Solution

A. Correct. CFA charterholders and candidates must place the integrity of the investment profession and the interests of clients above their own personal interests.

B. Incorrect. CFA charterholders and candidates must promote the integrity and viability of the global capital markets for the ultimate benefit of society.

C. Incorrect. Charterholders and candidates must practice and encourage others to participate in a professional and ethical manner that will reflect credit on themselves and the profession. By ignoring unprofessional conduct of others, a member or candidate is not encouraging others to behave in a manner that reflects well on the profession.

Ethical and Professional Standards

- identify the six components of the Code of Ethics and the seven Standards of Professional Conduct

Solution

A. Incorrect. A profession is based on a specialized knowledge and skills, not basic knowledge.

B. Correct. A profession is practiced by members who share and agree to adhere to a common code of ethics, and a profession is based on a specialized knowledge and skills and service to others.

C. Incorrect. A profession is based on service to others that may not necessarily mean the interests of its members come first.

Ethical and Professional Standards

- describe the role of a code of ethics in defining a profession

Solution

A. Incorrect. Justice is often considered an ethical principle in most societies.

B. **Correct.** Most societies acknowledge the ethical principles of honesty, fairness or justice, diligence, and respect for the rights of others. Duplicity or deception would be in violation of most ethical principles.

C. Incorrect. Diligence is often considered an ethical principle in most societies.

Ethical and Professional Standards

- explain ethics

Solution

A. Correct as members and candidates must self-disclose on the annual Professional Conduct Statement all matters that question their professional conduct, such as involvement in civil litigation or a criminal investigation or being the subject of a written complaint.

B. Incorrect as the Code and Standards do not prohibit a member from accepting a bonus while an investigation into his professional behavior is conducted. In this case, the member's actions have been questioned but he has not yet had an opportunity to defend his behavior and may in fact have acted within his authority and earned the compensation fairly.

C. Incorrect as the Code does not require a member to request a suspension of their membership while a complaint is being investigated.

Ethical and Professional Standards

- explain the ethical responsibilities required by the Code and Standards, including the sub-sections of each Standard

Solution

A. Correct as soliciting the bank's client did not violate Standard IV(A)–Loyalty because the manager is no longer an employee of the bank and there is no indication she obtained the client information from bank sources. The member, however, has violated Standard V(C)–Record Retention, because when she left the bank she took the property of the bank without express permission to do so. In addition, the analyst violated Standard I(C)–Misrepresentation by creating research materials without attribution, which is demonstrated when the manager adds to the new report a real estate study she saw in the *Wall Street Journal*, referencing the Journal only. In all instances, a member or candidate must cite the actual source of the information. If she does not obtain the report and review the information, the manager runs the risk of relying on second-hand information that may misstate facts. Best practice would be either to obtain the complete study from its original author and cite only that author or to use the information provided by the intermediary and cite both sources.

B. Incorrect because according to Standard V(C)–Record Retention, when a member or candidate leaves a firm to seek other employment, the member or candidate cannot take the property of the firm, including originals or copies of supporting records of the member's or candidate's work, to the new employer without the express consent of the previous employer.

C. Incorrect because the analyst violated Standard I(C)–Misrepresentation by creating research materials without attribution, which is demonstrated when the manager adds to the new report a real estate study she saw in the *Wall Street Journal*, referencing the Journal only. In all instances, a member or candidate must cite the actual source of the information. If she does not obtain the report and review the information, the manager runs the risk of relying on second-hand information that may misstate facts. Best practice would be to either obtain the complete study from its original author and cite only that author or to use the information provided by the intermediary and cite both sources.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because (1) Kim discusses his concerns with Frost before executing the trade, (2) Frost acknowledges this discussion and accepts the conditions of unsuitability, (3) Kim's firm does not require approval for unsuitable trades since it has no policy on the subject, and (4) the request does not have a material impact on Frost's portfolio since it represents only one percent of its value, hence no modification of the IPS is required. According to Standard III(C), Suitability, in cases of unsolicited trade requests that a member or candidate knows are unsuitable for a client, the member or candidate should refrain from making the trade until he or she discusses the concerns with the client. Following the discussion, the member or candidate may follow his or her firm's policies regarding the necessary client approval for executing unsuitable trades. At a minimum, the client should acknowledge the discussion and accept the conditions that make the recommendation unsuitable. Should the unsolicited request be expected to have a material impact on the portfolio, the member or candidate should use this opportunity to update the investment policy statement.

B. Incorrect because according to Standard III(C), Suitability, members may execute unsuitable trades for clients under certain conditions, which Kim fulfills, as described in the response rationale for the correct answer.

C. Incorrect because according to Standard III(C), Suitability, Kim is not required to update Frost's IPS since the trade size is immaterial, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because a recommended procedure for Standard III (A), Loyalty, Prudence, and Care is members and candidates must disclose all actual and potential conflicts of interest so that clients can evaluate those conflicts. They do not need to eliminate all actual and potential conflicts of interest.

B. **Correct** because a recommended procedure for Standard III (A), Loyalty, Prudence, and Care is members and candidates should make their clients aware of all forms of manager compensation.

C. Incorrect because a recommended procedure for Standard III (A), Loyalty, Prudence, and Care is members and candidates with control of client assets (1) should submit to each client, at least quarterly, an itemized statement showing the funds and securities in the custody. It is a recommended procedure to submit at least quarterly, not annually, itemized statements to clients.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard I (B), Independence and Objectivity, authors of issuer-paid research can accept cash compensation but need to avoid compensation that could influence its research, such as equity. Independent analysts must also strictly limit the type of compensation that they accept for conducting issuer-paid research. Otherwise, the content and conclusions of the reports could reasonably be expected to be determined or affected by compensation from the sponsoring companies. Compensation that might influence the research report could be direct, such as payment based on the conclusions of the report, or indirect, such as stock warrants or other equity instruments that could increase in value on the basis of positive coverage in the report.

B. **Correct** because according to Standard I (B), Independence and Objectivity, members are required to disclose their compensation. Members and candidates must adhere to strict standards of conduct that govern how the research is to be conducted and what disclosures must be made in the report. Analysts must engage in thorough, independent, and unbiased analysis and must fully disclose potential conflicts of interest, including the nature of their compensation.

C. Incorrect because according to Standard I (B), Independence and Objectivity, members are not required to decline to write the report if their firm provides investment banking services to the company. Members and candidates must adhere to strict standards of conduct that govern how the research is to be conducted and what disclosures must be made in the report. Analysts must engage in thorough, independent, and unbiased analysis and must fully disclose potential conflicts of interest. So, members need not decline to write the report if a potential conflict of interest exists (such as their firm providing investment banking services), although they do need to disclose such conflicts.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard V(B), Communication with Clients and Prospective Clients, if recommendations are contained in capsule form (such as a recommended stock list), members and candidates should notify clients that additional information and analyses are available from the producer of the report. Julies has not violated the Standards by emailing stock recommendations to her clients in capsule form because he offers additional information upon request.

B. **Correct** because according to Standard I(C), Misrepresentation members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities. By using PII's marketing brochure that inflates performance to present to prospective clients, Jules has violated Standard I(C).

C. Incorrect because according to Standard V(B), Communication with Clients and Prospective Clients, if recommendations are contained in capsule form (such as a recommended stock list), members and candidates should notify clients that additional information and analyses are available from the producer of the report. Julies has not violated the Standards by emailing stock recommendations to her clients in capsule form because he offers additional information upon request.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because Jennings violated Standard II (A), Material Nonpublic Information, by sharing what she overheard from United Retail CEO with her sister, as described in the response rationale for the correct answer.

B. Correct because according to Standard II (A), Material Nonpublic Information, Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information. Also, Information is "material" if its disclosure would probably have an impact on the price of a security or if reasonable investors would want to know the information before making an investment decision -- such as the results of an upcoming quarterly report from a reliable source (the CEO). Jennings prompted her sister to act on it, hence, violated the Standard.

C. Incorrect because according to Standard II (A), Material Nonpublic Information, The analyst may use significant conclusions derived from the analysis of public and nonmaterial nonpublic information as the basis for investment recommendations and decisions even if those conclusions would have been material inside information had they been communicated directly to the analyst by a company. Under the "mosaic theory," financial analysts are free to act on this collection, or mosaic, of information without risking violation. In this case, Jennings uses public and material nonpublic information to arrive at her recommendation, hence no violation.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard II(A) Material Nonpublic Information, information regarding orders before execution may be material, but not after execution. Material information may include, but is not limited to, information on the following: orders for large trades before they are executed.

B. **Correct** because according to Standard II(A) Material Nonpublic Information, material information may include, but is not limited to, information on the following: significant legal disputes.

C. Incorrect because according to Standard II(A) Material Nonpublic Information, information discussed at an annual general meeting is not nonpublic since the information is widely available. Information is 'nonpublic' until it has been disseminated or is available to the marketplace in general (as opposed to a select group of investors).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard III (B), Fair Dealing, the member is required to treat all clients in a fair and impartial manner, not necessarily an equal manner, as described in the response rationale for the correct answer.

B. **Correct** because according to Standard III (B), Fair Dealing, members and candidates must make every effort to treat all individual and institutional clients in a fair and impartial manner. Additionally, the term 'fairly' implies that the member or candidate must take care not to discriminate against any clients when disseminating investment recommendations or taking investment action. Standard III(B) does not state 'equally' because members and candidates could not possibly reach all clients at exactly the same time...

C. Incorrect because according to Standard III (B), Fair Dealing, the member is required to treat all clients in a fair and impartial manner, not necessarily an equal manner, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard III (B), Fair Dealing, Members and candidates should disclose to all clients whether the organization offers different levels of service to clients for the same fee or different fees. Different levels of service should not be offered to clients selectively.

B. **Correct** because according to Standard III (B), Fair Dealing, Members and candidates should disclose to clients and prospective clients how they select accounts to participate in an order.

C. Incorrect because Members and candidates should make reasonable efforts to limit the number of people who are privy to the fact that a recommendation is going to be disseminated. All staff should not be informed to avoid risk of leakage of recommendations before dissemination.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard IV(A), Loyalty, a member or candidate who is contemplating seeking other employment must not contact existing clients or potential clients prior to leaving his or her employer for purposes of soliciting their business for the new employer. Therefore, Statement 1 is not accurate.

B. Correct because according to Standard IV(A), Loyalty, a departing employee is generally free to make arrangements or preparations to go into a competitive business before terminating the relationship with his or her employer as long as such preparations do not breach the employee's duty of loyalty. Also, Allen's (the member's) preparation for the new business by registering with the regulatory authorities does not conflict with the work for her employer if the preparations have been done on Allen's (the member's) own time outside the office and if Allen (the member) will not be soliciting clients for the business or otherwise operating the new company until she has left her current employer. Therefore, Statement 2 is accurate.

C. Incorrect because, as described in the rationale for the correct answer, only Statement 2 is accurate. A member or candidate who is contemplating seeking other employment must not contact existing clients or potential clients prior to leaving his or her employer for purposes of soliciting their business for the new employer. Therefore, Statement 1 is in not accurate.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard VI(A), Disclosure of Conflicts, buy-side members and candidates should disclose their procedures for reporting requirements for personal transactions. Therefore, disclosing a beneficial ownership in any security is not a requirement.

B. Correct because according to Standard VI(A), Disclosure of Conflicts, buy-side members and candidates should disclose their procedures for reporting requirements for personal transactions. Conflicts arising from personal investing are discussed more fully in the guidance for Standard VI(B). Therefore, not disclosing the procedure for a buy-side member is a violation.

C. Incorrect because according to Standard VI(B), Priority of Transactions, investment personnel involved in the investment decision-making process should establish blackout periods prior to trades for clients so that managers cannot take advantage of their knowledge of client activity by "front-running" client trades (trading for one's

personal account before trading for client accounts). Therefore, blackout period is not to restrict trading for clients.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard VI(B), Priority of Transactions, family accounts that are client accounts should be treated like any other firm account and should neither be given special treatment nor be disadvantaged because of the family relationship. If a member or candidate has a beneficial ownership in the account, however, the member or candidate may be subject to preclearance or reporting requirements of the employer or applicable law. Mak should treat his brother's fee paying account like any other firm account and should not be disadvantaged. Therefore, Mak's actions are not consistent with the Standard relating to priority of transactions.

B. **Correct** because according to Standard VI(B), Priority of Transactions, family accounts that are client accounts should be treated like any other firm account and should neither be given special treatment nor be disadvantaged because of the family relationship. If a member or candidate has a beneficial ownership in the account, however, the member or candidate may be subject to preclearance or reporting requirements of the employer or applicable law. Mak should treat his brother's fee paying account like any other firm account and should not be disadvantaged. Therefore, Mak's actions are not consistent with the Standard relating to priority of transactions.

C. Incorrect because according to Standard V(A), Diligence and Reasonable Basis, Members and Candidates must: 1. Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions. 2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action. Mak has completed a comprehensive research before buying AOT's stock for his clients. Therefore, Mak's actions are consistent with the Standard relating to diligence and reasonable basis.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because once a firm claims compliance with the Standards, they may voluntarily hire an independent third party to perform a verification in order to increase confidence in the firm's claim of compliance. Therefore, verification is voluntary, not mandatory.

B. Incorrect because firms self-regulate their claim of compliance and once a firm claims compliance with the Standards, they may voluntarily hire an independent third party to perform a verification in order to increase confidence in the firm's claim of compliance. Therefore, a firm cannot certify its own claim of compliance.

C. **Correct** because according to GIPS, Verification is a process by which an independent verification firm (verifier) conducts testing of a firm on a firm-wide basis in accordance with the required verification procedures of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis.

Ethical and Professional Standards

- describe the concept of independent verification

Solution

A. Incorrect because Standard VII (A), Conduct as Participants in CFA Institute Programs, does not prohibit candidates from discussing nonconfidential information or curriculum material with others or in study groups in preparation for the exam. Therefore, the candidate has not violated Standard VII (A) by discussing broad topic areas covered in the curriculum in an online forum.

B. **Correct** because according to Standard VII (A), Conduct as Participants in CFA Institute Programs, CFA Institute program rules, regulations, and policies prohibit candidates from disclosing confidential material gained during the exam process. Examples of information that cannot be disclosed by candidates sitting for an exam include but are not limited to broad topical areas and formulas tested or not tested on the exam. Therefore, the candidate has violated Standard VII (A) by telling her brother how glad she was that no questions about the binomial model were asked.

C. Incorrect because Standard VII (A), Conduct as Participants in CFA Institute Programs, does not cover expressing opinions regarding CFA Institute, the CFA Program, or other CFA Institute programs. Members and candidates are free to disagree and express their disagreement with CFA Institute on its policies, its procedures, or any advocacy positions taken by the organization. When expressing a personal opinion, a candidate is prohibited from disclosing content-specific information, including any actual exam question and the information as to subject matter covered or not covered in the exam. Therefore, the candidate has not violated Standard VII (A) by publishing on a social media website her disappointment about what she thinks is an overly academic CFA Program.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Lumunon has violated not only Standard I (C), Misrepresentation, but also Standard III (D), Performance Presentation, as described in the rationale for the correct answer.

B. Incorrect because Lumunon has violated not only Standard III (D), Performance Presentation, but also Standard I (C), Misrepresentation, as described in the rationale for the correct answer.

C. **Correct** because according to Standard I (C), Misrepresentation, a member or candidate must not knowingly omit or misrepresent information or give a false impression of a firm, organization, or security in the member's or candidate's oral representations, advertising (whether in the press or through brochures), electronic communications, or written materials (whether publicly disseminated or not). By showing investment results of only one "balanced" account, and failing to disclose that that this is the best-performing account and that half of the balanced accounts underperformed the benchmark, Lumunon has violated Standard I (C). Further Standard III (D), Performance Presentation, requires members and candidates to avoid misstating performance or misleading clients and prospective clients about the investment performance of members or candidates or their firms. This standard encourages full disclosure of investment performance data to clients and prospective clients. Thus, Lumunon has also violated Standard III (D).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard I(A), Knowledge of the Law, Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations. In this case, by staying silent in a client meeting in which he knows false information is being given to a potential investor that could cause harm to that investor, Kope would be seen as assisting Bose in providing that false information, even though Kope is not actively engaging in the misconduct himself. Kope should report her conduct to the fund's compliance department for it to address and should dissociate himself from activities involving Bose and report Bose's conduct to the fund's compliance department.

