Question #1 of 144

Question ID: 1212293

Chuck Thomas is the trustee of a trust of which Jill Wyatt is the main beneficiary. Wyatt's husband is the president of a company. In emptying the recycling bin at home, Wyatt finds some papers that lead her to believe that her husband's company will make a tender offer to acquire another firm. Wyatt takes the information to Thomas, who uses it to purchase shares of the company for the trust, but does not further disclose the information. Thomas has:

A) not violated any Standards.

B) violated the Standards concerning material nonpublic information.

C) violated the Standards concerning loyalty, prudence, and care.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #2 of 144

Question ID: 1212310

Which of the following statements about a member's use of client brokerage commissions is NOT correct? Client brokerage commissions:

A) should be commensurate with the value of the brokerage and research services received.

B) may be directed to pay for the investment manager's operating expenses.

C) should be used by the member to ensure that fairness to the client is maintained.

Explanation

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

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

Related Material

SchweserNotes - Book 1

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Question #3 of 144

Question ID: 1152932

Which of the following statements about the CFA Institute Code and Standards is *most* accurate? The Code and Standards:

A) do not require that members report legal violations to the appropriate governmental or regulatory organization.

B) require members to persuade the perpetrator to cease illegal activities.

C) prohibit members from accepting gifts that create a conflict with their employer's interest.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #4 of 144

Question ID: 1212254

Which of the following is *least likely* to be a reason for imposing a suspension on a member or candidate?

A) Misdemeanor charge for possession of narcotics.

B) Failing to return the annual professional conduct statement.

C) Discussing a question from the CFA exams on social media.

Explanation

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

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(Study Session 1, Module 1.1, LOS 1.a)

Related Material

[SchweserNotes - Book 1]

Question #5 of 144

Question ID: 1152926

An analyst is allowed to trade on information that he has predicted, such as a corporate action or event, using perceptive assembly and analysis of material public information or nonmaterial, non-public information. This is called the:

A) mosaic theory.

B) deduction theory.

C) assessment theory.

Explanation

This deductive reasoning is legal (does not constitute trading with inside information) and is called the mosaic theory.

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

[SchweserNotes - Book 1]

Question #6 of 144

Question ID: 1212265

Jane Dawson, CFA, an analyst at a New York brokerage firm, suspects that Bob Boatman, CFA, another analyst at the same firm, has violated a state securities law. According to the CFA Institute Standards of Professional Conduct, Dawson is:

A) required to report the suspected violation to CFA Institute.

B) required to report the suspected violation to the appropriate state regulatory agency.

C) **NOT** required to report the violation to the appropriate governmental or regulatory organizations.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #7 of 144

Question ID: 1207877

When a firm seeks to allocate a disproportionate number of shares of a hot IPO to performance-based fee accounts this constitutes a violation of the Standard concerning:

A) additional compensation arrangements.

B) priority of transactions.

C) fiduciary duty.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #8 of 144

Question ID: 1212290

Greg Allen is a security analyst and visits David Dawson, the Chief Financial Officer of Edmonds Company. Dawson reveals a great deal of nonmaterial financial data to Allen, data that Dawson routinely reveals to all security analysts who visit him. From this data and other industry information, Allen conjectures that Edmonds is likely to make a tender offer for another company in the industry, a fact that if true would be considered material to the value of the company. Allen:

A) can publish his conclusion in a research report.

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B) must not disseminate the information or use it for trading purposes until the tender offer is announced.

C) should send a copy of the report to Dawson for verification before disseminating the report to clients.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #9 of 144

Question ID: 1207761

Marc Feldman, CFA, is manager of corporate investor relations for a high-tech startup, zippy.com, in Boise, Idaho. Feldman learns that Larry Smith, controller, is altering the accounting records. Knowing the data is incorrect, Feldman releases Smith's financial data to investors. This action:

A) constitutes a violation of his fundamental responsibilities under the Code and Standards.

B) constitutes a violation of Standard III(D) concerning performance presentation.

C) constitutes a violation of the Standard concerning duty to employer.

Explanation

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

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

Related Material

SchweserNotes - Book 1

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Question #10 of 144

Question ID: 1212257

Michael Malone, CFA, is an investment analyst for a large brokerage firm in New York who covers the airlines industry. After hours in his personal time, Malone maintains an online blog on which he expresses his personal opinions about various investment opportunities, including, but not limited to, the airlines industry. On his blog, he posts a very negative investment opinion about WestAir stock. Malone knows that WestAir's stock will be downgraded to a "sell" by his firm next week. Malone has *most likely* violated:

A) violated Standard IV(A) Loyalty.

B) Standard VI(B) Priority of Transactions.

C) violated Standard II(A) Material Nonpublic Information.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.b)

Related Material

SchweserNotes - Book 1

Question #11 of 144

Question ID: 1207823

Greg Allen is a security analyst and visits David Dawson, the Chief Financial Officer of Edmonds Company. Dawson reveals a great deal of nonmaterial financial data to Allen, data that Dawson routinely reveals to all security analysts who visit him. From this data and other industry information, Allen conjectures that Edmonds is likely to make a tender offer for another company in the industry, a fact that if true would be considered material to the value of the company. Allen:

A) should send a copy of the report to Dawson for verification before disseminating the report to clients.

B) can publish his conclusion in a research report.

C) must not disseminate the information or use it for trading purposes until the tender offer is announced.

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Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #12 of 144

Question ID: 1207860

Jordan Conomos is the new trustee for the Grant Trust, which has both current beneficiaries and remaindermen. Up until now, the trust has been entirely invested in long-term tax-free municipal bonds. Conomos decides to put 30 percent of the assets in common stocks, with the justification that taxes should be the concern of the trust beneficiaries and not the trust, and the trust needs some diversification and growth. Conomos is:

A) violating his fiduciary duty by not investing solely for the purposes of the current beneficiaries.

B) violating his fiduciary duty by not considering taxes.

C) not violating his fiduciary duty.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #13 of 144

Question ID: 1207861

All of the following would be effective components of a formal compliance system EXCEPT:

A) as a fiduciary under ERISA, the firm will strictly follow pension plan instructions and restrictions, which may include concentrating portfolios in a few securities

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B) the investor's objectives and constraints should be maintained and reviewed periodically to reflect any changes in the client's circumstances.

C) the firm prohibits analysts and portfolio managers from using material nonpublic information in making investment recommendations or taking

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #14 of 144

Question ID: 1212269

If an analyst suspects a client or a colleague of planning or engaging in ongoing illegal activities, which of the statements about the actions that the analyst should take is *most correct*? According to the CFA Institute Standards of Professional Conduct, the analyst should:

A) consult counsel to determine the legality of the activity.

B) consult counsel to determine the legality of the activity and disassociate from any illegal or unethical activity if the member has reasonable grounds to believe

C) disassociate from any illegal or unethical activity if the member has reasonable grounds to believe that the activity is illegal or unethical.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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Question #15 of 144

Question ID: 1207826

Jim Kent is an individual investment advisor in San Francisco with 300 clients. Kent uses open-ended mutual funds to implement his investment policy. For most of his clients, Kent has used the Baker fund, a small company growth fund based in Boston, for a portion of their portfolio. As a result he has become very friendly with Keith Dunston, the manager of the fund, whom Kent feels is mainly responsible for Baker's performance. One day Dunston calls Kent and tells him that he will be leaving the fund in four weeks and moving to San Francisco to work for a different money management company. Dunston is seeking suggestions on housing in the area. Baker has not yet announced Dunston's departure. Kent immediately finds a fund that is a suitable replacement for the Baker fund, and over the next two days he calls his 30 clients with the largest dollar investments in the funds and tells them he feels they should switch their holdings. Baker feels the remaining clients' positions are small enough to wait for their annual review to switch funds. Kent has:

A) violated the Standards by not dealing fairly with clients and regarding material nonpublic information.

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

C) violated the Standards regarding nonpublic information but has not violated the Standards in failing to deal fairly with clients.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #16 of 144

Question ID: 1212300

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Don Benjamin, CFA, is the compliance officer for a large brokerage firm. He wants to prevent the communication of material nonpublic information and other sensitive information from his firm's investment banking and corporate finance departments to its sales and research departments. The most common and widespread approach that Benjamin can use to prevent insider trading by employees is the:

A) fire wall.

B) Wall Street Rule.

C) legal list.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #17 of 144

Question ID: 1207793

A government committee has concluded that investment company fees should be disclosed to clients each quarter and has proposed new legislation to require this. Currently, the legal requirement is to report such data annually. In compliance with current legal requirements, Dolphin Investments discloses its fees annually. Eugene Shin, CFA, Dolphin's compliance officer, learns of the proposed changes but does not convert Dolphin's reporting to a quarterly basis. Shin's decision not to act:

A) constitutes professional misconduct as defined in the Code and Standards.

B) is a violation of his duty to employer as defined in the Code and Standards.

C) is not a violation of the Code and Standards.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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Question #18 of 144

Question ID: 1212314

Paul Drake is employed by a company to provide investment advice to participants in the firm's 401(k) plan. Company stock is one of the investment options in the plan. Drake feels that the stock is too risky for employees to own in their 401(k) plan and starts advising them to pull out of the stock. The Treasurer of the company calls Drake and tells him that he will be fired if he continues making such advice because he is violating his fiduciary duty to the company. Drake should:

A) make sell recommendations but point out that the company Treasurer has a differing and valid point of view.

B) tell employees that he cannot provide advice on company stock because of a conflict of interest.

C) continue to advise employees to sell their stock.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #19 of 144

Question ID: 1212244

In dealing with the public and others, the CFA Institute Code of Ethics requires that CFA Institute members act with:

A) candor, skill, and honor.

B) integrity, competence, and respect.

C) honesty, professionalism, and high ethical standards.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

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Question #20 of 144

Question ID: 1212284

Joshua Rosenberg, CFA, is an equity analyst who covers Northwest Implements, a farm implement manufacturer. Northwest's main factory is located in a sparsely inhabited region six hours by automobile from the nearest airport. Northwest has its own corporate jet and a landing strip is located near the facility. When Rosenberg contacts Northwest's management to gather information for a report he is preparing on the company, Northwest's chief financial officer, Thomas Blake, invites Rosenberg to visit Northwest's headquarters and meet with management. Blake offers to send Northwest's corporate jet to pick up Rosenberg from an airport near Rosenberg's home and to return him home the same evening. Rosenberg estimates that it would require three days for him to make the visit using commercial travel. If Rosenberg accepts Blake's offer and makes the trip to Northwest's headquarters on the corporate jet, Rosenberg:

A) has violated the Code and Standards unless he discloses the trip and the payment of his travel expenses in his report on Northwest.

