CHAPTER 42

READINGS 42 & 43 CODE OF ET…FOR STANDARDS I–VII (A)

1. (A) continue to recommend that new investors do not invest in the fund and existing investors reduce their holdings.

Explanation

The employees to whom Stevens owes fiduciary duty are the ones who are seeking his advice, even if acting on that advice hurts other employees who might eventually become clients.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

2. (A) use reasonable care and exercise independent professional judgment.

Explanation

Using reasonable care and exercising independent professional judgment is one of the components of the Code of Ethics, whereas the other statements are part of the Standards of Professional Conduct.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

3. (A) support the sponsor's management during proxy fights.

Explanation

Members are required to act in the interest of their client. In voting proxies, the client interest must prevail over management's interest.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

4. (A) discuss with Reilly whether she wishes to update her investment policy statement.

Explanation

According to the guidance for Standard III(C) Suitability, a member who receives an unsolicited trade request that is not suitable for the client should discuss the trade with the client before carrying it out. The nature of this discussion depends on whether the trade has a material effect on the client's portfolio. Because this trade will have a material effect, Miller's most appropriate action is to discuss with the client whether this trade request reflects a change in her investment objectives and risk tolerance and thus whether she wishes to update her IPS.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

5. (C) **Communicate investment recommendations to all customers including those accounts for which are not eligible for purchase.**

Explanation

To ensure compliance with the Standard, members should seek to communicate investment recommendations to all clients who have indicated an interest and also those for whom the securities are suitable. There is no need to communicate recommendations to clients for whom the securities are deemed unsuitable.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

6. (A) **the firm's counsel if he feels a law has been violated and contact his supervisor if he knows a law has been violated.**

Explanation

Standard I(A) says that when a member feels a law has been broken, the member should seek advice from the firm's counsel. If the member feels the advice is unbiased and competent, the member should follow it. If the member knows a law has been violated, the member should contact a supervisor.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

7. (B) **Brown must credit Dixon, no need to credit S&P.**

Explanation

The Standards require members to acknowledge the author of a model, but members are not required to acknowledge information from a recognized statistical and reporting service.

(Module 43.2, LOS 43.a)

Related Material

SchweserNotes - Book 5

8. (B) **not violated the Standards as long as the research provided by the broker will benefit the plan beneficiaries.**

Explanation

Simone must ensure that the research benefits the parties to whom she owes fiduciary duty, which are the plan participants.

(Module 43.4, LOS 43.b)

Related Material

SchweserNotes - Book 5

9. (C) **seek advice from company counsel to determine appropriate action.**

Explanation

Kenny's best choice is to seek the company counsel's advice. If Kenny does nothing, he is breaching Standard I(A) Knowledge of the Law. Disassociation is not enough.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

10. (A) **Portfolio managers of active funds must vote in all proxies; portfolio managers of index funds should vote only when they have a definitive opinion.**

Explanation

Proxies for stocks in passively managed funds must also be voted. A cost-benefit analysis may show that voting all proxies may not benefit all clients.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

11. (B) **Trading for regular accounts before discretionary accounts.**

Explanation

Do not discriminate against a client when disseminating investment recommendations. If the firm offers different levels of service, this fact must be offered and disclosed to all clients. The other choices are necessary parts of the Standard. The Standard actually says to have published personal guidelines for pre-dissemination, which implies that the guidelines be well-defined.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

12. (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

13. (A) only one of these Standards.

Explanation

By complying with the request, the analyst violated Standard II(A) Material Nonpublic Information Standard IV(A) Loyalty does not apply to this situation. That Standard deals with going into business for yourself, leaving an employer and continuing to act in the employer's best interest and whistleblowing.

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

Related Material

SchweserNotes - Book 5

14. (B) on a pro rata basis over all accounts.

Explanation

Allocating trades on a pro rata basis, pro rata based upon order size (when there are too few shares to fill all orders, e.g., filling 2/3 of all orders actually submitted), or pro rata based upon an advance indication of interest are all permissible. However, accounts must be checked for suitability.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

15. (C) Implement a similar policy for the other client who did not just get married.

Explanation

According to Standard III(C), Suitability, the analyst must assess the time horizon, return objectives, tax considerations, and liquidity needs of a client before changing an investment policy. The analyst must notify the client of the new policy. Implementing the policy for the other client may be a violation of the Standard unless that client's needs are totally reassessed and determined to be identical to the needs of the newly married client.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

16. (C) **document the details of the conversation with the client with regard to his investment recommendation.**

Explanation

Standard V(C) Record Retention requires that Members and Candidates document all recommendation and communications with clients. McCoy should document the details of the conversation, including any resulting investment decisions and/or actions. The suitability of the investment should have already been considered before the recommendation and McCoy should not execute the order until the client instructs him to. Identifying other clients for this investment would fall under Standard III(B) Fair Dealing.

(Module 42.1, LOS 42.b)

Related Material

SchweserNotes - Book 5

17. (C) **violated Standard IV(A) Loyalty.**

Explanation

By expressing his investment analysis on his personal blog ahead of his employer, Malone deprived his employer of the benefits of his skills and abilities and therefore violated Standard IV(A) Loyalty. Malone did not possess material nonpublic information about WestAir and no transactions have taken place.

(Module 42.1, LOS 42.b)

Related Material

SchweserNotes - Book 5

Hunter Harrison, CFA, is president and 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 follows 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. Harrison oversees Ironclad's research analysts and portfolio managers, including Michelle Myers, who passed Level II of the CFA examination last year and plans to sign up for next year's Level III exam as soon as registration opens. 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. During her correspondence with prospects and clients, Myers includes reference to her status as a "Level III CFA candidate" in her biographical background to increase her prominence in the industry.

18. (A) **Standard VII: Responsibilities as a CFA Member or CFA Candidate. Compliance: No.**

Explanation

The actions of Myers are covered under Standard (VII)—Responsibilities as a CFA Member or CFA Candidate. Standard VII(B)—Reference to CFA Institute, the CFA designation, and the CFA Program requires that CFA candidates appropriately reference their participation in the CFA program, clearly stating their candidate status and not implying the achievement of any type of partial designation. Importantly, to be considered a candidate an individual must be registered to take the next scheduled exam.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

19. (C) **Standard VI(B) - Priority of Transactions.**

Explanation

Standard VI(B)—Priority of Transactions most likely does not apply to Myers' participation in the software company. Standard VI(B) covers priority over transactions in securities or other investments for clients and employers to prevent any instances of "front-running" for the benefit of the member. Myers' software business is not transaction-oriented, and there is no information that describes any instances of the software company having priority in securities transactions over Ironclad or its clients. Preservation of confidentiality of clients is relevant here if she passes on their information in her capacity as a partner in the software firm. Disclosure of conflict of interest to her employer may be applicable so that the employer can ascertain that clients of the software company are not getting preferential treatment.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

20. (A) **can accept the offer from Worldwind, but cannot accept the offer from Better Trading.**

Explanation

Subject to additional disclosure, Harrison can accept the offer from Worldwind, but cannot accept / the offer from Better Trading. Harrison's actions are covered by Standard I(B) — Independence and Objectivity. Under Standard I(B), members shall use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. As such, Harrison's acceptance of the offer from Better Trading could be perceived to compromise his independence and objectivity on behalf of his clients, as the broker may be trying to influence Harrison to increase the amount of trading that Ironclad executes on behalf of clients. Since Better Trading is not a client of Ironclad, and its offer could negatively influence Harrison's actions on behalf of Ironclad's clients in violation of the Standard, the offer should be refused. The offer from Worldwind, who is one of Ironclad's clients, if accepted, does not cause Harrison to violate Standard I(B). Gifts from clients are distinguishable from gifts from third parties seeking to influence the activities of an investment manager. Worldwind's offer to Harrison may be accepted, provided it is disclosed to Ironclad in writing as additional compensation or benefits. Standard IV(B)—Additional Compensation Arrangements requires members to disclose in writing any additional compensation or other benefits received for their services in addition those provided by their employer. Harrison is obligated to disclose the offer and abide by any further requirements set forth by Ironclad prior to accepting the tickets.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

21. (C) violated the Standard.

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. In this example, Myers' software company owes a duty of loyal and confidentiality to Breakthrough. 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. Material 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.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

22. (B) Standard II(A) — Material Nonpublic Information.

Explanation

Standard II(A)-Material Nonpublic Information is least likely to apply to both Harrison and Myers in this situation. Given Harrison's role on the boards of directors for Internet and Wavelength, he is in the position to potentially receive material non-public information; however there are no facts presented that would infer that he either received or used material nonpublic information about Internet or Wavelength. Myers, as a benefits consultant for Speedy Chip, also may be in a position receive to material nonpublic information, but there are no facts presented that would infer Myers' receipt or use of material nonpublic information.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

23. (C) Harrison should discard all proxies on behalf of Ironclad's clients when there is a conflict of interest.

