# R60 Ethics Application

Ver: 1.0

## Introduction

This reading presents a number of short cases that demonstrate how to apply the Code and Standards in situations where professional and ethical judgement is required. For each case understand the rationale for why or why not a violation of the Code and Standards may have taken place and conduct that would comply with the Code and Standards.

**Instructor's Note**: We have covered the most important points of each case. We suggest that you also go through the curriculum to get a complete understanding of these cases.

We strongly recommend that you read the question and come up with your answer before reading the solution. To make this easier we have presented the solutions at the end rather than immediately after each question.

## I. Professionalism

### A. Knowledge of the Law

Members and Candidates must understand and comply with all applicable laws, rules, and regulations (including the CFA Institute Code of Ethics and Standards of Professional Conduct) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, Members and Candidates must comply with the more strict law, rule, or regulation. Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations.

**Mandracken**

SBS Bank (SBS) acts as a custody bank for a wide range of clients. It charges its clients an asset-based fee for the services it provides. According to the bank's client agreement, custody clients agree to reimburse the bank for out-of-pocket expenses for items paid by SBS on their behalf. Most of these expenses are for messages sent via SWIFT, a secure messaging network used by banks and other financial institutions.

While SBS charges a fixed rate for SWIFT messages, the rate is higher than the actual cost of providing this service. Mandracken, CFA, a vice president at SBS notices this discrepancy and brings it to the attention of his supervisor. Mandracken's supervisor tells him to reduce the SWIFT fee rate for new clients and to revisit the rate for existing clients when their contracts are renewed.

To meet his obligations under the CFA Institute Code and Standards, Mandracken should:

A. implement the corrective procedures as directed by his supervisor.

B. implement the corrective procedures as directed by his supervisor but report his objections to the bank's board of directors.

C. refuse to participate in any client interactions using the fee schedule until the bank revises the SWIFT rate to reflect the actual cost of the service.

View Solution

**Pellie**

Pellie, CFA, is CEO of Kwaume Investment Group (KIG), an investment adviser that is a wholly owned subsidiary of Kwaume Bank. A longtime bank customer that Pellie knows personally recently opened an investment account at KIG with a stated investment objective of earning income. Over the next year, the client made a few investments, but a majority of activity in the account involved several hundred bank transactions to and from individuals and entities located in bank secrecy havens and countries identified by the government as at risk for money-laundering activity.

Given the client's longstanding relationship, Pellie assumes the transactions have a legitimate business purpose and accepts vague descriptions, such as "for services provided," "consulting fees," and "commissions. He also approves the daily anti-money-laundering (AML) reports without further inquiry.

Pellie's actions are:

A. a violation of the CFA Institute Code and Standards.

B. appropriate because Pellie is protecting the confidentiality of client information.

C. appropriate because Pellie can rely on the account's clearing firm to report suspicious activity for the account.

View Solution

**Mwangi**

Mwangi, CFA, works for a firm that sells insurance products. Three of Mwangi's clients purchase one type of product (Class A). But they later change their minds and ask to switch to another, lower priced product (Class B). For this switch to happen, the law requires that her clients sign new sale and purchase documents for the Class B product.

When the Class B documents are ready, Mwangi tries to reach her clients for their signatures but is unable to do so. Because of the missing signatures, Mwangi's manager threatens to cancel the exchange. To prevent this from happening, Mwangi signs the necessary documents on behalf of her clients.

Mwangi's actions are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable because her clients had already given their permission for the exchange to be made.

C. acceptable if the clients gave Mwangi explicit permission to sign the documents on their behalf.

View Solution

### 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.

**Myers**

Myers, CFA, is a partner at Corboba, a hedge fund that focuses on ESG investments. To support upcoming public office elections, Myers wants to personally donate $10,000 to one of the candidates, DeFrietas. Myers is a passionate climate advocate and supports DeFrietas's backing of environmental policies to reduce air pollution and mitigate the effects of climate change.

Myers believes his political contribution may also be beneficial for Corboba because DeFrietas is running for a position that can influence which hedge funds receive investments from the state's pension plans.

Myers's best course of action is to

A. refrain from donating to DeFrietas.

B. donate to DeFrietas because he is using personal funds in an amount that is insignificant relative to the size of the hedge fund.

C. donate to DeFrietas because he will be supporting a candidate whose environmental policies align with his beliefs.

View Solution

### C. Misrepresentation

Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

**Lee**

Lee, CFA, is a financial planner for AKC. AKC compensates its planners based on the number of AKC products they sell. Lee advises a married couple to transfer their retirement funds totaling $125,000 into a single AKC investment fund that follows a large-cap equity strategy. Lee discloses to the couple that they will have to pay a penalty totaling $30,000 for closing their retirement accounts but claims they will make up the loss with better investment returns from the AKC product.

Lee's actions are:

 

A. acceptable if the AKC product is suitable for the couple.

B. a violation of the CFA Institute Code and Standards because she is promising a specific rate of return.

C. acceptable because she fully discloses the negative consequences of closing their retirement accounts.

View Solution

**Andersen**

Andersen, CFA, is the CEO of an asset management firm. He makes an in-person proposal to manage the investments of a large pension plan. In response to a request from the pension plan, Andersen provides a list of the key personnel who would manage the account. While waiting for the outcome of the evaluation, one of the key personnel that Andersen identified and who was part of the team that made the in-person presentation leaves the firm.

Andersen should:

A. do nothing because the pension plan is hiring the firm, not an individual.

B. immediately inform the pension plan that one of the key personnel has left the firm.

C. hire a competent replacement for the person who left and then inform the pension plan of the change.

View Solution

**Brodeur**

Brodeur, CFA, is CEO of LeTour, a global company that makes electric cars. Recent media reports mention that the company is having difficulty in producing and delivering its cars to buyers. In response to these reports, Brodeur posts on his social media that the company is "considering taking LeTour private at $420 a share. Funding is secure."

