Guidance for Standards I-VII

Test ID: 7658657

Question #1 of 76

Question ID: 412634

Susan Nielsen, CFA, works for a rating agency which competes directly with S&P and Moody's. Her friend, Lance Parker, works for the same company but in a different department which is involved in advisory services for structured products. Nielsen frequently receives pressure from Parker to "put a positive face" on client ratings to help him sell advisory services. She is reluctant to discuss client ratings with Parker and tries to avoid the topic. She consults her company's compliance department and learns that there are no policies or procedures to discourage Nielsen and Parker from sharing information and is encouraged to consider his advice on company ratings. Nielsen should *most likely*:

✗ A) **continue to consult with Parker on company ratings as the compliance department's position is that there is no conflict.**

✓ B) advise her firm to develop firewalls and protections to allow the different departments to function independently and avoid talking with Parker about client ratings.

✗ C) advise regulators of the potential conflict of interest and seek legal counsel.

Explanation

Nielsen should advise her firm to develop firewalls and protections to allow the different departments to function independently. If Nielsen and Parker are going to remain friends, they should stop talking about client ratings.

Question #2 of 76

Question ID: 412691

Brian Williams is a portfolio manager with Santo Capital and works on the Banks Company's account. Santo has a policy against accepting gifts over $500 from clients. The Banks' portfolio has a fantastic year, and in appreciation, a Banks manager sends Williams a rare bottle of wine that he estimates is worth $300. Williams must:

✓ A) **inform his supervisor in writing that he received additional compensation in the form of the wine.**

✗ B) return the bottle to the client.

✗ C) report the pension fund manager to the CFA Institute Professional Conduct Program.

Explanation

The Standards require that he inform his supervisor in writing about the gift.

Question #3 of 76

Question ID: 412665

Paul Drake is employed by a company to provide investment advice to participants in the firm's 401(k) plan. Company stock is one of the investment options in the plan. Drake feels that the stock is too risky for employees to own in their 401(k) plan and starts advising them to pull out of the stock. The Treasurer of the company calls Drake and tells him that he will be fired if he continues making such advice because he is violating his fiduciary duty to the company. Drake should:

✗ **A)** **tell employees that he cannot provide advice on company stock because of a conflict of interest.**

✗ **B)** make sell recommendations but point out that the company Treasurer has a differing and valid point of view.

✓ **C)** continue to advise employees to sell their stock.

Explanation

Although Drake is paid by the company, his fiduciary duty is to the plan participants. His advice cannot be compromised by business considerations, otherwise he will be violating the Standard on loyalty, prudence, and care.

Question #4 of 76

Question ID: 459983

Cynthia Abbott, a CFA charterholder, is preparing a research report on Boswell Company for her employer, Capital Asset Management. Bob Carter, president of Boswell, invites Abbott and several other analysts to visit his company and offers to pay her transportation and lodging. Abbott pays for her own transportation and lodging, but while visiting the company, accepts an item of small value from Carter. Abbott does not disclose this gift to her supervisor at Capital when she returns. In the course of the company visit, Abbott overhears a conversation between Carter and his chief financial officer that the company's earnings per share (EPS) are expected to be $1.10 for the next quarter. Abbott was surprised that this EPS is substantially above her initial earnings estimate of $0.70 per share. Without further investigation, Abbott decides to include the $1.10 EPS in her research report on Boswell. Using the high EPS positively affects her recommendation of Boswell.

Which of the following statements about whether Abbott violated Standard V(A), Diligence and Reasonable Basis and Standard I(B), Independence and Objectivity is CORRECT? Abbott:

✗ **A)** **did not violate Standard V(A) but she violated Standard I(B).**

✓ **B)** violated Standard V(A) but she did not violate Standard I(B).

✗ **C)** violated both Standard V(A) and Standard I(B).

Explanation

Abbott violated Standard V(A), Diligence and Reasonable Basis, because she did not have a reasonable and adequate basis to support the $1.10 EPS without further investigation. By including the $1.10 EPS in her report, she did not exercise diligence and thoroughness to ensure that any research report finding is accurate. If Abbott suspects that any information in a source is not accurate, she should refrain from relying on that information. Abbott did not violate Standard I(B), Independence and Objectivity, because the gift from Carter would not reasonably be expected to compromise her independent judgment.

Question #5 of 76

Question ID: 412690

Jack Harris, a CFA candidate, is a telecommunications analyst at Hasten Securities. Based upon his analysis of Midwest Telecom, he changes his recommendation of the company's common stock from "hold" to "sell." Before disseminating his recommendation and the reason for the change to Hasten's clients, Harris informs several portfolio managers at Hasten, whom he knows personally own Midwest stock, of the changed recommendation. Several days later, Hasten communicates the change in investment recommendation on Midwest to clients known to have bought Midwest and those who currently hold the stock.

Jane White, CFA, is a broker at Hasten Securities. One of her clients places a buy order contrary to the current recommendation on Midwest. After advising her client of the recommendation, she executes the transaction.

According to Standard III(B), Fair Dealing, which of the following statements about Harris and White's actions is CORRECT?

- ✗ **A) Neither Harris nor White violated Standard III(B).**
- ✓ **B)** Harris violated Standard III(B), but White did not violate Standard III(B).
- ✗ **C)** Both Harris and White violated Standard III(B).

Explanation

Harris violated Standard III(B), Fair Dealing by not treating all customers fairly. Instead, he disclosed the information selectively to some of his firm's portfolio managers. White did not violate Standard III(B) because she communicated to the person placing a buy order on Midwest that the order was contrary to the current recommendation before executing the order.

Question #6 of 76

Question ID: 412641

Marc Feldman, CFA, is manager of corporate investor relations for a high-tech startup, zippy.com, in Boise, Idaho. Feldman learns that Larry Smith, controller, is altering the accounting records. Feldman advises some of his personal friends to sell short zippy.com. This action:

- ✗ **A) constitutes professional misconduct but not the use of nonpublic information and is a violation of the Code and Standards.**
- ✓ **B)** constitutes the use of material nonpublic information and is a violation of the Code and Standards.
- ✗ **C)** constitutes a violation of the Standard concerning prohibition against misrepresentation.

Explanation

The information is apparently nonpublic, and is clearly material since the valuation of securities in the market place is predicated upon financial data and other relevant information. Trading or inducing others to trade is a clear violation of Standard II(A).

Question #7 of 76

Question ID: 412639

While copying some of her research materials at work, Mary Jones comes across a few incomplete research notes written by one of her colleagues. As a result of reading the notes, and without further review, Jones immediately changes one of her stock recommendations from sell to buy. Which of the following CFA Institute Standards has Jones violated?

- ✗ **A) Standard I(B), Independence and Objectivity.**
- ✗ **B)** Standard III(A), Loyalty, Prudence, and Care.
- ✓ **C)** Standard V(A), Diligence and Reasonable Basis.

Explanation

Jones has violated Standard V(A) by failing to exercise diligence and thoroughness.

Question #8 of 76

Question ID: 412683

Which of the following statements about a member's use of client brokerage commissions is NOT correct? Client brokerage commissions:

✓ **A) may be directed to pay for the investment manager's operating expenses.**

✗ **B)** should be commensurate with the value of the brokerage and research services received.

✗ **C)** should be used by the member to ensure that fairness to the client is maintained.

Explanation

Brokerage commissions are the property of the client and may only be used for client benefit.

Question #9 of 76

Question ID: 412638

Using as his universe all companies in the steel industry, Reynold Anderson analyses the performance of stock prices for the industry. He succeeds in developing a regression model with excellent statistical control measures. The extrapolation from the model shows low risk variance of the securities in this industry. Without the inclusion of non-steel stocks in the portfolio, Anderson concludes that, based on these results, every portfolio can use the steel industry securities to diversify and lower its risk. He persuades his clients to change their current portfolios. Anderson states that, as the model's results show, some particular industries, such as car manufacturers, have underpriced stocks, and investors should take advantage of it. Anderson has violated the Standards because he:

✓ **A) does not distinguish the opinion, based on his model, from the fact.**

✗ **B)** does not consider the suitability of the investment.

✗ **C)** is not clear enough about the model results.

Explanation

While any of the answers can be shown to violate CFA Institute Standards, this cannot be determined conclusively from the information given. However, the scenario clearly indicates that Anderson does not distinguish between opinion and fact in communicating to his clients. Therefore, he violates the Standards on this basis.

Question #10 of 76

Question ID: 412659

Scott Marsh is a research analyst for a brokerage firm following the computer industry. Joe Perry is Marsh's former college roommate and is the head of technology for Mercury, a large software company. Perry informs Marsh on Tuesday that in two days the company will be making an official announcement that its release of its newest version of its software will be moved up one month, from October 1 to September 1. The announcement will be surprising to the industry and will likely be met with skepticism because the company has had trouble meeting release dates in the past. Perry assures Marsh that he is certain that they will meet the September 1 date. Marsh considers Perry to be very honest and highly competent. Marsh should:

✓ **A) wait until the public announcement is made, then release a report explaining that he believes the company will make the release date, disclosing that one of the reasons for his opinion is Perry is a friend of his.**

✗ **B)** produce his research report in two days based solely on the official announcement, not taking into consideration the information from Perry.