B. Incorrect because according to Standard I(A), Knowledge of the Law, Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations. In this case, Kope should report Bose's conduct to the fund's compliance department for it to address and should report Bose's conduct to the fund's compliance department and dissociate himself from activities involving Bose.

C. **Correct** because according to Standard I(A), Knowledge of the Law, Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations. In this case, by staying silent in a client meeting in which he knows false information is being given to a potential investor that could cause harm to that investor, Kope would be seen as assisting Bose in providing that false information, even though Kope is not actively engaging in the misconduct himself. Kope should report her conduct to the fund's compliance department for it to address and should dissociate himself from activities involving Bose and report Bose's conduct to the fund's compliance department.

Ethical and Professional Standards

- explain how the practices, policies, and conduct do or do not violate the CFA Institute Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to recommended procedures for compliance with Standard IV (C), Responsibilities of Supervisors, Stand-alone codes of ethics should be written in plain language and should address general fiduciary concepts.

B. Incorrect because according to recommended procedures for compliance with Standard IV (C), Responsibilities of Supervisors, mingling compliance procedures in the firm's code of ethics goes against the goal of reinforcing the ethical obligations of employees.

C. Incorrect because according to recommended procedures for compliance with Standard IV (C), Responsibilities of Supervisors, Members and candidates should encourage their employers to provide their codes of ethics to clients.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to Standard V(A) Investment Analysis, Recommendations, and Actions - Diligence and Reasonable Basis, Members and Candidates must: Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions.

B. Incorrect because the guidance for Standard V(A) Diligence and Reasonable Basis states that although they are not required to become experts in every technical aspect of the models, they must understand the assumptions and limitations inherent in any model and how the results were used in the decision-making process.

C. Incorrect because the guidance for Standard V(A) Diligence and Reasonable Basis states that in some instances, a member or candidate will not agree with the view of the group. If, however, the member or candidate believes that the consensus opinion has a reasonable and adequate basis and is independent and objective, the member or candidate need not decline to be identified with the report. If the member or candidate is confident in the process, the member or candidate does not need to dissociate from the report even if it does not reflect his or her opinion.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard VII(A) does *not* cover expressing opinions regarding CFA Institute, the CFA Program, or other CFA Institute programs. Members and candidates are free to disagree and express their disagreement with CFA Institute on its policies, its procedures, or any advocacy positions taken by the organization. So, Comment 1 does not violate the Standard as it reflects Banerjee's opinion.

B. Correct because according to Standard VII(A), when expressing a personal opinion, a candidate is prohibited from disclosing content-specific information, including any actual exam question and the information as to subject matter covered or not covered in the exam. By making Comment 2, Banerjee may have provided information on the subject matter covered on the exam and hence violated the Standard.

C. Incorrect because Standard VII(A) does *not* cover expressing opinions regarding CFA Institute, the CFA Program, or other CFA Institute programs. Members and candidates are free to disagree and express their disagreement with CFA Institute on its policies, its procedures, or any advocacy positions taken by the organization. So, Comment 1 does not violate the Standard as it reflects Banerjee's opinion. However, in making Comment 2, Banerjee may have provided information on the subject matter covered on the exam and hence violated the Standard.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard II(B), Market Manipulation, transaction-based manipulation includes, but is not limited to, the following: transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market, and securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset. Also, the intent of the action is critical to determining whether it is a violation of this standard. Despite the losses, Activity 1 is a violation of Standard II(B) because the intent was to influence the price of the underlying. Activity 2 is also a violation as the intent was to increase the volume of the stock.

B. Incorrect because according to Standard II(B), Market Manipulation, transaction-based manipulation includes, but is not limited to, the following: transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market, and securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset. Also, the intent of the action is critical to determining whether it is a violation of this standard. Activity 2 is a violation as the intent was to increase the volume of the stock. Despite the losses, Activity 1 is also a violation of Standard II(B) because the intent was to influence the price of the underlying.

C. **Correct** because according to Standard II(B), Market Manipulation, transaction-based manipulation includes, but is not limited to, the following: transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market, and securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset. Also, the intent of the action is critical to determining whether it is a violation of this standard." Despite the losses, Activity 1 is a violation of Standard II(B) because the intent was to influence the price of the underlying. Activity 2 is also a violation as the intent was to increase the volume of the stock.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because according to the GIPS standards, a claim of compliance requires that all fee-paying discretionary accounts managed by the firm be included in at least one composite. Non-discretionary portfolios must not be included in a firm's composites. Fee-paying non-discretionary portfolios do not have to be included.

B. **Correct** because according to the GIPS standards, A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy.

C. Incorrect because according to the GIPS standards, the determination of which portfolios to include in the Composite should be done according to pre-established criteria (i.e., on an ex-ante basis), not after the fact. Basing it on actual performance would require the aggregation to be done after the fact which is incorrect.

Ethical and Professional Standards

- explain the purpose of composites in performance reporting

Solution

A. Incorrect because Holm violated both Standards III (A) and VI (C), as described in the Response Rationale for the correct answer.

B. Incorrect because Holm violated both Standards III (A) and VI (C), as described in the Response Rationale for the correct answer.

C. **Correct** because according to Standard III (A), Loyalty, Prudence and Care. Conflicts may arise when an investment manager uses client brokerage to purchase research services, a practice commonly called 'soft dollars' or 'soft commissions.' A member or candidate who pays a higher brokerage commission than he or she would normally pay to allow for the purchase of goods or services, without corresponding benefit to the client, violates the duty of loyalty to the client. Paying higher fees in return for referrals does not represent a corresponding benefit to Holm's clients. Therefore, this arrangement violates the duty of loyalty to his clients. In addition, Holm has violated Standard VI (C), Referral Fees, which states the responsibility of members and candidates to inform their employer, clients, and prospective clients of any benefit received for referrals of customers and clients.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard I (D), Misconduct, personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy, but if the circumstances of the bankruptcy involve fraudulent or deceitful business conduct, the bankruptcy may be a violation of this standard. Also, generally, Standard I(D) is not meant to cover legal transgressions resulting from acts of civil disobedience in support of personal beliefs because such conduct does not reflect poorly on the member's or candidate's professional reputation, integrity, or competence. Therefore, Fischer has not violated Standard I (D). Further, Standard III (A), Loyalty, Prudence, and Care, states that Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. Neither Fischer's bankruptcy no nor the act of trespassing during a protest imposes on her duty of loyalty to her clients. She has not violated Standard III (A).

B. Incorrect because according to Standard I (D), Misconduct, personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy, but if the circumstances of the bankruptcy involve fraudulent or deceitful business conduct, the bankruptcy may be a violation of this standard. Also, generally, Standard I(D) is not meant to cover legal transgressions resulting from acts of civil disobedience in support of personal beliefs because such conduct does not reflect poorly on the member's or candidate's professional reputation, integrity, or competence. Therefore, Fischer has not violated Standard I (D).

C. Incorrect because according to Standard III (A), Loyalty, Prudence, and Care, Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. Neither Fischer's bankruptcy no nor the act of trespassing during a protest imposes on her duty of loyalty to her clients. She has not violated Standard III (A).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to the recommended procedures for compliance with Standard I (B), Independence and Objectivity, Members and candidates should encourage their investment firms to develop formal policies related to employee purchases of equity or equity-related IPOs. Firms should require prior approval for employee participation in IPOs, with prompt disclosure of investment actions taken following the offering. So, the recommendation is to have regulation around IPOs, but not explicitly prohibit them.

B. Correct because according to the recommended procedures for compliance with Standard I (B), Independence and Objectivity, Create a restricted list: If the firm is unwilling to permit dissemination of adverse opinions about a corporate client, members and candidates should encourage the firm to remove the controversial company from the research universe and put it on a restricted list so that the firm disseminates only factual information about the company.

C. Incorrect because according to the recommended procedures for compliance with Standard I (B), Independence and Objectivity, Firms should provide every employee with the procedures and policies for reporting potentially unethical behavior, violations of regulations, or other activities that may harm the firm's reputation. So, firms should provide to every employee, not every client.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to the recommended procedures for compliance with Standard I(D), misconduct, members and candidates should encourage their firms to adopt the following policies and procedures to support the principles of Standard I(D): *List of violations*: Disseminate to all employees a list of potential violations and associated disciplinary sanctions, up to and including dismissal from the firm. Dissemination to clients is not among the recommended procedures.

B. Correct because according to the recommended procedures for compliance with Standard I(D), misconduct, members and candidates should encourage their firms to adopt the following policies and procedures to support the principles of Standard I(D):

List of violations: Disseminate to all employees a list of potential violations and associated disciplinary sanctions, up to and including dismissal from the firm.

C. Incorrect because according to the recommended procedures for compliance with Standard I(D), misconduct, members and candidates should encourage their firms to adopt the following policies and procedures to support the principles of Standard I(D): *List of violations*: Disseminate to all employees a list of potential violations and associated disciplinary sanctions, up to and including dismissal from the firm. Dissemination to clients is not among the recommended procedures.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to the recommended procedures for compliance with the Standard I (D), Misconduct, members should encourage their firms to check references of potential employees to ensure that they are of good character and not ineligible to work in the investment industry because of past infractions of the law. However, the Standard does not recommend to conduct background checks of all current (as opposed to potential) employees once per year.

B. Correct because according to the recommended procedures for compliance with the Standard I (D), Misconduct, members should encourage their firms to develop and/or adopt a code of ethics to which every employee must subscribe.

C. Incorrect because according to the recommended procedures for compliance with the Standard I (D), Misconduct, members should encourage their firms to check references of potential employees to ensure that they are of good character and not ineligible to work in the investment industry because of past infractions of the law. Therefore, the recommendation is to check references of potential employees, not clients.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard III (A), Loyalty, Prudence, and Care, 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.

B. **Correct** because according to Standard III (A), Loyalty, Prudence, and Care, proxies have economic value to a client, and members and candidates must ensure that they properly safeguard and maximize this value.

C. Incorrect because according to Standard III (A), Loyalty, Prudence, and Care, an investment manager who fails to vote, casts a vote without considering the impact of the question, or votes blindly with management on nonroutine governance issues (e.g., a change in company capitalization) may violate this standard. Therefore, the statement that consistent application of proxy policies includes voting with management on all nonroutine governance matters is not accurate.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard IV (A), Loyalty, employers must recognize the duties and responsibilities that they owe to their employees if they expect to have content and productive employees. Further, this standard is not meant to be a blanket requirement to place employer interests ahead of personal interests in all matters. Therefore, Statement 1 - employees must place employer interests ahead of personal interests in all matters - is not accurate.

B. **Correct** because according to Standard IV (A), Loyalty, the employer is responsible for a positive working environment, which includes an ethical workplace. Senior management has the additional responsibility to devise compensation structures and incentive arrangements that do not encourage unethical behavior. Therefore, Statement 2 is accurate.

C. Incorrect because according to Standard IV (A), Loyalty, employers must recognize the duties and responsibilities that they owe to their employees if they expect to have content and productive employees. Further, this standard is not meant to be a blanket requirement to place employer interests ahead of personal interests in all matters. Therefore, Statement 1 - employees must place employer interests ahead of personal interests in all matters - is not accurate.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard I(A) Knowledge of the Law, if a member or candidate has reasonable grounds to believe that imminent or ongoing client or employer activities are illegal or unethical, the member or candidate must disassociate, or separate, from the activity. Inaction combined with continuing association with those involved in illegal or unethical conduct may be constructed as participation or assistance in the illegal or unethical conduct.

B. Incorrect because according to Standard VI(A), Disclosure of Conflicts, Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and Candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively. This Standard does not apply to guiding a member's behaviour for cases in which the member believe that a colleague participates in unethical behaviour. Here, the member has not violated Standard VI (A).

C. Incorrect because according to Standard VI(A), Disclosure of Conflicts, Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and Candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively. This Standard does not apply to guiding a member's behaviour for cases in which the member believe that a colleague participates in unethical behaviour. Here, the member has not violated Standard VI (A).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard IV (A), Loyalty, this standard is not meant to be a blanket requirement to place employer interests ahead of personal interests in all matters. The standard does not require members and candidates to subordinate important personal and family obligations to their work.

B. **Correct** because although Standard IV (A), Loyalty, does not preclude members or candidates from entering into an independent business while still employed, members and candidates who plan to engage in independent practice for compensation must notify their employer and describe the types of services they will render to prospective independent clients, the expected duration of the services, and the compensation for the services. Members and candidates should not render services until they receive consent from their employer to all of the terms of the arrangement.

C. Incorrect because according to Standard IV (A), Loyalty, circumstances may arise (e.g., when an employer is engaged in illegal or unethical activity) in which members and candidates must act contrary to their employer's interests in order to comply with their duties to the market and clients. In such instances, activities that would normally violate a member's or candidate's duty to his or her employer (such as contradicting employer instructions, violating certain policies and procedures, or preserving a record by copying employer records) may be justified.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Milton must disclose that he receives a bonus for using the firm's proprietary funds to the client, so he is in violation of Standard III (A), Loyalty, Prudence, and Care, as described in the rationale for the correct answer.

B. Incorrect because Standard III (C), Suitability, requires that members and candidates who are in an investment advisory relationship with clients consider carefully the needs, circumstances, and objectives of the clients when determining the appropriateness and suitability of a given investment or course of investment action. Milton is making his investment decisions for his clients based on their objectives and risk tolerance, and suitability, and therefore is not in violation of this Standard.

C. Correct because according to Standard III (A), Loyalty, Prudence, and Care, Particular care must be taken to detect whether the goals of the investment manager or the firm in conducting business, selling products, and executing security transactions potentially conflict with the best interests and objectives of the client. When members and candidates cannot avoid potential conflicts between their firm and clients' interests, they must provide clear and factual disclosures of the circumstances to the clients. Milton must disclose that he receives a bonus for using the firm's proprietary funds to the client, and is in violation of this Standard.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard I(B), Independence and Objectivity, members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities.

As for Procedure 1, restrict investments: Members and candidates should encourage their investment firms to develop formal policies related to employee purchases of equity or equity-related IPOs. Firms should require prior approval for employee participation in IPOs, with prompt disclosure of investment actions taken following the offering. Strict limits should be imposed on investment personnel acquiring securities in private placements.

As for Procedure 2, restrict special cost arrangements: When attending meetings at an issuer's headquarters, members and candidates should pay for commercial transportation and hotel charges. No corporate issuer should reimburse members or candidates for air transportation.

B. Incorrect because Procedure 1 is among the recommended procedures for compliance with the Standard relating to independence and objectivity, but Procedure 3 is not.

As for Procedure 3, create a restricted list: If the firm is unwilling to permit dissemination of adverse opinions about a corporate client, members and candidates should encourage the firm to remove the controversial company from the research universe and put it on a restricted list so that the firm disseminates only factual information about the company. Thus, putting the company on the restricted list is among the recommended procedures.

C. Incorrect because Procedure 2 is among the recommended procedures for compliance with the Standard relating to independence and objectivity, but Procedure 3 is not.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard III (A), Loyalty, Prudence, and Care, the shareholders are not the beneficiaries of his fund. When the manager is responsible for the portfolios of pension plans or trusts, however, the client is not the person or entity who hires the manager but, rather, the beneficiaries of the plan or trust. The duty of loyalty is owed to the ultimate beneficiaries.

B. Incorrect because according to Standard III (A), Loyalty, Prudence, and Care, the shareholders are not the beneficiaries of his fund. When the manager is responsible for the portfolios of pension plans or trusts, however, the client is not the person or entity who hires the manager but, rather, the beneficiaries of the plan or trust. The duty of loyalty is owed to the ultimate beneficiaries.