B) has not violated the Code and Standards.

C) has violated the Code and Standards unless he reimburses Northwest for the cost of the trip.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(B))

Related Material

SchweserNotes - Book 1

Question #21 of 144

Question ID: 1212288

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Rachel Young, CFA, is making preparations to start a competitive business before terminating her relationship with her employer, a large money management company. Young asks Dot Wiggins, a colleague, to consider joining her. In subsequent discussions with Young, Wiggins learns that Young has used excerpts from research reports by others with only a slight change in wording without acknowledging the source. According to CFA Institute Standards of Professional Conduct, Young has:

A) violated Standard IV(A) Loyalty, because she was making preparations to start a competitive business before terminating her relationship with her employer.

B) not violated the Standards.

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

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #22 of 144

Question ID: 1212309

Mark Williamson is "bearish" on ABC Manufacturing Company. Williamson is so convinced that ABC is overpriced, two weeks ago, he shorted 100,000 shares. Today, Williamson is "surfing" several popular investment bulletin boards on the internet and posting false derogatory comments about company management. According to Standard II(B), Market Manipulation, Williamson has engaged in:

A) both transaction-based manipulation and information-based manipulation.

B) transaction-based manipulation, but not information-based manipulation.

C) information-based manipulation, but not transaction-based manipulation.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(B))

Related Material

SchweserNotes - Book 1

Question #23 of 144

Question ID: 1212307

Regarding non-public information, which one of the following statements is *NOT* correct?

A) Disclosing material non-public information would have an impact on the price of a security or be of interest to a reasonable investor.

B) An analyst may use some types of non-public information.

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

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #24 of 144

Question ID: 1207873

Tony Calaveccio, CFA, is the manager of the TrustCo Small Cap Venture Fund in Toronto. He places trades for the fund with Canadian Brokerage. Canadian provides Calaveccio with soft dollars to purchase research. He uses these soft dollars to get research reports from Canadian's research department regarding the issues currently held in the small cap portfolio, and also for firms he is contemplating adding to the portfolio. By using soft dollars in this manner, Calaveccio has:

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A) violated the Code and Standards by acquiring research on issues that the fund already holds but not by acquiring research on issues contemplated for

B) not violated the Code and Standards.

C) violated the Code and Standards by acquiring research on issues contemplated for purchase but not by acquiring research on currently held issues.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #25 of 144

Question ID: 1152933

A CFA Institute member works for Secure Securities, Inc., and plays rugby on the firm's rugby team. Secure Securities' team recently played the team of a rival firm. During the game, a fight broke out and the CFA Institute member was the instigator, but no one was seriously hurt. Is this a violation of I(A) concerning maintaining knowledge and complying with laws, rules, and regulations?

A) Yes, because the member is bound by the Code of Ethics.

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

C) Yes, because the member could have hurt someone in the fight.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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Question #26 of 144

Question ID: 1152964

The CFA Institute Code of Ethics *least likely* requires a Member or Candidate to:

A) Strive to maintain and improve the competence of others in the profession.

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

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

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Hunter Harrison, CFA, is president and chief investment officer (CIO) of Ironclad Investments, an investment adviser and pension consultant for medium and large corporate pension clients. Ironclad recently hired a compliance officer to update its compliance manual, which follows the CFA Institute Code and Standards. Harrison serves as a director on several non-profit and corporate boards of directors, some of which have their pension assets managed by Ironclad. Harrison oversees Ironclad's research analysts and portfolio managers, including Michelle Myers, who passed Level II of the CFA examination last year and plans to sign up for next year's Level III exam as soon as registration opens. Myers is a portfolio manager who regularly meets with clients and prospects. Myers is also a partner in a software company that sells retirement and benefit administration services to institutional clients, some of which are also clients of Ironclad. During her correspondence with prospects and clients, Myers includes reference to her status as a "Level III CFA candidate" in her biographical background to increase her prominence in the industry.

Question #27 - 32 of 144

Question ID: 1207845

Regarding Myers' references of her status as a candidate in the CFA program, what Standard governs these actions and is she in compliance?

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

B) Standard III: Duties to Clients. **Compliance**: No.

C) Standard I: Professionalism. **Compliance**: No.

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Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #28 - 32 of 144

Question ID: 1207846

All of the following *most likely* apply to Myers' participation as a partner in the software company EXCEPT:

A) Standard VI(B) - Priority of Transactions.

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

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

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #29 - 32 of 144

Question ID: 1207847

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As part of Ironclad's portfolio management activities on behalf of clients, Harrison and Myers maintain relationships with third party soft dollar providers and commission recapture brokers.

- Better Trading Brokerage ("Better Trading"), one of Ironclad's top ten brokers and soft dollar providers, has offered Harrison two round-trip airline tickets anywhere in the U.S. in appreciation for their two-year relationship with Ironclad.
- One of Harrison's clients, Worldwind Travel ("Worldwind"), who participates in commission recapture, has offered Harrison two round-trip airline tickets anywhere in the U.S. or Europe in appreciation for their two-year relationship with Ironclad.

Which of the following *best* describes Harrison's actions under the Code and Standards? Harrison:

A) cannot accept the offer from either Better Trading or Worldwind.

B) can accept the offer from Worldwind, but cannot accept the offer from Better Trading.

C) can accept the offer from both Better Trading and Worldwind.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Mahakali Book Center
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Question #30 - 32 of 144

Question ID: 1207848

Myers has disclosed her partnership interest in the software company to Harrison, including the potential for additional compensation and the possible conflicts of interest.

- One of Myers' software clients, Breakthrough Pharmaceuticals ("Breakthrough"), is a publicly-traded corporation that is also held in portfolios of Ironclad's clients. In the course of their business relationship, Breakthrough's chief executive officer (CEO) informs Myers that the company has been experiencing problems making retirement benefit payments, and its pension plan has recently gone from "overfunded" to "significantly underfunded" as a result of market conditions.
- Breakthrough's CEO indicates to Myers that he is attempting to source additional short-term financing to make retiree benefit payments and will disclose the significant "underfunded status" of the pension plan in the upcoming financial statements.
- Myers, concerned about Ironclad clients holding stock of Breakthrough given the impact on earnings from the current pension troubles and short-term liquidity issues, informs Harrison of the impending disclosure.
- Ironclad sells 1,800,000 shares of Breakthrough for clients, causing the price to drop $4 per share.
- Upon disclosure of the pension troubles, Breakthrough's stock dropped 18%.

According to Standard II—Integrity of Capital Markets, Myers has:

A) not violated the Standard since the information shared with Harrison was used to fulfill Ironclad's fiduciary duty to avoid significant losses.

B) violated the Standard.

C) not violated the Standard by sharing information with Harrison because the information did not involve a tender offer.

Explanation

Although the information shared by Myers may have helped Ironclad's clients avoid losses in shares of Breakthrough, the information was material nonpublic information. In this example, Myers' software company owes a duty of loyal and confidentiality to Breakthrough. Information is "material" if its disclosure would have an impact on the stock or if a reasonable investor would want to know the information prior to making an investment decision. Material is "nonpublic" until it has been generally disseminated to the marketplace and investors have had an opportunity to react to the information. The information about Breakthrough's pension difficulties was both material and nonpublic, as the stock dropped significantly upon disclosure of the information in the market. Therefore, Myers had a duty to keep the information confidential and not to trade, or cause others to trade, on the information.

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

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Question #31 - 32 of 144

Question ID: 1207849

Ironclad owns shares in several research and technology companies, including approximately 4% of the outstanding shares of Advanced DSL ("Advanced"), Internet Connections ("Internet"), and approximately 6% of the outstanding shares of Speedy Chip Technology ("Speedy Chip") and Wavelength Digital ("Wavelength").

- Harrison serves on the board of directors for Internet and Wavelength, while Myers provides consulting services for Speedy Chip. Harrison receives cash compensation and stock options for his services, while Myers receives restricted stock and stock options.
- The investment bank that led the public offering of Internet and Speedy Chip and seven of nine sell-side analysts covering the companies have "sell" ratings on the stocks. Ironclad's analysts have also issued "sell" recommendations on the companies due to lack of earnings transparency and quality of earnings, among other issues.
- Harrison increases his position in both Internet and Wavelength citing "growth opportunities" and "consensus opinion."

Which of the following Standards were *least likely* violated by Harrison and Myers?

A) Standard IV(B)—Additional Compensation Arrangements.

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

C) Standard III(A)—Loyalty, Prudence, and Care.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Mahakali Book Center
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Question #32 - 32 of 144

Question ID: 1207850

Harrison, as CIO, is chairman of Ironclad's proxy voting committee, while Myers is a voting member. Ironclad, as a discretionary investment manager, votes proxies on behalf of clients.

- Ironclad is currently reviewing proxies for several companies covered in research, including technology companies Advanced DSL ("Advanced"), Internet Connections ("Internet"), Speedy Chip Technology ("Speedy Chip") and Wavelength Digital ("Wavelength"), which have all presented the expensing of employee stock options for vote in their current proxies.
- Investment personnel of Ironclad recently participated in an industry forum in support of increased disclosure for company stock options, which Ironclad believes provides investors with a more accurate perspective of corporate earnings.
- Contrary to committee consensus, Harrison and Myers vote client proxies "against" the expensing of employee stock options for Internet, Wavelength and Speedy Chip.

All of the following describe Harrison's actions for compliance with the Code and Standards regarding proxy voting EXCEPT:

A) Harrison should vote in accordance with Ironclad’s policy and coordinate major proxy issues across all client accounts.

B) Harrison should maintain the confidentiality of voting information on behalf of Ironclad’s clients.

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

Explanation

Proxy voting is a plan asset under ERISA and as such, is subject to the fiduciary duty obligations. Ironclad, as a discretionary investment manager, is responsible (unless otherwise stipulated in the client guidelines or agreement) for making informed and reasonable decisions regarding proxy voting on behalf of clients. Among other things, Ironclad should have a proxy voting policy and a process for identifying and reviewing major proxy issues for appropriate clients. Ironclad and Harrison also have an obligation to avoid conflicts of interest when voting proxies. Although Harrison has a conflict of interest in voting issues on behalf of Internet and Wavelength due to his role on their board of directors, proxies should not be discarded under any circumstances, as such action would constitute a breach of fiduciary duty. Harrison should abstain from voting on matters affecting Internet and Wavelength to avoid the appearance of a conflict of interest. Harrison should also ensure proper treatment of any confidential information received in his role on the respective boards of directors. Harrison should maintain confidentiality of voting information on behalf of clients and follow Ironclad's proxy voting policy, coordinating major proxy voting issues across all client accounts.

