

## 学习最新网课加微信 ABE547 朋友圈更新两年

**PRACTICE PROBLEMS**

Unless otherwise stated in the question, all individuals in the following questions are CFA Institute members or candidates in the CFA Program and, therefore, are subject to the CFA Institute Code of Ethics and Standards of Professional Conduct.

- 1 Smith, a research analyst with a brokerage firm, decides to change his recommendation for the common stock of Green Company, Inc., from a “buy” to a “sell.” He mails this change in investment advice to all the firm’s clients on Wednesday. The day after the mailing, a client calls with a buy order for 500 shares of Green Company. In this circumstance, Smith should:
  - A Accept the order.
  - B Advise the customer of the change in recommendation before accepting the order.
  - C Not accept the order because it is contrary to the firm’s recommendation.
- 2 Which statement about a manager’s use of client brokerage commissions violates the Code and Standards?
  - A A client may direct a manager to use that client’s brokerage commissions to purchase goods and services for that client.
  - B Client brokerage commissions should be used to benefit the client and should be commensurate with the value of the brokerage and research services received.
  - C Client brokerage commissions may be directed to pay for the investment manager’s operating expenses.
- 3 Jamison is a junior research analyst with Howard & Howard, a brokerage and investment banking firm. Howard & Howard’s mergers and acquisitions department has represented the Britland Company in all of its acquisitions for the past 20 years. Two of Howard & Howard’s senior officers are directors of various Britland subsidiaries. Jamison has been asked to write a research report on Britland. What is the best course of action for her to follow?
  - A Jamison may write the report but must refrain from expressing any opinions because of the special relationships between the two companies.
  - B Jamison should not write the report because the two Howard & Howard officers serve as directors for subsidiaries of Britland.
  - C Jamison may write the report if she discloses the special relationships with the company in the report.
- 4 Which of the following statements clearly *conflicts* with the recommended procedures for compliance presented in the CFA Institute *Standards of Practice Handbook*?
  - A Firms should disclose to clients the personal investing policies and procedures established for their employees.
  - B Prior approval must be obtained for the personal investment transactions of all employees.
  - C For confidentiality reasons, personal transactions and holdings should not be reported to employers unless mandated by regulatory organizations.
- 5 Bronson provides investment advice to the board of trustees of a private university endowment fund. The trustees have provided Bronson with the fund’s financial information, including planned expenditures. Bronson receives a

phone call on Friday afternoon from Murdock, a prominent alumnus, requesting that Bronson fax him comprehensive financial information about the fund. According to Murdock, he has a potential contributor but needs the information that day to close the deal and cannot contact any of the trustees. Based on the CFA Institute Standards, Bronson should:

- A Send Murdock the information because disclosure would benefit the client.
  - B Not send Murdock the information to preserve confidentiality.
  - C Send Murdock the information, provided Bronson promptly notifies the trustees.
- 6 Willier is the research analyst responsible for following Company X. All the information he has accumulated and documented suggests that the outlook for the company's new products is poor, so the stock should be rated a weak "hold." During lunch, however, Willier overhears a financial analyst from another firm whom he respects offer opinions that conflict with Willier's forecasts and expectations. Upon returning to his office, Willier releases a strong "buy" recommendation to the public. Willier:
- A Violated the Standards by failing to distinguish between facts and opinions in his recommendation.
  - B Violated the Standards because he did not have a reasonable and adequate basis for his recommendation.
  - C Was in full compliance with the Standards.
- 7 An investment management firm has been hired by ETV Corporation to work on an additional public offering for the company. The firm's brokerage unit now has a "sell" recommendation on ETV, but the head of the investment banking department has asked the head of the brokerage unit to change the recommendation from "sell" to "buy." According to the Standards, the head of the brokerage unit would be permitted to:
- A Increase the recommendation by no more than one increment (in this case, to a "hold" recommendation).
  - B Place the company on a restricted list and give only factual information about the company.
  - C Assign a new analyst to decide if the stock deserves a higher rating.
- 8 Albert and Tye, who recently started their own investment advisory business, have registered to take the Level III CFA examination. Albert's business card reads, "Judy Albert, CFA Level II." Tye has not put anything about the CFA designation on his business card, but promotional material that he designed for the business describes the CFA requirements and indicates that Tye participates in the CFA Program and has completed Levels I and II. According to the Standards:
- A Albert has violated the Standards, but Tye has not.
  - B Tye has violated the Standards, but Albert has not.
  - C Both Albert and Tye have violated the Standards.
- 9 Scott works for a regional brokerage firm. He estimates that Walkton Industries will increase its dividend by US\$1.50 a share during the next year. He realizes that this increase is contingent on pending legislation that would, if enacted, give Walkton a substantial tax break. The US representative for Walkton's home district has told Scott that, although she is lobbying hard for the bill and prospects for its passage are favorable, concern of the US Congress over the federal deficit could cause the tax bill to be voted down. Walkton Industries has not made any statements about a change in dividend policy. Scott writes in his

research report, “We expect Walkton’s stock price to rise by at least US\$8.00 a share by the end of the year because the dividend will increase by US\$1.50 a share. Investors buying the stock at the current time should expect to realize a total return of at least 15% on the stock.” According to the Standards:

- A Scott violated the Standards because he used material inside information.
  - B Scott violated the Standards because he failed to separate opinion from fact.
  - C Scott violated the Standards by basing his research on uncertain predictions of future government action.
- 10 Which one of the following actions will help to ensure the fair treatment of brokerage firm clients when a new investment recommendation is made?
- A Informing all people in the firm in advance that a recommendation is to be disseminated.
  - B Distributing recommendations to institutional clients prior to individual accounts.
  - C Minimizing the time between the decision and the dissemination of a recommendation.
- 11 The mosaic theory holds that an analyst:
- A Violates the Code and Standards if the analyst fails to have knowledge of and comply with applicable laws.
  - B Can use material public information and nonmaterial nonpublic information in the analyst’s analysis.
  - C Should use all available and relevant information in support of an investment recommendation.
- 12 Jurgen is a portfolio manager. One of her firm’s clients has told Jurgen that he will compensate her beyond the compensation provided by her firm on the basis of the capital appreciation of his portfolio each year. Jurgen should:
- A Turn down the additional compensation because it will result in conflicts with the interests of other clients’ accounts.
  - B Turn down the additional compensation because it will create undue pressure on her to achieve strong short-term performance.
  - C Obtain permission from her employer prior to accepting the compensation arrangement.
- 13 One of the discretionary accounts managed by Farnsworth is the Jones Corporation employee profit-sharing plan. Jones, the company president, recently asked Farnsworth to vote the shares in the profit-sharing plan in favor of the slate of directors nominated by Jones Corporation and against the directors sponsored by a dissident stockholder group. Farnsworth does not want to lose this account because he directs all the account’s trades to a brokerage firm that provides Farnsworth with useful information about tax-free investments. Although this information is not of value in managing the Jones Corporation account, it does help in managing several other accounts. The brokerage firm providing this information also offers the lowest commissions for trades and provides best execution. Farnsworth investigates the director issue, concludes that the management-nominated slate is better for the long-run performance of the company than the dissident group’s slate, and votes accordingly. Farnsworth:
- A Violated the Standards in voting the shares in the manner requested by Jones but not in directing trades to the brokerage firm.
  - B Did not violate the Standards in voting the shares in the manner requested by Jones or in directing trades to the brokerage firm.

- C Violated the Standards in directing trades to the brokerage firm but not in voting the shares as requested by Jones.
- 14 Brown works for an investment counseling firm. Green, a new client of the firm, is meeting with Brown for the first time. Green used another counseling firm for financial advice for years, but she has switched her account to Brown's firm. After spending a few minutes getting acquainted, Brown explains to Green that she has discovered a highly undervalued stock that offers large potential gains. She recommends that Green purchase the stock. Brown has committed a violation of the Standards. What should she have done differently?
- A Brown should have determined Green's needs, objectives, and tolerance for risk before making a recommendation of any type of security.
- B Brown should have thoroughly explained the characteristics of the company to Green, including the characteristics of the industry in which the company operates.
- C Brown should have explained her qualifications, including her education, training, and experience and the meaning of the CFA designation.
- 15 Grey recommends the purchase of a mutual fund that invests solely in long-term US Treasury bonds. He makes the following statements to his clients:
- I. "The payment of the bonds is guaranteed by the US government; therefore, the default risk of the bonds is virtually zero."
- II. "If you invest in the mutual fund, you will earn a 10% rate of return each year for the next several years based on historical performance of the market."

Did Grey's statements violate the CFA Institute Code and Standards?