Previously, Brodeur had met with a large SWF that expressed interest in investing in the company and taking it private. But they had not reached any agreement or determined a share purchase price.

After the post, LeTour's stock price increased more than 6% and closed at $380 per share. When asked about the specific stock price in the post, Brodeur acknowledged that he had not discussed pricing with any potential investor but chose the price as a joke.

Brodeur's actions are:

A. inappropriate because the post was a misrepresentation of the facts.

B. inappropriate because not all investors use social media, so Brodeur is selectively disclosing information and putting some investors at a disadvantage.

C. appropriate because his post said only that he was "considering" taking the company private and thus contained only speculative, nonmaterial information.

View Solution

### 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.

**Hanse**

Hanse, CFA, is a portfolio manager employed by a global investment bank. She manages an ESG investment fund. In her free time, Hanse participates in civil disobedience demonstrations to protest climate breakdown, biodiversity loss, and ecological collapse. At several demonstrations held in the financial district, Hanse is arrested on charges of unlawful assembly, obstructing public transit, and disorderly conduct. She is ultimately convicted of several minor criminal offenses. Hanse has signed a standard employment contract with the bank that allows it to terminate any employee who is convicted of a criminal offense.

Under the CFA Institute Code and Standards, Hanse's actions:

A. do not violate the Code and Standards.

B. violate the Code and Standards because she has violated her employment contract with the bank.

C. violate the Code and Standards because she is arrested for misconduct in the financial district.

View Solution

**Mang**

Mang, CFA, is an investment adviser for a regional bank that serves many high-net-worth individuals. As per the bank's policies if an advisor forgets to send an order to the trading desk, a 30 days error correction period is permitted. To rectify the error, the adviser is allowed to buy or sell a security at the current market price. The price differential is charged to the adviser personally through an internal error account.

Mang frequently uses the trade error correction policy to benefit clients who are unhappy with their account's performance. He identifies a security whose price has increased in the past 30 days and tells the trade desk he mistakenly failed to buy that particular security. Once the request is approved, the trade desk purchases the security and charges the price differential to Mang personally through the error account. Shortly after that trade, Mang sells the security.

Mang's actions:

 

A. violate the CFA Institute Code and Standards.

B. are appropriate because Mang is acting for the benefit of the client.

C. are appropriate because the bank is not harmed by Mang's actions.

View Solution

## II. Integrity of Capital Markets

### 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.

**Khatri**

Khatri, a candidate in the CFA Program, plays on a local cricket team. Patel an attorney and Khatri's brother-in-law, and Ahuja, an owner of a software development company called ZeroPower (ZP) also play on the same team. Patel handles the legal work for ZP.

Recently, a large global information technology company (GIT) made an offer to buy ZP at a substantial premium over the company's current share price. Patel is working with lawyers from GIT to assist in their due diligence.

One weekend, between matches, Khatri overhears Patel speaking with representatives of GIT on his cell phone. Although mention of a ZP acquisition is not made, Khatri hears Patel repeatedly reference the name "GIT". Khatri also sees Patel and Ahuja huddled in private conversation several times over the course of the weekend. Based on this he guesses that ZP is being acquired. On Monday, Khatri purchases 5,000 shares of ZP. One week later, ZP announces its acquisition by GIT and its share price increases 30%.

Khatri's actions are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable because Khatri's investment was based on his own speculation.

C. acceptable because Khatri received the information in a public environment.

View Solution

**Kwame**

Kwame, CFA, is the chief financial officer of PH3D, a biotech firm that researches, develops, and commercializes pharmaceutical drugs. PH3D submits a drug application to the government regulator for a promising new drug.

When the meeting between the regulator and PH3D takes place, PH3D presents unpublished preliminary test data with favorable indicators for the drug. The regulator reacts positively and gives PH3D provisional regulatory approval, contingent on further studies.

 

Later, some research analysts covering PH3D ask Kwame about the meeting. Kwame responds by email, mentioning that the meeting with the regulator was "very positive and productive" and that the company was "pleasantly surprised" by the regulator's reaction. Kwame does not share the favorable preliminary test data. After Kwame's emails to the analysts, the company's stock price increases 19%.

Kwame's actions:

A. violate the CFA Institute Code and Standards.

B. are appropriate because he does not share the unpublished preliminary test data with the analysts and restricts his comments to the general tenor of the meeting.

C. are appropriate because he responds to questions from research analysts covering the company.

View Solution

### B. Market Manipulation

Members and Candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.

**Abbha**

Abbha, CFA, is a securities contractor. She is helping Superior Energy (SE) list its shares on the Regional Security Exchange (RSX). RSX's current listing rule states that entities seeking admission must meet a "minimum spread requirement" of at least 300 shareholders with a minimum holding value to qualify for listing.

SE already has some shareholders. Abbha arranges an additional 31 shareholders which enables SE to meet the minimum spread requirement of 300 shareholders in its listing application. However, none of the 31 shareholders are actual buyers of SE securities. Abbha provides false names and addresses for these shareholders.

Eventually, the SE listing is successful, and the stock is admitted to the official list of the RSX. Over time, SE's share price steadily increases, the company attracts many new investors and the original early investors get an excellent return on their investment.

Abbha's actions:

A. violate the CFA Institute Code and Standards.

B. are acceptable because SE proved to be a strong company with excellent performance.

C. are acceptable because no investors were harmed by the technical violation of RSX rules.

View Solution

 

## III. Duties to Clients

### 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.

**Maste**

Maste, CFA, is the sole director of Dov Services (Dov), a firm that sells financial products and advice. Maste asks Dov's authorized representatives to incorporate the Dov Client Protection Policy into their contracts with clients.

