Standards of Professional Conduct & Guidance: Duties to Clients

Test ID: 7658618

Question #1 of 55

Question ID: 412431

Kim Lee manages a variety of accounts at Superior Investments. Some are permitted to invest in tax-exempt issues only; others may not invest in a stock unless it pays dividends. Lee 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!" Lee returns to her office and buys shares for all accounts under her supervision. This action is:

✗ **A)** **a violation of the Standard concerning fiduciary duties.**

✓ **B)** a violation of the Standard concerning appropriateness and suitability of investment actions.

✗ **C)** appropriate given the obvious potential of the therapy.

Explanation

Given the variety of accounts under her supervision, it is not likely the shares of a speculative biotech firm would be suitable for all accounts. Placing such shares in all accounts indicates that she has failed to consider the appropriateness and suitability of the investment for each account, and this places her in violation of Standard III(C).

Question #2 of 55

Question ID: 454909

According to Standard III(C) Suitability, which of the following is *least likely* to be considered a relevant factor in determining the appropriateness and suitability of investment recommendations or actions for each portfolio or client?

✗ **A)** **Needs and circumstances of the portfolio or client.**

✓ **B)** Best interests of the investment professional.

✗ **C)** Basic characteristics of the total portfolio.

Explanation

Determining appropriateness and suitability focuses on the portfolio or client, not on the investment professional. Investment professionals should take particular care to ensure that their goals in selling products or executing security transactions do not conflict with the best interests of the client.

Question #3 of 55

Question ID: 412457

A CFA charterholder may disclose confidential information about a client when:

✓ **A)** **the CFA Institute Professional Conduct Program requests it.**

✗ **B)** the information is nonmaterial.

✗ **C)** it is a necessary step in proceeding with research on client preferences.

Explanation

According to Standard III(E), Preservation of Confidentiality, a CFA charter holder cannot discuss client information received in the process of performing services for them except when related to an illegal action or when requested by the CFA Institute Professional Conduct Program.

Question #4 of 55

Question ID: 412412

Heidi Krueger, CFA, an investment advisor, applies soft dollars generated from client accounts to purchase a report on the economic impact of world events, and to purchase a new conference table for the office she uses to meet with clients and prospects. Do these purchases violate Standard III(A) Loyalty, Prudence, and Care?

✗ **A)** **Both of these purchases violate the Standard.**

✗ **B)** Neither of these purchases violates the Standard.

✓ **C)** Only one of these purchases violates the Standard.

Explanation

Using soft dollars for the purchase of office furniture does not benefit clients and is a violation. Purchasing research reports with soft dollars is not a violation, but the advisor should ensure that research purchased with client brokerage will benefit her clients.

Question #5 of 55

Question ID: 412452

Greg Stiles, CFA, may withhold from CFA Institute information about a client acquired in the regular performance of his duties:

✓ **A)** **for neither of the reasons listed.**

✗ **B)** only if Stiles is a relative of the client.

✗ **C)** only if Stiles has a special confidentiality agreement with the client.

Explanation

According to Standard III(E), Preservation of Confidentiality, Stiles may not withhold information under any of the listed reasons. The reason is that CFA Institute will keep the information confidential.

Question #6 of 55

Question ID: 412426

Calvin Moore, CFA, has been transferred from the brokerage house of the Browning Company to the portfolio management department. In portfolio management, Moore learns that clients are grouped into three divisions according to portfolio value, divided as follows:

- Group 1 up to $10,000
- Group 2 from $10,001 to $100,000
- Group 3 more than $100,000

When recommendations are announced or trades are initiated, a particular sequence is followed in communicating to these groups. At the next monthly meeting, Moore suggests that the sequencing practice is a breach of CFA Institute Standards. One of Moore's co-workers replies that the grouping approach helps the company in applying the Standard regarding portfolio recommendations. He further suggests that because Browning's overall performance is more strongly affected by actions taken on the high value portfolios, that these portfolios should take priority over the small value portfolios. What should Moore do? Moore should:

✗ **A)** **do nothing since there is no breach with the Standards.**

✗ **B)** prepare a written report to the CEO describing the problem.

✓ **C)** disassociate himself from the problem and seek legal advice.

Explanation

Taking a special approach in disseminating information in relation to initiating trades is a breach of Standard III(B), Fair Dealing. Given the fact that Moore works in the department and has already unsuccessfully tried to prevent the practice from continuing, he needs to disassociate himself and seek legal advice.