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

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Question #33 of 144

Question ID: 1212274

Michael Bellow, CFA, CAIA, is an investment banker who is involved with an initial public offering (IPO) of NewCo. Because this is Bellow's first involvement in an IPO, he reports to an experienced supervisor. While reviewing past financial statements provided by NewCo, Bellow suspects that NewCo deliberately overstated its earnings for the past several quarters. Bellow seeks the advice of his firm's highly competent general counsel and follows the advice given without deviation. Based on the general counsel's advice, Bellow consults his immediate supervisor about the suspected overstatement of earnings. After reviewing the situation, Bellow's supervisor explains why NewCo's calculations of its earnings are correct. Bellow realizes that his inexperience and exuberance initially led him to an incorrect conclusion about NewCo's earnings.

Which of the following statements about Bellow's actions involving Standard I(A), Knowledge of the law, and Standard I(C), Misrepresentation, is CORRECT? Bellow:

A) violated Standard I(A) but did not violate Standard I(C).

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

C) violated both Standard I(A) and Standard I(C).

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #34 of 144

Question ID: 1212242

Which of the following is NOT part of the CFA Institute Code of Ethics?

A) Competence.

B) Contractual provisions.

C) Independent judgment.

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Explanation

Contractual provisions are not part of the Code of Ethics.

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #35 of 144

Question ID: 1212297

Which of the following statements regarding Standard II(A), Material, Nonpublic Information, is *least* accurate?

A) If you receive the information in a public forum, it has been disseminated, and you can trade on it.

B) Information received from an insider who is not breaching his fiduciary responsibility may be traded on.

C) Material, non-public information regarding a tender offer may not be traded on.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #36 of 144

Question ID: 1212252

Which of the following is a component of the Code of Ethics?

A) Members shall not engage in any professional conduct involving dishonesty, fraud, deceit, or misrepresentation or commit any act that reflects adversely on

B) Members shall use reasonable care and exercise independent professional judgment.

C) Members shall not knowingly participate or assist in any violation of such laws, rules, or regulations.

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Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #37 of 144

Question ID: 1212306

Klaus Gerber, CFA, is a regular contributor to the Internet site WizeGuy. This past week Gerber has been incorrectly quoted as recommending that investors buy shares in Bradford, Inc. He is unaware that this message has been placed on the site as the quote was placed as a prank by an unknown source. This is the third time this has happened over the past month and each time the stock being mentioned moved in price according to the buy or sell recommendation.

Fritz Fox, CFA, maintains and updates the WizeGuy site and has learned how to determine if the quotes being attributed to Gerber are actually valid. Several days later, he observes an investment recommendation, posted on the site, to buy Gresham, Inc. The investment recommendation is purported to be from Gerber, but Fox actually knows it to be bogus. He immediately sells 1,000 Gresham short and e-mails Gerber to inform him of the bogus recommendation. Gerber immediately issues a rebuttal, and Gresham falls by 14%. Fox's action is:

A) not in violation of the Code and Standards.

B) a violation of the Standard concerning fiduciary duties.

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

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

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Question #38 of 144

A stockbroker who is a CFA Institute member is called on the telephone by the CEO of a large company. The CEO asks to buy shares of the CEO's company for the accounts of the CEO's children. In the course of the conversation, the CEO says this will really pay off when the upcoming takeover goes through. The stockbroker checks her sources and finds no information about the takeover. In this case the broker should:

A) do neither of the actions listed here.

B) only execute the order in compliance with Standard III(A), Loyalty, Prudence, and Care. Since the client is buying the stock for the children, there is not a problem.

C) execute the order for all clients as required by Standard III(B), Fair Dealing.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

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

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

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

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analysts who cover IMed. In addition, Hunt, a portfolio manager at Primary Pensions, a major institutional investor, has told Lance she will also be on the call. Primary Pensions has accumulated the largest single holding in IMed equity.

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

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

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

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

Question #39 - 44 of 144

Question ID: 1207765

What Standard governs Lance's response to Cunningham's question and is he in compliance?

	Standard	Compliance
A)	I: Professionalism	Yes
B)	VII: Responsibilities as a CFA	
C)	III: Duties to Clients	No

Explanation

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

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

Related Material

SchweserNotes - Book 1

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Question #40 - 44 of 144

Question ID: 1207766

Hunt's concerns about IMed increased after her dinner with Cunningham and Lance. She believes that Lance would have told them if IMed's earnings would meet analysts' expectations. She is convinced that Lance's failure to "look her in the eye" when he answered Cunningham's question confirms her suspicions that IMed is in trouble and is determined to start selling Primary Pensions' shares of IMed first thing in the morning.

Based on her conclusions from the dinner with Lance and Cunningham, which of the following *best* describes the actions Hunt should take regarding IMed?

A) Hunt can sell the IMed shares in the Primary Pensions' portfolio but cannot encourage her mother to sell the investment club's shares. ✗

B) Hunt can both tell her mother to sell the investment club's shares of IMed and sell the shares in the Primary Pensions' portfolio. ✗

C) Hunt cannot sell IMed and cannot encourage others to sell IMed. ✓

Explanation

According to Standard V(A), Diligence and Reasonable Basis, Hunt is required to exercise diligence and thoroughness in taking investment actions and she is required to have a reasonable and adequate basis, supported by appropriate research and investigation, for such actions. Her conclusions about Lance's response and actions during the dinner do not constitute a reasonable and adequate basis for selling IMed shares from Primary Pensions' portfolio.

In addition, even if Hunt were to reach the same conclusion after developing a reasonable basis for selling IMed shares, she would be able to sell Primary Pensions' share of IMed but would be prohibited under Standard VI(B), Priority of Transactions, from telling her mother and encouraging her to sell the investment club's shares until after she sells the shares in the Primary Pensions portfolio. Members must ensure that transactions for clients and employers have priority over transactions in securities or other investments of which a member is a beneficial owner so that such personal transactions do not operate adversely to their clients' or employer's interests. Hunt's relationship to her mother could reasonably be assumed to constitute an "indirect" interest in the investment club's securities.

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

Related Material

SchweserNotes - Book 1

Question #41 - 44 of 144

Question ID: 1207767

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If Lance had disclosed material that was nonpublic information about the decline of sales of Mediplex and its effect on IMed's earnings, Cunningham would have been *least likely* to be obligated to do which of the following?

A) Not trade in shares of IMed.

B) Make reasonable efforts to achieve public dissemination of material nonpublic information disclosed in a breach of duty.

C) Inform the appropriate regulatory authority that Lance had violated securities laws.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #42 - 44 of 144

Question ID: 1207768

Dinners with Lance, Cunningham and Hunt at Cunningham's exclusive country club usually cost more than $200 per person. When he and Lance worked for the same broker-dealer and Hunt was a client, Cunningham has always paid the bill.

Which Standard will Lance violate if he continues to allow Cunningham to pay for dinner?

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

B) Standard III(B), Fair Dealing.

C) Standard IV(B), Additional Compensation Arrangements.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #43 - 44 of 144

Question ID: 1207769

Cunningham arrives in his office early on the day of the conference call. He has conducted an extensive analysis of IMed's financial statements and has reviewed his assessment of Lance's conclusions in the report that Lance issued before his departure. He regrets having asked Lance about IMed's earnings at the previous night's dinner and decides to ask Lance some very pointed questions in public during the conference call, especially regarding Lance's inclusion of some significant non-recurring gains in operating income. Based on his own knowledge and experience, Cunningham doesn't believe that Lance's target price for IMed would be sustained. He decides that, if he doesn't get clear answers to his questions on the call, he will recommend to client's in his research report that IMed's rating drop to "hold". Cunningham's research report and recommendation is sent to all of his firm's clients and is not directed to a specific client.

In conducting his analysis and developing his recommendation, which of the following requirements of Standard V, Investment Analysis, Recommendations and Actions, would Cunningham *least likely* be concerned with?

A) Consider the appropriateness and suitability of investment recommendations for each client.

B) Clearly differentiate fact from opinion in making recommendations.

C) Exercise diligence and thoroughness in making investment recommendations.

Explanation

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The research report and recommendation prepared by Cunningham is sent to all relevant clients of the broker-dealer and is not directed toward a particular client or portfolio. In simple terms, Cunningham's responsibility is to develop a forecast of IMed's share price and to make a general recommendation to buy, sell, or hold shares of IMed based on the difference between the current market price and his forecast. Cunningham does not interact with individual clients and is not making a specific recommendation to a client to take an investment action. He is not expected to have knowledge of the risk and return objectives, portfolio holdings or unique circumstances and constraints of individual clients. Therefore, he does not have a responsibility to consider the suitability of his recommendation for each client of the firm. Cunningham's research report should contain sufficient information so that individual clients and their investment advisors can judge the appropriateness and suitability to the client's particular situation.

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

Related Material

SchweserNotes - Book 1

Question #44 - 44 of 144

Question ID: 1207770

Lance is very nervous before the conference call. Norton, IMed's president, has told him that he must not disclose the decline in sales of Mediplex.

During the call, Hunt asks Lance whether the rumors of the side effects of Mediplex are true and whether these rumors have negatively impacted sales. Lance assures Hunt that Mediplex sales are strong and that IMed is confident that sales will continue to rise for the remainder of the year.

Which of the following *best* describes Lance's actions when he stated that sales of Mediplex were strong?

A) Lance violated Standard I(D), Misconduct. ✓

B) Lance complied with Standard IV(A), Loyalty to Employer. ✗

C) Lance violated Standard III(B), Fair Dealing. ✗

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #45 of 144

Question ID: 1212289

Dick Charles is a security analyst with a large brokerage company. Sean Donaldson is a money manager. They both listen in on a conference call for security analysts with the president of Stoppard, Inc., who states that in two days the company will be holding a press conference announcing a new product. Both Charles and Donaldson feel the news will increase the value of Stoppard.

A) Charles must wait until after the press conference to disseminate the information to clients, and Donaldson must wait until after the press conference

B) Charles can disseminate the information to clients, and Donaldson can purchase the stock for his clients immediately.