The protection policy's terms (1) excuse Dov and its authorized representatives from various liabilities arising from their failure to act in a client's best interest, (2) relieve Dov and its authorized representatives of their duty to conduct suitability analyses of clients and investments, and (3) lead clients to believe that they cannot make claims against Dov or its representatives for violating securities law.

Maste's actions:

A. violate the CFA Institute Code and Standards.

B. are appropriate because Dov and Maste fully disclose the terms of the Dov Client Protection Policy to clients.

C. are appropriate because Dov and Maste are free to negotiate the terms of advisory agreements with clients.

View Solution

**Gaini**

Gaini, CFA, is a commodities trader with a number of retail clients. Laube, opens a self-directed foreign exchange retail account for which Gaini does not advise on any trades. Laube signs Gaini's standard customer agreement which authorizes Gaini, at his discretion, "to liquidate, without notice, any or all open positions in an account with insufficient margin."

Laube initially purchases two currency contracts and sets her margin requirement to $4,000. Laube then places two additional "pending limit" orders that will execute if the contract trading prices reach a specified level. Shortly after placing the orders, Laube goes on an extended vacation. While she is away, execution on the first limit order occurs, and the margin requirement increases to $6,000. Then, the next limit price is reached, and the second order executes, increasing the margin requirement to $8,000. Post trades, while Laube is still on vacation, her account balance drops to $6,900. Without notice, Gaini liquidates all positions in Laube's account, realizing a loss of $37,000 from the liquidation.

 

Gaini's actions:

A. are appropriate because Gaini followed the policy and procedures set forth in Laube's client agreement.

B. violate the CFA Institute Code and Standards because Gaini has a duty to act in the best interest of Laube by protecting her financial position.

C. are inappropriate because Gaini could have met the margin requirement by liquidating only one foreign exchange contract position.

View Solution

**Braung**

Braung, CFA is hired as a financial adviser by a regional government entity. Braung helps the entity issue bonds, and in connection with the bond issues, he makes a number of trips to New York City to meet with ratings agencies. The trips are usually planned for a Monday or Friday because the costs for weekend travel are lower. Braung's wife accompanies him on the trips, and they normally spend the weekend in New York City to enjoy sporting events, theater performances, and museums.

Braung also frequently makes a number of train and hotel changes after a trip is booked to accommodate meetings with other clients.

Braung submits his travel expenses to his supervisor, who deducts costs she believes are unrelated to the business purpose of the trip and submits the bills to the municipality for reimbursement.

Which of the following expenses can *most likely* be billed to the government entity issuing the bonds?

A. Braung's accommodation and meal expenses for the weekend days because the travel rates are less expensive over a weekend

B. Tickets to the sporting and theater events, as long as they do not exceed a reasonable amount for business entertainment

C. Flight and hotel change fees that result from the regular course of Braung's business activities

View Solution

## 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.

 

**Scherzer**

Scherzer, CFA, is the head of research at a large investment management firm. She publishes monthly "Recommendation Update Reports" to communicate to clients any investment recommendation changes her firm has made. The reports are sent to clients via email on the first Friday of the month and posted on the firm's website the following Monday. The firm's internal policy is that a change in recommendation can only be made once a month through this report.

Scherzer also publishes weekly reports that may lead a reader to infer that a recommendation will be changing. The monthly "Recommendation Update Reports" are sent to all clients. However, clients who wish to receive the weekly publication must pay an annual fee of $1,000. This option is available to any client and is fully disclosed as part of every client agreement.

To comply with the CFA Institute Code and Standards, Scherzer is required to:

A. do nothing because her actions comply with the Code and Standards.

B. publish the monthly report on the firm's website at the same time it is sent to clients.

C. send the weekly reports to all clients at no additional charge.

View Solution

### C. Suitability

1. When Members and Candidates are in an advisory relationship with a client, they must:
    a. Make a reasonable inquiry into a client's or prospective client's investment experience, risk and return objectives, and financial constraints prior to making any investment recommendation or taking investment action and must reassess and update this information regularly.
    b. 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.
    c. Judge the suitability of investments in the context of the client's total portfolio.
2. When Members and Candidates are responsible for managing a portfolio to a specific mandate, strategy, or style, they must make only investment recommendations or take only investment actions that are consistent with the stated objectives and constraints of the portfolio.

**Marte**

Marte, CFA, is an asset manager in Puerto Rico, a US territory. Residents of Puerto Rico receive significant tax advantages when they invest in local securities. To take advantage of the tax laws, Marte's firm offers its clients shares in a closed-end investment fund, organized under Puerto Rico's financial laws and regulations, that holds at least 67% local securities and is permitted to borrow against up to 50% of its assets. The fund is usually leveraged to the extent legally permitted.

Many of Marte's clients have a modest net worth and conservative or moderate investment objectives. Marte persuades them to invest 85% or more of their assets in shares of the closed-end fund.

Marte's actions:

A. violate the CFA Institute Code and Standards.

B. are appropriate because they take advantage of the fund's unique tax benefits for his clients.

C. are appropriate as long as Marte fully discloses the risks and benefits of the fund to his clients.

View Solution

**Duri**

Duri, CFA, is a registered financial advisor for retail clients. She is also a principal partner of Tabak Accountants. Duri helps many advisory clients switch from existing pension accounts to self-managed superannuation funds (SMSFs) that invest in direct residential property.

When clients express interest in SMSFs, Duri accepts their reasoning and assumes that they have the time and expertise to manage these funds. She also reclassifies their investment objectives as "growth" to match the new investment strategy.