✗ **C)** immediately put out a report recommending the stock, but waiting until the official announcement to state his reasons.

Explanation

The research report cannot be released until the official announcement is made, otherwise he will be violating the Standard on prohibition against the use of material nonpublic information. Once it is made public, Marsh can disclose the nature of the conversation without violating that Standard because the information will now be public. However, he should disclose the relationship with Perry or he will be violating the Standard on communications with clients and prospective clients.

Question #11 of 76

Question ID: 412658

While having a conversation with a prospective client, John Henry states that his performance across all of his past clients over the past five years was over 20%, which was 200 basis points higher than his benchmark. He tells the client that while the benchmark may rise or fall over time, his excess performance will remain consistent. Henry violated the Standards of Professional Conduct because:

✓ **A)** **the statement of excess performance is misleading with respect to its certainty.**

✗ **B)** he cannot discuss performance without clearly stating that the composite does not conform to GIPS.

✗ **C)** he cannot discuss prospective future performance in any manner.

Explanation

Guaranteeing performance on investments that are inherently volatile is misleading to clients.

Question #12 of 76

Question ID: 412700

Kim Lee is a research analyst at Superior Investments and is researching a biotech firm specializing in the analysis of "mad cow" disease. While touring company facilities and meeting with management, she learns that they believe they may have found a way to reverse the disease. Moreover, one manager conjectured, "Suppose that we reversed the disease in someone who didn't even have it? We might then be able to boost that individual's IQ into the stratosphere!" After returning to her office, Lee issues a research report describing the compound as an "IQ booster with huge potential." This statement:

✗ **A)** **is reasonable given the information she was provided by the company.**

✓ **B)** lacks a reasonable and adequate basis in fact.

✗ **C)** is allowable but only if quoted verbatim from her conversations with management.

Explanation

Standard V(A) requires that a member have a "reasonable and adequate basis" before making an investment recommendation. Extrapolating on the basis of the conjecture of one member of the management team, without independent corroboration, is clearly in violation of this Standard. She is also in violation of Standard V(B) concerning the use of reasonable judgment regarding what is included or excluded in a communication with a client or prospective client.

Question #13 of 76

Question ID: 412643

Juan Lopez manages accounts for Street Capital. Lopez's mother is a client of the firm. Lopez does not make trades in his mother's accounts until all other clients of the firm have been given an opportunity to trade. Lopez has:

✗ **A)** **violated CFA Institute Standards of Professional Conduct because he is not allowed to trade in family accounts.**

✗ **B)** not violated CFA Institute Standards of Professional Conduct because transactions for clients should have priority over personal transactions and transactions for beneficial owners.

✓ **C)** violated CFA Institute Standards of Professional Conduct because family accounts that are client accounts should be treated like any other firm accounts.

Explanation

Standard VI(B) Priority of Transactions. Family accounts that are client accounts should be treated like any other firm accounts. Lopez should refrain from exercising excess caution since his mother is a client of the firm like all other clients.

Question #14 of 76

Question ID: 412644

Greg Allen is a security analyst and visits David Dawson, the Chief Financial Officer of Edmonds Company. Dawson reveals a great deal of nonmaterial financial data to Allen, data that Dawson routinely reveals to all security analysts who visit him. From this data and other industry information, Allen conjectures that Edmonds is likely to make a tender offer for another company in the industry, a fact that if true would be considered material to the value of the company. Allen:

✗ **A)** **should send a copy of the report to Dawson for verification before disseminating the report to clients.**

✗ **B)** must not disseminate the information or use it for trading purposes until the tender offer is announced.

✓ **C)** can publish his conclusion in a research report.

Explanation

While the information that Allen received from the Edmonds CEO may be non-public, we are also told that it is non-material. Because Allen has reached his investment conclusion through an analysis of public information together with items of non-material non-public information (ie. "mosaic theory"), publishing this conclusion is not a violation of the Code and Standards.

Question #15 of 76

Question ID: 412686

Janine Walker is an individual investment advisor with 200 individual clients. When she first obtains a client, Walker solicits personal data that helps her formulate an investment recommendation, including tax status, income, expenditure needs, and risk tolerance. The Standards:

✗ **A)** **only require to update a client's data when a material change is being made to the clients' portfolio.**

✓ **B)** require Walker to update the data regularly.

✗ **C)** require updating a client's data only when a material change occurs to the personal data.

Explanation

According to Standard III(C), Suitability, Members and Candidates must reassess client information and update regularly.

Question #16 of 76

Question ID: 412648

Rachel Young, CFA, is making preparations to start a competitive business before terminating her relationship with her employer, a large money management company. Young asks Dot Wiggins, CFA, to consider joining her. In subsequent discussions with Young, Wiggins learns that Young has not disclosed to her employer ownership of stocks that Young recommended. She also learns that Young has used excerpts from research reports by others with only a slight change in wording without acknowledging the source. Wiggins declines Young's offer to join the new business but does not dissociate herself from the violations. According to CFA Institute Standards of Professional Conduct, which of the following statements is NOT correct?

✓ **A)** **Young violated Standard IV(A) Loyalty to Employer, because she was making preparations to start a competitive business before terminating her relationship with her employer.**

✗ **B)** Wiggins violated Standard I(A) Knowledge of the Law, because she did not dissociate herself from the violations.

✗ **C)** Young violated Standard I(C) Misrepresentation, because she did not acknowledge the source of excepts that she used in research reports.

Explanation

Young did not violate Standard IV(A) Loyalty to Employer because such preparations are permitted provided that they do not breach Young's duty of loyalty to her employer. Breaches that would violate Standard IV(A) include soliciting clients or taking records or files while still working for the current employer.

Question #17 of 76

Question ID: 412671

Todd Gregory has been recently hired as the head of compliance for Speed Capital. He decides the firm should precisely follow the recommendations of the CFA Institute Standards of Professional Conduct to ensure integrity within the firm. Which of the following is NOT a compliance procedure that Speed should put in place?

✗ **A)** **A requirement that employees provide duplicate confirmations of personal investing transactions.**

✗ **B)** A requirement that investment personnel should clear all personal investments to identify possible conflicts.

✓ **C)** A requirement of disclosure of all investment holdings of friends and family members of employees on an annual basis.

Explanation

Members and Candidates are not required to disclose investment holdings of friends unless those holdings create a conflict of interest.

Question #18 of 76

Question ID: 412676

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

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

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

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

Explanation

Non-fee-paying clients can be included in the same composite as fee-paying clients as long as it is disclosed. Nondiscretionary clients should not be included in the composite as the clients would not adhere to the investment strategy used by the investment advisor.

Question #19 of 76

Question ID: 412694

Chuck Thomas is the trustee of a trust of which Jill Wyatt is the main beneficiary. Wyatt's husband is the president of a company. In emptying the recycling bin at home, Wyatt finds some papers that lead her to believe that her husband's company will make a tender offer to acquire another firm. Wyatt takes the information to Thomas, who uses it to purchase shares of the company for the trust, but does not further disclose the information. Thomas has:

✗ **A)** **violated the Standards concerning loyalty, prudence, and care.**

✗ **B)** not violated any Standards.

✓ **C)** violated the Standards concerning material nonpublic information.

Explanation

Thomas cannot act or cause others to act on material nonpublic information.

Question #20 of 76

Question ID: 412706

Sharon Pope has been asked by the Chief Investment Officer to develop a firm-wide policy for proxy voting. Which of the following would NOT be acceptable to include in the policy statement?

✗ **A)** **The value of proxy voting must be maximized.**

✓ **B)** Portfolio managers of active funds must vote in all proxies; portfolio managers of index funds should vote only when they have a definitive opinion.

✗ **C)** Voting proxies may not be necessary in all instances.

Explanation

Proxies for stocks in passively managed funds must also be voted. A cost-benefit analysis may show that voting all proxies may not benefit all clients.

Question #21 of 76

Question ID: 412708

The use of client brokerage by an investment manager to obtain certain products and services to aid the manager in the investment decision-making process is called:

✓ **A) soft dollar practices.**

✗ **B)** trading practices.

✗ **C)** quid pro quo practices.

Explanation

Directing client brokerage for research and/or services is called soft dollar practices.

Question #22 of 76

Question ID: 412672

Williams and Fudd is a major London-based brokerage and investment banking firm. Heritage Group, a money management firm, is the first, second, or third largest holder of each of the securities listed on Williams & Fudd's "PrimeShare #10" equity security list.

