Question #1 of 180

Question ID: 1212413

An analyst finds a stock with historical returns that are not correlated with interest rate changes. The analyst writes a report for his clients that have large allocations in fixed-income instruments and emphasizes the observed lack of correlation. He feels the stock would be of little value to investors whose portfolios are composed primarily of equities. The clients with allocations of fixed income instruments are the only clients to see the report. According to Standard V(B), Communication with Clients and Prospective Clients, the analyst has:

A) violated the Standard concerning fair dealings with all clients. ✗

B) not violated the Standard. ✓

C) violated the article in the Standard concerning facts and opinions. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #2 of 180

Question ID: 1208060

Wanda Brunner, CFA, is preparing for her first meeting with the Johnsons—her firm's newest clients. She makes notes regarding disclosure of the investment process. These notes *most likely* include reminders to:

A) adequately disclose the basic security selection and portfolio construction process. ✓

B) notify her supervisors of any potential change in the security selection and portfolio construction process. ✗

C) anticipate changes in her clients' investment objectives that could cause them to leave her firm. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #3 of 180

Question ID: 1212354

Chuck Daniels has just been hired to manage a security analysis group for Aaron Asset Management. Daniels performed a similar function at another firm and finds the compliance system at Aaron inadequate. He develops a system that he feels is appropriate, but senior management tells him he will have to wait six months to implement the system. Daniels should:

A) decline in writing to accept supervisory responsibility until a satisfactory compliance system is put into place.

B) resign his position immediately.

C) protest in writing the delay, listing the potential dangers that can occur.

Explanation

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

(Study Session 1, Module 2.7, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #4 of 180

Question ID: 1212347

A money manager is meeting with a prospect. She gives the client a list of stocks and says, "These are the winners I picked this past year for my clients. Their double-digit returns indicate the type of returns I can earn for you." The list includes stocks the manager had picked for her clients, and each stock has listed with it an accurately measured return that exceeds 10%. Is this a violation of Standard III(D), Performance Presentation?

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

B) Yes, because the manager cannot reveal historical returns of recent stock picks.

C) No, because the manager had the historical information in writing.

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.

(Study Session 1, Module 2.6, LOS 2: III(D))

Related Material

SchweserNotes - Book 1

Question #5 of 180

Question ID: 1212327

Steven Wade, CFA, writes an investment newsletter focusing on high-tech companies, which he distributes by e-mail to paid subscribers. Wade does not gather any information about his clients' needs and circumstances. Wade has developed several complex valuation models that serve as the basis for his recommendations. Each month, his newsletter contains a list of "buy" and "sell" recommendations. He states that his recommendations are suitable for all types of portfolios and clients. Because of their proprietary nature, Wade does not disclose, except in general terms, the nature of his valuation models. He conducted numerous statistical tests of these models and they appear to have worked well in the past. In his newsletter, Wade claims that subscribers who follow his recommendations can expect to earn superior returns because of the past success of his models.

Wade violated all of the following CFA Institute Standards of Professional Conduct EXCEPT:

A) Standard V(B), Communication with Clients and Prospective Clients.

B) Standard I(C), Misrepresentation.

C) 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.

(Study Session 1, Module 2.5, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #6 of 180

Question ID: 1212345

Nancy Korthauer, CFA, has launched a new hedge fund called the Korthauer Tautology Fund and is actively soliciting clients from competitor's firms. Client presentations are necessarily brief and often take place with the prospective client's current investment advisor in the room. The Code and Standards require that:

A) all client presentations provide a thorough review of all elements of the investment management process. Abbreviated presentations are forbidden.

B) a prospective client's current investment advisor not participate in meetings.

C) 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.

(Study Session 1, Module 2.6, LOS 2: III(D))

Related Material

SchweserNotes - Book 1

Question #7 of 180

Question ID: 1212411

Standard V(B), Communication with Clients and Prospective Clients, *least likely* requires members to:

A) disclose the general principles of investment processes used to analyze and select securities, and construct portfolios.

B) use reasonable judgment regarding the inclusion or exclusion of relevant factors in research reports.

C) make clear buy or sell recommendations on the securities covered in research reports.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #8 of 180

Question ID: 1212341

Ned Brenan manages two dozen pension accounts, one of which earned over 25% during the past two years. Brenan tells prospective clients that based on past experience they can expect a 25% return on their funds. Which of the following statements is CORRECT?

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

B) Brenan has not violated Standard of Professional Conduct III(D), Performance Presentation, but Brenan has violated Standard I(C), Misrepresentation.

C) Brenan has violated Standard of Professional Conduct III(D), Performance Presentation, but Brenan has not violated 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").

(Study Session 1, Module 2.6, LOS 2.b)

Related Material

SchweserNotes - Book 1

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

The policy states that in order to reward customer loyalty, customers that utilize the services of GlobalBank's divisions other than investment advisory will receive allocations on all trades (including IPOs and secondary offerings) based on the relative size of their order, before clients that utilize only investment advisory services. After filling orders for multi-relationship clients, clients that only utilize investment advisory services will receive trade allocations on all trades, including IPOs and secondary offerings, based on the relative size of their order. This policy reflects GlobalBank's long-term goal of being a full-service provider of financial products and services to all of its clients.

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

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

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

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

Question #9 - 14 of 180

Question ID: 1207887

Did GlobalBank's trade allocation policy violate the CFA Institute's Standards of Professional Conduct?

A) No, because the firm fully disclosed its allocation policy to all clients and employees.

B) Yes, because the policy favors one group of clients over another and will disadvantage those clients that do not have multiple relationships with the firm.

C) No, because the firm is allowed to offer different levels of service to its clients as long as they are disclosed and available to all clients.

Explanation

The actions of GlobalBank are covered under Standard III(B)—"Fair Dealing. According to Standard III(B), members must deal fairly and objectively with all clients. Trade allocation procedures must be fair and equitable to ensure that investment opportunities are available to all clients. A firm may offer different levels of service to its clients, but a policy may not favor clients that have multiple relationships with the firm over those that do not. The Standards also recommend that a pro rata system, rather than an ad hoc system, be utilized in order to avoid conflict of interest.

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #10 - 14 of 180

Question ID: 1207888

According to the CFA Institute's Standards of Professional Conduct, Fleming's execution of Waverly's trade order after confirming the appropriateness of the trade is *most likely* in violation of:

A) Standard V(B)—Communication with Clients and Prospective Clients for not separating fact from opinion, but is not in violation of Standard I(C)—

B) Standard V(A)—Diligence and Reasonable Basis for not exercising diligence and thoroughness in his analysis of the investment and Standard III(C)—Suitability for

C) Standard I(C)—Misrepresentation for not disclosing to Waverly that he did not read the marketing materials, but is not in violation of Standard III(C)—Suitability

Explanation

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

(Study Session 1, Module 2.8, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #11 - 14 of 180

Question ID: 1207889

According to CFA Institute Standards of Professional Conduct, which of the following of Fleming's actions is *most likely* a violation of Standard I(C)—Misrepresentation? Fleming:

A) tells the CIO of Crocket Foundation that shares of DCH's IPO outperformed the S&P 500 by at least 15% in each of the last three years since the offering.

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

C) executes the trades on DCH Corp. per Waverly's instructions without first referring to Waverly's IPS.

Explanation

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

(Study Session 1, Module 2.2, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #12 - 14 of 180

Question ID: 1207890

Which of the following statements *most* accurately assesses Fleming's comment about Waverly during his conversation with the CIO of the Crockett Foundation? According to the Code and Standards, Fleming's statement is:

A) in violation of Standard III(E)—Preservation of Confidentiality because his failure to keep information about a client's investment action confidential.

B) not in violation of any standard because he only disclosed factual information, and he did not disclose the details of Waverly's purchase.

C) in violation of Standard I(C)—Misrepresentation because his statement may be misleading with regard to future performance of the offering.

Explanation

According to Standard III(E)—Preservation of Confidentiality, members and candidates must keep information about current, former, and prospective clients confidential unless the information concerns illegal activities, disclosure is required by law, or the client permits disclosure. By telling other clients of Waverly's investment actions, whether offering specific information on the trade or not, Fleming could adversely affect Waverly's investment in the offering.

(Study Session 1, Module 2.6, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #13 - 14 of 180

Question ID: 1207891

According to CFA Institute Standards of Professional Conduct, did Fleming's conversation with the CIO of the Crockett Foundation or his decision to sell GlobalBank's position in DCH stock *most likely* violate Standard II(B)—Market Manipulation?

	Conversation with CIO	Sell decision
A)	No	Yes
B)	Yes	Yes
C)	Yes	No

Explanation

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

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #14 - 14 of 180

Question ID: 1207892

Is it *most likely* that Fleming violated any CFA Institute Standards of Professional Conduct related to his meeting with the CIO of the Crockett Foundation?

A) No—he maintained an IPS and followed established procedures in maintaining client records and data.

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

C) No—he does not have a duty to maintain client records, only his employer does.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #15 of 180

Question ID: 1212398

An analyst writes a report and includes the forecasts of an econometric model developed by the firm's research department. The analyst identifies the source of the forecast and includes all the relevant statistics concerning the model and his opinion of the model's accuracy. With respect to Standard V(A), Diligence and Reasonable Basis, the analyst has:

A) complied with the Standard.

B) violated the Standard by including quantitative details in a report.

C) violated the Standard by not testing the model himself.

Explanation

Including quantitative details in a report is not a violation of the Standard. The analyst has more of an obligation to give an opinion on the accuracy of the model than withhold such an opinion. Although the analyst should use reasonable care to verify information included in a report, retesting models developed by the research department of a firm is not explicitly required.

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #16 of 180

Question ID: 1212361

John Hill, CFA, has been working for Advisors, Inc., for eight years. Hill is about to start his own money management business and has given his two-week notice of his resignation from Advisors. A few days before his resignation takes effect, a former client of Advisors calls Hill at his home about his new firm. The former client says that he is very happy that Hill is leaving Advisors because now he and Hill can resume a professional relationship. The client says that he would never become a client of Advisors again. Hill promises to call the client back after he has left Advisors. Hill does not tell his employer about the call. Hill has *most likely*:

A) violated the Standard concerning loyalty to employer.

B) violated the Standard concerning disclosure of conflicts.

C) not violated the Standards.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

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

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

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

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

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

1. Regular orders are processed and executed on a pro-rata basis.
2. Shares in initial public offerings will be allocated on a pro-rata basis to the firm's portfolio managers according to advance indications of interest from the managers.

3. When the full amount of a block order is not executed, partially executed orders are allocated on a first-in, first-out basis.
4. Orders must be recorded in writing and stamped with the time of the order and the execution.
5. All clients participating in block trades are give the same execution price, and all clients are charged the same commission.

Question #17 - 22 of 180

Question ID: 1207880

When Singh receives the sell order for QuickStop, he should:

A) process the sell order immediately to fulfill his fiduciary duty to the client. ✗

B) ask the client to delay the order until he sees the new research report. ✗

C) tell the client about the buy rating and advise him not to sell the stock. ✓

Explanation

Standard III(B)—Fair Dealing requires analysts to inform clients of rank changes before accepting the order. Delaying the order or asking a client to wait without explanation could violate the fair dealing Standard as well as the Standard relating to fiduciary duties.

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #18 - 22 of 180

Question ID: 1207881

Womack's trading actions are a violation of:

A) Standard IV(A)—Loyalty to Employer and Standard III(B)—Fair Dealing. ✗

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

C) Standard III(E)—Preservation of Confidentiality and Standard VI(B)—Priority of Transactions. ✗

Explanation

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

(Study Session 1, Module 2.4, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #19 - 22 of 180

Question ID: 1207882

With regard to his coverage of HighLife stock, Singh:

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

B) violated the research reports Standard because he failed to differentiate between facts and opinions. ✗

C) violated the reasonable basis Standard by downgrading a stock because it missed one quarterly earnings estimate. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #20 - 22 of 180

Question ID: 1207883

After Singh changed his investment recommendation for HighLife from a "buy" to a "hold," he violated:

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

B) Standard I(C)—Misrepresentation by not exercising diligence and thoroughness in his research.

C) Standard V(A)—Loyalty, Prudence, and Care by not exercising reasonable care and prudent judgment in his research.

Explanation

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

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #21 - 22 of 180

Question ID: 1207884

Horizon's proposed IPO allocation procedures are:

A) not a violation of Standard III(B)—Fair Dealing if they are disclosed to all clients and prospects.

B) not a violation of Standard I(B)—Independence and Objectivity.

C) a violation of Standard—Loyalty, Prudence, and Care and Standard VI(B)—Priority of Transactions.

Explanation

Independence and objectivity has not been violated. According to Standard III(B), allocation of new issues according to advance indications of interest should be done on a pro-rata basis by client, rather than by portfolio manager. Therefore, Horizon's policy is not fair and equitable. Disclosure of this inequitable allocation method does not relieve Horizon of its obligation that the allocation method be fair and equitable. While the policy may violate fiduciary duty as required by Standard III(A), it does not violate either Standard III(C), which addresses investment suitability, or Standard VI(B), which relates to the priority of transactions.

(Study Session 1, Module 2.1, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #22 - 22 of 180

Question ID: 1207885

Which of the following trade allocation procedures being considered for Horizon's trade allocation policy would *NOT* be consistent with Standard III(B)—Fair Dealing?

A) All clients participating in block trades are give the same execution price and are charged the same commission.