Duri charges her clients for establishing the SMSFs and recommends that her firm, Tabak Accountants, prepare the clients' annual accounts and tax returns.

Duri's actions:

A. violate the CFA Institute Code and Standards.

B. are acceptable because she is following the directives of her clients.

C. are acceptable if the services provided by Tabak Accountants are reasonable and the costs of services are competitive.

View Solution

### D. Performance Presentation

When communicating investment performance information, Members and Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.

**Jergenn**

Jergenn, CFA, is the portfolio manager for the Volare Investment Management (VIM) fund, a registered collective investment scheme (CIS) organized under the laws of South Africa.

 

VIM's 2022 regulatory disclosure and marketing material for the fund, produced by Jergenn, presents annual investment performance data for the 2014–2020 period that is accurate and calculated correctly. The performance history is that of a composite of separate accounts that followed the strategy used by the VIM fund before the assets were moved over to the CIS environment in 2021.

In presenting the fund's performance history, Jergenn's actions:

A. violate the CFA Institute Code and Standards.

B. are appropriate because the investment performance is accurate.

C. are appropriate as long as the performance calculations are net of fees.

View Solution

### E. Preservation of Confidentiality

Members and Candidates must keep information about current, former, and prospective clients confidential unless:

1. The information concerns illegal activities on the part of the client or prospective client,
2. Disclosure is required by law, or
3. The client or prospective client permits disclosure of the information.

**Giddings and Marsh**

Giddings, CFA, is a compliance officer at GWH, a large broker/dealer and investment advisor. GWH maintains confidential information of its clients: such as names, addresses, phone numbers, account numbers, balances, and holdings. Giddings puts a number of policies and restrictions in place to address employee's access to and handling of this confidential information.

Marsh, CFA works at GWH as a client services associate. He downloads client data to his personal server at his home to enable telecommuting. Marsh's server is hacked, and portions of the personal client information Marsh downloaded are posted for sale on the internet.

Did either Marsh or Giddings violate the CFA Institute Code and Standards?

A. Marsh violated the Code and Standards.

B. Giddings violated the Code and Standards.

C. Both Marsh and Giddings violated the Code and Standards.

View Solution

## IV. Duties to Employers

### 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.

**Nickoli**

Nickoli, CFA, is an investment counselor with HHI Capital Management (HHI). A colleague at her local society encourages Nickoli to leave HHI and join her at Vesuvius Asset Advisers. Nickoli eventually agrees and decides to leave at the beginning of the new year.

In the weeks before submitting her resignation, she informs her clients that they will likely be working with a new investment counselor because she is leaving HHI. Her clients express surprise, and when asked for details about why she is leaving, Nickoli shares that she is frustrated by the firm's structure, disagrees with the direction the firm is going, lacks confidence in the current leadership, doubts the firm will be able to attract and retain good people, and believes other HHI employees have been mistreated and will also be leaving soon.

Several of Nickoli's HHI clients indicate that they would like information about Vesuvius and might be interested in switching their accounts. After submitting her resignation, Nickoli immediately shares the names of the interested clients with Vesuvius, and after the first of the year, she begins soliciting them to transfer their accounts from HHI to her new firm.

Nickoli's conduct is:

A. a violation of the Code and Standards.

B. acceptable because she did not solicit clients until after she left HHI.

C. acceptable because she is looking out for her clients' best interests and believes Vesuvius provides better service.

View Solution

**Kuznetsov**

Kuznetsov, CFA, is a portfolio manager at an investment firm. Kuznetsov's firm encourages its employees to sell proprietary investment products to their clients. Kuznetsov starts selling these products and within a year, he becomes the firm's top seller. He also receives a large bonus for his performance.

Later, however, Kuznetsov realizes that the firm's investment products are underperforming, and are more expensive than other external investment options that are suitable for his clients. He therefore stops selling the firm's products.

Kuznetsov's supervisor puts pressure on him to resume selling, but Kuznetsov refuses. He complains several times to the management that he is being pressured. He also secretly records several conversations with his supervisor and makes copies of client records that document what he considers inappropriate conduct by his supervisor. When management ignores his complaints and his supervisor starts giving him poor performance reviews, he files a complaint with the local regulator against his supervisor and his firm, providing the recordings and copies of client files as evidence. He is eventually fired from the firm.

Kuznetsov's actions are:

A. appropriate because he is protecting his clients' interests.

B. a violation of the CFA Institute Code and Standards because he fails to keep client information confidential.

C. a violation of the CFA Institute Code and Standards because he violates his duty of loyalty to his employer by taking his dispute with his supervisor to the regulator and exposing the employer to financial and reputational harm.

View Solution

**Clemence**

Clemence, CFA, is a wealth management adviser for DeLaurier Strategic Advisers. She looks after the financial planning and wealth management for many retail clients. She met many of her clients through her spouse and sister.

Clemence has decided to leave DeLaurier and join another firm. In her new role, she will take on more research and investment management responsibilities. She will not be expected to generate new advisory clients.

Clemence leaves DeLaurier on good terms. On her final day, she downloads a spreadsheet of DeLaurier's clients, prospects, and former clients and sends it to her personal email. The list includes names, assets under management, addresses, and phone numbers. Clemence plans to contact her clients as a courtesy to inform them of her new position, thank them for being clients, and express her confidence that DeLaurier will continue to provide them with competent and professional service even though she has left the firm.

Clemence's actions are:

A. a violation of the CFA Institute Code and Standards.

B. appropriate because she is protecting the interests of her clients.

C. appropriate as long as she contacts only those clients who are personal friends to inform them of her new position.

View Solution

### 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.

**Estevez**

 

Estevez, CFA, is a senior research analyst with BIR, a boutique investment research firm covering micro- and small-cap companies. BIR engages in issuer-paid research whereby companies hire BIR to provide research to promote their stock to investors.