Question #7 of 55

Question ID: 454910

Janet Reilly has just approached Betty Miller, CFA, about purchasing 10,000 shares of Brookshire Co., a newly incorporated real estate development firm. Reilly is a retired schoolteacher living off the income from her late husband's life insurance policy. This investment will represent a significant shift in her investment portfolio. Miller believes this trade is unsuitable with respect to Reilly's investment policy statement. Consistent with the Standards, Miller should *most appropriately*:

✗ **A)** **follow her firm's procedures for obtaining Reilly's approval to carry out the unsolicited trade request.**

✓ **B)** discuss with Reilly whether she wishes to update her investment policy statement.

✗ **C)** not accept the order, because it is not a suitable investment for Reilly.

Explanation

According to the guidance for Standard III(C) Suitability, a member who receives an unsolicited trade request that is not suitable for the client should discuss the trade with the client before carrying it out. The nature of this discussion depends on whether the trade has a material effect on the client's portfolio. Because this trade will have a material effect, Miller's most appropriate action is to discuss with the client whether this trade request reflects a change in her investment objectives and risk tolerance and thus whether she wishes to update her IPS.

Question #8 of 55

Question ID: 412401

Alan Cramer, CFA, practices in a country that does not regulate the investment of company retirement plans. He was retained by Bingham Companies to manage their corporate pension plan. Bingham's management has approached Cramer and requested that Cramer invest the entire plan in Bingham stock.

Cramer may:

✗ **A)** **invest all of the retirement plan assets in Bingham Company stock according to management's request only if Cramer can document that the investment is more prudent than any other investment opportunity he finds.**

✗ **B)** not invest any of Bingham Company's retirement plan in its own stock regardless of the stock's prospects and in spite of management's request.

✓ **C)** invest a portion of the retirement plan in Bingham Company stock if the investment is prudent and if he keeps the overall portfolio properly diversified.

Explanation

Standard III(A), Loyalty, Prudence, and Care, requires members to comply with their fiduciary duty. Retirement plan managers owe their duty to the plan participants, not to the management of the company sponsoring the plan. The fiduciary duty includes the obligation to diversify the plan's investments, regardless of the quality of the sponsoring company's stock. Investing in the company's stock is not prohibited.

Question #9 of 55

Question ID: 412446

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

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

✗ **B)** in compliance.

✓ **C)** a violation because the advertisement implies the firm generated this return.

Explanation

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

Question #10 of 55

Question ID: 412421

Which of the following statements regarding allocating trades is CORRECT? It is permissible under the Standards to allocate trades:

✓ **A)** **on a pro-rata basis over all suitable accounts.**

✗ **B)** based upon any method the firm deems suitable so long as the allocation procedure has been disclosed to all clients.

✗ **C)** based upon compensation arrangements.

Explanation

It is permissible to allocate trades on a pro-rata basis over all suitable accounts. It is not permissible to base allocations upon compensation arrangements. Any method is not necessarily suitable, and disclosure does not absolve the member from ensuring that the allocation is necessarily fair.

Question #11 of 55

Question ID: 454914

Stephen Rangen, a broker, has three accounts consisting of unsophisticated, inexperienced individual investors with limited means. One of these accounts is an elderly couple. The clients want to invest in safe, income-producing investments. They rely heavily on Rangen's advice and expect him to initiate most transactions in their respective accounts. In managing their accounts, Rangen pursues the following strategies: (1) buys U.S. treasury strips and non-dividend paying over-the-counter (OTC) stocks recommended by his firm's research department, (2) uses margin accounts, and (3) concentrates the equity portion of their portfolio in one or two stocks. Rangen's approach leads to extremely high turnover rates in all three accounts.

Which of the following statements about Rangen's conduct is *most accurate*? Rangen's conduct:

✗ **A)** **meets the requirements of the Code and Standards because his firm's research department recommended the U.S. Treasury strips and non-dividend paying stocks.**

✓ **B)** does not meet the requirements of the Code and Standards because his investment strategy is inconsistent with his clients' objectives.

✗ **C)** meets the requirements of the Code and Standards because his clients are aware of the risks that he is taking in managing their accounts.