On Tuesday morning, August 22, Williams & Fudd released a research report recommending the purchase of Skelmerdale Industries to the public and to its clients. On Wednesday afternoon, August 23, Heritage Group bought 1.5 million shares of Skelmerdale. This action is:

✓ **A) in accordance with the CFA Institute Code and Standards.**

✗ **B)** a violation of the Standard concerning fair dealing.

✗ **C)** a violation of the Standard concerning disclosure of conflicts.

Explanation

These actions are in accordance with both Standards III(B), Fair Dealing, and VI(B), Priority of Transactions. There is no violation.

Question #23 of 76

Question ID: 412674

Noah Johnson, CFA, is a broker with a money management company, Factor, Inc. In a conversation with Tom Williams, Johnson describes the activities of Factor and discusses the characteristics of portfolio construction. Which of the following statements would NOT, on its face, be considered a misrepresentation?

✓ **A) The portfolio securities were carefully selected by Factor to minimize Williams' risk.**

✗ **B)** If Williams is not satisfied with the current target return, Johnson can always improve it by increasing his T-bills share.

✗ **C)** Factor guarantees the portfolio will achieve its goal return.

Explanation

Standard I(C), Misrepresentation, prohibits CFA charterholders from misrepresenting characteristics of the portfolio or the services that the company can provide. The only statement that can be accepted as plausible is that the securities were selected to minimize the risk.

Question #24 of 76

Question ID: 441012

Rickard Advisors recently had a trading error in a customer account that was subsequently discovered by Rickard. The firm felt embarrassed by the disclosure of this error, and, in order to induce the client to continue its relationship, Rickard offers the client preferential access to a new issue that is expected to be "hot." Which Standard is violated, if any?

✗ **A)** **The Standard concerning Fiduciary Duty.**

✗ **B)** The Standard concerning Independence and Objectivity.

✓ **C)** The Standard concerning Fair Dealing.

Explanation

Rickard is in violation of the Standard concerning Fair Dealing by offering the client preferential access to a "hot" new issue. There is no obvious violation of Fiduciary Duty, since there is no evidence that Rickard is placing its own *financial* interest ahead of the client.

Question #25 of 76

Question ID: 412699

Brendan Duval works as a research analyst for Toby Securities. Duval recommends changing a recommendation from "sell" to "buy" on Dalton Company. His firm, which manages several mutual funds, may be interested in buying Dalton's stock. He also manages the retirement account that his parents established with Toby. Duval wants to buy shares of Dalton's stock because it is an appropriate investment for his parent's retirement account and obtains approval from his employer to do so. Duval is also thinking about personally investing in Dalton stock. According to CFA Institute Standards of Professional Conduct, which of the following *best* describes the priority of transactions? Duval should give:

✓ **A)** **Toby's clients and his parent's account equal priority, followed by his employer, and then his personal account.**

✗ **B)** priority of transactions to Toby's clients, followed by his employer, then his parent's retirement account, and finally his personal account.

✗ **C)** priority to Toby's clients and his employer concurrently, followed by his parent's retirement account, and finally his personal account.

Explanation

According Standard VI(B) Priority of Transactions, Duval should give transactions for clients and employers priority over his personal transactions. Because his parent's retirement account represents a client account at Toby, Duval should treat this account just like any other firm account. His parent's retirement account should neither be given special treatment nor disadvantaged because of an existing family relationship with Duval. If Duval treats his parent's retirement account differently from other accounts at Toby, he would breach his fiduciary duty to his parents.

Question #26 of 76

Question ID: 412707

Preston Partners is an investment management firm that adopted the Code and Standards as part of its policy manual. Gerald Smithson, CFA, has recently added the stock of Utah Biochemical Company and Norgood PLC to all his client's investment portfolios. Shortly afterwards Utah Biochemical and Norgood announced a merger that increased the share price of both companies. Smithson contends he saw the president of Utah Biochemical dining with the chairman of Norgood, but did not overhear their conversation. Smithson researched both companies extensively and determined that each company was a good investment. He put in a block trade for shares in each company. Preston's policies were not clear in this area as he allocated the shares by starting with his largest client accounts and working down to the small accounts. Some of Smithson's clients were very conservative personal trust accounts, others were pension funds who had aggressive investment objectives. Which standard was NOT broken?

- ✗ **A)** **Standard III(C)-- Suitability.**
- ✗ **B)** Standard IV(C)--Responsibilities of Supervisors.
- ✓ **C)** Standard V(A)--Diligence and Reasonable Basis.

Explanation

Standard V(A)-Diligence and Reasonable Basis was not broken because Smithson conducted thorough and diligent research. Standard III(C)-- Suitability, Smithson failed to consider the needs of his conservative and aggressive clients. Standard IV(C)--Responsibilities of Supervisors, Preston Partners didn't have policies explaining how to allocate shares among clients.

Question #27 of 76

Question ID: 412679

Steven Wade, CFA, writes an investment newsletter focusing on high-tech companies, which he distributes by e-mail to paid subscribers. Wade does not gather any information about his clients' needs and circumstances. Wade has developed several complex valuation models that serve as the basis for his recommendations. Each month, his newsletter contains a list of "buy" and "sell" recommendations. He states that his recommendations are suitable for all types of portfolios and clients. Because of their proprietary nature, Wade does not disclose, except in general terms, the nature of his valuation models. He conducted numerous statistical tests of these models and they appear to have worked well in the past. In his newsletter, Wade claims that subscribers who follow his recommendations can expect to earn superior returns because of the past success of his models.

Wade violated all of the following CFA Institute Standards of Professional Conduct EXCEPT:

- ✗ **A)** **Standard V(B), Communication with Clients and Prospective Clients.**
- ✓ **B)** Standard III(B), Fair Dealing.
- ✗ **C)** Standard I(C), Misrepresentation.

Explanation

Wade did not violate Standard III(B), Fair Dealing, because this situation does not indicate that he failed to deal fairly and objectively with all clients when disseminating his newsletter containing investment recommendations.

Wade violated Standard V(B), Communication with Clients and Prospective Clients, because he failed to include all relevant factors behind his recommendations. Without providing the basis for his recommendations, clients cannot evaluate the limitations or the risks inherent in his recommendations.

Wade violated Standard I(C), Misrepresentation, because his claims about gaining superior expected returns are misleading to potential investors.

Question #28 of 76

Question ID: 412693

Jack Stevens is employed by a company to provide investment advice to participants in the firm's 401(k) plan. One of the investment options is a stable value fund run by the company. Stevens' research indicates that the fund is far riskier and less liquid than the typical stable value fund and has a fundamental asset value lower than book value of the assets. He tells Jessica Cox, the head of employee benefits, about his research, and indicates that he will advise new employees to not invest in the fund and will advise employees who already own the fund to reduce their holdings in the fund. Cox points out that the fund is not in any current danger because there are very few redemptions requested of the fund. Cox also states that a sell recommendation may become a self fulfilling prophecy, causing investors to redeem their shares and forcing the fund to liquidate, which in turn will cause the remaining investors to receive less than their promised value. Stevens agrees with this assessment and feels his fiduciary duty is to all employees. Stevens should:

✗ **A)** **continue to recommend that new investors do not invest in the fund, but not advise existing investors to reduce their holdings.**

✗ **B)** tell investors he cannot give advice on the fund because of a conflict of interest.

✓ **C)** continue to recommend that new investors do not invest in the fund and existing investors reduce their holdings.

Explanation

The employees to whom Stephens owes fiduciary duty are the ones who are seeking his advice, even if acting on that advice hurts other employees who might eventually become clients.

Question #29 of 76

Question ID: 412669

Milton Baker, CFA, prepares a research report on the dynamics of a stock price. In his study, he uses a considerable number of information sources, both outside sources and his company's own research papers, prepared for both internal and public use. The report will first be distributed at the monthly department meeting and then later will be published on the company's Internet site. He thinks that he may have neglected to mention some of his sources in his reference list but decides that he needs to be concerned about full disclosure of his sources only for the public version of the report, so he will wait to revise his work until after the monthly meeting but before it is published on the internet site. Which Standards does Baker NOT comply with?

✓ **A)** **Standard I(C), Misrepresentation, and I(A), Knowledge of the Law.**

✗ **B)** Standard I(C), Misrepresentation, I(B), Independence and Objectivity, and I(A), Knowledge of the Law.

✗ **C)** Standard I(C), Misrepresentation, only.

Explanation

Baker has some doubts but does not initiate any action presuming they only apply to the publicly disclosed report. The lack of action is a violation of Standard I(A), Knowledge of the Law. He also violates Standard I(C), Misrepresentation, by failing to properly disclose the sources of his information, where necessary.