Estevez helps BIR select which companies to cover and also oversees a team of junior research analysts. Some companies offer Estevez a separate bonus if she selects them for coverage.

Estevez's actions are:

A. a violation of the CFA Institute Code and Standards because her independence and objectivity in conducting the research are compromised.

B. acceptable as long as Estevez does not use material nonpublic information from the company.

C. acceptable as long as her company approves in writing the payments offered by covered companies.

View Solution

### 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.

**Duhih**

RC Group (RCG) is a registered futures commission merchant with several branch offices. Duhih, CFA is hired to be the branch manager at one of RCG's offices in Memphis, Tennessee (USA). Duhih supervises many employees including Lewes, CFA. Duhih allows Lewes to work from home and seldom checks in with Lewes regarding work.

Unknown to either Duhih or RCG, Lewes also works for another futures commission merchant, called AFCM. Working with another employee at RCG, Lewes arranges swap agreements for AFCM through RCG. The other RCG employee receives all the commissions for the accounts, but she secretly splits them with Lewes. Duhih is not aware of Lewes' involvement in this commission sharing arrangement.

Duhih's actions as a supervisor are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable if the RCG headquarters conducts regular audits of the Memphis branch.

C. acceptable if RCG did not develop adequate policies and procedures for the detection and deterrence of possible employee misconduct.

View Solution

**Denikin & Denikin**

Sasha Denikin, CFA, began his investment career as a research analyst for Galak Investment Partners. Galak was founded and is controlled by Sasha's father, Franz Denikin, CFA. After a few years, Sasha becomes a director of the company and Franz transfers ownership of Galak to him. Franz tells the firm's clients that he retains management of all client accounts

When the longtime chief compliance officer (CCO) of Galak retires, Sasha is also promoted to CCO. Sasha has no previous compliance experience. The prior CCO will retain compliance responsibilities as a consultant and mentor and train Sasha.

In spite of his designation, Sasha has no real authority to supervise his father's conduct and Franz continues to exert absolute control over Galak. Sasha raises multiple compliance issues to his father regarding his father's actions, but Sasha is powerless to enforce company policies and procedures concerning his father's conduct. After continuing to serve as Galak CCO for some time, Sasha finally resigns in frustration.

Sasha Denikin's actions are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable because Franz holds the actual power and client responsibilities at the firm and thus cannot be under the supervision of a subordinate.

C. acceptable because Sasha resigns as CCO when he is frustrated by his inability to exercise his compliance responsibilities.

View Solution

## V. Investment Analysis, Recommendations, and Actions

### 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.

**Harrel and Chong**

Corix Bioscience is a startup company in the manufacturing and distribution of cannabidiol (CBD) products. Corix hires Harrel, an independent research analyst and CFA Program candidate, to write a research report on the company.

Corix's CEO tells Harrel the following:

- Corix has an agreement with indigenous tribes that allows it to access tribal lands for commercial hemp and cannabis farming and to sell hemp and cannabis products in retail outlets on tribal lands.

- Corix has a certificate of compliance from the national regulator that permits the company to transport, process, and export industrial hemp products.
- The prior year's harvest of hemp exceeded expectations in both quality and quantity, resulting in a substantial inventory of product.

Harrel includes all this information and writes a positive research report on Corix. However, the information provided by the CEO is fake.

Chong, a CFA charterholder and research analyst at Nature's Harvest Investment Management (NHIM), incorporates the information from Harrel's research report into his own research on Corix and puts a "buy" recommendation on the company. Chong's report is distributed to portfolio managers at NHIM. Corix is eventually shown to be a phony operation and NHIM's clients suffer significant losses.

Which individual(s) *most likely* violated the CFA Institute Code and Standards?

A. Harrel only

B. Chong only

C. Both Harrel and Chong

View Solution

### B. Communication with Clients and Prospective Clients

Members and Candidates must:

1. Disclose to clients and prospective clients the basic format and general principles of the investment processes they use to analyze investments, select securities, and construct portfolios and must promptly disclose any changes that might materially affect those processes.
2. Disclose to clients and prospective clients significant limitations and risks associated with the investment process.
3. 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 clients.
4. Distinguish between fact and opinion in the presentation of investment analysis and recommendations.

**Maalouf**

Maalouf, CFA, works for a large wealth management firm. The firm's fees are calculated as a percentage of the asset value managed for each client account. The firm has a standard method for valuing assets and calculating fees, which is disclosed to clients when they open their account.

Over time, the firm shifts to (1) using the market value of client assets at the end of the billing cycle instead of the average daily balance of the account; (2) including assets that were previously excluded, such as cash or cash equivalents, in the fee calculation; and (3) charging clients for a full billing period rather than prorating fees for clients that start or terminate accounts mid-billing period.

Under the CFA Institute Code and Standards, Maalouf

A. must notify clients of the changes in the valuation and fee calculation method.

B. cannot use end-of-cycle valuations, include cash equivalents, or charge fees for a full billing cycle for partial cycle accounts.

C. can change the valuation and fee calculation methodology as long as actual fees charged to clients are lower.

View Solution

**Dukis**

Dukis, CFA, is a managing director at a global credit ratings service. Her team assigns new issue and surveillance credit ratings to commercial mortgage-backed securities (CMBSs). They use the debt service coverage ratio (DSCR) to determine ratings.

After the global financial crisis, the ratings agency changes its methodology for calculating DSCR so that it more accurately reflects risk. However, subsequent credit ratings are published without disclosing this change.

Dukis's actions are:

A. appropriate because the new methodology more accurately reflects risk.

B. a violation of the CFA Institute Code and Standards because she did not disclose the change in methodology to the investing public.