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

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

Explanation

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

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #23 of 180

Question ID: 1212359

May Frost, CFA, is concerned about the comments and activities of several of her coworkers and feels both ethical and legal violations are routinely overlooked. According to the Code and Standards, a recommended first step would *least likely* be to:

A) provide her supervisor with a copy of the Code and Standards.

B) review the company's policies and procedures for reporting ethical violations.

C) contact industry regulators.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #24 of 180

Question ID: 1212385

Wanda Kirby, CFA, recently joined Allegheny Investments as a senior analyst. Because of her extensive experience in the investments business and knowledge of the Code and Standards, Allegheny's management asked her to assume supervisory responsibility. Kirby reviewed Allegheny's existing compliance system and determined that it was inadequate to allow her to clearly discharge her supervisory responsibility. According to CFA Institute Standards, Kirby should:

A) agree to accept supervisory responsibility and to develop reasonable procedures to allow her to adequately exercise such responsibility.

B) agree to accept supervisory responsibility provided that Allegheny adopts reasonable procedures to allow her to adequately exercise such responsibility.

C) decline in writing to accept supervisory responsibility until Allegheny adopts reasonable procedures to allow her to adequately exercise such responsibility.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(C))

Related Material

SchweserNotes - Book 1

Question #25 of 180

Question ID: 1212382

Jess Green, CFA is the research director for Castle Investment, Inc., and has supervisory responsibility over eight analysts, including three CFA charterholders. Castle has a compliance program in place. According to CFA Institute Standards of Professional Conduct, which of the following is *least likely* an action that Green should take to adhere to the compliance procedures involving responsibilities of supervisors? Green should:

A) disseminate the contents of the compliance program to the eight analysts.

B) issue periodic reminders of the procedures to all analysts under his supervision.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(C))

Related Material

SchweserNotes - Book 1

Question #26 of 180

Question ID: 1212356

Nick O'Donnell, CFA, unsuspectingly joins the research team at Wickett & Co., an investment banking firm controlled by organized crime. None of the managers at Wickett are CFA Institute members. Because of his tenuous situation at Wickett, O'Donnell begins making preparations for independent practice. He knows he will be terminated if he informs management at Wickett that he is preparing to leave. Consequently, he determines that "if he can just hang on for one year, he will likely have a client base sufficient for him to strike out on his own." This action is:

A) a violation of his duty to disclose conflicts to his employer.

B) not a violation of his duty to employer.

C) a violation of his fiduciary duties.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #27 of 180

Question ID: 1208058

A manager of pooled funds must do all of the following to remain in compliance with the Standards EXCEPT:

A) seek authorization for any trade that involves more than 1 percent of the fund's assets.

B) seek authorization for any proposed changes.

C) disclose portfolio construction processes.

Explanation

There is no requirement to seek authorization for trades on the basis of size.

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #28 of 180

Question ID: 1212355

Brendan Duval works as a research analyst for Toby Securities. Duval recommends changing a recommendation from "sell" to "buy" on Dalton Company. His firm, which manages several mutual funds, may be interested in buying Dalton's stock. He also manages the retirement account that his parents established with Toby. Duval wants to buy shares of Dalton's stock because it is an appropriate investment for his parent's retirement account and obtains approval from his employer to do so. Duval is also thinking about personally investing in Dalton stock. According to CFA Institute Standards of Professional Conduct, which of the following *best* describes the priority of transactions? Duval should give:

A) priority of transactions to Toby's clients, followed by his employer, then his parent's retirement account, and finally his personal account.

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

C) priority to Toby's clients and his employer concurrently, followed by his parent's retirement account, and finally his personal account.

Explanation

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

(Study Session 1, Module 2.7, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #29 of 180

Question ID: 1208013

Scott LaRue is a portfolio manager for Washington Advisors. Washington has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Washington model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research—an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. La Rue feels the model would be improved by adding some factors but he has not fully tested this new version of the model. LaRue discloses his model to his own clients but not to his supervisor. LaRue is:

A) not violating the Standards.

B) violating the Standards by not having a reasonable and adequate basis for his investment recommendation.

C) violating the Standards by not considering the appropriateness of the recommendations to clients.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #30 of 180

Question ID: 1212337

Bob Hatfield, CFA, has his own money management firm with two clients. The accounts of the two clients are equal in value. One of the clients gets married and the assets of the new spouse and the client are combined. With the larger portfolio of the now married client, Hatfield determines that they can assume a higher level of risk and begins a change in the policy concerning that portfolio. Which of the following would violate Standard III(C), Suitability?

A) Assess the time horizon of the newly married client and his spouse.

B) Assess the return objectives of the newly married client and his spouse.

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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #31 of 180

Question ID: 1212328

The following information pertains to the Galaxy Trust, a trust established by Stephen P. House and managed by Gamma Investment LLC:

- At the time the trust was established House provided $5 million in cash to fund the trust, but Gamma was aware that 93% of his personal assets were in the form of Oracle stock.
- Gamma has been asked to view his funds and the trust as a single entity for planning purposes, since House's will stipulates that all of his estate will pass to the trust upon his death.
- The investment policy statement, developed in September 1996, stipulates that the trust should maintain a short position in Oracle stock and use the proceeds to diversify the trust more adequately.
- House was able to sell all of his Oracle shares back to the corporation in January 1999 for cash.
- The policy statement redrawn in September 1999 continues to stipulate that the trust hold a short position in Oracle stock.
- House has given the portfolio manager in charge of the trust an all expenses paid vacation package anywhere in the world each year at Christmas. The portfolio manager has reported this fact in writing to his immediate supervisor at Gamma.

Which of the following is *most* correct? The investment manager is:

A) not in violation of the Code and Standards for not properly updating the investment policy statement in light of the change in the circumstances and is

B) 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

C) in violation of the Code and Standards by not properly updating the investment policy statement in light of the change in the circumstances and is in violation

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.

(Study Session 1, Module 2.5, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #32 of 180

Question ID: 1212397

Several years ago, Hilton and Ross, a full service investment firm, managed the initial public offering of eCom, Inc. Now, eCom wants Hilton and Ross to underwrite its secondary public offering. A senior manager at Hilton and Ross asks Brent Whitman, CFA, one of its equity analysts, to write a favorable research report on eCom to help make the underwriting a success. Whitman conducts a thorough analysis of eCom and concludes that the company has serious problems that do not suggest a favorable financial outlook. Nevertheless, Whitman writes a favorable report because he is fearful of losing his job. Hilton and Ross publicly distribute a report that only contains a buy recommendation and a brief description of the basic characteristics of eCom. Whitman has violated:

A) Standard I(B) Independence and Objectivity, only.

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

C) Standard V(A) Diligence and Reasonable Basis only.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #33 of 180

Question ID: 1212331

An investment advisor goes straight from a research seminar to a meeting with a prospective new client with whom she has never been in contact. The advisor is very excited about the information she just received in the seminar and begins showing the prospect the new ideas her firm is coming up with. This is *most likely* a violation of:

A) Standard III(B), Fair Dealing.

B) both of these.

C) Standard III(C), Suitability.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #34 of 180

Question ID: 1212360

Which of the following statements is *most correct* under the Code and Standards?

A) Members are prohibited from making arrangements or preparations to go into competitive business before terminating their relationship with their employer.

B) CFA Institute members are prohibited from undertaking independent practice in competition with their employer.

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

Explanation

Members are not prohibited from making arrangements or preparations to go into competitive business before terminating their relationship with their employer. CFA Institute members are not prohibited from undertaking independent practice in competition with their employer provided they have consent from their employer. Members must provide notification to their employer describing the types of services to be rendered, the expected duration, and compensation for the services.

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #35 of 180

Question ID: 1212332

Which of the following would be a violation of Standard III(B), Fair Dealing?

A) Limiting the number of employees privy to recommendations and changes.

B) Having well defined guidelines for pre-dissemination.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Michael Smyth is Senior Vice President of equity investments at Systematic Investment Advisors, Inc. (SIA). He manages a team of analysts and portfolio managers and is responsible for maintaining and developing client relationships. SIA is located in a small European country and provides investment management services to high net worth individuals. Smyth is also a Level III Candidate for the CFA designation.

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

- Muller was the president of a publicly traded manufacturing company, Comax, and 20% of his portfolio's assets were invested in Comax equity. His contract with Comax prohibited his selling his Comax shares while he was employed.
- Muller had little liquidity needs. His children were grown and his salary at Comax was sufficient to cover his annual expenditures as well as contribute to his investment portfolio.
- A former Chartered Accountant, Muller had been extremely knowledgeable and comfortable with the investment decision-making process.
- Smyth owns 10,000 shares of Comax and serves on Comax's board.
- Smyth played golf with Muller on a regular basis and, with Muller's help, developed many client relationships from these outings.

SIA has a soft dollar arrangement with a local brokerage firm, First Brokerage, owned by Smyth's sister.

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

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

Question #36 - 41 of 180

Question ID: 1207894

Which of the following Standards is *most* relevant regarding Smyth's meeting with Durand?

A) Standard III(C), Suitability.

B) Standard III(A), Loyalty, Prudence, and Care.

C) Standard III(E), Preservation of Confidentiality.

Explanation

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

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #37 - 41 of 180

Question ID: 1207895

Standard VI(A), Disclosures of Conflicts, requires Smyth to disclose all matters, including beneficial ownership of securities of other investments, that could be expected to impair the member's ability to make unbiased and objective recommendations. Which of the following matters would *least likely* be disclosed to Durand?

A) Smyth owns shares in Comax.

B) SIA has a soft dollar arrangement with a brokerage firm owned by Smyth's sister.

C) Smyth played golf with Muller on a regular basis and developed client relationships.

Explanation

Smyth playing golf with Muller is not a conflict with respect to his relationship with Durand and he need not disclose to her that he played golf with Muller. Muller was his client at the time and there was full disclosure that Smyth developed new client relationships. All the other matters must be disclosed. Smyth must get Durand's approval to continue to direct brokerage from her portfolio to his sister's firm. As a director and shareowner of Comax, he has a potential conflict of interest when making a recommendation regarding Durand's Comax shares.

(Study Session 1, Module 2.9, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #38 - 41 of 180

Question ID: 1207896

Which of the following *best* describes Smyth's compliance with the CFA Institute Soft Dollar Standards in his use of client brokerage?

A) Purchase of research reports and attending the conference are allowable uses of client brokerage.

B) Purchase of both research reports and carpeting are allowable uses of client brokerage.

C) Purchase of research reports is an allowable use of client brokerage.

Explanation

The primary principles regarding use of client brokerage are (1) brokerage is the property of the client and (2) the investment manager has an ongoing responsibility to seek to obtain best execution, minimize transaction costs, and use client brokerage to benefit clients. Consequently, contingent on disclosure of the soft dollar arrangement to clients whose portfolios might be affected, the CFA Institute Soft Dollar Standards permit client brokerage only to be used to purchase research; that is, goods and services, the primary use of which directly assists the investment manager in the investment decision-making process and not in the management of the firm. Therefore, the only allowable use of soft dollars by Smyth is purchase of the research reports. The purchase of the carpeting to create a more pleasant environment would, at best, only contribute indirectly to the investment manager and use of client brokerage is not permitted. Conferences may sometimes be considered research if their programs are designed to improve the investment decision-making process. In Smyth's case, the conference he attended only had sessions on the management of the investment management firm, not the investment decision-making process.

(Study Session 1, Module 2.4, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #39 - 41 of 180

Question ID: 1207897

Smyth would like to continue to direct brokerage from Durand's portfolio to Smyth's sister's brokerage firm. In order to continue the arrangement and comply with the CFA Institute Soft Dollar Standards, which of the following disclosures are required (and not simply recommended)? Smyth is required to disclose:

A) that his duty as the investment manager is to continue to seek to obtain best execution.

B) SIA's policies with respect to all Soft Dollar Arrangements.

C) that directed brokerage arrangements that require the investment manager to commit a certain percentage of brokerage might affect his ability to seek to

Explanation

Investment managers are required to clearly disclose, with specificity and in "plain language," policies with respect to all Soft Dollar Arrangements. Because brokerage is an asset of the client, not the investment manager, the practice of client-directed brokerage does not violate the CFA Institute Soft Dollar Standards. However, directed brokerage arrangements have no required disclosures beyond those required for other soft dollar arrangements. Several disclosures are recommended. Because directed brokerage may impede the investment manager's ability to seek to obtain best execution, which is one of the investment manager's fundamental responsibilities, it is recommended that investment managers disclose his duty to seek to obtain best execution and that arrangements to commit a certain percentage of brokerage may affect his ability to do so. For all soft dollar arrangements, it is recommended, but not required, that, on request from the client, investment managers provide a description of the product or service obtained through brokerage generated from the client's account.

(Study Session 1, Module 2.4, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #40 - 41 of 180

Question ID: 1207898

After determining Durand's risk and return objectives, liquidity needs, tax considerations, and unique circumstances, Smyth has decided that he must reduce Durand's holdings of Comax shares. He has several other clients, whom he met through Muller, who also have significant holdings in Comax. Smyth has also decided to reduce his own holdings in Comax since his term as a director of Comax will be up in June. He does not plan to seek reappointment but as a member of the audit committee he is privy to information about a tender offer. Smyth realizes this is a complex situation.

Of the following Standards, determine which would *least likely* help Smyth decide what actions with respect to selling shares of Comax would be in compliance with the CFA Institute Standards of Practice.