Question #30 of 76

Question ID: 412650

Nancy Westfall is an individual investment advisor who uses mutual funds for her clients. She typically chooses funds from a list of 40 funds that she has thoroughly researched. The Craigs, a married couple that is a client, asked her to consider the Eligis fund for their portfolio. Westfall had not previously considered the fund because when she first conducted her research three years ago, Eligis was too small to be considered. However, the fund has now grown in value, and after doing thorough research on the fund, she finds the fund has suitable characteristics to be included in her acceptable list of funds. She puts the fund in the Craigs' portfolio but not in any of her other clients' portfolios. The fund ends up being the poorest performing fund in the Craigs' portfolio. Has Westfall violated any Standards? Westfall has:

✓ **A) not violated the Standards.**

✗ **B)** violated the Standards by not having a reasonable and adequate basis for making the recommendation.

✗ **C)** violated the Standards by not dealing fairly with clients.

Explanation

Because Westfall performed the same degree of research as she did for the other funds on her list, she provided a reasonable and adequate basis for her recommendation. There is not enough information given about the Eligis fund and how it fits in with the other funds on Westfall's list to determine whether or not the standard on Fair Dealing was broken. It was the Craigs who wanted the Eligis fund and Westfall found it to be acceptable for them and thus added it to her list of acceptable funds. If the Eligis fund was found to possess unique characteristics that were not found in any of the other funds on Westfall's list and the Eligis fund was suitable for some of Westfall's other clients and Westfall hadn't added it to their portfolios after their periodic review then a violation of fair dealing would have occurred.

Question #31 of 76

Question ID: 412697

Dick Charles is a security analyst with a large brokerage company. Sean Donaldson is a money manager. They both listen in on a conference call for security analysts with the president of Stoppard, Inc., who states that in two days the company will be holding a press conference announcing a new product. Both Charles and Donaldson feel the news will increase the value of Stoppard.

✗ **A) Charles must wait until after the press conference to disseminate the information to clients, but Donaldson can purchase the stock for his clients immediately.**

✓ **B)** Charles must wait until after the press conference to disseminate the information to clients, and Donaldson must wait until after the press conference to purchase the stock for his clients.

✗ **C)** Charles can disseminate the information to clients, and Donaldson can purchase the stock for his clients immediately.

Explanation

By waiting until after the press conference the information would then be considered public information and can then be disseminated to clients and traded on without there being any issues of insider trading.

Question #32 of 76

Question ID: 412640

Patricia Spraetz is the chief financial officer and compliance officer at Super Selection Investment Advisors. Super Selection is a medium-sized money management firm which has incorporated the CFA Institute Code of Ethics and Standards of Practice into the firm's compliance manual.

Karen Jackson is a portfolio manager for Super Selection. She is not a CFA charterholder. Jackson is friendly with David James, president of AMD, a rapidly growing biotech company. James has provided Jackson with recommendations in the biotech industry, which she buys for her own portfolio before buying them for her clients. For three years, Jackson has also served on AMD's board of directors but has never notified Super Selection of this fact. She has received options and fees as compensation.

Recently, the board of AMD decided to raise capital by voting to issue shares to the public. This was attractive to board members (including Jackson) who wanted to exercise their stock options and sell their shares to get cash. When the demand for initial public offerings (IPO) diminished, just before AMD's public offering, James asked Jackson to commit to a large purchase of the offering for her portfolios. Jackson had previously determined that AMD was a questionable investment but agreed to reconsider at James' request. Her reevaluation confirmed the stock to be overpriced, but she nevertheless decided to purchase AMD for her clients' portfolios.

Which of the following statements is NOT correct?

- ✗ **A)** **Jackson violated Standard IV(B) regarding Disclosure of Additional Compensation by not disclosing additional compensation in the form of cash and stock options received from AMD, as its board member to her employer.**
- ✗ **B)** Jackson violated Standard VI(A) regarding Conflicts of interest by not disclosing her board membership and ownership of stock options to her employer.
- ✓ **C)** Jackson did not violate Standard III(A) on Fiduciary Duty to clients because she was bound by her fiduciary duty to AMD and its stockholders as a board member. Therefore, when she reversed her decision to buy AMD shares for Super Selection's clients, portfolios on James' request, her obligation to AMD took precedence.

Explanation

Jackson has violated Standard III(A) because her first obligation is to her firm's clients. Standard VI(A) addresses precisely these kinds of situations regarding potential conflict of interest. Given this conflict of interest, Jackson also compromised her objectivity in violation of Standard I(B). Her fiduciary duty to her clients takes precedence over her fiduciary duty to AMD's stockholders under the CFA Institute Code and Standards. By not disclosing her relationship with AMD, she also violated Standard IV(B). Making past personal security transactions ahead of purchase of the same securities for her clients has put Jackson in violation of Standard VI(B). This standard clearly prohibits such actions.

Question #33 of 76

Question ID: 412657

Jennifer Gates is an individual portfolio manager who only uses mutual funds for her clients; she has therefore never created a portfolio of stocks. She enters an Internet chat room on investments and starts answering questions about investments. She states in the chat room that she has a CFA designation. One woman in particular is interested and questions her about the viability of creating her own stock portfolio. Gates feels that this would be a mistake because she only has $150,000 to invest, and states, "I have experience creating stock portfolios, and it does not make sense to do so with only $150,000." The woman she has chatted with sends her an e-mail and eventually becomes a client of hers. Gates has:

- ✗ **A)** **violated the Standards by soliciting business over the Internet.**

✓ **B)** violated the Standards by misrepresenting her experience.

✗ **C)** not violated the Standards.

Explanation

One cannot misrepresent their experience, even over the Internet.

Question #34 of 76

Question ID: 412678

Jim Crockett is a portfolio manager for Miami Advisors and reports to Vicki Tubbs, the Chief Investment Officer. Miami has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Miami model. The model is purely quantitative and takes a given set of client characteristics and universe of potential securities and forms a portfolio for the investor. Individual portfolio managers are responsible for selecting securities to fit into the model based on recommendations from the firm's research department and the managers' own judgment. Because of the specific nature of the inputs to the model, each manager is responsible for applying the model on his or her own computer. The basic philosophy of the process is thoroughly explained to clients. Crockett does not understand the basics of the model, but feels that since it provides pure quantitative output, he does not need to understand it. However, he misapplies the model for several of his clients. In reviewing some of Crockett's portfolios, Tubbs finds the errors and points them out to Crockett. Which of the following statements regarding Tubbs and Crockett is CORRECT?

✗ **A)** **Tubbs has violated the Standards by failing to supervise adequately.**

✗ **B)** Crockett has violated the Standards by not considering the appropriateness and suitability of the investment for his clients.

✓ **C)** Crockett has violated the Standards by not exercising diligence and thoroughness in making investment recommendations.

Explanation

Crockett had a responsibility to know the model well enough to detect the mistakes that could occur from misapplication, so he violated the Standard of diligence and reasonable basis.

Question #35 of 76

Question ID: 412663

Brenda Simone is a money manager and the Blue Streets Pension Fund is one of her clients. The director of the pension fund calls Simone and asks her to use a particular broker so that the fund can obtain some research services with the soft dollars from that broker. Simone believes that the desired broker will provide the same price and execution as the normal broker that Simone uses. Simone does as the client wishes. Simone has:

✗ **A)** **not violated the Standards as long as the research provided by the broker will benefit Blue Streets.**

✗ **B)** violated the Standards.

✓ **C)** not violated the Standards as long as the research provided by the broker will benefit the plan beneficiaries.

Explanation

Simone must ensure that the research benefits the parties to whom she owes fiduciary duty, which are the plan participants.

Question #36 of 76

Question ID: 412664

Janice Melfi is a portfolio manager for Soprano Advisors. Soprano has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Soprano model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research-an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers use the model to assist them in making portfolio decisions, but, based on their own fundamental research, are allowed to purchase securities not recommended by the model. This fact is not disclosed to the clients, because the head of marketing does not think it is relevant. Which of the following statements regarding the portfolio manager's investment decisions is CORRECT?

✓ **A) Soprano is violating the Standards by not disclosing the fundamental research aspect of the investment process.**

✗ **B)** There is no violation of the Standards.

✗ **C)** Melfi is violating the Standards by using two investment processes that are in conflict with each other.

Explanation

Soprano is violating the Standard on portfolio investment recommendations and actions by excluding relevant factors of the investment process. The fundamental research aspect is highly relevant to the process and should be disclosed to clients. It is acceptable for Melfi to use two investment processes that may be in conflict with each other and to use a process that was not developed by her.

Question #37 of 76

Question ID: 412711

Member compliance on issues relating to corporate governance or to soft dollars is primarily addressed by the Standard concerning:

✓ **A) Loyalty, Prudence, and Care.**

✗ **B)** Disclosure of Conflicts to Clients and Prospects.

✗ **C)** Disclosure of Referral Fees.

Explanation

Fiduciary duty on issues relating to corporate governance or to soft dollars is primarily addressed by Standard III(A), Loyalty, Prudence, and Care.

Question #38 of 76

Question ID: 412681

Which of the following would be the *least* important proxy issue?

✗ **A) Takeover defense and related actions.**

✓ **B)** Election of internal auditors.

