Question 1
L2ET-PQ0602-1506
LOS: LOS-5850
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: hard
An investment manager is very confident that the stock of a company is undervalued and buys the stock across a broad array of different accounts under their discretion. Which of the following statements regarding this behavior is *most likely* to be accurate?

- ○ The manager's actions are not in violation of the Standards.
- ◉ The manager is in violation of Standard III(C): Suitability.
- ○ The manager is in violation of Standard V(B): Communication with Clients.

Rationale

This Answer is Correct

Allocating an investment across a broad array of accounts is likely to be a violation of Standard III(C): Suitability. The manager should have considered clients' needs and circumstances prior to taking investment actions should establish a periodic review to occur at least annually to compare the suitability of investment actions taken for client accounts with their written investment policy statements.

Question 2
L2ET-TBB217-1412
LOS: LOS-5850
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: medium
Which of the following recommendations or actions is *least likely* to be in violation of Standard V(A): Diligence and Reasonable Basis?

- (selected) A strong buy recommendation on a stock that subsequently issues a profit warning causing a significant fall in share price and losses to any investors who followed the recommendation.
- A buy recommendation issued at the request of the investment banking division in order to boost demand for shares and ensure a successful IPO.
- A buy recommendation issued by an analyst under time pressure to meet research output targets.

Rationale

This Answer is Correct

Under Standard V(A), analysts must consider all applicable relevant factors for each investment recommendation. The second choice is likely to have breached the Standard, since the recommendation has been made at the request of the investment banking division. This will certainly also be a breach of Standard II(B): Independence and Objectivity. The third choice is likely to be a breach of Standard V(A), since time pressure and the need to meet research output targets will likely lead to recommendations being made where all applicable relevant factors have not been considered. The first choice is the best answer, since it is not necessarily the case that a recommendation that causes investors to lose money was one that did not consider all relevant factors at the time the recommendation was made.

Question 3
L2ET-PQ0401-1506
LOS: LOS-5810
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: hard

Peter Allen, CFA, has resigned his notice at his current firm and is working his notice period until he can start a similar role at a competitor. In his last few days at work, having gained his employer's consent, Allen collects together some news articles to take with him to his new job. The articles in question were used for research that was ultimately rejected by his current employer.

Do Allen's actions comply with the CFA Institute Standards of Professional Conduct?

- (selected) Yes
- No, because the research articles remain the property of his employer
- No, because the research articles were deemed unsuitable by his current employer

Rationale

This Answer is Correct

According to Standard IV(A)'Duties to Employer: Loyalty, employees must obtain permission to take with them to new employment any work or work product prepared in the course of the employee's employment or on behalf of the employer. Since Allen has consent in this case, he has the right to take the news articles. The fact that research based on the articles was rejected by his current employer is not relevant.

Question 4
L2ET-TB0024-1412
LOS: LOS-5810
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: medium
Joe Browne has recently resigned from his employment position and has taken a new role with a competitor of his current employer. Browne is aware that under Standard IV(A): Loyalty, he is obliged to refrain from taking any research completed for his current employer without permission. He also has a database of research ideas that were rejected by his current employer, and he decides to take this with him to his new employer. If Browne goes ahead with this decision, he will be:

- (selected) In violation of the standards since even rejected research ideas are the property of the firm.
- In accordance with the standards provided he discloses to his new firm that the research ideas were rejected at his previous employer.
- In accordance with the standards provided he gets prior permission from his new firm to use the rejected research ideas.

Rationale

This Answer is Correct

All research done at his current employer remains the property of the firm and not the individual. Even rejected research ideas could be used by the firm subsequent to the employee leaving if they review ideas that have already been considered and rejected by the firm.

Question 5
L2ET-TBB216-1412
LOS: LOS-5830
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: medium
Which of the following statements regarding the responsibility of members and candidates under Standard IV(C): Responsibilities of Supervisors is *most likely* to be accurate?

- (selected) Supervisors must take the necessary steps to monitor the actions of all investment professionals and enforce established policies and procedures.
- Compliance procedures should be designed preferably to detect violations of the standards rather than to prevent violations.
- Supervisors and managers must document compliance policies and make them available to all staff.

Rationale

This Answer is Correct

The first choice is a direct requirement of Standard IV(C). The second choice is incorrect since compliance procedures should be designed to prevent rather than simply uncover violations. The third choice is incorrect since supervisors and managers must document compliance policies and disseminate them to staff, rather than simply make them available to staff.