C. **Correct** because according to Standard III (A), Loyalty, Prudence, and Care, the shareholders are not the beneficiaries of his fund. When the manager is responsible for the portfolios of pension plans or trusts, however, the client is not the person or entity who hires the manager but, rather, the beneficiaries of the plan or trust. The duty of loyalty is owed to the ultimate beneficiaries.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard I(D), Misconduct, Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence. Joon's actions do not result from fraudulent or deceitful business conduct and personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy. Also, according to Standard III(A), Loyalty, Prudence, and Care, Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. There is nothing here to suggest that Joon has not acted for the benefit of his clients.

B. Incorrect because according to Standard I(D), Misconduct, Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence. Joon's actions do not result from fraudulent or deceitful business conduct and personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy. So, Joon has not violated this Standard.

C. Incorrect because according to Standard III(A), Loyalty, Prudence, and Care, Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. There is nothing here to suggest that Joon has not acted for the benefit of his clients. So, Joon has not violated this Standard.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard II (B), Market Manipulation, Transaction-based manipulation involves instances where a member or candidate knew or should have known that his or her actions could affect the pricing of a security. This type of manipulation includes, but is not limited to, the following: securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset.

B. Incorrect because according to Standard II (B), Market Manipulation, Information-based manipulation includes, but is not limited to, spreading false rumors to induce trading by others. Here, the member is not engaging in spreading rumours or alike; the member actions are not an example of information-based manipulation.

C. Incorrect because the member has violated Standard II (B), Market Manipulation, by engaging in transaction-based manipulation, as described in the response rationale for the correct answer. Meanwhile, Information-based manipulation includes, but is not limited to, spreading false rumors to induce trading by others.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because "[m]embers and candidates can also meet their obligations under Standard III (D) [relating to performance presentation] by... ▪ including terminated accounts as part of performance history with a clear indication of when the accounts were terminated..." Hence, terminated accounts should be included, not excluded, in the performance presentation.

B. Incorrect because according to Standard III (D), Performance Presentation, "[m]embers and candidates can also meet their obligations under Standard III (D) [relating to performance presentation] by ... ▪ presenting the performance of the weighted composite of similar portfolios rather than using a single representative account..." Hence, a single representative account should not be used.

C. **Correct** because according to Standard III (D), Performance Presentation, "[m]embers and candidates can also meet their obligations under Standard III (D) [relating to performance presentation] by ... ▪ including disclosures that fully explain the performance results being reported (for example, stating, when appropriate, that results are simulated when model results are used, clearly indicating when the performance record is that of a prior entity, or disclosing whether the performance is gross of fees, net of fees, or after tax)..." Hence, the use of simulated results should be disclosed.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard III (D), Performance Presentation, information should be made available to both clients and prospects on request, as described in the response rationale for the correct answer.

B. Incorrect because according to Standard III (D), Performance Presentation, information should be made available to both clients and prospects on request, as described in the response rationale for the correct answer.

C. **Correct** because according to Standard III (D), Performance Presentation, if the presentation is brief, the member or candidate must make available to clients and prospects, on request, the detailed information supporting that communication. Best practice dictates that brief presentations include a reference to the limited nature of the information provided.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard III (C), Suitability, Some members and candidates do not manage money for individuals but are responsible for managing a fund to an index or an expected mandate. The responsibility of these members and candidates is to invest in a manner consistent with the stated mandate.

B. Incorrect because according to Standard III (C), Suitability, Members and candidates who manage pooled assets to a specific mandate are not responsible for determining the suitability of the fund as an investment for investors who may be purchasing shares in the fund. The responsibility for determining the suitability of an investment for clients can be conferred only on members and candidates who have an advisory relationship with clients. Therefore, members managing a mutual fund to a mandate are not required to determine the suitability of the fund for investors who may be purchasing shares in the fund.

C. Incorrect because according to Standard III (C), Suitability, Members and candidates who manage pooled assets to a specific mandate are not responsible for determining the suitability of the fund as an investment for investors who may be purchasing shares in the fund. The responsibility for determining the suitability of an investment for clients can be conferred only on members and candidates who have an advisory relationship with clients. Therefore, members managing a mutual fund to a mandate are not required to determine the suitability of the fund for investors who may be purchasing shares in the fund.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Hicks violated Standard III (E), Preservation of Confidentiality, by providing e-mails of his former clients to his friend, as described in the response rationale for the correct answer.

B. Incorrect because according to Standard I (D), Misconduct, Personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy, but if the circumstances of the bankruptcy involve fraudulent or deceitful business conduct, the bankruptcy may be a violation of this standard. In this case Moll's bankruptcy is due to medical bills, thus a personal rather than a professional matter, hence no violation.

C. **Correct** because according to Standard III (E), Preservation of Confidentiality, This standard protects the confidentiality of client information even if the person or entity is no longer a client of the member or candidate. Therefore, members and candidates must continue to maintain the confidentiality of client records even after the client relationship has ended. Thus revealing e-mails of former clients is a violation.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Dixon violates Standard III(D), Performance Presentation, by telling his clients they can expect a return of 5% in the next three years as described in the response rationale of the correct answer.

B. Incorrect because Dixon violates Standard III(D), Performance Presentation, by telling his clients they can expect a return of 5% in the next three years as described in the response rationale of the correct answer.

C. **Correct** because according to Standard III(D), Performance Presentation, members and candidates should not state or imply that clients will obtain or benefit from a rate of return that was generated in the past. Also, If the presentation is brief, the member or candidate must make available to clients and prospects, on request, the detailed information supporting that communication.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard IV (B), Additional Compensation Arrangements, compensation and benefits include direct compensation by the client and any indirect compensation or other benefits received from third parties. Thus a member may accept compensation from both existing clients and other third parties but must gain consent in writing from both parties before accepting the compensation.

B. Incorrect because according to Standard IV (B), Additional Compensation Arrangements, members must obtain permission from their employer before accepting compensation or other benefits from third parties for the services rendered to the employer or for any services that might create a conflict with their employer's interest.

C. Correct because according to Standard IV (B), Additional Compensation Arrangements, Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain written consent from all parties involved. Also, Standard IV (B) requires members and candidates to obtain permission from their employer before accepting compensation or other benefits from third parties for the services rendered to the employer or for any services that might create a conflict with their employer's interest. Thus, the consent in writing from both parties is needed before accepting the compensation.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard IV (B), Additional Compensation Arrangements, requires Run to obtain written consent from his employer before accepting both the beach home offer and the family flight voucher. By failing to obtain his employer's consent, Run has violated Standard IV (B), as described in the response rationale for the correct answer.

B. Incorrect because Standard IV (B), Additional Compensation Arrangements, requires Run to obtain written consent from his employer before accepting not only the beach home offer but also the family flight voucher. Therefore, as described in the response rationale for the correct answer, Run has violated Standard IV (B) by accepting both the beach home offer and the family flight voucher without informing his employer.

C. **Correct** because according to Standard IV (B), Additional Compensation Arrangements, Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain written consent from all parties involved. Further, Standard IV (B) states: Compensation and benefits include direct compensation by the client and any indirect compensation or other benefits received from third parties. Therefore, Run has to obtain written consent from his employer before accepting the beach home offer and the family flight voucher. By failing to do so, Run has violated Standard IV (B).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard III (C), Suitability, suitability review can be done most effectively when the client fully discloses his or her complete financial portfolio, including those portions not managed by the member or candidate. If clients withhold information about their financial portfolios, the suitability analysis conducted by members and candidates cannot be expected to be complete; it must be based on the information provided. Ayers may develop an investment program that is suitable for the client without knowing about their other assets, even though the information is not complete. In addition, Standard III (C) also states after formulating long-term capital market expectations, members and candidates can assist in developing an appropriate strategic asset allocation and investment program for the client, whether these are presented in separate documents or incorporated in the IPS or in appendices to the IPS. Ayers may keep these records in a separate document.

B. Incorrect because using separate documents for the investment program is allowed by Standard III (C), Suitability, as stated in the rationale for the correct answer.

C. Incorrect because members are allowed by Standard III (C), Suitability, to develop an investment program as best they can given incomplete information about all of the client's assets, as stated in the rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard IV (C) Responsibilities of Supervisors encourages members and candidates to recommend that their employers to adopt a code of ethics, but it does not require the member to decline supervisory responsibilities if no code of ethics in place. A member or candidate with supervisory responsibilities should bring an inadequate compliance system to the attention of the firm's senior managers and recommend corrective action. If the member or candidate clearly cannot discharge supervisory responsibilities because of the absence of a compliance system or because of an inadequate compliance system, the member or candidate should decline in writing to accept supervisory responsibility until the firm adopts reasonable procedures to allow adequate exercise of supervisor responsibility.

B. Incorrect because according to Standard IV(C) Responsibilities of Supervisors, Members and Candidates may delegate supervisory duties to subordinates who directly oversee the other employees.

C. **Correct** because according to Standard IV (C) Responsibilities of Supervisors, once a supervisor learns that an employee has violated or may have violated the law or the Code and Standards, the supervisor must promptly initiate an assessment to determine the extent of the wrongdoing. Relying on an employee's statements about the extent of the violation or assurances that the wrongdoing will not reoccur is not enough.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard IV(A), Loyalty, in matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer. Activities that might constitute a violation, especially in combination, include the following: misappropriation of clients or client lists. Therefore, emailing himself a list of his clients when leaving his employer is not permitted by Standard IV(A).

B. Incorrect because according to Standard IV(A), Loyalty, Included in Standard IV(A) is the requirement that members and candidates abstain from independent competitive activity that could conflict with the interests of their employer. Although Standard IV(A) does not preclude members or candidates from entering into an independent business while still employed, members and candidates who plan to engage in independent practice for compensation must notify their employer and describe the types of services they will render to prospective independent clients, the expected duration of the services, and the compensation for the services. Members and candidates should not render competitive services until they receive consent from their employer to all of the terms of the arrangement.

C. **Correct** because according to Standard IV(A), Loyalty, the standard does not prohibit former employees from contacting clients of their previous firm as long as the contact information does not come from the records of the former employer or violate an applicable 'noncompete agreement'. Members and candidates are free to use public information after departing to contact former clients without violating Standard IV(A) as long as there is no specific agreement not to do so.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard V (A), Diligence and Reasonable Basis, to use quantitative models in her investment research, a member is not required to personally develop or co-develop the model. The Standard requires a member to understand the assumptions and limitations inherent in the model developed by others, as described in the response rationale for the correct answer.

B. Incorrect because according to Standard V (A), Diligence and Reasonable Basis, Although they [members] are not required to become experts in every technical aspect of the models, they must understand the assumptions and limitations inherent in any model and how the results were used in the decision-making process. Therefore, to use quantitative models in her investment research, a member is only required to understand the assumptions and limitations inherent in the model developed by others, as described in the response rationale for the correct answer.

C. **Correct** because according to Standard V (A), Diligence and Reasonable Basis, Members and candidates need to have an understanding of the parameters used in models and quantitative research that are incorporated into their investment recommendations. Although they are not required to become experts in every technical aspect of the models, they must understand the assumptions and limitations inherent in any model and how the results were used in the decision-making process. Therefore, to use quantitative models in her investment research, a member is required to understand the assumptions and limitations inherent in the model developed by others.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard III(A) Loyalty, Prudence and Care, from time to time, a client will direct a manager to use the client's brokerage to purchase goods or services for the client, a practice that is commonly called "directed brokerage." Because brokerage commission is an asset of the client and is used to benefit that client, not the manager, such a practice does not violate any duty of loyalty. Also, the member or candidate should disclose to the client that the client may not be getting best execution from the directed brokerage. In addition, conflicts may arise when an investment manager uses client brokerage to purchase research services, a practice commonly called "soft dollars" or "soft commissions." A member or candidate who pays a higher brokerage commission than he or she would normally pay to allow for the purchase of goods or services, without corresponding benefit to the client, violates the duty of loyalty to the client. In this case, the research is of high quality and benefits the client, so Newman is not in violation of the Standard.

B. Incorrect because according to Standard III(A) Loyalty, Prudence and Care, conflicts may arise when an investment manager uses client brokerage to purchase research services, a practice commonly called "soft dollars" or "soft commissions." A member or candidate who pays a higher brokerage commission than he or she would normally pay to allow for the purchase of goods or services, without corresponding benefit to the client, violates the duty of loyalty to the client. In this case, the research is of high quality and benefits the client, so Newman is not in violation of the Standard.

C. Incorrect, because according to Standard III(A) Loyalty, Prudence and Care, from time to time, a client will direct a manager to use the client's brokerage to purchase goods or services for the client, a practice that is commonly called "directed brokerage." Because brokerage commission is an asset of the client and is used to benefit that client, not the manager, such a practice does not violate any duty of loyalty.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard V (B), Communication with Clients and Prospective Clients, facts must be separated from opinions, as described in the response rationale for the correct answer.

B. Incorrect because according to Standard III (B), Fair Dealing, Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities. Also, Standard III(B) does not state "equally" because members and candidates could not possibly reach all clients at exactly the same time—whether by printed mail, telephone (including text messaging), computer (including internet updates and e-mail distribution), facsimile (fax), or wire. Each client has unique needs, investment criteria, and investment objectives, so not all investment opportunities are suitable for all clients. In this case, the email was sent to all clients, and then clients got a call, so they all received the recommendation in a fair manner.

In addition, Standard V (B), Communication with Clients and Prospective Clients, suggests: communication is not confined to a written report of the type traditionally generated by an analyst researching a security, company, or industry. A presentation of information can be made via any means of communication, including in-person recommendation or description, telephone conversation, media broadcast, or transmission by computer (e.g., on the internet).

C. **Correct** because according to Standard V (B), Communication with Clients and Prospective Clients, opinion be separated from fact. Violations often occur when reports fail to separate the past from the future by not indicating that earnings estimates, changes in the outlook for dividends, or future market price information are opinions subject to future circumstances. In this case, the statement was referring to future outcome which may or may not turn out to be true, thus a violation.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Kon violated Standard V (C), Record Retention, by re-creating supporting records from memory as described in the correct response rationale.

B. Incorrect because according to Standard V (C), Record Retention, Kon did not violate the Standards by publishing the updated research report since she obtained the express consent of her former employer. Standard V(C), Record Retention, states When a member or candidate leaves a firm to seek other employment, the member or candidate cannot take the property of the firm, including original forms or copies of supporting records of the member's or candidate's work, to the new employer without the express consent of the previous employer.

C. **Correct** because according to Standard V (C), Record Retention, a member must not re-create supporting records from memory. Standard V(C), Record Retention, states The member or candidate cannot use historical recommendations or research reports created at the previous firm because the supporting documentation is unavailable. For future use, the member or candidate must re-create the supporting records at the new firm with information gathered through public sources or directly from the covered company and not from memory or sources obtained at the previous employer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard III(D), Performance Presentation, if the presentation is brief, the member or candidate must make available to clients and prospects, on request, the detailed information supporting that communication. By making available detailed supporting information on request, Joy does not violate Standard III(D). In addition, Joy does not violate Standard III(B), Fair Dealing, which states that members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

B. Incorrect because Standard III(B), Fair Dealing, has not been violated as described in the response rationale of the correct answer.

C. Incorrect because Standard III(D), Performance Presentation, has not been violated as described in the response rationale of the correct answer.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because Hostettler violated the Standards as described in the justification for the correct answer.

B. Incorrect because Hostettler would need to disclose the referral arrangement to both existing and prospective clients as described in the justification for the correct answer.

C. **Correct** because according to Standard VI (C), Referral Fees, members must disclose to clients and potential clients any referral arrangements and must disclose all consideration. "Consideration includes all fees, whether paid in cash, in soft dollars, or in-kind." Thus, Hostettler would need to disclose the full bi-lateral referral arrangement to both clients and prospective clients.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard VI(C), Referral Fees, Huang must disclose the estimated dollar value of the fee as described in the correct response rationale.

B. Incorrect because Standard VI(C), Referral Fees, allows members to accept client referral fees under certain conditions as described in the correct response rationale.