✗ **C)** Compensation plans for officers.

Explanation

Election of internal auditors is not a major proxy issue.

Question #39 of 76

Question ID: 412635

After a very successful quarter of high investment returns, Judy O'Berry, CFA, receives several gifts from grateful clients. O'Berry considers the gifts to be of novelty or sentimental value only, but she hears rumors that several junior employees are jealous of the attention she received for the group's efforts. She decides to consult the company's compliance rules on gifts and is surprised to learn her firm has no established rules. She consults the Standards of Practice Handbook, and then submits proposed rules on gifts to her company's compliance department. These rules should contain all of the following EXCEPT:

✓ **A)** **restrictions on all types business entertainment.**

✗ **B)** a requirement to disclose the gift.

✗ **C)** a formal value limit based on local customs.

Explanation

The rules should contain a formal value limit based on local customs. Not all types of business entertainment are forbidden. Only business entertainment which is intended to influence or reward members and candidates should be avoided.

Question #40 of 76

Question ID: 412675

Patricia Cuff is the chief financial officer and compliance officer at Super Selection Investment Advisors, an organization that has incorporated the CFA Institute Code of Standards into the firm's compliance manual. Karen Trader is a portfolio manager for Super Selection. Trader is friendly with Josey James, president of AMD, a rapidly growing biotech company. Trader has served on AMD's board of directors for the last three years. James has asked Trader to commit to a large purchase of AMD stock for Trader's clients' portfolios. Trader had previously determined that AMD was a questionable investment but agreed to reconsider. Her reevaluation deemed the stock to be overpriced, but Trader nevertheless decides to purchase for her portfolios. Which standard was *least likely* violated?

✗ **A)** **III(A) Loyalty, Prudence, and Care.**

✓ **B)** III(B) Fair Dealing.

✗ **C)** V(A) Diligence and Reasonable Basis.

Explanation

Standard III(B) Fair Dealing is not directly applicable to this situation; that standard prohibits members and candidates from discriminating against any clients when disseminating recommendations or taking investment action. Trader has clearly violated standard III(A) Loyalty, Prudence, and Care, which requires that members and candidates act for the benefit of their clients and place their clients' interests before their own interests. Trader has also violated standard V(A) Diligence and Reasonable Basis, which requires members and candidates to have a reasonable and adequate basis for any investment recommendation or action.

Question #41 of 76

Question ID: 412695

Which of the following actions is *least* likely to prevent the misuse of insider information?

✓ **A) Monitoring all the phone calls made by the brokers.**

✗ **B)** Controlling relevant interdepartmental information.

✗ **C)** Placing securities on a restricted list when the firm is in possession of material nonpublic information.

Explanation

Standard II(A), Material Nonpublic Information, applies in this situation. Standard II(A) suggests the use of "fire walls" to protect the firm and to conform to the Standards. A fire wall is an information barrier designed to prevent the communication of material nonpublic information between departments of a firm. Although the fire wall system should provide a means to review transactions, *it is not feasible to monitor all communications into/out of departments*. Placing sensitive securities/firms on "watch, "restricted," or "rumor" lists helps management target monitoring of transactions.

Question #42 of 76

Question ID: 412680

Randal Brooks is the chief economist for a large brokerage firm. In the aftermath of a national tragedy, Brooks feels that it is very possible that the stock market will drop significantly and not recover for several years. However, he does not believe that this is the most likely scenario but merely that the risk of investing in equities has increased. He decides to write a market commentary to the brokerage clients that discusses the reasons why the market will remain stable and talks about why he, as a private citizen, feels patriotic. He does not mention the increase risk in equities. Brooks has:

✗ **A) not violated the Standards.**

✓ **B)** violated the Standards by not including all of the relevant factors in the research report, but not by making patriotic statements.

✗ **C)** violated the Standards by not including all of the relevant factors in the research report and making patriotic statements.

Explanation

By not mentioning the increased risk of the market, Brooks has violated the Standard on using reasonable judgment in a research report. However, the patriotic statements do not violate the Standards.

Question #43 of 76

Question ID: 412647

Steve Jones is a portfolio manager for Gregg Advisors. Gregg has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Gregg model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research-an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. Jones thoroughly understands the model and uses it with all of his clients. Jones is:

✗ **A) violating the Standards in purchasing stocks without a thorough research basis and in not disclosing all alterations of the model to clients.**

✓ **B)** not violating the Standards either in purchasing stocks without a thorough research basis or in not disclosing all alterations of the model to clients.

✗ **C)** violating the Standards in not disclosing all alterations of the model to clients, but not in purchasing stocks without a thorough research basis.

Explanation

Jones and Gregg are using reasonable judgment in not continually disclosing all of the alterations of the model. It is acceptable to use a pure quantitative model as a sole basis for purchasing stocks, as long as it is thoroughly researched.

Question #44 of 76

Question ID: 412670

Patricia Young is an individual investment advisor who uses a computer model to place each of her clients into an appropriate portfolio. The model analyzes a range of simulated portfolios and computes for each the probabilities of achieving various levels of return. Young then selects the portfolio that provides the highest probability of achieving the clients' minimum required return. By using this process, Young is:

✗ **A)** **violating Standard I(C) - Misrepresentation.**

✗ **B)** not violating the Standards.

✓ **C)** violating Standard III(C) - Suitability.

Explanation

Standard III(C) Suitability requires that Young select investments that are consistent with clients' risk and return objectives. However risk tolerance is not adequately addressed by Young's process.

Question #45 of 76

Question ID: 412660

Lee Roth, who is an investment advisor, is riding in a taxi and finds a file of information labeled "Genco Valuation." The folder contains a great deal of financial data, projections and nonpublic information concerning the food products industry that lead Roth to believe that Genco will be worth 50% more than its current stock value. Roth also finds some correspondence that leads him to believe that the file belonged to Tom Hagan. Roth tries to find out where Hagan works so he can return the file. Roth can recommend Genco to his clients unless Hagan works for:

✓ **A)** **Roth cannot recommend Genco to his clients at this time.**

✗ **B)** the corporate finance department for Genco.

✗ **C)** the equity research department for a brokerage firm.

Explanation

The information is material and nonpublic; therefore, Roth cannot act or cause others to act at this time.

Question #46 of 76

Question ID: 412696

Albert Long, CFA, manages portfolios of high net worth individuals for HKB Corp. Alice Thurmont, one of his close friends, heads a local charity for homeless children that depends on donations to operate. Because donations have declined during the past year, the charity is experiencing financial difficulty. Thurmont asks Long to give her a partial list of his clients so that she can contact them to make tax-deductible donations. Because Long knows that the charity provides much benefit to the community, he provides Thurmont with the requested list.

Betty Short, CFA, also works for HKB Corp. She receives a letter from CFA Institute's Professional Conduct Program (PCP) requesting that she provide information about one of HKB's clients who is being investigated. Short complies with the request despite the confidential nature of the information requested by the PCP.

Based on Standard III(E), Preservation of Confidentiality, which of the following statements about Long and Short's actions is CORRECT?

- ✗ **A)** **Both Long and Short violated Standard III(E).**
- ✓ **B)** Long violated Standard III(E) but Short did not violate Standard III(E).
- ✗ **C)** Short violated Standard III(E) but Long did not violate Standard III(E).

Explanation

Long violated Standard III(E) because he did not preserve the confidentiality of information communicated by clients. Short did not violate Standard III(E) because this standard does not prevent members from cooperating with an investigation by CFA Institute's Professional Conduct Program. Thus, Short can forward confidential information to the PCP.

Question #47 of 76

Question ID: 412642

Randy Wesson is a research analyst for a large brokerage company following the chemical industry. Wesson receives a phone call from his nephew who works part-time in an airport hospitality center for an airline while going to business school. Many meetings take place at the center on any given day. The nephew tells Wesson that while bringing some faxes into a conference room, he overheard executives of Hunt Chemical talking about the likely divestiture of one of their subsidiaries. His nephew wants to know whether that will be good for Hunt. Wesson should:

- ✓ **A)** **not use the information.**
- ✗ **B)** write a research report describing that he learned about the likely divestiture from his nephew who works at the hospitality center.
- ✗ **C)** write a research report describing the possibility of a divestiture, but not mention how he learned about it.

Explanation

The information is material and nonpublic; therefore, Wesson cannot trade or cause others to trade on the information. Any action concerning the information would violate the Standard on material nonpublic information.

Question #48 of 76

Question ID: 412645

Brenda Clark is an investment advisor. Two years ago Clark decided to stop calculating a return composite because of the time required to make those calculations. A prospective client asks Clark what she thinks her performance would have been over the past two years. Clark:

✗ **A)** **cannot answer the question, nor can she discuss potential future market returns with the prospective client.**

✓ **B)** cannot answer the question because it would be misleading.

✗ **C)** can answer the question orally but cannot state the numbers in writing.