A) Standard III(B), Fair Dealing.

B) Standard III(C), Suitability.

C) Standard VI(A), Disclosure of Conflicts.

Explanation

Standard III(C), Suitability, is the standard least likely to provide Smyth with guidance when he considers selling Durand's holdings of Comax. This standard describes members' responsibilities in developing appropriate recommendations and taking suitable actions. To reach the point where he has decided to sell Durand's shares, Smyth would already have met these requirements. He has determined Durand's and his other clients' requirements and has recommended an appropriate and suitable investment action. His concern is how to implement his recommendation and be in compliance with the Standards of Professional Conduct.

Smyth has several problems with respect to selling shares of Comax from Durand's portfolio and the portfolios of his other clients. First, he must comply with Standard III(B) and deal fairly and objectively with all clients and prospects when taking this investment action. Smyth must disclose his ownership of Comax to all affected clients according to Standard VI(A) and ensure that transactions for clients take precedence over transactions on his own behalf according to Standard VI(B).

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #41 - 41 of 180

Question ID: 1207899

Since Smyth is a director of Comax and a member of the audit committee, what additional Standard is specifically applicable to Smyth's decision to sell his and his clients' shares of Comax?

A) Standard VII, Responsibilities as a CFA Institute Member or CFA Candidate. ✗

B) Standard II, Integrity of Capital Markets. ✓

C) Standard IV, Duties to Employers. ✗

Explanation

As a director and member of Comax's audit committee, Smyth possesses material nonpublic information about a tender offer. Therefore, Smyth must be particularly concerned about complying with Standard II(A), Material Nonpublic Information. Under this standard, Smyth may not trade nor cause others until the information becomes public.

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #42 of 180

Question ID: 1212362

Which of the following statements regarding employee/employer relationships is NOT correct?

A) An employee is someone in the service of another.

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

C) A written contract may or may not exist between employer and employee.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #43 of 180

Question ID: 1212410

Roger Halpert, CFA, prepares a company research report in which he recommends a strong "buy." He has been careful to ensure that his report complies with the CFA Institute Standard on research reports. According to CFA Institute Standards of Professional Conduct, which of the following statements about how Halpert can communicate the report is *most correct*?

A) Halpert can transmit his report by computer on the Internet.

B) Halpert can make his report in person.

C) Halpert can make his report in person, by telephone, or by computer on the Internet.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #44 of 180

Question ID: 1212365

Michel Marchant, CFA, recently became an independent money manager. After six months, he has only ten clients, who are family and friends. To supplement his income, Marchant accepted part-time employment as an advisor at Middleton Financial Advisors. According to CFA Institute Standards of Professional Conduct, which of the following statements about Marchant's duty to his new employer is CORRECT?

A) Marchant need not inform Middleton about his existing clients but must inform his existing clients about his new part-time employment at Middleton.

B) Marchant must inform Middleton about his existing clients but need not inform his existing clients about his new part-time employment with Middleton.

C) Marchant must inform Middleton to keep his existing clients and must inform his existing clients of his new part-time employment at Middleton.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #45 of 180

Question ID: 1212335

Which of the following statements is *least* accurate regarding being a part of Standard III(B), Fair Dealing?

A) Maintain a list of clients and their holdings.

B) Shorten the time between decision and dissemination.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

Question #46 of 180

Question ID: 1212370

Brian Bellow, a CFA Institute member, is a portfolio manager for Progressive Trust Company. Several friends asked Bellow to review their investment portfolios. On his own time, Bellow examined their portfolios and made several recommendations. He received no monetary compensation from his friends for his investment advice and provided no future investment counsel to them. According to CFA Institute Standards of Professional Conduct, did Bellow violate his duty to Progressive Trust?

A) No, because Bellow provided no ongoing investment advice.

B) No, because Bellow received no compensation for his services.

C) Yes, because he undertook an independent practice that could result in compensation or other benefit to him.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #47 of 180

Question ID: 1212402

A financial analyst and CFA Institute member sends a preliminary research report on a company to his supervisor. The supervisor approves the report, but then the analyst receives news that causes him to revise downward the earnings estimate of the company. The analyst resubmits the report to the supervisor with the new earnings estimate. The analyst soon finds out that the supervisor plans to release the first version of the report with the first earnings estimate without a reasonable and adequate basis. In response to this the analyst must:

A) only insist that the first report be followed up by a revision.

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

C) both insist that a follow up report be issued and take up the issue with regulatory authorities.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #48 of 180

Question ID: 1212401

An analyst has found an investment with what appears to be a great return-to-risk ratio. The analyst double-checks the data for accuracy, keeps careful records, and is careful to not make any misrepresentations as he simultaneously sends an e-mail to all his clients with a "buy" recommendation. According to Standard V(A), Diligence and Reasonable Basis, the analyst has:

A) violated the Standard by communicating the recommendation via e-mail.

B) violated the Standard if he does not verify whether the investment is appropriate for all the clients.

C) fulfilled all obligations.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #49 of 180

Question ID: 1208052

Midland Investment Banking issues a prospectus for its open-end Midland Gold Fund. In the prospectus, the investment policy is disclosed as, "We will maintain an investment posture of 50% or more in gold stocks and/or bullion, depending upon market conditions." This policy is maintained until the price of gold falls by 20%, leaving the fund 40% invested in gold stocks and bullion. Management decides that since the allocation was affected by market conditions, no action to either change the investment policy or to rebalance the portfolio is required. This decision is:

A) in violation of the Standard concerning disclosure of investment processes.

B) in violation of the Standard concerning fiduciary duties to clients.

C) under the circumstances, not in violation of the Code and Standards.

Explanation

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

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

Midland is in violation of the Standard.

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #50 of 180

Question ID: 1207919

Alba Vasquez allocates trades of hot new IPOs as follows: m×p/(p+s) shares to performance-based fee accounts, m×s/(p+s) shares to standard fee accounts, where there are p suitable performance based fee accounts, s suitable standard fee accounts, and m shares available. This action is:

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

B) not permissible since it effectively favors the performance-based fee accounts.

C) not permissible since it is based upon a formula that is not inherently fair.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #51 of 180

Question ID: 1212390

Patricia Hoolihan is an individual investment advisor who uses mutual funds for her clients. She typically chooses funds from a list of 40 funds that she has thoroughly researched. The Burns, a married couple that are a client, asked her to consider the Hawkeye fund for their portfolio. Hoolihan had not previously considered the fund because when she first conducted her research three years ago, Hawkeye was too small to be considered. However, the fund has now grown in value, and cursory research uncovers no fundamental flaws with the fund. She puts the fund in the Burns' portfolio but not in any of her other clients' portfolios. The fund ends up being the best performing fund on her list. Hoolihan has:

A) violated the Standards by not having a reasonable and adequate basis for making the recommendation.

B) not violated the Standards.

C) violated the Standards by not dealing fairly with clients.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.c)

Related Material

SchweserNotes - Book 1

Question #52 of 180

Question ID: 1212414

Joni Black, CFA, works for a portfolio management firm. Black is a partner of the firm and is primarily responsible for managing several large pension plans. Black has just finished a research report in which she recommends Zeta Corporation as a "Strong Buy." Her rating is based on solid management in a growing and expanding industry. She just handed the report to the marketing department of the firm for immediate dissemination. Upon returning to her desk she notices a news flash by CNN reporting that management for Zeta Corporation is retiring. Black wishes she did not recommend Zeta Corporation as a "Strong Buy," but believes the corporation is still a good investment regardless of the management. What course of action for Black is *best*? Black:

A) should revise the recommendation based on this new information.

B) should report the new information to her immediate supervisor so that they can determine whether or not the marketing department should send out the report

C) may send out the report as written as long as a follow up is disseminated within a reasonable amount of time reflecting the changes in management.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #53 of 180

Question ID: 1212358

A CFA Institute member, undertaking independent practice that could result in compensation or other benefit:

A) must notify the entities for whom he plans to undertake independent practice of the compensation he receives from his employer.

B) must notify his employer and clients of the types of service to be rendered and the expected compensation.

C) must notify his employer of the types of service to be rendered, the expected duration, and the expected compensation.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #54 of 180

Question ID: 1212395

The following scenarios refer to recommendations made by two analysts.

> Jean King, CFA, is a quantitative analyst at Quantlogic, Inc. King uses computer-generated screens to differentiate value and growth stocks based on accounting numbers such as sales, cash flow, earnings, and book value. Based on her analysis of all domestically traded stocks in the U.S. over the past year, King concludes that value stocks as a class have underperformed growth stocks over that period. Using only this analysis, she recommends that account executives at Quantlogic sell all value stocks from the portfolios for which they have discretionary authority to trade and replace these stocks with growth stocks.
>
> James Capelli, CFA, is a fundamental analyst at Wheaton Capital Management, which focuses on regional stocks. His analysis of Branson Wireless includes the investment's basic characteristics such as information about historical earnings, ownership of assets, outstanding contracts, and other business factors. In addition to conducting both a general industry analysis and a company financial analysis, Capelli interviews key executives at Branson. Based on his analysis, he concludes that the company's future prospects are strong and issues a "buy" recommendation.

According to CFA Institute Standards of Professional Conduct, did King and Capelli have a reasonable and adequate basis for making their recommendations?

A) Capelli has a reasonable basis for his recommendation, but King does not. ✓

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

C) Both King and Capelli have a reasonable basis for their recommendations. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #55 of 180

Question ID: 1212375

Grant Starks, CFA, has been working for Advisors, Inc., for eight years. Starks is about to start his own money management business and has given his two-week notice of his resignation. A few days before his resignation takes effect, a current client of Advisors calls him at his office to inquire about some services for her account at Advisors. During the conversation, Starks tells the client that his new business will have lower commissions than Advisors. Starks has *most likely* violated:

A) Standard V(B), Communication with Clients and Prospecitve Clients. ✗

B) Standard IV(A), Loyalty to Employer. ✓

C) Standard VI(B), Priority of Transactions. ✗

Explanation

This is a breach of loyalty to his current employer. By telling a current client of his employer about the lower commissions he will charge in his new business, Starks is placing himself in direct competition with Advisors, and this is a violation of Standard IV(A).

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #56 of 180

Question ID: 1208059

In order to remain in compliance when managing private client accounts, members must do all of the following EXCEPT:

A) Seek authorization for changes in investment policy. ✗

B) Conduct regular reviews of client circumstances. ✗

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

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #57 of 180

Question ID: 1208065

An analyst has constructed an investment policy statement (IPS) and a portfolio for a new client, Susan Stevens. He has also provided written guidelines on the processes used to make investment management decisions. Six month later, Stevens questions the analyst about several portfolio holdings. Although the analyst cannot remember his reasoning for recommending specific securities, and cannot find supporting documents, he assures her that the recommendations were made within the limits of her IPS and the firm's stated processes for making investment management decisions. Stevens is not satisfied by this response, but leaves the portfolio unchanged. The analyst has *most likely* violated:

A) Standard III(C) Suitability.

B) Standard V(C) Record Retention.

C) Standard V(B) Communications with Clients and Prospective Clients.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(C))

Related Material

SchweserNotes - Book 1

Question #58 of 180

Question ID: 1212377

David Saul, CFA, heads the trust department at Savage National Bank. Fairway Enterprises invites Saul to sit on its Board of Directors. In return for his services on the Board, Fairway offers to provide Saul and his family with access to the facilities at Wilmont Country Club at no cost. Saul will not receive any monetary compensation for his services on the Board. According to CFA Institute Standards of Professional Conduct, which of the following actions must Saul take?

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

B) Saul must disclose in writing to Savage Bank the terms of the offer whether or not he accepts the offer to serve on the Board of Directors. ✗

C) Saul must reject the offer to serve on the Board of Directors. ✗

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #59 of 180

Question ID: 1212380

Jill Marsh, CFA, works for Advisors where she manages various portfolios. Marsh's godfather is an accountant and has done Marsh's tax returns every year as a birthday gift. Marsh's godfather has recently become a client of Advisors and asked specifically for Marsh to manage his account. In order to comply Standard IV(B), Disclosure of Additional Compensation Arrangements, she needs to:

A) liquidate from her personal portfolio any stocks her godfather owns and verbally tell her supervisor about the tax services. ✗

B) have her godfather cease doing her taxes. ✗

C) do neither of the actions listed here. ✓

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #60 of 180

Question ID: 1212383

A firm recently hired Hal Crane, CFA, to be a supervisor in the firm. Crane has reviewed the procedures for complying with the Code and Standards in the company. It is Crane's belief that the procedures need revision in order to be effective. Crane must:

A) make reasonable efforts to encourage the company to adopt an adequate compliance system.

B) decline supervisory responsibilities in writing until the company adopts an adequate compliance system.

C) exercise his supervisory responsibilities with the greater level of diligence required by the Code and Standards.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(C))

Related Material

SchweserNotes - Book 1

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

Susan Jones, CFA, is an analyst at LMS Securities. She is responsible for a subset of the companies for which LMS offers research coverage. She recently received her annual CFA

Institute Professional Conduct statement, but has not yet filled it out and turned it in. Steve Brown is an analyst who directs the due diligence process for LMS Securities' private placements. Brown passed the Level II exam five years ago, and has registered for the Level III exam every year since then, but has never taken it. He is registered for the Level III CFA exam next June, but nobody at the office believes he will actually take the test.

