Question #1 of 20

Question ID: 1553639

Wes Smith, CFA, refers many of his clients to Bill Towers, CPA, for accounting services. In return, Towers performs routine services for Smith, such as his tax returns, for no charge. With respect to this relationship, Smith:

A) is only in violation of Standard III(B), Fair Dealing, by not putting the client first. ✗

B) is in violation of both Standard V(B) and III(B). ✗

C) **must disclose to his clients that Towers provides services for Smith's personal benefit.** ✓

Explanation

According to VI(C), Referral Fees, Smith must disclose to his clients that Towers provides services for Smith's personal benefit. Neither of the Standards listed in the other answers apply.

(Module 30.8, LOS 30: VI(C))

Question #2 of 20

Question ID: 1553260

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

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

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

C) require members to persuade the perpetrator to cease illegal activities. ✗

Explanation

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

(Module 30.1, LOS 30: I(A))

Question #3 of 20

Question ID: 1553542

Jess Green, CFA is the research director for Castle Investment, Inc., and has supervisory responsibility over eight analysts, including three CFA charterholders. Castle has a compliance program in place. According to CFA Institute Standards of Professional Conduct, which of the following is *least likely* an action that Green should take to adhere to the compliance procedures involving responsibilities of supervisors? Green should:

A) **incorporate a professional conduct evaluation as part of the performance review only for the three CFA charterholders.** ✓

B) issue periodic reminders of the procedures to all analysts under his supervision. ✗

C) disseminate the contents of the compliance program to the eight analysts. ✗

Explanation

Green should incorporate a professional conduct evaluation as part of his review of all eight analysts under his supervision, not just the three CFA charterholders.

(Module 30.6, LOS 30: IV(C))

Question #4 of 20

Question ID: 1553566

A financial analyst and CFA Institute member sends a preliminary research report on a company to his supervisor. The supervisor approves the report, but then the analyst receives news that causes him to revise downward the earnings estimate of the company. The analyst resubmits the report to the supervisor with the new earnings estimate. The analyst soon finds out that the supervisor plans to release the first version of the report with the first earnings estimate without a reasonable and adequate basis. In response to this the analyst must:

A) **insist that the supervisor change the earnings forecast or remove his (the analyst's) name from the report.**

B) only insist that the first report be followed up by a revision.

C) both insist that a follow up report be issued and take up the issue with regulatory authorities.

Explanation

According to Standard V(A), Diligence and Reasonable Basis, the analyst must exercise diligence, independence, and thoroughness when performing investment analysis, making a recommendation, or taking investment action. The analyst should document the difference in opinion including any request to remove his or her name from the report.

(Module 30.7, LOS 30: V(A))

Question #5 of 20

Question ID: 1553505

An analyst belongs to a nationally recognized charitable organization, which requires dues for membership. The analyst has worked out a deal where he provides money management advice in lieu of paying dues. Which of the following must the analyst do?

A) Resign from the position because the relationship is a conflict with the Standards.

B) Nothing since he is not an employee of the charitable organization.

C) **Must treat the charitable organization as his employer.**

Explanation

An employee/employer relationship does not necessarily mean monetary compensation for services. If the analyst is performing services for the organization, then the analyst must treat the position as if he were an employee.

(Module 30.6, LOS 30: IV(A))

Question #6 of 20

Question ID: 1553731

Marc Feldman, a CFA Institute member, is treasurer of zippy.com, and is also Larry Goldman's boss. Feldman is informed of "accounting irregularities of an unknown origin" during an audit by Zippy's external accounting firm. There are 3 individuals, including Goldman, handling the accounting function. According to the Code and Standards, Feldman should do all of the following except:

A) conduct a thorough investigation of activities.

B) **terminate the accounting staff immediately and issue a press release describing the situation.**

C) leave the staff in their current jobs and increase supervision while the external auditors complete their work.

Explanation

Standard IV(C) spells out responsibilities of supervisors in the Standards of Practice Handbook. Since the investigation is ongoing, it would clearly be inappropriate to terminate the entire accounting staff until their complicity in the wrongdoing is established.