Explanation

Any discussion of past performance would imply that Clark had made some calculations, which would be misleading. However, Clark need not calculate historical performance to be an advisor. She can also talk about her view on the future of capital markets.

Question #49 of 76

Question ID: 412646

Chuck Daniels has just been hired to manage a security analysis group for Aaron Asset Management. Daniels performed a similar function at another firm and finds the compliance system at Aaron inadequate. He develops a system that he feels is appropriate, but senior management tells him he will have to wait six months to implement the system. Daniels should:

✓ **A)** **decline in writing to accept supervisory responsibility until a satisfactory compliance system is put into place.**

✗ **B)** resign his position immediately.

✗ **C)** protest in writing the delay, listing the potential dangers that can occur.

Explanation

According to the Standard on supervisory responsibilities, Daniels should decline in writing to accept supervisory responsibility until a satisfactory compliance system is put into place.

Question #50 of 76

Question ID: 412705

In the course of reviewing the Corn Co., an analyst has received comments from management that, while not meaningful by themselves, when pieced together with data he has accumulated from outside sources, lead him to recommend placing Corn Co. on his firm's sell list. What should the analyst do?

✓ **A)** **The comments are non material and the report can be issued as long as he maintains a file of the facts as supplied by management.**

✗ **B)** Show his report to his own manager and counsel for their review since this information has become material once it was combined with his analysis.

✗ **C)** Not issue the report until the comments are publicly announced.

Explanation

This is an example of the mosaic theory where separate pieces of nonmaterial information are pieced together to make an investment recommendation.

Question #51 of 76

Question ID: 412682

Steve Phillips is the new director of equity research for a brokerage company. He receives a call from a reporter at the Financial News, a weekly publication that comes out on Mondays. The reporter explains the relationship she had with his predecessor. They would share information that they both learned on stocks-the former director would benefit the company's clients by news he obtained from the reporter in exchange for information he gave to her. The former director could ask her not to publish any information he gave her until after a certain date, ensuring that the brokerage clients would be informed before the publication date. After the conversation, Phillips called the former director, who confirmed that the reporter was trustworthy with respect to honoring the agreement for delaying publication until clients have been informed. Philips should:

✗ **A) disclose research not yet disclosed to clients, as long as the reporter promises not to publish the information until after all clients have received the research, and the reporter provides valuable information of her own.**

✓ **B)** only disclose research that has already been disseminated to clients, as long as the reporter is providing valuable information of her own.

✗ **C)** not disclose any research even after it has been disseminated to clients regardless of the value of the information that the reporter may have.

Explanation

In no case should information be disclosed to a reporter before all clients are provided with the research-doing so will violate the Standard on fair dealing. However, once clients have been informed, there is no violation in releasing the information to the reporter, and in doing so Phillips might obtain information that can further help his clients.

Question #52 of 76

Question ID: 412653

Scott LaRue is a portfolio manager for Washington Advisors. Washington has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the Washington model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. The director of research frequently alters the model based on rigorous research-an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. La Rue feels the model would be improved by adding some factors but he has not fully tested this new version of the model. LaRue discloses his model to his own clients but not to his supervisor. LaRue is:

✓ **A) violating the Standards by not having a reasonable and adequate basis for his investment recommendation.**

✗ **B)** not violating the Standards.

✗ **C)** violating the Standards by not considering the appropriateness of the recommendations to clients.

Explanation

The ad hoc model is not part of the formal research process and does not formulate an adequate basis for a recommendation.

Question #53 of 76

Question ID: 412685

The following information pertains to the Galaxy Trust, a trust established by Stephen P. House and managed by Gamma Investment LLC:

- At the time the trust was established House provided $5 million in cash to fund the trust, but Gamma was aware that 93% of his personal assets were in the form of Oracle stock.
- Gamma has been asked to view his funds and the trust as a single entity for planning purposes, since House's will stipulates that all of his estate will pass to the trust upon his death.
- The investment policy statement, developed in September 1996, stipulates that the trust should maintain a short position in Oracle stock and use the proceeds to diversify the trust more adequately.
- House was able to sell all of his Oracle shares back to the corporation in January 1999 for cash.
- The policy statement redrawn in September 1999 continues to stipulate that the trust hold a short position in Oracle stock.
- House has given the portfolio manager in charge of the trust an all expenses paid vacation package anywhere in the world each year at Christmas. The portfolio manager has reported this fact in writing to his immediate supervisor at Gamma.

Which of the following is *most* correct? The investment manager is:

✗ **A)** **not in violation of the Code and Standards for not properly updating the investment policy statement in light of the change in the circumstances and is not in violation with regard to the acceptance of the gift from House.**

✗ **B)** in violation of the Code and Standards by not properly updating the investment policy statement in light of the change in the circumstances and is in violation with regard to the acceptance of the gift from House.

✓ **C)** in violation of the Code and Standards by not properly updating the investment policy statement in light of the change in the circumstances but is not in violation with regard to the acceptance of the gift from House.

Explanation

The investment manager is in violation of the Standard requiring him to make a reasonable inquiry into the client's financial situation and update the investment policy statement since such a dramatic change in the client's circumstances would undoubtedly alter the investment policy statement and would probably eliminate the need to hold a short position in Oracle. The investment manager is not in violation of the Standard concerning additional compensation, since the gift has been reported to his supervisor and has come from a client. If there was a failure to report such a gift, if the firm had a rule in place against the acceptance of gifts from clients, or if the gift had come from a non-client, there would be a violation of the standard.

Question #54 of 76

Question ID: 412651

A company has a defined benefit plan that is currently under-funded. The plan sponsor has instructed the portfolio manager of the plan to invest more aggressively to bring the funding level up to an adequate amount. Which of the following statements *best* describes the course of action the portfolio manager should take? The portfolio manager should:

✓ **A)** **not invest more aggressively since this may expose the plan to too much risk and may not be in the best interest of the plan's beneficiaries.**

✗ **B)** not invest more aggressively because this is not the method used to increase the funding level of a plan.

✗ **C)** invest more aggressively because his fiduciary duties lie with the plan sponsor.

Explanation

Standard III(A), Loyalty, Prudence, and Care, applies in this situation. According to this Standard, investment actions should be carried out for the sole benefit of the client and in a manner the manager believes to be in the best interest of the client. Here, the client is the plan beneficiaries, not the manager or the entity that hired the manager.

Question #55 of 76

Question ID: 412655

While attending his wife's office party, Donald North, CFA, overhears two top executives from Parker Industries discussing that the company's Board of Directors just approved to omit its cash dividend due to unexpected losses during the quarter. Parker has paid a quarterly dividend for the past ten years. The next day, North calls his broker and instructs her to sell short Parker's common stock.

While in a coffee shop, Diane South, CFA, overhears two top executives from Ryland Products say that their company is about to be acquired by another company for a substantial premium over the market price. The next day, South calls her broker and instructs him to buy 500 shares of Ryland's common stock.

Which of the following statements about whether North and South violated Standard II(A), Material Nonpublic Information, is CORRECT?

- ✗ **A)** **Neither North nor South violated Standards II(A).**
- ✗ **B)** North violated Standard II(A) but South did not violate Standard II(A).
- ✓ **C)** Both North and South violated Standard II(A).

Explanation

According to Standard II(A), a member or candidate must not act or cause others to act on material nonpublic information until that same information is made public. In both cases, the information was material nonpublic information; therefore, both North and South are in violation.

Question #56 of 76

Question ID: 412649

Denise Weaver is a portfolio manager who manages a mutual fund and has pension clients. When Weaver receives a proxy for stock in the mutual fund, she gives it to Susan Griffith, her administrative assistant, to complete. When the proxy is for a stock owned in a pension plan, she asks Griffith to send the proxy on to the sponsor of the pension fund. Weaver has:

- ✗ **A)** **violated the Standards by her policy on mutual fund proxies, but not her policy on pension fund proxies.**
- ✗ **B)** not violated the Standards.
- ✓ **C)** violated the Standards by her policy on mutual fund and pension fund proxies.

Explanation

Proxies should be taken seriously, and although it is likely that Griffith can understand some of the issues, it is likely that she is not capable of making responsible decisions on all potential proxy issues. Proxies for a pension plan should be voted in the best interests of the beneficiaries, not the plan sponsor. The sponsor's interests will not always be the same as the beneficiary's interest.

Question #57 of 76

Question ID: 412637

The Konkol Company implements a new methodology for portfolio valuation that is licensed to them by ABC Statistics. Konkol complies with the CFA Institute Code and Standards by:

✓ **A)** **discussing the new methodology with the clients, in its entirety.**

✗ **B)** discussing the new methodology with clients only when a change in the security selection process is involved.

✗ **C)** not discussing the new methodology with clients because there is no need to, as it will not change their risk and yield preferences.

Explanation

Standard V(B), Communication with Clients and Prospects, requires any change in the scope, valuation methodology, or focus of the portfolio to be discussed with clients.