Question 6
L2ET-TB0027-1412
LOS: LOS-5850
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: medium
Which of the following policies is *least likely* to adhere to the recommendation of Standard VI(A): Disclosure of Conflicts?

- (selected) Portfolio managers should be prevented from serving as directors of companies in which they invest.
- Portfolio managers should disclose to their employer when they are serving as directors of companies in which they invest.
- Portfolio managers should request prior approval when they wish to serve as directors of companies in which they invest.

Rationale

This Answer is Correct

Standard IV(A): Disclosure of Conflicts requires that members and candidates inform their employers of any outside activities in which they are engaged or into which they propose to enter and receive approval for these activities prior to engaging in them.

Question 7
L2ET-PQ0601-1506
LOS: LOS-5850
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: hard
Brian Blade is a senior portfolio manager at a large investment firm. He becomes aware that his assistant, Peter Madden, has been engaging in the unethical practice of front running firm orders on his own personal account. While Blade is not formally the supervisor of Madden, he is, however, in a position of influence and control where he can hire, fire, reward, and punish Madden. Blade is unsurprised that unethical behavior has occurred since he was well aware that there were no systems and controls in place to monitor employee actions with regard to front running firm orders. Is Blade in violation of the Standards?

- (selected) Yes
- No, because he is not the formal supervisor of Madden
- No, provided he immediately suspends Madden and fully investigates his behavior

Rationale

This Answer is Correct

Generally, determining whether an individual has supervisory responsibilities depends on whether employees are subject to that individual's control or influence. In other words, does the individual have the authority, for example, to hire, fire, reward, and punish an employee? In this case, even though Madden does not report directly to Blade, we assume Blade supervises the actions of Madden of the firm. Therefore, he must comply with the Standard IV(C): Responsibilities of Supervisors. As a supervisor, Blade has a responsibility to take appropriate steps to prevent any violation by those he oversees of applicable statutes, regulations, or CFA Institute Standards.

Question 8
L2ET-TB0025-1412
LOS: LOS-5840
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: medium
According the Standard III(B): Fair Dealing, trade allocations should be made:

- ○ On a case-by-case basis.
- ◉ On a pro-rata basis.
- ○ On a suitability basis.

Rationale

This Answer is Correct

While the Code and Standards do not specify which allocation method a firm should use for allocating orders across multiple client accounts, they are clear in that the firm should have a well-defined policy designed to achieve fair dealing. The recommended method to achieve this is to allocate trades on a pro-rata basis.

Question 9
L2ET-TBX111-1502
LOS: LOS-5810
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: easy
Ben Lewin is an investment manager who is considering leaving his current employer and starting his own fund management business similar to his current job. He notifies his employer of his intention to leave in writing and begins to search for appropriate office space and draw up business plans in his spare time prior to his resignation becoming effective. Once his resignation becomes effective, he moves into a new office and begins recruiting staff. He contacts some of his old clients through a popular Internet networking platform and encourages them to do business with him at his new firm. Lewin has:

- (selected) Not violated the Standards.
- Violated the Standards by searching for office space and drawing up business plans prior to his resignation becoming effective.
- Violated the Standards by soliciting former clients at his new firm.

Rationale

This Answer is Correct

Making arrangements to engage in independent practice prior to resignation becoming effective is permissible as long as this does not involve the solicitation of the clients of the current employer. Once he has moved to his new firm, Lewin is free to contact his prior clients from publicly available information. He is not allowed to take client list information, which should remain the property of his previous employer.

Question 10
L2ET-TBB215-1412
LOS: LOS-5820
Lesson Reference: Lesson 1: Application of the Code and Standards
Difficulty: medium

Owen Johnson, CFA, has just begun his employment as a research analyst at the Fluid Investment Company. Fluid currently has no formal written policy on independent practice, and as a member of CFA Institute, Johnson encourages the firm to adopt the following policy statement:

"Employees shall not undertake any independent practice that could result in compensation or other benefit in competition with the firm unless they disclose the practice to the firm."

The policy statement is:

- ○ In compliance with the recommendations of Standard IV(A).
- ○ Not in compliance with the recommendations of Standard IV(A), since employees should obtain written permission from the firm before engaging in the independent practice.
- ◉ Not in compliance with the recommendations of Standard IV(A), since employees should obtain written permission from the firm and the entity for whom they undertake independent practice before engaging in the independence practice.

Rationale

This Answer is Correct

Standard IV(A) recommends that employees should obtain written permission from the firm and the entity for whom they undertake independent practice before engaging in the independence practice.