Ethical and Professional Standards

1. Jimmy Lee, CFA, is an investment banker in a country with strict confidentiality laws. He is working on an acquisition for Panda Mining Co. (PMC). While performing due diligence, Lee notices that PMC has a number of questionable offshore partnerships. He investigates the legality of the partnerships and finds evidence of illegal activity. According to the Standards of Professional Conduct, Lee's best course of action would be to:

A. alert CFA Institute

B. consult outside counsel

C. notify regulatory authorities

Answer: B

Members must keep client information confidential and must comply with applicable law. If applicable law requires disclosure of client information in certain circumstances, members and candidates must comply with the law. If applicable law requires members to maintain confidentiality, even if the information concerns illegal activities on the part of the client, members should not disclose such information. Lee's best course of action would be to consult with outside counsel to determine applicable law.

2. Bryan Barrett, CFA has an investment advisory service providing advice on gold and other commodities to several large retail banks. Barrett advertises his services in widely read publications to broaden his business to include retail clients. Because the client base for the institutions that Barrett serves is large, he is comfortable stating in the ads that thousands of his clients have benefited from his advice. Does Barrett's advertisement *most likely* violate any CFA Institute Standards of Professional Conduct?

A. No

B. Yes, related to Misrepresentation

C. Yes, related to Communication with Clients

Answer = B

B is correct because Barrett's client base is made up of a small number of large institutions so stating in the advertisement that his client base is a larger number is a misrepresentation and a violation of Standard I(C). In addition, since the advertisement focuses only on the benefits and does not mention the potential risks of these investments it is also potentially misleading to clients.

3. Darden Crux, CFA, a portfolio manager at SWIFT Asset Management Ltd., (SWIFT) calls a friend to join him for dinner. The friend, a financial analyst at Cyber Kinetics (CK) declines the invitation and explains she is performing due diligence on Orca Electronics, a company CK is about to acquire. After the phone call, Crux searches the Internet for any news of the acquisition but finds nothing. Upon verifying Orca is on SWIFT's approved stock list, Crux purchases Orca's common stock and call options for selective SWIFT clients. Two weeks later, CK announces its intention to acquire Orca. The next day, Crux sells all of the Orca securities, giving the fund a profit of $3 million. What action should Crux *most*

likely take to avoid violating any CFA Institute Standards of Professional Conduct?

A. Refuse to trade based on the information

B. Purchase the stock and call options for all clients

C. Trade only after analyzing the stock diligently and thoroughly

Answer: A

A is correct as members/candidates who possess material nonpublic information that could affect the value of an investment should not act or cause others to act on the information. Crux traded on the material information that Orca is about to be acquired by Cyber Kinetics. The information is non-public because it is not publicly available, which was verified when Crux researched Orca on the Internet and found nothing about the acquisition. Standard II (A).

4. Carla Scott, CFA, is a portfolio manager for a company that manages investment accounts for wealthy individuals. Scott has no beneficial interest in any of the fee-paying accounts she manages, including her uncle's account. When shares in initial public offerings (IPOs) become available, Scott first allocates shares to all her other clients for whom the investment is appropriate; only if shares are still available does she purchase shares in her uncle's account, if the issue is appropriate for him. Scott provides each of her clients with full disclosure of her allocation procedures and has received each client's verbal consent to her allocation procedures. According to the Standards of Practice Handbook, does Scott's method of allocating oversubscribed IPOs violate any CFA Institute Standards of Professional Conduct?

A. No

B. Yes, because she has breached her duty to her uncle

C. Yes, because she has not precleared and reported her Uncle's transactions

Answer: B

Scott's method of allocating oversubscribed IPOs discriminates against her uncle, who is a fee-paying client; she violates the Standard related to Fair Dealing. Family accounts that are fee-paying client accounts should be treated like any other firm account. They should neither receive special treatment nor be disadvantaged because of an existing family relationship.

