip appear to drive their proxy voting decisions, on behalf of Ironclad's clients, regarding the expensing of stock options. Thus both Harrison and Myers have also violated Standard I(B). Harrison and Myers may have also violated Statement VI(A) — Disclosure of Conflict by failing to disclose the conflicts of interest that exist as a result of Harrison's directorships with Interconnect and Wavelength and Myers' consulting arrangement with Speedy Chip. Such conflicts (whether actual or potential) are required to be disclosed prominently and in clear language to clients, prospects, and employers according to Standard VI(A).

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

132. (A) discard all proxies on behalf of Ironclad's clients when there is a conflict of interest.

Explanation

According to Standard III(A) — Loyalty, Prudence, and Care, Ironclad, as a discretionary investment manager, is responsible (unless otherwise stipulated in the client guidelines or agreement) for making informed and reasonable decisions regarding proxy voting on behalf of clients. Among other things, Ironclad should have a proxy voting policy and a process for identifying and reviewing major proxy issues for appropriate clients. Ironclad and Harrison also have an obligation to avoid conflicts of interest when voting proxies. Although Harrison has a conflict of interest in voting issues on behalf of InterConnect and Wavelength due to his role on their board of directors, proxies on non-routine matters should not be discarded under any circumstances, as such action would constitute a breach of fiduciary duty. Harrison should abstain from voting on matters affecting InterConnect and Wavelength to avoid the appearance of a conflict of interest. Harrison should also ensure proper treatment of any confidential information received in his role on the respective boards of directors. Harrison should maintain confidentiality of voting information on behalf of clients and follow Ironclad's proxy voting policy. Clients must be made aware of the firm's policies on voting routine and non-routine proxy issues.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

Lon Smith is an analyst in the Research Department of Lincoln & Co., a large investment bank. Smith has just completed a temporary assignment in Lincoln's Corporate Finance Department related to underwriting a debt offering for FinSoft, a computer software company. FinSoft's recent operating record has reflected lagging sales volume and heavy product development expenses. Smith has marked his FinSoft notes and work sheets "CONFIDENTIAL / CORPORATE FINANCE DEPARTMENT" and sent them to the company file in the Research Department. This material reveals that FinSoft is about to receive a major contract for an innovative software program that will have a very significant positive impact on earnings as well as on the company's visibility and stature in the industry.

Jay Jones, a CFA candidate and a portfolio manager for Lincoln, has come upon these notes and work sheets while reviewing the FinSoft research file. Jones had been considering sale of the stock from the accounts under his management, but realizes after reading the file material that the recent weakness in operating results is about to be reversed and that the company's prospects are actually quite favorable. Perhaps, he thinks, he should add to his clients' FinSoft positions instead of considering their sale.

Jones briefly reflects on the matter of "inside information" in relation to perhaps buying more of the stock instead of selling it, but his recollection is hazy and Lincoln has no formal guidelines on the subject to which he can refer. Based on the circumstances, Jones believes he is free to use this new knowledge for the benefit of Lincoln's clients.

At a local CFA society event, Jones mentions to Mohammed Bamyeh, a friend and financial advisor, that FinSoft is about to receive a major new contract that has yet to be announced. Later that day, Bamyeh takes a large long position in a technology ETF that has a large weight for FinSoft stock.

133. (A) **There is no breach of duty if traded on Smith's report because Jones did not conduct the research that produced the information.**

Explanation

Jones has a duty not to trade or cause others to trade on material nonpublic information. It does not matter that he did not conduct the research.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

134. (B) **wait to trade on the information until after a reasonable period has passed.**

Explanation

Jones has an obligation to not trade on the information until after he is sure the information has been made public.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

135. (B) **prohibit exchange of personnel, even temporary, between investment banking and institutional money management departments.**

Explanation

There is no need to avoid transfer of personnel as long as proper safeguards and procedures are observed.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

136. (A) **diligence and reasonable basis.**

Explanation

It is unlikely that Jones violated the Standard relating to diligence and reasonable basis, as Jones appears to have had a reasonable basis for the recommendation as Standard V(A) requires. Once Jones was in possession of material nonpublic information, he was prohibited by Standard II(A) of acting or causing others to act on this information. Jones also violated her duty of loyalty to her employer under Standard IV(A) by encouraging Bamyeh to trade in FinSoft and other securities, possibly harming Lincoln's customer's ability to acquire FinSoft at an attractive price.

(Module 43.8, LOS 43.a)

Related Material

SchweserNotes - Book 5

137. (C) **Print the investment policy statement in all quarterly reports.**

Explanation

There is no requirement to include the investment policy statement in all quarterly reports.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

Rajiv Singh, a CFA charterholder, works as an equity analyst with Horizon Investments, a large broker/dealer. After ski-resort developer HighLife misses a quarterly earnings target, Singh changes his recommendation on HighLife from buy to hold. Singh has been following HighLife for years. In several previous research reports on HighLife, Singh told clients that, based on his detailed analysis of the financial statements and market position, he believed HighLife had stopped picking up market share. He had mentioned concerns about HighLife several times in his reports and said in the most recent report that he would downgrade the stock if it missed quarterly earnings.

Singh had produced his monthly report on HighLife just a week before the earnings announcement, and because he had just written about his intention to downgrade the stock, he felt he did not need to inform clients of his recommendation change until the next monthly report.

On the same day that the HighLife report was released, Singh initiated coverage on another company with a buy rating, the convenience store operator QuickStop. His research report is distributed that afternoon. A client sends Singh a sell order for QuickStop via e-mail the same day the new recommendation is being disseminated to all Singh's clients and prospects.