C. appropriate because no disclosure is necessary, given that calculating DSCR is only one element in determining the overall rating of the security.

View Solution

### C. Record Retention

Members and Candidates must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients.

**Duermott**

Duermott, CFA, is president of Enhanced Investment Strategies (EIS), a small investment firm. Duermott has close personal relationship with his clients and is very familiar with their investment profile, income and retirement requirements, and risk tolerance. He keeps up with all his clients' life-changing events—such as health issues, real estate purchases, children's university expenses, and retirement—and adjusts the clients' portfolios accordingly.

Duermott frequently meets with his clients at EIS's offices, and he also sees them on several occasions outside the office, which give him additional opportunities to update them on their investments. EIS clients complete a client agreement and risk profile when opening their account, and those profiles are updated whenever Duermott finds the time to do so.

Duermott's business practices are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable because he regularly communicates with clients about their investments.

C. acceptable because he adjusts clients' investments to ensure that they are suitable for the clients' needs given their changing income and risk profile.

View Solution

## VI. Conflicts of Interest

### 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.

**Reebh**

Reebh, CFA, is the CEO and founding partner of Lux Asset Management (Lux). Lux provides asset management and allocation services. The services include investing client funds with third-party subadvisers who specialize in a particular asset class.

Reebh's clients are aware, and approve, of Lux's allocation of their assets to subadvisers. The third-party subadvisers make payments to Lux based on the total value of a client's assets placed in the subadvisers' funds.

Reebh's actions are:

A. appropriate because Reebh has disclosed the use of subadvisers.

B. inappropriate because the payments are an improper referral fee.

C. inappropriate unless Reebh discloses the financial arrangement he has with the subadvisers to his clients.

View Solution

 

## B. Priority of Transactions

Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner.

**Yang**

Yang, CFA, is a research analyst at Dacco, a registered broker/dealer and investment adviser. While working at Dacco, Yang starts Prestige Trade Investments Limited (Prestige) and acts as investment adviser for the firm's clients. Yang is responsible for directing all trades on behalf of Prestige.

Over several days, Yang purchases 50,000 shares of Zhongpin stock and 1,978 Zhongpin call options for his personal account at Dacco. Soon after, Yang purchases more than 3 million shares of Zhongpin stock using $29.8 million of Prestige's funds.

Yang's actions are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable because Yang's personal investments are not in conflict with the investment advice being given to his clients at Prestige.

C. acceptable as long as Prestige clients are not negatively affected by Yang's prior purchase of Zhongpin securities through his account at Dacco.

View Solution

**Kapadia**

Kapadia, CFA, is a trader for an asset management company that manages several large global mutual funds. Kapadia executes trade orders for one of the company's mutual funds. He has the discretion to execute the orders at any time during the day, depending on market conditions.

Before executing the orders, Kapadia contacts several close friends and relatives and gives them information on which securities the mutual fund will be trading. In turn, these friends and relatives make trades that mirror the trades to be executed by Kapadia on behalf of the mutual fund.

Kapadia's actions are:

A. a violation of the CFA Institute Code and Standards.

B. inappropriate only if the client is harmed financially by the conduct.

C. appropriate because he does not share confidential information about individual clients.

View Solution

**Perrkins**

Perrkins, CFA, is the chief investment officer of GT Financial (GTF). Perrkins's wife is GTF's compliance officer. GTF has several dozen retail clients and total assets under management of $70 million. All client assets are managed on a discretionary basis.

Perrkins frequently buys and sells securities in a block trade on behalf of multiple clients simultaneously. He allocates the trades to individual client accounts after the market closes. Over one six-month period, Perrkins allocates 75% of the profitable trades to nine accounts that Perrkins and his wife own or control. At the same time, he allocates 82% of the unprofitable trades to the account of the three largest GTF clients.

Perrkins's actions are:

A. a violation of the CFA Institute Code and Standards.

B. acceptable as long as he discloses the trade allocation practices to his clients.

C. acceptable as long as he reverses his trade allocation practices to favor the larger clients so that they are not harmed over the long term.

View Solution

### C. Referral Fees

Members and Candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services.

**Kiang**

Kiang, CFA, is a successful investment adviser with several high-net-worth clients. Kiang has acquired many clients through referrals by existing clients.

Each year, Kiang hosts an elaborate party for clients who have referred new clients to his advisory firm. At the party, Kiang distributes nominal gift cards to attendees. In some cases, Kiang offers discounts on advisory fees to clients who sent him referrals that were very profitable.

Many of the clients attending these parties were referred to Kiang by other clients, and they, in turn, continue the cycle of recommending Kiang to a broader circle of friends and family.

Kiang's actions *most likely* are:

A. acceptable as a reward for client loyalty.

B. acceptable because he treats all clients fairly.

C. a violation of the CFA Institute Code and Standards.

View Solution

 

## VII. Responsibilities as a CFA Institute Member or CFA Candidate

### A. Conduct as Participants in CFA Institute Programs

Members and Candidates must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation or the integrity, validity, or security of the CFA Institute programs.

**Taveras**

Taveras, CFA, conducts an exam preparation course sponsored by his local society. The society hosts an event for the students after the exam is over. During the event, many students describe their experience of taking the exam. Most express their views on the relative difficulty of the exam compared to their expectations. Some describe their surprise about areas of the curriculum that were not tested. Taveras asks his students for their thoughts on the most difficult exam questions.

Under the CFA Institute Code and Standards, Taveras is *most likely*:

A. prohibited from discussing the exam with students after it is over.

B. free to pass along information about the exam to candidates in future prep courses to help prepare them for the exam.

C. allowed to share the opinions of his students about the difficulty of the exam with candidates in future prep courses to emphasize the need to thoroughly prepare.