C. **Correct** because according to Standard VI(C), Referral Fees, members must disclose both the nature of the consideration and the estimated dollar value. Appropriate disclosure means that members and candidates must advise the client or prospective client, before entry into any formal agreement for services, of any benefit given or received for the recommendation of any services provided by the member or candidate. In addition, the member or candidate must disclose the nature of the consideration or benefit—for example, flat fee or percentage basis, one-time or continuing benefit, based on performance, benefit in the form of provision of research or other noncash benefit—together with the estimated dollar value. Consideration includes all fees, whether paid in cash, in soft dollars, or in kind.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard III(E) relating to preservation of confidentiality, members and candidates should convey to clients that not all firm-sponsored resources may be appropriate for such communications.

B. Incorrect because according to Standard III(E) relating to preservation of confidentiality, members and candidates should encourage their firm to conduct regular periodic training on confidentiality procedures for all firm personnel, including portfolio associates, receptionists, and other non-investment staff who have routine direct contact with clients and their records. The training should be for firm personnel and not for clients.

C. Incorrect because Standard III(E) relating to preservation of confidentiality, does not require members or candidates to become experts in information security technology, but they should have a thorough understanding of the policies of their employer.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard VII(B), Reference to CFA Institute, the CFA Designation and the CFA Program, both have violated the Standard, as described in the response rationale of the correct answer.

B. Incorrect because according to Standard VII(B), Reference to CFA Institute, the CFA Designation and the CFA Program, both have violated the Standard, as described in the response rationale of the correct answer.

C. **Correct** because according to Standard VII(B), Reference to CFA Institute, the CFA Designation and the CFA Program, Petrov violates Standard VII(B) because where individuals may anonymously express their opinions, pseudonyms or online profile names created to hide a member's identity should not be tagged with the CFA designation. Lynn violates Standard VII(B) because if an individual is registered for the CFA Program but declines to sit for an exam or otherwise does not meet the definition of a candidate as described in the CFA Institute Bylaws, then that individual is no longer considered an active candidate.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard IV (A), Loyalty, there is a requirement that members and candidates abstain from independent competitive activity that could conflict with the interests of their employer. Jacobs' teaching assignment at a business school on weekends does not appear to be in conflict with her role as a portfolio manager. Also, with respect to Standard IV (B), Additional Compensation Arrangements, Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain written consent from all parties involved. Because her teaching activity is not in competition with, nor would it be expected to create a conflict of interest with her employer, she is not in violation of the Standards regarding her teaching assignment. Jacobs is also not in violation of the Standards with respect to her actions to make arrangements to start a competing business because a departing employee is generally free to make arrangements or preparations to go into a competitive business before terminating the relationship with his or her employer as long as such preparations do not breach the employee's duty of loyalty. There is nothing in this instance to suggest that is the case.

B. Incorrect because neither Jacob's weekend teaching assignment nor her actions to make arrangements to go into competing business before terminating the relationship with her employer is in violation of the Standards, as described in the justification for the correct answer.

C. Incorrect because neither Jacob's weekend teaching assignment nor her actions to make arrangements to go into competing business before terminating the relationship with her employer is in violation of the Standards, as described in the justification for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program, a person is a candidate in the CFA Program if the person's application for registration in the CFA Program has been accepted by CFA Institute, as evidenced by issuance of a notice of acceptance, and the person is enrolled to sit for a specified examination. As this individual has not registered for the Level III exam the individual cannot refer to himself/herself as a CFA candidate.

B. Incorrect because according to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program, a person is a candidate in the CFA Program if the person's application for registration in the CFA Program has been accepted by CFA Institute, as evidenced by issuance of a notice of acceptance, and the person is enrolled to sit for a specified examination. As this individual has not registered for the Level III exam the individual cannot refer to himself/herself as a CFA candidate.

C. **Correct** because according to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program, a person is a candidate in the CFA Program if the registered person has sat for a specified examination but exam results have not yet been received.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because according to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program, those who have earned the right to use the Chartered Financial Analyst designation are encouraged to do so but only in a manner that does not misrepresent or exaggerate the meaning or implications of the designation. In addition, if the candidate then goes on to claim or imply superior ability by obtaining the designation in only three years, however, he or she is in violation of Standard VII(B). Lee states that as a CFA charterholder, he achieves better investment performance results. Therefore, he has violated the Standard VII(B).

B. Incorrect because according to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program, if a candidate passes each level of the exam in consecutive years and wants to state that he or she did so, that is not a violation of Standard VII(B) because it is a statement of fact. Lee only states the fact that he passed all three CFA Program examinations in three consecutive years. Therefore, he has not violated the Standard VII(B).

C. Correct because according to Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program, those who have earned the right to use the Chartered Financial Analyst designation are encouraged to do so but only in a manner that does not misrepresent or exaggerate the meaning or implications of the designation. In addition, if the candidate then goes on to claim or imply superior ability by obtaining the designation in only three years, however, he or she is in violation of Standard VII(B). Lee states that as a CFA charterholder, he achieves better investment performance results. Therefore, he has violated the Standard VII(B).

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. **Correct** because according to Standard IV(C), Responsibilities of Supervisors, Members and Candidates must make reasonable efforts to ensure that anyone subject to their supervision or authority complies with applicable laws, rules, regulations, and the Code and Standards. Therefore, Statement 1 is accurate.

B. Incorrect because according to Standard IV(C), Responsibilities of Supervisors, if the member or candidate clearly cannot discharge supervisory responsibilities because of the absence of a compliance system or because of an inadequate compliance system, the member or candidate should decline in writing to accept supervisory responsibility until the firm adopts reasonable procedures to allow adequate exercise of supervisory responsibility. Therefore, Statement 2 is not accurate.

C. Incorrect because according to Standard IV(C), Responsibilities of Supervisors, if the member or candidate clearly cannot discharge supervisory responsibilities because of the absence of a compliance system or because of an inadequate compliance system, the member or candidate should decline in writing to accept supervisory responsibility until the firm adopts reasonable procedures to allow adequate exercise of supervisory responsibility. Therefore, Statement 2 is not accurate.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard V (A), Diligence and Reasonable Basis, A member or candidate may rely on others in his or her firm to determine whether secondary or third-party research is sound and use the information in good faith unless the member or candidate has reason to question its validity or the processes and procedures used by those responsible for the research. Berkstein relied on her senior colleague's due diligence, and there is nothing in the case to suggest she has reason to question it, hence no violation. Nor did Brooks violate the Standard by leaving his name on the group report: The conclusions or recommendations of the group report represent the consensus of the group and are not necessarily the views of the member or candidate, even though the name of the member or candidate is included on the report. In some instances, a member or candidate will not agree with the view of the group. If, however, the member or candidate believes that the consensus opinion has a reasonable and adequate basis and is independent and objective, the member or candidate need not decline to be identified with the report. If the member or candidate is confident in the process, the member or candidate does not need to dissociate from the report even if it does not reflect his or her opinion.

B. Incorrect because according to Standard V (A), Diligence and Reasonable Basis, Brooks can leave his name in the report even if he disagrees with the conclusion, as described in the response rationale for the correct answer.

C. Incorrect because according to Standard V (A), Diligence and Reasonable Basis, Berkstein can rely on her colleagues to do the due diligence, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard V (B), Communication with Clients and Prospective Clients, If recommendations are contained in capsule form (such as a recommended stock list), members and candidates should notify clients that additional information and analyses are available from the producer of the report. Also, Members and candidates must disclose significant risks known to them at the time of the disclosure. Members and candidates cannot be expected to disclose risks they are unaware of at the time recommendations or investment actions are made. In this case, the central bank action happened after the recommendation was sent out, and it was an unexpected move, so Watt cannot be blamed for not warning clients and causing portfolio losses.

B. Incorrect as Watt did not violate Standard V (B), Communication with Clients and Prospective Clients, as described in the response rationale for the correct answer.

C. Incorrect as Watt did not violate Standard V (B), Communication with Clients and Prospective Clients, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to the fundamentals of compliance of the GIPS standards, non-discretionary portfolios must not be included in a firm's composites.

B. Incorrect because according to the fundamentals of compliance of the GIPS standards, statements referring to the calculation methodology as being 'in accordance,' 'in compliance,' or 'consistent' with the Global Investment Performance Standards, or similar statements, are prohibited.

C. **Correct** because according to the fundamentals of compliance of the GIPS standards, If documented client-imposed restrictions interfere with the implementation of the intended strategy to the extent that the portfolio is no longer representative of the strategy, the firm may determine that the portfolio is non-discretionary.

Ethical and Professional Standards

- describe the fundamentals of compliance, including the recommendations of the GIPS standards with respect to the definition of the firm and the firm's definition of discretion

Solution

A. Incorrect because according to the GIPS standards one of the key concepts of the standards is the required uses of composites. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. Therefore, it is a key concept that the GIPS standards require to aggregate one or more portfolios managed according to similar investment strategies in a composite.

B. Incorrect because according to the GIPS standards, the GIPS standards rely on the integrity of input data, the quality of which is critical to creating accurate performance presentations. Therefore, it is a key concept to rely on the integrity of input data.

C. **Correct** because according to the GIPS standards, the GIPS standards do not address every aspect of performance measurement. Therefore, it is not a key concept of the GIPS standards to address every aspect of performance measurement.

Ethical and Professional Standards

- describe the key concepts of the GIPS Standards for Firms

Solution

A. Incorrect because according to the recommended procedures for compliance with Standard III (B), Fair Dealing, a common practice to assure fair dealing is to communicate recommendations simultaneously within the firm and to customers.

B. Incorrect because according to the recommended procedures for compliance with Standard III (B), Fair Dealing, a common practice to assure fair dealing is to communicate recommendations simultaneously within the firm and to customers.

C. **Correct** because according to the recommended procedures for compliance with Standard III (B), Fair Dealing, a common practice to assure fair dealing is to communicate recommendations simultaneously within the firm and to customers. Members and candidates should encourage firms to develop guidelines that prohibit personnel who have prior knowledge of an investment recommendation from discussing or taking any action on the pending recommendation. Members and candidates should encourage firms to develop guidelines that prohibit personnel who have prior knowledge of an investment recommendation from discussing or taking any action on the pending recommendation.

Ethical and Professional Standards

- evaluate practices, policies, and conduct relative to the CFA Institute Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to Standard V (B), Investment Analysis, Recommendations, and Actions - Communication with Clients and Prospective Clients, Members and candidates cannot be expected to disclose risks they are unaware of at the time recommendations or investment actions are made. In assessing compliance with Standard V(B), it is important to establish knowledge of a purported significant risk or limitation. A one-time investment loss that occurs after the disclosure does not constitute a pertinent factor in assessing whether significant risks and limitations were properly disclosed. Having no knowledge of a risk or limitation that subsequently triggers a loss may reveal a deficiency in the diligence and reasonable basis of the research of the member or candidate but may not reveal a breach of Standard V(B).

B. Incorrect because described conduct does not violate the Standard V(A) Diligence and Reasonable Basis, Members and Candidates must: 1.Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions. 2.Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

C. Incorrect because according to Standard V (B), Communication with Clients and Prospective Clients, The appropriateness of risk disclosure should be assessed on the basis of what was known at the time the investment action was taken (often called an ex ante basis). Members and candidates must disclose significant risks known to them at the time of the disclosure. Members and candidates cannot be expected to disclose risks they are unaware of at the time recommendations or investment actions are made. In assessing compliance with Standard V(B), it is important to establish knowledge of a purported significant risk or limitation. A one-time investment loss that occurs after the disclosure does not constitute a pertinent factor in assessing whether significant risks and limitations were properly disclosed.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because according to the recommended procedures for compliance with Standard V (A), Diligence and Reasonable Basis, members and candidates should encourage their firms to adopt a standardized set of criteria for evaluating the adequacy of external advisers. Therefore, customizing the evaluation criteria for each external advisor is not a recommended procedure for compliance with Standard V (A).

B. Incorrect because according to the recommended procedures for compliance with Standard V (A), Diligence and Reasonable Basis, members and candidates should encourage their firms to develop detailed, written guidance that establishes minimum levels of scenario testing of all computer-based models used in developing, rating, and evaluating financial instruments. Therefore, establishing maximum levels of scenario testing is incorrect.

C. **Correct** because according to the recommended procedures for compliance with Standard V (A), Diligence and Reasonable Basis, members and candidates should encourage their firms to establish a policy requiring that research reports, credit ratings, and investment recommendations have a basis that can be substantiated as reasonable and adequate. An individual employee (a supervisory analyst) or a group of employees (a review committee) should be appointed to review and approve such items prior to external circulation to determine whether the criteria established in the policy have been met. Therefore, appointing a supervisory analyst to determine whether research reports have a reasonable and adequate basis, before circulating the reports externally, is a recommended procedure for compliance with Standard V (A).

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to Standard V (C), Record Retention, Local regulators often impose requirements on members, candidates, and their firms related to record retention that must be followed. Firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C). In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years. Here, there is no applicable law. Also, the recommendation of the local industry body and the clients' preferences are not relevant. Instead, the member has to abide by the firm's policy to maintain records for at least 5 years.

B. Incorrect because according to Standard V (C), Record Retention, Local regulators often impose requirements on members, candidates, and their firms related to record retention that must be followed. Firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C). In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years. Here, there is no applicable law. Also, the recommendation of the local industry body and the clients' preferences are not relevant. Instead, the member has to abide by the firm's policy to maintain records for at least 5 years.

C. Incorrect because according to Standard V (C), Record Retention, Local regulators often impose requirements on members, candidates, and their firms related to record retention that must be followed. Firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C). In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years. Here, there is no applicable law. Also, the recommendation of the local industry body and the clients' preferences are not relevant. Instead, the member has to abide by the firm's policy to maintain records for at least 5 years.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard VI(B), Priority of Transactions, recommends blackout/restricted periods to prohibit members from early personal trading ("front-running"), not to discourage clients from trading. According to the recommended procedures for compliance with Standard VI(B), investment personnel involved in the investment decision-making process should establish blackout periods prior to trades for clients so that managers cannot take advantage of their knowledge of client activity by "front-running" client trades (trading for one's personal account before trading for client accounts).

B. Incorrect because Standard VI(B), Priority of Transactions, makes no recommendation with respect to members supplying clients with copies of personal securities transactions. According to the recommended procedures for compliance with Standard VI(B), investment personnel should be required to direct their brokers to supply to firms duplicate copies or confirmations of all their personal securities transactions and copies of periodic statements for all securities accounts.

C. **Correct** because according to the recommended procedures for compliance with Standard VI(B), Priority of Transactions, members and candidates should preclear their participation in IPOs, even in situations without any conflict of interest between a member's or candidate's participation in an IPO and the client's interest.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to Standard V (C), Record Retention, The retention requirement applies to decisions to buy or sell a security as well as reviews undertaken that do not lead to a change in position.

B. Incorrect because according to Standard V (C), Record Retention, Records may be maintained either in hard copy or electronic form.

C. Incorrect because the member only violates Standard V (C), Record Retention, by discarding the records that do not lead to changes in positions, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard V(B), Communication with Clients and Prospective Clients, The member or candidate must keep clients and other interested parties informed on an ongoing basis about changes to the investment process. Also, For purposes of Standard V(B), communication is not confined to a written report. A presentation of information can be made via any means of communication, including in-person recommendation or description, telephone conversation. Therefore, Lorraine does not violate Standard V(B) because changing the investment process is not prohibited and verbal communication by phone regarding this change is permitted.

B. Incorrect because Lorraine has not violated Standard V(B), Communication with Clients and Prospective Clients, as described in the response rationale for the correct answer.

C. Incorrect because Lorraine has not violated Standard V(B), Communication with Clients and Prospective Clients, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because actions involving unearned designations not only violate Standard IV (A), Loyalty but also Standard I (D), Misconduct. The Standard relating to loyalty deals with matters related to employment, Members must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer. Actions regarding unearned designations are potentially harmful to an employer.

B. Incorrect because actions involving unearned designations not only violate Standard IV (A), Loyalty but also Standard I (D), Misconduct. The standard relating to misconduct requires, Members must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence. Actions regarding unearned designations are dishonest, an act of fraud and deceitful and will reflect adversely on a person's professional reputation, integrity and competence.