John Womack, a Level II CFA candidate, is a trader at Horizon. Womack, walking past the conference room during an investment meeting, learns of the initiation of the buy rating on QuickStop. Prior to the dissemination of the buy rating to Horizon's clients, he buys up a large block of QuickStop shares for Horizon's account in anticipation of clients' interest in the stock. When the rating is released to the firm's customers, he fills the incoming customer orders out of Horizon's inventory, generating a modest profit for the company.

Horizon is drafting trade-allocation guidelines for companywide use. Five regulations the company is considering are listed below:

(1) Regular orders are processed and executed on a pro-rata basis.

(2) Shares in initial public offerings will be allocated on a pro-rata basis to the firm's portfolio managers according to advance indications of interest from the managers.

(3) When the full amount of a block order is not executed, partially executed orders are allocated on a first-in, first-out basis.

(4) Orders must be recorded in writing and stamped with the time of the order and the execution.

(5) All clients participating in block trades are given the same execution price, and all clients are charged the same commission.

138. (C) Standard III(A)—Loyalty, Prudence, and Care and Standard VI(B)—Priority of Transactions.

Explanation

Womack's actions violate the Standards related to fair dealing, priority of transactions, and fiduciary duties. Standard III(A) is about members' duty of loyalty to clients and talks about how members should place their clients' interests before their employers' or their own interests. Womack's actions violate Standard III(A): Womack is essentially front running Horizon's clients. Standard III(E) concerns keeping information about current, former, and prospective clients confidential; QuickStop is not a current, former, or prospective client of Horizon so Standard III(E) does not apply in this case.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

139. (A) did not violate the Standards for reasonable basis or research reports.

Explanation

Singh reported a series of facts that led him to draw a conclusion, and identified the conclusion as his own. No nonpublic information was used in the HighLife analysis. While Singh did say that missing an earnings target would spur a downgrade, he made it clear that he had broader concerns about the firm's market share. Missing an earnings target would simply be confirmation of his concerns, and thus be the catalyst to his change of opinion.

(Module 43.8, LOS 43.a)

Related Material

SchweserNotes - Book 5

140. (B) Standard III(B)—Fair Dealing by not telling clients about the downgrade of HighLife in the wake of his promise to downgrade the stock if it missed estimates.

Explanation

A change in stock rating is always material, and must always be disclosed to clients. Thus, Singh violated Standard III(B). Singh did not violate a fiduciary duty to his clients because he did not put anyone's interest above theirs. As an analyst, Singh's job is to assess the appeal of an investment, not make investment decisions for individual accounts. As such, he did not violate Standard III(C); Standard I(C) relates to misrepresenting qualifications or guaranteeing investment returns, and is not relevant to this situation.

(Module 43.5, LOS 43.a)

Related Material

SchweserNotes - Book 5

141. (B) **When the full amount of a block order is not executed, partially executed orders are allocated on a first-in, first-out basis.**

Explanation

All orders should be allocated on a pro rata basis based on order size, not on a first-in, first-out basis. The other regulations satisfy the fair-dealing Standard.

(Module 43.5, LOS 43.a)

Related Material

SchweserNotes - Book 5

142. (C) **Misrepresenting information on the Professional Conduct Statement.**

Explanation

Misrepresenting information on the Professional Conduct Statement is a direct violation of Standard VII(A) Conduct as Participants in CFA Institute Programs. The other choices are violations of Standard VII(B) Reference to CFA Institute, the CFA Designation, and the CFA Program.

(Module 43.10, LOS 43: VII(A))

Related Material

SchweserNotes - Book 5

143. (B) **decline in writing to accept supervisory responsibility until a satisfactory compliance system is put into place.**

Explanation

According to the Standard on supervisory responsibilities, Daniels should decline in writing to accept supervisory responsibility until a satisfactory compliance system is put into place.

(Module 43.7, LOS 43.b)

Related Material

SchweserNotes - Book 5

144. (B) **start the registration of her new company.**

Explanation

The only action that will not breach Standard IV(A) Loyalty to Employer, is to start the registration of her new company.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

145. (B) **Marchant must inform Middleton to keep his existing clients and must inform his existing clients of his new part-time employment at Middleton.**

Explanation

Standard IV(A) and IV(B) requires that Marchant inform both Middleton and his existing clients.

(Module 43.7, LOS 43.IV(A))

Related Material

SchweserNotes - Book 5

146. (C) **terminate the contract with JMT prior to issuing any research on the company.**

Explanation

Standard VI(A)—Disclosure of Conflicts requires members and candidates to inform clients, prospects, and their employers of any situation that may impair their independence and objectivity or interfere with duties owed to the same groups. The Standard notes that best practice is to avoid conflicts of interest when possible. This best practice recommendation is consistent with Standard I(B) – Independence and Objectivity, which requires that independence and objectivity be maintained. The consulting arrangement with JMT, a company about which Copper will write research reports, divides his loyalty between JMT and the clients purchasing Copper's research on the same company. This is a clear conflict of interest which must be disclosed to clients, prospects, and Copper's employer if the conflict cannot be avoided. However, there is no penalty for ending the consulting relationship and best practice would dictate that Copper terminate the contract with JMT.

