



Ethics



Overview: Ethics and GIPS



Exam Focus

- Introduction to the Code of Ethics and Standards of Professional Conduct
- Introduction to the Global Investment Performance Standards (GIPS)

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Mastering CFAI Ethics

The importance of Ethics for CFA L1 candidates

- At L1, Ethics has the highest topic weight: 15%–20%, 27–36 questions
- Important for marginal candidates
- Time spent studying Ethics will give you an advantage at LI, LII, and LIII

Mastering Ethics is a challenge!

- Appears at end of the curriculum
- Time may be limited
- Appears long and wordy
- Learn the Code and Standards so that Ethics questions are **easier marks**

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Scope of CFA Level I Ethics

Ethical and Professional Standards

- Ethics and trust in the investment profession
- Code of Ethics and Standards of Professional Conduct
- Guidance for **Standards I–VII**

Introduction to GIPS

- Why were GIPS created? Who can claim compliance? Who benefits?
- Composites
- Fundamentals of Compliance
- Verification

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Scope of CFA Level I Ethics

Ethics application of Standards I–VII

- Professionalism
- Integrity of capital markets
- Duties to clients
- Duties to employers
- Investment analysis, recommendations, and actions
- Conflicts of interest
- Responsibilities as a CFA Institute Member or CFA Candidate

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Ethics and Professional Behavior

Professional behavior

- Society
- Clients
- The professionals

Important that you know your responsibilities as **a CFA candidate**

- See **Standard VII**

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The Code and Standards

Learn the rules that apply to each standard

- Focus on one standard at a time
- Read the guidance, learn the rules

Example: Standard I(A): Knowledge of the Law

- If **no** securities laws or regulations, follow the code and standards
- If **less strict** laws or regulations, follow the code and standards
- If the securities laws **are stricter**, follow these

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Read Through the CFAI Examples

Application of each standard

- Read through the **applied examples** that follow each standard
- Each example has a scenario that **may** or **may not** contain a **violation** of the code and standards

Example: Standard I(A): Knowledge of the Law

- There are 8 examples that follow Standard I(A):
 - (1) Notification of known violations
 - (2 & 3) Dissociating from a violation
 - (4 & 5) Following the highest requirements
 - (6) Laws and regulations, religious tenets
 - (7) Reporting unethical actions (8) Failure to maintain knowledge of the law

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Question Practice

Build your expertise in CFAI Ethics

- Make sure you allocate **sufficient practice**
- CFAI Code and Standards **applied examples** (**206 in total**, across Standards I–VII)
- SchweserPro QBank
- CFAI Ecosystem
- **OnDemand Review** Questions
- **Kaplan Mock Exams**

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Instructor Study Tips

Make Ethics a priority!

- Ethics is a **set of rules**—know the rules and the **questions become easier**
- If you haven't learned the rules, Ethics questions are difficult
- Read through the **CFAI applied examples** (206 in total)
- Do all the ethics questions you can find
- Getting questions wrong is a good way to get them right—**learn from mistakes**
- Ethics questions are not deep or complex ideas—you can get good fast
- There is **alpha in ethics**—your chance to get ahead of the average candidate

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Ethics Question 1

Which of the following is a *correct* statement of a member's or candidate's duty under the code and standards?

- A. In the absence of specific applicable law or other regulatory requirements, the Code and Standards govern the member's or candidate's actions.
- B. A member or candidate is required to comply only with applicable local laws, rules, regulations or customs, even though the Code and Standards may impose a higher degree of responsibility or a higher duty on the member or candidate.
- C. A member or candidate who trades securities in a securities market where no applicable local laws or stock exchange rules regulate the use of material nonpublic information may take investment action based upon material nonpublic information.

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Ethics Question 2

Quinn sat for the CFA LIII exam this past weekend. He updates his resume with the following statement: "In finishing the CFA Program, I improved my skills related to researching investments and managing portfolios. I will be eligible for the CFA Charter upon completion of the required work experience".

- A. Quinn violated the Code and Standards by claiming he improved his skills through the CFA Program.
- B. Quinn violated the Code and Standards by incorrectly stating that he is eligible for the CFA Charter.
- C. Quinn did not violate the Code and Standards with his resume update.

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GIPS

Past performance data

- It is difficult to make **meaningful comparisons** between the past performance of investment firms
- Selecting **top-performing** accounts
- Survivorship bias
- Varying time periods

GIPS standards

- Establish an industry-wide approach for investment firms
- **Fair and full disclosure** of investment performance

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GIPS Objectives

GIPS objectives

- Instill investor confidence
- Accurate and consistent data
- Worldwide acceptance of a single standard for presenting performance
- Promote fair, global competition among investment firms
- Promote industry self-regulation

GIPS compliance is voluntary

- Only firms that **manage assets** may claim compliance
- Must fully comply with **all GIPS requirements**

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GIPS

The scope of GIPS at CFA Level I

- Why GIPS was created, who can claim compliance, and who benefits from GIPS
- GIPS standards for firms
- Purpose of composites
- Fundamentals of compliance
 - Definition of the firm
 - Definition of discretion
- Independent verification

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Who Benefits From Compliance?

Who benefits from GIPS compliance?

- Firms, prospective clients and investors, asset owners, and their oversight bodies

Firms

- Assure prospective investors that their records are complete and fairly presented
- Better compete against other GIPS-compliant firms

Clients and investors

- Have a greater level of confidence in the integrity of performance presentations

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Who Benefits From Compliance?

Who benefits from GIPS compliance?

Asset owners

- Provide performance information to their oversight bodies
- Enable investment decisions and evaluate investment performance

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Composites

Composites show performance data for portfolios with a similar **investment mandate, objective, or strategy**

- All actual, fee-paying, discretionary portfolios must be included in at least one composite

Example: Global Equity Composite includes portfolios that are currently managed or were historically managed in the firm's global equity strategy

Allocating portfolios to composites

- Strict criteria are used to prevent firms from switching portfolios between composites (e.g., to remove a poor-performing portfolio)

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Fundamentals of Compliance

Definition of the firm

- GIPS compliance must be **firm-wide**
- GIPS requires a **broad**, meaningful definition of the firm
- Scope includes geographical offices and businesses under the same brand name

Definition of discretion

- GIPS only applies to **discretionary portfolios**
- Discretion allows investment manager to implement **investment strategies**
- Firms must have their own **definition of discretion**

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Verification

GIPS verification: an independent audit of a firm's GIPS standards-related performance information

- Verification is **voluntary**
- Carried out by an **independent** verification firm
- Provides assurance on whether the firm's **GIPS policies and procedures** are:
 - In compliance with GIPS standards
 - Implemented on a firm-wide basis
- Verification is in respect of the **entire firm**
- Verification **does not** ensure accuracy of any specific performance report

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GIPS

Instructor advice

- GIPS is a **set of rules** and **jargon**; not technically difficult
- GIPS expands for CFA LIII
- **Learn the rules**—GIPS questions are easy
- At LI, GIPS is short; read the concepts
- As with Ethics . . . practice, practice, practice
- Practice questions from **all sources**

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GIPS Question 1

Which of the following statements regarding GIPS compliance is *correct*?

- A. Asset owners that manage assets can claim compliance with the GIPS standards.
- B. Software that calculates performance in a manner consistent with the GIPS standards can claim compliance with the GIPS Standards.
- C. Firms can comply with the GIPS standards by limiting their compliance claims to the provisions they have chosen to follow.

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GIPS Question 2

Which of the following *cannot* claim compliance with the GIPS standards?

- A. Investment management firms.
- B. Software vendors.
- C. Private pension funds.

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Solutions

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