C. **Correct** because actions involving unearned designations are violations of Standard IV (A), Loyalty but also Standard I (D), Misconduct. The Standard relating to loyalty deals with matters related to employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer. Actions regarding unearned designations are potentially harmful to an employer. The standard relating to misconduct requires, Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence. Actions regarding unearned designations are dishonest, an act of fraud and deceitful and will reflect adversely on a person's professional reputation, integrity and competence.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard VI(A), Disclosure of Conflicts, Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. In addition, sell-side members and candidates should disclose any materially beneficial ownership interest in a security or other investment that the member or candidate is recommending. Chan has no beneficial ownership in her brother's account, so she is not required to disclose it. Therefore, Chan has not violated the Standard VI(A).

In addition, Standard V(B), Communication with Clients and Prospective Clients, states that members and candidates should communicate in a recommendation the factors that were instrumental in making the investment recommendation. A critical part of this requirement is to distinguish clearly between opinions and facts. In preparing a research report, the member or candidate must present the basic characteristics of the securities being analyzed, which will allow the reader to evaluate the report and incorporate information the reader deems relevant to his or her investment decision-making process. Standard V(B) is addressing the investment process communication with clients. Chan has not violated the Standard V(B).

B. Incorrect because according to Standard VI(A), Disclosure of Conflicts, Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. In addition, sell-side members and candidates should disclose any materially beneficial ownership interest in a security or other investment that the member or candidate is recommending. Chan has no beneficial ownership in her brother's account, so she is not required to disclose it. Therefore, Chan has not violated the Standard VI(A).

C. Incorrect because Standard V(B), Communication with Clients and Prospective Clients, states that members and candidates should communicate in a recommendation the factors that were instrumental in making the investment recommendation. A critical part of this requirement is to distinguish clearly between opinions and facts. In preparing a research report, the member or candidate must present the basic characteristics of the security(ies) being analyzed, which will allow the reader to evaluate the report and incorporate information the reader deems relevant to his or her investment decision-making process. Standard V(B) is addressing the investment process communication with clients. Chan has not violated the Standard V(B).

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Correct because according to Standard VII (A), Conduct as Participants in CFA Institute Programs, CFA Institute program rules, regulations, and policies prohibit candidates from disclosing confidential material gained during the exam process. Examples of information that cannot be disclosed by candidates sitting for an exam include but are not limited to: broad topical areas and formulas tested or not tested on the exam. Further, All aspects of the exam, including questions, broad topical areas, and formulas, tested or not tested, are considered confidential until such time as CFA Institute elects to release them publicly. There is no indication that CFA Institute has released details about the exam. Therefore, Macmara has violated Standard VII (A) by stating "Thankfully, the CAPM formula was not tested.

B. Incorrect because Standard VII (A), Conduct as Participants in CFA Institute Programs, does not cover expressing opinions regarding CFA Institute, the CFA Program, or other CFA Institute programs. Members and candidates are free to disagree and express their disagreement with CFA Institute on its policies, its procedures, or any advocacy positions taken by the organization. When expressing a personal opinion, a candidate is prohibited from disclosing content-specific information, including any actual exam question and the information as to subject matter covered or not covered in the exam. Macmara has not disclosed content-specific information but has only expressed her opinion about the CFA exams. Therefore, Macmara has not violated Standard VII (A) by writing "CFA exams are outrageously difficult"

C. Incorrect because according to Standard VII (A), Conduct as Participants in CFA Institute Programs, Macmara has violated Standard VII (A) only by writing "Thankfully, the CAPM formula was not tested". CFA Institute program rules, regulations, and policies prohibit candidates from disclosing confidential material gained during the exam process. Examples of information that cannot be disclosed by candidates sitting for an exam include but are not limited to: broad topical areas and formulas tested or not tested on the exam. Further, All aspects of the exam, including questions, broad topical areas, and formulas, tested or not tested, are considered confidential until such time as CFA Institute elects to release them publicly. There is no indication that CFA Institute has released details about the exam.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because according to Standard I (C), Misrepresentation, changing pricing providers should not be based solely on the justification that the new provider reports a higher current value of a security.

B. Incorrect because Standard I(C), Misrepresentation, does not require that a benchmark always be provided in order to comply. Some investment strategies may not lend themselves to displaying an appropriate benchmark because of the complexity or diversity of the investments included. Grae's ownership of several liquid and illiquid asset classes exhibits a diversity of investments.

C. Incorrect because Standard I(C), Misrepresentation, does not require that a benchmark always be provided in order to comply. Some investment strategies may not lend themselves to displaying an appropriate benchmark because of the complexity or diversity of the investments included. Grae's ownership of liquid and illiquid securities suggests a diversity of investments, so marketing performance without a benchmark is not a violation of the Standard.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because consultants cannot make a claim of compliance unless they actually manage the assets for which they are making a claim of compliance. They can claim to endorse the GIPS standards and/or require that their investment managers comply with the GIPS standards.

B. **Correct** because asset owners may comply with the GIPS standards in the same way as firms if they compete for business. If they don't compete for business but report their performance to an oversight body, asset owners may choose to comply with the GIPS Standards for Asset Owners.

C. Incorrect because only a firm managing assets can claim compliance. Similarly, software (and the vendors who supply software) cannot be 'compliant.' Software can assist firms in achieving compliance with the GIPS standards (e.g., by calculating performance in a manner consistent with the calculation requirements of the GIPS standards), but only a firm managing assets can claim compliance once the firm has satisfied all applicable requirements of the GIPS standards.

Ethical and Professional Standards

- explain why the GIPS standards were created, who can claim compliance, and who benefits from compliance

Solution

A. Correct because according to the GIPS standards, in cases in which laws and/or regulations conflict with the GIPS standards, firms are required to comply with the laws and regulations and make full disclosure of the conflict in the GIPS Report.

B. Incorrect because, as explained in the justification for the correct answer, firms are required to comply with the laws and regulations and make full disclosure of the conflict in the GIPS Report.

C. Incorrect because, as explained in the justification for the correct answer, firms are required to comply with the laws and regulations and make full disclosure of the conflict in the GIPS report.

Ethical and Professional Standards

- describe the fundamentals of compliance, including the recommendations of the GIPS standards with respect to the definition of the firm and the firm's definition of discretion

Solution

A. Correct because according to the GIPS standards, the firm must include terminated composites on this list for at least five years after the composite termination date.

B. Incorrect because firms must include terminated composites on the firm's list of composite descriptions for at least five years after the composite termination date, as described in the response rationale for the correct answer, and not for 7 years.

C. Incorrect because firms must include terminated composites on the firm's list of composite descriptions for at least five years after the composite termination date, as described in the response rationale for the correct answer, and not for 10 years.

Ethical and Professional Standards

- describe the fundamentals of compliance, including the recommendations of the GIPS standards with respect to the definition of the firm and the firm's definition of discretion

Solution

A. Correct because according to the GIPS standards, verification is performed with respect to an entire firm, not on specific composites or pooled funds.

B. Incorrect because according to the GIPS standards, Verification is a process by which an independent verification firm (verifier) conducts testing of a firm on a firm-wide basis in accordance with the required verification procedures of the GIPS standards.

C. Incorrect because according to the GIPS standards, Once a firm claims compliance with the GIPS standards, it may voluntarily hire an independent third party to perform a verification in order to increase confidence in the firm's claim of compliance.

Ethical and Professional Standards

- describe the concept of independent verification

Solution

A. Correct because according to the recommended procedures for compliance with Standard II (E), Preservation of Confidentiality, avoid disclosing any information received from a client except to authorized fellow employees who are also working for the client. Is the information background material that, if disclosed, will enable the member or candidate to improve service to the client?

B. Incorrect because according to the recommended procedures for compliance with Standard II (E), Preservation of Confidentiality, members should encourage the development of procedures that appropriately reflect the firm's size and business operations and not only large firm's standard models.

C. Incorrect because according to the recommended procedures for compliance with Standard II (E), Preservation of Confidentiality, members should encourage the development of procedures that appropriately reflect the firm's size and business operations and not only large firm's standard models.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to the recommended procedures for compliance with Standard II(A) Material Nonpublic Information the use of watch lists is a minimum element of such a system. The minimum elements of such a system include, but are not limited to, the review of employee trading through the maintenance of "watch," "restricted," and "rumor" lists.

B. Incorrect because according to the recommended procedure for compliance with Standard II(A) Material Nonpublic Information, prohibition on all types of proprietary activity when a firm comes into possession of material nonpublic information is not appropriate. For example, when a firm acts as a market maker, a prohibition on proprietary trading may be counterproductive to the goals of maintaining the confidentiality of information and market liquidity.

C. Incorrect because according to the recommended procedure for compliance with Standard II(A) Material Nonpublic Information interdepartmental communication between such departments and their employees should be generally minimised to restrict the possible flow on material nonpublic information. The guidance notes that, The minimum elements of such a system include, but are not limited to, the substantial control of relevant interdepartmental communications, preferably through a clearance area within the firm in either the compliance or legal department.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to the Standard II(B), market manipulation includes (1) the dissemination of false or misleading information. Also, information-based manipulation includes, but is not limited to, spreading false rumors to induce trading by others. For example, members and candidates must refrain from "pumping up" the price of an investment by issuing misleading positive information or overly optimistic projections of a security's worth only to later "dump" the investment (i.e., sell it) once the price, fueled by the misleading information's effect on other market participants, reaches an artificially high level.

B. Incorrect because according to Standard I(B), independence and objectivity, Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and Candidates must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another's independence and objectivity.

C. Incorrect because according to Standard II(A), material nonpublic information, Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information.

Ethical and Professional Standards

- evaluate practices, policies, and conduct relative to the CFA Institute Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because according to the GIPS standards, only a firm managing assets can claim compliance once the firm has satisfied all applicable requirements of the GIPS standards. Further, asset owners may comply with the GIPS standards in the same way as firms if they compete for business. If they don't compete for business but report their performance to an oversight body, asset owners may choose to comply with the GIPS Standards for Asset Owners. Therefore, a pension fund that manages investments for its beneficiaries can claim compliance with the GIPS standards.

B. Incorrect because according to the GIPS standards, consultants cannot make a claim of compliance unless they actually manage the assets for which they are making a claim of compliance. Therefore, an investment consulting firm that focuses on enabling clients to self-manage their investments cannot claim compliance with the GIPS standards.

C. Incorrect because according to the GIPS standards, software (and the vendors who supply software) cannot be "compliant." Software can assist firms in achieving compliance with the GIPS standards (e.g., by calculating performance in a manner consistent with the calculation requirements of the GIPS standards), but only a firm managing assets can claim compliance once the firm has satisfied all applicable requirements of the GIPS standards.

Ethical and Professional Standards

- explain why the GIPS standards were created, who can claim compliance, and who benefits from compliance

Solution

A. Incorrect because both statements violate Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program as described in the correct response rationale.

B. Incorrect because both statements violate Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program as described in the correct response rationale.

C. **Correct** because both statements violate Standard VII(B), Reference to CFA Institute, the CFA Designation, and the CFA Program by implying that superior performance from someone with the CFA designation can be expected. Statements referring to CFA Institute, the CFA designation, or the CFA Program that overstate the competency of an individual or imply, either directly or indirectly, that superior performance can be expected from someone with the CFA designation are not allowed under the standard. Improper References ... 'CFA charterholders achieve better performance results' ... 'As a CFA charterholder, I am the most qualified to manage client investments.'"

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Bravoria violated Standard III(A)–Loyalty, Prudence, and Care.

B. Incorrect because Bravoria provided his client with investment statements more frequently than required, i.e., quarterly.

C. **Correct** because Bravoria violated Standard III(A)–Loyalty, Prudence, and Care as he had not updated his client's profile in more than two years and thus should not have made further investments, particularly in high-risk investments, until such time as he updated the client's risk and return objectives, financial constraints, and financial position. Bravoria provided his client with investment statements more frequently than that which is required, i.e., quarterly, so was not in violation of regular account information.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because GIPS standards certainly do not eliminate the need for in-depth due diligence on the part of the investor.

B. **Correct** because compliance enables the GIPS-compliant firm to participate in competitive bids against other compliant firms throughout the world.

C. Incorrect because as described in the response rationale for the correct answer compliance enables the GIPS-compliant firm to participate in competitive bids against other compliant firms throughout the world but GIPS standards certainly do not eliminate the need for in-depth due diligence on the part of the investor.

Ethical and Professional Standards

- describe the fundamentals of compliance, including the recommendations of the GIPS standards with respect to the definition of the firm and the firm's definition of discretion

Solution

A. Incorrect because the GIPS standards certainly do not eliminate the need for in-depth due diligence on the part of the client or investor, but compliance with the Standards enhances the credibility of investment management firms that have chosen to undertake this responsibility.

B. **Correct** because compliance enables the GIPS-compliant firm to participate in competitive bids against other compliant firms throughout the world.

C. Incorrect because complying with the GIPS standards is voluntary. Compliance with the GIPS standards is not typically required by legal or regulatory authorities.

Ethical and Professional Standards

- explain why the GIPS standards were created, who can claim compliance, and who benefits from compliance

Solution

A. Incorrect because once a firm claims compliance with the Standards, they may voluntarily hire an independent third party to perform a verification in order to increase confidence in the firm's claim of compliance. Therefore, the firm is not required to but may elect an independent third party to perform verification of the firm's claim of compliance.

B. **Correct** because firms that claim compliance with the GIPS standards are responsible for their claim of compliance and for maintaining that compliance. That is, firms self-regulate their claim of compliance. Therefore, including when compliance is verified by an independent third party, the firm is always responsible for maintaining that compliance.

C. Incorrect because the determination of which portfolios to include in the Composite should be done according to pre-established criteria (i.e., on an ex-ante basis), not after the fact.

Ethical and Professional Standards

- explain the purpose of composites in performance reporting

Solution

A. Correct because Delgado did not violate Standard VII (A), Responsibilities as a CFA Institute Member of CFA Candidate. Candidates are prohibited from disclosing confidential material gained during the exam process but are free to discuss the examination in a general manner, such as the fact that she found the exam difficult. Regarding her opinion about the CFA Institute, a member must not engage in any conduct that compromises the reputation or integrity of CFA Institute. However, Standard VII (A) does *not* cover expressing opinions regarding the CFA Program or CFA Institute. Therefore, Delgado's voicing her opinion is not a conduct that compromises the reputation or integrity of CFA Institute.

B. Incorrect because Delgado did not violate the Standards by posting information about the exam on a public website, as described in the Response Rationale for the answer key.

C. Incorrect because Delgado did not violate the Standards by expressing her opinion that the CFA Program and CFA Institute were losing credibility with the public, as described in the Response Rationale for the answer key.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because for the purposes of Standard VI(A), Disclosure of Conflicts, members and candidates beneficially own securities or other investments if they have a direct or indirect pecuniary interest in the securities, have the power to vote or direct the voting of the shares of the securities or investments, or have the power to dispose or direct the disposition of the security or investment. Therefore, the member is considered a beneficial owner for shares held in both Account 1 and Account 2.

B. Incorrect because for the purposes of Standard VI(A) Disclosure of Conflicts, members and candidates beneficially own securities or other investments if they have a direct or indirect pecuniary interest in the securities, have the power to vote or direct the voting of the shares of the securities or investments, or have the power to dispose or direct the disposition of the security or investment. Therefore, the member is considered a beneficial owner for shares held in both Account 1 and Account 2.

C. **Correct** because for the purposes of Standard VI(A) Disclosure of Conflicts, members and candidates beneficially own securities or other investments if they have a direct or indirect pecuniary interest in the securities, have the power to vote or direct the voting of the shares of the securities or investments, or have the power to dispose or direct the disposition of the security or investment. Therefore, the member is considered a beneficial owner for shares held in both Account 1 and Account 2.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because a claim of compliance requires that all fee-paying discretionary accounts be included in at least one composite. It does not include all accounts which could include non-discretionary accounts.