C) Charles must wait until after the press conference to disseminate the information to clients, but Donaldson can purchase the stock for his clients

Explanation

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

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

Related Material

SchweserNotes - Book 1

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Question #46 of 144

Question ID: 1152913

An analyst has been writing research reports on a company for many years. As part of the analyst's continuing research efforts, the analyst allows the firm to fly him to the firm's headquarters and put him up in the guest quarters the company has for all corporate visitors. According to Standard I(B), Independence and Objectivity, this is:

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

B) a violation no matter what the circumstances.

C) not a violation under any circumstances.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(B))

Related Material

SchweserNotes - Book 1

Question #47 of 144

Question ID: 1212250

According to the CFA Institute Code of Ethics, CFA Institute members shall:

A) maintain knowledge and comply with all applicable laws, rules and regulations.

B) preserve the confidentiality of information communicated by clients, prospects, or employers concerning investment matters.

C) act with integrity, competence, diligence, respect, and in an ethical manner when dealing with the public, clients, prospective clients, employers, employees,

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

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Question #48 of 144

Question ID: 1207759

The Code of Ethics does *NOT* explicitly say that a CFA Institute member shall do which of the following?

A) Act with integrity.

B) Exercise independent professional judgment.

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

Explanation

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

(Study Session 1, Module 1.1, LOS 1.b)

Related Material

SchweserNotes - Book 1

Question #49 of 144

Question ID: 1207822

Steve Wynn, CFA, is an investment advisor and Jennifer Carey has been a client of his for three years. Carey has shown an interest in international stocks, so they agree to consider putting a portion of Carey's portfolio in foreign stocks. Wynn makes sure that Carey is aware of the currency and political risks inherent in foreign investing before proceeding. They jointly agree to purchase a small portfolio of stocks in the country of Bellagio because one of the brokerage houses that Wynn uses has a great deal of fundamental research on companies domiciled there. Six months later it is revealed in the news media that Bellagio has had severe insider trading problems which have contributed to the loss on the portfolio. Wynn has:

A) not violated the Standards.

B) violated the Standards by not informing Carey about the insider trading risks and contributing to the problem of insider trading.

C) violated the Standards by not informing Carey about the insider trading risks, but not by contributing to the problem of insider trading.

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Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #50 of 144

Question ID: 1212278

Sometimes a CFA Institute member simply *feels* a law has been violated by his firm, and sometimes the member *knows* a law has been violated. Which of the following pairs of guidelines is CORRECT with respect to the first step a member should take in each case? The member should first contact:

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

B) the firm's counsel if he feels a law has been violated and the SEC if he knows a law has been violated.

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

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #51 of 144

Question ID: 1207855

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Perley & Sons is an investment advisor company that just signed a contract with full discretionary power for the management of assets for Bright Future, a charitable fund. Without consultation, portfolio manager Martin Brown, CFA, decides to trade the funds' assets through a brokerage firm that provides, as an additional benefit, research reports for companies in the microchip industry. These companies represent the main investment interest for most of the Perley & Sons clients. The Bright Future portfolio does not hold any equities in the microchip industry, and, because of its risk profile, is unlikely to ever do so. Which of the following activities represents a possible breach with the CFA Institute standards?

A) Lack of action in consulting with the client before choosing the brokerage firm.

B) Accepting research reports from the brokerage firm that do not benefit client portfolios.

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

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #52 of 144

Question ID: 1207811

Brenda Clark is an investment advisor. Two years ago Clark decided to stop calculating a return composite because of the time required to make those calculations. A prospective client asks Clark what she thinks her performance would have been over the past two years. Clark:

A) cannot answer the question, nor can she discuss potential future market returns with the prospective client.

B) can answer the question orally but cannot state the numbers in writing.

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

Explanation

Any discussion of past performance would imply that Clark had made some calculations, which would be misleading. However, Clark need not calculate historical performance to be an advisor. She can also talk about her view on the future of capital markets.

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

Related Material

SchweserNotes - Book 1

Question #53 of 144

Question ID: 1212263

According to the CFA Institute Standards of Professional Conduct, Standard I(A), Knowledge of the Law, members shall not knowingly participate or assist in any violations of laws, rules, or regulations. An analyst:

A) is held responsible for participating in illegal acts when the law is evident to anyone knowing the law and is held responsible for violations by others when

B) must report all legal violations to the proper regulatory commission and is held responsible for participating in illegal acts when the law is evident to anyone

C) is held responsible for participating in illegal acts when the law is evident to anyone knowing the law and can participate in a violation by having knowledge

Explanation

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

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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Question #54 of 144

Question ID: 1152912

John Elliot, CFA, says that in issues of ethics he always puts the clients first according to the guidelines in the *Code of Ethics*. In doing so he is:

A) not correct, because no such ordering or priority is given in the Code.

B) correct.

C) not correct, because his first duty is to the public.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.b)

Related Material

SchweserNotes - Book 1

Question #55 of 144

Question ID: 1212313

Brenda Simone is a money manager and the Blue Streets Pension Fund is one of her clients. The director of the pension fund calls Simone and asks her to use a particular broker so that the fund can obtain some research services with the soft dollars from that broker. Simone believes that the desired broker will provide the same price and execution as the normal broker that Simone uses. Simone does as the client wishes. Simone has:

A) not violated the Standards as long as the research provided by the broker will benefit the plan beneficiaries.

B) not violated the Standards as long as the research provided by the broker will benefit Blue Streets.

C) violated the Standards.

Explanation

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

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

Related Material

SchweserNotes - Book 1

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Question #56 of 144

Question ID: 1207763

Harold Klein, CFA, is an expert on ethical conduct in the investment banking industry and has been asked by an association of investment bankers to give a presentation on interpreting codes of ethics and standards of practice such as the *CFA Institute Code of Ethics and Standards of Professional Conduct*. In his presentation, Klein makes two key points:

1. Sound ethical judgment requires careful and thoughtful application of ethical standards which are precise and exacting in nature
2. An ethical professional must begin the ethical decision making process by determining the applicable code and standards that govern the situation.

Determine whether Klein's statements are correct or incorrect and state your conclusion.

	Statement 1	Statement 2	
A)	Incorrect	Incorrect	✗
B)	Incorrect	Correct	✓
C)	Correct	Correct	✗

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #57 of 144

Question ID: 1207762

Marc Feldman, CFA, is manager of corporate investor relations for a high-tech startup, zippy.com, in Boise, Idaho. Feldman learns that Larry Smith, controller, is altering the accounting records. He decides that any ramifications from such activity is Smith's problem and does not report this fact. According to the *CFA Institute Code and Standards* he should or is required to do all of the following EXCEPT:

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A) urge Smith to cease altering the accounting records.

B) report the activity to the FASB or other relevant regulatory body.

C) determine legality, consulting counsel if necessary.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #58 of 144

Question ID: 1212275

The CFA Institute Standards of Practice Handbook requires CFA Institute members to do all the following EXCEPT:

A) receive written permission from both their employer and outside clients to engage in investment consulting outside the firm.

B) to inform employer, clients, and potential clients of benefits received for recommending products or services.

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

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #59 of 144

Question ID: 1207760

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According to the Standards of Professional Conduct, investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner. This concept is most directly addressed in:

A) Standard VI, Conflicts of Interest

B) Standard I, Professionalism

C) Standard V, Investment Analysis, Recommendations, and Actions

Explanation

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

(Study Session 1, Module 1.1, LOS 1.b)

Related Material

SchweserNotes - Book 1

Question #60 of 144

Question ID: 1212249

Which of the following is a component of the Code of Ethics?

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

B) Transactions for clients and employers have priority over transactions in which a member or candidate is the beneficial owner.

C) Members and candidates must not engage in conduct that compromises the integrity of the CFA designation or the security of the CFA examinations.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #61 of 144

Question ID: 1212316

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Member compliance on issues relating to corporate governance or to soft dollars is primarily addressed by the Standard concerning:

A) Disclosure of Conflicts to Clients and Prospects.

B) Loyalty, Prudence, and Care.

C) Disclosure of Referral Fees.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #62 of 144

Question ID: 1212311

Jack Stevens is employed by a company to provide investment advice to participants in the firm's 401(k) plan. One of the investment options is a stable value fund run by the company. Stevens' research indicates that the fund is far riskier and less liquid than the typical stable value fund and has a fundamental asset value lower than the book value of the assets. He tells Jessica Cox, the head of employee benefits, about his research, and indicates that he will advise new employees to not invest in the fund and will advise employees who already own the fund to reduce their holdings in the fund. Cox points out that the fund is not in any current danger because there are very few redemptions requested of the fund. Cox also states that a sell recommendation may become a self fulfilling prophecy, causing investors to redeem their shares and forcing the fund to liquidate, which in turn will cause the remaining investors to receive less than their promised value. Stevens agrees with this assessment and feels his fiduciary duty is to all employees. Stevens should:

A) continue to recommend that new investors do not invest in the fund, but not advise existing investors to reduce their holdings.

B) tell investors he cannot give advice on the fund because of a conflict of interest.

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

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Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #63 of 144

Question ID: 1207836

Carl Weather, CFA, is the chief financial officer of Talbot Enterprises. Based on inside information about Talbot's favorable prospects, Weather concludes that Talbot's common stock price is substantially undervalued in the market. With the approval of Talbot's Board of Directors, Weather announces a program for his firm to repurchase $100 million of its own stock in the market. Talbot's stock price rises immediately after the announcement of the repurchase program.

Reese Winter, a CFA Institute member, is Weather's assistant. While waiting in Weather's office, Winter reads an internal memo marked "confidential" from Talbot's chief accountant to Weather. The memo states that Talbot sustained an unexpected substantial profit during the past quarter, and its earnings projections show a substantial increase compared with previous estimates. Winter uses her cell phone to call her brother and discloses this information to him. Her brother immediately buys 1000 shares of Talbot's stock.

Did the actions of Weather and Winter violate Standard II(A): Material Nonpublic Information?

	Weather	Winter	
A)	No	Yes	✔
B)	Yes	Yes	✘
C)	Yes	No	✘

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

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Related Material

SchweserNotes - Book 1

Question #64 of 144

Question ID: 1212255

Liam McCoy has lunch with a wealthy client whose portfolio he manages. McCoy advises the client to double his current position in the JKM Corporation due to an anticipated increase in sales. In accordance with Standard (V) Investment Analysis, Recommendations and Actions, when McCoy returns to his office he should:

A) document the details of the conversation with the client with regard to his investment recommendation.

B) identify other clients for whom JKM may be a suitable investment and notify them immediately of his recommendation.