- A Neither statement violated the Code and Standards.
- B Only statement I violated the Code and Standards.
- C Only statement II violated the Code and Standards.
- 16 Anderb, a portfolio manager for XYZ Investment Management Company—a registered investment organization that advises investment firms and private accounts—was promoted to that position three years ago. Bates, her supervisor, is responsible for reviewing Anderb's portfolio account transactions and her required monthly reports of personal stock transactions. Anderb has been using Jonelli, a broker, almost exclusively for brokerage transactions for the portfolio account. For securities in which Jonelli's firm makes a market, Jonelli has been giving Anderb lower prices for personal purchases and higher prices for personal sales than Jonelli gives to Anderb's portfolio accounts and other investors. Anderb has been filing monthly reports with Bates only for those months in which she has no personal transactions, which is about every fourth month. Which of the following is *most likely* to be a violation of the Code and Standards?
- A Anderb failed to disclose to her employer her personal transactions.
- B Anderb owned the same securities as those of her clients.
- C Bates allowed Anderb to use Jonelli as her broker for personal trades.
- 17 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 on material nonpublic information.
- 18** Ward is scheduled to visit the corporate headquarters of Evans Industries. Ward expects to use the information he obtains there to complete his research report on Evans stock. Ward learns that Evans plans to pay all of Ward's expenses for the trip, including costs of meals, hotel room, and air transportation. Which of the following actions would be the *best* course for Ward to take under the Code and Standards?
  - A** Accept the expense-paid trip and write an objective report.
  - B** Pay for all travel expenses, including costs of meals and incidental items.
  - C** Accept the expense-paid trip but disclose the value of the services accepted in the report.
- 19** Which of the following statements is *correct* under the Code and Standards?
  - A** CFA Institute members and candidates are prohibited from undertaking independent practice in competition with their employer.
  - B** Written consent from the employer is necessary to permit independent practice that could result in compensation or other benefits in competition with a member's or candidate's employer.
  - C** Members and candidates are prohibited from making arrangements or preparations to go into a competitive business before terminating their relationship with their employer.
- 20** Smith is a financial analyst with XYZ Brokerage Firm. She is preparing a purchase recommendation on JNI Corporation. Which of the following situations is *most likely* to represent a conflict of interest for Smith that would have to be disclosed?
  - A** Smith frequently purchases items produced by JNI.
  - B** XYZ holds for its own account a substantial common stock position in JNI.
  - C** Smith's brother-in-law is a supplier to JNI.
- 21** Michelieu tells a prospective client, "I may not have a long-term track record yet, but I'm sure that you'll be very pleased with my recommendations and service. In the three years that I've been in the business, my equity-oriented clients have averaged a total return of more than 26% a year." The statement is true, but Michelieu only has a few clients, and one of his clients took a large position in a penny stock (against Michelieu's advice) and realized a huge gain. This large return caused the average of all of Michelieu's clients to exceed 26% a year. Without this one investment, the average gain would have been 8% a year. Has Michelieu violated the Standards?
  - A** No, because Michelieu is not promising that he can earn a 26% return in the future.
  - B** No, because the statement is a true and accurate description of Michelieu's track record.
  - C** Yes, because the statement misrepresents Michelieu's track record.

- 22 An investment banking department of a brokerage firm often receives material nonpublic information that could have considerable value if used in advising the firm's brokerage clients. In order to conform to the Code and Standards, which one of the following is the best policy for the brokerage firm?
- A Permanently prohibit both "buy" and "sell" recommendations of the stocks of clients of the investment banking department.
  - B Establish physical and informational barriers within the firm to prevent the exchange of information between the investment banking and brokerage operations.
  - C Monitor the exchange of information between the investment banking department and the brokerage operation.
- 23 Stewart has been hired by Goodner Industries, Inc., to manage its pension fund. Stewart's duty of loyalty, prudence, and care is owed to:
- A The management of Goodner.
  - B The participants and beneficiaries of Goodner's pension plan.
  - C The shareholders of Goodner.
- 24 Which of the following statements is a stated purpose of disclosure in Standard VI(C)–Referral Fees?
- A Disclosure will allow the client to request discounted service fees.
  - B Disclosure will help the client evaluate any possible partiality shown in the recommendation of services.
  - C Disclosure means advising a prospective client about the referral arrangement once a formal client relationship has been established.
- 25 Rose, a portfolio manager for a local investment advisory firm, is planning to sell a portion of his personal investment portfolio to cover the costs of his child's academic tuition. Rose wants to sell a portion of his holdings in Household Products, but his firm recently upgraded the stock to "strong buy." Which of the following describes Rose's options under the Code and Standards?
- A Based on his firm's "buy" recommendation, Rose cannot sell the shares because he would be improperly prospering from the inflated recommendation.
  - B Rose is free to sell his personal holdings once his firm is properly informed of his intentions.
  - C Rose can sell his personal holdings but only when a client of the firm places an order to buy shares of Household.
- 26 A former hedge fund manager, Jackman, has decided to launch a new private wealth management firm. From his prior experiences, he believes the new firm needs to achieve US\$1 million in assets under management in the first year. Jackman offers a \$10,000 incentive to any adviser who joins his firm with the minimum of \$200,000 in committed investments. Jackman places notice of the opening on several industry web portals and career search sites. Which of the following is *correct* according to the Code and Standards?
- A A member or candidate is eligible for the new position and incentive if he or she can arrange for enough current clients to switch to the new firm and if the member or candidate discloses the incentive fee.
  - B A member or candidate may not accept employment with the new firm because Jackman's incentive offer violates the Code and Standards.



- C A member or candidate is not eligible for the new position unless he or she is currently unemployed because soliciting the clients of the member's or candidate's current employer is prohibited.
- 27 Carter works for Invest Today, a local asset management firm. A broker that provides Carter with proprietary research through client brokerage arrangements is offering a new trading service. The broker is offering low-fee, execution-only trades to complement its traditional full-service, execution-and-research trades. To entice Carter and other asset managers to send additional business its way, the broker will apply the commissions paid on the new service toward satisfying the brokerage commitment of the prior full-service arrangements. Carter has always been satisfied with the execution provided on the full-service trades, and the new low-fee trades are comparable to the fees of other brokers currently used for the accounts that prohibit soft dollar arrangements.
- A Carter can trade for his accounts that prohibit soft dollar arrangements under the new low-fee trading scheme.
- B Carter cannot use the new trading scheme because the commissions are prohibited by the soft dollar restrictions of the accounts.
- C Carter should trade only through the new low-fee scheme and should increase his trading volume to meet his required commission commitment.
- 28 Rule has worked as a portfolio manager for a large investment management firm for the past 10 years. Rule earned his CFA charter last year and has decided to open his own investment management firm. After leaving his current employer, Rule creates some marketing material for his new firm. He states in the material, "In earning the CFA charter, a highly regarded credential in the investment management industry, I further enhanced the portfolio management skills learned during my professional career. While completing the examination process in three consecutive years, I consistently received the highest possible scores on the topics of Ethics, Alternative Investments, and Portfolio Management." Has Rule violated Standard VII(B)—Reference to CFA Institute, the CFA Designation, and the CFA Program in his marketing material?
- A Rule violated Standard VII(B) in stating that he completed the exams in three consecutive years.
- B Rule violated Standard VII(B) in stating that he received the highest scores in the topics of Ethics, Alternative Investments, and Portfolio Management.
- C Rule did not violate Standard VII(B).
- 29 Stafford is a portfolio manager for a specialized real estate mutual fund. Her firm clearly describes in the fund's prospectus its soft dollar policies. Stafford decides that entering the CFA Program will enhance her investment decision-making skill and decides to use the fund's soft dollar account to pay the registration and exam fees for the CFA Program. Which of the following statements is *most likely* correct?
- A Stafford did not violate the Code and Standards because the prospectus informed investors of the fund's soft dollar policies.
- B Stafford violated the Code and Standards because improving her investment skills is not a reasonable use of the soft dollar account.
- C Stafford violated the Code and Standards because the CFA Program does not meet the definition of research allowed to be purchased with brokerage commissions.
- 30 Long has been asked to be the keynote speaker at an upcoming investment conference. The event is being hosted by one of the third-party investment managers currently used by his pension fund. The manager offers to cover all

conference and travel costs for Long and make the conference registrations free for three additional members of his investment management team. To ensure that the conference obtains the best speakers, the host firm has arranged for an exclusive golf outing for the day following the conference on a local championship-caliber course. Which of the following is *least likely* to violate Standard I(B)?

- A Long may accept only the offer to have his conference-related expenses paid by the host firm.
  - B Long may accept the offer to have his conference-related expenses paid and may attend the exclusive golf outing at the expense of the hosting firm.
  - C Long may accept the entire package of incentives offered to speak at this conference.
- 31 Andrews, a private wealth manager, is conducting interviews for a new research analyst for his firm. One of the candidates is Wright, an analyst with a local investment bank. During the interview, while Wright is describing his analytical skills, he mentions a current merger in which his firm is acting as the adviser. Andrews has heard rumors of a possible merger between the two companies, but no releases have been made by the companies concerned. Which of the following actions by Andrews is *least likely* a violation of the Code and Standards?
- A Waiting until the next day before trading on the information to allow time for it to become public.
  - B Notifying all investment managers in his firm of the new information so none of their clients are disadvantaged.
  - C Placing the securities mentioned as part of the merger on the firm's restricted trading list.
- 32 Pietro, president of Local Bank, has hired the bank's market maker, Vogt, to seek a merger partner. Local is currently not listed on a stock exchange and has not reported that it is seeking strategic alternatives. Vogt has discussed the possibility of a merger with several firms, but they have all decided to wait until after the next period's financial data are available. The potential buyers believe the results will be worse than the results of prior periods and will allow them to pay less for Local Bank.
- Pietro wants to increase the likelihood of structuring a merger deal quickly. Which of the following actions would *most likely* be a violation of the Code and Standards?
- A Pietro could instruct Local Bank to issue a press release announcing that it has retained Vogt to find a merger partner.
  - B Pietro could place a buy order for 2,000 shares (or four times the average weekly volume) through Vogt for his personal account.
  - C After confirming with Local's chief financial officer, Pietro could instruct Local to issue a press release reaffirming the firm's prior announced earnings guidance for the full fiscal year.
- 33 ABC Investment Management acquires a new, very large account with two concentrated positions. The firm's current policy is to add new accounts for the purpose of performance calculation after the first full month of management. Cupp is responsible for calculating the firm's performance returns. Before the end of the initial month, Cupp notices that one of the significant holdings of the new accounts is acquired by another company, causing the value of the investment to double. Because of this holding, Cupp decides to account for the new portfolio as of the date of transfer, thereby allowing ABC Investment to reap the positive impact of that month's portfolio return.