Explanation

Proxy voting is a plan asset under ERISA and as such, is subject to the fiduciary duty obligations. 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 Internet and Wavelength due to his role on their board of directors, proxies 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 Internet 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, coordinating major proxy voting issues across all client accounts.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

24. (B) Standard III(C) Duties to Clients: Suitability because it misleads the reader as to the process by which securities are selected.

Explanation

LLC must adequately disclose the basic security selection and portfolio construction process, and the portfolio manager recommendations and investment actions must be consistent with the stated objectives and constraints of the fund. By failing to acknowledge the fund's dependence on technical trading, the fund fails to meet this standard.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

25. (B) **can offer this security on a prorated basis to all clients for which the security is appropriate.**

Explanation

Standard III(B), Fair Dealing, applies. When new issues or secondary offerings are available or are being offered by the firm or if the firm is part of a selling syndicate, all clients for whom the security is appropriate are to be offered a chance to take part in the issue. If the issue is oversubscribed, then the issue is to be prorated to all subscribers.

(Module 43.5, LOS 43.b)

Related Material

SchweserNotes - Book 5

26. (A) **practices in a professional and ethical manner.**

Explanation

Component four of the Code says that a member shall "Practice and encourage others to practice in a professional and ethical manner that will reflect credit on members and the profession." Neither of the other choices are implied by the Code.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

27. (B) **client.**

Explanation

Brokerage is an asset of the client.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

28. (A) **on a pro-rata basis over all suitable accounts.**

Explanation

It is permissible to allocate trades on a pro-rata basis over all suitable accounts. It is not permissible to base allocations upon compensation arrangements. Any method is not necessarily suitable, and disclosure does not absolve the member from ensuring that the allocation is necessarily fair.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

29. (B) **in violation of his fiduciary duties regarding the municipal bond research but not so regarding the research on the small cap issues.**

Explanation

The issue at hand is the member's fiduciary responsibilities in handling "soft dollars" which are technically the property of the client. Standard III(A), Loyalty, Prudence, and Care, delineates the member's fiduciary responsibilities with regard to soft dollars. Since municipal bond research is clearly not relevant to the Small Cap Fund holders, he is clearly using the soft dollars to obtain research for his personal benefit and is in violation of the Standard.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

30. (A) **violated the Standards by not informing Carey about the insider trading risks, but not by contributing to the problem of insider trading.**

Explanation

Wynn should have known about the risks and should have informed Carey of the risks. However, merely investing in a market in which insider trading is prevalent is not a violation of the Standards.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

31. (B) **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

32. (A) **Practice and encourage others to practice in a professional and ethical manner that will reflect credit on members and their profession.**

Explanation

This is a component of the Code of Ethics. Others pertain to the Standards of Practice.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

33. (C) CFA Institute members and candidates in the CFA Program.

Explanation

Participants in the CFA Program are not specifically mentioned in the Code of Ethics. Component one mentions duties to the public, clients, prospects, employers, employees, colleagues, and other participants in the global capital markets.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

34. (B) does both of the actions listed here.

Explanation

According to Standard III(A), Loyalty, Prudence, and Care, the analyst must put the client first and inform the client of any possible conflicts of interest. The analyst must channel any benefits derived from his service to the client, back to the client, and inform the client of the benefits.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

35. (A) Attending continuing education seminars on investing and inviting colleagues to come along.

Explanation

The Code states that a member shall "Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals." None of the other answers qualify.

(Module 42.1, LOS 42.b)

Related Material

SchweserNotes - Book 5

36. (C) humility.

Explanation

Although acting with humility may be desirable, CFA Institute members are not required to do so.

However, they should act in a manner that reflects credit on themselves and their profession:

Related Material

SchweserNotes - Book 5

37. (C) **integrity, competence, and respect.**

Explanation

Integrity, competence, and respect are mentioned by name in the first component of the Code of Ethics.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

38. (A) **must cease distributing the cards with the CFA designation, but can continue to use the existing promotional materials.**

Explanation

Use of the CFA designation must be stopped immediately, however, the receipt of the Charter is a matter of fact.

(Module 43.1, LOS 43.b)

Related Material

SchweserNotes - Book 5

39. (C) **Election of internal auditors.**

Explanation

Election of internal auditors is not a major proxy issue.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

40. (B) **inform the Securities and Exchange Commission.**

Explanation

Jones must pursue her concerns about a possible misstatement, because, if material, it may be misleading to investors. Consistent with Standard I(A), Jones must not knowingly participate or assist in a regulatory violation. As long as her concerns exist, she must not validate any financial statements by voting to approve them. In addition she should seek competent legal counsel both at her own firm and at Dewey Manufacturing. She should not go to regulatory bodies until she has more certainty about the possible misstatement and has received counsel that she should proceed.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

41. (A) **report the violation to the CFA Institute Professional Conduct Program.**

Explanation

Members are encouraged -- but not required -- to report violations of others. Standard I(A), Knowledge of the Law. Prohibition against knowingly practicing or assisting in violation of laws, rules, and regulations. If White knows that someone has engaged in a possible illegal activity, she should: (1) report the finding to the appropriate supervisory person at her firm, (2) if the situation is not remedied, disassociate herself from the situation, and (3) seek legal advice to see what other actions, such as notifying the proper regulatory agency, should be taken.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

42. (A) **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

43. (A) **do neither of the actions listed here.**

Explanation

Doing any of these actions would be a violation of Standard II(A), Material Nonpublic Information. Members and Candidates must not act or induce others to act on material nonpublic information.

Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

44. (B) **engaging in neither of these practices.**

Explanation

Proxies have economic value to the client. To comply with Standard III(A) Loyalty, Prudence, and Care, the analyst is obligated to vote proxies in an informed and responsible manner. A cost benefit analysis may show that voting all proxies may not benefit the client, so voting proxies may not be necessary in all instances. Directed brokerage occurs when the client requests that a portion of the client's brokerage be used to purchase services that directly benefit the client. Although this may prevent best execution, it does not violate the Standards as it was directed by the client, not the brokerage firm.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

45. (B) **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

46. (A) **can use the information to make investment recommendations and decisions.**

Explanation

Members who can piece together items of nonmaterial nonpublic information with public information can, based upon the mosaic theory, use such information for trading purposes.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

47. (C) **a violation of the Standard concerning use of material nonpublic information.**

Explanation

Even though the information is false, this fact is known only to Fox and is thus nonpublic information. Since such recommendations have in the past had a significant effect on the price of the security in question, the information is clearly material. Fox is in violation of Standard II(A) Material Nonpublic Information.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

48. (B) **Understand and comply with all applicable laws, rules, and regulations.**

Explanation

Understanding and complying with all applicable laws, rules, and regulations is required by Standard I(A) — Knowledge of the Law. The other choices are included in the Code of Ethics.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

49. (B) **violated the Standards by her policy on mutual fund and pension fund proxies.**

Explanation

Proxies should be taken seriously, and although it is likely that Griffith can understand some of the issues, it is likely that she is not capable of making responsible decisions on all potential proxy issues. Proxies for a pension plan should be voted in the best interests of the beneficiaries, not the plan sponsor. The sponsor's interests will not always be the same as the beneficiary's interest.

(Module 43.4, LOS 43.b)

Related Material

SchweserNotes - Book 5

50. (C) **Directed brokerage are soft dollars to be used for research that benefits the investment firm.**

Explanation

Directed brokerage are soft dollars directed by the client to the investment manager to pay for goods and services that benefits the client only and not the firm.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

51. (C) **invest a portion of the retirement plan in Bingham Company stock if the investment is prudent and if he keeps the overall portfolio properly diversified.**

Explanation

Standard III(A), Loyalty, Prudence, and Care, requires members to comply with their fiduciary duty. Retirement plan managers owe their duty to the plan participants, not to the management of the company sponsoring the plan. The fiduciary duty includes the obligation to diversify the plan's investments, regardless of the quality of the sponsoring company's stock. Investing in the company's stock is not prohibited.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

52. (B) **not correct, because no such ordering or priority is given in the Code.**

Explanation

Component one of the Code of Ethics mentions duties to the public, clients, prospects, employers, employees, and fellow members. No ordering of priorities is given. Standards of Professional Conduct on the other hand, does give priority. Standard III.A, Duties to Clients, specifies that clients have priority over employers.

(Module 42.1, LOS 42.b)

Related Material

SchweserNotes - Book 5

53. (A) **a violation of Standard III(C), Suitability.**

Explanation

According to Standard III(C), the analyst needs to determine the suitability of an investment for each client. It is doubtful that all her clients are identical in their needs. According to the information, the analyst mentions the upside potential but does not mention the downside risk. Although the information says that she thinks that the change in the tax law will benefit holders of utility company stocks and says nothing of how she arrived at this conclusion, we do not know if she has or has not made her decision on a reasonable basis.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

54. (A) **Vote all proxies on behalf of clients in a responsible manner.**

Explanation

Because of the time and expense involved in voting a proxy, Members and Candidates are not required to vote every proxy. A cost benefit analysis can be performed to determine if it is necessary to vote a proxy. Standard III(A) requires that client brokerage be used to benefit the client. Quarterly statements to clients are recommended.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

55. (A) **A member can be summarily suspended for having received material non-public information.**

Explanation

All of these are true except that a member can be suspended for having received material non-public information. The member can receive such information as part of their regular duties or by accident. Neither is punishable in and of itself, and penalties only apply if the member trades or causes others to trade on the information. The member may have certain duties, such as trying to disseminate the information after receiving it. An analyst may use nonmaterial non-public information.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

56. (B) permissible under the standards to allocate trades on the basis of a predetermined formula that may deviate from a pro rata basis but is inherently fair.