Question #58 of 76

Question ID: 412666

June Carter passed Level III of the CFA examination in June but will not complete her work experience requirement until August of next year. Carter can state on her resume that she:

✗ **A)** **is a CFA in waiting.**

✗ **B)** will be a CFA charterholder in August of next year as long as she is on track to complete her work experience.

✓ **C)** passed Levels I, II, and III of the CFA examination.

Explanation

A candidate cannot use any form of the CFA designation until receiving her charter.

Question #59 of 76

Question ID: 412688

One year ago, Karen Jason left the employment as a portfolio manager of Howe Advisors. The departure was contentious and both parties threatened legal action. As a result, both parties signed a settlement in which Jason was paid a pro rated bonus, but agreed not to work on the portfolios of any existing Howe client for two years. The terms of the agreement were that both parties agreed to keep all aspects of the agreement confidential, including the fact that there was hostility surrounding the departure. Jason now works for Torre Advisors, who has the Stein Company as a new client. At the time Jason left Howe, Stein was a client of Howe, although Jason did not personally work on the Stein portfolio. Jason's supervisor at Torre wants Jason to work on the Stein portfolio. Jason should:

✗ **A)** **inform her supervisor that she cannot work on the portfolio because of a non-compete agreement.**

✗ **B)** work on the portfolio because she did not personally work on the portfolio when she was at Howe.

✓ **C)** inform her supervisor that she cannot work on the portfolio because of a legal agreement, but cannot tell him why.

Explanation

Jason must inform her supervisor of the conflict, but she cannot violate the terms of the confidentiality agreement and she cannot work on the portfolio.

Question #60 of 76

Question ID: 412698

Caroline Turner, an analyst for Lansing Asset Management, just completed an investment report in which she recommends changing a "buy" to a "sell" for Gallup Company. Her supervisor at Lansing approves of the change in recommendation. Turner wonders about whether she needs to disseminate this investment recommendation to Lansing's clients and if so, how to distribute this information. According to CFA Institute Standards of Professional Conduct, Turner is:

✗ **A)** **required to disseminate the change in a prior investment recommendation to all clients and customers on a uniform basis.**

✗ **B)** not required to disseminate the change of recommendation from a buy to a sell because the change is not material.

✓ **C)** required to design an equitable system to disseminate the change in a prior investment recommendation.

Explanation

Standard III(B) - Fair Dealing requires dealing fairly and objectively with all clients and prospects when disseminating material changes in prior investment recommendations. Note that the standard requires the dissemination be fair, but not necessarily equal due to the impossibility of contacting all clients simultaneously. A change of recommendation from "buy" to "sell" is generally material.

Question #61 of 76

Question ID: 412709

Scott Andrews, CFA, is a stockbroker selling an oversubscribed stock issue. Which of the following *best* describes Andrews' actions regarding this sale? Andrews:

✗ **A)** **cannot offer an oversubscribed issue of stock to any clients.**

✗ **B)** can only offer this security to clients for which it is appropriate on a first come first serve basis.

✓ **C)** can offer this security on a prorated basis to all clients for which the security is appropriate.

Explanation

Standard III(B), Fair Dealing, applies. When new issues or secondary offerings are available or are being offered by the firm or if the firm is part of a selling syndicate, all clients for whom the security is appropriate are to be offered a chance to take part in the issue. *If the issue is oversubscribed, then the issue is to be prorated to all subscribers.*

Question #62 of 76

Question ID: 412668

Lynne Jennings is a chemical industry research analyst for a large brokerage company. That industry is currently seeing an increase in mergers and acquisitions. While flying through Chicago, Jennings sees several senior officers who she knows are from the largest and fourth largest chemical companies walk into a conference room. She concludes that negotiations for an acquisition might be taking place. Jennings:

✗ **A)** **may not act or cause others to act on this information.**

✗ **B)** should inform her compliance officer that she has material nonpublic information on firms she covers.

✓ **C)** may use this information to support an investment recommendation.

Explanation

The fact that the company officers met is not material nonpublic information. As long as she bases her investment recommendation on her own independent research, Jennings will not violate any Standards if she uses this additional information to support it.

Question #63 of 76

Question ID: 434183

Amanda Brad, CFA, is a security analyst at UpTrend, Inc. During a routine visit to a beauty salon, she learns that a major cosmetic company, Lorean, is expected to present a revolutionary formula for facial cream. Brad buys Lorean stock for her portfolio and prepares a special report on the company. Brad also makes a call to Hillary Lang, another security analyst at UpTrend, to inform her about the news. Lang starts trading on her clients' portfolios. Brad's report states that given the on-going research activity at Lorean within the last months, investors can expect some successful new products and a sharp increase in the price of the stock. Lang's actions:

✗ **A)** **violate the Standard of Objectivity and Independence.**

✓ **B)** violate the Standard of Fair Dealing.

✗ **C)** violate the Standards because she trades on inside information.

Explanation

Lang violates Standard III(B), Fair Dealing, which imposes the requirement to start trading on the clients' portfolios only after the information is disseminated to all clients. We don't know if the information is non-public which would make it insider information if it were.

Question #64 of 76

Question ID: 412692

Victor Logan is a portfolio manager for McCoy Advisors, and Jack Brisco is the Director of Research for McCoy. Brisco has developed a proprietary model that has been thoroughly researched and is known throughout the industry as the McCoy model. The model is purely quantitative and screens stocks into buy, hold, and sell categories. The basic philosophy of the model is thoroughly explained to clients. Brisco frequently alters the model based on rigorous research-an aspect that is well explained to clients, although the specific alterations are not continually disclosed. Portfolio managers then make specific sector and security holding decisions, purchasing only securities that are indicated as "buys" by the model. Logan has conducted very thorough research on his own, using the same process that Brisco uses to validate his findings. Logan feels the model is missing some key elements that would further reduce the list of acceptable securities to purchase, however, Brisco has refused to look at Logan's research. Frustrated by this, Logan applies his own version of the model, with the justification that he is still only purchasing securities on the buy list. Because of the conflict with Brisco, he does not disclose the use of the model to anyone at McCoy or to clients. Which of the following statements regarding Logan and Brisco is CORRECT? Logan is:

✗ **A)** **violating the Standards by applying his version of the model and by not disclosing it to clients. Brisco is violating the Standards by failing to consider Logan's research.**

✗ **B)** violating the Standards by applying his version of the model and by not disclosing it to clients. Brisco is not violating the Standards.

✓ **C)** not violating the Standards by applying his version of the model, but is violating the Standards by not disclosing it to clients. Brisco is not violating the Standards.

Explanation

Because the research is thoroughly conducted, and Logan has authority to make individual security selection decisions, Logan is not violating the Standards by applying his model. However, Logan is violating the Standard on communication with clients and prospective clients by excluding relevant factors of the investment process. The use of his model is an important aspect of the investment process and should be disclosed to clients. Brisco is not violating the Standards by not considering Logan's research.

Question #65 of 76

Question ID: 412654

Maggie McCarthy is an individual investment advisor who uses mutual funds for her clients. She typically chooses from a list of 40 funds that she has thoroughly researched. The Figgs, a married couple that are a client, asked her to consider the Boilermaker fund for their portfolio. McCarthy had not previously considered the fund because when she first conducted her research three years ago, Boilermaker was too small to be considered. However, the fund has now grown in value, and after doing thorough research on Boilermaker, she found the fund was by far the most outstanding large company value fund in her list of funds. She puts the fund in the Figgs' portfolio, and in all new clients portfolios, but not in any of her other clients' portfolios. Her reasoning is that her existing clients were comfortable with their current holdings, and she did not want to risk disturbing their comfort. Has McCarthy violated any Standards? McCarthy has:

✓ **A)** **violated the Standards by not dealing fairly with clients.**

✗ **B)** not violated the Standards.

✗ **C)** violated the Standards by not having a reasonable and adequate basis for making the recommendation.

Explanation

The fund should have been considered for the existing clients' portfolios. There may have been reasons not to add the fund to their portfolios, such as tax consequences or a lack of suitability, but disturbing their comfort is not sufficient.

Question #66 of 76

Question ID: 412656

Ned Brenan manages two dozen pension accounts, one of which earned over 25% during the past two years. Brenan tells prospective clients that based on past experience they can expect a 25% return on their funds. Which of the following statements is CORRECT?

✗ **A)** **Brenan has violated Standard of Professional Conduct III(D), Performance Presentation, but Brenan has not violated Standard I(C), Misrepresentation.**

✓ **B)** Brenan has violated both Standard of Professional Conduct III(D), Performance Presentation, and Standard I(C), Misrepresentation.

✗ **C)** Brenan has not violated Standard of Professional Conduct III(D), Performance Presentation, but Brenan has violated Standard I(C), Misrepresentation.