Explanation

Rangen's actions are inconsistent with Standard III(C) Suitability because his investment actions are neither appropriate nor suitable for each client. Even if his clients were aware of the risks, the portfolios that he constructed are inconsistent with their financial needs. Although Rangen relies upon recommendations from his firm's research department, he cannot shift blame to his employer because he must follow recommendations that are in the best interests of his clients.

Question #12 of 55

Question ID: 454911

Karen Jackson is a portfolio manager. Jackson is friendly with David James, president of Acme Medical, 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 Acme Medical's board of directors. She has received options and fees as compensation.

Recently, the board of Acme Medical 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 Acme Medical's public offering, James asked Jackson to commit to a large purchase of the offering for her portfolios. Jackson had previously determined that Acme Medical 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 Acme Medical for her clients' portfolios.

Did Jackson violate Standard III(C) Suitability concerning portfolio recommendations and actions?

✗ **A)** **No.**

✓ **B)** Yes, because she did not consider the appropriateness and suitability of investment recommendations or actions for each portfolio or client.

✗ **C)** Yes, because she did not deal fairly with all clients.

Explanation

Jackson violated Standard III(C) Suitability because she did not consider her clients' financial situation, investment experience, and investment objectives.

Question #13 of 55

Question ID: 412423

Rey Sanchez, CFA, covers the specialty chemical industry for Rock Advisory Associates. Until today he has had a buy recommendation on ChemStar, and many of the firm's customers have purchased shares based upon his recommendation. The firm's client accounts are divided into two fundamental categories: trading and buy-and-hold accounts. The firm holds discretionary trading authority over the trading accounts, but not the buy-and-hold accounts. Sanchez has recently come to believe that the fundamentals are changing for the worse at ChemStar, and is preparing a sell recommendation. He calls a meeting of the firm's portfolio managers with accounts holding ChemStar and tells them of the pending release of the sell recommendation. On this basis, the portfolio managers sell all positions in the discretionary accounts but not in the buy-and-hold accounts. Sanchez completes and mails the report to all clients two days later, and, shortly thereafter, many of the buy-and-hold accounts sell their ChemStar positions. With regard to these actions, Sanchez is:

✓ **A) in violation of the Standard on Fair Dealing; the portfolio managers are in violation of the Standard on Fair Dealing.**

✗ **B)** not in violation of the Standard on Fair Dealing; the portfolio managers are in violation of the Standard on Fair Dealing.

✗ **C)** in violation of the Standard on Fair Dealing; the portfolio managers are not in violation of the Standard on Fair Dealing.

Explanation

Sanchez is in violation of the Standard III(B), Fair Dealing, since he has disseminated his recommendation preferentially to the portfolio managers in advance of making the report available to all clients who hold shares of ChemStar. The portfolio managers are in violation of the Standard since they are effectively giving preferential treatment to the trading accounts over the buy-and-hold accounts in the placement of orders based upon the change in recommendation.

Question #14 of 55

Question ID: 412409

Which of the following is *least likely* required of fiduciaries who are responsible for pension plans?

✗ **A) Judging investments in the context of the total portfolio.**

✓ **B)** Supporting the sponsor's management during proxy fights.

✗ **C)** Acting solely in the interest of plan participants.

Explanation

Under Standard III(A) Loyalty, Prudence, and Care, fiduciaries must evaluate management's proposals during proxy fights to see if they are in the best interest of the plan participants. If management's ideas are justifiable and reasonably ensure plan participants' betterment, then fiduciaries can support them. If management is only trying to further its own objectives, especially at the cost of plan participants, then fiduciaries must vote against management in proxy fights.

Question #15 of 55

Question ID: 412444

A money manager, who is a member of CFA Institute, suggests during phone calls to his clients that, "I hope you will relay to your friends the great returns I earned for you this past year." The manager had generated above average returns in the past year. Is this a violation of Standard III(D), Performance Presentation?

- ✗ **A)** **Yes, because the Standard forbids members asking their clients to say anything about how well the member has done.**
- ✗ **B)** Not if it is true.
- ✓ **C)** Yes, because the intended message fails the test of completeness as required under the standard.

Explanation

Standard III(D) requires that members communicate performance in a fair, accurate, and complete fashion, and covers both written and oral communication. Asking someone to advertise only one year's performance is unlikely to be representative since this constitutes a timeframe that is too short.