- A Cupp did not violate the Code and Standards because the GIPS standards allow composites to be updated on the date of large external cash flows.
  - B Cupp did not violate the Code and Standards because companies are allowed to determine when to incorporate new accounts into their composite calculation.
  - C Cupp violated the Code and Standards because the inclusion of the new account produces an inaccurate calculation of the monthly results according to the firm's stated policies.
- 34 Cannan has been working from home on weekends and occasionally saves correspondence with clients and completed work on her home computer. Because of worsening market conditions, Cannan is one of several employees released by her firm. While Cannan is looking for a new job, she uses the files she saved at home to request letters of recommendation from former clients. She also provides to prospective clients some of the reports as examples of her abilities.
  - A Cannan violated the Code and Standards because she did not receive permission from her former employer to keep or use the files after her employment ended.
  - B Cannan did not violate the Code and Standards because the files were created and saved on her own time and computer.
  - C Cannan violated the Code and Standards because she is prohibited from saving files on her home computer.
- 35 Quinn sat for the Level III CFA 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.
- 36 During a round of golf, Rodriguez, chief financial officer of Mega Retail, mentions to Hart, a local investment adviser and long-time personal friend, that Mega is having an exceptional sales quarter. Rodriguez expects the results to be almost 10% above the current estimates. The next day, Hart initiates the purchase of a large stake in the local exchange-traded retail fund for her personal account.
  - A Hart violated the Code and Standards by investing in the exchange-traded fund that included Mega Retail.
  - B Hart did not violate the Code and Standards because she did not invest directly in securities of Mega Retail.
  - C Rodriguez did not violate the Code and Standards because the comments made to Hart were not intended to solicit an investment in Mega Retail.
- 37 Park is very frustrated after taking her Level II exam. While she was studying for the exam, to supplement the curriculum provided, she ordered and used study material from a third-party provider. Park believes the additional material focused her attention on specific topic areas that were not tested while ignoring other areas. She posts the following statement on the provider's discussion board: "I am very dissatisfied with your firm's CFA Program Level II material. I found the exam extremely difficult and myself unprepared for specific questions after using your product. How could your service provide such limited

instructional resources on the analysis of inventories and taxes when the exam had multiple questions about them? I will not recommend your products to other candidates.”

- A** Park violated the Code and Standards by purchasing third-party review material.
  - B** Park violated the Code and Standards by providing her opinion on the difficulty of the exam.
  - C** Park violated the Code and Standards by providing specific information on topics tested on the exam.
- 38** Paper was recently terminated as one of a team of five managers of an equity fund. The fund had two value-focused managers and terminated one of them to reduce costs. In a letter sent to prospective employers, Paper presents, with written permission of the firm, the performance history of the fund to demonstrate his past success.
- A** Paper did not violate the Code and Standards.
  - B** Paper violated the Code and Standards by claiming the performance of the entire fund as his own.
  - C** Paper violated the Code and Standards by including the historical results of his prior employer.
- 39** Townsend was recently appointed to the board of directors of a youth golf program that is the local chapter of a national not-for-profit organization. The program is beginning a new fund-raising campaign to expand the number of annual scholarships it provides. Townsend believes many of her clients make annual donations to charity. The next week in her regular newsletter to all clients, she includes a small section discussing the fund-raising campaign and her position on the organization’s board.
- A** Townsend did not violate the Code and Standards.
  - B** Townsend violated the Code and Standards by soliciting donations from her clients through the newsletter.
  - C** Townsend violated the Code and Standards by not getting approval of the organization before soliciting her clients.

## **The following information relates to Questions 40–45**

Anne Boswin, CFA, is a senior fixed-income analyst at Greenfield Financial Corporation. Boswin develops financial models for predicting changes in bond prices. On the premise that bonds of firms targeted for leveraged buyouts (LBOs) often decline in value, Boswin develops a model to predict which firms are likely to be subject to LBOs.

Boswin works closely with another analyst, Robert Acertado, CFA. Acertado uses Boswin’s model frequently to identify potential LBO targets for further research. Using the model and his extensive research skills, Acertado makes timely investment recommendations and develops a strong track record.

Based on this record, Acertado receives an employment offer from the asset management division of Smith & Garner Investments, Inc., a diversified financial services firm. With Boswin’s consent, Acertado downloads the model before leaving Greenfield.

At Smith & Garner, Acertado presents the idea of predicting LBO targets as a way to identify bonds that might decline in value and thus be good sell recommendations. After Acertado walks his boss through the model, the supervisor comments, “I like your idea and your model, Robert. I can see that we made the right decision in hiring you.”

Because Smith & Garner has both an Investment Banking (IB) and Asset Management (AM) division, Acertado’s supervisor reminds him that he should not attempt to contact or engage in conversation with anyone from the Investment Banking division. The supervisor also directs him to eat in the East end of the company cafeteria. “The West end is reserved for the IB folks, and you may laugh at this, but we actually put up a wall between the two ends. If anyone were to accuse us of not having a firewall, we could actually point to it!” Robert’s supervisor also tells him, “There should be absolutely no conversation about divisional business while in the hall and elevator that serves as a common access to the cafeteria for both divisions. We are very strict about this.”

The following week, Acertado is riding alone in the elevator when it stops on an IB floor. As the doors begin to slide open, Acertado hears a voice whispering, “I am so pleased that we were able to put the financing together for Country Industries. I was concerned because the leverage will go to 80%—higher than our typical deal.” As soon as the doors open enough to reveal that the elevator is occupied, all conversation stops.

Late that afternoon, Acertado uses the LBO model to measure the probability of Country Industries receiving an LBO offer. According to the model, the probability is 62%—slightly more than the 60% Acertado generally requires before conducting additional research. It is late in the afternoon and Acertado has little time to research the matter fully before the end of the trading day. He checks his inputs to the model. In the interest of time, Acertado immediately recommends selling Country Industries’ senior bonds held in any long-only accounts. He also recommends establishing positions in derivatives contracts that will benefit from a decline in the value of Country Industries’ bonds.

The next morning, after the firm has established the derivatives positions he recommended, Acertado calls Boswin. Knowing that his former associate will be preparing Greenfield’s monthly newsletter, he tells her, “I ran Country Industries through your model and I think it is likely that they will receive an LBO offer.” Acertado explains some of the inputs he used in the model. At the conclusion of the conversation Boswin responds, “You may be right. Country Industries sounds like a possible LBO candidate, and thus, a sell rating on their senior bonds would be in order. If I’m lucky, I can finish researching the issue in time to include the recommendation in the upcoming newsletter. Thanks. It was good talking with you, Robert.”

After the conversation with Acertado, Boswin quickly runs Country Industries through the model. Based on her inputs, the model calculates that the probability of an LBO is 40%—not enough, in Boswin’s opinion, to justify further research. She wonders if there is a discrepancy between her inputs and Acertado’s. Pressed for time, Boswin resumes her work on the upcoming newsletter rather than investigating the matter.

Acertado soon begins searching the internet for information on companies that the model predicts have more than a 60% probability of an LBO offer. He scours blogs and company websites looking for signs of a potential offer. He uses evidence of rumored offers in developing sell recommendations on various corporations’ bonds.

**40** When downloading the model from Greenfield Financial Corporation, does Acertado violate any CFA Institute Standards of Practice and Professional Conduct?

- A** No.
- B** Yes, because he does not have written permission from Boswin.
- C** Yes, because he does not have permission from Greenfield Financial Corporation.

- 41 When using the model at Smith & Garner, Acertado is *least likely* to violate the Standard relating to:
- A misrepresentation.
  - B loyalty to employer.
  - C material nonpublic information.
- 42 When making the recommendation regarding Country Industries, does Acertado violate any CFA Institute Standards?
- A No.
  - B Yes, relating to diligence and reasonable basis.
  - C Yes, relating to material nonpublic information.
- 43 In his phone conversation with Boswin, Acertado *least likely* violates the CFA Institute Standard relating to:
- A suitability.
  - B integrity of capital markets.
  - C preservation of confidentiality.
- 44 When analyzing the probability of an LBO of Country Industries, does Boswin violate any CFA Institute Standards?
- A No.
  - B Yes, relating to independence and objectivity.
  - C Yes, relating to diligence and reasonable basis.
- 45 When searching blogs, does Acertado violate any CFA Institute Standards?
- A No.
  - B Yes, because he misuses company resources.
  - C Yes, because he seeks inside information on the blogs.