C) verify the suitability of the investment recommendation before placing the client's order.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.b)

Related Material

SchweserNotes - Book 1

Question #65 of 144

Question ID: 1212245

The CFA Institute Code of Ethics specifies that CFA Institute Members and Candidates must do all of the following EXCEPT:

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

B) act with integrity, competence, diligence, respect, and in an ethical manner.

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C) use reasonable care and exercise independent professional judgment when engaging in professional activities.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #66 of 144

Question ID: 1207805

Kenny Barrett, CFA, is working in the Australian office of American Investments Co. From an informal conversation, Barrett learns that the company's most recent investment report was based on misappropriated information. No one at the Australian office expresses concern, however, because there has been no breach of Australian law. Barrett should:

A) seek advice from company counsel to determine appropriate action.

B) do nothing because the branch is outside of U.S. jurisdiction.

C) disassociate himself from the case with a written report to his supervisor.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #67 of 144

Question ID: 1212296

Andrea Waters is an investment analyst who has accumulated and analyzed several pieces of nonpublic information through her contacts with drug firms. Although no one piece of the information she collected is "material," Waters correctly concluded that the earnings of one of the drug companies would be unexpectedly high in the coming year. According to CFA Institute Standards of Professional Conduct, Waters:

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A) cannot legally invest or make recommendations based on this information.

B) can use the information to make investment recommendations and decisions.

C) may use the information, but only after approval from a compliance officer or supervisor.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #68 of 144

Question ID: 1212251

According to the Code of Ethics, a member reflects credit on the profession when a member:

A) consults with other members on a regular basis.

B) practices in a professional and ethical manner.

C) places the clients first.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #69 of 144

Question ID: 1212279

CFA Institute believes:

A) that firms should comply with all domestic laws and regulations and that these laws also govern behavior in foreign markets, regardless of foreign laws and

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B) that a minimum level of professional responsibility and conduct dictates that members be aware of and comply with laws, rules, and regulations governing

C) that a maximum level of professional responsibility and conduct dictates that members be aware of and comply with laws, rules, and regulations governing

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #70 of 144

Question ID: 1212322

According to Standard III(A) Loyalty, Prudence and Care, brokerage is an asset of the:

A) client.

B) managing firm.

C) brokerage firm conducting the trades.

Explanation

Brokerage is an asset of the client.

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

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

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contract for an innovative software program that will have a very significant positive impact on earnings as well as on the company's visibility and stature in the industry.

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

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

Question #71 - 76 of 144

Question ID: 1207816

Based on CFA Institute Standards of Professional Conduct, which of the following is *least accurate*?

A) There is misappropriation of information by Jones because the file is marked "Confidential / Corporate Finance Department." ✗

B) The information is material because the new software is likely to significantly increase FinSoft's future earnings. ✗

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

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #72 - 76 of 144

Question ID: 1207817

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Based on the information presented in this situation, Jones has an obligation to do all of the following EXCEPT:

A) encourage public dissemination of the information.

B) encourage his employer to review the compliance procedures as they relate to material nonpublic information issues.

C) wait to trade on the information until after a reasonable period has passed.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #73 - 76 of 144

Question ID: 1207818

Based on the information presented, Lincoln should adopt a set of guidelines on inside information that include each of the following EXCEPT:

A) develop criteria for identifying inside information.

B) have in place a supervisor or compliance officer who has the authority and responsibility to decide whether information is material and nonpublic.

C) prohibit exchange of personnel, even temporary, between investment banking and institutional money management departments.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #74 - 76 of 144

Question ID: 1207819

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Which of the following policies would be the *most appropriate* way for Lincoln & Co. to conform to the CFA Institute Standard II(A) concerning Material Nonpublic Information?

A) Prevent the exchange of information between the investment banking and research department by creating information barriers between these groups.

B) Permanently prohibiting the research department from issuing recommendations on FinSoft.

C) Require that the compliance department implement increased scrutiny of the interchange of information between the research department and the

Explanation

Creating informational firewalls in a firm to prevent exchange of insider information is the best method of complying with Standard II(A) concerning Material Nonpublic Information. An information barrier between the investment banking department and research department will prevent the flow of information from the investment banking department to research analysts that are writing recommendations on securities. A permanent prohibition on issuing recommendations on FinSoft securities would not be appropriate or necessary. A temporary prohibition would be an acceptable option: after the material nonpublic information becomes public, publishing recommendations on FinSoft would not be a violation of the Code and Standards. Increased scrutiny of the exchange of information flowing between the investment banking department and the research operation would be inadequate.

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

Related Material

SchweserNotes - Book 1

Question #75 - 76 of 144

Question ID: 1207820

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

A) Bamyeh violated the Code and Standards by investing in the ETF.

B) Jones did not violate the Code and Standards because the comments made to Bamyeh were on a personal rather than professional basis.

C) Bamyeh did not violate the Code and Standards because Bamyeh did not directly invest in any FinSoft securities.

Explanation

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Bamyeh's decision to invest in the ETF appears to have stemmed from Jones's tip about FinSoft's prospects, so Bamyeh's action violates Standard II(A)—Material Nonpublic Information. Jones's inside information should be considered material because if made public it would cause the price of FinSoft, as well as the associated mutual fund, to rise. Jones's decision to share material non-public information was a violation of Standard II(A), even though Jones and Bamyeh are personal rather than professional acquaintances. Under Standard II(A), prohibition to trade based on inside information extends to derivatives that derive their value based on the value of the security for which inside information was used.

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

Related Material

SchweserNotes - Book 1

Question #76 - 76 of 144

Question ID: 1207821

When recommending the purchase of FinSoft company shares to Bamyeh, Jones *least likely* violated the Standard relating to:

A) integrity of capital markets. ✗

B) loyalty to employer. ✗

C) diligence and reasonable basis. ✓

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #77 of 144

Question ID: 1212280

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Deloris Johnson, CFA, observed that her supervisor has violated a federal securities regulation. Johnson discussed the matter with her company's compliance department but they have taken no action. According to the CFA Institute Code and Standards of Professional Conduct, Johnson is required to:

A) dissociate from the supervisor's activity

B) confront the supervisor and attempt to stop the violation.

C) report the violation to securities regulators.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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

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

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Exhibit B

LANG & COMPANY Company Report

Industrial: Specialty Chemicals Equity Research

Rating: Buy

SpecChem Inc. (NYSE: SCM)

> We are initiating coverage of SpecChem Inc. with this report.
> Earnings, up to 51% in the first quarter, are expected to be up again in the quarter ending June 30. Higher sales, better margins, an improved geographic sales mix, and savings from reduced pension expense are all contributing to this year's gains.
> Although European production is up only modestly year-over-year, successful cost reduction efforts are limiting the adverse effects of weak volume and pricing. A possible plant closure in September could improve plant utilization by 10%, accompanied by potentially dramatic margin improvement. However, a $30 million after-tax special charge could be taken at the time of the closure.
> We expect a moderate increase in second half 2014 sales. Although management looks for European demand to remain slow, it feels that U.S. sales could be above expectations if auto-related demand strengthens. Management is also optimistic about receiving a sizable U.S. government contract in the next few months.
> Based on the factors noted above, our confidence level concerning earnings levels over the balance of the year is high.
> We think SpecChem stock is undervalued and believe it can easily reach the low 100s on the strength of continuing earnings momentum. The downside is estimated to be in the mid-80s. There is plenty of room for upside earnings surprises if volume and prices improve, which would take the stock up strongly. Purchase is recommended.

Analyst: Bella Brown

Research Department

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

Question #78 - 83 of 144

Question ID: 1207772

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Under the CFA Institute Code and Standards, it is the responsibility of the Director of Research, a CFA Institute member to:

A) both of these.

B) exercise reasonable supervision over those subject to their supervision or authority to prevent any violation of applicable statues, regulations or provisions

C) not knowingly participate or assist in any violation of laws, rules, or regulations.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #79 - 83 of 144

Question ID: 1207773

Under the current circumstances, the Director of Research should:

A) allow the report to be distributed, as is.

B) require the report to be redone with a neutral or hold rating pending the outcome of the awarding of the investment banking business.

C) require the report to be redone to ensure compliance with CFA Institute Standards.

Explanation

Based on the current circumstances, the supervisor (Director of Research) must not allow the report to be distributed. In this situation the overriding responsibility is to ensure that diligence, thoroughness, and independence be exercised in forming the investment judgment and in preparing the research report.

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

Related Material

SchweserNotes - Book 1

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Question #80 - 83 of 144

Question ID: 1207774

The research report, as shown, has several aspects which violate CFA Institute Standards of Professional Conduct. Which of the following is NOT an apparent violation of CFA Institute Standards?

A) The report does not distinguish between fact and opinion.

B) The report does not adequately discuss the factors important to analysis, recommendations, or action.

C) The report violates guidelines on investment performance presentation.

Explanation

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

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

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

Related Material

SchweserNotes - Book 1

Question #81 - 83 of 144

Question ID: 1207775

As to the process by which Brown's report in Exhibit B came into being, which of the following is *least likely* a procedural error in violation of CFA Institute Standards of Professional Conduct?

A) Brown has violated the Standard relating to disclosure of basic characteristics.

B) Brown has violated the Standard relating to the prohibition against plagiarism.

C) Brown has violated the Standard relating to independence and objectivity.

Explanation

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

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

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

Related Material

SchweserNotes - Book 1

Question #82 - 83 of 144

Question ID: 1207776

Brown has been invited to visit the world headquarters of SpecChem. Brown expects that the information that she learns there will help her to flush out some of the fine details in her research on SpecChem's stock. SpecChem plans to pay for all of Brown's expenses trip, including meals, accommodations and lodging. In order to comply with the Code and Standards, which of the following actions should Brown take? Brown should:

A) Accept the reimbursement but disclose the total reimbursed expense-paid trip in the report.

B) Pay for all her travel expenses.

C) Accept the reimbursement if she is confident that her report will still be objective.

Explanation

Brown's best solution to comply with Standard I(B)–Independence and Objectivity is to avoid any perception of conflict of interest. Brown's firms should pay for all of her expenses. Disclosing the trip is not enough to avoid a conflict of interest.

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

Related Material

SchweserNotes - Book 1

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Question #83 - 83 of 144

Question ID: 1207777

Brown submits her report to the Director of Research for review, as required by Lang's procedures. Although the Director of Research supports Brown's general conclusion, he is somewhat more optimistic about SpecChem's near-term prospects, and based on his own thorough investigation believes that the stock could touch $150. The Director of Research changes the report to indicate a target price somewhat higher than originally predicted by Brown. Brown is confident that the Director of Research's conclusion has a reasonable basis, but thinks that $150 is on the high side of what is likely. The Director of Research adds his own name to the report to reflect his contribution.