B. **Correct** because one of the key concepts of the standards is the required use of composites. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. The requirement to create, use and maintain composites is designed to prevent firms from cherry-picking—using the best-performing accounts to represent the performance of an investment strategy.

C. Incorrect because a composite must include all actual, fee-paying, discretionary portfolios managed in accordance with the same investment mandate, objective, or strategy. It does not include non-discretionary accounts.

Ethical and Professional Standards

- explain the purpose of composites in performance reporting

Solution

A. Incorrect because securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset is transaction-based manipulation, however, Standard II(B) is not intended to preclude transactions undertaken on legitimate trading strategies. To win a proxy vote is a legitimate strategy.

B. Incorrect because Standard II(B) is not intended to preclude transactions undertaken on legitimate trading strategies based on perceived market inefficiencies. The intent of the action is critical to determining whether it is a violation of this standard. Therefore the member does not violate the Standard.

C. **Correct** because Members and Candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants. Transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because one of the objectives of the GIPS standards is to promote investor interests and instill investor confidence, and not to promote financial regulator interests.

B. **Correct** because one of the objectives of the GIPS standards is to promote industry self-regulation on a global basis.

C. Incorrect because one the objectives of the GIPS standards is to obtain worldwide acceptance of a single standard [not diverse standards] for calculating and presenting performance.

Ethical and Professional Standards

- explain why the GIPS standards were created, who can claim compliance, and who benefits from compliance

Solution

A. Incorrect because recommended procedures for compliance with Standard I (A), Knowledge of the Law, state that pertinent information that highlights applicable laws and regulations might be distributed to employees or made available in a central location. Thus, the recommended procedure is to provide such information to employees and not to clients.

B. Correct because recommended procedures for compliance with Standard I (A), Knowledge of the Law, state: Establish procedures for reporting violations: Firms might provide written protocols for reporting suspected violations of laws, regulations, or company policies.

C. Incorrect because recommended procedures for compliance with Standard I (A), Knowledge of the Law, state that when in doubt about the appropriate action to undertake, it is recommended that a member or candidate seek the advice of compliance personnel or legal counsel concerning legal requirements. If a potential violation is being committed by a fellow employee, it may also be prudent for the member or candidate to seek the advice of the firm's compliance department or legal counsel. The recommended procedures for compliance with Standard I (A) do not suggest seeking advice of regulatory agency personnel.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because Murphy has not violated any Standards. Standard V(B), Communication with Clients and Prospective Clients, requires members, use reasonable judgment in identifying which factors are important to their investment analyses, recommendations, or actions and include those factors in communications with clients and prospective client. Murphy has done this when she reviewed the investment rationale behind buying the security and the potential investment risks. The appropriateness of risk disclosure should be assessed on the basis of what was known at the time the investment action was taken (often called an ex ante basis). Members must disclose significant risks known to them at the time of the disclosure. Members cannot be expected to disclose risks they are unaware of at the time recommendations or investment actions are made. A one-time investment loss that occurs after the disclosure does not constitute a pertinent factor in assessing whether significant risks and limitations were properly disclosed. Murphy has also not violated Standard V(A), Diligence and Reasonable Basis, which requires members, have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action. Murphy has explained the investment thesis supporting the purchase of the security as well as the risk to the earnings stream. While having no knowledge of a risk or limitation that subsequently triggers a loss may reveal a deficiency in the diligence and reasonable basis of the research it is not a violation of the Standard.

B. Incorrect because Murphy has not violated Standard V(B), Communication with Clients and Prospective Clients, which requires members, use reasonable judgment in identifying which factors are important to their investment analyses, recommendations, or actions and include those factors in communications with clients and prospective client. Murphy has done this when she reviewed the investment rationale behind buying the security and the risks of the investment. The appropriateness of risk disclosure should be assessed on the basis of what was known at the time the investment action was taken (often called an ex ante basis). Members must disclose significant risks known to them at the time of the disclosure. Members cannot be expected to disclose risks they are unaware of at the time recommendations or investment actions are made. A one-time investment loss that occurs after the disclosure does not constitute a pertinent factor in assessing whether significant risks and limitations were properly disclosed.

C. Incorrect because Murphy has not violated Standard V(A), Diligence and Reasonable Basis, which requires members, have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action. Murphy has explained the investment rationale supporting the purchase of the security as well as the risks of the investment. While having no knowledge of a risk or limitation that subsequently triggers a loss may reveal a deficiency in the diligence and reasonable basis of the research it is not a violation of the Standard.

Ethical and Professional Standards

- explain how the practices, policies, and conduct do or do not violate the CFA Institute Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because Standard II(B), Market Manipulation, require members to uphold market integrity by prohibiting market manipulation. Market manipulation includes practices that distort security prices or trading volume with the intent to deceive people or entities that rely on information in the market. The intent here is to minimize tax liability and not to deceive.

B. Correct because Standard II(B), Market Manipulation, require members to uphold market integrity by prohibiting market manipulation. Market manipulation includes practices that distort security prices or trading volume with the intent to deceive people or entities that rely on information in the market. This is an example of information-base manipulation as misleading fake information affects other market participants.

C. Incorrect because Standard II(B), Market Manipulation require members to uphold market integrity by prohibiting market manipulation. Market manipulation includes practices that distort security prices or trading volume with the intent to deceive people or entities that rely on information in the market. Order splitting is legitimate for optimal trade executions.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because neither Paralova or Klemmer violated CFA Standards through their statements. Paralova did not violate Standard VII(B) Reference to CFA Institute, the CFA Designation, and the CFA Program when she made her comments about what getting the Charter will reflect and the hope for a pay raise. The Standard states, When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, Members and Candidates must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA program. Klemmer did not violate Standard VII (B) Reference to CFA Institute, the CFA Designation, and the CFA Program when he expressed his opinion that Paralova's potential pay raise will reflect her enhanced skills. Klemmer also complied with Standard VII(A) Responsibilities as a CFA Institute Member or CFA Candidate, Conduct as Participants in CFA Institute Programs when stating an opinion about the difficulty of the exam without revealing any specific details or the need to study all subjects. The Standard states that candidates must not engage in any conduct that compromises . . . the integrity, validity, or security of CFA Institute programs.

B. Incorrect as Paralova did not violate Standard VII (B) Reference to CFA Institute, the CFA Designation, and the CFA Program when she made her comments about what getting the Charter will reflect and the hope for a pay raise. The Standard states, When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, Members and Candidates must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA program.

C. Incorrect as Klemmer did not violate Standard VII (B) Reference to CFA Institute, the CFA Designation, and the CFA Program when he expressed his opinion that Paralova's potential pay raise will reflect her enhanced skills. Klemmer also complied with Standard VII(A): Responsibilities as a CFA Institute Member or CFA Candidate, Conduct as Participants in CFA Institute Programs when stating an opinion about the difficulty of the exam without revealing any specific details or the need to study all subjects. The Standard states that candidates must not engage in any conduct that compromises . . . the integrity, validity, or security of CFA Institute programs.

Ethical and Professional Standards

- explain how the practices, policies, and conduct do or do not violate the CFA Institute Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because Covington did violate the Standards in that she did not follow her employer's compliance procedures, Standard VI(B).

B. Incorrect as there is nothing to indicate she violated Standard V(A)–Diligence and Reasonable Basis.

C. **Correct** because prior clearance processes guard against potential and actual conflicts of interest; members are required to abide by their employer's compliance procedures, Standard VI(B).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard IV (C), Responsibilities of Supervisors, states that if a member cannot establish an adequate compliance system, the member or candidate should decline in writing to accept supervisory responsibility until the firm adopts reasonable procedures. The Standard does not indicate that the member should resign a position due to inadequate compliance systems. Standard I (A), Knowledge of the Law, states that members should resign in certain situations involving legal violations by colleagues or their firms and not due to flaws in compliance systems.

B. **Correct** because Standard IV (C), Responsibilities of Supervisors, states if the member or candidate clearly cannot discharge supervisory responsibilities because of the absence of a compliance system or because of an inadequate compliance system, the member or candidate should decline in writing to accept supervisory responsibility until the firm adopts reasonable procedures to allow adequate exercise of supervisory responsibility.

C. Incorrect because Standard IV (C), Responsibilities of Supervisors, states: members and candidates must promote actions by all employees under their supervision and authority to comply with applicable laws, rules, regulations, and firm policies and the Code and Standards. Ensuring compliance only by Charterholders would not comply with the Standard.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because the trade allocation procedure does not meet the requirements of Standard VI(B), which requires client transactions to be given precedence over transactions made on behalf of the member's or candidate's firm or personal transactions.

B. **Correct** because Standard VI(B)–requires client transactions to be given precedence over transactions made on behalf of the member's or candidate's firm or personal transactions. Because the advisor trades alongside his clients and allocates trades on a rotating basis, there are times when the advisor's trades will receive priority over his clients in violation of the Code and Standards. A member or candidate having the same investment positions or being co-invested with clients does not always create a conflict. Some clients in certain investment situations require members or candidates to have aligned interests. Personal investment positions or transactions of members or candidates or their firms should never, however, adversely affect client investments.

C. Incorrect because even though trade allocation procedures should be disclosed to clients, in this case the procedure fails to meet the requirement of the Code and Standards, so disclosure is not sufficient and the procedures should be revised.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because Kawasaki has violated the Standards.

B. **Correct** because Standard VI(C) requires disclosure of any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services. Even without cash changing hands the arrangement provides for a quid pro quo referral of clients and should be disclosed.

C. Incorrect because this Standard has not been violated as it relates to disclosure to clients of the general principles of the investment process used and not disclosure of any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services as Standard VI(C) requires.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because, according to Standard VII (A), Members and candidates are free to disagree and express their disagreement with CFA Institute on its policies, its procedures, or any advocacy position taken by the organization. When expressing a personal opinion, a candidate is prohibited from disclosing content-specific information, including any actual exam question and the information as to subject matter covered or not covered in the exam. Bernod is free to disagree with CFA Institute policies.

B. **Correct** because Standard VII (A), Conduct as Participants in CFA Institute Programs, states: Standard VII (A) covers the conduct of CFA Institute members and candidates involved with the CFA Program and prohibits any conduct that undermines the public's confidence that the CFA charter represents a level of achievement based on merit and ethical conduct. Conduct covered includes but is not limited to improperly using an association with CFA Institute to further personal or professional goals. Bernod violated the Standard by stating that his involvement in exam writing gave him unique investment insights that will be of value to his firm's clients.

C. Incorrect because according to Standard VII (A), Members and candidates are free to disagree and express their disagreement with CFA Institute on its policies, its procedures, or any advocacy position taken by the organization. When expressing a personal opinion, a candidate is prohibited from disclosing content-specific information, including any actual exam question and the information as to subject matter covered or not covered in the exam. Bernod is free to disagree with CFA Institute policies, but he violated VII (A), as described in the justification for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because Professional Conduct inquiries come from a number of sources including the monitoring of online and social media to detect disclosure of confidential exam information.

B. Incorrect because candidate conduct is monitored by exam proctors who complete reports on candidates suspected to have violated testing rules during the exam and at the exam center.

C. Incorrect because members and candidates must self-disclose on the annual Professional Conduct Statement all matters that question their professional conduct, such as involvement in civil litigation or a criminal investigation or being the subject of a written complaint. Disclosure of confidential exam information will not be found on the annual statement.

Ethical and Professional Standards

- describe the structure of the CFA Institute Professional Conduct Program and the process for the enforcement of the Code and Standards

Solution

A. Correct because receiving a gift, benefit, or consideration from a client can be distinguished from gifts given by entities seeking to influence a member or candidate to the detriment of other clients. In a client relationship, the client has already entered some type of compensation arrangement with the member, candidate, or his or her firm. A gift from a client could be considered supplementary compensation.

B. Incorrect because compensation arrangements should not link analyst remuneration directly to investment banking assignments in which the analyst may participate as a team member.

C. Incorrect because portfolio managers have a responsibility to respect and foster the intellectual honesty of sell-side research. Therefore, it is improper for portfolio managers to threaten or engage in retaliatory practices, such as reporting sell-side analysts to the covered company in order to instigate negative corporate reactions.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because Regali did not violate Standard II (A), Nonpublic Material Information. The Standards permit the use of industry experts. Members and candidates may provide compensation to individuals [industry experts] for their insights without violating this standard. In this case, the industry experts are unaffiliated with the trials and thus do not have access to inside information on the trials, so their insights can be used to make investment decisions. The Standards also permit the sell-side analysts to distribute material information to only clients. Simply because the public in general would find the conclusions material does not require that the analyst make his or her work public.

B. Incorrect because distributing the report to only her clients (and not making it public) is not a violation of Standard II (A), Nonpublic Material Information. The Standards permit the sell-side analysts to distribute material information only to clients. Simply because the public in general would find the conclusions material does not require that the analyst make his or her work public.

C. Incorrect because Regali did not violate Standard II (A), Nonpublic Material Information. The Standards permit the use of industry experts. Members and candidates may provide compensation to individuals [industry experts] for their insights without violating this standard. In this case, the industry experts are unaffiliated with the trials and thus do not have access to inside information on the trials, so their opinions can be used to make investment decisions.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because Standard II(A), Material Nonpublic Information, states that Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information. Also, Members and candidates must not use material nonpublic information to influence their investment actions related to derivatives. Therefore, a member analyst buying call option on a company stock after learning from its CEO that the company will report earnings exceeding analyst expectation is a violation of Standard II(A). In contrast, a member analyst buying an oil company stock after speaking to a well-known industry expert who believes oil prices will rise due to geopolitical risk is not a violation of Standard II(A). This is because a well-known industry expert's view is unlikely to be nonpublic information. Therefore, only Action 1 violates Standard II(A).

B. Incorrect because only Action 1 violates Standard II(A), Material Nonpublic Information as described in the response rationale of the correct answer.

C. Incorrect because only Action 1 violates Standard II(A), Material Nonpublic Information as described in the response rationale of the correct answer.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Correct because Standard III (B), Fair Dealing, states that if the issue is oversubscribed, then the issue should be prorated to all subscribers. In addition, if the investment professional's family-member accounts are managed similarly to the accounts of other clients of the firm, however, the family-member accounts should not be excluded from buying such shares.

B. Incorrect because Standard III (B), Fair Dealing, states that if the issue is oversubscribed, then the issue should be prorated to all subscribers.

C. Incorrect because Standard III (B), Fair Dealing, states that if the investment professional's family-member accounts are managed similarly to the accounts of other clients of the firm, however, the family-member accounts should not be excluded from buying such shares.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because Standard III (B), Fair Dealing, states: For example, when making investments in new offerings or in secondary financings, members and candidates should distribute the issues to all customers for whom the investments are appropriate in a manner consistent with the policies of the firm for allocating blocks of stock. In addition, if the issue is oversubscribed, members and candidates should forgo any sales to themselves or their immediate families in order to free up additional shares for clients. If the investment professional's family-member accounts are managed similarly to the accounts of other clients of the firm, however, the family-member accounts should not be excluded from buying such shares. In this case, Lee's brother has a standard fee-paying, regular account, the IPO is suitable, so Lee should include his brother in the pro-rata allocation of the IPO shares.

B. Incorrect because Standard III (B), Fair Dealing, states that Lee should have included his brother's account in the IPO allocation, as described in the rationale for the correct answer.

C. Incorrect because Standard III (C), Suitability, requires that members and candidates who are in an investment advisory relationship with clients consider carefully the needs, circumstances, and objectives of the clients when determining the appropriateness and suitability of a given investment or course of investment action. Lee subscribes to an IPO for those clients for whom he has assessed it is suitable and not for a client for whom the investment is not suitable. Therefore, he has not violated the Standards.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because Standard III (E), Preservation of Confidentiality, requires Members and Candidates must keep information about current, former, and prospective clients confidential. Also, this standard protects the confidentiality of client information even if the person or entity is no longer a client of the member or candidate.

B. Incorrect because the requirements of Standard III (E) are not intended to prevent members and candidates from cooperating with an investigation by the CFA Institute Professional Conduct Program (PCP).