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## The following information relates to Questions 46–50

Erik Brecksen, CFA, a portfolio manager at Apfelbaum Kapital, recently recruited Hans Grohl, a CFA candidate and recent MBA graduate from a top university with excellent quantitative analysis skills. Apfelbaum Kapital stresses “top-down” fundamental analysis and uses a team approach to investment management. The firm’s investment professionals, all of whom are CFA charterholders or candidates, attend weekly investment committee meetings. At the meetings, analysts responsible for different industrial sectors present their research and recommendations. Following each presentation, the investment committee, consisting of senior portfolio managers, questions the analyst about the recommendation. If the majority of the committee agrees with the recommendation, the recommendation is approved and the stock is placed on a restricted list while the firm executes the necessary trades.

Apfelbaum considers its research proprietary. It is intended for the sole use of its investment professionals and is not distributed outside the firm. The names of all the investment personnel associated with the sector or investment class are listed on each research report regardless of their actual level of contribution to the report.

On Grohl's first day of work, Brecksen assigns him responsibility for a company that Brecksen covered previously. He provides Grohl with his past research including all of his files and reports. Brecksen instructs Grohl to report back when he has finished his research and is ready to submit his own research report on the company.

Grohl reads Brecksen's old reports before studying the financial statements of the company and its competitors. Taking advantage of his quantitative analysis skills, Grohl then conducts a detailed multi-factor analysis. Afterward, he produces a written buy recommendation using Brecksen's old research reports as a guide for format and submits a draft to Brecksen for review.

Brecksen reviews the work and indicates that he is not familiar with multi-factor analysis. He tells Grohl that he agrees with the buy recommendation, but instructs Grohl to omit the multi-factor analysis from the report. Grohl attempts to defend his research methodology, but is interrupted when Brecksen accepts a phone call. Grohl follows Brecksen's instructions and removes all mention of the multi-factor analysis from the final report. Brecksen presents the completed report at the weekly meeting with both his and Grohl's names listed on the document. After Brecksen's initial presentation, the committee turns to Grohl and asks about his research. Grohl takes the opportunity to mention the multi-factor analysis. Satisfied, the committee votes in favor of the recommendation and congratulates Grohl on his work.

Ottie Zardt, CFA, has worked as a real estate analyst for Apfelbaum for the past 18 months. A new independent rating service has determined that Zardt's recommendations have resulted in an excess return of 12% versus the industry's return of 2.7% for the past twelve months. After learning about the rating service, Zardt immediately updates the promotional material he is preparing for distribution at an upcoming industry conference. He includes a reference to the rating service and quotes its returns results and other information. Before distributing the material at the conference, he adds a footnote stating "Past performance is no guarantee of future success."

- 46 When preparing the initial draft for Brecksen's review, does Grohl violate any CFA Standards?
- A No.
  - B Yes, because he used Brecksen's research reports without permission.
  - C Yes, because he did not use reasonable judgment in identifying which factors were important to the analysis.
- 47 When instructing Grohl to eliminate the multi-factor analysis from the research report, does Brecksen violate any CFA Standards?
- A No.
  - B Yes, relating to record retention.
  - C Yes, relating to diligence and reasonable basis.
- 48 When removing the multi-factor analysis from his research report, does Grohl violate any CFA Standards?
- A No.
  - B Yes, because he no longer has a reasonable basis for his recommendation.
  - C Yes, because he is required to make full and fair disclosure of all relevant information.
- 49 When listing their names on the research report, do Brecksen and Grohl violate any CFA Standards?
- A No.
  - B Yes, because Brecksen misrepresents his authorship.
  - C Yes, because Grohl should dissociate from the report.

- 50 When distributing the material at the industry conference, does Zardt violate any CFA Standards?
- A No.
  - B Yes, because Zardt does not verify the accuracy of the information.
  - C Yes, because analysts cannot claim performance or promote the accuracy of their recommendations.

## The following information relates to Questions 51–56

Samuel Telline, CFA, is a portfolio manager at Aiklin Investments with discretionary authority over all of his accounts. One of his clients, Alan Caper, Chief Executive Officer (CEO) of Ellipse Manufacturing, invites Telline to lunch.

At the restaurant, the CEO reveals the reason for the lunch. “As you know Reinhold Partners has made an unsolicited cash offer for all outstanding shares of Ellipse Manufacturing. Reinhold has made it clear that I will not be CEO if they are successful. I can assure you that our shareholders will be better off in the long term if I’m in charge.” Caper then shows Telline his projections for a new plan designed to boost both sales and operating margins.

“I know that your firm is the trustee for our firm’s Employee Stock Ownership Plan (ESOP). I hope that the trustee will vote in the best interest of our shareholders—and that would be a vote against the takeover offer.”

After looking through Caper’s business plans, Telline says, “This plan looks good. I will recommend that the trustee vote against the offer.”

Caper responds, “I remember my friend Karen Leighton telling me that the Leighton Family’s Trust is managed by your firm. Perhaps the trustee could vote those shares against the acquisition as well. Karen Leighton is a close friend. I am sure that she would agree.”

Telline responds, “The Family Trust is no longer managed by Aiklin.” He adds, “I understand that the Trust is very conservatively managed. I doubt it that it would have holdings in Ellipse Manufacturing.” Telline does not mention that although the Family Trust has changed investment managers, Karen Leighton remains an important client at Aiklin with significant personal holdings in Ellipse.

After lunch, Telline meets with Sydney Brown, CFA, trustee of the Ellipse ESOP. He shows her Caper’s plan for improvements. “I think the plan is a good one and Caper is one of the firm’s most profitable accounts. We don’t want to lose him.” Brown agrees to analyze the plan. After thoroughly analyzing both the plan and the takeover offer, Brown concludes that the takeover offer is best for the shareholders in the ESOP and votes the plan’s shares in favor of the takeover offer.

A few months later the acquisition of Ellipse by Reinhold Partners is completed. Caper again meets Telline for lunch. “I received a generous severance package and I’m counting on you to manage my money well for me. While we are on the subject, I would like to be more aggressive with my portfolio. With my severance package, I can take additional risk.” Telline and Caper discuss his current financial situation, risk tolerance, and financial objectives throughout lunch. Telline agrees to adjust Caper’s investment policy statement (IPS) to reflect his greater appetite for risk and his increased wealth.



Back at the office, Telline realizes that with the severance package, Caper is now his wealthiest client. He also realizes that Caper's increased appetite for risk gives him a risk profile similar to that of another client. He pulls a copy of the other client's investment policy statement (IPS) and reviews it quickly before realizing that the two clients have very different tax situations. Telline quickly revises Caper's IPS to reflect the changes in his financial situation. He uses the other client's IPS as a reference when revising the section relating to Caper's risk tolerance. He then files the revised IPS in Caper's file.

The following week, an Aiklin analyst issues a buy recommendation on a small technology company with a promising software product. Telline reads the report carefully and concludes it would be suitable under Caper's new IPS. Telline places an order for 10,000 shares in Caper's account and then calls Caper to discuss the stock in more detail. Telline does not purchase the stock for any other clients. Although the one client has the same risk profile as Caper, that client does not have cash available in his account and Telline determines that selling existing holdings does not make sense.

In a subsequent telephone conversation, Caper expresses his lingering anger over the takeover. "You didn't do enough to persuade Aiklin's clients to vote against the takeover. Maybe I should look for an investment manager who is more loyal." Telline tries to calm Caper but is unsuccessful. In an attempt to change the topic of conversation, Telline states, "The firm was just notified of our allocation of a long-awaited IPO. Your account should receive a significant allocation. I would hate to see you lose out by moving your account." Caper seems mollified and concludes the phone call, "I look forward to a long-term relationship with you and your firm."

Aiklin distributes a copy of its firm policies regarding IPO allocations to all clients annually. According to the policy, Aiklin allocates IPO shares to each investment manager and each manager has responsibility for allocating shares to accounts for which the IPO is suitable. The statement also discloses that Aiklin offers different levels of service for different fees.

After carefully reviewing the proposed IPO and his client accounts, Telline determines that the IPO is suitable for 11 clients including Caper. Because the deal is oversubscribed, he receives only half of the shares he expected. Telline directs 50% of his allocation to Caper's account and divides the remaining 50% between the other ten accounts, each with a value equal to half of Caper's account.

- 51 When discussing the Leighton Family Trust, does Telline violate any CFA Institute Standards of Professional Conduct?
- A No.
  - B Yes, relating to duties to clients.
  - C Yes, relating to misrepresentation.
- 52 When deciding how to vote the ESOP shares, does Brown violate any CFA Institute Standards?
- A No.
  - B Yes, relating to loyalty, prudence, and care.
  - C Yes, relating to diligence and reasonable basis.
- 53 The Standard *least likely* to provide guidance for Telline when working with the clients' investment policy statements would be the Standard relating to:
- A suitability.
  - B fair dealing.
  - C loyalty, prudence, and care.
- 54 Does Telline violate any CFA Institute Standards when he places the buy order for shares in the technology company for Caper's account?

- A No.
  - B Yes, relating to fair dealing.
  - C Yes, relating to diligence and reasonable basis.
- 55 Is Aiklin's policy with respect to IPO allocations consistent with required and recommended CFA Institute Standards?
- A Yes.
  - B No, because the IPO policy disadvantages certain clients.
  - C No, because the different levels of service disadvantage certain clients.
- 56 Does Telline violate any CFA Institute Standards in his allocation of IPO shares to Caper's account?
- A No.
  - B Yes, because the IPO is not suitable for Caper.
  - C Yes, because he does not treat all his clients fairly.