Question #16 of 55

Question ID: 412419

A money management firm has the following policy concerning new recommendations: When a new recommendation is made, each portfolio manager estimates the likely transaction size for each of their clients. Clients are notified of the new recommendation in the order of their estimated transaction size-largest first. All clients have signed a form where they acknowledge and consent to this allocation procedure. With respect to Standard III(B), Fair Dealing, this is:

- ✗ **A)** **not a violation because the clients are aware of the policy.**
- ✗ **B)** not a violation because the clients have signed the consent form.
- ✓ **C)** a violation of the standard.

Explanation

Such a policy is a violation of the Standard and client acknowledgement and/or consent does not change that fact.

Question #17 of 55

Question ID: 412406

Which of the following is a possible breach of fiduciary duties by a CFA Institute member who manages assets on behalf of a client?

- ✗ **A)** **Neither of these breach fiduciary duties.**
- ✓ **B)** Voting all proxies of stocks the client owns.
- ✗ **C)** Using directed brokerage.

Explanation

Proxies have economic value to the client. To comply with Standard III(A), the analyst is obligated to vote proxies in an informed and responsible manner. A cost benefit analysis may show that voting all proxies may not benefit the client, so voting proxies may not be necessary in all instances. Directed brokerage occurs when the client requests that a portion of the client's brokerage be used to purchase services that directly benefit the client. Although, this may prevent best execution, it does not violate the Standards as it was directed by the client, not the brokerage firm.

Question #18 of 55

Question ID: 412410

Bertha Mader, CFA, received proxy material related to a hostile takeover attempt of Danube Industries by Balnet Company. She holds shares of Danube in most of her client accounts. Mader has a high opinion of Danube's management because they have run the company successfully and have always responded directly and honestly to her inquiries. She is not acquainted with Balnet's management team but knows they have a reputation for improving the bottom line at the companies they acquire, partly because they tend to replace upper management at their targets and assume their functions. Balnet's offer is 60% higher than the price of Danube shares before the announcement. Danube's management has contacted Mader and requested that she vote the shares she controls against the takeover because the management is concerned for their jobs and for the welfare of the company. To comply with the Code and Standards, Mader should:

- ✗ **A)** **vote for the takeover if she can get assurance that Danube's management team will remain in place.**
- ✓ **B)** vote for the takeover if it is in the best interest of Danube's shareholders, regardless of the consequences to current management.
- ✗ **C)** delegate her proxy vote to another member of her firm due to the conflict of interest created when she was contacted by management.

Explanation

Standard III(A), Loyalty, Prudence, and Care, requires that members act for the benefit of their clients. Mader's duty is to her clients, who are shareholders of Danube. She has no duty to Danube's management, nor to the company itself, and must vote the shares accordingly.

Question #19 of 55

Question ID: 412416

An analyst meets with a new client. During the meeting, the analyst sees that the new client's portfolio is heavily invested in one over-the-counter stock. The analyst has been following the stock and thinks it will perform well in the long run. The analyst arranges through a brokerage firm to simultaneously sell a large number of shares of the stock via a series of cross trades from the new client's portfolio to various existing clients. He arranges the trades to be executed at a price that approximates the current market price. This action is:

- ✗ **A)** **a violation of Standard III(A), Loyalty, Prudence, and Care.**
- ✓ **B)** not in violation of the Standards.
- ✗ **C)** a violation of Standard III(B), Fair Dealing.

Explanation

There is no violation. It is in the best interest of the client to be diversified and selling via a series of cross trades will likely reduce price impact costs when compared to selling directly into the market. The analyst appears to have reasonable basis for putting the securities in the accounts of other clients.

Question #20 of 55

Question ID: 470999

Tony Calaveccio, CFA, is the manager of the TrustCo Small Cap Venture Fund in Toronto. Calaveccio places a trade with Quantco Brokerage. While Calaveccio's part of the transaction was conveyed correctly to Quantco, there was a trading error made in Calaveccio's account due to a slip up within Quantco. Calaveccio realizes that the error has taken place, and informs his contact at Quantco. Calaveccio allows Quantco to cover the error, with no cost to TrustCo. This is:

- ✗ **A)** **a violation of Calaveccio's fiduciary duties.**
- ✓ **B)** permissible under CFA Institute Standards.
- ✗ **C)** a violation of Calaveccio's duty to his employer.