Explanation

If the firm has developed an allocation procedure that is formula-based, inherently fair, and the details are disclosed to clients, it is possible to deviate from a pro rata allocation basis.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

Christopher Lance, CFA, Chuck Cunningham, and Lucy Hunt, CFA, went to graduate school together and have remained close friends ever since. Lance and Hunt earned their CFA charters this past June and Cunningham is a Level III candidate. Lance, Cunningham, and Hunt have dinner every month at Cunningham's country club, one of the most prestigious in the metropolitan area where they live.

Lance was a well-respected research analyst covering the pharmaceutical industry at an international broker-dealer before accepting a job as Vice President, Investor Relations, at IMed, a large multinational pharmaceutical company that he covered as an analyst. Since he started coverage of IMed, Lance had consistently been named "top analyst" of the pharmaceutical industry by Investment Professional, the leading journal of the investment industry.

In his new position at IMed, Lance is the principal spokesperson on the company's financial performance and is responsible for developing and maintaining good relationships with the company's shareholders, especially large institutional investors, and with approximately 30 research analysts who issue research reports and make recommendations about publicly-traded equity and debt securities. It is April 12th and Lance is preparing to conduct the next conference call following the release on April 15th of IMed's quarterly earnings. Participating in the call will be Lance's former colleague and good friend, Cunningham, and the other analysts who cover IMed. In addition, Hunt, a portfolio manager at Primary Pensions, a major institutional investor, has told Lance she will also be on the call. Primary Pensions has accumulated the largest single holding in IMed equity.

Lance is concerned about this call because IMed's president, Bill Norton, has just told the management team that sales of Mediplex, its new cancer drug, have begun to sag after rumors of serious side effects, including death, have hit the press. Norton told Lance that if sales continue to fall that this year's earnings would be considerably less than the current consensus forecast. Norton is also concerned that the regulatory agency that approves the sale of drugs will repeal IMed's license to market Mediplex.

Cunningham is a research analyst at Lance's former employer and has taken over coverage of IMed following Lance's resignation. Until his promotion to Lance's former position, Cunningham was a junior analyst covering the oil and gas industry. Although knowledgeable about fundamental financial analysis and equity valuation, he is unfamiliar with IMed and the pharmaceutical industry. Cunningham has been reviewing the past 5 years of IMed's financial statements and Lance's research reports in preparation for participating in IMed's quarterly conference call to discuss its quarterly earnings release. Cunningham is under considerable pressure from his employer to meet or exceed Lance's reputation and be rated "top analyst" by Investment Professional. His firm's currently rates IMed as a "strong buy" based on Lance's last research report. Based on his own preliminary analysis, Cunningham has a hard time justifying a "hold" recommendation. He is puzzled by several of the earnings adjustments that Lance made to achieve his target share price for IMed. He plans to ask Lance about these adjustments at their dinner on April 14^{th}.

Hunt has been managing a large cap equity portfolio at Primary Pensions for 5 years. Based almost exclusively on Lance's buy recommendations in his research report, she began purchasing IMed several years ago just before it made several major acquisitions that contributed to its phenomenal growth and to her portfolio's performance over the last 5 years. Since Lance moved to IMed, Hunt has been doing some due diligence and has become concerned that the growth of IMed's earnings is overly dependent on sales of Mediplex. Based on her enthusiasm for IMed and her portfolio's performance, other managers at Primary Pensions have also taken considerable positions in IMed to the extent that Primary Pensions is IMed's largest single stockholder. If she is right, Hunt knows that she will need to reduce her portfolio's holdings. Since Primary Pensions prohibits its employees from owning individual equity securities, Hunt has no personal investment in IMed. However, she had boasted about IMed's performance to her mother and is aware that her mother's investment club invested 10 percent of the club's assets in IMed. Hunt is preparing her questions for the upcoming conference call and her exit strategy if the answers confirm her fears.

Lance, Cunningham, and Hunt met for their regular monthly dinner on April 14th. Cunningham opens the after dinner discussion by questioning Lance about his new job and asks him if he and Hunt should anticipate any surprises at tomorrow's conference call. Cunningham specifically asks Lance if IMed will meet or beat analyst expectations and the consensus earnings forecast. Lance responds that, under current securities laws, he is unable to discuss details of IMed's performance with Cunningham and Hunt and that they'll both be briefed with the other analysts and shareholders on tomorrow's call. Shortly thereafter, the three friends say their good-byes. Hunt and Cunningham wish Lance well on the next day's conference call.

57.

Standard	Compliance
(B) I: Professionalism	Yes

Explanation

Lance's response to Cunningham's question is covered under Standard I(A) which requires members to maintain knowledge of and comply with applicable laws and regulations (including they CFA Institute's Code of Ethics and Standards of Professional Conduct). In this case, Lance specifically references the requirements of securities laws not to discuss IMed's performance in advance of the quarterly conference call. If he had done so, he would have disclosed material nonpublic information, since he knows that information about the decline in sales of Mediplex will have an adverse effect on IMed's share price. In addition, Standard I(A) prohibits Lance from knowingly participating or assisting in any violation of such laws. If Lance had responded in any other way to Cunningham's question he would potentially have assisted Cunningham and Hunt in violating Standard II(A), Material Nonpublic Information.

(Module 43.1, LOS 43.a)

Related Material

SchweserNotes - Book 5

58. (B) Inform the appropriate regulatory authority that Lance had violated securities laws.

Explanation

Unless required by law, the Code of Ethics and Standards of Professional Conduct do not require members to report legal violations to the appropriate governmental or regulatory authority. Such disclosure may be prudent in certain circumstances. Cunningham would be prohibited under Standard II(A), Material Nonpublic Information, from trading in the securities of IMed or causing others to trade by issuing a research report incorporating the material nonpublic information before that information is made public by IMed. Cunningham would also be required to make reasonable efforts to have Lance and IMed make public disclosure of the information.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

59. (A) **Standard I(B), Independence and Objectivity.**

Explanation

Over the course of a year, Lance will have received gifts of more $2400 from Cunningham. Standard I(B), Independence and Objectivity, covers receipt of gifts from external parties that may try to influence members' professional actions to the possible detriment of Lance's employer, IMed, and the investing public. Even though Lance and Cunningham are long-time friends and former colleagues at Cunningham's employer, the potential for undue influence exists. Lance should be particularly concerned given Cunningham's inappropriate question regarding IMed's earnings. In determining how best to comply with Standard I(B), Lance should no longer permit Cunningham to pay for his dinner and, given the prestigious nature of the country club, should also consider moving the monthly dinner to a different venue to avoid the appearance of impropriety.

(Module 43.1, LOS 43.a)

Related Material

SchweserNotes - Book 5

60. (B) **Lance violated Standard I(D), Misconduct.**

Explanation

Lance violated Standards I(D), Misconduct, when he lied about the sales of Mediplex. Under Standard I(D), members are prohibited from engaging in any professional conduct involving dishonesty, fraud, deceit, or misrepresentation or commit any act that reflects adversely on their dishonesty, trustworthiness, or professional misconduct. Neither Standard IV(A), Loyalty to Employer, which relates to independent practice that could result in compensation or other benefit in competition with their employer and does not relate in this situation nor Standard III(B), Fair Dealing, which relates to dealing fairly and objectively when making recommendations to clients, are relevant or apply to this situation. Lance is also **NOT** in compliance with Standard I, Professionalism, because he violated Standard I(D), Misconduct.

(Module 43.2, LOS 43.a)

Related Material

SchweserNotes - Book 5

61.

Statement 1	Statement 2
(A) Incorrect	Correct

Explanation

Statement 1 is incorrect. Ethical standards and codes of conduct are not mathematically precise and exacting but are ambiguous and open to interpretation. This characteristic requires wisdom and a mature approach on the part of the professional. Statement 2 is correct. In deciding what course of action is ethically sound, a professional must first determine the applicable code and standards and assess their requirements in light of the circumstances.

(Module 43.1, LOS 43.a)

Related Material

SchweserNotes - Book 5

62. (C) **act with integrity, competence, diligence, respect and in an ethical manner when dealing with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.**

Explanation

Acting with integrity, competence, diligence, respect, and in an ethical manner when dealing with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets is one of the six components of the Code of Ethics, whereas the other statements are part of the Standards of Professional Conduct.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

63. (C) **it is recommended that members deliver a copy of the Code and Standards to their employer.**

Explanation

Standard IV(A) Loyalty recommends (not requires) that members and candidates provide their employer with a copy of the Code and Standards and notify their employer that they are required to follow the Code and Standards. There is no recommendation to leave a firm simply because the Code and Standards have not been adopted by the firm in its policies and procedures.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

64. (C) **did not violate either Standard I(A) or Standard I(C).**

Explanation

Bellow did not violate Standard I(A), Knowledge of the law, because he sought advice of counsel and followed that advice. Bellow did not violate Standard I(C), Misrepresentation, because he made reasonable and diligent efforts to ensure the accuracy of the information and to avoid any material representation.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

65. (A) **reflect credit on members and the profession.**

Explanation

The Code states that a member shall "Practice and encourage others to practice in a professional and ethical manner that will reflect credit on members and their profession.