## The following information relates to Questions 57–62

Adam Craw, CFA, is chief executive officer (CEO) of Crawfood, a European private equity firm specializing in food retailers. The retail food industry has been consolidating during the past two years as private equity funds have closed numerous deals and taken many companies private.

Crawfood recently hired Lillian Voser, a CFA Level II candidate, as a controller. On Voser's first day of work, the head of personnel informs her that by signing the employment contract, Voser agrees to comply with the company's code of ethics and compliance manual. She hands Voser copies of the code and compliance manual without further comment. Voser spends the next hour reading both documents. An excerpt from the compliance manual appears in Exhibit 1.

### Exhibit 1 Crawfood Company Compliance Manual Excerpts

- 1 Employees 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.
- 2 Officers have responsibility for ensuring that their direct reports—that is, employees whom they directly supervise—adhere to applicable laws, rules, and regulations.
- 3 Employees in possession of material nonpublic information should make reasonable efforts to achieve public dissemination of the information if such actions would not breach a duty.
- 4 Employees shall not trade or cause others to trade in securities of food retailers that may be potential takeover targets of their employer.

When she enters her new office that afternoon, Voser finds a large gift basket sent by her sister. The card reads “Congratulations on your new position.” The basket is filled with expensive high-quality food items from Greenhornfood—a local small, publicly-traded food retailer, which produces many delicatessen products under its own brand name.

During the next two weeks, Voser meets with all of Crawford’s upper management, including the CEO. In his office, Craw praises Voser’s efforts to complete the CFA program. “The program is demanding, but it is worthwhile.” Craw then explains his investment strategy for choosing Crawford’s acquisition targets. He points to a large map on the wall with multi-colored pins marking Crawford’s previous takeovers. The map shows acquisitions in all the major cities of Germany with one exception—the home of Crawford headquarters. Craw remarks, “We are currently in talks for another purchase. Confidentiality prohibits me from discussing it any further, but you will hear more about it soon.”

Introduced to Greenhornfood by her sister, Voser quickly becomes a loyal customer. She considers it the best food retailer in the vicinity and she frequently purchases its products.

The following week, the local newspaper features an article about Greenhornfood and its young founders. The article describes the company’s loyal and growing customer base as well as its poor quarterly financial results. Voser notes that the stock has steadily declined during the past twelve months. She concludes that the company has an inexperienced management team, but its popular product line and loyal customer base make the company a potential acquisition target. Voser calls her sister and recommends that she purchase Greenhornfood shares because “it would be an attractive acquisition for a larger company.” Based on Voser’s recommendation, her sister buys €3,000 worth of shares.

During the following two weeks the stock price of Greenhornfood continues to decline. Voser’s sister is uncertain of what she should do with her position. She seeks Voser’s advice. Voser recommends that her sister wait another few days before making her decision and promises to analyze the situation in the meantime.

While walking by Craw’s office the following day, Voser sees a document with Greenhornfood’s distinctive logo and overhears the company’s name through an open office door. That evening, Voser tells her sister, “with the price decline, the stock is even more attractive.” She recommends that her sister increase her position. Based on her recommendation her sister buys an additional €3,000 worth of Greenhornfood shares.

One month later, Crawford publicly announces the acquisition of Greenhornfood Company at a 20% premium to the previous day’s closing price. Following the announcement, Voser’s sister boasts about Voser’s excellent recommendation and timing to her broker.

Regulatory authorities initiate an investigation into suspicious trading in Greenhornfood shares and options preceding the formal announcement of the acquisition. Craw receives a letter from regulatory authorities stating that he is the subject of a formal investigation into his professional conduct surrounding the acquisition. He learns from the compliance officer that Voser is also under investigation. The compliance officer provides no details and out of respect for Voser’s privacy, Craw makes no inquiries.

The situation remains unchanged and the matter is still pending with regulatory authorities several months later when Craw receives his annual Professional Conduct Statement (PCS) from CFA Institute. He reviews the text asking “In the last two years, have you been . . . the subject of . . . any investigation . . . in which your professional conduct, in either a direct or supervisory capacity, was at issue?”

- 57** Are Excerpts 2 and 3 of Crawford’s compliance procedures consistent with the CFA Institute Standards of Professional Conduct?

- A Yes.
  - B No, because Excerpt 2 applies only to officers and their direct reports.
  - C No, because Excerpt 3 does not require employees to achieve public dissemination.
- 58 According to the CFA Institute Standards, must Voser obtain permission from her supervisor before accepting the Greenhornfood gift basket?
- A No.
  - B Yes, because the value of the basket is higher than €50.
  - C Yes, because consent is required by the company's compliance procedures.
- 59 When making her initial recommendation to purchase Greenhornfood company shares, Voser *most likely* violates the Standard relating to:
- A loyalty to employer.
  - B integrity of capital markets.
  - C diligence and reasonable basis.
- 60 When recommending the purchase of additional Greenhornfood company shares, Voser *least likely* violates the Standard relating to:
- A loyalty to employer.
  - B integrity of capital markets.
  - C diligence and reasonable basis.
- 61 Does Craw violate any CFA Institute Standards?
- A No.
  - B Yes, because he passes material nonpublic information to Voser.
  - C Yes, because he does not make reasonable efforts to prevent violations of applicable law.
- 62 According to the CFA Standards, Craw must disclose to CFA Institute the investigation into:
- A his conduct.
  - B Voser's conduct.
  - C neither his conduct nor Voser's conduct.

## SOLUTIONS

- 1 The correct answer is B. This question involves Standard III(B)—Fair Dealing. Smith disseminated a change in the stock recommendation to his clients but then received a request contrary to that recommendation from a client who probably had not yet received the recommendation. Prior to executing the order, Smith should take additional steps to ensure that the customer has received the change of recommendation. Answer A is incorrect because the client placed the order prior to receiving the recommendation and, therefore, does not have the benefit of Smith's most recent recommendation. Answer C is also incorrect; simply because the client request is contrary to the firm's recommendation does not mean a member can override a direct request by a client. After Smith contacts the client to ensure that the client has received the changed recommendation, if the client still wants to place a buy order for the shares, Smith is obligated to comply with the client's directive.
- 2 The correct answer is C. This question involves Standard III(A)—Loyalty, Prudence, and Care and the specific topic of soft dollars or soft commissions. Answer C is the correct choice because client brokerage commissions may not be directed to pay for the investment manager's operating expenses. Answer B describes how members and candidates should determine how to use brokerage commissions—that is, if the use is in the best interests of clients and is commensurate with the value of the services provided. Answer A describes a practice that is commonly referred to as "directed brokerage." Because brokerage is an asset of the client and is used to benefit the client, not the manager, such practice does not violate a duty of loyalty to the client. Members and candidates are obligated in all situations to disclose to clients their practices in the use of client brokerage commissions.
- 3 The correct answer is C. This question involves Standard VI(A)—Disclosure of Conflicts. The question establishes a conflict of interest in which an analyst, Jamison, is asked to write a research report on a company that is a client of the analyst's employer. In addition, two directors of the company are senior officers of Jamison's employer. Both facts establish that there are conflicts of interest that must be disclosed by Jamison in her research report. Answer B is incorrect because an analyst is not prevented from writing a report simply because of the special relationship the analyst's employer has with the company as long as that relationship is disclosed. Answer A is incorrect because whether or not Jamison expresses any opinions in the report is irrelevant to her duty to disclose a conflict of interest. Not expressing opinions does not relieve the analyst of the responsibility to disclose the special relationships between the two companies.
- 4 The correct answer is C. This question asks about compliance procedures relating to personal investments of members and candidates. The statement in answer C clearly conflicts with the recommended procedures in the *Standards of Practice Handbook*. Employers should compare personal transactions of employees with those of clients on a regular basis regardless of the existence of a requirement by any regulatory organization. Such comparisons ensure that employees' personal trades do not conflict with their duty to their clients, and the comparisons can be conducted in a confidential manner. The statement in answer A does not conflict with the procedures in the *Handbook*. Disclosure of such policies will give full information to clients regarding potential conflicts of interest on the part of those entrusted to manage their money. Answer B is incorrect because firms are encouraged to establish policies whereby employees clear their personal holdings and transactions with their employers.