View Solution

### B. Reference to CFA Institute, the CFA Designation, and the CFA Program

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.

**Ahmed**

Ahmed recently received his CFA designation and joined a medium-sized hedge fund as a senior analyst. His supervisor, Bennett, the firm's founder, earned her CFA designation 10 years ago. She proudly uses the CFA designation on her business card and on all marketing materials for the fund.

Bennett tells Ahmed that she has not paid her CFA Institute membership dues for the past four years and no longer participates in the organization's continuing education program. When Ahmed asks Bennett about her use of the designation, she states that by passing the CFA exam she earned the CFA charter, and that the credential is like a university degree that cannot be taken away.

Later, during a marketing meeting with a potential investor, the investor mentions that he narrowed his search to only firms that employ CFA charterholders in senior positions. When he asks Bennett if everyone in the firm on the investment side is a CFA charterholder, she responds, “Yes, that is correct.” Ahmed does not respond.

Did either Ahmed or Bennett violate the CFA Institute Code and Standards?

A. Ahmed violated the Code and Standards, but Bennett did not.

B. Bennett violated the Code and Standards, but Ahmed did not.

C. Both Ahmed and Bennett violated the Code and Standards.

View Solution

 

## Solutions

*Mandracken*

C is correct. According to Standard I(A), CFA Institute members and candidates must not knowingly participate in legal or ethical violations and should dissociate from such activity. SBS is misrepresenting its reimbursable expenses to its custody clients and overcharging them.

Mandracken' supervisor's corrective measures are inadequate because they (1) address the issue only for new clients, (2) do not immediately address the issue for existing clients, and (3) do not address the misrepresentation and overcharges to past clients.

Mandracken must thus refuse to participate in any client interactions that use the fee schedule until the bank revises the SWIFT fees charged to custody clients to reflect actual out-of-pocket costs. Therefore, A and B are incorrect.

Back to Notes.

*Pellie*

A is correct. The low number of investments and high volume of other transactions do not match the investment account's stated objective of earning income. The transactions look suspicious and should have been scrutinized by Pellie for possible money-laundering activity.

B is incorrect. Protecting the confidentiality of client information cannot be used as a justification to allow clients to violate the law.

C is incorrect. It is Pellie's responsibility to review the transactions for suspicious activity, he cannot rely on the account's clearing firm for this.

Back to Notes.

*Mwangi*

A is correct. By signing the documents on behalf of the clients, Mwangi forged their signatures which is a violation of the law and Standard I(A). Permission from the client is irrelevant, Mwangi is still not permitted to forge signatures and break the law.

Back to Notes.

*Myers*

A is correct. According to Standard I(B), members and candidates must not offer any gift, benefit, compensation, or consideration that could compromise another's independence and objectivity. Although Myers has a genuine reason for donating to DeFrietas, the facts clearly indicate that he believes the donation might also influence DeFrietas to choose Corboba to manage money for the state's pension plans.

B is incorrect. The source of funds does not matter.

C is incorrect. To avoid potential conflict, Myres should not donate to DeFrietas campaign and should instead find other ways to support the environmental protection policies.

Back to Notes.

*Lee*

B is correct. Standard I(C) prohibits members and candidates from making any statements that promise or guarantee a specific rate of return on volatile investments. Since equity based investments are volatile, Lee's promise of making up for the penalty violates Standard I(C).

Back to Notes.

*Andersen*

B is correct. Standard I(C) prohibits members and candidates from knowingly misrepresenting anything related to their professional activities. Since the pension plan specifically asked for a list of individuals who would be handling the account, this information is clearly important to them. Withholding the information about the person leaving would be a misrepresentation by omission. Hence A is incorrect.

Waiting to inform until a replacement is found is too late. Hence C is incorrect.

Back to Notes.

*Brodeur*

A is correct. Brodeur's post was based on assumptions. It violated Standard I(C) which states that members and candidates must not knowingly make any misrepresentation related to professional or investment activities.

Back to Notes.

*Hanse*

A is correct. Acts of civil disobedience by Hanse reflect her personal beliefs. They do not reflect adversely on her professional reputation, integrity, or competence. Therefore, these actions do not violate the Code and Standards.

Back to Notes.

*Mang*

A is correct. Mang is engaging in a misleading, fraudulent and deceptive practice.

B and C are incorrect. The fact that this practice benefits the client and does not harm the bank does not make the conduct any less deceptive, fraudulent, or misleading.

Back to Notes.

*Khatri*

A is correct. Khatri comes into possession of material nonpublic information and acts on it which violates Standard II (A).

B is incorrect. Although Khatri was required to make some speculation, the information was confidential, nonpublic and material. His actions did not meet the mosaic theory.

C is incorrect. Although Khatri received the information in a public environment, it does not automatically mean that the information was public.

Back to Notes.

*Kwame*

A is correct. Kwame violated Standard II (A) by selectively disclosing material nonpublic information.

B is incorrect. In this case both the preliminary test data and regulator's positive reaction are material nonpublic information.

C is incorrect. Disclosing information to a select group of analysts covering the company does not mean that the information was publicly disclosed. The fact that Kwame is only responding to questions is irrelevant.

Back to Notes.

*Abbha*

A is correct. Abbha has engaged in information-based manipulation and has violated Standard II (B).

B and C are incorrect. The fact that SE's stock eventually delivered excellent performance and that no investors were harmed does not mitigate Abbha's unethical conduct.

Back to Notes.

*Maste*

A is correct. The terms set in the client protection policy are in violation of the Code and Standards. Disclosures cannot be used to relieve advisers of their fundamental ethical obligations to clients.

Back to Notes.