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

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

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

LMS Securities has an arrangement with Clampett Securities, an investment adviser, under which the investment manager uses its client brokerage to obtain LMS's research. Clampett manages accounts for wealthy individual investors. About half of Clampett's clients have a growth objective, while the rest seek income.

Question #61 - 66 of 180

Question ID: 1208039

In order to remain an active member of CFA Institute, Jones must annually:

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

B) pay applicable membership dues and complete forty hours of continuing education.

C) submit her completed Professional Conduct Statement, pay applicable membership dues, and complete forty hours of continuing education.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #62 - 66 of 180

Question ID: 1208040

Which of the following statements regarding the research report on Sunrise Technologies after the company went public is CORRECT?

A) Jones has violated the misrepresentation Standard with her aggressive growth prediction for Sunrise Technologies; Karloff has violated the plagiarism Standard

B) Jones has violated the Standard on research reports because she failed to distinguish between fact and opinion; Karloff is in compliance with the

C) Jones is in compliance with the objectivity Standard because she made her recommendation based facts, not conjecture; Karloff has violated the Standard

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #63 - 66 of 180

Question ID: 1208041

According to CFA Institute Standards concerning fair dealing, Jones is required to do which of the following?

A) Ensure that accounts belonging to her immediate family purchase securities only after other clients have had the chance to buy.

B) Disclose to all clients whether different levels of service are offered.

C) Disseminate new investment recommendations to all clients at the same time.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #64 - 66 of 180

Question ID: 1208042

Which of the following statements could Brown put on his resume without violating Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program?

A) I am a Level III CFA candidate eligible to receive my charter in November 2005.

B) I am a Level III CFA and should become a chartered financial analyst next year.

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

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #65 - 66 of 180

Question ID: 1208043

In order for Clampett Securities to claim compliance with CFA Institute Soft Dollar Standards, the company must:

A) send all purchased research to the client whose brokerage was used to pay for it.

B) comply with all recommended provisions of the Soft Dollar Standards.

C) re-evaluate mixed-use research at least once a year.

Explanation

Mixed-use research must be evaluated at least annually. Companies that claim soft-dollar compliance must follow the mandatory provisions, but can forgo some of the recommended provisions. If research only benefits some clients, it is acceptable to use just their brokerage to pay for it. The Standards do not require sending research to clients.

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #66 - 66 of 180

Question ID: 1208044

When Jones produced the research report on Sunrise Technologies before it went public, she violated:

A) Standard V(B): Communication with Clients and Prospective Clients by leaving relevant facts out of the report, but not Standard III(A): Loyalty, Prudence, and

B) Standard I(B): Independence and Objectivity because of her obedience to her CEO, and Standard II(A): Material Nonpublic Information because of Karloff's

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

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #67 of 180

Question ID: 1212391

Janice Melfi is a portfolio manager for Soprano Advisors. Soprano has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Soprano model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research—an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers use the model to assist them in making portfolio decisions, but, based on their own fundamental research, are allowed to purchase securities not recommended by the model. This fact is not disclosed to the clients, because the head of marketing does not think it is relevant. Which of the following statements regarding the portfolio manager's investment decisions is CORRECT?

A) There is no violation of the Standards.

B) Melfi is violating the Standards by using two investment processes that are in conflict with each other.

C) Soprano is violating the Standards by not disclosing the fundamental research aspect of the investment process.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.c)

Related Material

SchweserNotes - Book 1

Question #68 of 180

Question ID: 1212408

Bob Hatfield, CFA, has his own money management firm with two clients. The accounts of the two clients are equal in value. It is Hatfield's opinion that interest rates will fall in the near future. Based upon this, Hatfield begins increasing the bond allocation of each portfolio. In order to comply with Standard V(B), Communication with Clients and Prospective Clients, the analyst needs to:

A) perform both of these functions.

B) inform the clients of the change and tell them it is based upon an opinion and not a fact.

C) make sure that the change is identical for both clients.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #69 of 180

Question ID: 1212405

Rhonda Meyer, CFA, is preparing a research report on Moon Ventures, Inc. In the course of her research she learns the following:

> Moon had its credit rating downgraded by a prominent rating agency 3 years ago due to sales pressure in the industry. The rating was restored 3 months later when the pressure resolved.
>
> Moon's insider trading has been substantial over the last 3 months. Holdings of Moon shares by officers, directors, and key employees were reduced by 50% during that period.

In Meyer's detailed report making a buy recommendation for Moon, both the credit rating downgrade and the insider trading were omitted from the report.

Meyer has:

A) violated the Code and Standards by not including the insider trading information and by not including the credit rating downgrade in her report.

B) violated the Code and Standards by not including the insider trading information in her report.

C) not violated the Code and Standards in her report.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #70 of 180

Question ID: 1212409

Janet Coleman, CFA, is preparing a research report on Union Power and Light. Due to deregulation, utility companies face increased competition. During the past year, three of the five utility companies in her region have cut their dividends by 50%, on average, to provide more internal funds for investment purposes. In a discussion with Union's chief executive officer, Coleman learned that Union expects to have a record amount of capital expenditures during the next year. Although Union subsequently issued a press release about its capital expenditure plans, it did not make any public statements about a change in dividend policy. Coleman reasons that the management of Union will be under pressure to cut its dividends within the next year to remain competitive. Coleman issues a research report in which she states:

"Union Power and Light will decrease its dividend from $2 to $1 a share by the second quarter. We expect that Union will strengthen its competitive position by using more internally generated funds to finance its investment opportunities. If investors buy the stock now at around $50 a share, their total return could exceed 20% on the stock."

Based on CFA Institute Standards of Professional Conduct, which of the following statements about Coleman's actions is *most accurate*?

A) Coleman violated the Standards because she used material nonpublic information.

B) Coleman violated the Standards because she failed to separate opinion from fact in her research report.

C) Coleman did not violate the Standards.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #71 of 180

Question ID: 1212336

In securing the shares for all accounts under her management, Linda Kammel of Northwest Futures purchased three blocks of shares at three different prices. She then allocated these shares by placing shares from the first block in accounts with surnames beginning with A-G. The second was allocated over accounts H-P, and the third over Q-Z. This action is:

A) not permissible under the Code and Standards. ✓

B) consistent with her responsibilities under the Code and Standards. ✗

C) permissible only if the clients are informed of the allocation procedure. ✗

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #72 of 180

Question ID: 1212330

Caroline Turner, an analyst for Lansing Asset Management, just completed an investment report in which she recommends changing a "buy" to a "sell" for Gallup Company. Her supervisor at Lansing approves of the change in recommendation. Turner wonders about whether she needs to disseminate this investment recommendation to Lansing's clients and if so, how to distribute this information. According to CFA Institute Standards of Professional Conduct, Turner is:

A) not required to disseminate the change of recommendation from a buy to a sell because the change is not material.

B) required to disseminate the change in a prior investment recommendation to all clients and customers on a uniform basis.

C) 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.

(Study Session 1, Module 2.5, LOS 2.c)

Related Material

SchweserNotes - Book 1

Question #73 of 180

Question ID: 1208011

Randal Brooks is the chief economist for a large brokerage firm. In the aftermath of a national tragedy, Brooks feels that it is very possible that the stock market will drop significantly and not recover for several years. However, he does not believe that this is the most likely scenario but merely that the risk of investing in equities has increased. He decides to write a market commentary to the brokerage clients that discusses the reasons why the market will remain stable and talks about why he, as a private citizen, feels patriotic. He does not mention the increase risk in equities. Brooks has:

A) violated the Standards by not including all of the relevant factors in the research report and making patriotic statements.

B) not violated the Standards.

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

Explanation

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

(Study Session 1, Module 2.8, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #74 of 180

Question ID: 1212348

While servicing his clients' accounts, an analyst who is a CFA charterholder, determines that one client is probably involved in illegal activities. According to Standard III(E), Preservation of Confidentiality, the analyst may NOT do which of the following?

A) Contact the appropriate governmental authorities about the determination.

B) Contact CFA Institute about the determination.

C) There are no exceptions in this list.

Explanation

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

(Study Session 1, Module 2.6, LOS 2: III(E))

Related Material

SchweserNotes - Book 1

Question #75 of 180

Question ID: 1207918

Rickard Advisors recently had a trading error in a customer account that was subsequently discovered by Rickard. The firm felt embarrassed by the disclosure of this error, and, in order to induce the client to continue its relationship, Rickard offers the client preferential access to a new issue that is expected to be "hot." Which Standard is violated, if any?

A) The Standard concerning Independence and Objectivity.

B) The Standard concerning Fiduciary Duty.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #76 of 180

Question ID: 1212366

Janet Thompson, CFA, is employed as an analyst by Nationwide Securities. According to CFA Institute Standards of Professional Conduct, which of the following statements about Thompson's duty to Nationwide is NOT correct? Thompson must refrain from:

A) engaging in independent competitive activity that could conflict with the business of Nationwide unless she receives written consent. ✗

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

C) engaging in any conduct that would injure Nationwide. ✗

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #77 of 180

Question ID: 1212388

Preston Partners is an investment management firm that adopted the Code and Standards as part of its policy manual. Gerald Smithson, CFA, has recently added the stock of Utah Biochemical Company and Norgood PLC to all his client's investment portfolios. Shortly afterwards Utah Biochemical and Norgood announced a merger that increased the share price of both companies. Smithson contends he saw the president of Utah Biochemical dining with the chairman of Norgood, but did not overhear their conversation. Smithson researched both companies extensively and determined that each company was a good investment. He put in a block trade for shares in each company. Preston's policies were not clear in this area as he allocated the shares by starting with his largest client accounts and working down to the small accounts. Some of Smithson's clients were very conservative personal trust accounts, others were pension funds who had aggressive investment objectives. Which standard was NOT broken?

A) Standard V(A)—Diligence and Reasonable Basis.

B) Standard IV(C)—Responsibilities of Supervisors.

C) Standard III(C)—Suitability.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #78 of 180

Question ID: 1212389

Victor Logan is a portfolio manager for McCoy Advisors, and Jack Brisco is the Director of Research for McCoy. Brisco has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the McCoy model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. Brisco frequently alters the model based on rigorous research—an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. Logan has conducted very thorough research on his own, using the same process that Brisco uses to validate his findings. Logan feels the model is missing some key elements that would further reduce the list of acceptable securities to purchase, however, Brisco has refused to look at Logan's research. Frustrated by this, Logan applies his own version of the model, with the justification that he is still only purchasing securities on the buy list. Because of the conflict with Brisco, he does not disclose the use of the model to anyone at McCoy or to clients. Which of the following statements regarding Logan and Brisco is CORRECT? Logan is:

A) not violating the Standards by applying his version of the model, but is violating the Standards by not disclosing it to clients. Brisco is not violating the Standards.

B) violating the Standards by applying his version of the model and by not disclosing it to clients. Brisco is violating the Standards by failing to consider

C) violating the Standards by applying his version of the model and by not disclosing it to clients. Brisco is not violating the Standards.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #79 of 180

Question ID: 1212364

An analyst belongs to a nationally recognized charitable organization, which requires dues for membership. The analyst has worked out a deal where he provides money management advice in lieu of paying dues. Which of the following must the analyst do?

A) Nothing since he is not an employee of the charitable organization.

B) Must treat the charitable organization as his employer.

C) Resign from the position because the relationship is a conflict with the Standards.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #80 of 180

Question ID: 1212404

Nicole Wise, CFA, is an analyst at Chicago Securities. She attends a meeting with management of one of the companies that she covers. During the meeting, management expresses great optimism about the company's recent acquisition of a new business. Wise is excited about these prospects and issues a research report that states that the company is about to achieve significant success with the new acquisition. Wise has:

A) violated CFA Institute Standards of Professional Conduct because she misrepresented the optimism by turning it to certainty.

B) not violated CFA Institute Standards of Professional Conduct because she had reasonable reason to believe that the statements in her report were true.

C) violated CFA Institute Standards of Professional Conduct because she did not check the accuracy of the statements that management made.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #81 of 180

Question ID: 1208067

Four months ago Lance Tuipuloto, CFA, analyzed three equity securities for Janet Scadden. However, Scadden decided to invest in bonds instead. Tuipuloto now wants to destroy the records from the stock analysis. Is this action in compliance with Standard V(C)?

A) Yes. Tuipuloto does not need to keep the records because his advice was not followed.

B) Yes. Tuipuloto only needs to keep the records for 90 days.

C) No.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(C))

Related Material

SchweserNotes - Book 1

Question #82 of 180

Question ID: 1212376

An analyst working at an investment firm has a client that rents limousines. The client tells the analyst that as long as he is the client's analyst, he can have free use of a limousine several times a year. The analyst needs to:

A) explicitly refuse such an offer.

B) do nothing since the offer is not linked to the performance of the client's portfolio.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #83 of 180

Question ID: 1207953

Marc Feldman, a CFA Institute member, is treasurer of zippy.com, and is also Larry Goldman's boss. Feldman is informed of "accounting irregularities of an unknown origin" during an audit by zippy's external accounting firm. There are 3 individuals, including Goldman, handling the accounting function. According to the Code and Standards, Feldman should do all of the following EXCEPT:

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

B) leave the staff in their current jobs and increase supervision while the external auditors complete their work.

C) conduct a thorough investigation of activities.