In order to comply with CFA standards, must Brown request that her name be taken off the report before it is disseminated?

A) Yes, because the Director of Research has misrepresented his contribution. ✗

B) No. ✓

C) Yes, because Brown should dissociate from the report. ✗

Explanation

It is natural for different contributors to come to different conclusions based on the same data. In this case, the Director of Research appears to have a reasonable basis for his target price that is higher than Brown's. The Director of Research is free to issue a report that differs somewhat from Brown's conclusions as long as there is a reasonable basis. Brown should not put her name on a report that differs from her opinion. However, when a report is a group effort, not all members of the team may agree with every aspect of the report. Brown could ask to have her name removed from the report, but since she is satisfied that the conclusion has a reasonable basis, she does not have to disassociate from the report.

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

Related Material

SchweserNotes - Book 1

Question #84 of 144

Question ID: 1212292

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Betsy Fox is an investment advisor who has a client, Don Gordon, who is an employment lawyer. At lunch, Fox noticed Gordon and the Chief Financial Officer of Blue Star Company at the next table. She overhears them talking and ascertains that Blue Star is about to announce higher than expected earnings. Before the earnings release, Gordon contacts Fox and asks her to purchase 3,000 shares for his portfolio. Fox:

A) must refuse to purchase shares for Gordon.

B) can purchase shares for Gordon, but cannot ever purchase shares for her personal account.

C) can only purchase shares for her personal account after informing all of her clients about the potential of the increase in earnings.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #85 of 144

Question ID: 1212319

All of the following are required by fiduciaries under Standard III(A), Loyalty, Prudence, and Care, EXCEPT:

A) place the client’s interest before the employer’s interest.

B) support the sponsor's management during proxy fights.

C) act solely in the interest of the ultimate beneficiaries.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Mahakali Book Center
9920411158 / 9820665601

Question #86 of 144

Question ID: 1212266

Robe Advisory Services operates an office in San Francisco, where it manages portfolios for its clients based in the United States. The firm also maintains an office in Tokyo, where it employs Sam Lee, CFA who researches Japanese stocks. According to the CFA Institute Standards of Professional Conduct, Lee is required to maintain knowledge of and comply with all applicable laws, rules, and regulations in:

A) Japan, but not the U.S., and the CFA Institute Standards of Professional Conduct.

B) both the U.S. and Japan and the CFA Institute Standards of Professional Conduct.

C) both the U.S. and Japan, but not the CFA Institute Standards of Professional Conduct.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #87 of 144

Question ID: 1212271

Janet Green, CFA, provides investment advice and other services to clients in several countries. She resides in Country A whose securities laws and regulations are less strict than the Code and Standards. She also conducts business with clients in Country B, which has no securities laws or regulations, and in Country C, which has securities laws and regulations that are stricter than the Code and Standards. Which of the following statements is CORRECT? According to CFA Institute Standards of Professional Conduct, Green must adhere to the Code and Standards in:

A) Country A but the law in Country B and Country C.

B) Country A, Country B, and Country C.

C) Country A and Country B but the law in Country C.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #88 of 144

Question ID: 1212253

All of the following are components of the Code of Ethics EXCEPT:

A) striving to maintain and improve their competence and the competence of others in the profession.

B) using reasonable care and exercising independent professional judgment.

C) demonstrating diligence, independence, and thoroughness when preparing investment reports.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #89 of 144

Question ID: 1212261

Lee Roth, who is an investment advisor, is riding in a taxi and finds a file of information labeled "Genco Valuation." The folder contains a great deal of financial data, projections and nonpublic information concerning the food products industry that lead Roth to believe that Genco will be worth 50% more than its current stock value. Roth also finds some correspondence that leads him to believe that the file belonged to Tom Hagan. Roth tries to find out where Hagan works so he can return the file. Roth can recommend Genco to his clients unless Hagan works for:

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A) the equity research department for a brokerage firm.

B) the corporate finance department for Genco.

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

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #90 of 144

Question ID: 1212268

Shortly after becoming employed by Valco & Co., an investment banking firm, Stan McDowell, CFA, learns that most of Valco's initial public offerings (IPO) are really effected in order to profit management via price manipulation of the shares. McDowell observes an illegal act, sanctioned by senior management, in progress and refuses to sign off on his responsibility. Instead, McDowell takes the documentation to his supervisor and tells him he should sign it in his place. This action is:

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

B) an overreaction. Senior management's sanctioning of the act absolves McDowell from his ordinary responsibility as a CFA Institute member.

C) a suitable reaction, and he is in compliance with the Code and Standards.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #91 of 144

Question ID: 1212298

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Which one of the following *least* accurately describes the CFA Institute Standard about using material nonpublic information?

A) An analyst using material nonpublic information may be fined by CFA Institute. ✔

B) An analyst may use nonmaterial nonpublic information as long as it has been developed under the Mosaic Theory. ✘

C) An analyst may violate this Standard by passing information to others even when it has been obtained from outside the company. ✘

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #92 of 144

Question ID: 1212267

A CFA Institute member is also a member and the portfolio manager of an environmentalist group. In its charter, the environmentalist group lists a group of companies its members should boycott. The CFA Institute member would violate Standard I(A) concerning obeying all rules and regulations if the member:

A) purchases stock of a boycotted firm for the group's portfolio. ✔

B) actively protests against a publicly traded firm boycotted by the group. ✘

C) performs either of the activities listed here. ✘

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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Question #93 of 144

Question ID: 1212247

According to the *Code of Ethics*, which of the following statements is NOT correct? CFA Institute members are required to:

A) comply with the CFA Institute Global Investment Performance Standards.

B) maintain and improve their competence and strive to maintain the competence of others in the profession.

C) use reasonable care and exercise independent professional judgment.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #94 of 144

Question ID: 1212270

Maria Valdes, CFA, is an analyst for Venture Investments in the country of Newamerica, which has laws prohibiting the acceptance of any gift from a vendor if the gift exceeds US $250. Valdes has evidence that her Venture Investments colleague, Ernesto Martinez, CFA, has been receiving gifts from vendors in excess of US $250.

Valdes is obligated to:

A) disassociate herself from the activity, urge Venture to persuade Martinez to cease the activity, and inform CFA Institute of the violation.

B) disassociate herself from the activity, urge Venture to persuade Martinez to cease the activity, and inform CFA Institute and regulatory authorities of the

C) disassociate herself from the activity, and urge Venture to persuade Martinez to cease the activity.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #95 of 144

Question ID: 1212302

An analyst provides services for a charitable organization and in return gets free membership in the organization. Part of her job is to manage the liquid assets of the organization, and those assets include stocks. Her supervisor in the organization calls her and tells her to buy a certain stock for the portfolio based upon insider information from a board member in the organization. The analyst objects, but the supervisor says this is what they have always done and sees no reason for changing now. The analyst complies with the request. With respect to Standards IV(A), Loyalty to Employer, and II(A), Material Nonpublic Information, the analyst violated:

A) only Standard IV(A) requiring duty of loyalty. ✗

B) only Standard II(A) that prohibits insider trading. ✓

C) both Standards IV(A) and II(A). ✗

Explanation

An employee/employer relationship does not necessarily mean monetary compensation for services. Complying with the request is a violation of II(A) which prohibits trading on insider information. Standard IV(A) Loyalty deals with going into business for yourself, leaving an employer and continuing to act in the employer's best interest until their resignation becomes effective, and whistleblowing which means that the member's interests and their firm's interests are secondary to protecting the integrity of capital markets and the interests of the clients.

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

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Question #96 of 144

Question ID: 1212259

After a very successful quarter of high investment returns, Judy O'Berry, CFA, receives several gifts from grateful clients. O'Berry considers the gifts to be of novelty or sentimental value only, but she hears rumors that several junior employees are jealous of the attention she received for the group's efforts. She decides to consult the company's compliance rules on gifts and is surprised to learn her firm has no established rules. She consults the Standards of Practice Handbook, and then submits proposed rules on gifts to her company's compliance department. These rules should contain all of the following EXCEPT:

A) a requirement to disclose the gift.

B) restrictions on all types business entertainment.

C) a formal value limit based on local customs.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #97 of 144

Question ID: 1152958

Which of the following is a component of the *Code of Ethics*? CFA Institute members shall:

A) strive to maintain and improve their competence and the competence of others in the profession.

B) disclose to their employer all matters that reasonably could be expected to interfere with their duty to their employer or ability to make unbiased and

C) make reasonable efforts to detect and prevent violations by those who are under their supervision.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

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Question #98 of 144

Question ID: 1212301

A stockbroker who is a member of CFA Institute has a part-time housekeeper who also works for the CEO of Festival, Inc. One day the housekeeper mentions to the broker that she saw the CEO of Festival having a conversation at his home with John Tater, who is a nationally known corporate lawyer and consultant. The stockbroker is restricted from trading on this information:

A) only if the broker knows that the meeting is non-public information.

B) for both of the reasons listed here.

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

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #99 of 144

Question ID: 1212291

In the course of reviewing the Corn Co., an analyst has received comments from management that, while not meaningful by themselves, when pieced together with data he has accumulated from outside sources, lead him to recommend placing Corn Co. on his firm's sell list. What should the analyst do?

A) Not issue the report until the comments are publicly announced.

B) Show his report to his own manager and counsel for their review since this information has become material once it was combined with his analysis.

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

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Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #100 of 144

Question ID: 1207878

Mohawk Asset Management buys on-the-run Treasuries at auction for its standard fee accounts. When these move off-the-run, they are placed in performance-based accounts via in-house cross-trades at prevailing market prices, and replaced in the standard fee accounts with new on-the-run issues. Which standard is violated, if any?

A) The Standard concerning Priority of Transactions.

B) The Standard concerning Fiduciary Duty.

C) No Standard is violated.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #101 of 144

Question ID: 1212317

Sharon Pope has been asked by the Chief Investment Officer to develop a firm-wide policy for proxy voting. Which of the following would NOT be acceptable to include in the policy statement?

A) Voting proxies may not be necessary in all instances.

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

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C) The value of proxy voting must be maximized.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #102 of 144

Question ID: 1212273

Under Standard IV(A) Loyalty (to employers):

A) members are encouraged to leave an employer that does not adopt the Code and Standards as part of its policies and procedures.

B) members are required to deliver a copy of the Code and Standards to their employer.