5. Narupa Rhasta, CFA, is manager of the fast-growing individual account division of a bank and treats all clients equally. When the bank's research department issues a buy or a sell recommendation on a security, she ensures that the recommended action is implemented in all accounts. Do Rhasta's investment actions violate any CFA Institute Standards?

A. No

B. Yes, with respect to suitability

C. Yes, with respect to diligence and a reasonable basis

Answer: B

Members must consider the needs, circumstances and objectives of clients when taking investment action for their accounts. By treating all accounts as if they were the same, Rhasta failed to consider the uniqueness of each client's circumstances.

6. A CFA charter holder agreed in writing with his former employer not to solicit former clients for a period of one year after his termination. After he left his former employer, he consulted with a lawyer about whether the agreement was legally enforceable. The lawyer advised the charter holder that it was doubtful that the agreement could be enforced, so the charter holder sent a marketing brochure about his new firm to his former clients. According to the Standards of Practice Handbook, which of the following statements is *most* accurate with respect to the charter holder's conduct?

A. The Standards do not apply to the charter holder's conduct

B. The Standards require the charter holder to comply with the agreement with his former employer

C. Because the charter holder relied upon the opinion of legal counsel, he did not violate the Standards

Answer: B

A member's duty of loyalty to his employer prohibits him from violating any applicable non-compete agreement. By not complying with a non-compete agreement he also puts his integrity in question.

7. William Wong, CFA, is an equity analyst with Hayswick Securities. Based on his fundamental analysis, Wong concludes the stock of a company he follows, Nolvec Inc., is substantially undervalued and will experience a large price increase. He delays revising his recommendation on the stock from "hold" to "buy" to allow his brother to buy shares at a lower price. Wong is *least likely* to have violated the CFA Institute Standards of Professional Conduct related to:

A. duty to clients

B. reasonable basis

C. priority of transactions

Answer: B

B is correct because there is nothing to suggest that Wong does not have a reasonable basis for his conclusion related to Nolvec. Standard V (A).

8. Sergio Morales, CFA believes he has found evidence his supervisor is engaged in fraudulent activity concerning a client's account. When Morales confronts his supervisor, he is told the client is fully aware of the issue. Later that day, Morales contacts the client and upon disclosing his evidence, is told he should mind his own business. Concerned his job is at risk, Morales provides his evidence, along with copies of the client's most recent account statements, to a government whistle blower program. Morales is *least likely* to have violated which of the following CFA Institute Standards of Professional Conduct?

A. Duties to Clients

B. Duties to Employers

C. Communication with Clients

Answer = C

C is correct because this Standard has not been violated. Even though he talked to the client, the communication did not relate to the investment process. He has violated his duties to clients by disclosing confidential information to the government whistle blower program. He has also violated a duty to his employer as contradicting employer instructions are not permitted unless the member is acting to protect the integrity of capital markets and the interests of clients.

9. Teresa Avila, CFA is a micro cap investment analyst at a hedge fund. The fund requires Avila to hold any securities she recommends for the fund in her own account as well. Because Avila has such a small account, whenever she trades for her own portfolio she combines the transactions with those of the hedge fund so she is sure to have her account aligned with the fund. Has Avila *most likely* violated any CFA Institute Standards of Professional Conduct?

A. No

B. Yes, related to Misconduct

C. Yes, related to Priority of Transactions

Answer = C

C is correct as Standard VI (B) requires that investment transactions for clients and employers have priority over transactions in which members have beneficial ownership. By executing her own accounts transactions with those of the hedge fund the analyst has violated this Standard. Micro cap securities can be thinly traded and easily influenced by changes in the volume of activity so that the analyst may benefit when she combines her transactions with the hedge funds and she should let the fund execute its orders before she makes changes to her account.

10. In order to comply with the GIPS Standards, a firm must initially show GIPS-compliant history for a minimum of:

A. five years, or since inception if the firm has been in existence for less than five years

B. two years, or since inception if the firm has been in existence for less than two years

C. three years, or since inception if the firm has been in existence for less than three years

Answer: A

A firm must initially show GIPS-compliant history for a minimum of five years, or since inception if the firm has been in existence for less than five years.