(Module 43.9, LOS 43.a)

Related Material

SchweserNotes - Book 5

147. (A) **a violation because he cannot guarantee better service.**

Explanation

According to Standard VII(B), the analyst cannot guarantee better service. Smith can mention the fact that all analysts have the designation, but he is limited in what he can say with respect to this fact. He could say, for example, that this means the analysts all had to take and pass three rigorous exams.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

148. (B) **All employees of a firm are bound by CFA Institute's Code and Standards if they are incorporated in the company's policies manual, and the firm subscribes to them explicitly.**

Explanation

Even though Jackson is not a CFA charterholder, she is nevertheless required to follow the Code and Standards since her firm subscribes to them and has incorporated them in its policy manual.

Standard IV(C) violation is not clear or obvious since the case does not say much about a lack of guidelines or explicit gaps in the policy manual. Under this assumption, Spraetz is not guilty of any supervisory violation. Even though Jackson did not personally trade ahead of purchasing AMD shares for her clients, she had done so in the past and is in violation of Standard VI(B). Spraetz needs to act on it because this violation has only just come to light.

(Module 44.1, LOS 44.a)

Related Material

SchweserNotes - Book 5

149. (A) **for neither of the reasons listed.**

Explanation

According to Standard III(E), Preservation of Confidentiality, Stiles may not withhold information under any of the listed reasons. The reason is that CFA Institute will keep the information confidential.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

150. (B) **Yes, unless the positions listed constitute a complete presentation (i.e., there were no stocks omitted that did not perform in the double digits).**

Explanation

Standard III(D) requires fair representations concerning past and potential future performance. Unless the list of the "winners" includes all the positions that the firm held, the manager is misrepresenting past performance. The following statement is questionable: "Their double-digit returns indicate the type of returns I can earn for you," but the action of submitting a partial list is clearly a violation. The manager should have information on past performance in writing.

(Module 43.6, LOS 43: III(D))

Related Material

SchweserNotes - Book 5

Bella Brown is an experienced generalist securities analyst employed by Lang & Co., a major U.S. brokerage firm whose clients have a high regard for her research and stock selection abilities. She was visited recently by a Lang managing director who said, "Please take a look at SpecChem Inc., the specialty chemical producer. They are going to need an investment banker soon and, because we make a market in their stock, we will be one of the firms considered for this business. I had lunch with SpecChem's Treasurer today, who told me that their European problems are being resolved and that earnings results are definitely looking good. He likes us and is expecting you to call him for details." The managing director then left Brown's office, saying, "It would be great if you could rate the stock a 'Buy'."

In a subsequent hour-long telephone discussion with the Treasurer, Brown obtained some useful information concerning recent company trends and developments as well as SpecChem's overall view of the outlook for sales and earnings during the next several quarters. Brown began thinking quite positively about the company and its prospects. She then reviewed some general source material on the chemical industry and read the Standard & Poor's Stock Guide on SpecChem Inc. That afternoon, she wrote a report recommending purchase of the stock, shown below as Exhibit B. In accordance with Lang's routine procedures for pre-dissemination review of Research Department recommendations, the report has been sent to the firm's Director of Research, who is aware of the circumstances under which it was prepared.

Exhibit B

LANG & COMPANY Company Report

Industrial: Specialty Chemicals Equity Research

Rating: Buy

SpecChem Inc. (NYSE: SCM)

- We are initiating coverage of SpecChem Inc. with this report.
- Earnings, up to 51% in the first quarter, are expected to be up again in the quarter ending June 30. Higher sales, better margins, an improved geographic sales mix, and savings from reduced pension expense are all contributing to this year's gains.
- Although European production is up only modestly year-over-year, successful cost reduction efforts are limiting the adverse effects of weak volume and pricing. A possible plant closure in September could improve plant utilization by 10%, accompanied by potentially dramatic margin improvement. However, a $30 million after-tax special charge could be taken at the time of the closure.
- We expect a moderate increase in second half 2014 sales. Although management looks for European demand to remain slow, it feels that U.S.

sales could be above expectations if auto-related demand strengthens. Management is also optimistic about receiving a sizable U.S. government contract in the next few months.

- Based on the factors noted above, our confidence level concerning earnings levels over the balance of the year is high.
- We think SpecChem stock is undervalued and believe it can easily reach the low 100s on the strength of continuing earnings momentum. The downside is estimated to be in the mid-80s. There is plenty of room for upside earnings surprises if volume and prices improve, which would take the stock up strongly. Purchase is recommended.

Analyst: Bella Brown
Research Department
This report is based upon information which we consider reliable, but we do not represent that it is accurate, and it should not be relied upon as such. We, or persons involved in the preparation or issuance of this material, may, from time to time, have long or short positions in the securities of the company mentioned herein.

151. (B) **both of these.**

Explanation
The Director of Research, as a CFA Institute member, is bound by the Standards of Professional Conduct. Accordingly, "members shall not knowingly participate or assist in any violation of such laws, rules or regulations" (Standard I(A): Knowledge of the Law). This responsibility is applicable under the circumstances. As a supervisor, the director of research has a responsibility to exercise reasonable supervision over subordinates to prevent violations of laws, regulations, and the provisions of CFA Institute Standards of Professional Conduct (Standard IV(C): Responsibilities of Supervisors).
(Module 43.1, LOS 43.a)
Related Material
SchweserNotes – Book 5

152. (B) **require the report to be redone to ensure compliance with CFA Institute Standards.**

Explanation
Based on the current circumstances, the supervisor (Director of Research) must not allow the report to be distributed. In this situation the overriding responsibility is to ensure that diligence, thoroughness, and independence be exercised in forming the investment judgment and in preparing the research report.
(Module 43.8, LOS 43.a)
Related Material
SchweserNotes - Book 5

153. (B) **The report violates guidelines on investment performance presentation.**

Explanation

There is no attempt in the report to present data on the firm's performance as an investment manager. Violations relating to the report itself include the following:

- Though SpecChem's current and prospective earnings are mentioned, no real basis of SpecChem's earnings power is discussed, nor are such factors as cash flow, operating strength or financial condition. Brown has violated Standard V(B): Communication with Clients and Prospective Clients.
- The report fails to disclose Lang's market-making activities with SpecChem. This omission violates Standard VI(A): Disclosure of Conflicts.
- Brown is not separating fact from opinion in her comment, "There is plenty of room for upside earnings surprises if volume and prices improve further, which would take the stock up strongly." This is a violation of Standard V(B): Communication with Clients and Prospective Clients. The above-noted comment could also be considered a violation of Standard I(C): Misrepresentation.