Explanation

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

(Study Session 1, Module 2.7, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #84 of 180

Question ID: 1208061

A manager of pooled funds must do all of the following to remain in compliance with the Standards EXCEPT:

A) Notify potential investors of any changes in investment policy.

B) Print the investment policy statement in all quarterly reports.

C) Disclose basic security selection processes.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #85 of 180

Question ID: 1212378

Chris Babcock, CFA, a portfolio manager for a large Texas investment firm, has been offered compensation in addition to what her firm pays her. The offer is from one of her clients and the additional compensation will be based on her yearly performance in excess of the market index. Babcock should:

A) make written disclosure to her other clients before she accepts this offer.

B) make written disclosure to all parties involved before she accepts this offer.

C) turn down the offer because it represents a clear conflict between this client and Babcock's other clients.

Explanation

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

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #86 of 180

Question ID: 1212393

Todd Gable, CFA, was attending a noon luncheon when he overheard two software executives talking about a common vendor, Datagen, about how wonderful they thought the company was, and about a rumor that a major brokerage firm was preparing to issue a strong buy recommendation on the stock. Gable returned to the office, checked a couple of online sources, and then placed an order to purchase Datagen in all of his discretionary portfolios. The orders were filled within an hour. Three days later, a brokerage house issued a strong buy recommendation and Datagen's share price went up 20%. Gable then proceeded to gather data on the stock and prepared a report that he dated the day before the stock purchase.

Gable has:

A) violated the Standards by improper use of inside information.

B) violated the Standards by using the recommendation of another brokerage firm in his report.

C) violated the Standards by not having a reasonable basis for making the purchase of Datagen.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #87 of 180

Question ID: 1212412

An analyst has several groups of clients who are categorized according to their specific needs. Compared to research reports distributed to all of the clients, reports for a specific group:

A) will definitely include more basic facts.

B) may generally exclude more basic facts.

C) will not be allowed because it violates the Standard III(B), Fair Dealing.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #88 of 180

Question ID: 1212351

Standard III(E), Preservation of Confidentiality, applies to the information that an analyst learns from:

A) current clients and former clients only.

B) current clients, former clients, and prospects.

C) current clients and prospects only.

Explanation

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

(Study Session 1, Module 2.6, LOS 2: III(E))

Related Material

SchweserNotes - Book 1

Question #89 of 180

Question ID: 1207926

Which of the following trade allocation procedures is improper? Allocation:

A) based upon past participation in IPOs.

B) on a strict pro rata basis over all suitable accounts.

C) based upon a predetermined formula.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #90 of 180

Question ID: 1212329

Maggie McCarthy is an individual investment advisor who uses mutual funds for her clients. She typically chooses from a list of 40 funds that she has thoroughly researched. The Figgs, a married couple that are a client, asked her to consider the Boilermaker fund for their portfolio. McCarthy had not previously considered the fund because when she first conducted her research three years ago, Boilermaker was too small to be considered. However, the fund has now grown in value, and after doing thorough research on Boilermaker, she found the fund was by far the most outstanding large company value fund in her list of funds. She puts the fund in the Figgs' portfolio, and in all new clients portfolios, but not in any of her other clients' portfolios. Her reasoning is that her existing clients were comfortable with their current holdings, and she did not want to risk disturbing their comfort. Has McCarthy violated any Standards? McCarthy has:

A) not violated the Standards. ✗

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

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

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.

(Study Session 1, Module 2.5, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #91 of 180

Question ID: 1212416

Lee Hurst, CFA, is an equity research analyst who has recently left a large firm to start independent practice. He is able to re-create several of his previous recommendation reports, based on his clear recollection of supporting documentation he compiled at his previous employer. He publishes the reports and obtains several new clients. Hurst is *most likely*:

A) in violation of Standard V(A) Diligence and Reasonable Basis.

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

C) not in violation of any Standard.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(C))

Related Material

SchweserNotes - Book 1

Question #92 of 180

Question ID: 1212369

Francisco Perez, CFA, is an equity research analyst for a long-term investment fund. The fund is seeking new clients, so Perez contacts old clients he knew through his former employer. Which of the following is *most* accurate?

A) Perez is not prevented from soliciting clients as long as he is working from memory and publically available information rather than a list generated while

B) Perez cannot solicit clients from a former employer.

C) Perez can only solicit clients after notifying his former employer.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #93 of 180

Question ID: 1212381

An analyst belongs to a nationally recognized charitable organization, which requires dues for membership. The analyst has worked out a deal that he provides money management advice in lieu of paying dues. For this arrangement to comply with the standards, the analyst needs consent from:

A) his supervisor in the organization only.

B) his supervisor in his regular place of work only.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #94 of 180

Question ID: 1212339

Janet Reilly has just approached Betty Miller, CFA, about purchasing 10,000 shares of Brookshire Co., a newly incorporated real estate development firm. Reilly is a retired schoolteacher living off the income from her late husband's life insurance policy. This investment will represent a significant shift in her investment portfolio. Miller believes this trade is unsuitable with respect to Reilly's investment policy statement. Consistent with the Standards, Miller should *most appropriately*:

A) not accept the order, because it is not a suitable investment for Reilly.

B) follow her firm's procedures for obtaining Reilly's approval to carry out the unsolicited trade request.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #95 of 180

Question ID: 1212344

Paul Salyer,a portfolio manager, is making a presentation to a prospective client. Paul says that as a new portfolio manager, he made an average annual rate of return of 50% in the last two years at his previous firm and that based on this, he can guarantee a 50% return to the client. Which of the following statements is in accordance with Standard III(D), Performance Presentation?

A) Stating his past performance as long as it is fact.

B) Imputing his past performance to future performance.

C) Implying that he can guarantee a return.

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.

(Study Session 1, Module 2.6, LOS 2: III(D))

Related Material

SchweserNotes - Book 1

Question #96 of 180

Question ID: 1212334

A money management firm has the following policy concerning new recommendations: When a new recommendation is made, each portfolio manager estimates the likely transaction size for each of their clients. Clients are notified of the new recommendation in the order of their estimated transaction size—largest first. All clients have signed a form where they acknowledge and consent to this allocation procedure. With respect to Standard III(B), Fair Dealing, this is:

A) not a violation because the clients have signed the consent form.

B) a violation of the standard.

C) not a violation because the clients are aware of the policy.

Explanation

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

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #97 of 180

Question ID: 1212350

Greg Stiles, CFA, keeps a list of his clients' birthdays and has personally sent them a birthday card each year at the appropriate time. With respect to this action, which of the following may be a violation of Standard III(E), Preservation of Confidentiality?

A) Sending a gift along with the card.

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

C) The mere act of sending a birthday card each year.

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.

(Study Session 1, Module 2.6, LOS 2: III(E))

Related Material

SchweserNotes - Book 1

Question #98 of 180

Question ID: 1212387

Bill Fence, CFA, supervises a group of research analysts, none of whom have earned the CFA designation (nor are they CFA candidates). On several occasions he has attempted to get his firm to adopt a compliance system to ensure that applicable laws and regulations are followed. However, the firm's principals have never adopted his recommendations. Fence should *most* appropriately:

A) take no further action, because by encouraging his firm to adopt a compliance system he has fulfilled his obligations under the Code and Standards. ✗

B) report the inadequacy by submitting a complaint in writing to the CFA Institute Professional Conduct Program. ✗

C) refuse supervisory responsibility. ✓

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(C))

Related Material

SchweserNotes - Book 1

Question #99 of 180

Question ID: 1212338

Lance Tuipulotu, CFA, manages investments for 400 individuals and families and often finds his resources stretched. When his largest investors petition him to include a 5% to 7% allocation of non-investment-grade bonds in their portfolios, he decides he needs additional help to meet the request. He considers various independent advisors to use as submanagers, but determines that the most qualified advisors would be too expensive. Reasoning that a lower-cost provider would enable him to pass the savings along to his clients, he chooses that provider to invest the new bond allocation. Tuipulotu has violated:

A) Standard III(C) Suitability by failing to consider the appropriateness of the non-investment-grade bonds. ✗

B) Standard V(A) Diligence and Reasonable Basis by letting fee structure determine the selection of the submanager. ✗

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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

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

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

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

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

Textiles, a maker of various kinds of silk fabrics. It is widely known in the market that Bradley is seeking a potential merger partner, as the founder and CEO is ready to retire.

Ferrazzo did additional research and concluded that Kellogg Industries and Bradley Textiles had complementary product lines in several areas and similar management cultures. She also remembered reading in Forbes a story in which Kellogg's CFO was quoted as saying the company had the financial wherewithal for a merger and an interest in expansion. Ferrazzo's research indicated that Bradley's market value exceeded its intrinsic value, suggesting that Kellogg was unlikely to pay a high merger premium. Nonetheless, Ferrazzo proceeded to purchase stock in Bradley on behalf of her clients. Six months later, Kellogg acquired Bradley and paid a 40 percent premium over market price.

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

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

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

Question #100 - 105 of 180

Question ID: 1208032

With regard to Ferrazzo's purchase of Bradley stock, she violated:

A) Standard III(E): Preservation of Confidentiality and Standard II(A): Material Nonpublic Information.

B) Standard III(E): Preservation of Confidentiality, but not Standard V(A): Diligence and Reasonable Basis.

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

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #101 - 105 of 180

Question ID: 1208033

Regarding the high-tech stock model, which of the following actions is least likely to help Sandro avoid violating the standards regarding plagiarism and research reports?

A) Acknowledging Standard & Poor's as the original data source and Moody's Investors Service as the new data source. ✗

B) Providing basic information about technology stocks in the research report. ✓

C) Acknowledging Wright's development of the initial model. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #102 - 105 of 180

Question ID: 1208034

The production of the advertising represented a violation of:

A) Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program, and Standard I(C): Misrepresentation.

B) Standard IV(C):Responsibilities of Supervisors, but not Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program.

C) Standard IV(A): Loyalty to Employer and Standard I(C): Misrepresentation.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #103 - 105 of 180

Question ID: 1208035

Ferrazzo may use which of the following brokers?

A) Blue only.

B) White and Blue only.

C) Blue and Green only.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #104 - 105 of 180

Question ID: 1208036

Which of the following statements regarding Alpha Co. is *least* accurate?

A) Sandro has breached a fiduciary duty to her client.

B) Both Wilson and Sandro have a reasonable basis for their recommendations.

C) The fair-dealing standard has not been violated.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #105 - 105 of 180

Question ID: 1208037

Which of the following statements regarding Sandro's biography is *least* accurate?

A) Sandro need not deliver a copy of the Code and Standards to Ferrazzo.

B) Sandro can begin using the CFA designation as soon as she receives her exam results.

C) Sandro must disclose her stake in a thinly traded, family-owned construction company.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

Question #106 of 180

Question ID: 1212396

An analyst receives a research report from a colleague. The colleague's report has an elaborate table with performance data on publicly traded stocks. The colleague says the data in the table consists of measures provided by Standard & Poor's. The analyst finds the table a useful reference for a report she is writing. She uses several pieces of data from the table. The analyst is potentially in violation of:

A) no particular standard because this is appropriate activity.

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

C) Standard I(C), Misrepresentation, concerning the use of the work of others.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #107 of 180

Question ID: 1212352

Calvin Doggett, CFA, has been contacted by the CFA Institute Professional Conduct Program (PCP) regarding allegations that he has taken investment actions that were unsuitable for his clients. Doggett is questioned by PCP concerning the identity of his clients he considered suitable for investing in a very risky start-up company that eventually went bankrupt.

Doggett will:

A) violate the Code and Standards by fully cooperating with a PCP investigation if it means revealing confidential information.

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

C) not violate the Code and Standards only if he reveals the financial condition and investment objectives of his clients on an anonymous basis and does not reveal

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.

(Study Session 1, Module 2.6, LOS 2: III(E))

Related Material

SchweserNotes - Book 1

Question #108 of 180

Question ID: 1207954

Marc Feldman, CFA, is manager of corporate investor relations for a high-tech startup, zippy.com, in Boise, Idaho. Feldman is well-known in the high tech community in Boise, and Dragon.com has asked if he will help them organize their investor relations function on a consulting basis. They offer him an all-expenses-paid two-week holiday for two on Australia's Gold Coast in payment. Regarding this offer as a CFA Institute member Feldman is:

A) allowed to accept the offer only with written approval from zippy.

B) not allowed to accept such an offer since it effectively places him in competition with his employer.

C) allowed to accept the offer only with written approval from zippy and from Dragon.

Explanation

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

(Study Session 1, Module 2.7, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #109 of 180

Question ID: 1207928

An analyst thinks that a major change in the tax law will benefit holders of utility company stocks. She immediately begins calling all her clients and telling them of the upside potential of investing in such assets now. Based upon this information, this is *most likely*:

A) a violation of Standard V(A), Diligence and Reasonable Basis.

B) congruent with Standard V(A), Diligence and Reasonable Basis.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #110 of 180

Question ID: 1212379

Sharon West is a CFA charterholder and trust officer for REO Trust Company. Soon after beginning work for REO, West finds that REO has been conducting all its securities transactions through her brother who is a registered representative. West's brother charges REO commissions that are equal to the lowest available from another broker. West's brother tells her that if she continues doing business with him, he will give her a substantial discount on all personal transactions she conducts through him. West:

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

B) must inform her employer of the arrangement because she is doing business with a member of her immediate family.