- 5 The correct answer is B. This question relates to Standard III(A)–Loyalty, Prudence, and Care and Standard III(E)–Preservation of Confidentiality. In this case, the member manages funds of a private endowment. Clients, who are, in this case, the trustees of the fund, must place some trust in members and candidates. Bronson cannot disclose confidential financial information to anyone without the permission of the fund, regardless of whether the disclosure may benefit the fund. Therefore, answer A is incorrect. Answer C is incorrect because Bronson must notify the fund and obtain the fund’s permission before publicizing the information.
- 6 The correct answer is B. This question relates to Standard V(A)–Diligence and Reasonable Basis. The opinion of another financial analyst is not an adequate basis for Willier’s action in changing the recommendation. Answer C is thus incorrect. So is answer A because, although it is true that members and candidates must distinguish between facts and opinions in recommendations, the question does not illustrate a violation of that nature. If the opinion overheard by Willier had sparked him to conduct additional research and investigation that justified a change of opinion, then a changed recommendation would be appropriate.
- 7 The correct answer is B. This question relates to Standard I(B)–Independence and Objectivity. When asked to change a recommendation on a company stock to gain business for the firm, the head of the brokerage unit must refuse in order to maintain his independence and objectivity in making recommendations. He must not yield to pressure by the firm’s investment banking department. To avoid the appearance of a conflict of interest, the firm should discontinue issuing recommendations about the company. Answer A is incorrect; changing the recommendation in any manner that is contrary to the analyst’s opinion violates the duty to maintain independence and objectivity. Answer C is incorrect because merely assigning a new analyst to decide whether the stock deserves a higher rating will not address the conflict of interest.
- 8 The correct answer is A. Standard VII(B)–Reference to CFA Institute, the CFA Designation, and the CFA Program is the subject of this question. The reference on Albert’s business card implies that there is a “CFA Level II” designation; Tye merely indicates in promotional material that he is participating in the CFA Program and has completed Levels I and II. Candidates may not imply that there is some sort of partial designation earned after passing a level of the CFA exam. Therefore, Albert has violated Standard VII(B). Candidates may communicate that they are participating in the CFA Program, however, and may state the levels that they have completed. Therefore, Tye has not violated Standard VII(B).
- 9 The correct answer is B. This question relates to Standard V(B)–Communication with Clients and Prospective Clients. Scott has issued a research report stating that he expects the price of Walkton Industries stock to rise by US\$8 a share “because the dividend will increase” by US\$1.50 per share. He has made this statement knowing that the dividend will increase only if Congress enacts certain legislation, an uncertain prospect. By stating that the dividend will increase, Scott failed to separate fact from opinion.  
The information regarding passage of legislation is not material nonpublic information because it is conjecture, and the question does not state whether the US representative gave Scott her opinion on the passage of the legislation in confidence. She could have been offering this opinion to anyone who asked. Therefore, statement A is incorrect. It may be acceptable to base a recommendation, in part, on an expectation of future events, even though they may be uncertain. Therefore, answer C is incorrect.



- 10 The correct answer is C. This question, which relates to Standard III(B)—Fair Dealing, tests the knowledge of the procedures that will assist members and candidates in treating clients fairly when making investment recommendations. The step listed in C will help ensure the fair treatment of clients. Answer A may have negative effects on the fair treatment of clients. The more people who know about a pending change, the greater the chance that someone will inform some clients before the information's release. The firm should establish policies that limit the number of people who are aware in advance that a recommendation is to be disseminated. Answer B, distributing recommendations to institutional clients before distributing them to individual accounts, discriminates among clients on the basis of size and class of assets and is a violation of Standard III(B).
- 11 The correct answer is B. This question deals with Standard II(A)—Material Nonpublic Information. The mosaic theory states that an analyst may use material public information and nonmaterial nonpublic information in creating a larger picture than shown by any individual piece of information and the conclusions the analyst reaches become material only after the pieces are assembled. Answers A and C are accurate statements relating to the Code and Standards but do not describe the mosaic theory.
- 12 The correct answer is C. This question involves Standard IV(B)—Additional Compensation Arrangements. The arrangement described in the question—whereby Jurgen would be compensated beyond the compensation provided by her firm, on the basis of an account's performance—is not a violation of the Standards as long as Jurgen discloses the arrangement in writing to her employer and obtains permission from her employer prior to entering into the arrangement. Answers A and B are incorrect; although the private compensation arrangement could conflict with the interests of other clients and lead to short-term performance pressures, members and candidates may enter into such agreements as long as they have disclosed the arrangements to their employer and obtained permission for the arrangement from their employer.
- 13 The correct answer is B. This question relates to Standard III(A)—Loyalty, Prudence, and Care—specifically, a member's or candidate's responsibility for voting proxies and the use of client brokerage. According to the facts stated in the question, Farnsworth did not violate Standard III(A). Although the company president asked Farnsworth to vote the shares of the Jones Corporation profit-sharing plan a certain way, Farnsworth investigated the issue and concluded, independently, the best way to vote. Therefore, even though his decision coincided with the wishes of the company president, Farnsworth is not in violation of his responsibility to be loyal and to provide care to his clients. In this case, the participants and the beneficiaries of the profit-sharing plan are the clients, not the company's management. Had Farnsworth not investigated the issue or had he yielded to the president's wishes and voted for a slate of directors that he had determined was not in the best interest of the company, Farnsworth would have violated his responsibilities to the beneficiaries of the plan. In addition, because the brokerage firm provides the lowest commissions and best execution for securities transactions, Farnsworth has met his obligations to the client in using this brokerage firm. It does not matter that the brokerage firm also provides research information that is not useful for the account generating the commission because Farnsworth is not paying extra money of the client's for that information.
- 14 The correct answer is A. In this question, Brown is providing investment recommendations before making inquiries about the client's financial situation, investment experience, or investment objectives. Brown is thus violating

Standard III(C)–Suitability. Answers B and C provide examples of information members and candidates should discuss with their clients at the outset of the relationship, but these answers do not constitute a complete list of those factors. Answer A is the best answer.

- 15 The correct answer is C. This question involves Standard I(C)–Misrepresentation. Statement I is a factual statement that discloses to clients and prospects accurate information about the terms of the investment instrument. Statement II, which guarantees a specific rate of return for a mutual fund, is an opinion stated as a fact and, therefore, violates Standard I(C). If statement II were rephrased to include a qualifying statement, such as “in my opinion, investors may earn . . .,” it would not be in violation of the Standards.
- 16 The correct answer is A. This question involves three of the Standards. Anderb, the portfolio manager, has been obtaining more favorable prices for her personal securities transactions than she gets for her clients, which is a breach of Standard III(A)–Loyalty, Prudence, and Care. In addition, she violated Standard I(D)–Misconduct by failing to adhere to company policy and by hiding her personal transactions from her firm. Anderb’s supervisor, Bates, violated Standard IV(C)–Responsibilities of Supervisors; although the company had requirements for reporting personal trading, Bates failed to adequately enforce those requirements. Answer B does not represent a violation because Standard VI(B)–Priority of Transactions requires that personal trading in a security be conducted after the trading in that security of clients and the employer. The Code and Standards do not prohibit owning such investments, although firms may establish policies that limit the investment opportunities of members and candidates. Answer C does not represent a violation because the Code and Standards do not contain a prohibition against employees using the same broker for their personal accounts that they use for their client accounts. This arrangement should be disclosed to the employer so that the employer may determine whether a conflict of interest exists.
- 17 The correct answer is A because this question relates to Standard I(A)–Knowledge of the Law—specifically, global application of the Code and Standards. Members and candidates who practice in multiple jurisdictions may be subject to various securities laws and regulations. If applicable law is more strict than the requirements of the Code and Standards, members and candidates must adhere to applicable law; otherwise, members and candidates must adhere to the Code and Standards. Therefore, answer A is correct. Answer B is incorrect because members and candidates must adhere to the higher standard set by the Code and Standards if local applicable law is less strict. Answer C is incorrect because when no applicable law exists, members and candidates are required to adhere to the Code and Standards, and the Code and Standards prohibit the use of material nonpublic information.
- 18 The correct answer is B. The best course of action under Standard I(B)–Independence and Objectivity is to avoid a conflict of interest whenever possible. Therefore, for Ward to pay for all his expenses is the correct answer. Answer C details a course of action in which the conflict would be disclosed, but the solution is not as appropriate as avoiding the conflict of interest. Answer A would not be the best course because it would not remove the appearance of a conflict of interest; even though the report would not be affected by the reimbursement of expenses, it could appear to be.
- 19 The correct answer is B. Under Standard IV(A)–Loyalty, members and candidates may undertake independent practice that may result in compensation or other benefit in competition with their employer as long as they obtain consent from their employer. Answer C is not consistent with the Standards because

the Standards allow members and candidates to make arrangements or preparations to go into competitive business as long as those arrangements do not interfere with their duty to their current employer. Answer A is not consistent with the Standards because the Standards do not include a complete prohibition against undertaking independent practice.