(Module 43.6, LOS 43.a)

Related Material

SchweserNotes - Book 5

154. (A) **Brown has violated the Standard relating to the prohibition against plagiarism.**

Explanation

There is nothing to indicate that a violation of the Standard on Prohibition against plagiarism has occurred. The word "process" violations include:

- Brown's report and investment conclusions were influenced by a senior member of her firm. In addition, near total reliance was put on the information supplied by SpecChem's management. She has violated Standard I(B): Independence and Objectivity.
- Brown showed a lack of diligence and thoroughness in forming her investment decision and preparing the report. Her analysis was cursory at best; the report was not objective nor was it based on adequate understanding of company fundamentals. Standard V(A): Diligence and Reasonable Basis was violated by Brown.
- A violation of Standard V(B): Communication with Clients and Prospective Clients has also occurred. Brown failed to investigate SpecChem's basic investment characteristics properly and did not communicate the company's investment characteristics through the research report.

(Module 43.2, LOS 43.a)

Related Material

SchweserNotes – Book 5

155. (C) **His son-in-law was formerly employed by Burch.**

Explanation

Standard VI(A) Disclosure of Conflicts requires that Members and Candidates fully disclose all matters which may impair their independence or objectivity or interfere with their duties to their employer, clients and prospects. Beneficial ownership of shares in a firm on which a member is making investment recommendations is an example of such a matter.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

156. (B) **both of theses.**

Explanation

Standard VI(B) addresses the treatment of both these accounts. The accounts of clients and employers have priority over personal accounts.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

157. (B) **adequately disclose the basic security selection and portfolio construction process.**

Explanation

Wanda should adequately disclose the basic security selection and portfolio construction process. Wanda should generally stick with the stated investment strategy in the IPS, notify clients and prospective clients of any potential change in the security selection and portfolio construction process, and secure documentation of authorization for proposed changes.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

158. (B) **allowed to accept the offer only with written approval from zippy and from Dragon.**

Explanation

Under Standard IV(A) Loyalty to Employer, and Standard IV(B) Additional Compensation Arrangements, Feldman is allowed to accept the offer, but only with written permission from both zippy and Dragon.

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

159. (A) **violated the Standards by not having a reasonable basis for making the purchase of Datagen.**

Explanation

Standard V(A) requires members to have a reasonable and adequate basis for taking investment actions. Overhearing a conversation does not provide adequate basis. It is not improper to use overheard conversations that do not include inside information, nor is it improper to reference another firm's report to substantiate adequate basis, if the other report is justified.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

160. (B) **violated CFA Institute Standards of Professional Conduct because he implied superior performance that would be linked to the CFA Charter.**

Explanation

According to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA, Program, Johnson may indicate that he has completed the requirements and is eligible for the CFA charter along with an accurate explanation of the requirements. However, he may not imply that the designation would mean superior performance capabilities.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

161. (A) **Expressing opinions in disagreement with CFA Institute advocacy positions.**

Explanation

Members and Candidates are allowed to express their opinions about the CFA Institute and CFA Program. Both of the other choices violate Standard VII(A) Conduct as Participants in CFA Institute Programs.

(Module 43.10, LOS 43: VII(A))

Related Material

SchweserNotes - Book 5

162. (C) **not in violation of Standard I(D) Misconduct or Standard VII(A) Conduct as Participants in CFA Institute Programs.**

Explanation

Standard VII(A) Conduct as Participants in CFA Institute Programs does not prohibit expressing opinions about the program or the CFA Institute. Thus, Vasquez is not in violation. Nothing in the facts indicates a violation of Standard I(D), Misconduct. Standard I(D) deals with professional conduct involving dishonesty, fraud, or deceit.

(Module 43.10, LOS 43: VII(A))

Related Material

SchweserNotes - Book 5

William Fleming is an investment advisor for GlobalBank, a large, multinational financial corporation. He is based in the New York office, and his client base consists of medium to large institutional accounts in the United States and Western Europe. Roughly three-quarters of his clients pay performance-based fees, while the remaining one-quarter pay fees based on assets. GlobalBank's investment banking division is an industry leader, and Fleming is able to offer his clients the opportunity to participate in some of the hottest initial public offerings (IPOs) and secondary offerings brought to market.

One of Fleming's accounts, Waverly Capital Partners, has contacted him regarding an upcoming secondary offering by DCH Corp., for which GlobalBank will serve as lead underwriter. Waverly has already performed its due diligence on the offering and is interested in purchasing a substantial position in the secondary offering in order to employ the company's current surplus of cash. Waverly's representative tells Fleming over the phone that they would like to purchase 5,000 shares of the offering but gives no other details of its analysis of the offering. Fleming has not read the prospectus for the offering yet and is not familiar with the details, but because he has confidence in Waverly's investment expertise, he tells them that he too believes they should participate in the offering. Because Waverly does a significant amount of business with GlobalBank's other divisions, Fleming assures them that they will be able to obtain their desired allocation of the offering and takes the order.