C) does not need to inform her employer of the arrangement because the commissions her brother charges the firm are the lowest possible.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #111 of 180

Question ID: 1212342

One year ago, Karen Jason left the employment as a portfolio manager of Howe Advisors. The departure was contentious and both parties threatened legal action. As a result, both parties signed a settlement in which Jason was paid a pro rated bonus, but agreed not to work on the portfolios of any existing Howe client for two years. The terms of the agreement were that both parties agreed to keep all aspects of the agreement confidential, including the fact that there was hostility surrounding the departure. Jason now works for Torre Advisors, who has the Stein Company as a new client. At the time Jason left Howe, Stein was a client of Howe, although Jason did not personally work on the Stein portfolio. Jason's supervisor at Torre wants Jason to work on the Stein portfolio. Jason should:

A) inform her supervisor that she cannot work on the portfolio because of a legal agreement, but cannot tell him why. ✓

B) work on the portfolio because she did not personally work on the portfolio when she was at Howe. ✗

C) inform her supervisor that she cannot work on the portfolio because of a non-compete agreement. ✗

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.

(Study Session 1, Module 2.6, LOS 2.c)

Related Material

SchweserNotes - Book 1

Question #112 of 180

Question ID: 1212400

Bill Fox, CFA, has been preparing a research report on New London Wire and Cable, one of his major investment clients. He had completed much of his analysis and had planned on having his report typed and bound today. Unfortunately, his briefcase was stolen while he ate breakfast, and he lost all his notes and working papers. The lost materials included his notes from management interviews, conversations with suppliers and competitors, dates of company visits, and his computer diskette containing much of his quantitative analysis. Fox's client needs this report tomorrow. In a panic, Fox called New London's vice president of finance and was faxed a copy of the company's most recent financial projections. Fox remembered that his own analysis showed that management's estimates were too high. He did not remember the exact amount, so he revised New London's figures downward 10%. Fox incorporated some charts and graphs on New London from a research report he received last week from a small regional research firm and some information from a Standard & Poor's reference work in his report, without reference to their sources. Fox has:

A) violated the requirement to have a reasonable basis for a recommendation, the prohibition against plagiarism, and the requirement to maintain appropriate

B) violated the requirement to have a reasonable basis for a recommendation and the prohibition against plagiarism.

C) violated none of the Standards.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

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 investment policy statement (IPS) for each client.

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 leading to the award of the CFA designation, QED sends a promotional email to all of the firm's clients. The email states "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.

Question #113 - 118 of 180

Question ID: 1207932

Do QED's policies comply with CFA Institute Standards of Professional Conduct with respect to the information contained within the client IPS' and the frequency with which the information is updated?

	Information	Frequecy
A)	No	Yes
B)	No	No
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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #114 - 118 of 180

Question ID: 1207933

In light of Singh's comments during his telephone call to Patel prior to his uncle's death, which of the following actions that Patel can take comply with CFA Institute Standards of Professional Conduct?

A) 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

B) Patel may change the current portfolio strategy and begin trading based upon Singh's expectations because he advised her to do so.

C) Patel must not place any trades in the account until she meets with Singh to develop a new portfolio strategy based on the updated information.

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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #115 - 118 of 180

Question ID: 1207934

According to CFA Institute Standards of Professional Conduct, may Patel reallocate Singh's portfolio toward technology stocks after his Uncle dies, but before the meeting with Singh?

A) No—Patel and Singh must meet and revise the IPS and portfolio strategy before reallocating.

B) No—Patel must wait until the next annual meeting to reallocate.

C) Yes—the total value of the municipal bonds received into the account will be too large relative to the other assets in the portfolio.

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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #116 - 118 of 180

Question ID: 1207935

Did Patel violate any CFA Institute Standards of Professional Conduct when she purchased the NetWin stock for Singh's portfolio or for the other clients' portfolios?

	Singh's portfolio	Other portfolios
A)	Yes	Yes
B)	No	No
C)	No	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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #117 - 118 of 180

Question ID: 1207936

Which of the following is *least* accurate regarding the promotional announcement of Patel passing the Level III exam?

A) The announcement violates the Code of Ethics because it implies that obtaining a CFA charter leads to superior performance.

B) The promotional announcement uses the letters “CFA” as a noun and hence is an improper use of the designation.

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"). 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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #118 - 118 of 180

Question ID: 1207937

With respect to the choice of broker, did Patel violate any CFA Institute Standards of Professional Conduct?

A) Yes, since Patel failed to properly notify Singh that using TradeRight would lead to higher commissions and opportunity costs. ✗

B) Yes, since Patel is obligated to seek the best possible price and execution for all clients. ✗

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #119 of 180

Question ID: 1212406

An analyst finds a stock that has had a low beta given its historical return, but its total risk has been commensurate with its return. When writing a research report about the stock for clients with well-diversified portfolios, according to Standard V(B), Communication with Clients and Prospective Clients, the analyst needs to mention:

A) both the historical beta and total risk and return.

B) the relationship of the historical total risk to return only.

C) the relationship of the historical beta and return only.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #120 of 180

Question ID: 1212363

Dave Kline, CFA, is a personal investment advisor with 200 individual, family, and corporate accounts. After a dispute with a coworker on margin policy, he formally resigns his position by giving suitable notice. However, he does not follow his firm's established "Transition and Exit Policies" regarding his accounts. The firm's stated policies require him to notify each client of his planned departure and personally introduce them to their new account representative, Greg Potter. Kline sees Potter as a rival and states "...let Potter do his own work and find his own clients." Kline is *most likely*:

A) not in violation of the Code and Standards.

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

C) in violation of Standard I(D) "Misconduct" for leaving clients subject to an account representative he does not find suitable.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #121 of 180

Question ID: 1208015

Using as his universe all companies in the steel industry, Reynold Anderson analyses the performance of stock prices for the industry. He succeeds in developing a regression model with excellent statistical control measures. The extrapolation from the model shows low risk variance of the securities in this industry. Without the inclusion of non-steel stocks in the portfolio, Anderson concludes that, based on these results, every portfolio can use the steel industry securities to diversify and lower its risk. He persuades his clients to change their current portfolios. Anderson states that, as the model's results show, some particular industries, such as car manufacturers, have underpriced stocks, and investors should take advantage of it. Anderson has violated the Standards because he:

A) is not clear enough about the model results. ✗

B) does not distinguish the opinion, based on his model, from the fact. ✓

C) does not consider the suitability of the investment. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2.b)

Related Material

SchweserNotes - Book 1

Michael Pennington Case Scenario

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

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

- Flanders was the president of a publicly traded manufacturing company, Allux, and 20% of his portfolio's assets were invested in Allux equity. His contract with Allux prohibited selling his Allux shares while he was employed.
- Flanders had little liquidity needs. His children were grown, and his salary at Allux was sufficient to cover his annual expenditures as well as contribute to his investment portfolio.
- A former accountant, Flanders had been extremely knowledgeable and comfortable with the investment decision-making process.
- Pennington owns 10,000 shares of Allux and serves on Allux's board.
- Pennington played golf with Flanders on a regular basis and, with Flanders's help, developed many client relationships from these outings.

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

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

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

Question #122 - 127 of 180

Question ID: 1207901

Which of the following Standards is *most* relevant regarding Pennington's meeting with Elise?

A) Standard III(E), Preservation of Confidentiality.

B) Standard III(A), Loyalty, Prudence, and Care.

C) Standard III(C), Suitability.

Explanation

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

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #123 - 127 of 180

Question ID: 1207902

Standard VI(A), Disclosures of Conflicts, requires Pennington to disclose all matters, including beneficial ownership of securities of other investments, that could be expected to impair the member's ability to make unbiased and objective recommendations. Which of the following matters would *least likely* be disclosed to Elise?

A) Pennington owns shares in Allux.

B) AIA has a soft dollar arrangement with a brokerage firm owned by Pennington’s sister.

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

Explanation

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

(Study Session 1, Module 2.9, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #124 - 127 of 180

Question ID: 1207903

Which of the following *best* describes Pennington's compliance with the CFA Institute Standards regarding his use of soft dollars? The purchase of:

A) both research reports and carpeting are allowable uses of soft dollars.

B) research reports and attending the conference are allowable uses of soft dollars.

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

Explanation

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

(Study Session 1, Module 2.4, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #125 - 127 of 180

Question ID: 1207904

Pennington would like to continue to direct trades from Elise's portfolio to his sister's brokerage firm. In order to continue with this arrangement and comply with the CFA Institute Standards, which of the following disclosures are required?

A) Pennington must disclose that directed brokerage arrangements that require the investment manager to commit a certain percentage of brokerage might

B) Pennington must clearly disclose that his duty as the investment manager is to continue to seek to obtain best execution.

C) Pennington must disclose policies with respect to all soft dollar arrangements and receive written consent from Elise that she understands the consequences if

Explanation

Investment managers are required to disclose policies with respect to soft dollar arrangements. Standard III(A), Loyalty, Prudence, and Care, requires Pennington to seek best price and execution with his trades and if he directs trades through a broker in which he may not receive best price and execution he must get a written statement from his clients that they are aware that he is not seeking best price and execution and the consequences for their accounts.

(Study Session 1, Module 2.4, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #126 - 127 of 180

Question ID: 1207905

After determining Elise's risk and return objectives, liquidity needs, tax considerations, and unique circumstances, Pennington has decided the he must reduce Elise's holding of Allux shares. He has several other clients, whom he met through Flanders, who also have significant holdings in Allux. Pennington has also decided to reduce his own holdings in Allux since his term as a director of Allux will be up in June. He does not plan to seek reappointment, but as a member of the audit committee, he is privy to information about a tender offer. Pennington realizes this is a complex situation.

Of the following Standards, determine which would *least likely* help Pennington decide what actions with respect to selling shares of Allux would be in compliance with the CFA Institute Standards of Practice.

A) Standard VI(A), Disclosure of Conflicts.

B) Standard III(B), Fair Dealing.

C) Standard III(C), Suitability.

Explanation

Standard III(C), Suitability, is least likely to provide Pennington with guidance when he considers selling Elise's holdings of Allux. This standard describes members' responsibilities in developing appropriate recommendations and taking suitable actions. To reach the point where he has decided to sell Elise's shares, Pennington would already have met these requirements. He has determined Elise's and his other clients' requirements and has recommended an appropriate and suitable investment action. His concern is how to implement his recommendation and be in compliance with the Standards of Professional Conduct.

Pennington has several problems with respect to selling shares of Allux from Elise's portfolio and the portfolios of his other clients. First, he must comply with Standard III(B) and deal fairly and objectively with all clients and prospects when taking this investment action. Pennington must disclose his ownership of Allux to all affected clients according to Standard VI(A) and ensure that transactions for clients take precedence over transactions on his own behalf according to Standard VI(B).

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #127 - 127 of 180

Question ID: 1207906

Since Pennington is a director of Allux and a member of the audit committee, what additional Standard is specifically applicable to Pennington's decision to sell his and his clients' shares of Allux?

A) Standard VII, Responsibilities as a CFA Institute Member or CFA Candidate.

B) Standard II, Integrity of Capital Markets.

C) Standard IV, Duties to Employers.

Explanation

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

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #128 of 180

Question ID: 1212415

According to CFA Institute Standards of Professional Conduct, members are *least likely* required to:

A) distribute a detailed research report to clients with any recommendation.

B) make diligent efforts to determine whether third party research relied on is sound.

C) analyze the investment's basic characteristics before recommending a specific investment to a broad client group.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(C))

Related Material

SchweserNotes - Book 1

Question #129 of 180

Question ID: 1212353

A CFA charterholder may disclose confidential information about a client when:

A) the CFA Institute Professional Conduct Program requests it.

B) it is a necessary step in proceeding with research on client preferences.

C) the information is nonmaterial.

Explanation

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

(Study Session 1, Module 2.6, LOS 2: III(E))

Related Material

SchweserNotes - Book 1

Question #130 of 180

Question ID: 1208020

An analyst receives a report from his research department that summarizes and interprets a recent speech from the chairman of the U.S. Federal Reserve. The summary says that the chairman thinks inflation is under control. Based upon this summary, the analyst says in his next newsletter that inflation is under control. This is a violation of:

A) Standard V(A), Diligence and Reasonable Basis, only.

B) none of the Standards listed here.

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

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #131 of 180

Question ID: 1212373

Bill Valley has been working for Advisors, Inc., for several years, and he just joined CFA Institute. Valley's sister just received a large bonus in the form of stock options in Zephyr, Inc. Valley's sister knows nothing about financial assets and offers Valley a week at her holiday home each year in exchange for Valley monitoring Zephyr and the value of her stock options. In order to comply with the Code and Standards, Valley needs to inform Advisors of:

A) nothing since no money is involved and it is a favor for a family member.

B) the compensation in the form of the use of the holiday home only.

C) both the use of the holiday home and his sister's options.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #132 of 180

Question ID: 1212357

Fernando Abrea, CFA was an analyst for Pacific Investments. In October he left Pacific and joined Global Securities as manager of a local office. Abrea's change of employment came about in the following manner:

> In April, Abrea contacted Global about a possible position he saw advertised in a financial publication and had exploratory meetings with Global.
> In July, Abrea submitted a strategic plan to Global and signed an agreement to join Global. He then contracted for office space on behalf of Global.
> On October 15, Abrea's resignation from Pacific became effective. He did not take any client lists from Pacific.
> On October 16, Abrea mailed a letter that explained his new undertaking with Global to prospective clients, including his former clients at Pacific.