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

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #103 of 144

Question ID: 1207830

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Susan Nielsen, CFA, works for a rating agency which competes directly with S&P and Moody's. Her friend, Lance Parker, works for the same company but in a different department which is involved in advisory services for structured products. Nielsen frequently receives pressure from Parker to "put a positive face" on client ratings to help him sell advisory services. She is reluctant to discuss client ratings with Parker and tries to avoid the topic. She consults her company's compliance department and learns that there are no policies or procedures to discourage Nielsen and Parker from sharing information and is encouraged to consider his advice on company ratings. Nielsen should feel *least* obligated to:

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

B) advise her firm to develop firewalls. ✗

C) avoid talking with Parker about client ratings. ✗

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #104 of 144

Question ID: 1212283

If a CFA Institute member knows that a fellow member has violated the Code and Standards, according to Standard I(A) the member is:

A) required to dissociate from the activity and strongly encouraged to report it. ✓

B) strongly encouraged to dissociate from the activity. ✗

C) required to report the activity. ✗

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

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Question #105 of 144

Question ID: 1212312

A company has a defined benefit plan that is currently under-funded. The plan sponsor has instructed the portfolio manager of the plan to invest more aggressively to bring the funding level up to an adequate amount. Which of the following statements *best* describes the course of action the portfolio manager should take? The portfolio manager should:

A) invest more aggressively because his fiduciary duties lie with the plan sponsor.

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

C) not invest more aggressively because this is not the method used to increase the funding level of a plan.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #106 of 144

Question ID: 1212305

A CFO who is a CFA Institute member is careful to make his press releases—some of them containing material and previously undisclosed information—clear and understandable to his readers. While writing a new release, he often has his current intern proofread rough drafts. He also sends electronic copies to his brother, an English teacher, to get suggestions concerning style and grammar. With respect to Standard II(A), Material Nonpublic Information, the CFO is:

A) only in violation by e-mailing the pre-release version to his brother but not the intern, because the intern is in essence an employee of the firm.

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

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C) not in violation of the Standard.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #107 of 144

Question ID: 1212308

Steve Waters, a Level I CFA candidate, has decided to enter into a long position of Farmco stock. Since Farmco is thinly traded, Waters is concerned the order will overwhelm the liquidity of Farmco and the price will surge. Waters engages in a series of block trades in order to accomplish the purchase. According to Standard II(B), Market Manipulation, Waters has engaged in:

A) both transaction-based manipulation and information-based manipulation. ✗

B) neither transaction-based manipulation nor information-based manipulation. ✓

C) transaction-based manipulation, but not information-based manipulation. ✗

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(B))

Related Material

SchweserNotes - Book 1

Question #108 of 144

Question ID: 1212304

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The *mosaic theory* is the idea that an analyst can:

A) base his recommendations on nonpublic material information only for the clients of the company, but not for the general public. ✗

B) make investment recommendations on the basis of several pieces of nonpublic information as long as the aggregate information remains nonmaterial.

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

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #109 of 144

Question ID: 1152937

An analyst who is a CFA Institute member receives an invitation from a business associate's firm to spend the weekend in a high-quality resort. In order to abide by the Standards, the analyst should (may):

A) do both of the actions listed here.

B) obtain written consent from his supervisor if the offer is contingent on achieving a target investment return.

C) refuse the invitation if the associate is from a firm he analyzes for his employer.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(B))

Related Material

SchweserNotes - Book 1

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Question #110 of 144

Question ID: 1212318

Tony Calaveccio, CFA, is the manager of the TrustCo Small Cap Venture Fund in Toronto. He places trades for the fund with River City Brokerage. River City provides Calaveccio with soft dollars to purchase research. River City also deals in municipal bonds, some of which Calaveccio holds in his personal portfolio. He periodically uses the soft dollars to request research reports on various small cap stocks and also on the status of the municipal bond market and issues that he holds. These actions are:

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

B) in violation of his fiduciary duties regarding both the small cap research and the municipal bond research.

C) not in violation of the Code and Standards.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #111 of 144

Question ID: 1212256

Which of the following activities would be following a component of the Code of Ethics explicitly?

A) Consulting with colleagues about opinions you reach in your research.

B) Maintaining a list of colleagues who have violated the CFA Institute standards.

C) Attending continuing education seminars on investing and inviting colleagues to come along.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.b)

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Related Material

SchweserNotes - Book 1

Question #112 of 144

Question ID: 1212264

The Securities and Exchange Board of India (SEBI) has just enacted a new stock-trading rule. SEBI will give brokers a 10-day grace period, during which violators of the rule will be immediately notified and given a chance to remedy their situation to comply with the new rule. If a CFA Institute member located in India or doing business in India unknowingly violates the rule and then remedies the situation within the 10-day grace period, has the member violated Standard I(A)?

A) No, because the member remedied the situation.

B) No, because the member unknowingly broke the rule.

C) Yes, because the member did not maintain knowledge and know of the rule.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #113 of 144

Question ID: 1207810

Travis Brown is a partner in a money management firm. He recently attended a seminar and learned about a quantitative model presented by Dixon. Upon returning to his office, Brown began testing the model and making a few minor alterations. He showed the model to his partners who were impressed and decided to promote the model as proof of the firm's value added. In the firm's next newsletter, Brown included a discussion of the model, the results, and financial data on several stocks selected by the model. These factual data were taken from Standard and Poor's publication. According to the *CFA Institute Standards of Professional Conduct*, which of the following actions is Brown required to take?

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A) Brown must credit Dixon, no need to credit S&P.

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

C) Brown must credit both Dixon and S&P.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #114 of 144

Question ID: 1207858

June Bird is a pension consultant asked to advise on the Backwater County Pension Plan. Bird notices that 20 percent of the plan's assets are invested in privately held local businesses. Bird is concerned about the lack of liquidity and diversification caused by such an investment. She learns that state law allows investing in local businesses and county law requires at least one-fifth of the plan's assets to be dedicated to investing in local businesses. Bird:

A) can continue to advise the pension plan as best she can with the restrictions.

B) should recommend that the trustees resign or risk being sued for violating the Prudent Expert Rule.

C) should file a written complaint to the Department of Labor pointing out that the law is in conflict with the Employee Retirement Income Security Act (ERISA).

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #115 of 144

Question ID: 1212315

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Denise Weaver is a portfolio manager who manages a mutual fund and has pension clients. When Weaver receives a proxy for stock in the mutual fund, she gives it to Susan Griffith, her administrative assistant, to complete. When the proxy is for a stock owned in a pension plan, she asks Griffith to send the proxy on to the sponsor of the pension fund. Weaver has:

A) violated the Standards by her policy on mutual fund and pension fund proxies. ✓

B) not violated the Standards. ✗

C) violated the Standards by her policy on mutual fund proxies, but not her policy on pension fund proxies. ✗

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #116 of 144

Question ID: 1212287

Milton Baker, CFA, prepares a research report on the dynamics of a stock price. In his study, he uses a considerable number of information sources, both outside sources and his company's own research papers, prepared for both internal and public use. The report will first be distributed at the monthly department meeting and then later will be published on the company's Internet site. He thinks that he may have neglected to mention some of his sources in his reference list but decides that he needs to be concerned about full disclosure of his sources only for the public version of the report, so he will wait to revise his work until after the monthly meeting but before it is published on the internet site. Which Standards does Baker NOT comply with?

A) Standard I(C), Misrepresentation, only. ✗

B) Standard I(C), Misrepresentation, and I(A), Knowledge of the Law. ✓

C) Standard I(C), Misrepresentation, I(B), Independence and Objectivity, and I(A), Knowledge of the Law. ✗

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #117 of 144

Question ID: 1212243

Which of the following is a component of the *Code of Ethics*? CFA Institute members shall:

A) use particular care in determining applicable fiduciary duty. ✗

B) use reasonable care and exercise independent professional judgment. ✓

C) not knowingly participate or assist in any violation of laws, rules, or regulations. ✗

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #118 of 144

Question ID: 1212282

A CFA Institute member conscientiously maintains records of changes in security regulations. The member notices that his colleagues do not, and does NOT say anything. Is this a violation of Standard I(A)?

A) No, as long as the colleagues do not violate the new rules. ✗

B) Yes, and the member should disassociate from these colleagues. ✗

C) Yes, because the member is bound by the Code of Ethics. ✓

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #119 of 144

Question ID: 1212281

WEB, an investment-banking firm, is the principal underwriter for MTEX's upcoming debenture issue. Wendy Berry, CFA, an analyst with WEB, has found out from an employee in MTEX's programming department that a serious glitch was recently discovered in the software program of their major new product line. In fact, the glitch is so bad that most of their orders have been canceled. Berry checked the debenture's prospectus and found no mention of this development. The red herring prospectus has already been distributed. Berry's *best* course of action is to:

A) keep quiet since this is material non-public inside information.

B) inform her immediate supervisor at WEB of her discovery.

C) notify potential investors of the omission on a fair and equitable basis.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #120 of 144

Question ID: 1212258

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Judy Gonzales is a portfolio manager with Brenly Capital and works on Johnson Company's account. Brenly has a policy against accepting gifts over $25 from clients. The Johnson portfolio has a fantastic year, and in appreciation, the pension fund manager sent Gonzales a rare bottle of wine. Gonzales should:

A) present the bottle of wine to her supervisor.

B) return the bottle to the client explaining Brenly's policy.

C) inform her supervisor in writing that she received additional compensation in the form of the wine.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #121 of 144

Question ID: 1212295

Lynne Jennings is a chemical industry research analyst for a large brokerage company. That industry is currently seeing an increase in mergers and acquisitions. While flying through Chicago, Jennings sees several senior officers who she knows are from the largest and fourth largest chemical companies walk into a conference room. She concludes that negotiations for an acquisition might be taking place. Jennings:

A) may use this information to support an investment recommendation.

B) may not act or cause others to act on this information.

C) should inform her compliance officer that she has material nonpublic information on firms she covers.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Mahakali Book Center
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Question #122 of 144

Question ID: 1207857

Which of the following statements about soft dollars is *least* accurate?

A) Directed brokerage are soft dollars to be used for research that benefits the investment firm.

B) Soft dollars are assets of the client.

C) Soft dollars are third party research arrangements.

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #123 of 144

Question ID: 1212321

Regarding (1) not voting all client proxies, and (2) using a directed brokerage arrangement, a member would violate the Standards by:

A) engaging in neither of these practices.

B) using a directed brokerage arrangement.