- 20 The correct answer is B. This question involves Standard VI(A)—Disclosure of Conflicts—specifically, the holdings of an analyst’s employer in company stock. Answers A and C do not describe conflicts of interest that Smith would have to disclose. Answer A describes the use of a firm’s products, which would not be a required disclosure. In answer C, the relationship between the analyst and the company through a relative is so tangential that it does not create a conflict of interest necessitating disclosure.
- 21 The correct answer is C. This question relates to Standard I(C)—Misrepresentation. Although Michelieu’s statement about the total return of his clients’ accounts on average may be technically true, it is misleading because the majority of the gain resulted from one client’s large position taken against Michelieu’s advice. Therefore, this statement misrepresents the investment performance the member is responsible for. He has not taken steps to present a fair, accurate, and complete presentation of performance. Answer B is thus incorrect. Answer A is incorrect because although Michelieu is not guaranteeing future results, his words are still a misrepresentation of his performance history.
- 22 The correct answer is B. The best policy to prevent violation of Standard II(A)—Material Nonpublic Information is the establishment of firewalls in a firm to prevent exchange of insider information. The physical and informational barrier of a firewall between the investment banking department and the brokerage operation prevents the investment banking department from providing information to analysts on the brokerage side who may be writing recommendations on a company stock. Prohibiting recommendations of the stock of companies that are clients of the investment banking department is an alternative, but answer A states that this prohibition would be permanent, which is not the best answer. Once an offering is complete and the material nonpublic information obtained by the investment banking department becomes public, resuming publishing recommendations on the stock is not a violation of the Code and Standards because the information of the investment banking department no longer gives the brokerage operation an advantage in writing the report. Answer C is incorrect because no exchange of information should be occurring between the investment banking department and the brokerage operation, so monitoring of such exchanges is not an effective compliance procedure for preventing the use of material nonpublic information.
- 23 The correct answer is B. Under Standard III(A)—Loyalty, Prudence, and Care, members and candidates who manage a company’s pension fund owe these duties to the participants and beneficiaries of the pension plan, not the management of the company or the company’s shareholders.
- 24 The correct answer is B. Answer B gives one of the two primary reasons listed in the *Handbook* for disclosing referral fees to clients under Standard VI(C)—Referral Fees. (The other is to allow clients and employers to evaluate the full cost of the services.) Answer A is incorrect because Standard VI(C) does not require members or candidates to discount their fees when they receive referral fees. Answer C is inconsistent with Standard VI(C) because disclosure of referral fees, to be effective, should be made to prospective clients before entering into a formal client relationship with them.

- 25** The correct answer is B. Standard VI(B)—Priority of Transactions does not limit transactions of company employees that differ from current recommendations as long as the sale does not disadvantage current clients. Thus, answer A is incorrect. Answer C is incorrect because the Standard does not require the matching of personal and client trades.
- 26** Answer C is correct. Standard IV(A)—Loyalty discusses activities permissible to members and candidates when they are leaving their current employer; soliciting clients is strictly prohibited. Thus, answer A is inconsistent with the Code and Standards even with the required disclosure. Answer B is incorrect because the offer does not directly violate the Code and Standards. There may be out-of-work members and candidates who can arrange the necessary commitments without violating the Code and Standards.
- 27** Answer A is correct. The question relates to Standard III(A)—Loyalty, Prudence, and Care. Carter believes the broker offers effective execution at a fee that is comparable with those of other brokers, so he is free to use the broker for all accounts. Answer B is incorrect because the accounts that prohibit soft dollar arrangements do not want to fund the purchase of research by Carter. The new trading scheme does not incur additional commissions from clients, so it would not go against the prohibitions. Answer C is incorrect because Carter should not incur unnecessary or excessive “churning” of the portfolios (excessive trading) for the purpose of meeting the brokerage commitments of soft dollar arrangements.
- 28** Answer B is correct according to Standard VII(B)—Reference to CFA Institute, the CFA Designation, and the CFA Program. CFA Program candidates do not receive their actual scores on the exam. Topic and subtopic results are grouped into three broad categories, and the exam is graded only as “pass” or “fail.” Although a candidate may have achieved a topical score of “above 70%,” she or he cannot factually state that she or he received the highest possible score because that information is not reported. Thus, answer C is incorrect. Answer A is incorrect as long as the member or candidate actually completed the exams consecutively. Standard VII(B) does not prohibit the communication of factual information about completing the CFA Program in three consecutive years.
- 29** Answer C is correct. According to Standard III(A)—Loyalty, Prudence, and Care, the CFA Program would be considered a personal or firm expense and should not be paid for with the fund’s brokerage commissions. Soft dollar accounts should be used only to purchase research services that directly assist the investment manager in the investment decision-making process, not to assist the management of the firm or to further education. Thus, answer A is incorrect. Answer B is incorrect because the reasonableness of how the money is used is not an issue; the issue is that educational expense is not research.
- 30** Answer A is correct. Standard I(B)—Independence and Objectivity emphasizes the need for members and candidates to maintain their independence and objectivity. Best practices dictate that firms adopt a strict policy not to accept compensation for travel arrangements. At times, however, accepting paid travel would not compromise one’s independence and objectivity. Answers B and C are incorrect because the added benefits—free conference admission for additional staff members and an exclusive golf retreat for the speaker—could be viewed as inducements related to the firm’s working arrangements and not solely related to the speaking engagement. Should Long wish to bring other team members or participate in the golf outing, he or his firm should be responsible for the associated fees.

- 31** Answer C is correct. The guidance to Standard II(A)–Material Nonpublic Information recommends adding securities to the firm’s restricted list when the firm has or may have material nonpublic information. By adding these securities to this list, Andrews would uphold this standard. Because waiting until the next day will not ensure that news of the merger is made public, answer A is incorrect. Negotiations may take much longer between the two companies, and the merger may never happen. Andrews must wait until the information is disseminated to the market before he trades on that information. Answer B is incorrect because Andrews should not disclose the information to other managers; no trading is allowed on material nonpublic information.
- 32** Answer B is correct. Through placing a personal purchase order that is significantly greater than the average volume, Pietro is violating Standard IIB–Market Manipulation. He is attempting to manipulate an increase in the share price and thus bring a buyer to the negotiating table. The news of a possible merger and confirmation of the firm’s earnings guidance may also have positive effects on the price of Local Bank, but Pietro’s actions in instructing the release of the information does not represent a violation through market manipulation. Announcements of this nature are common and practical to keep investors informed. Thus, answers A and C are incorrect.
- 33** Answer C is correct. Cupp violated Standard III(D)–Performance Presentations when he deviated from the firm’s stated policies solely to capture the gain from the holding being acquired. Answer A is incorrect because the firm does not claim GIPS compliance and the GIPS standards require external cash flows to be treated in a consistent manner with the firm’s documented policies. Answer B is incorrect because the firm does not state that it is updating its composite policies. If such a change were to occur, all cash flows for the month would have to be reviewed to ensure their consistent treatment under the new policy.
- 34** Answer A is correct. According to Standard V(C)–Record Retention, Cannan needed the permission of her employer to maintain the files at home after her employment ended. Without that permission, she should have deleted the files. All files created as part of a member’s or candidate’s professional activity are the property of the firm, even those created outside normal work hours. Thus, answer B is incorrect. Answer C is incorrect because the Code and Standards do not prohibit using one’s personal computer to complete work for one’s employer.
- 35** Answer B is correct. According to Standard VII(B)–Reference to CFA Institute, the CFA Designation, and the CFA Program, Quinn cannot claim to have finished the CFA Program or be eligible for the CFA charter until he officially learns that he has passed the Level III exam. Until the results for the most recent exam are released, those who sat for the exam should continue to refer to themselves as “candidates.” Thus, answer C is incorrect. Answer A is incorrect because members and candidates may discuss areas of practice in which they believe the CFA Program improved their personal skills.
- 36** Answer A is correct. Hart’s decision to invest in the retail fund appears directly correlated with Rodriguez’s statement about the successful quarter of Mega Retail and thus violates Standard II(A)–Material Nonpublic Information. Rodriguez’s information would be considered material because it would influence the share price of Mega Retail and probably influence the price of the entire exchange-traded retail fund. Thus, answer B is incorrect. Answer C is also incorrect because Rodriguez shared information that was both material and nonpublic. Company officers regularly have such knowledge about their firms, which is not a violation. The sharing of such information, however, even in a conversation between friends, does violate Standard II(A).



- 37** Answer C is correct. Standard VII(A)—Conduct as Members and Candidates in the CFA Program prohibits providing information to candidates or the public that is considered confidential to the CFA Program. In revealing that questions related to the analysis of inventories and analysis of taxes were on the exam, Park has violated this standard. Answer B is incorrect because the guidance for the standard explicitly acknowledges that members and candidates are allowed to offer their opinions about the CFA Program. Answer A is incorrect because candidates are not prohibited from using outside resources.
- 38** Answer B is correct. Paper has violated Standard III(D)—Performance Presentation by not disclosing that he was part of a team of managers that achieved the results shown. If he had also included the return of the portion he directly managed, he would not have violated the standard. Thus, answer A is incorrect. Answer C is incorrect because Paper received written permission from his prior employer to include the results.
- 39** Answer A is correct. Townsend has not provided any information about her clients to the leaders or managers of the golf program; thus, she has not violated Standard III(E)—Preservation of Confidentiality. Providing contact information about her clients for a direct-mail solicitation would have been a violation. Answer B is incorrect because the notice in the newsletter does not violate Standard III(E). Answer C is incorrect because the golf program's fund-raising campaign had already begun, so discussing the opportunity to donate was appropriate.
- 40** C is correct. Boswin, as an employee, developed the model on behalf of Greenfield. Therefore, Greenfield, not Boswin, is the owner of the model. Acertado violates Standard IV(A) Duties to Employers: Loyalty when he downloads the model without proper written permission from Greenfield Financial. Acertado is misappropriating employer assets.
- 41** C is correct. Acertado is least likely to violate Standard II(A) regarding Material Nonpublic Information when using the model at Smith and Garner. Acertado likely violated Standard IV(A), Loyalty, when he used the model. The Standard prohibits members who leave an employer from taking records or files—such as the model—without the written permission of the employer. Acertado also likely violated Standard I(C)—Misrepresentation when he failed to correct his supervisor's impression that the investment idea and the model were Acertado's creation.
- 42** C is correct. Acertado violates Standard II(A)—Material Nonpublic Information. He has a reasonable belief that the conversation that he overhears is from a reliable source and would have a material impact on security prices. According to the CFA Standards, he must not act, nor cause others to act on the information. Acertado does not violate the Standard relating to Diligence and Reasonable Basis because he bases the recommendation on a reliable model and checks his inputs prior to making the recommendation.
- 43** A is correct. Acertado least likely violates Standard III(C), which relates to suitability during his phone conversation with Boswin. According to the Standard, members in an advisory relationship with a client must determine an investment's suitability within the context of the client's portfolio. The Standard also requires that members make reasonable inquiries into a client or prospective client's investment experience; risk and return objectives; and financial constraints prior to making investment recommendations. Boswin is neither a client nor a prospective client, thus Acertado is not bound by the Standard of Suitability during their conversation. Acertado is, however, in jeopardy of violating other Standards—specifically those relating to Integrity of Capital Markets



and Preservation of Confidentiality by revealing material nonpublic information about a Smith & Garner client. According to Standard II(A), Acertado, who is in possession of material nonpublic information, must not act, nor cause others to act on the information. According to Standard III(E), members must keep information about current, former, and prospective clients confidential.