Explanation

Brenan violated Standard of Professional Conduct III(D) by using only one portfolio's results to create a false impression of all the portfolios, and Brenan violated Standard of Professional Conduct I(C) by creating the impression that a certain return was assured (he should have used the words "might" or "could" instead of "can").

Question #67 of 76

Question ID: 412689

Judy Gonzales is a portfolio manager with Brenly Capital and works on Johnson Company's account. Brenly has a policy against accepting gifts over $25 from clients. The Johnson portfolio has a fantastic year, and in appreciation, the pension fund manager sent Gonzales a rare bottle of wine. Gonzales should:

✗ **A)** **inform her supervisor in writing that she received additional compensation in the form of the wine.**

✗ **B)** present the bottle of wine to her supervisor.

✓ **C)** return the bottle to the client explaining Brenly's policy.

Explanation

By not returning the bottle she would be violating the Standard on disclosure of conflicts to the employer, which states that employees must comply with prohibitions imposed by their employer.

Question #68 of 76

Question ID: 412667

Betsy Fox is an investment advisor who has a client, Don Gordon, who is an employment lawyer. At lunch, Fox noticed Gordon and the Chief Financial Officer of Blue Star Company at the next table. She overhears them talking and ascertains that Blue Star is about to announce higher than expected earnings. Before the earnings release, Gordon contacts Fox and asks her to purchase 3,000 shares for his portfolio. Fox:

✗ **A)** **can purchase shares for Gordon, but cannot ever purchase shares for her personal account.**

✗ **B)** can only purchase shares for her personal account after informing all of her clients about the potential of the increase in earnings.

✓ **C)** must refuse to purchase shares for Gordon.

Explanation

According to Standard II(A), Material Nonpublic Information, Fox cannot act or cause others to act on material nonpublic information until the information is made public. The information overheard at lunch was material and nonpublic; therefore, Fox must wait until the information is made public before accepting Gordon's order.

Question #69 of 76

Question ID: 412704

Sallie Reid, CFA, is asked by her boss, also a CFA charterholder, to use a research report of a competing firm, change a few details, sign it and send it to a large client. He says their firm's researchers will draw the same conclusions but haven't gotten to them yet. If she complies, she is doing all of the following EXCEPT:

✗ **A)** **obeying her boss, a CFA charterholder, but violating several of the CFA Institute Code and Standards.**

✓ **B)** complying with CFA Institute standards because she cannot disobey her boss.

✗ **C)** violating CFA Institute standards dealing with plagiarism.

Explanation

If Sallie complies, she is violating Standard I(C) Misrepresentation, because copying the report is plagiarism. Sallie should attempt to disassociate from any activity that she knows is in violation of the standards.

Question #70 of 76

Question ID: 412662

Dan Jeffries is a portfolio manager who is being sued by one of his clients for inappropriate investment advice. The Professional Conduct Program of CFA Institute is investigating Jeffries for the same offense. Jeffries settles the lawsuit with the client while the Professional Conduct Program investigation is ongoing. When the Professional Conduct Program staff questions Jeffries about the problematic investment advice, Jeffries claims he cannot talk about it because doing so would violate the confidentiality of his client. Jeffries has:

✓ **A)** **violated the Standards by refusing to talk about the case with the Professional Conduct Program, but not by executing the settlement agreement.**

✗ **B)** not violated the Standards by executing the settlement agreement or by refusing to talk about the case with the Professional Conduct Program.

✗ **C)** violated the Standards by executing the settlement agreement, but not by refusing to talk about the case with the Professional Conduct Program.

Explanation

Because the Professional Conduct Program will maintain client confidentiality, Standard III(E) Preservation of Confidentiality does not permit members to refuse to cooperate with a PCP investigation because of confidentiality concerns. The Standards do not require members to delay dealing with related legal matters while a PCP investigation is in progress.

Question #71 of 76

Question ID: 412652

If the Chief Investment Officer of an investment advisory firm also is a CFA charterholder, which of the following statements is CORRECT?

✗ **A)** **All performance results that are presented must comply with the CFA Institute Global Investment Performance Standards.**

✓ **B)** The firm must comply with the CFA Institute Global Investment Performance Standards only if it states that it follows the Standards.

✗ **C)** The firm must present an historical composite.

Explanation

Global Investment Performance Standards (GIPS) are the best way to comply with the Standard on performance presentation; however, adoption of GIPS is voluntary.

Question #72 of 76

Question ID: 412687

Jim Kent is an individual investment advisor in San Francisco with 300 clients. Kent uses open-ended mutual funds to implement his investment policy. For most of his clients, Kent has used the Baker fund, a small company growth fund based in Boston, for a portion of their portfolio. As a result he has become very friendly with Keith Dunston, the manager of the fund, whom Kent feels is mainly responsible for Baker's performance. One day Dunston calls Kent and tells him that he will be leaving the fund in four weeks and moving to San Francisco to work for a different money management company. Dunston is seeking suggestions on housing in the area. Baker has not yet announced Dunston's departure. Kent immediately finds a fund that is a suitable replacement for the Baker fund, and over the next two days he calls his 30 clients with the largest dollar investments in the funds and tells them he feels they should switch their holdings. Baker feels the remaining clients' positions are small enough to wait for their annual review to switch funds. Kent has:

✗ **A)** **violated the Standards by not dealing fairly with clients and regarding material nonpublic information.**

✗ **B)** violated the Standards regarding nonpublic information but has not violated the Standards in failing to deal fairly with clients.

✓ **C)** violated the Standards by not dealing fairly with clients but has not violated the Standards regarding material nonpublic information.

Explanation

Kent must treat all clients fairly in acting on the information, regardless of the size of the investment. The information concerning the fund manager's departure is not material nonpublic information because its release would have no effect on individual stock prices within the fund and thus should not impact the fund's net asset value.

Question #73 of 76

Question ID: 412636

John McNeal, CFA, has a friend named Stan Green, a journalist at Investment News, a weekly magazine. In one of their conversations, Green tells McNeal about material nonpublic problems at Brightstar.com, a heavily traded firm. Green has written a special article about Brightstar.com's problems that will appear in the next issue of Investment News. According to the Standards, can McNeal act on the information Green has shared with him?

✗ **A)** **Yes, McNeal can trade on the information but should ask Green to disseminate the information immediately.**

✓ **B)** No, McNeal cannot trade on the information.

✗ **C)** Yes, McNeal can trade on the information, because it is already public.

Explanation

McNeal cannot trade on the information before the article is published. Trading on the information received from the journalist before the magazine is published is trading on material nonpublic information, a breach of Standard II(A).

Question #74 of 76

Question ID: 412702

While visiting the CSI Company, Mark Ramsey, CFA, overheard management make comments that were not public information, but were not really meaningful by themselves. However, when this information is combined with his own analysis and other outside sources, Ramsey decides to change his recommendation on CSI from buy to sell. According to CFA Institute Standards of Professional Conduct, Ramsey should:

✗ **A)** **not issue his report until these comments are made public.**

✓ **B)** issue his sell report because the facts are nonmaterial, but maintain a file of the facts and documents leading to this conclusion.

✗ **C)** report these events to his immediate supervisor and legal counsel, since they have become material in combination with his analysis.

Explanation

The use of security analysis combined with nonmaterial nonpublic information to arrive at significant conclusions is legal and is called the mosaic theory.

Question #75 of 76

Question ID: 412684

Ken James has been an independent financial advisor for 15 years. He received his CFA Charter in 1993, but did not feel it helped his business, so he let his dues lapse this year. He still has several hundred business cards with the CFA designation printed on them. His promotional materials state that he received his CFA designation in 1993. James:

✗ **A)** **must cease distributing the cards with the CFA designation and the existing promotional materials.**

✗ **B)** can continue to use the existing promotional materials, and can use the cards until his supply runs out-his new cards cannot have the designation.

✓ **C)** must cease distributing the cards with the CFA designation, but can continue to use the existing promotional materials.

Explanation

Use of the CFA designation must be stopped immediately, however, the receipt of the Charter is a matter of fact.

Question #76 of 76

Question ID: 412661

Patricia Hoolihan is an individual investment advisor who uses mutual funds for her clients. She typically chooses funds from a list of 40 funds that she has thoroughly researched. The Burns, a married couple that are a client, asked her to consider the Hawkeye fund for their portfolio. Hoolihan had not previously considered the fund because when she first conducted her research three years ago, Hawkeye was too small to be considered. However, the fund has now grown in value, and cursory research uncovers no fundamental flaws with the fund. She puts the fund in the Burns' portfolio but not in any of her other clients' portfolios. The fund ends up being the best performing fund on her list. Hoolihan has:

✗ **A)** **not violated the Standards.**

✓ **B)** violated the Standards by not having a reasonable and adequate basis for making the recommendation.

✗ **C)** violated the Standards by not dealing fairly with clients.

Explanation

Despite the fact the addition of the fund was successful, Hoolihan acted improperly in not conducting the same degree of research as she did for the other funds on her list.