(Module 42.1, LOS 42. a)

Related Material

SchweserNotes - Book 5

66. (B) **Loyalty, Prudence, and Care.**

Explanation

Fiduciary duty on issues relating to corporate governance or to soft dollars is primarily addressed by Standard III(A), Loyalty, Prudence, and Care.

(Module 43.4, LOS 43.b)

Related Material

SchweserNotes - Book 5

67. (C) **constitutes a violation of his fundamental responsibilities under the Code and Standards.**

Explanation

As a CFA Institute member, Feldman is bound, under Standard I(A), not to "knowingly participate or assist in any violation of such laws, rules, or regulations." Since it should be clear that releasing bogus financial information is in contravention of laws, rules, and regulations, and since he knows that the data is purposely distorted, he must not release the data to the public. Doing so places him in violation of the Code and Standards.

(Module 43.1, LOS 43.a)

Related Material

SchweserNotes - Book 5

68. (B) **An analyst using material nonpublic information may be fined by CFA Institute.**

Explanation

There is no provision for CFA Institute to issue fines to members. Members may not use material nonpublic information for trading purposes. Nonmaterial, nonpublic information may be used together with analysis of public information under the Mosaic Theory.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

69. (B) **should restrict employee trading in securities for which the firm is in possession of material non-public information.**

Explanation

Restricting employee trading in stocks for which the firm has material non-public information is the best answer. Recording the exchange of information between the two departments is not the best option because there should be no exchange of information between these two departments. Divesting a department is not a suitable method for addressing this potential problem.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

70. (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

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

Explanation

According to Standard III(E), Preservation of Confidentiality, 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

72. (A) can publish his conclusion in a research report.

Explanation

While the information that Allen received from the Edmonds CEO may be non-public, we are also told that it is non-material. Because Allen has reached his investment conclusion through an analysis of public information together with items of non-material non-public information (i.e., "mosaic theory"), publishing this conclusion is not a violation of the Code and Standards.

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

73. (A) take no action.

Explanation

Because Blanford suspects Shanti of engaging in ongoing illegal activities, Blanford should take action by determining the legality of the suspected action, disassociating from any illegal activity, and urging his firm to attempt to persuade Shanti to cease such conduct if such an activity is illegal or unethical.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

74. (B) is held responsible for participating in illegal acts when the law is evident to anyone knowing the law and can participate in a violation by having knowledge of the violation and taking no action to stop it or disassociate from it.

Explanation

If you suspect someone is planning or engaging in illegal activities, you should:

1. Determine the legality of the activities. Consult your supervisor and legal counsel.
2. Take appropriate action. Disassociate, attempt to persuade the perpetrator to stop. CFA Institute does not require you to report them to the authorities, but the law might.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

75. (A) refrain from any conduct that compromises the reputation or integrity of the CFA designation.

Explanation

Not compromising the reputation or integrity of the CFA designation is a part of the Standards of Professional Conduct, but is not specifically mentioned the Code of Ethics.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

76. (C) **neither transaction-based manipulation nor information-based manipulation.**

Explanation

Waters is not in violation of Standard II(B), Market Manipulation. Transaction-based manipulation includes, but is not limited to, transactions that artificially distort prices or volume. Information-based manipulation includes, but is not limited to, spreading false rumors about a firm in order to induce others to trade.

(Module 43.3, LOS 43: II(B))

Related Material

SchweserNotes - Book 5

77. (A) **in violation of the Code and Standards by not properly updating the investment policy statement in light of the change in the circumstances but is not in violation with regard to the acceptance of the gift from House.**

Explanation

The investment manager is in violation of the Standard requiring him to make a reasonable inquiry into the client's financial situation and update the investment policy statement since such a dramatic change in the client's circumstances would undoubtedly alter the investment policy statement and would probably eliminate the need to hold a short position in Oracle. The investment manager is not in violation of the Standard concerning additional compensation, since the gift has been reported to his supervisor and has come from a client. If there was a failure to report such a gift, if the firm had a rule in place against the acceptance of gifts from clients, or if the gift had come from a non-client, there would be a violation of the standard.

(Module 43.5, LOS 43.b)

Related Material

SchweserNotes - Book 5

78. (A) **not permissible under the Code and Standards.**

Explanation

Standard III(B) requires a member to deal fairly with all clients when taking investment actions. Since she knew at the outset that she was going to place shares in all accounts, regardless of the first letter of the surname, all accounts must participate on a pro-rata basis in each block in order to conform to the Standard. Her actions constitute a violation of the Standard concerning fair dealing.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

79. (C) **both the U.S. and Japan and the CFA Institute Standards of Professional Conduct.**

Explanation

To abide by the Standards, employees who work for foreign-based firms are required to apply the stricter of the foreign (here, U.S.) law, the domestic (here, Japanese) law, or CFA Institute standards.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

80. (A) **permissible since it effectively amounts to a strict pro rata basis of allocation.**

Explanation

The formula shown above is nothing more than a simple pro rata basis of allocation (assuming that the shares are then subsequently allocated in the same fashion over all of the sub accounts by category). Hence, this is permissible.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

81. (B) **inform her immediate supervisor at WEB of her discovery**

Explanation

Berry should report this information only to her immediate supervisor. Subsequently, she and her supervisor may consult with legal counsel concerning the competing issues in this situation. For the present, she should avoid disclosure to colleagues who do not need to know the information and she should also avoid disclosure to clients.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

82. (B) **Standard III(B), Fair Dealing.**

Explanation

Wade did not violate Standard III(B), Fair Dealing, because this situation does not indicate that he failed to deal fairly and objectively with all clients when disseminating his newsletter containing investment recommendations.

Wade violated Standard V(B), Communication with Clients and Prospective Clients, because he failed to include all relevant factors behind his recommendations. Without providing the basis for his recommendations, clients cannot evaluate the limitations or the risks inherent in his recommendations.

Wade violated Standard I(C), Misrepresentation, because his claims about gaining superior expected returns are misleading to potential investors.

(Module 43.5, LOS 43.b)

Related Material

SchweserNotes - Book 5

83. (C) **do not require that members report legal violations to the appropriate governmental or regulatory organization.**

Explanation

The Code and Standards do not require members to report violations to legal authorities, but such disclosure may be prudent or required in certain circumstances. They do not require members to quit their jobs or to persuade violators to cease illegal activities. They do require that members report the activities to the appropriate person(s) in their own firm and disassociate themselves from the illegal actions. Members must obtain written permission to accept gifts that create a conflict with their employer's interest.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

84. (B) **dissociate from the supervisor's activity.**

Explanation

Johnson must dissociate herself from her supervisor's activity, for example by asking to be reassigned. The Code and Standards do not require Johnson to report the violation to governmental or regulatory organizations unless doing so is required by applicable law. Johnson has attempted to stop the violation by discussing it with her compliance department. She is not required by the Code and Standards to confront the supervisor.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

85. (A) **Information received from an insider who is not breaching his fiduciary responsibility may be traded on.**

Explanation

If the information is material and nonpublic, the Member or Candidate cannot trade or cause others to trade. It does not matter if the insider did not breach his fiduciary responsibility. The inside information is still material and nonpublic.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

86. (A) **fire wall.**

Explanation

To comply with Standard II(A), a fire wall provides an information barrier that prevents communication of material nonpublic information and other sensitive information from one department to another within a firm.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

87. (C) **Standard I(C), Misrepresentation, and I(A), Knowledge of the Law.**

Explanation

Baker has some doubts but does not initiate any action presuming they only apply to the publicly disclosed report. The lack of action is a violation of Standard I(A), Knowledge of the Law. He also violates Standard I(C), Misrepresentation, by failing to properly disclose the sources of his information, where necessary.

(Module 43.2, LOS 43.b)

Related Material

SchweserNotes - Book 5

88. (C) **illegal or unethical activity if the member has reasonable grounds to believe that the activity is illegal or unethical.**

Explanation

According to the procedures for compliance involving Standard I(A), CFA Institute members should determine legality and disassociate from any illegal or unethical activity.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

89. (C) **the statement of excess performance is misleading with respect to its certainty.**

Explanation

Guaranteeing performance on investments that are inherently volatile is misleading to clients.

(Module 43.2, LOS 43.b)

Related Material

SchweserNotes - Book 5

90. (B) **violating the standard by either showing the pre-release version to his intern or sending it to his brother.**

Explanation

Standard II(A), Material Nonpublic Information, says that a member must be careful about handling material non-public information. As a member of CFA Institute, the CFO must limit the people who see important information before it is released. It would not be appropriate to involve an intern or a relative in the process.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

91. (C) make recommendations or trade based on several pieces of public or nonpublic. information, each piece by itself being nonmaterial, but when compiled the information becomes material.