- 44 A is correct. Boswin uses her usual process in researching Country Industries. She is not in possession of material nonpublic information and she maintains her objectivity. Her use of the model provides a reasonable basis for the decision not to pursue additional research or make an investment recommendation regarding Country Industries.
- 45 A is correct. Blogs and company websites are in the public domain and thus do not constitute inside information. Acertado's use of blog sites to supplement his current research process is acceptable.
- 46 A is correct. Grohl exercised diligence, independence, and thoroughness in analyzing the company and its competitors. Brecksen provided his research reports for Grohl's use and using the reports as a guide was appropriate. Standard V(A) requires that members distinguish between fact and opinion in communicating investment recommendations to clients. The Standard does not apply to investment recommendations communicated to supervisors or internal investment committees.
- 47 A is correct. Brecksen does not consider the multi-factor analysis a critical component of the analysis or the resulting investment recommendation and thus, under Standards V(A) and (C), is not required to maintain a record of the analysis within the completed report.
- Apfelbaum uses traditional "top-down" fundamental analysis in the investment process. The report followed the traditional format of previous reports on the same company. It contained a complete fundamental analysis and recommendation—indicating diligence and reasonable basis. The report also contained a multi-factor analysis—which is a quantitative analysis tool. If quantitative analysis were the basis of the investment recommendation, it would constitute a change in the general investment principles used by the firm. According to Standard V(B)—Communications with Clients and Prospective Clients, Brecksen and Grohl would be required to promptly disclose those changes to clients and prospective clients.
- 48 A is correct. Removing the multi-factor analysis from the research report does not constitute a violation. Grohl diligently prepared the internal document according to the firm's traditional format with a complete fundamental analysis and recommendation—indicating diligence and a reasonable basis for his recommendation. It would be wise for Grohl to retain records of the multi-factor analysis but he need not retain the analysis in the research report to comply with Standards V(A)—Diligence and Reasonable Basis or V(C)—Record Retention.
- 49 A is correct. According to Standard V(A)—Diligence and Reasonable Basis, research report conclusions or recommendations may represent the consensus of a group and not necessarily the views of the individual members listed. If the member believes that the consensus opinion has a reasonable basis, then he need not dissociate from the report.
- 50 B is correct. Zardt violated the Standard relating to Performance Presentation because he did not verify the accuracy of the return information before its distribution. According to Standard III(D), analysts may promote the success or accuracy of their recommendations, but they must make reasonable efforts

to ensure that the information is fair, accurate, and complete. In addition to providing attribution, Zardt should take steps to ensure the accuracy of the data prior to distributing the material.

- 51 B is correct. Telline has a duty to preserve the confidentiality of current, former, and prospective clients. Telline violates Standard III(E)–Preservation of Confidentiality when he reveals information about the Leighton Family Trust.
- 52 A is correct. Brown conducts an independent and careful analysis of the plans’ benefits for shareholders as well as the takeover offer. In doing so she puts the client’s interests ahead of the firm’s. Brown’s actions are consistent with Standard III(A)–Loyalty, Prudence, and Care; Standard V(A)–Diligence and Reasonable Basis; and Standard III(B)–Fair Dealing.
- 53 B is correct. Telline is not likely to receive appropriate guidance on developing or revising investment policy statements from the Standard relating to Fair Dealing. Standard III(B) provides members with guidance on treating clients fairly when making investment recommendations, providing investment analysis, or taking investment action. Telline could obtain guidance from the Standards relating to Loyalty, Prudence, and Care and Suitability. Both Standard III(A) and (C) provide guidance for members in determining client objectives and the suitability of investments.
- 54 A is correct. Telline is careful to consider the investment’s suitability for Caper’s account. Telline’s actions are consistent with CFA Institute Standards III(A)–Loyalty, Prudence, and Care and III(B)–Fair Dealing. Telline determines that the other client does not have the cash available in his account and selling existing holdings does not make sense.
- 55 B is correct. The firm violates Standard III(B)–Fair Dealing. Under Aiklin’s policy, some clients for whom an IPO is suitable may not receive their pro-rata share of the issue. CFA Standards recommend that firms allocate IPOs on a pro-rata basis to clients, not to portfolio managers.
- 56 C is correct. Telline violates Standard III(B)–Fair Dealing by over-allocating shares to Caper. Telline carefully reviews both the proposed IPO and his client accounts to determine suitability. He fails to allocate the IPO shares on a pro-rata basis to all clients for whom the investment is suitable.
- 57 B is correct. Excerpt 2 is inconsistent with CFA Standards because it addresses only officers and only their direct reports, that is, employees whom they directly supervise. Standard IV (C) states that “any investment professionals who have employees subject to their control or influence” exercise supervisory responsibility. Excerpt 3 is consistent with CFA Standards. It is based on a quote from the *Standards of Practice Handbook* stating that “if a member or candidate determines that information is material, the member . . . should make reasonable efforts to achieve public dissemination.” Members are not required to achieve public dissemination and those bound by a duty of loyalty or a duty to preserve confidentiality would refrain from doing so because it would breach their duty.
- 58 A is correct. According to Standard I(B)–Independence and Objectivity, members must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Although it was sent to Voser’s office, the gift basket is a private gift from Voser’s sister and not likely to affect Voser’s professional activities. According to Excerpt 4 of the Crawford compliance manual and Standard IV(B)–Additional Compensation Arrangements, employees must obtain permission from their employer before

accepting gifts, compensation, or other benefits that compete with, or might create a conflict of interest with, the employer's interests. The gift basket does not create a conflict or compete with the employer's interests.

- 59** A is correct. Voser most likely violated the Standard relating to loyalty to employer, Standard IV(A). While Voser used public information to develop the recommendation to purchase Greenhornfood shares, the company compliance guide states that she should not trade or cause others to trade in securities of companies that may be potential takeover targets. Voser's recommendation caused her sister to trade in Greenhornfood, violating the company's compliance policies, and possibly harming her employer in its attempt to acquire Greenhornfood.

By advising others to invest in a food retailer that she considered an attractive acquisition target, Voser deprived her employer of the advantage of her skills and abilities and may have caused harm to her employer. Voser could have recommended Greenhornfood to Craw rather than her sister as an acquisition target. Although the sister's trade in Greenhornfood was small, a large trade might have moved the stock price and caused harm to Crawfood in terms of additional cost.

- 60** C is correct. Voser least likely violated the Standard relating to diligence and reasonable basis. Voser initially applied the mosaic theory and had a reasonable basis for the trade as required by Standard V(A). Eventually, she came into possession of material nonpublic information (corporate logo on a document, overheard conversation). According to Standard II(A), once in possession of material nonpublic information, she is prohibited from acting or causing others to act. Voser also violated her duty of loyalty to her employer, Standard IV(A), by encouraging others to trade in Greenhornfood and possibly harming Crawfood's attempts to acquire the smaller company at an attractive price.
- 61** C is correct. Craw did not adequately fulfill his responsibilities as a supervisor. As stated in the *Standards of Practice Handbook*, members and candidates with supervisory responsibility also must understand what constitutes an adequate compliance system for their firms and make reasonable efforts to see that appropriate compliance procedures are established, documented, communicated to covered personnel, and followed. "Adequate" procedures are those designed to meet industry standards, regulatory requirements, the requirements of the Code and Standards, and the circumstances of the firm. Once compliance procedures are established, the supervisor must also make reasonable efforts to ensure that the procedures are monitored and enforced. According to Standard IV(C)—Responsibilities of Supervisors, adequate compliance procedures require that once a violation is discovered, Craw conduct a thorough investigation to determine the scope of wrongdoing.
- 62** A is correct. As stated on page ix of the *Standards of Practice Handbook*, "Members and candidates must self disclose on the annual Professional Conduct Statement all matters that question their professional conduct, such as involvement in civil litigation, a criminal investigation, or being the subject of a written complaint." Standard VII(A)—Conduct as Members and Candidates in the CFA Program prohibits conduct that compromises the reputation of the CFA designation including misrepresenting information on the Professional Conduct Statement. Members are encouraged but not required to report violations of others. At a minimum, Craw should remind Voser of her duty to report the investigation.