After taking the purchase order for the Waverly account, Fleming thoroughly reads the prospectus and marketing materials for the offering, as well as past research reports on the issuing company. He determines that DCH shares would be a suitable investment for one of his other clients, The Crockett Foundation. He contacts the Chief Investment Officer (CIO) of the foundation, explains how an investment in DCH would fit with its current risk and return objectives as detailed in the foundation's investment policy statement (IPS) and provides her with the prospectus for the offering. Fleming tells her that GlobalBank was the lead underwriter for DCH's initial public offering three years ago and that since then, the stock has outperformed the S&P 500 by at least 15% every year. Fleming also states that the company's financial position is now even stronger and that the shares will perform at least as well as the lowest return earned on the IPO shares in the last three years. He then proceeds to tell her, "If the foundation is interested in the offering, you should place an order immediately because the issue may be oversubscribed due to strong interest in the offering from Waverly Capital Partners and other clients." This information is enough to motivate Crocket's CIO to call a meeting with the foundation's investment committee.

After a quick meeting with Crockett's investment committee, the CIO calls Fleming to say that the foundation is interested in the offering and would like to place a purchase order. Crockett does not currently conduct any additional business through GlobalBank's other divisions. Because of GlobalBank's trade allocation policy, coupled with the high probability that the offering will be oversubscribed, Crockett is unlikely to be allocated as many shares of the offering as they would like to purchase. In order to obtain the desired number of shares for the client, Fleming devises a plan. He plans to add the Crockett Foundation's order to Waverly's order, and once the order is filled he will re-allocate the extra shares back to the foundation's account at the end of the day. He feels that his action is justified because Crockett has maintained its account with Fleming and GlobalBank for over ten years. In addition, Fleming has traders at GlobalBank sell large blocks of DCH over several days in order to push the stock price lower. The drop in value causes smaller investors at GlobalBank, who are not Fleming's clients, to withdraw their orders for shares of DCH's secondary offering. Fleming determines that the fewer number of purchase orders and the plan to piggyback on Waverly's order will allow Crocket to acquire its desired allocation of shares in DCH's secondary offering. Having achieved his goal, Fleming allows GlobalBank's traders to repurchase the firm's shares of DCH.

Twelve months pass, and the shares of DCH's secondary offering have declined in price by nearly 20%. The CIO of the Crockett Foundation calls a meeting with Fleming to discuss the poor performance of the security and to review the basis upon which Fleming recommended the investment. Fleming prepares Crockett's file to take with him to the meeting. The file contains Crockett's IPS, a detailed account of the purchase order and all conversations held between Fleming and the CIO. In accordance with his own established procedures, however, Fleming maintained the original analysis supporting the purchase of shares in DCH's secondary offering for nine months after the investment was made.

163. (C) **Standard V(A)—Diligence and Reasonable Basis for not exercising diligence and thoroughness in his analysis of the investment and Standard III(C)—Suitability for recommending an investment before determining if the investment was appropriate for the client.**

Explanation

Fleming violated Standard V(A)—Diligence and Reasonable Basis because he was not familiar with the specifics of the investment, but made an investment recommendation based upon his confidence in Waverly's investment expertise. Fleming is also in violation of Standard III(C)—Suitability because his agreement with Waverly's investment decision was not based upon the suitability of the offering within the context of Waverly's total portfolio. Standard I(C)—Misrepresentation was also violated when Fleming confirmed that Waverly should purchase shares in DCH's secondary offering, but failed to inform the client that he had not analyzed the investment in any way. Waverly would reasonably expect Fleming to analyze an investment prior to its recommendation and was therefore misled.

(Module 43.8, LOS 43.a)

Related Material

SchweserNotes - Book 5

164. (C) **tells the CIO of the Crockett Foundation that DCH's secondary offering will earn at least the lowest return earned on its IPO shares over the last three years.**

Explanation

Standard I(C)—Misrepresentation prohibits members and candidates from making any untrue statements or omissions of facts that may be false or misleading. Guaranteeing a particular rate of return on an investment is in direct violation of the standard. Fleming has essentially guaranteed a minimum rate of return on the secondary offering equal to the lowest rate of return earned on the IPO shares over the last three years. Even though a specific number isn't mentioned in the question, it would be observable by the Crockett Foundation. The other statements might also be considered violations of the standards but are not specifically violations of I(C)— Misrepresentation as noted in the question.

(Module 43.2, LOS 43.a)

Related Material

SchweserNotes - Book 5

165.

	Conversation with CIO	Sell decision
(C)	No	Yes

Explanation

Standard II(B)—Market Manipulation prohibits practices that distort prices or artificially inflate trading volume with the intent to mislead market participants, including the dissemination of false or misleading information. Although Fleming's conversation included two prohibited comments (a guarantee of performance and an inappropriate disclosure of client information), he did not give the CIO of Crockett information in an attempt to manipulate prices or trading volume and thus did not violate Standard II(B). His decision to sell GlobalBank's shares of DCH, however, was intended to manipulate the price of DCH stock in order to intimidate smaller investors into withdrawing their purchase order in the secondary offering, thereby freeing up shares for his client, the Crockett Foundation. This action is clearly a violation of Standard II(B).