With respect to Standard IV(A) Loyalty, Abrea:

A) did not violate the Standard. ✔

B) violated the Standard by contracting for office space on behalf of Global. ✘

C) violated the Standard by contacting his former clients at Pacific. ✘

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #133 of 180

Question ID: 1212403

Susan Plumb is the supervisor of her firm's research department. Her firm has been seeking the mandate to underwrite Wings Industries' proposed secondary stock offering. Without mentioning that the firm is seeking the mandate, she asks Jack Dawson to analyze Wings common stock and prepare a research report. After reasonable effort, Dawson produces a favorable report on Wings stock. After reviewing the report, Plumb then adds a footnote describing the underwriting relationship with Wings and disseminates the report to the firm's clients. According to CFA Institute Standards of Professional Conduct, these actions are:

A) a violation of Standard VI(A), Disclosure of Conflicts. ✗

B) a violation of Standard V(A), Diligence and Reasonable Basis. ✗

C) not a violation of any Standard. ✓

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #134 of 180

Question ID: 1207917

Rey Sanchez, CFA, covers the specialty chemical industry for Rock Advisory Associates. Until today he has had a buy recommendation on ChemStar, and many of the firm's customers have purchased shares based upon his recommendation. The firm's client accounts are divided into two fundamental categories: trading and buy-and-hold accounts. The firm holds discretionary trading authority over the trading accounts, but not the buy-and-hold accounts. Sanchez has recently come to believe that the fundamentals are changing for the worse at ChemStar, and is preparing a sell recommendation. He calls a meeting of the firm's portfolio managers with accounts holding ChemStar and tells them of the pending release of the sell recommendation. On this basis, the portfolio managers sell all positions in the discretionary accounts but not in the buy-and-hold accounts. Sanchez completes and mails the report to all clients two days later, and, shortly thereafter, many of the buy-and-hold accounts sell their ChemStar positions. With regard to these actions, Sanchez is:

A) in violation of the Standard on Fair Dealing; the portfolio managers are not in violation of the Standard on Fair Dealing.

B) not in violation of the Standard on Fair Dealing; the portfolio managers are in violation of the Standard on Fair Dealing.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #135 of 180

Question ID: 1212326

Scott Andrews, CFA, is a stockbroker selling an oversubscribed stock issue. Which of the following *best* describes Andrews' actions regarding this sale? Andrews:

A) can offer this security on a prorated basis to all clients for which the security is appropriate.

B) can only offer this security to clients for which it is appropriate on a first come first serve basis.

C) cannot offer an oversubscribed issue of stock to any clients.

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.*

(Study Session 1, Module 2.5, LOS 2.b)

Related Material

SchweserNotes - Book 1

Question #136 of 180

Question ID: 1212346

A money management firm has created a new junk-bond fund. When the firm advertised the new fund at its issuance, they used care to accurately compute the returns from the past 10 years for all assets in the fund. The firm used the current portfolio weights to determine an average annual historical return equal to 18% and claim an 18% annual historical return in their advertising literature. With respect to Standard III(D), Performance Presentation, this is:

A) a violation because the Standard prohibits computing historical returns on risky assets like junk bonds.

B) in compliance.

C) 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.

(Study Session 1, Module 2.6, LOS 2: III(D))

Related Material

SchweserNotes - Book 1

Question #137 of 180

Question ID: 1212349

Greg Stiles, CFA, may withhold from CFA Institute information about a client acquired in the regular performance of his duties:

A) only if Stiles has a special confidentiality agreement with the client.

B) only if Stiles is a relative of the client.

C) 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.

(Study Session 1, Module 2.6, LOS 2: III(E))

Related Material

SchweserNotes - Book 1

In August 2005, the following events occurred related to Aggregate Opportunities, 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.

Question #138 - 143 of 180

Question ID: 1208005

In issuing a sell recommendation for Aggregate, Henderson:

A) violated none of the Standards. ✓

B) violated Standard V(B): Communication with Clients and Prospective Clients because she failed to distinguish between fact and opinion. ✗

C) violated Standard V(A): Diligence and Reasonable Basis because she lacked sufficient reason to justify the downgrade. ✗

Explanation

The information published in the *Wall Street Journal* was public information, so Henderson did not violate Standard II(A). Henderson did check his research papers and relied on the *Journal* which is a credible source. As such, using the story to justify a downgrade did not violate Standard V(A) or Standard V(B).

(Study Session 1, Module 2.8, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #139 - 143 of 180

Question ID: 1208006

In selling his clients' holdings in Aggregate, Watkins:

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

B) did not violate Standard II(A): Material Nonpublic Information because there was no breach of duty.

C) did not violate Standard II(A): Material Nonpublic Information because the information did not involve a tender offer.

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.

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #140 - 143 of 180

Question ID: 1208007

In advising his clients to sell Aggregate, Black:

A) did not violate Standard I(B): Independence and Objectivity, but his supervisor violated Standard IV(C): Responsibilities of Supervisors.

B) violated Standard III(B): Fair Dealing because he did not take his own advice and sell the stock.

C) violated Standard V(A): Diligence and Reasonable Basis because he did not have sufficient information to spur investment action.

Explanation

Black's conduct does not violate Standard I(B), because a reasonable person would not call his independence into question, even though his ethics are suspect. Black's supervisor should have asked Black where he got the information before the research report was circulated, and the failure to do so means that the supervisor violated Standard IV(C). Black is also clearly in violation of Standard II(A): Material Nonpublic Information, because he would clearly have known that the information received from his Brother was both material and nonpublic. However, Standard II(A) is not one of the choices. Black's failure to follow his own advice does not violate Standard III(B). Ignoring all of the other details, knowledge that an earnings restatement is possible could certainly be considered a reasonable basis to dump a stock, so Black did not violate Standard V(A). Standard VI(A) pertains only when a relationship would impair investment judgment, and that is not the case here.

(Study Session 1, Module 2.7, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #141 - 143 of 180

Question ID: 1208008

After changing her recommendation on Aggregate, Sanders:

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

B) violated Standard VI(B): Priority of Transactions by trading Aggregate from her own account.

C) did not violate Standard II(A): Material Nonpublic Information because the information was disclosed to a select group of analysts.

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.

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #142 - 143 of 180

Question ID: 1208009

In selling his fund's stake in Aggregate, Martinez:

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

B) violated Standard III(A): Loyalty, Prudence, and Care by using information obtained from Watkins.

C) violated no standards.

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).

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #143 - 143 of 180

Question ID: 1208010

Which statement about violations of the Code and Standards is CORRECT?

A) Aggregate's CFO violated the fair-dealing Standard, but Black did not violate the fiduciary-duties Standard. ✓

B) Henderson violated the reasonable-basis standard, but Sanders did not violate the Standard regarding use of material nonpublic information. ✗

C) Martinez did not violate the Standard regarding use of material nonpublic information and 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.

(Study Session 1, Module 2.5, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #144 of 180

Question ID: 1212394

Wes Smith, CFA, works for Advisors, Inc. In order to remain in compliance with Standard V(A), Diligence and Reasonable Basis, Smith may recommend a security in which of the following situations?

A) Advisors' research department recommends a stock.

B) For either of the reasons listed here.

C) Smith reads a favorable review of the security in a widely read periodical.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #145 of 180

Question ID: 1207920

Concerning Standard III(B), Fair Dealing, which of the following statements is CORRECT? The Standard:

A) concerns the dissemination of investment recommendations and the taking of investment action.

B) is not concerned with the dissemination of investment recommendations so long as the taking of investment action is inherently fair.

C) concerns the dissemination of investment recommendations but is not concerned with 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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #146 of 180

Question ID: 1208057

BlueRock Fund uses a proprietary asset selection model that it believes gives the firm a competitive advantage. The model is applied to a universe of all small-cap domestic equities and all publicly-traded corporate bonds. The asset allocations generated by this model range from +200 percent in small-cap equities/-100 percent in bonds to +200 percent in bonds/-100 percent in small-cap equities. Since the fund can invest in both equities and bonds, it is classified as a balanced fund. In the prospectus BlueRock describes the fund's investment policy as "a balanced fund, with 50 percent of the assets invested in bonds and 50 percent in equities, on average." On this basis, BlueRock is:

A) in violation of CFA Institute Standards concerning the disclosure of security selection and portfolio construction processes. ✓

B) in violation of the CFA Institute Standard concerning Fiduciary Duty. ✗

C) not in violation of any CFA Institute Standard. ✗

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

Question #147 of 180

Question ID: 1212343

Albert Long, CFA, manages portfolios of high net worth individuals for HKB Corp. Alice Thurmont, one of his close friends, heads a local charity for homeless children that depends on donations to operate. Because donations have declined during the past year, the charity is experiencing financial difficulty. Thurmont asks Long to give her a partial list of his clients so that she can contact them to make tax-deductible donations. Because Long knows that the charity provides much benefit to the community, he provides Thurmont with the requested list.

Betty Short, CFA, also works for HKB Corp. She receives a letter from CFA Institute's Professional Conduct Program (PCP) requesting that she provide information about one of HKB's clients who is being investigated. Short complies with the request despite the confidential nature of the information requested by the PCP.

Based on Standard III(E), Preservation of Confidentiality, which of the following statements about Long and Short's actions is CORRECT?

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

B) Short violated Standard III(E) but Long did not violate Standard III(E).

C) Both Long and Short violated 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.

(Study Session 1, Module 2.6, LOS 2.c)

Related Material

SchweserNotes - Book 1

Question #148 of 180

Question ID: 1208064

An analyst has constructed an investment policy statement (IPS) and a portfolio for a new client, Stephanie Sasser. He has also provided written guidelines on the processes used to make investment management decisions. Six month later, Sasser questions the analyst about several portfolio holdings. Due to a large allocation in financial services stocks during a severe market downturn, her portfolio has underperformed the benchmark by a large margin. Although the analyst remembers discussing the over-allocation with Sasser, and receiving her approval, he is unable to find supporting documents. Which of the following Standards has the analyst *most likely* violated?

A) Standard V(C) Record Retention.

B) Standard V(A) Diligence and Reasonable Basis.

C) Standard V(B) Communications with Clients and Prospective Clients.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(C))

Related Material

SchweserNotes - Book 1

Question #149 of 180

Question ID: 1208066

Ten years ago Lance Tuipuloto, CFA, met with Horace and Nichole Scadden to discuss potential investments, but these prospects never became clients. Tuipuloto now wants to destroy the records from the meeting with the prospective clients. Is this action in compliance with Standard V(C)?

A) Yes; A sufficient number of years have passed since the meeting.

B) No.

C) Yes; the prospects never became clients.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(C))

Related Material

SchweserNotes - Book 1

Question #150 of 180

Question ID: 1212384

Martin Tripp, CFA, is vice-president of the equity department at Walker Financial, a large money management firm. Of the twenty analysts in his department for whom he has supervisory responsibility, eight are subject to CFA Institute Standards of Professional Conduct. Tripp believes that he cannot personally evaluate the conduct of the twenty analysts on a continuing basis. Therefore, he plans to delegate some of his supervisory duties to Sarah Green, who is subject to the Standards, and some to Bob Brown, who is not subject to the Standards. According to CFA Institute Standards of Professional Conduct, which of the following statements about Tripp's ability to delegate supervisory duties is *most accurate*?

A) Tripp may not delegate any of his supervisory duties to either Green or Brown.

B) Tripp may delegate some or all of his supervisory duties only to Green because she is subject to the Standards.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(C))

Related Material

SchweserNotes - Book 1

Question #151 of 180

Question ID: 1212368

John Hill, CFA, has been working for Advisors, Inc., for eight years. Hill is about to start his own money management business and has given his two-week notice of his resignation from Advisors. A few days before his resignation takes effect, on his lunch hour, he takes out a loan from a bank on behalf of his new business and uses the money to buy some office equipment for his new business. Since he engaged in these transactions while still an employee of Advisors, Hill violated Standard IV(A), Loyalty to Employer, by:

A) neither taking out the loan nor buying the equipment.

B) breaching his duty of loyalty to his current employer by making preparations to go into a competitive business.

C) preparing to undertake independent practice before giving notice to his current employer of his intent to resign.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #152 of 180

Question ID: 1212392

The Konkol Company implements a new methodology for portfolio valuation that is licensed to them by ABC Statistics. Konkol complies with the CFA Institute Code and Standards by:

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

B) not discussing the new methodology with clients because there is no need to, as it will not change their risk and yield preferences.

C) discussing the new methodology with clients only when a change in the security selection process is involved.

Explanation

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

(Study Session 1, Module 2.8, LOS 2.c)

Related Material

Question #153 of 180

Question ID: 1207925

Concerning Standard III(B), Fair Dealing, which of the following actions is *NOT* a valid procedure for compliance with the Standard?

A) Communicate investment recommendations simultaneously within the firm and to customers, where possible.

B) Communicate investment recommendations to all customers including those accounts for which the securities are not eligible for purchase.

C) Limit the number of people that are involved and are privy to the fact that an investment recommendation is going to be disseminated.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #154 of 180

Question ID: 1212371

Nancy Korthauer, CFA, has launched a new hedge fund called the Korthauer Tautology Fund but has had trouble hiring analysts who are CFA charterholders as well as with finding clients. She offers a $15,000 incentive bonus to any charterholder who joins the firm with over $1 million in committed client investments. Which of the following interpretations of the Code and Standards is *most* accurate?