Explanation

The mosaic theory permits an analyst to make recommendations based upon several pieces of public or nonmaterial information, even though the complied result is both material and nonpublic.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

92. (B) a violation if the headquarters are within reasonable driving distance from the analyst's home.

Explanation

If such a trip is "out-of-the-way", payment by the company for the trip is acceptable. If the headquarters are within reasonable driving distance, the analyst should drive there.

(Module 43.1, LOS 43: I(B))

Related Material

SchweserNotes - Book 5

93. (B) comply with the CFA Institute Global Investment Performance Standards.

Explanation

The CFA Institute-GIPS are voluntary standards for the industry. Firms are not required to comply with these standards when presenting performance. The other statements are each components of the CFA Institute Code of Ethics.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

94. (B) The Standard concerning Fiduciary Duty.

Explanation

In addition to being a violation of the Standard concerning Fair Dealing, this constitutes a violation of Mohawk's Fiduciary Duty. Why? Because the on-the-run issues are benchmarks and trade at lower yields than the off-the-run issues. In essence, the off-the-run issues have marginally higher returns, and this will boost the returns in the performance-based fee accounts. Mohawk is allocating trades based upon compensation arrangements, and this is not permissible under the Code and Standards.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

95. (C) cannot answer the question because it would be misleading.

Explanation

Any discussion of past performance would imply that Clark had made some calculations, which would be misleading. However, Clark need not calculate historical performance to be an advisor.

She can also talk about her view on the future of capital markets.

(Module 43.2, LOS 43.b)

SchweserNotes - Book 5

96. (B) can publish his conclusion in a research report.

Explanation

Releasing information to analysts does not constitute a public release of information. Dawson's information should be considered nonpublic until it is released to the public. Allen has used this information, along with other industry information, to come to his conclusion of a pending tender offer which he can use to trade upon based on the mosaic theory.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

97. (B) Misdemeanor change for possession of narcotics.

Explanation

A misdemeanor charge not related to professional conduct is not grounds for a suspension. The other choices are violations of the Code and Standards and may result in CFA Institute imposing a suspension of membership or participation.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

98. (A) continue to advise employees to sell their stock.

Explanation

Although Drake is paid by the company, his fiduciary duty is to the plan participants. His advice cannot be compromised by business considerations, otherwise he will be violating the Standard on loyalty, prudence, and care.

(Module 43.4, LOS 43.b)

Related Material

SchweserNotes - Book 5

99. (A) Maintain files to support investment recommendations.

Explanation

Maintaining files to support investment recommendations is not a compliance procedure for Standard I(B): Independence and Objectivity, but it is a compliance procedure for Standard V(C): Record Retention.

(Module 43.1, LOS 43: 1(B))

Related Material

SchweserNotes - Book 5

100. (B) 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

101. (A) Yes, because the member did not maintain knowledge and know of the rule.

Explanation

Standard I(A) explicitly says that a member shall maintain knowledge and comply with laws, rules, and regulations. By not knowing of the rule, the member broke the standard.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

102. (C) that a minimum level of professional responsibility and conduct dictates that members be aware of and comply with laws, rules, and regulations governing their conduct.

Explanation

CFA Institute's Code and Standards dictate a minimum level of conduct. Standards should not be based on ethics of upper management and the board of directors of a company. Firms must comply with the strictest applicable standards, whether they be foreign or domestic laws and regulations.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

103. (B) if the housekeeper says the meeting concerned a tender offer and the broker knows that it is non-public information.

Explanation

Standard II(A), Material Nonpublic Information, states "a member cannot trade or cause others to trade in a security while the member possesses material nonpublic information" A tender offer would certainly be material nonpublic information. Knowing that the meeting took place, and nothing else, does not restrict the broker. A reasonable investor would need to know more to determine if the information was material.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

104. (B) **violated the Standards by not dealing fairly with clients but has not violated the Standards regarding material nonpublic information.**

Explanation

Kent must treat all clients fairly in acting on the information, regardless of the size of the investment. The information concerning the fund manager's departure is not material nonpublic information because its release would have no effect on individual stock prices within the fund and thus should not impact the fund's net asset value. (An open ended mutual fund's Net Asset Value will very closely track the value of the fund's underlying assets, because such a fund can be redeemed by investors at any time.)

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

105. (C) **permissible under CFA Institute Standards.**

Explanation

The issue is similar to an allocation of soft dollars. Clearly, if the broker absorbs the loss, they expect to make up the difference in some way. However, since the error was on the part of Quantco Brokerage, Calaveccio is under no obligation to cover the cost of the trading error. Moreover, no reasonable observer expects that there exists any implied future allocation of trades to Quantco in return for correcting their own mistake. There is no violation of Standard III(A), Loyalty, Prudence, and Care.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

106. (B) **Long violated Standard III(E) but 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

107. (C) **Contractual provisions.**

Explanation

Contractual provisions are not part of the Code of Ethics.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

108. (C) **strive to maintain and improve their competence and the competence of others in the profession.**

Explanation

Striving to maintain and improve their competence and the competence of others in the profession is one of the components of the Code of Ethics, whereas the other statements are part of the Standards of Professional Conduct.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

109. (A) **disassociate herself from the activity, and urge Venture to persuade Martinez to cease the activity.**

Explanation

Standard 1(A), Knowledge of the Law requires members who have knowledge of colleagues engaging in illegal activities to disassociate from the activity and urge their firms to persuade the individual to cease such activity. Reporting to regulatory authorities may be prudent in certain circumstances, but is not required. Reporting to CFA Institute is not required.

(Module 43.1, LOS 43:I(A))

Related Material

SchweserNotes - Book 5

110. (B) **do both of the actions listed here.**

Explanation

According to Standard I(B) Independence and Objectivity, the analyst should refuse the invitation if it is from a firm the analyst covers for his employer. The analyst can accept the invitation if it is from a client but the analyst must get written consent from his employer if the offer is contingent on future performance, to comply with Standard IV(B) Additional Compensation Arrangements.

(Module 43.1, LOS 43: 1(B))

Related Material

SchweserNotes - Book 5

111. (C) **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

112. (C) **a violation of the standard.**

Explanation

Such a policy is a violation of the Standard and client acknowledgement and/or consent does not change that fact.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

113. (A) **is required to report this legal violation to the appropriate governmental or regulatory organizations.**

Explanation

Standard I(A), Knowledge of the law, does not require that Parsons report legal violations to the appropriate governmental or regulatory organizations, but such disclosures may be appropriate under certain circumstances.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

114. (A) **may be directed to pay for the investment manager's operating expenses.**

Explanation

Brokerage commissions are the property of the client and may only be used for client benefit.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

115. (C) **Roth cannot recommend Genco to his clients at this time.**

Explanation

The information is material and nonpublic; therefore, Roth cannot act or cause others to act at this time.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

116. (B) violated the Standards by not dealing fairly with clients.

Explanation

The fund should have been considered for the existing clients' portfolios. There may have been reasons not to add the fund to their portfolios, such as tax consequences or a lack of suitability, but disturbing their comfort is not sufficient.

(Module 43.5, LOS 43.b)

Related Material

SchweserNotes - Book 5

117. (B) mosaic theory.

Explanation

Based on the mosaic theory, a member or candidate may act on a combination of public information and nonmaterial nonpublic information, without violating Standard II(A) Material Nonpublic Information.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

118. (A) advise regulators of the potential conflict of interest and seek legal counsel.

Explanation

Nielsen should advise her firm to develop firewalls and protections to allow the different departments to function independently. If Nielsen and Parker are going to remain friends, they should stop talking about client ratings.

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

119. (B) has not violated the Code and Standards.

Explanation

Standard 1(B) requires members to maintain independence and objectivity. A visit by an analyst to an out-of-the-way site may be paid for by a client company host as long as the analyst can maintain objectivity. Members should encourage clients to limit the use of corporate aircraft, but exceptions can be made if transportation would not otherwise be available or would be inefficient.

(Module 43.1, LOS 43: I(B))

Related Material

SchweserNotes - Book 5

120. (C) **Actively lobby for new laws to protect the public.**

Explanation

The Code of Ethics says nothing about a CFA Institute member lobbying for new laws. In fact, legal issues are not a part of the Code. The Standards of Professional Conduct say that the member shall obey laws.

(Module 42.1, LOS 42.b)

Related Material

SchweserNotes - Book 5

121. (C) **not invest more aggressively since this may expose the plan to too much risk and may not be in the best interest of the plan's beneficiaries.**

Explanation

Standard III(A), Loyalty, Prudence, and Care, applies in this situation. According to this Standard, investment actions should be carried out for the sole benefit of the client and in a manner the manager believes to be in the best interest of the client. Here, the client is the plan beneficiaries, not the manager or the entity that hired the manager.