C. Incorrect because Members and Candidates must keep information about current, former, and prospective clients confidential unless the client or prospective client permits disclosure of the information.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because Standard III (E), Preservation of Confidentiality, requires that members and candidates preserve the confidentiality of information communicated to them by their clients, prospective clients, and former clients. Further, if a client or former client expressly authorizes the member or candidate to disclose information, however, the member or candidate may follow the terms of the authorization and provide the information. The unsolicited stock order from the client is confidential. So, Barr must obtain the original client's authorization before recommending the stock to other clients. Therefore, Barr has violated Standard III (E) by executing without the original's client authorization, a single block trade for the original client as well as other clients for whom the stock is suitable.

B. Incorrect because according to the recommended procedures for compliance with Standard III (E), Preservation of Confidentiality, the simplest, most conservative, and most effective way to comply with Standard III (E) is to avoid disclosing any information received from a client except to authorized fellow employees who are also working for the client. Barr discusses the order with her firm's analysts to determine how the unsolicited stock order will impact the client's portfolio. As analysts work for the clients, Barr has not violated Standard III (E) by discussing unsolicited client orders with her analysts.

C. Incorrect because Barr has violated Standard III (E), Preservation of Confidentiality, only by executing a single block trade for the original client as well as other clients for whom the stock is suitable, as described in the response rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because the member violates Standard I (A), as described in the response rationale for the correct answer.

B. Incorrect because Standard III (B), Fair Dealing, states that Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities. However, this case is not about fairness related to investment analysis, making investment recommendations, taking investment action on behalf of clients. Instead, the member violates Standard I (A), Knowledge of the Law, as described in the response rationale for the correct answer.

C. Correct because Standard I (A), Knowledge of the Law, states that Members and Candidates must understand and comply with all applicable laws, rules, and regulations. While Standard III (E), Preservation of Confidentiality, states that When permissible under applicable law, members and candidates shall consider the PCP an extension of themselves when requested to provide information about a client in support of a PCP investigation into their own conduct, this case clearly states that disclosure is not permitted by applicable law. Therefore, the member violates Standard I (A) by disclosing client information.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard II(A), Material Nonpublic Information, has been violated by both Hadid and Jackson as described in the response rationale of the correct answer.

B. Incorrect because Standard II(A), Material Nonpublic Information, has been violated by both Hadid and Jackson as described in the response rationale of the correct answer.

C. **Correct** because Standard II(A), Material Nonpublic Information, states that Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information. Also, Members and candidates must not use material nonpublic information to influence their investment actions related to derivatives. Hadid caused Jackson to act by telling Jackson about her work on SML. Jackson acts on the information and buys call options on SML. Therefore, both Hadid and Jackson violate Standard II(A).

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Incorrect because according to Standard II(B), Market Manipulation, members are prohibited from disseminating false, not verifiable, information to induce trading by others. Market manipulation includes the dissemination of false or misleading information and Information-based manipulation includes spreading false rumors to induce trading by others.

B. Incorrect because Standard II(B) Market Manipulation allows trading strategies based on perceived market inefficiencies. Standard II(B) is not intended to preclude transactions undertaken on legitimate trading strategies based on perceived market inefficiencies.

C. **Correct** because Standard II(B), Market Manipulation, prohibits such activity. Transaction-based manipulation includes, but is not limited to securing a controlling, dominant position in a financial instrument to exploit the price of the underlying asset.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard III (E), Preservation of Confidentiality, states that this standard protects the confidentiality of client information even if the person or entity is no longer a client of the member or candidate.

B. Incorrect because Standard III (E), Preservation of Confidentiality, states that if applicable law requires members and candidates to maintain confidentiality, even if the information concerns illegal activities on the part of the client, members and candidates should not disclose such information.

C. **Correct** because Standard III (E), Preservation of Confidentiality, states that members must keep information about current, former, and prospective clients confidential unless: the client or prospective client permits disclosure of the information.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because, as described in the rationale for the correct answer, Lee has violated both Standard III(A) and Standard III(C).

B. Incorrect because, as described in the rationale for the correct answer, Lee has violated both Standard III(A) and Standard III(C).

C. **Correct** because Standard III(C), Suitability, When Members and Candidates are in an advisory relationship with a client, they must determine that an investment is suitable to the client's financial situation and consistent with the client's written objectives, mandates, and constraints before making an investment recommendation or taking investment action. Also, the investment professional's determination of suitability should reflect only the investment recommendations or actions that a prudent person would be willing to undertake. Not every investment opportunity will be suitable for every portfolio, regardless of the potential return being offered. Lee has ignored her client's mandate of an equal-weighted portfolio and is in violation of this standard. Further, according to Standard III(A), Loyalty, Prudence, and Care, ;Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Also, members and candidates must follow any guidelines set by their clients for the management of their assets. Lee's decision not to rebalance the portfolio is a violation of this Standard. So, Lee has violated both Standard III(C) and Standard III(A).

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard IV (B), Additional Compensation Arrangements, requires members and candidates to obtain permission from their employer before accepting compensation or other benefits from third parties for the services rendered to the employer or for any services that might create a conflict with their employer's interest. Compensation and benefits include direct compensation by the client and any indirect compensation or other benefits received from third parties.

B. Incorrect because Standard IV (B), Additional Compensation Arrangements, requires members and candidates to obtain permission from their employer before accepting compensation or other benefits from third parties for the services rendered to the employer or for any services that might create a conflict with their employer's interest. Compensation and benefits include direct compensation by the client and any indirect compensation or other benefits received from third parties.

C. **Correct** because Standard IV (B), Additional Compensation Arrangements, requires members and candidates to obtain permission from their employer before accepting compensation or other benefits from third parties for the services rendered to the employer or for any services that might create a conflict with their employer's interest. Compensation and benefits include direct compensation by the client and any indirect compensation or other benefits received from third parties.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Inorrect because Taylor violated Standard IV (B), Additional Compensation Arrangements. The standard states that Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain consent from all parties involved.Taylor must inform his employer and obtain consent for accepting the front-row ticket to an upcoming sold out match.

B. Incorrect because Standard III (A), Loyalty, Prudence, and Care, states that Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. The violation described in this question of receiving additional compensation without employer consent does not pertain to Standard III(A).

C. **Correct** because Standard IV (B), Additional Compensation Arrangements, states that Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain consent from all parties involved.Taylor must inform his employer and obtain consent for accepting the front-row ticket to an upcoming sold out match. Therefore, he has violated this Standard.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard V (A), Diligence and Reasonable Basis, states members and candidates who are directly involved with the use of external advisers need to ensure that their firms have standardized criteria for reviewing these selected external advisers and managers. This is not a requirement of Standard III (C), Suitability.

B. Incorrect because Standard V (A), Diligence and Reasonable Basis, states members and candidates who are directly involved with the use of external advisers need to ensure that their firms have standardized criteria for reviewing these selected external advisers and managers. This is not a requirement of Standard I (B), Independence and Objectivity.

C. **Correct** because Standard V (A), Diligence and Reasonable Basis, states members and candidates who are directly involved with the use of external advisers need to ensure that their firms have standardized criteria for reviewing these selected external advisers and managers. Such criteria would include, but would not be limited to, the following:

reviewing the adviser's established code of ethics,
understanding the adviser's compliance and internal control procedures,
assessing the quality of the published return information, and
reviewing the adviser's investment process and adherence to its stated strategy.

Understanding the managers' compliance procedures is a criteria for selecting external managers.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because Standard VI(A), Disclosure of Conflicts requires members and candidates to make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer and protects investors and employers by requiring members and candidates to fully disclose to clients, potential clients, and employers all actual and potential conflicts of interest. Once a member or candidate has made full disclosure, the member's or candidate's employer, clients, and prospective clients will have the information needed to evaluate the objectivity of the investment advice or action taken on their behalf.

B. Incorrect because Standard VI(A), Disclosure of Conflicts, makes no requirement or recommendation with respect to fair dealing between and among clients. According to Standard III(B), Fair Dealing, Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

C. **Correct** because Standard VI(A), Disclosure of Conflicts requires members and candidates to make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer and protects investors and employers by requiring members and candidates to fully disclose to clients, potential clients, and employers all actual and potential conflicts of interest. Once a member or candidate has made full disclosure, the member's or candidate's employer, clients, and prospective clients will have the information needed to evaluate the objectivity of the investment advice or action taken on their behalf.

Ethical and Professional Standards

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Solution

A. Correct because the member has not violated either of the Standards. Standard I (C), Misrepresentation, prohibits members and candidates from guaranteeing clients any specific return on volatile investments. The member is not making a guarantee or implying a future return to the prospective client, and therefore is not in violation of this Standard. Standard III (D), Performance Presentation, states a member or candidate must give a fair and complete presentation of performance information whenever communicating data with respect to the performance history of individual accounts, composites or groups of accounts, or composites of an analyst's or firm's performance results. Furthermore, members and candidates should not state or imply that clients will obtain or benefit from a rate of return that was generated in the past. The member is stating a fact that the composite shows outperformance, gross of fees, and not implying future returns and therefore is not in violation of this Standard.

B. Incorrect because the member has not guaranteed a rate of future returns and so has not violated Standard I (C), Misrepresentation, as described in the rationale for the correct answer.

C. Incorrect because the member has properly used a composite return to represent past performance and has not guaranteed a rate of future returns and so has not violated Standard III (D), Performance Presentation, as described in the rationale for the correct answer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because the member has returned investor capital, which is not a violation of the Code and Standards. However, the member has violated Standard I(C), which prohibits members and candidates from guaranteeing clients any specific return on volatile investments. With the return of their capital, investors did not lose their original investment, but they did suffer an economic opportunity loss.

B. **Correct** because the member has misrepresented the returns she could realistically achieve for her clients, violating Standard I(C), which prohibits members and candidates from guaranteeing clients any specific return on volatile investments.

C. Incorrect because the investment mandate is not a violation of the Code and Standards. The mandate is very broadly defined and while it may or may not be appropriate, there is not enough information in the vignette to make this determination. The promised, but unachieved, yield is the violation that can be clearly identified.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to the GIPS standards misleading practices include Representative Accounts: Selecting a top-performing portfolio to represent the firm's overall investment results for a specific mandate. Therefore, the GIPS standards does not allow the use of a representative account to present the firm's overall investment results.

B. Incorrect because presenting an 'average' performance history that excludes portfolios whose poor performance was weak enough to result in termination of the firm is known as survivorship bias and is a misleading practice when presenting investment performance data. Therefore, presenting performance history that only includes accounts remaining at the firm (and excludes accounts that has left the firm) is incorrect.

C. **Correct** because the GIPS standards are a practitioner-driven set of ethical principles that establish a standardized, industry-wide approach for investment firms to follow in calculating and presenting their historical investment results to prospective clients. Therefore, the GIPS standard establish a standardized approach to presenting historical investment results to prospective clients, and this answer is **Correct** .

Ethical and Professional Standards

- describe the fundamentals of compliance, including the recommendations of the GIPS standards with respect to the definition of the firm and the firm's definition of discretion

Solution

A. Correct because the objectives of the GIPS standards are as follows: Promote fair, global competition among investment firms.

B. Incorrect because the GIPS standards certainly do not eliminate the need for in-depth due diligence on the part of the client or investor, but compliance with the Standards enhances the credibility of investment management firms that have chosen to undertake this responsibility.

C. Incorrect because complying with the GIPS standards is voluntary. Compliance with the GIPS standards is not typically required by legal or regulatory authorities. Also, the preamble to the GIPS standards states that by adhering to a global standard, firms in countries with minimal or no investment performance standards can compete for business on an equal footing with firms from countries with more-developed standards.

Therefore, it is clear that GIPS standards were not created to serve as a mandatory performance standard for asset management firms in countries without investment performance regulation.

Ethical and Professional Standards

- explain why the GIPS standards were created, who can claim compliance, and who benefits from compliance

Solution

A. Incorrect because the portfolio manager took property of his former employer, proprietary trading software, and violated Standard IV(A)–Loyalty. Although the manager created the software himself, it was during a period of time when the large money manager employed him and the software is not his property to take.

B. Incorrect because the member violated Standard IV(A)–Loyalty as he did not act for the benefit of his former employer. In this case, the member may cause harm to his former employer if his weekend messages result in clients moving to his new business.

C. **Correct** because the portfolio manager received permission to use his investment performance history from his prior employer. The member violated his non-solicitation agreement by indicating his availability to new clients on several social media sites accessible by clients of his former employer. This is a violation of Standard IV(A)–Loyalty because he did not act for the benefit of his former employer. In this case, the member may cause harm to his former employer if his weekend messages result in clients moving to his new business from his former employer. The member also violated this standard by taking his employer's property, trading software.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because the recommended procedures for compliance with Standard I (C), Misrepresentation, state that firms can also help prevent misrepresentation by specifically designating which employees are authorized to speak on behalf of the firm.

B. Incorrect because the recommended procedures for compliance with Standard I (C), Misrepresentation, state that firms can assist members by periodically reviewing employee correspondence and documents that contain representations of individual or firm qualifications. Performing quarterly competence reviews of employees who deliver firm presentations to clients is not a recommended procedure.

C. Incorrect because the recommended procedures for compliance with Standard I (C), Misrepresentation, state that members and candidates should encourage their employers to develop procedures for verifying information of third party firms. Therefore, it is not a recommended procedure for firms to ensure each employee develops processes for verifying information of third party firms provided to clients.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because the recommended procedures for compliance with Standard VI (B), Priority of Transactions, recommend that investment personnel should examine all planned personal trades to identify possible conflicts prior to the execution of the trades. Therefore, a recommended procedure for compliance with the Standard is to examine all planned personal trades prior to [not immediately after] the execution of the trade.

B. **Correct** because the recommended procedures for compliance with Standard VI (B), Priority of Transactions, recommend that investment personnel should be required to direct their brokers to supply to firms duplicate copies or confirmations of all their personal securities transactions and copies of periodic statements for all securities accounts.

C. Incorrect because the recommended procedures for compliance with Standard VI (B), Priority of Transactions, recommend that disclosure by investment personnel to the firm should be made upon commencement of the employment relationship and at least annually thereafter.& Therefore, a recommended procedure for compliance with the Standard is to disclose upon commencement of the employment relationship and at least annually thereafter [not a one off disclosure on commencement of employment only].

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because, as described in the rationale for the correct answer, both Procedure 1 and Procedure 2 are recommended procedures.

B. Incorrect because, as described in the rationale for the correct answer, both Procedure 2 and Procedure 1 are recommended procedures.

C. **Correct** because the recommended procedures for compliance with Standard III(C), Suitability, state that an investor's objectives and constraints should be maintained and reviewed periodically to reflect any changes in the client's circumstances. Annual review is reasonable unless business or other reasons, such as a major change in market conditions, dictate more frequent review. In addition, in formulating an investment policy for the client, the member or candidate should take the following into consideration: performance measurement benchmarks. Therefore, both procedures are recommended for compliance with Standard III(C).

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard I(B), Independence and Objectivity, members are permitted to accept token business-related gifts. Per the Standard, members and candidates must limit the acceptance of gratuities and/or gifts to token items. Firms should consider a strict value limit for acceptable gifts that is based on the local or regional customs and should address whether the limit is per gift or an aggregate annual value.

B. **Correct** because this is a requirement of Standard I(B), Independence and Objectivity. Issuer-paid research conducted by independent analysts, however, is fraught with potential conflicts. Members must adhere to strict standards of conduct that govern how the research is to be conducted and what disclosures must be made in the report. Analysts must engage in thorough, independent, and unbiased analysis and must fully disclose potential conflicts of interest, including the nature of their compensation.

C. Incorrect because according to Standard I(B), Independence and Objectivity, it is recommended (not required) that members pay for commercial transportation and hotel charges, not meals, when attending meetings at an issuer's headquarters.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because under Standard I(A), Knowledge of the Law, members and candidates have a responsibility to step away and dissociate from the [unethical] activity. Inaction combined with continuing association with those involved in illegal or unethical conduct may be construed as participation or assistance in the illegal or unethical conduct.