C) not voting all proxies for client stocks.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Mahakali Book Center
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Question #124 of 144

Question ID: 1212276

Bob Blanford, CFA, is an investment analyst for a large global brokerage firm. He recently moved to Ragatan, a developing country with few securities laws and regulations. As part of conducting a company analysis, Blanford interviews Ravi Shanti, vice-president of finance at Starr Industries. Starr is a major industrial firm in Ragatan and a client at Blanford's firm. Based on his analysis, Blanford suspects that Shanti may have deliberately overstated Starr's current earnings and its earnings for the past several quarters. If this information becomes public, Blanford believes that Starr's stock price will drop substantially. Blanford suspects that Shanti may have violated Ragatan's securities laws. Which of the following statements is *least likely* to comply with Standard I, Professionalism? Blanford should:

A) take no action. ✓

B) determine the legality of the activity, possibly by consulting counsel. ✗

C) disassociate himself from the client, if the activity is illegal or unethical. ✗

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #125 of 144

Question ID: 1207802

Georgia Jones, CFA, is an analyst for Johnson, Thomas & Co. She also serves as an outside director for Dewey Manufacturing, Inc. In the course of her duties, she begins to believe that Dewey's income statement for the most recent period may have been misstated. Georgia should do all of the following EXCEPT:

A) inform the Securities and Exchange Commission. ✓

B) consult with Dewey Manufacturing's legal counsel. ✗

C) consult with Johnson, Thomas' legal counsel. ✗

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Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #126 of 144

Question ID: 1152930

A brokerage firm has a trading department and an investment-banking department. Often the investment-banking department receives material non-public information that would be valuable in advising the firm's brokerage clients. In order to comply with the Standards, the firm:

A) must divest one of the departments. ✗

B) should record the exchange of information between the investment-banking department and the brokerage department. ✗

C) should restrict employee trading in securities for which the firm is in possession of material non-public information. ✓

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #127 of 144

Question ID: 1152944

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Which of the following is least likely a component of the Code of Ethics? In dealing with the public, clients, prospects, employers, employees, and fellow members, CFA Institute members shall act with:

A) respect.

B) integrity.

C) humility.

Explanation

Although acting with humility may be desirable, CFA Institute members are not required to do so. However, they should act in a manner that reflects credit on themselves and their profession.

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #128 of 144

Question ID: 1212286

While having a conversation with a prospective client, John Henry states that his performance across all of his past clients over the past five years was over 20%, which was 200 basis points higher than his benchmark. He tells the client that while the benchmark may rise or fall over time, his excess performance will remain consistent. Henry violated the Standards of Professional Conduct because:

A) he cannot discuss performance without clearly stating that the composite does not conform to GIPS.

B) he cannot discuss prospective future performance in any manner.

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

Explanation

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

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

Related Material

SchweserNotes - Book 1

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Question #129 of 144

Question ID: 1212324

A member would *most likely* violate the Standard regarding duties to clients by:

A) adding a risky derivative security to the portfolio of a client with moderate risk tolerance.

B) executing a client order for a security the member believes is greatly overvalued.

C) recommending purchase of securities without a reasonable inquiry into the investment experience of the client.

Explanation

Standard III(A) Loyalty, Prudence, and Care requires members acting as advisors to make a reasonable inquiry into the client's investment experience, risk and return objectives, and financial constraints before making investment recommendations. Investment decisions must be made based on a total portfolio approach, rather than the quality of an individual investment in isolation. Some members are not acting as investment advisors and may only have a duty to provide best execution of client orders.

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #130 of 144

Question ID: 1212285

In order to comply with the CFA Institute Standards, an analyst should:

A) use only his own research in making investment recommendations, because anything else would violate Standard I(B), Independence and Objectivity.

B) use only his company's research when making investment recommendations and use outside research for reports and analysis on stocks.

C) use outside research only after verifying its accuracy.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(B))

Related Material

SchweserNotes - Book 1

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Question #131 of 144

Question ID: 1212325

An independent analyst has only one client. One of the client's largest holdings is a brokerage firm. Because of the large holding by his client, the brokerage firm recently began allowing the analyst to tap into the firm's computer network to use the firm's research facilities. This is allowable as long as the analyst:

A) uses the resources to help manage the client's account.

B) discloses the relationship to the client.

C) does both of the actions listed here.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #132 of 144

Question ID: 1212260

Paul Clark, CFA, has just learned from a financial analyst at Corvac Industries that orders for their core products are running ahead of last year's orders by 15%, information that has not been publicly disclosed by the company. Clark currently has a hold rating on Corvac based on his expectation of a 5% increase in revenues for the current year. Based on Standard II(A) Material Non-public Information, Clark's *most appropriate* course of action is to:

A) disclose the information publicly prior to making any changes in his recommendation.

B) put Corvac on his firm's restricted list and not make a recommendation until the increase in orders is publicly disclosed.

C) encourage Corvac to publicly release the order information and not act on that information until it is publicly disclosed.

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Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #133 of 144

Question ID: 1212246

In accordance with Standard III (A) Loyalty, Prudence and Care, which of the following statements is *not* a required or recommended action?

A) Submit to clients, at least quarterly, itemized statements detailing all of the period's transactions. ✗

B) Utilize client brokerage to the sole benefit of the client. ✗

C) Vote all proxies on behalf of clients in a responsible manner. ✓

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Question #134 of 144

Question ID: 1212320

Tony Calaveccio, CFA, is the manager of the TrustCo Small Cap Venture Fund in Toronto. Calaveccio places a trade with Quantco Brokerage. While Calaveccio's part of the transaction was conveyed correctly to Quantco, there was a trading error made in Calaveccio's account due to a slip up within Quantco. Calaveccio realizes that the error has taken place, and informs his contact at Quantco. Calaveccio allows Quantco to cover the error, with no cost to TrustCo. This is:

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A) permissible under CFA Institute Standards.

B) a violation of Calaveccio's duty to his employer.

C) a violation of Calaveccio's fiduciary duties.

Explanation

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

(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #135 of 144

Question ID: 1212323

Alan Cramer, CFA, practices in a country that does not regulate the investment of company retirement plans. He was retained by Bingham Companies to manage their corporate pension plan. Bingham's management has approached Cramer and requested that Cramer invest the entire plan in Bingham stock.

Cramer may:

A) invest all of the retirement plan assets in Bingham Company stock according to management's request only if Cramer can document that the investment is

B) not invest any of Bingham Company's retirement plan in its own stock regardless of the stock's prospects and in spite of management's request.

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

Explanation

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

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(Study Session 1, Module 2.4, LOS 2: III(A))

Related Material

SchweserNotes - Book 1

Question #136 of 144

Question ID: 1207807

According to CFA Institute Standards of Professional Conduct, which of the following is *least likely* a compliance procedure for maintaining independence and objectivity in making investment recommendations or taking investment action?

A) Restrict special cost arrangements related to travel.

B) Maintain files to support investment recommendations.

C) Create a restricted list so that the firm disseminates only factual information about a controversial company.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(B))

Related Material

SchweserNotes - Book 1

Question #137 of 144

Question ID: 1212272

Allen Parsons, a CFA candidate, suspects a colleague at his firm of engaging in an illegal activity. Which of the following statements about procedures for compliance involving Standard I(A), Knowledge of the law is NOT correct? Parsons:

A) should consult counsel to determine whether the conduct is, in fact, illegal.

B) is required to report this legal violation to the appropriate governmental or regulatory organizations.

C) should urge his firm to attempt to persuade the perpetrator to cease such conduct.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

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Related Material

SchweserNotes - Book 1

Question #138 of 144

Question ID: 1212299

The term "material" in the phrase "material nonpublic information" refers to information that is likely to affect significantly the market price of the issuing company's securities or that:

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

B) is derived by the financial analyst from direct communication with an issuing company's management.

C) is acquired by the financial analyst from a special or confidential relationship with the issuing company.

Explanation

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

(Study Session 1, Module 2.3, LOS 2: II(A))

Related Material

SchweserNotes - Book 1

Question #139 of 144

Question ID: 1212294

While visiting the CSI Company, Mark Ramsey, CFA, overheard management make comments that were not public information, but were not really meaningful by themselves. However, when this information is combined with his own analysis and other outside sources, Ramsey decides to change his recommendation on CSI from buy to sell. According to CFA Institute Standards of Professional Conduct, Ramsey should:

A) not issue his report until these comments are made public.

B) report these events to his immediate supervisor and legal counsel, since they have become material in combination with his analysis.

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

Explanation

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

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

Related Material

SchweserNotes - Book 1

Question #140 of 144

Question ID: 1212277

Mary White, CFA, sits on the board of directors of XYZ Manufacturing, Inc. She discovers that management has knowingly participated in an activity she knows is illegal. According to the CFA Institute Standards of Professional Conduct, White is *least likely* to be required to:

A) seek legal advice to determine what actions should be taken.

B) disassociate herself from the activity.

C) report the violation to the CFA Institute Professional Conduct Program.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #141 of 144

Question ID: 1212262

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Nicholas Brynne, CFA, is a fixed-income analyst who trades in mortgage-backed securities (MBS). The MBS industry has seen sweeping regulatory changes since Brynne took his current position, and he now feels his understanding of applicable laws and regulatory standards is dated. Brynne must:

A) rely on his firm's policies and procedures for guidance on legal and regulatory standards.

B) have all trades reviewed by his compliance department until he has obtained an expert level of knowledge in compliance.

C) update his understanding of applicable laws and regulatory standards relating to his position.

Explanation

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

(Study Session 1, Module 2.1, LOS 2: I(A))

Related Material

SchweserNotes - Book 1

Question #142 of 144

Question ID: 1212248

According to the Code of Ethics, when practicing in a professional and ethical manner the goal is to:

A) resolve conflicts between clients and employers.

B) reflect credit on members and the profession.

C) increase membership in CFA Institute.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

Mahakali Book Center
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Question #143 of 144

Question ID: 1207867

Which of the following would be the *least* important proxy issue?

A) Compensation plans for officers.

B) Election of internal auditors.

C) Takeover defense and related actions.

Explanation

Election of internal auditors is not a major proxy issue.

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

Related Material

SchweserNotes - Book 1

Question #144 of 144

Question ID: 1212241

The first component of the Code of Ethics does NOT explicitly say that a CFA Institute member will act in a certain manner with respect to which of the following groups?

A) Colleagues.

B) CFA Institute members and candidates in the CFA Program.

C) Prospective clients.

Explanation

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

(Study Session 1, Module 1.1, LOS 1.a)

Related Material

SchweserNotes - Book 1

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