(Module 43.4, LOS 43.b)

Related Material

SchweserNotes - Book 5

122. (B) **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

123. (C) **use outside research only after verifying its accuracy.**

Explanation

Standard I(B), Independence and Objectivity: the analyst is allowed to use outside research only after an insightful review. There are no restrictions regarding the exclusive use of outside information or in-house information.

(Module 43.1, LOS 43: I(B))

Related Material

SchweserNotes - Book 5

124. (C) **violated Standard I(C) Misrepresentation, because she did not acknowledge the source of excepts that she used in research reports.**

Explanation

By using excerpts from research reports by others with only a slight change in wording without acknowledging the source, Young committed plagiarism and violated Standard I(C) Misrepresentation. Young did not violate Standard IV(A) Loyalty because preparations to begin an independent business are permitted provided that they do not breach Young's duty of loyalty to her employer. Actions that would violate Standard IV(A) include soliciting clients or taking records or files while still working for the current employer.

(Module 43.2, LOS 43: I(C))

Related Material

SchweserNotes - Book 5

125. (A) **Standard VI, Conflicts of Interest.**

Explanation

Standard VI(B) addresses priority of transactions, and states that "Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner."

(Module 42.1, LOS 42.b)

Related Material

SchweserNotes - Book 5

126. (C) **based upon past participation in IPOs.**

Explanation

Participation in prior IPOs does not insure suitability for subsequent IPOs. Moreover, this method of allocation could result in a fairness problem, since larger accounts are more likely to have had a greater level of participation in past IPOs.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

127. (A) **a violation of the Code and Standards since he is required not to knowingly participate or assist in such an act.**

Explanation

McDowell, by his action in taking the documentation to his supervisor, is knowingly participating in and/or assisting in an illegal act. This is clearly prohibited under Standard I(A), and he is in violation of the Standard.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

128. (C) **Both Standard III(C) Suitability and Standard V(A) Diligence and Reasonable Basis.**

Explanation

Both Standard III(C) Suitability and Standard V(A) Diligence and Reasonable Basis were violated. Tuipulotu must perform a full IPS review to determine the appropriateness of the new portfolio allocations. Submanagers should not be selected by cost structure alone, as the quality and appropriateness of the submanager is Tuipulotu's responsibility.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

129. (C) **information-based manipulation, but not transaction-based manipulation.**

Explanation

Williamson is in violation of Standard II(B), Market Manipulation, by engaging in information-based manipulation. Information-based manipulation includes, but is not limited to, spreading false rumors about a firm in order to induce others to trade.

(Module 43.3, LOS 43: II(B))

Related Material

SchweserNotes - Book 5

130. (A) **update his understanding of applicable laws and regulatory standards relating to his position.**

Explanation

See Standard I(A) "Knowledge of the Law." Brynne should update his understanding of applicable laws and regulatory standards relating to his position, although he is not required to be an expert in compliance. Relying only on firm policies and procedures is not sufficient.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

131. (B) **fiduciary duty**

Explanation

The allocation of a disproportionate number of shares to performance-based fee accounts constitutes a violation of fiduciary duty, in addition to being a violation of the Standard concerning fair dealing.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

132.

	Weather	Winter
(A)	No	Yes

Explanation

Weather did not violate Standard II(A) because this prohibition applies to recipients who are not directly or indirectly associated with the firm the material nonpublic information is about. As a corporate insider, Weather can use insider information to benefit his firm's shareholders. Winter violated Standard II(A) because the information is both material and nonpublic and she is required not to trade or cause others to trade on the information.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

In August 2005, the following events occurred related to Aggregate pportunities, Inc.:

- Aug. 8: The Wall Street Journal reported that Aggregate Opportunities had inflated its 2004 earnings due to questionable accounting practices. The story was based on interviews with unnamed sources within Aggregate and its auditor, Millennium Partners. On that day the stock fell 42 percent to $12.50 from $21.55.
- Aug. 10: At 9 a.m., Aggregate revealed in a conference call to analysts a restatement of earnings for the previous three fiscal years that almost completely erased the reported net income for fiscal years 2002, 2003, and 2004. Aggregate's chief financial officer personally selected the small group of analysts participating in this call. Company officers said the restatement resulted from questionable accounting practices for off-balance sheet limited partnerships. At 1 p.m., the company issued a news release containing the information provided in the conference call. By the end of the trading day the stock had fallen 74 percent to $3.25.
- Aug. 11: At 10 a.m., Aggregate's Chief Financial Officer Buster Lockhart, CFA, publicly announced his resignation, and the Securities and Exchange Commission said it was pursuing an investigation.

During July and August of 2005, the following actions were taken:

- July 20: Michael Cho, CFA, a highly respected analyst with 25 years of experience covering Aggregate's industry, had spent several days reading Aggregate's 10-K and 10-Q documents and other analysis published by some of his competitors at major brokerage houses. Based on his reading and conversations with Aggregate management concerning nonmaterial, nonpublic information, Cho concluded that Aggregate had inflated its earnings. On July 20, Cho issued a detailed research report to his clients and concluded that Aggregate should be sold. He subsequently participated in the Aug. 10 conference call, although it only confirmed what he had already detailed in his July research report.

Aug. 2: Equity analyst Harold Black, a CFA charterholder, received from his brother information that Aggregate might restate its earnings. Black's brother is a senior partner at Millennium Partners. Based on this information, Black immediately prepared a new research report that advised his clients to sell Aggregate, but did not liquidate his personal holdings in the company.

Aug. 4: Bob Watkins, a CFA Level II candidate and portfolio manager, was golfing at his club. Approaching the third tee, he heard the chief executive officer and chief financial officer of Aggregate discussing company finances. Concealing himself behind a tree, Watkins overheard them discussing the upcoming Wall Street Journal article and the earnings restatement. Based on this conversation, he immediately sold all Aggregate holdings in his clients' portfolios. Later that day, Watkins told his friend Juan Martinez, CFA, what he learned about Aggregate and how he learned it. Martinez, a subscriber to Cho's research, then read Cho's report on Aggregate. Immediately after finishing Cho's report, Martinez sold the fund's entire stake in Aggregate. Watkins and Martinez were not participants in the Aug. 10 conference call.

- Aug. 8: Barb Henderson, a CFA charterholder, read the Wall Street Journal article in the morning and after going over her research papers, issued a sell recommendation for Aggregate. On Aug. 10, she participated in the conference call and heard the details of the earnings restatement.
- Aug. 10: Lisa Sanders, CFA, participated in the Aggregate conference call. At 10 a.m., she changed her recommendation on Aggregate from hold to sell and informed all of her clients. At 1 p.m., Sanders sold Aggregate from her personal account.

133. (B) violated Standard II(A): Material Nonpublic Information by taking investment action.

Explanation

Watkins violated the CFA Institute Standards because the information was both material and nonpublic. It does not matter if the information was not misappropriated, not received in a breach of duty or not related to a tender offer. Watkins still cannot trade or cause others to trade. CFA candidates are indeed subject to the CFA Institute Standards. While the misappropriated information did not involve a tender offer, Watkins' use of it still violated the Standards simply because it was material nonpublic information.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

134. (B) **violated Standard II(A): Material Nonpublic Information by taking investment action based on information not accessible to the public.**

Explanation

The way in which Aggregate handled the conference call was an instance of selective dissemination, Members and Candidates must be aware that disclosure to selected analysts is not necessarily public disclosure. Thus, until the material information is made public, Sanders cannot trade or cause others to trade. Once the information is made public, Sanders must disseminate the information to her clients first, and give them adequate time to act on the recommendation before trading for her own account. In the absence of knowledge of any company policy with stricter requirements, 3 hours is probably sufficient, and we cannot assume she violated Standard VI(B). Standard III(B) does not require equal dissemination of information but rather fair dissemination. Nothing in the question indicated that Sanders disseminated the information unfairly.

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

135. (C) **violated Standard II(A): Material Nonpublic Information by using information obtained from Watkins.**

Explanation

Martinez was aware of how Watkins obtained the information; therefore, Martinez violated II(A) by trading on material nonpublic information. Martinez has no fiduciary duty to Watkins, and as such did not violate Standard III(A). It would be difficult to argue that Cho's thorough research is not sufficient reason to trade Aggregate stock, so Martinez did not violate Standard V(A).

(Module 43.3, LOS 43.a)

Related Material

SchweserNotes - Book 5

136. (B) **Aggregate's CFO violated the fair-dealing Standard, but Black did not violate the fiduciary-duties Standard.**

Explanation

Aggregate's selective disclosure did violate the fair-dealing Standard, and while Black violated a number of Standards, his brother's fiduciary duty cannot be imposed on him. Black did not violate the fiduciary-duties Standard. While Cho did not violate the insider-trading standard because he came to his conclusions through the mosaic method, Watkins certainly did because he misappropriated the information. Martinez violated the Standard on material nonpublic information.

Henderson did not violate the reasonable-basis Standard. Sanders did violate the insider-trading Standard.

(Module 43.5, LOS 43.a)

Related Material

SchweserNotes - Book 5

137. (B) NOT required to report the violation to the appropriate governmental or regulatory organizations.