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

166. (B) **Yes—he failed to maintain appropriate records to support his investment recommendation.**

Explanation

Standard V(C)—Record Retention states that members and candidate must maintain appropriate records to support their investment recommendations and actions. Fleming maintained an IPS and records of conversations, but he is also required by the standard to keep research and other documentation supporting investment recommendations and actions, which Fleming did not do. When there are no regulatory requirements related to record retention, the Standard recommends that members and candidates keep client records for a minimum of seven years.

(Module 43.8, LOS 43.a)

Related Material

SchweserNotes - Book 5

167. (B) **Standard V(C) Record Retention.**

Explanation

Standard V(C) Record Retention requires analysts to develop and maintain "...records to support their investment analysis, recommendations...with clients and prospective clients." The analyst is unable to explain why securities were added to the portfolio; this is a violation of Standard V(C).

(Module 43.8, LOS 43: V(C))

Related Material

SchweserNotes - Book 5

168. (A) **does not distinguish the opinion, based on his model, from the fact.**

Explanation

While any of the answers can be shown to violate CFA Institute Standards, this cannot be determined conclusively from the information given. However, the scenario clearly indicates that Anderson does not distinguish between opinion and fact in communicating to his clients. Therefore, he violates the Standards on this basis.

(Module 43.8, LOS 43.b)

Related Material

SchweserNotes - Book 5

169. (B) **Both Standard I(B) Independence and Objectivity and Standard V(A) Diligence and Reasonable Basis.**

Explanation

Whitman violated Standard V(A) Diligence and Reasonable Basis because he did not have a reasonable and adequate basis for issuing a favorable recommendation. Whitman violated Standard I(B) Independence and Objectivity because he did not act independently in issuing his recommendation but instead was influenced by senior management at Hilton and Ross.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

170. (B) **inform her supervisor that she cannot work on the portfolio because of a legal agreement. but cannot tell him why.**

Explanation

Jason must inform her supervisor of the conflict, but she cannot violate the terms of the confidentiality agreement and she cannot work on the portfolio.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5

171. (C) **should revise the recommendation based on this new information.**

Explanation

This question is related to Standard V(B) which states that CFA Institute members should use reasonable judgment regarding the inclusion or exclusion of relevant factors in research reports. The change in management was a relevant factor and must be disclosed before dissemination.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

172. (A) **A supervisory analyst who reviews all research reports prior to dissemination.**

Explanation

Persons with access to information during the normal preparation of research recommendations are subject to Standard VI(B). An independent auditor is not involved in the normal preparation of research recommendations.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

173. (A) **terminate the accounting staff immediately and issue a press release describing the situation.**

Explanation

Standard IV(C) spells out responsibilities of supervisors in the Standards of Practice Handbook. Since the investigation is ongoing, it would clearly be inappropriate to terminate the entire accounting staff until their complicity in the wrongdoing is established.

(Module 43.7, LOS 43.a)

Related Material

SchweserNotes - Book 5

174. (A) **Must treat the charitable organization as his employer.**

Explanation

An employee/employer relationship does not necessarily mean monetary compensation for services. If the analyst is performing services for the organization, then the analyst must treat the position as if he were an employee.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

175. (C) **violated the Standards by not having a reasonable and adequate basis for making the recommendation.**

Explanation

Despite the fact the addition of the fund was successful. Hoolihan acted improperly in not conducting the same degree of research as she did for the funds on her list.

(Module 43.8, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

176. (A) **disclose to the referred client the percentage of the member's business that comes from referrals.**

Explanation

The applicable Standard, VI(C), does not require a member to disclose the percentage of their business that comes from referrals.

Standard VI(C) states, "Members shall disclose to clients and prospects any consideration or benefit received by the member or delivered to others for the recommendation of any services to the client or prospect. "Appropriate disclosure means telling the client or prospect, before agreeing to perform services, of any benefit given or received for recommending the member's services.

(Module 43.9, LOS 43: VI(C))

Related Material

SchweserNotes - Book 5

177. (A) **did not violate the Standard.**

Explanation

According to Standard IV(A) Loyalty, preparations to leave employment are not prohibited. Even though Abrea engaged in significant preparatory activities prior to beginning his new venture, none of these actions suggest Abrea did not continue to act in Pacific's interests while he was employed by Pacific. Abrea may contact his former clients on behalf of Global after his employment by Pacific has officially ended, as long as he did not misappropriate their contact information from Pacific.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

178. (A) **not violated the Standard.**

Explanation

Recommending a stock whose return is uncorrelated with interest rate changes is appropriate for the clients described in the problem. Emphasizing the lack of correlation is appropriate as long as the analyst makes no guarantees concerning the relationship in the future. Reporting historical correlation is a presentation of fact, and is not in violation. The analyst is free to show the report only to investors for whom the investment is appropriate.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

179. (B) **No.**

Explanation

According to Standard V(C), Record Retention, the files should be not be destroyed. The CFA Institute recommends keeping all records for at least 7 years.

(Module 43.8, LOS 43: V(C))

Related Material

SchweserNotes - Book 5

180. (B) **Yes; A sufficient number of years have passed since the meeting.**

Explanation

According to Standard V(C), Record Retention, the files may be destroyed. The CFA Institute recommends keeping all records for at least 7 years. Given that more than 7 years have passed since Tuipuloto's meeting with the Scaddens, it is not against Standard V(C) to get rid of the records from that meeting.