(Module 31.1, LOS 31.b)

Question #7 of 20

Question ID: 1553778

All of the following are reasons why the Global Investment Performance Standards (GIPS) were created *except* to enhance:

A) consistency in performance presentation for inter-country holdings.

B) the enforcement of global accounting standards.

C) **competition in global markets.**

Explanation

The objectives of GIPS are to:

- Advance the interests of investors and increase their confidence in the investment industry.
- Provide accurate and comparable data to investors.
- Create a globally accepted standard for the determination and presentation of investment performance.
- Facilitate fair competition among global investment managers.
- Encourage self-regulation in the global investment industry.

(Module 33.1, LOS 33.a)

Question #8 of 20

Question ID: 1553479

A money management firm has created a new junk-bond fund. When the firm advertised the new fund at its issuance, they used care to accurately compute the returns from the past 10 years for all assets in the fund. The firm used the current portfolio weights to determine an average annual historical return equal to 18% and claim an 18% annual historical return in their advertising literature. With respect to Standard III(D), Performance Presentation, this is:

A) in compliance.

B) a violation because the advertisement implies the firm generated this return.

C) a violation because the Standard prohibits computing historical returns on risky assets like junk bonds.

Explanation

Reporting the historical returns of all assets now in the fund introduces a survivorship bias. Also, the advertisement is misleading because the fund just came into existence and has no historical record. Thus, the firm has misled the public as to their performance history.

(Module 30.5, LOS 30: III(D))

Question #9 of 20

Question ID: 1553815

Jessica French is an individual investment advisor with 200 clients and claims she conforms to Global Investment Performance Standards (GIPS). French includes all of the clients on her books. One of those clients is her father, to whom she charges no fee. However, she manages that portfolio using the same processes as she uses for her paying clients. Another client included in the composite is John Randolph, a wealthy entrepreneur. Randolph is the only client who does not give her discretion over the assets and makes every decision himself, getting suggestions from French and using her to implement decisions. French:

A) has violated GIPS because it includes her father's account, but not because it includes Randolph's account.

B) conforms to GIPS, if disclosures are made about the non-fee-paying account.

C) has violated GIPS because it includes Randolph's account, but not because it includes her father's account.

Explanation

Non-fee-paying clients can be included in the same composite as fee-paying clients as long as the percentage of composite assets represented by non-fee-paying portfolios is disclosed. Nondiscretionary clients (Randolph) should not be included in the composite as the clients would not adhere to the investment strategy used by the investment advisor.

(Module 33.4, LOS 33.e)

Question #10 of 20

Question ID: 1553666

Janet Olson, CFA, is an analyst at Quantech Associates. Olson attended a conference at which Brian Wright presented several proprietary computerized spreadsheets that he had developed to value high-tech stocks. While at the conference, Olson copied the spreadsheets without Wright's knowledge. Later, Olson made several minor changes to Wright's initial model. After testing the revised model, Olson was impressed with the results. As inputs for the model, she used factual materials supplied by Moody's Investors Service, a recognized financial and statistical reporting service. Olson wrote a research report describing the revised model and its results and distributed the report to Quantech's clients. According to CFA Institute Standards of Professional Conduct, which of the following actions is Olson required to take? Olson is:

A) required to acknowledge Moody's Investors Service as the source of the data but is not required to seek authorization from Wright to copy the spreadsheets or to acknowledge Wright for developing the initial model.

B) **required to seek authorization from Wright to copy the spreadsheets and acknowledge Wright for developing the initial model and Moody's Investors Service as the source of the data.**

C) required to seek the authorization from Wright to copy the spreadsheets, acknowledge Wright for developing the initial model but is not required to acknowledge Moody's Investors Service as the source of the data.

Explanation

To comply with Standard I(C) Misrepresentation, Olson should have gotten the authorization from Wright to copy the spreadsheets. The prohibition against plagiarism requires that Olson identify Wright as the source of the initial model. However, the Standard permits publishing factual information from Moody's Investors Service without acknowledgment because Moody's is recognized as a source of factual materials.

(Module 30.9, LOS 30: VII(B))

Question #11 of 20

Question ID: 1553226

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

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

B) Prospective clients.