Explanation

The Code and Standards **do not** require that members report legal violations to the appropriate governmental or regulatory organizations, but such disclosure may be prudent in certain circumstances. Dawson should consult legal counsel and disassociate from the activity.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

138. (C) violated the Standards concerning material non-public information.

Explanation

Thomas cannot act or cause others to act on material nonpublic information.

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

139. (C) The comments are non material and the report can be issued as long as he maintains a file of the facts as supplied by management.

Explanation

This is an example of the mosaic theory where separate pieces of nonmaterial information are pieced together to make an investment recommendation.

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

140. (A) not violated the Code and Standards.

Explanation

"Soft dollars" are the property of the client (in this case the holders of the shares of the Small Cap Venture Fund). Standard III(A) Loyalty, Prudence, and Care delineates the member's responsibilities. Since he is clearly using the soft dollars to obtain research that is directly applicable to his professional duties, there is no violation of the Standard.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

141. (A) **in violation of the Standard on Fair Dealing; the portfolio managers are in violation of the Standard on Fair Dealing.**

Explanation

Sanchez is in violation of the Standard III(B), Fair Dealing, since he has disseminated his recommendation preferentially to the portfolio managers in advance of making the report available to all clients who hold shares of ChemStar. The portfolio managers are in violation of the Standard since they are effectively giving preferential treatment to the trading accounts over the buy-and-hold accounts in the placement of orders based upon the change in recommendation.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

142. I **purchases stock of a boycotted firm for the group's portfolio.**

Explanation

Standard I(A) says the member must be guided by all applicable rules and regulations of professional associations governing the member's professional activities. Purchasing the stock for the firm would be a violation because it involves the member's professional activities and the rules of a group to which the member belongs and works for. Actively protesting would not be covered by that standard.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes – Book 5

143. I **the CFA Institute Professional Conduct Program request it.**

Explanation

According to Standard IIII, 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: IIII)

Related Material

SchweserNotes – Book 5

144. I **not in violation of the Standards.**

Explanation

There is no violation. It is in the best interest of the client to be diversified and selling via a series of cross trades will likely reduce price impact costs when compared to selling directly into the market. The analyst appears to have reasonable basis for putting the securities in the accounts of other clients.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes – Book 5

145. (B) **Country A and Country B but the law in Country C.**

Explanation

Green needs to follow Standard 1(A) – Knowledge of the law. In Country A, Green must adhere to the Code and Standards because Country A's laws are less strict. In Country B, Green must also adheres to the Code and Standards because Country B has no securities laws. Because Country C's applicable law is stricter than the requirements of the Code and Standards, Green must adhere to the laws of Country C.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes – Book 5

Chandra Patel, CFA, manages private client portfolios for QED Investment Advisers. Part of QED's firm-wide policy is to adhere to CFA Institute Standards of Professional Conduct in the management of all client portfolios, and to this end, the firm requires that client objectives, investment experience, and financial limitations be clearly established at the outset of the relationship. This information is updated at regular intervals not to exceed eighteen months. The information is maintained in a written policy statement (IPS) for each clients.

Anarudh Singh has been one of Patel's clients ever since she began managing money ten years ago. Shortly after his regular situational update, Singh calls to inform Patel that his uncle is ill, and it is not known how long he will survive. Singh expects to inherit "a sizeable sum of money," mainly in the form of municipal bonds. His existing portfolio allocation guidelines are for 75% to be invested in bonds. Singh believes that the expected inheritance will allow him to assume a more aggressive investment profile and asks Patel to begin moving toward a 75% allocation to equities. He is specifically interested in opening sizable positions in several technology firms, some of which have only recently become publicly traded companies. Patel agrees to begin making the changes to the portfolio and the next day begins selling bonds from the portfolio and purchasing stocks in the technology sector as well as in other sectors. After placing the trade orders, Patel sends Singh an email to request that he come to her office sometime during the next week to update his IPS. Singh replies to Patel, saying that he can meet with her next Friday.

A few days before the meeting, however, Singh's uncle dies and the portfolio of municipal bonds is transferred to Singh's account with QED. Patel sees this as an opportunity to purchase more technology stocks for the portfolio and suggests taking such action during her meeting with Singh, who agrees. Patel reviews her files on technology companies and locates a report on NetWin. The analyst's recommendation is that this stock is a "core holding" in the technology sector. Patel decides to purchase the stock for Singh's account in addition to several other wealthy client accounts with high risk tolerance levels, but due to time constraints she does not review the holdings in each account. Patel does examine the aggregate holdings of the accounts to determine the approximate weight that NetWin should represent in each portfolio.

Since Patel has very recently passed the Level III examination, QED sends a promotional email to all of the firm's clients. The email states that "QED is proud to announce that Chandra Patel is now a CFA (Chartered Financial Analyst). This distinction, which is the culmination of many years of work and study, is further evidence of the superior performance you've come to expect at QED." Patel also places phone calls to several brokers that she uses to place trades for her accounts, stating that she "passed all three CFA examinations on the first attempt." One of the people Patel contacts is Max Spellman, a long-time friend and broker with TradeRight Brokers Inc. Patel uses the opportunity to discuss her exclusive trading agreement with TradeRight for Singh's account.

When ordering trades for Singh's account, Patel's agreement with TradeRight for brokerage services requires her to first offer the trade to TradeRight, and then to another broker if TradeRight declines to take the trade. TradeRight never refuses the trades from any manager's clients. Patel established the relationship with TradeRight because Singh, knowing the firm's fee schedule relative to other brokers, asked her to do so. However, because TradeRight is very expensive and offers only moderate quality of execution, Patel is considering directing trades on Singh's account to BullBroker, which charges lower commissions and generally completes trades sooner than TradeRight.

146.

	Information	Frequecy
(C)	Yes	No

Explanation

According to Standard III(C)—Suitability, members and candidates must consider investment experience, objectives (risk and return), and constraints before investing funds on the client's behalf or recommending investments to the client. The firm has complied with the information content. The investment policy statement must be updated at least annually, or after significant changes in client circumstances, however, according to the guidance statement accompanying Standard III(C). Thus, the firm has not complied with Standard III(C) in this regard.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

147. (B) **Patel must adhere to the existing portfolio strategy until she meets with Singh to develop a new portfolio strategy based upon updated financial information, but may place trades which are consistent with the existing strategy.**

Explanation

According to Standard III(C)—Suitability, Patel must observe the written investment objectives now in effect as determined in cooperation with the client and may trade only on that basis. Because the anticipated change in Singh's financial condition was subject to an event of indeterminable timing, she should continue to honor the existing written investment objectives until a change is warranted by an actual increase in the client's total financial assets and has been agreed upon with her client.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

148. (B) **No — Patel and Singh must meet and revise the IPS and portfolio strategy before reallocating.**

Explanation

According to Standard III(C)—Suitability, investment recommendations and actions must be consistent with a client's written objectives and constraints (typically in the form of an IPS). Because Singh's written IPS would not allow the large allocation to technology stocks prior to receiving the inheritance, the IPS must be updated by Singh and Patel prior to taking any actions that deviate from the original IPS. Patel will violate Standard III(C) by reallocating the portfolio before meeting with Singh.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

149.

	Singh's portfolio	Other portfolios
(C)	Yes	Yes

Explanation

According to Standard III(C)—Suitability, Patel must analyze the appropriateness and suitability of NetWin.com stock on a case-by-case basis before buying it. This will necessarily consider the basic characteristics of the security and how these will affect overall portfolio characteristics relative to the existing investment strategy for each portfolio. Patel has not analyzed the effect that the stock will have on any of the individual portfolios in question and has thus violated the Standard. Patel cannot look at aggregate measures to determine the appropriate weight that the security should represent in the individual portfolios because the portfolios are being managed individually, not in aggregate.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

150. (C) The promotional announcement violates the restrictions on misrepresenting the meaning of the CFA designation.

Explanation

An announcement that a member of a firm has received the right to use the CFA® designation is not a violation of the Code or Standards. However, Standard VII(B) requires that any reference to the charter must not misrepresent or exaggerate the meaning or implications of the CFA designation. A charterholder cannot claim that holding a charter leads to superior performance results. The letters "CFA" can only be used as an adjective (never a noun, as in "he is a CFA").') (C) Finally, passing all three exams does not give one the right to use the designation. All criteria must be met (e.g., experience requirements) before Patel can use the designation.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

151. (B) No.

Explanation

Since Singh directed Patel to use TradeRight, this should be considered client-directed brokerage. While Patel should inform Singh of the implications of that choice, Patel has no option but to follow the client's direction according to Standard III(A)–Loyalty, Prudence, and Care. Singh was fully aware of the fees charged by TradeRight relative to other brokerage firms, but elected to use them anyway. Investment managers are obligated to seek the best price and execution in the absence of client direction.

(Module 43.5, LOS 43: III(C))

Related Material

SchweserNotes - Book 5

152. (B) required to dissociate from the activity and strongly encouraged to report it.