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

B) A member or candidate may arrange for current clients to switch to the Korthauer Tautology Fund provided the member or candidate refuses to accept

C) A member or candidate may arrange for current clients to switch to the Korthauer Tautology Fund provided clients are informed of the incentive bonus.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #155 of 180

Question ID: 1212374

Pamela Gee is a portfolio manager. She is planning to establish her own money management firm. She has already informed her employer, Branford, Inc., about her plans. In her remaining time at Branford, she can:

A) start the registration of her new company.

B) solicit Branford colleagues but not Branford clients.

C) inform her current clients about her resignation and let them know how to reach her, in case any problems arise in the future.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #156 of 180

Question ID: 1207923

Which of the following statements regarding allocating trades is CORRECT? It is:

A) 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

B) never permissible to deviate from a pro rata basis, unless this is done on the basis of an advance indication of interest in the issue.

C) never permissible to deviate from a proportional account value weighting method of trade allocation, unless this is done on the basis of an advance

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #157 of 180

Question ID: 1207922

Which of the following statements regarding allocating trades is CORRECT? It is permissible under the Standards to allocate trades:

A) based upon any method the firm deems suitable so long as the allocation procedure has been disclosed to all clients.

B) based upon compensation arrangements.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #158 of 180

Question ID: 1212407

In the preparation of a research report, a CFA Institute member may emphasize certain matters, touch briefly on others, and omit some altogether:

A) under no circumstances.

B) provided that the analyst both has a reasonable basis and is unconstrained by the Mosaic theory.

C) provided that the analyst has a reasonable basis for his or her actions.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(B))

Related Material

SchweserNotes - Book 1

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

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

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

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

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

Question #159 - 164 of 180

Question ID: 1207991

Regarding the Paris trip, Lindquist:

A) cannot accept the gift without disclosing it to his employer.

B) cannot accept the gift under any circumstances.

C) can accept the gift if he determines, in consultation with his employer, that accepting the gift would not compromise his objectivity.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #160 - 164 of 180

Question ID: 1207992

With regard to the Chandler portfolio, Lindquist violated:

A) Standard III(A): Loyalty, Prudence, and Care, but not Standard I(D): Misconduct.

B) Standard III(C): Suitability, but not Standard III(A): Loyalty, Prudence, and Care.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #161 - 164 of 180

Question ID: 1207993

With regard to Lindquist's seat on the board of Western Inns, he violated:

A) Standard VI(A): Disclosure of Conflicts, but not Standard IV(B): Additional Compensation Arrangements.

B) no standards.

C) Standard VI(A): Disclosure of Conflicts, and Standard IV(B): Additional Compensation Arrangements.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #162 - 164 of 180

Question ID: 1207994

Which of the following standards is *most likely* violated in Lindquist's use of his experimental version of the Midwestern model?

A) Standard IV(C): Responsibilities of Supervisors.

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

C) Standard I(C): Misrepresentation (plagiarism).

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #163 - 164 of 180

Question ID: 1207995

Lindquist's actions in advertising his investment performance:

A) conform to standards concerning performance presentation as long as Lindquist does not claim compliance with CFA Institute Global Investment Performance Standards.

B) conform to all standards.

C) violate Standard III(D): Performance Presentation.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #164 - 164 of 180

Question ID: 1207996

Regarding the NCAA tickets, what action must Lindquist take to avoid a violation of Standard I(B): Independence and Objectivity?

A) Obtain written consent from all parties involved.

B) Disclose his receipt of the tickets to all other clients with the same investment objective as the Olson account.

C) Informing his employer is sufficient.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #165 of 180

Question ID: 1212386

Which of the following statements about Standard IV(C) Responsibilities of Supervisors is *least* accurate?

A) If the supervisor makes a reasonable effort to detect violations, but fails to detect a violation that occurs, she is in compliance with Standard IV(C).

B) If no effort is made to detect violations, the supervisor is in violation of Standard IV(C) even if no violations by her subordinates have occurred.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(C))

Related Material

SchweserNotes - Book 1

Question #166 of 180

Question ID: 1212367

Sue Parsons, CFA, works full-time as an investment advisor for the Malloy Group, an asset management firm. To help pay for her children's college expenses, Parsons wants to engage in independent practice in which she would advise individual clients on their portfolios. She would conduct these investment activities only on weekends. She is currently only in the preparation stage and has not started independent practice yet. Which of the following statements about Standard IV(A), Loyalty to Employer, is *most* accurate? Standard IV(A):

A) does not require Parsons to notify Malloy of preparing to undertake independent practice under the current conditions.

B) requires Parsons to obtain written consent from both Malloy and the persons from whom she undertakes independent practice.

C) requires Parsons to notify Malloy in writing about her intention to undertake an independent practice.

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #167 of 180

Question ID: 1207921

Which of the following statements is *least* accurate? It is permissible under the Standards to allocate trades:

A) on a pro rata basis over all accounts.

B) on a pro rata basis over all suitable accounts based upon account value.

C) on a pro rata basis over all suitable accounts on the basis of an advance indication of interest and indicated order size.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #168 of 180

Question ID: 1212333

An analyst meets with a new client. During the meeting, the analyst sees that the new client's portfolio is heavily invested in one over-the-counter stock. The analyst has been following the stock and thinks it will perform well in the long run. The analyst arranges through a brokerage firm to simultaneously sell a large number of shares of the stock via a series of cross trades from the new client's portfolio to various existing clients. He arranges the trades to be executed at a price that approximates the current market price. This action is:

A) a violation of Standard III(A), Loyalty, Prudence, and Care.

B) a violation of Standard III(B), Fair Dealing.

C) 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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

Question #169 of 180

Question ID: 1207924

Pro rata allocation on the basis of an advance indication of interest means each account for which the shares are suitable:

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

B) and which has expressed an advance indication of interest, shall receive w*m shares, where w is the account's proportional value of all such accounts and

C) shall receive m/n shares, where there are m shares available and n such accounts.

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.

(Study Session 1, Module 2.5, LOS 2: III(B))

Related Material

SchweserNotes - Book 1

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

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

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

In preparation for a client meeting, James asks Taylor to prepare a research report on attractive companies in the healthcare industry. Since Taylor is busy preparing for company conference calls, James tells him to "throw something together." To meet James' request, Taylor obtains reports on Immune Health Care and Remedy Corp., two companies that he likes, but has not researched in depth. Taylor takes the original reports, which were prepared by a small brokerage firm in the Netherlands, adds some general industry information, incorporates World Class's proprietary earnings-growth model, and submits "strong buy" recommendations to James for the stocks. Although written procedures require James to review all analyst reports prior to release, time constraints consistently prevent him from reviewing the reports prior to distribution.

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

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

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

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

Question #170 - 175 of 180

Question ID: 1207956

Which of the following is a violation of the Code and Standards?

A) Reynolds approves Montpier’s report on Circuit Secrets immediately, but tells his traders to wait a week before buying the stock themselves.

B) James has dinner with Taylor and promises to provide Taylor with three weeks off in May to study for the CFA exam and offer some test-taking tips.

C) Taylor sends out a resume referring to himself as a Level II CFA candidate and indicating his intention to take the Level II test in June.

Explanation

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

(Study Session 1, Module 2.7, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #171 - 175 of 180

Question ID: 1207957

Which of the following statements about Montpier's analysis of Circuit Secrets is CORRECT?

A) If Montpier prepares a research report for all World Class clients recommending Circuit Secrets as a "buy," but does not reveal the nonpublic information, she has

B) Montpier could satisfy the requirements of Standard II(A)—Material Nonpublic Information by producing a research report on Circuit Secrets for Malaysian

C) Montpier’s best course of action is to initiate coverage of Circuit Secrets as a “hold,” and attempt to get the company to disclose the nonpublic information.

Explanation

Standard II(A) prohibits not only the revelation of nonpublic information, but also trading on the basis of that information. The buy rating itself is a product of the nonpublic information, and as such is a violation. Montpier must comply with the Code and Standards regardless of the laxness of regulations in her country. If Montpier believes the stock is a buy, initiating it as a hold would be inappropriate. Analysts cannot be expected to have a recommendation on every stock, so failing to recommend a potentially good stock is not a breach of fiduciary duty.

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #172 - 175 of 180

Question ID: 1207958

With regard to Standard VII(B)—Reference to CFA Institute, the CFA Designation, and the CFA Program:

A) neither Montpier nor Taylor is in compliance.

B) only Taylor is in compliance.

C) both Montpier and Taylor are in compliance.

Explanation

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

(Study Session 1, Module 2.10, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #173 - 175 of 180

Question ID: 1207959

Which of the following actions could Taylor take to ensure he is not in violation of Standard I(C)—Misrepresentation?

A) Initiate coverage of Immune Health Care and Remedy Corp. as holds, not strong buys, until he has time to do further research.

B) Base his report on information from Value Line and Standard & Poor's reports rather than research from rival analysts.

C) Just use excerpts from the original reports, rather than copying the whole reports.

Explanation

Value Line and Standard & Poor's are "recognized financial or statistical reporting services," and as such, can be used as the basis for reports without acknowledgment. Caveat: Those publications are copyrighted, and copying directly from them may be illegal in some circumstances, even if it does not technically violate the plagiarism Standard. Using excerpts is still plagiarism and changing the stock recommendation will not change that fact. It is unlikely that a Dutch research report would not be protected under U.S. copyright, and even if it were not, using the material without attribution still violates the Standard.

(Study Session 1, Module 2.2, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #174 - 175 of 180

Question ID: 1207960

Which of the following statements regarding Standard IV(A)—Loyalty to Employer is CORRECT?

A) By accepting compensation for his role in the medical study, Taylor is violating the Standard.

B) Despite getting written permission from her client to consult, Montpier is not in compliance with the Standard.

C) Neither Taylor nor Montpier is in violation of the Standard.

Explanation

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

(Study Session 1, Module 2.7, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #175 - 175 of 180

Question ID: 1207961

Taylor's actions regarding Breakthrough Corp.:

A) did not violate Standard I(D)—Misconduct because he did not misappropriate the information.

B) violate Standard II(A)—Material Nonpublic Information because the information was not in the public domain.

C) do not violate Standard II(A)—Material Nonpublic Information because he was only confirming what he already suspected.

Explanation

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

(Study Session 1, Module 2.3, LOS 2.a)

Related Material

SchweserNotes - Book 1

Question #176 of 180

Question ID: 1207938

Wanda Brunner, CFA, is reviewing a draft fund prospectus for her new "Leveraged Long Coffee" (LLC), a closed-end fund. LLC uses a of combination fundamental and technical trading models to evaluate individual securities. She notes the LLC prospectus has several disclosures which cause her to worry that prospective clients will avoid her fund.

> Disclosure 1: "LLC charges a flat 3.00% of assets under management."
> Disclosure 2: "LLC may invest up to 40% of the fund's assets in securities which are not related to coffee or other consumer products."
> Disclosure 3: "LLC relies only on fundamental valuation of individual securities."

Which of the following standards will *most likely* be violated by distribution of the prospectus?

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

B) Standard III(C) Duties to Clients: Suitability because the fees are exorbitant.

C) Standard III(C) Duties to Clients: Suitability because the fund can hold an excessive portion of the portfolio in non-core assets.

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.

(Study Session 1, Module 2.5, LOS 2: III(C))

Related Material

SchweserNotes - Book 1

Question #177 of 180

Question ID: 1207984

Karen Dalby, CFA, volunteers on her church's finance board but receives no cash compensation so she does not report the arrangement to her employer. Board compensation is limited to an annual retreat to Hawaii, but the accommodations are modest. Dalby does not enjoy the retreat and often considers skipping the event entirely. Dalby is *most likely*:

A) not in violation of the Code and Standards.

B) in violation of Standard IV(A) "Loyalty."

C) in violation of Standard IV(B) "Additional Compensation Arrangements."

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(B))

Related Material

SchweserNotes - Book 1

Question #178 of 180

Question ID: 1212372

Which of the following statements is *most correct* concerning a member's obligation to his or her employer under the Code and Standards?

A) Members are prohibited from making arrangements or preparations to go into competitive business before terminating their relationship with their employer.

B) Members are prohibited from undertaking independent practice in competition with their employer.

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

Explanation

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

(Study Session 1, Module 2.7, LOS 2: IV(A))

Related Material

SchweserNotes - Book 1

Question #179 of 180

Question ID: 1212399

In the process of recommending an investment, in order to comply with Standard V(A), Diligence and Reasonable Basis, a CFA Institute member must:

A) support a recommendation with appropriate research and investigation.

B) have a reasonable and adequate basis for the recommendation.

C) do both of these.

Explanation

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

(Study Session 1, Module 2.8, LOS 2: V(A))

Related Material

SchweserNotes - Book 1

Question #180 of 180

Question ID: 1212340

If the Chief Investment Officer of an investment advisory firm also is a CFA charterholder, which of the following statements is CORRECT?

A) All performance results that are presented must comply with the CFA Institute Global Investment Performance Standards.

B) The firm must comply with the CFA Institute Global Investment Performance Standards only if it states that it follows the Standards.

C) The firm must present an historical composite.

Explanation

Global Investment Performance Standards (GIPS) are the best way to comply with the Standard on performance presentation; however, adoption of GIPS is voluntary.

(Study Session 1, Module 2.6, LOS 2.b)

Related Material

SchweserNotes - Book 1