C) Colleagues.

Explanation

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

(Module 29.1, LOS 29.b)

Question #12 of 20

Question ID: 1553285

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

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

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

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

Explanation

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

(Module 30.1, LOS 30: I(A))

William Fleming is an investment advisor for GlobalBank, a large, multinational financial corporation. He is based in the New York office, and his client base consists of medium-to-large institutional accounts in the United States and Western Europe. Roughly three-quarters of his clients pay performance-based fees, while the remaining one-quarter pay fees based on assets. GlobalBank's investment banking division is an industry leader, and Fleming is able to offer his clients the opportunity to participate in some of the hottest initial public offerings (IPOs) and secondary offerings brought to market. GlobalBank's compliance department formulated and distributed to its employees and clients its policy on how to allocate trades among clients.

The policy states that to reward customer loyalty, customers who use the services of GlobalBank's divisions other than investment advisory will receive allocations on all trades, including IPOs and secondary offerings, based on the relative size of their order, before clients who use only investment advisory services. After filling orders for multi-relationship clients, clients who only use investment advisory services will receive trade allocations on all trades, including IPOs and secondary offerings, based on the relative size of their order. This policy reflects GlobalBank's long-term goal of being a full-service provider of financial products and services to all of its clients.

One of Fleming's accounts, Waverly Capital Partners (Waverly), has contacted him regarding an upcoming secondary offering by DCH Corp. (DCH), for which GlobalBank will serve as lead underwriter. Waverly has already performed its due diligence on the offering and is interested in purchasing a substantial position in the secondary offering to employ the company's current surplus of cash. Waverly's representative tells Fleming over the phone that Waverly would like to purchase 5,000 shares of the offering, but gives no other details of its analysis of the offering. Fleming has not read the prospectus for the offering yet and is not familiar with the details, but because he has confidence in Waverly's investment expertise, he tells them that he, too, believes they should participate in the offering. Because Waverly does a significant amount of business with GlobalBank's other divisions, Fleming assures them that they will be able to obtain their desired allocation of the offering and takes the order.

After taking the purchase order for the Waverly account, Fleming thoroughly reads the prospectus and marketing materials for the offering, as well as past research reports on the issuing company. He determines that DCH shares would be a suitable investment for one of his other clients, The Crockett Foundation (Crockett). He contacts the chief investment officer (CIO) of the foundation, explains how an investment in DCH would fit with its current risk and return objectives as detailed in the foundation's investment policy statement (IPS), and provides her with the prospectus for the offering. Fleming tells her that GlobalBank was the lead underwriter for DCH's IPO three years ago and that since then, the stock has outperformed the S&P 500 by at least 15% every year. Fleming also states that the company's financial position is now even stronger, and that the shares will perform at least as well as the lowest return earned on the IPO shares in the last three years. He then proceeds to tell her, "If the foundation is interested in the offering, you should place an order immediately because the issue may be oversubscribed due to strong interest in the offering from Waverly Capital Partners and other clients." This information is enough to motivate Crockett's CIO to call a meeting with the foundation's investment committee.

After a quick meeting with Crockett's investment committee, the CIO calls Fleming to say that the foundation is interested in the offering and would like to place a purchase order. Crockett does not currently conduct any additional business through GlobalBank's other divisions. Because of GlobalBank's trade allocation policy, coupled with the high probability that the offering will be oversubscribed, Crockett is unlikely to be allocated as many shares of the offering as it would like to purchase. To obtain the desired number of shares for the client, Fleming devises a plan. He plans to add Crockett's order to Waverly's order, and once the order is filled, he will reallocate the extra shares back to the foundation's account at the end of the day. He feels that his action is justified because Crockett has maintained its account with Fleming and GlobalBank for over 10 years. In addition, Fleming has traders at GlobalBank sell large blocks of DCH over several days to push the stock price lower. The drop in value causes smaller investors at GlobalBank, who are not Fleming's clients, to withdraw their orders for shares of DCH's secondary offering. Fleming determines that the fewer number of purchase orders and the plan to piggyback on Waverly's order will allow Crockett to acquire its desired allocation of shares in DCH's secondary offering. Having achieved his goal, Fleming allows GlobalBank's traders to repurchase the firm's shares of DCH.