Explanation

Standard I(A) does not require a CFA Institute member to report potential violations by others, but "strongly encourages members and candidates to report potential violations of the Code and Standards committed by fellow members and candidates."

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

153. (B) 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

154. (B) as a fiduciary under ERISA, the firm will strictly follow pension plan instructions and restrictions, which may include concentrating portfolios in a few securities or industries.

Explanation

According to Standard III(A)–Loyalty, Prudence, and Care, "members shall use particular care in determining applicable fiduciary duty." Under ERISA, a fiduciary has the duty to diversify the plan's investments in order to protect it from the risk of substantial loss. The firm must follow pension plan instructions and restrictions unless they conflict with ERISA or other applicable laws and regulations. Having concentrated portfolios does not constitute effective diversification. An appropriate policy statement would be: "The firm will follow pension plan documents only to the extent that they are consistent with applicable laws and regulations. The firm will diversify plan assets to minimize the risk of loss."

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

155. (A) recommending purchase of securities without a reasonable inquiry into the investment experience of the client.

Explanation

Standard III(A) Loyalty, Prudence, and Care requires members acting as advisors to make a reasonable inquiry into the client's investment experience, risk and return objectives, and financial constraints before making investment recommendations. Investment decisions must be made based on a total portfolio approach, rather than the quality of an individual investment in isolation.

Some members are not acting as investment advisors and may only have a duty to provide best execution of client orders.

(Module 43.4, LOS 43: III(A))

Related Material

SchweserNotes - Book 5

156. (C) The Standard concerning Fair Dealing.

Explanation

Rickard is in violation of the Standard concerning Fair Dealing by offering the client preferential access to a "hot" new issue. There is no obvious violation of Fiduciary Duty, since there is no evidence that Rickard is placing its own financial interest ahead of the client.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

157. (B) to disclose in writing to the proper regulatory authority all observed violations of the securities laws and regulations.

Explanation

Members are not required to report violations of others to regulatory authorities, either verbally or in writing, but such reporting may be prudent.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

158. (B) **No, because a fight at a rugby game is not a professional activity.**

Explanation

Standard I(A) covers members' professional activity only. Violations outside professional activity that involve fraud, theft or deceit would potentially be violations.

(Module 43.1 , LOS 43: I(A))

Related Material

SchweserNotes - Book 5

159. (C) **both of these.**

Explanation

It is a violation of Standard III(B) because the advisor should act first on behalf of existing clients whose needs and characteristics she already knows. It is a violation of Standard III(C) because she has never met the prospect and does not know if the new ideas are appropriate for the prospect. Thus, "both of these" is the best response.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

160. (A) **issue his sell report because the facts are nonmaterial, but maintain a file of the facts and documents leading to this conclusion.**

Explanation

The use of security analysis combined with nonmaterial nonpublic information to arrive at significant conclusions is legal and is called the mosaic theory.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

161. (B) **required to design an equitable system to disseminate the change in a prior investment recommendation.**

Explanation

Standard III(B) — Fair Dealing requires dealing fairly and objectively with all clients and prospects when disseminating material changes in prior investment recommendations. Note that the standard requires the dissemination be fair, but not necessarily equal due to the impossibility of contacting all clients simultaneously. A change of recommendation from "buy" to "sell" is generally material.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

162. (C) **Members shall use reasonable care and exercise independent professional judgment.**

Explanation

This is a component of the reasonable care and exercise independent professional judgment.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

163. (C) **Exercising a selection principle that does not comply with the idea of best trade price and execution.**

Explanation

The problem refers to the fiduciary duties of the analyst and brokerage contracts involving soft money. Trades placed with a broker that provides the firm with research are implicitly paying for the research. In a competitive marketplace, it is probable that the trades could have been as effectively placed with a broker that was able to provide research that would apply to the holdings of Bright Future. According to Standard III(A) Loyalty, Prudence, and Care, it is permissible to direct trades of the client portfolio through a broker who provides research that does not directly benefit the client portfolio, but the client should be informed about the situation.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

164. (C) **may use this information to support an investment recommendation.**

Explanation

The fact that the company officers met is not material nonpublic information. As long as she bases her investment recommendation on her own independent research, Jennings will not violate any Standards if she uses this additional information to support it.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

165. (C) **report the activity to the FASB or other relevant regulatory body.**

Explanation

As per the Standards of Practice Handbook "The Code and Standards do not require that members report legal violations to the appropriate governmental or regulatory organizations, but such disclosure may be prudent in certain circumstances." In this instance, he would likely be better off discussing the matter with the firm's legal counsel and Smith's superiors.

(Module 43.1, LOS 43.a)

Related Material

SchweserNotes - Book 5

166. (A) restrictions on all types business entertainment.

Explanation

The rules should contain a formal value limit based on local customs. Not all types of business entertainment are forbidden. Only business entertainment which is intended to influence or reward is, members and candidates should be avoided.

(Module 43.1, LOS 43.b)

Related Material

SchweserNotes - Book 5

167. (A) is not a violation of the Code and Standards.

Explanation

The potential change in the law is only a proposal at this stage. There is no violation as long as Dolphin is following the regulations currently in force.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

168. (C) must refuse to purchase shares for Gordon.

Explanation

According to Standard II(A), Material Nonpublic Information, Fox cannot act or cause others to act on material nonpublic information until the information is made public. The information overheard at lunch was material and nonpublic; therefore, Fox must wait until the information is made public before accepting Gordon's order.

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

169. (A) Charles must wait until after the press conference to disseminate the information to clients, and Donaldson must wait until after the press conference to purchase the stock for his clients.

Explanation

By waiting until after the press conference the information would then be considered public information and can then be disseminated to clients and traded on without there being any issues of insider trading.

(Module 43.3, LOS 43.b)

Related Material

SchweserNotes - Book 5

170. (A) **At the same time notify clients for whom an investment is suitable of a new investment recommendation.**

Explanation

All of these are part of Standard III(B) except notifying clients at the same time. Standard III(B) states that clients for whom the investment is suitable should be notified at approximately the same time.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

171. (A) **encourage Corvac to publicly release the order information and not act on that information until it is publicly disclosed.**

Explanation

The Standard recommends that an analyst who possesses material non-public information encourage the company to release the information publicly. The Standards prohibit Clark from acting on the information until it is publicly disclosed. Since the information is only known by Clark, putting it on a restricted list is not necessary. Public disclosure of material non-public information by an analyst would likely be considered a violation of the Standard.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5

172. (C) **Yes, because the member is bound by the Code of Ethics.**

Explanation

The last bullet point of the Code says that a member shall "Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals." Ignoring the neglect of rule changes of others would clearly be incongruent with this component. As long as the colleagues do not violate the laws, the member does not have to disassociate himself from the colleagues.

(Module 43.1, LOS 43: I(A))

Related Material

SchweserNotes - Book 5

173. (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

174. (C) return the bottle to the client explaining Brenly's policy.

Explanation

By not returning the bottle she would be violating the Standard on disclosure of conflicts to the employer, which states that employees must comply with prohibitions imposed by their employer.

(Module 43.1, LOS 43.b)

Related Material

SchweserNotes - Book 5

175. (A) and which has expressed an advance indication of interest, shall receive m/n fraction of their indication, where there are m shares available and indications of interest for n shares.

Explanation

Pro rata allocation on the basis of an advance indication of interest means that all accounts that have expressed an interest in the issue shall receive m/n fraction of their indication of interest, where there are m shares available and indications of interest for n shares.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

176. (C) concerns the dissemination of investment recommendations and the taking of investment action.

Explanation

Standard III(B), Fair Dealing is concerned with both the dissemination of investment recommendations and with the taking of investment action. It follows that this concern is irrespective of whether or not there has been a prior recommendation on the securities in question.

(Module 43.5, LOS 43: III(B))

Related Material

SchweserNotes - Book 5

177. (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

178. (A) violating his fiduciary duty by not considering taxes.

Explanation

The trustee must consider tax liabilities of beneficiaries. However, he should also provide diversification and be concerned with the desires of the remaindermen. (Remaindermen refers to the group that is to receive the remainder of the trust once its term is complete. Of course, some trusts never expire so not every trust has remaindermen.)

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

179. (C) can continue to advise the pension plan as best she can with the restrictions.

Explanation

According to Standard III(A), Loyalty, Prudence, and Care, Bird can continue to serve as a consultant to the plan, but must follow the applicable law.

(Module 43.4, LOS 43.a)

Related Material

SchweserNotes - Book 5

180. (B) demonstrating diligence, independence, and thoroughness when preparing investment reports.

Explanation

Demonstrating diligence, independence, and thoroughness when preparing investment reports is found in the Standards of Professional Conduct.

(Module 42.1, LOS 42.a)

Related Material

SchweserNotes - Book 5

181. (C) is likely to be considered important by reasonable investors in determining whether to trade a particular security.

Explanation

An item of information is material if its disclosure would be likely to have an impact on the price of a security, or if reasonable investors would want to know the information before investing.

(Module 43.3, LOS 43: II(A))

Related Material

SchweserNotes - Book 5