B. Incorrect because under Standard I(A), Knowledge of the Law, a failure to report is less likely to be construed as a violation than a failure to dissociate from unethical conduct, the impact of inactivity on the integrity of capital market can be significant. Although the Code and Standards do not compel members and candidates to report violations to their governmental or regulatory organizations..., such disclosure may be prudent under certain circumstances.

C. Incorrect because under Standard I(A), Knowledge of the Law, while members and candidates must understand the applicable laws and regulations of the countries and jurisdictions where they engage in professional activities, 'members and candidates are not required to have detailed knowledge of or be experts on all the laws that could potentially govern their activities.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because under Standard IV(C), Responsibilities of Supervisors, members and candidates should encourage their employers to provide their codes to clients... the code of ethics will be effective in conveying that the firm is committed to conducting business in an ethical manner and in the best interests of the clients.

B. Incorrect because under Standard IV(C), Responsibilities of Supervisors, members and candidates are encouraged to recommend [not require] that their employers adopt a code of ethics. Adoption of a code of ethics is critical to establishing a strong ethical foundation for investment advisory firms and their employees.

C. Incorrect because under Standard IV(C), Responsibilities of Supervisors, members are recommended to separate the code of ethics from compliance procedures. A stand-alone codes of ethics should be written in plain language and should address general fiduciary concepts. They should be unencumbered by numerous detailed procedures.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Correct because verification is performed with respect to an entire firm, not on specific composites or pooled funds.

B. Incorrect because verification is performed with respect to an entire firm, not on specific composites or pooled funds.

C. Incorrect because verification must be performed by an independent third party. A firm cannot perform its own verification.

Ethical and Professional Standards

- describe the concept of independent verification

Solution

A. Incorrect because this is not permitted by Standard V(C), Record Retention. For future use, the member or candidate must re-create the supporting records at the new firm with information gathered through public sources or directly from the covered company and not from memory or sources obtained at the previous employer.

B. Incorrect because this is not permitted by Standard V(C), Record Retention. For future use, the member or candidate must re-create the supporting records at the new firm with information gathered through public sources or directly from the covered company and not from memory or sources obtained at the previous employer.

C. **Correct** because this is consistent with Standard V(C), Record Retention. For future use, the member or candidate must re-create the supporting records at the new firm with information gathered through public sources or directly from the covered company and not from memory or sources obtained at the previous employer.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct because verification is performed with respect to an entire firm, not on specific composites.

B. Incorrect because verification of GIPS standards must be conducted by a third party, not the firm itself: verification must be performed by an independent third party. A firm cannot perform its own verification.

C. Incorrect because verification does not ensure the accuracy of any specific composite presentation.

Ethical and Professional Standards

- describe the concept of independent verification

Solution

A. Incorrect because the design of both performance calculation and firm policies related to pooled fund maintenance are assured by a GIPS verifier: verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis.

B. Incorrect because the design of both performance calculation and firm policies related to pooled fund maintenance are assured by a GIPS verifier: verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis.

C. **Correct** because verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis.

Ethical and Professional Standards

- describe the concept of independent verification

Solution

A. Correct because according to Standard V (A), Diligence and Reasonable basis, Members and Candidates must:

1. Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions.

2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

Additionally, the results of research are not always clear, and different people may have different opinions based on the same factual evidence. In this case, the committee may have valid reasons for issuing a report that differs from the analyst's original research. The firm can issue a report that is different from the original report of an analyst as long as there is a reasonable and adequate basis for its conclusions.

Generally, analysts must write research reports that reflect their own opinion and can ask the firm not to put their name on reports that ultimately differ from that opinion. When the work is a group effort, however, not all members of the team may agree with all aspects of the report. Ultimately, members and candidates can ask to have their names removed from the report, but if they are satisfied that the process has produced results or conclusions that have a reasonable and adequate basis, members and candidates do not have to dissociate from the report even when they do not agree with its contents.

Yong was thorough in her research and There is no evidence to assume that she did not have a reasonable and adequate basis for her recommendation. Additionally there is no violation of the standard relating to loyalty, prudence and care.

B. Incorrect because according to Standard III (A), Loyalty, Prudence, and Care Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. By contrast, this case is about whether Yong was thorough in her analysis. This case does not pertain to Standard III (A). Therefore, Standard III (A) has not been violated.

C. Incorrect because Yong has not violated this Standard as described in the rationale to the correct response.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to the recommended procedures for compliance with Standard I (B), Independence and Objectivity, if the firm is unwilling to permit dissemination of adverse opinions about a corporate client, members and candidates should encourage the firm to remove the controversial company from the research universe and put it on a restricted list so that the firm disseminates only factual information about the company. Therefore, a member should encourage her firm to place a company on (not remove a company from) a restricted list if the firm is unwilling to permit dissemination of adverse opinion about the company. So, Statement 1 is not accurate.

B. Correct because according to Standard I (B), Independence and Objectivity, one type of benefit is the allocation of shares in oversubscribed IPOs to investment managers for their personal accounts. This practice affords managers the opportunity to make quick profits that may not be available to their clients. Such a practice is prohibited under Standard I (B). Therefore, a member is prohibited from accepting benefits from corporate issuers in the form of allocation of shares in oversubscribed IPOs that are suitable for firm's clients. So, Statement 2 is accurate.

C. Incorrect because according to the recommended procedures for compliance with Standard I (B), Independence and Objectivity, if the firm is unwilling to permit dissemination of adverse opinions about a corporate client, members and candidates should encourage the firm to remove the controversial company from the research universe and put it on a restricted list so that the firm disseminates only factual information about the company. Therefore, a member should encourage her firm to place a company on (not remove a company from) a restricted list if the firm is unwilling to permit dissemination of adverse opinion about the company. So, Statement 1 is not accurate.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard IV (A), Loyalty, in matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer. Working on weekends for a charity to do tasks that do not compete with her investment role employer does not violate this Standard.

B. Correct because according to Standard I (D), Misconduct, Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence. Overcharging the charity by any amount is fraud and reflects adversely on Melmo as an investment professional and potentially on her employer and and the investment profession.

C. Incorrect because according to Standard I (D), Misconduct, Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence. Further, and according to Standard IV (A), Loyalty, in matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer. Working on weekends for a charity does not violate either Standard. However, overcharging the charity is fraud and reflects adversely on Melmo as an investment professional and potentially on her employer and on the investment profession.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard VI(A), Disclosure of Conflicts, when members or candidates providing investment services also serve as directors, they should be isolated from those making investment decisions by the use of firewalls or similar restrictions. Standard VI(A) protects investors and employers by requiring members and candidates to fully disclose to clients, potential clients, and employers all actual and potential conflicts of interest. Once a member or candidate has made full disclosure, the member's or candidate's employer, clients, and prospective clients will have the information needed to evaluate the objectivity of the investment advice or action taken on their behalf. Therefore, with disclosure, accepting the board position is acceptable.

B. Correct because according to Standard VI(A), Disclosure of Conflicts, equally important is the disclosure of arrangements in which the firm benefits directly from investment recommendations. An obvious conflict of interest is the rebate of a portion of the service fee some classes of mutual funds charge to investors. Members and candidates should ensure that their firms disclose such relationships so clients can fully understand the costs of their investments and the benefits received by their investment manager's employer.

C. Incorrect because according to the recommended procedure for compliance with Standard VI(A), Disclosure of Conflicts, if a member, a candidate, or a member's or candidate's firm has outstanding agent options to buy stock as part of the compensation package for corporate financing activities, the amount and expiration date of these options should be disclosed as a footnote to any research report published by the member's or candidate's firm. Therefore, a member need not place the company on a restricted list and issue factual information about the company if the member's firm holds options on the company's shares.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because according to Standard VI(B), Priority of Transactions, members and candidates should fully disclose to investors their firm's policies regarding personal investing. The information about employees' personal investment activities and policies will foster an atmosphere of full and complete disclosure and calm the public's legitimate concerns about the conflicts of interest posed by investment personnel's personal trading.

B. Correct because according to Standard VI(B), Priority of Transactions, investment personnel involved in the investment decision-making process should establish blackout periods prior to trades for clients so that managers cannot take advantage of their knowledge of client activity by "front-running" client trades (trading for one's personal account before trading for client accounts).

C. Incorrect because according to Standard VI(B), Priority of Transactions, members or candidates may undertake transactions in accounts for which they are a beneficial owner only after their clients and employers have had adequate opportunity to act on a recommendation. Family accounts that are client accounts should be treated like any other firm account and should neither be given special treatment nor be disadvantaged because of the family relationship.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because Garcia has not violated Standard III (B), Fair Dealing, by calling her largest client, since she widely disseminated the recommendation and provided the information to all her clients prior to discussing it with her largest client. Members and candidates should establish procedures for the timing of dissemination of investment recommendations so that all clients are treated fairly—that is, are informed at approximately the same time. Once this distribution has occurred, the member or candidate may follow up separately with individual clients, but members and candidates should not give favored clients advance information when such advance notification may disadvantage other clients.

B. **Correct** because Garcia has violated Standard III (B), Fair Dealing, by disseminating the sell recommendation to her largest client before the recommendation is sent to all clients. Each member or candidate is obligated to ensure that information is disseminated in such a manner that all clients have a fair opportunity to act on every recommendation. Garcia has not violated Standard III (B) by calling her largest client, since she widely disseminated the recommendation and provided the information to all her clients prior to discussing it with her largest client. Members and candidates should establish procedures for the timing of dissemination of investment recommendations so that all clients are treated fairly—that is, are informed at approximately the same time. Once this distribution has occurred, the member or candidate may follow up separately with individual clients, but members and candidates should not give favored clients advance information when such advance notification may disadvantage other clients.

C. Incorrect because Garcia has not violated Standard III (B), Fair Dealing, by calling her largest client, since she widely disseminated the recommendation and provided the information to all her clients prior to discussing it with her largest client. Members and candidates should establish procedures for the timing of dissemination of investment recommendations so that all clients are treated fairly—that is, are informed at approximately the same time. Once this distribution has occurred, the member or candidate may follow up separately with individual clients, but members and candidates should not give favored clients advance information when such advance notification may disadvantage other clients.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Incorrect because according to Standard V (C), Investment Analysis, Recommendations, and Actions - Record Retention, Local regulators often impose requirements on members, candidates, and their firms related to record retention that must be followed. Firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C). In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years.

B. Incorrect because Incorrect because according to Standard V (C), Investment Analysis, Recommendations, and Actions - Record Retention, Local regulators often impose requirements on members, candidates, and their firms related to record retention that must be followed. Firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C). In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years.

C. **Correct** because according to Standard V (C), Investment Analysis, Recommendations, and Actions - Record Retention, Local regulators often impose requirements on members, candidates, and their firms related to record retention that must be followed. Firms may also implement policies detailing the applicable time frame for retaining research and client communication records. Fulfilling such regulatory and firm requirements satisfies the requirements of Standard V(C). In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years.

Ethical and Professional Standards

- recommend practices and procedures designed to prevent violations of the Code of Ethics and Standards of Professional Conduct

Solution

A. Incorrect because Standard VI (C), Referral Fees, states the responsibility of members and candidates to inform their employer, clients, and prospective clients of any benefit received for referrals of customers and clients. Therefore, a member has to inform his employer and his potential clients.

B. Incorrect because Standard VI (C), Referral Fees, states the responsibility of members and candidates to inform their employer, clients, and prospective clients of any benefit received for referrals of customers and clients. Therefore, a member has to inform his employer and his potential clients.

C. **Correct** because Standard VI (C), Referral Fees, states the responsibility of members and candidates to inform their employer, clients, and prospective clients of any benefit received for referrals of customers and clients.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct, because the GIPS standards rely on the integrity of input data, the quality of which is critical to creating accurate performance presentations. The underlying valuations of portfolio holdings drive performance. It is essential for these and other inputs to be accurate. The GIPS standards require firms to adhere to certain calculation methodologies to allow for comparability across firms.

B. Incorrect, because meeting the objectives of fair representation and full disclosure is likely to require more than simply adhering to the minimum requirements of the GIPS standards. Firms should also adhere to the recommendations to achieve best practice in the calculation and presentation of performance. In addition, GIPS standards will

continue to evolve over time to address additional areas of investment performance and firms will be required to keep up with the updated standards.

C. Incorrect, because the GIPS standards require firms to create and maintain composites for all strategies for which the firm manages segregated accounts or markets to segregated accounts. Firms must include all actual, fee-paying, discretionary segregated accounts in at least one composite defined by investment mandate, objective, or strategy. Non-discretionary accounts must not be included in composites.

Ethical and Professional Standards

- describe the key concepts of the GIPS Standards for Firms

Solution

A. Incorrect because, according to Standard V (C), Record Retention, records created as part of a member's or candidate's professional activity on behalf of his or her employer are the property of the firm, not the client.

B. Incorrect because, according to Standard V (C), Record Retention, records created as part of a member's or candidate's professional activity on behalf of his or her employer are the property of the firm, not the member.

C. **Correct** because, according to Standard V (C), Record Retention, records created as part of a member's or candidate's professional activity on behalf of his or her employer are the property of the firm.

Ethical and Professional Standards

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Solution

A. Correct, because the identical material reflected in her previous client's proposal belongs to that client, even though she wrote it on their behalf as their consultant. To use it in its identical format would be considered plagiarism. In addition, the description also identifies a proprietary process and is therefore not applicable to her existing client's investment process. Consequently, to prevent violating Standard I(C) Misrepresentation the material should be removed. The Standard states Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities. Standard I(C) Misrepresentation prohibits plagiarism in the preparation of material for distribution to employers, associates, clients, prospects, or the general public. Macharia should also report the use of plagiarized material to the client so they can take action to prevent the event being repeated in the future (Standard I(A) Knowledge of the Law). Allowing the use of plagiarized material reflects poorly on a firm and can hurt their reputation. By reporting to the client Macharia is also protecting the interests of her clients (Standard III(A) Loyalty, Prudence, and Care).

B. Incorrect, Standard I(A) Knowledge of the Law states if a member has reasonable grounds to believe that ongoing activities within a firm are illegal or unethical, the member or candidate must dissociate, or separate, from the activity. In this case, Macharia is required to protect the interests of her clients (Standard III(A) Loyalty, Prudence, and Care) by helping them avoid plagiarism and misrepresenting their investment process (Standard I(C) Misrepresentation). To most effectively do this, the first step should be to attempt to stop the behavior by bringing it to the attention of the employer (or client in this case) through a supervisor or the firm's compliance department.

C. Incorrect, because making a few changes here and there would be insufficient to avoid the statement from being considered plagiarized or misrepresenting the firm's investment process by using a description of the previous client's proprietary investment process. Macharia has a duty to take the necessary action to prevent this unethical behavior. To do otherwise would cause her to violate Standard I(A) Knowledge of the Law and Standard I(C) Misrepresentation. Standard I(A) Knowledge of the Law states if a member has reasonable grounds to believe that ongoing activities within a firm are illegal or unethical, the member or candidate must dissociate, or separate, from the activity. When direct discussions with the person committing the violation are unsuccessful, the first step should be to attempt to stop the behavior by bringing it to the attention of the employer through a supervisor or the firm's compliance department. Standard I(C) Misrepresentation states Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

Ethical and Professional Standards

- evaluate practices, policies, and conduct relative to the CFA Institute Code of Ethics and Standards of Professional Conduct

Solution

A. Correct. GIPS standards are ethical standards for investment performance presentation to ensure fair representation and full disclosure of investment performance. So, Statement 1 is a key concept of the GIPS standards.

B. Incorrect because, the GIPS standards require firms to create and maintain composites for all strategies for which the firm manages segregated accounts or markets to segregated accounts. Firms must include all actual, fee-paying, discretionary segregated accounts in at least one composite defined by investment mandate, objective, or strategy. So, Statement 2 is not a key concept of the GIPS standards.

C. Incorrect because the GIPS standards do not address every aspect of performance measurement and will continue to evolve over time to address additional areas of investment performance. So, Statement 3 is not a key concept of the GIPS standards.

Ethical and Professional Standards

- describe the key concepts of the GIPS Standards for Firms