One year passes, and the shares of DCH's secondary offering have declined in price by nearly 20%. The CIO of the Crockett Foundation calls a meeting with Fleming to discuss the poor performance of the security and to review the basis upon which Fleming recommended the investment. Fleming prepares Crockett's file to take with him to the meeting. The file contains Crockett's IPS, a detailed account of the purchase order, and all conversations held between

Fleming and the CIO. In accordance with his own established procedures, however, Fleming maintained the original analysis supporting the purchase of shares in DCH's secondary offering for nine months after the investment was made.

Question #13 - 18 of 20

Question ID: 1572046

Is it *likely* that GlobalBank's trade allocation policy violated the CFA Institute's Standards of Professional Conduct?

A) No—the firm fully disclosed its allocation policy to all clients and employees.

B) **Yes—the policy favors one group of clients over another and will disadvantage those clients who do not have multiple relationships with the firm.**

C) No—the firm is allowed to offer different levels of service to its clients as long as the different levels are disclosed and available to all clients.

Explanation

The actions of GlobalBank are covered under Standard III(B): Fair Dealing. According to Standard III(B), members must deal fairly and objectively with all clients. Trade allocation procedures must be fair and equitable to ensure that investment opportunities are available to all clients. A firm may offer different levels of service to its clients, but a policy may not favor clients who have multiple relationships with the firm over those who do not. The Standards also recommend that a pro rata system, rather than an ad hoc system, be used to avoid conflict of interest.

(Module 30.2, LOS 30.a)

Question #14 - 18 of 20

Question ID: 1572047

According to CFA Institute's Standards of Professional Conduct, Fleming's execution of Waverly's trade order after confirming the appropriateness of the trade is *most likely*:

A) in violation of Standard V(B): Communication with Clients and Prospective Clients for not separating fact from opinion, but is not in violation of Standard I(C): Misrepresentation because his guarantee of future investment performance was not a written representation.

B) in violation of Standard V(A): Diligence and Reasonable Basis for not exercising diligence and thoroughness in his analysis of the investment and Standard III(C): Suitability for recommending an investment before determining if the investment was appropriate for the client.

C) **in violation of Standard I(C): Misrepresentation for not disclosing to Waverly that he did not read the marketing materials, but is not in violation of Standard III(C): Suitability because the client analyzed the investment thoroughly.**

Explanation

Fleming violated Standard V(A): Diligence and Reasonable Basis because he was not familiar with the specifics of the investment, but he made an investment recommendation based upon his confidence in Waverly's investment expertise. Fleming is also in violation of Standard III(C): Suitability because his agreement with Waverly's investment decision was not based upon the suitability of the offering within the context of Waverly's total portfolio. Fleming also violated Standard I(C): Misrepresentation when he confirmed that Waverly should purchase shares in DCH's secondary offering but failed to inform the client that he had not analyzed the investment in any way. Waverly would reasonably expect Fleming to analyze an investment before its recommendation and was, therefore, misled by Fleming.

(Module 30.2, LOS 30.a)

Question #15 - 18 of 20

Question ID: 1572048

According to CFA Institute Standards of Professional Conduct, which of the following of Fleming's actions is *most likely* a violation of Standard I(C): Misrepresentation?

A) **Fleming executes the trades on DCH Corp. per Waverly’s instructions without first referring to Waverly’s IPS.**

B) Fleming tells the CIO of the Crockett Foundation that shares of DCH’s IPO outperformed the S&P 500 by at least 15% in each of the last three years since the offering.

C) Fleming tells the CIO of the Crockett Foundation that DCH’s secondary offering will earn at least the lowest return earned on its IPO shares over the last three years.