(Module 43.8, LOS 43: V(C))

Related Material

SchweserNotes - Book 5

181. (B) **must notify his employer of the types of service to be rendered, the expected duration, and the expected compensation.**

Explanation

According to Standard IV(A), Loyalty to Employer, a CFA Institute member, undertaking, independent practice that could result in compensation or other benefit, must notify his employer, of the types of service to be rendered, the expected duration, and the expected compensation.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

182. (C) **violated the requirement to have a reasonable basis for a recommendation, the prohibition against plagiarism, and the requirement to maintain appropriate records.**

Explanation

New London's report is potentially self serving, so Fox did not exercise diligence or have an adequate basis for his recommendation. In addition, Fox did not acknowledge his source of the charts and graphs. Finally, he did not maintain adequate records.

(Module 43.8, LOS 43: V(A))

Related Material

SchweserNotes - Book 5

183. (B) **do neither of the actions listed here.**

Explanation

Standard IV(B) requires that members disclose to their employer in writing all benefits that they receive in addition to their regular compensation for services they perform on behalf of their employer. It is not unreasonable for an individual's godfather to give them a birthday gift. Moreover, since the tax services were a regular birthday present before her godfather became a client, this implies that they are unrelated to any investment management services.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

184. (C) **Use a risk-factor model to assess the client's risk tolerance.**

Explanation

There is no requirement to use a specific model in order to assess and document a client's risk tolerance. Risk tolerance is more likely to be addressed implicitly in the asset allocation guidelines that are established and updated based upon client circumstances.

(Module 43.8, LOS 43: V(B))

Related Material

SchweserNotes - Book 5

185. (C) **Only one of these analysts must disclose a potential conflict of interest.**

Explanation

The possibility that Linstrom's friend may own shares of Delta's stock does not create a conflict of interest for Linstrom, who has no beneficial interest in these shares. On the other hand, Wadel has a beneficial interest in his wife's ownership of Gamma shares. Standard VI(A) Disclosure of Conflicts requires that Wadel disclose this information so that his employer can make the proper determination.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

186. (B) **Standard VI(A) - Disclosure of Conflicts.**

Explanation

Standard VI(A)requires that members fully disclose all potential conflicts of interest, including ownership of stock in companies that the member recommends or that clients hold. Standard III(B), Fair Dealing, forbids members and Candidates from discriminating against any clients when disseminating recommendations or taking investment action. Standard V(B), Communication with Clients and Prospective Clients, requires that members disclose the general principles of the investment processes used, and distinguish between opinions and facts.

(Module 43.9, LOS 43: VI(A))

Related Material

SchweserNotes - Book 5

187. (B) **Albert has violated the Standards but Tye has not.**

Explanation

On letterheads and business cards and in directory listings, only the mark CFA or the words Chartered Financial Analyst should appear after the charterholder's name.

(Module 43.10, LOS 43: VII(B))

Related Material

SchweserNotes - Book 5

188. (B) **Perez is not prevented from soliciting clients as long as he is working from memory and publically available information rather than a list generated while he was still with the former employer.**

Explanation

According to Standard IV(A), Perez is not prevented from soliciting clients as long as he is working from memory and publically available information rather than a list generated while he was still with the former employer.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

189. (A) **acceptable as he is not in competition with his current employer.**

Explanation

It is acceptable for Smith to solicit clients for his new employer on his own time as long as he is not in any way competing with his employer. Standard IV(A) prohibits only actions that have the potential to cause harm to Smith's employer.

(Module 44.1, LOS 44.a)

Related Material

SchweserNotes - Book 5

190. (B) **congruent with the Standard as long as he does not have a direct personal interest in his brother's account.**

Explanation

Client accounts that belong to family members should be treated like any other account so long as there is no direct interest on the part of the analyst. In other words, these types of accounts should not be at a disadvantage relative to other client accounts when there is no direct interest on the part of the analyst overseeing the account.

(Module 43.9, LOS 43: VI(B))

Related Material

SchweserNotes - Book 5

191. (C) **Jackson did not violate Standard III(A) on Fiduciary Duty to clients because she was bound by her fiduciary duty to AMD and its stockholders as a board member. Therefore, when she reversed her decision to buy AMD shares for Super Selection's clients, portfolios on James' request, her obligation to AMD took precedence.**

Explanation

Jackson has violated Standard III(A) because her first obligation is to her firm's clients. Standard VI(A) addresses precisely these kinds of situations regarding potential conflict of interest. Given this conflict of interest, Jackson also compromised her objectivity in violation of Standard I(B). Her fiduciary duty to her clients takes precedence over her fiduciary duty to AMD's stockholders under the CFA Institute Code and Standards. By not disclosing her relationship with AMD, she also violated Standard IV(B). Making past personal security transactions ahead of purchase of the same securities for her clients has put Jackson in violation of Standard VI(B). This standard clearly prohibits such actions.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

192. (C) **neither taking out the loan nor buying the equipment.**

Explanation

The Standards of Practice under IV(A) states that a departing employee is "generally free to make arrangements or preparations to go into a competitive business before terminating the relationship with the employee's employer provided that such preparations do not breach the employee's duty of loyalty." Neither of these actions are in conflict with the interests of Advisors, and Hill performed them on his own time.

(Module 43.7, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

193. (A) **fulfilled all obligations.**

Explanation

If the analyst had been an investment manager, it would have been inappropriate for him to make a blanket recommendation for all of his clients without considering the unique needs of each. However, the analyst is merely stating that given the qualities of the investment, it is an attractive buy. He has kept adequate records, and made fair disclosure of his rating decision.

(Module 43.8, LOS 43: IV(A))

Related Material

SchweserNotes - Book 5

Jacques Claudel, a CFA Institute member, represents Vector Funds, a U.S.-based fund manager, in Canada. Although Vector Funds is properly licensed to deal in all Canadian and U.S. securities, its primary objective is to sell United States funds to Canadian institutional investors seeking diversification into the U.S. dollar. While it would be willing to do so if requested by its clients, Vector has not placed trades in Canadian securities since Claudel began working there two years ago.