*Gaini*

 

A is correct. Although Laube suffered significant trading losses, Gaini's actions were in accordance with the policy and procedures set forth in Laube's client agreement. Standard III (A) was not violated.

Back to Notes.

*Braung*

A is correct. The travel fees saved by booking a weekend travel schedule could be greater than the additional accommodation and meal expenses for Braung to stay the extra days. Thus, the overall cost to the client could be lower and Braung would be meeting his duty of loyalty to the client by choosing the most inexpensive travel schedule.

B and C are incorrect. Charging personal theater and sporting event tickets or travel change fees associated with seeing unrelated clients should not be billed to the government entity issuing the bonds.

Back to Notes.

*Scherzer*

A is correct. Scherzer does not violate the Code and Standards by providing weekly reports to clients who pay a subscription fee for the service as long as (1) all clients are eligible to purchase the service, (2) the different levels of service are disclosed to clients, and (3) no change in recommendations is made that would disadvantage existing clients who receive only the monthly report.

Back to Notes.

*Marte*

A is correct. Given the fact that many of Marte's clients have a modest net worth and conservative or moderate investment objectives, the high allocation to this fund and use of leverage makes this investment unsuitable.

B is incorrect. Given the favorable tax advantages some allocation to this fund may be beneficial. However, the recommended '85% or more' allocation is unsuitable.

C is incorrect. Disclosures do not take away the need for the investments to be suitable to the client.

Back to Notes.

*Duri*

A is correct. Duri should perform a suitability analysis before accepting her client's request to switch their retirement assets into an SMSF.

Back to Notes.

 

*Jergenn*

A is correct. Jergenn's should clearly disclose that the 2014-2020 performance history was for a similar entity with the same investment strategy and objectives; and that the VIM fund, as a CIS, has been in existence since only 2021. Failing to do so can mislead investors into believing that the CIS fund had a long track record.

Back to Notes.

*Giddings and Marsh*

C is correct. Standard III(E) requires that members and candidates must make reasonable efforts to prevent the accidental distribution of confidential information.

Marsh did not have permission to download client data to his personal server.

Polices put in place by Giddings to safeguard client data were insufficient because Marsh was able to download company files to his personal computer. Hence both Marsh and Giddings violated Standard III(E).

Back to Notes.

*Nickoli*

A is correct. Nickoli violates her duty of loyalty to HHI by making harmful statements about the firm to its clients before she submits her resignation and by promoting Vesuvius to HHI clients while she is still employed by HHI.

Back to Notes.

*Kuznetsov*

A is correct. Kuznetsov is acting in the best interest of clients by notifying the regulators of his employer's unethical practices.

Back to Notes.

*Clemence*

A is correct. Clemence has violated Standard IV(A) by downloading the client list and taking it with her for use after she leaves DeLaurier. The client list is DeLaurier's property.

Instead of downloading this information, she could have asked her employer's permission to send a "thank you" note to her clients before leaving.

Back to Notes.

*Estevez*

C is correct. Standard IV(B) requires members and candidates to obtain written consent from their employer before they accept any gift, benefit, or compensation that "might reasonably be expected to create a conflict of interest with their employer's interest."

Back to Notes.

*Duhih*

A is correct. According to Standard IV(C), supervisors must make reasonable efforts to detect and prevent legal, regulatory, and policy violations by ensuring that effective compliance systems have been established. As per the facts presented in the case Duhih's supervision is inadequate.

Back to Notes.

*Denikin & Denikin*

A is correct. Sasha should have refused to accept the supervisory responsibility until he was fully trained and Galak adopted reasonable procedures to allow him to effectively exercise his supervisory responsibility.

Back to Notes.

*Harrel and Chong*

C is correct. Harrel simply relied on statements given by Corix. He did not conduct an independent investigation into the accuracy of the information.

Similarly, Chong simply relied on Harrel's research and did not conduct his own independent research.

Thus, both Harrel and Chong failed to exercise diligence and thoroughness in analyzing the company.

Back to Notes.

*Maalouf*

A is correct. Maalouf must notify his clients ahead of the changes.

Back to Notes.

*Dukis*

B is correct. Dukis should have disclosed to investors the change in methodology for calculating the DSCR.

Back to Notes.

*Duermott*

A is correct. Although Duermott is reviewing and adjusting client portfolios on a timely basis to meet clients' changing financial circumstances, he is not keeping regular, up-to-date client records. He updates client records only when he “finds the time to do so”.

Back to Notes.

*Reebh*

C is correct. The financial arrangement that Lux has with its subadvisor creates a conflict of interest. To mitigate this conflict, Reebh must disclose this arrangement to clients.

Back to Notes.

*Yang*

A is correct. Yang is “front-running” his Prestige clients’ trades which is a violation of the Code and Standards.

Back to Notes.

*Kapadia*

A is correct. Kapadia is facilitating front-running which is a violation of the Code and Standards.

Back to Notes.

*Perrkins*

A is correct. Perrkin’s is allocating winning trades to his personal accounts and allocating losing trades to client accounts that are large enough to absorb losses without raising suspicion. This practice is clearly a violation of the Code and Standards.

Back to Notes.

*Kiang*

C is correct. Kiang should disclose the referral fees to potential clients.

Back to Notes.

*Taveras*

C is correct. Sharing general opinions of previous students who found the CFA exam more difficult than expected is acceptable. However, information regarding the specifics of the exam should not be solicited or shared.

Back to Notes.

*Ahmed*

C is correct. Bennett’s membership has lapsed because she has not been paying dues to CFA Institute. Until she reactivates her membership, Bennett should not use the CFA designation.

 

By staying silent, Ahmed can be seen as having assisted Bennett in providing false information to the potential investor. Thus, both Ahmed and Bennett have violated the Code and Standards.

Back to Notes.

 