Explanation

Standard I(C): Misrepresentation prohibits members and candidates from making any untrue statements or omissions of facts that may be false or misleading. Guaranteeing a particular rate of return on an investment is in direct violation of the standard. Fleming has essentially guaranteed a minimum rate of return on the secondary offering equal to the lowest rate of return earned on the IPO shares over the last three years. Even though a specific number isn't mentioned in the question, it would be observable by the Crockett Foundation. The other two choices might also be considered violations of the Standards, but they are not specifically violations of I(C): Misrepresentation, as noted in the question.

(Module 30.2, LOS 30.a)

Question #16 - 18 of 20

Question ID: 1572049

Which of the following statements *most accurately* assesses Fleming's comment about Waverly during his conversation with the chief investment officer of the Crockett Foundation? According to the Code and Standards, Fleming's statement is:

A) not in violation of any Standard because he only disclosed factual information, and he did not disclose the details of Waverly's purchase.

B) in violation of Standard III(E): Preservation of Confidentiality because of his failure to keep information about a client's investment action confidential.

C) **in violation of Standard I(C): Misrepresentation because his statement may be misleading with regard to future performance of the offering.**

Explanation

According to Standard III(E): Preservation of Confidentiality, members and candidates must keep information about current, former, and prospective clients confidential unless the information concerns illegal activities, disclosure is required by law, or the client permits disclosure. By telling other clients of Waverly's investment actions, whether offering specific information on the trade or not, Fleming could adversely affect Waverly's investment in the offering.

(Module 30.2, LOS 30.a)

Question #17 - 18 of 20

Question ID: 1572050

According to CFA Institute Standards of Professional Conduct, did Fleming's conversation with the chief investment officer of the Crockett Foundation or his decision to sell GlobalBank's position in DCH stock *likely* violate Standard II(B): Market Manipulation?

	Conversation with CIO sell decision	Sell decision	
A)	**Yes**	**Yes**	✗
B)	Yes	No	✗
C)	No	Yes	✓

Explanation

Standard II(B): Market Manipulation prohibits practices that distort prices or artificially inflate trading volume with the intent to mislead market participants, including the dissemination of false or misleading information. Although Fleming's conversation included two prohibited comments (a guarantee of performance and an inappropriate disclosure of client information), he did not give the CIO of Crockett information in an attempt to manipulate prices or trading volume and thus did not violate Standard II(B). His decision to sell GlobalBank's shares of DCH, however, was intended to manipulate the price of DCH stock to intimidate smaller investors into withdrawing their purchase order in the secondary offering, thereby freeing up shares for his client, the Crockett Foundation. This action is clearly a violation of Standard II(B).

(Module 30.2, LOS 30.a)

Question #18 - 18 of 20

Question ID: 1572051

Is it *likely* that Fleming violated any CFA Institute Standards of Professional Conduct related to his meeting with the chief investment officer of the Crockett Foundation?

A) Yes—he failed to maintain appropriate records to support his investment recommendation. ✓

B) No—he maintained an IPS and followed established procedures in maintaining client records and data. ✗

C) No—he does not have a duty to maintain client records; only his employer does. ✗

Explanation

Standard V(C): Record Retention states that members and candidates must maintain appropriate records to support their investment recommendations and actions. Fleming maintained an IPS and records of conversations, but he is also required by the standard to keep research and other documentation supporting investment recommendations and actions, which Fleming did not do because the case facts suggest that the documentation was only maintained for nine months (his own established procedures). When there are no regulatory requirements related to record retention, the Standard recommends that members and candidates keep client records for a minimum of seven years.

(Module 30.2, LOS 30.a)

Question #19 of 20

Question ID: 1553251

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

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

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

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

Explanation

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

(Module 30.1, LOS 30: I(A))

Question #20 of 20

Question ID: 1553822

Which of the following is a GIPS requirement with respect to composite construction?

A) Portfolios must stay in the same composite that their original size indicated. ✗

B) A firm must specify in advance a minimum asset level for portfolios to be included in a composite. ✓

C) Portfolios that are removed from a composite must have their prior performance removed from the old composite's historical record and moved to a new composite.

Explanation

The minimum asset level must be specified in advance. Portfolios removed from a composite cannot have their prior performance removed from the composite's historical record and as portfolios change in size, they can be added to or removed from a composite.

(Module 33.4, LOS 33.g)