Prior to joining Vector's Canadian operations, Claudel was an independent asset manager handling the funds of wealthy individuals and small institutions. Most of these accounts remain under his management, under the business name Coup de Gras. Claudel is unclear as to whether his consulting work is in competition with his new employer, as the accounts under his management are invested strictly in Canadian securities, while Vector has not traded Canadian securities. However, just to be on the safe side, he obtained written permission from Vector to continue serving his former clients. His former clients were not notified.

Claudel receives cash compensation for most of the accounts he handles independently, but for one he receives a new car for his personal use every two years, and for another he is compensated with a one-week, expenses-paid holiday in the European country of his choice.

As part of his responsibility, Claudel makes trades for some of his Canadian clients. He runs all of his trades through two brokers, Ace Equity Traders and the Parlay Group. Ace offers some of the best research available on health-care stocks, but charges fairly hefty commissions. Parley has some of the cheapest commissions in Toronto, but provides no research of value to Claudel.

Henri Bonnet, CFA, a friend of Claudel's, works on the floor of the Vancouver Stock Exchange. He asks Claudel to establish an account for him at Coup de Gras. Claudel learns that it is Bonnet's intention to manipulate the prices of penny stocks he trades on the exchange, and profit from the price movements in the account at Coup de Gras. Claudel sets up the account, but advises Bonnet that he "will have nothing to do" with the manipulation scheme beyond placing trades as Bonnet directs.

Claudel is currently pursuing a master's degree in financial economics in the evenings. During the interview with Vector and on his resume he indicated that he "attended Victoria University," giving his estimated date of graduation. He is not sure whether Vector understood that he did not have his master's degree.

194. (A) **In some circumstances the employee must receive the employer's written permission prior to receiving additional compensation from parties other than the firm. This requirement applies to both monetary and non-monetary compensation.**

Explanation

Standard IV(A): Loyalty to Employer requires written permission from both the employer and the consulting customer if the work involves competition with the employer. An example of an instance not requiring permission would be if a CFA charterholder who works for a broker wishes to write grants for a nonprofit foundation. In such case, he need not get permission, nor does he need to disclose the compensation. This Standard applies for work that provides either monetary or nonmonetary compensation.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

195. (B) **truthful, and in accord with the Code and Standards.**

Explanation

Standard I(C) Misrepresentation states that "members shall not make any statements, orally or in writing, that misrepresent the member's academic or professional credentials." In this case, Claudel's statements are truthful, and are not a violation of the Standard. He could have been more clear, but what he said is undeniably correct. Whether Vector understood what he told them is not his problem, as long as he was truthful and did not attempt to deceive them.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

196. (C) Bonnet has violated Standard IV(A): Loyalty to Employer, and Claudel has violated Standard I(A): Knowledge of the Law.

Explanation

Bonnet violated several Standards, including IV(A) and II(B), by manipulating stock prices and profiting from that manipulation at the expense of other purchasers. Standard IV(A) requires that employees not act to injure the firm or deprive it of profits, and Bonnet's personal trading and market manipulation crosses well over that line. However, Bonnet did not violate Standard II(A) Material Nonpublic Information because no nonpublic information was involved. Claudel violated Standard I(A) by contributing to Bonnet's plans to break the law. Under the Code and Standards, Claudel cannot knowingly assist others who are violating the Standards or the law, even if he does not profit personally. While Claudel's ethics are in question, nothing he did for Bonnet is likely to affect his independence, and he did not violate Standard I(B) Independence and Objectivity.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

197. (B) must direct all the trades for clients who do not wish to own health-care stocks to the Parlay Group.

Explanation

The Standards require that purchased brokerage directly benefits the client. Clients who do not hold health-care stocks get no benefit from Ace's research, so Claudel is obligated to send their trades to the broker with the lowest transaction costs. While disclosing the risks of client-directed brokerage is a good idea, it is not relevant in this case because we are not given any information about client directed trades. Referrals can play no part in the broker-selection process.

(Module 44.1, LOS 44.b)

Related Material

SchweserNotes - Book 5

198. (C) **Standard V(A)—Diligence and Reasonable Basis.**

Explanation

Standard V(A)—Diligence and Reasonable Basis was not broken because Smithson conducted thorough and diligent research. Standard III(C)—Suitability, Smithson failed to consider the needs of his conservative and aggressive clients. Standard IV(C)—Responsibilities of Supervisors, Preston Partners didn't have policies explaining how to allocate shares among clients.

(Module 43.8, LOS 43.b)

Related Material

SchweserNotes - Book 5

199. (C) **inform his supervisor in writing of the offer if the analyst intends to accept the offer.**

Explanation

Standard IV(B) requires that members disclose to their employer in writing all benefits that they receive in addition to their regular compensation for services they perform on behalf of their employer. They also need to get consent from their employer in writing. The written report to the employer should include the details of any written or oral agreement for extra compensation. The analyst does not have to refuse the offer.

(Module 43.7, LOS 43: IV(B))

Related Material

SchweserNotes - Book 5

200. (B) **the CFA Institute Professional Conduct Program requests it.**

Explanation

According to Standard III(E), Preservation of Confidentiality, a CFA charter holder cannot discuss client information received in the process of performing services for them except when related to an illegal action or when requested by the CFA Institute Professional Conduct Program.

(Module 43.6, LOS 43: III(E))

Related Material

SchweserNotes - Book 5