Explanation

The issue is similar to an allocation of soft dollars. Clearly, if the broker absorbs the loss, they expect to make up the difference in some way. However, since the error was on the part of Quantco Brokerage, Calaveccio is under no obligation to cover the cost of the trading error. Moreover, no reasonable observer expects that there exists any implied future allocation of trades to Quantco in return for correcting their own mistake. There is no violation of Standard III(A), Loyalty, Prudence, and Care.

Question #21 of 55

Question ID: 412411

According to Standard III(A) Loyalty, Prudence and Care, brokerage is an asset of the:

- ✗ **A)** **managing firm.**
- ✗ **B)** brokerage firm conducting the trades.
- ✓ **C)** client.

Explanation

Brokerage is an asset of the client.

Question #22 of 55

Question ID: 412447

While it would be customary to report both five-year and ten-year performance data, Seminole Equity Partners has been in existence for only eight years. Because of this, Kurt Dambach does not report ten-year data but reports for both five years and since the inception of the fund. This he notes in a footnote at the bottom of the information sheet. This action is:

- ✗ **A)** **a violation of the Standard concerning performance presentation.**
- ✗ **B)** a violation of the Standard concerning prohibition against misrepresentation.
- ✓ **C)** in accordance with the Code and Standards since he has indicated the basis in a footnote.

Explanation

Members who communicate performance information must ensure that the information is fair, accurate, and complete. Seminole Equity's presentation meets this standard.

Question #23 of 55

Question ID: 412417

An investment advisor goes straight from a research seminar to a meeting with a prospective new client with whom she has never been in contact. The advisor is very excited about the information she just received in the seminar and begins showing the prospect the new ideas her firm is coming up with. This is *most likely* a violation of:

- ✗ **A)** **Standard III(B), Fair Dealing.**
- ✗ **B)** Standard III(C), Suitability.
- ✓ **C)** both of these.

Explanation

It is a violation of Standard III(B) because the advisor should act first on behalf of existing clients whose needs and characteristics she already knows. It is a violation of Standard III(C) because she has never met the prospect and does not know if the new ideas are appropriate for the prospect. Thus, "both of these" is the best response.

Question #24 of 55

Question ID: 412424

Which of the following *most accurately* states a limitation that the Fair Dealing standard imposes?

- ✗ **A)** **Referral fees may be disclosed after proceeding with an agreement for service.**
- ✓ **B)** Clients should not be discriminated against when disseminating investment recommendations.
- ✗ **C)** Before trading on her own portfolio, a CFA charterholder must wait for employer and client deals to be executed.

Explanation

Standard III(B) Fair Dealing states that the dissemination of information and recommendations to clients must be handled fairly. The other choices are related to Standard VI(B) Priority of Transactions and Standard VI(C) Referral Fees.

Question #25 of 55

Question ID: 412439

Carol Hull, CFA, is an investment advisor whose prospective client, Frank Peters, presents special requirements. To construct an investment policy statement for Peters, Hull inquires about Peters' investment experience, risk and return objectives, and financial constraints. Peters states that he has a great deal of investment experience in the capital markets and does not wish to answer questions about his tolerance for risk or his other holdings. Under Standard III(C), Suitability, Hull:

- ✗ **A)** **may accept Peters' account but may only manage his portfolio to a benchmark or index.**
- ✓ **B)** is permitted to manage Peters' account without any knowledge of his risk preferences.
- ✗ **C)** must decline to enter into an advisory relationship with Peters.

Explanation

Hull would not violate Standard III(C), Suitability, by managing Peters' account without knowledge of his risk preferences. She made a reasonable inquiry into Peters' investment experience, risk and return objectives, and financial constraints, as the Standard requires. If a client chooses not to provide some of this information, the member or candidate can only be responsible for assessing the suitability of investments based on the information the client does provide.

Question #26 of 55

Question ID: 412445

A money manager is meeting with a prospect. She gives the client a list of stocks and says, "These are the winners I picked this past year for my clients. Their double-digit returns indicate the type of returns I can earn for you." The list includes stocks the manager had picked for her clients, and each stock has listed with it an accurately measured return that exceeds 10%. Is this a violation of Standard III(D), Performance Presentation?

✗ **A)** **No, because the manager had the historical information in writing.**

✗ **B)** Yes, because the manager cannot reveal historical returns of recent stock picks.

✓ **C)** Yes, unless the positions listed constitute a complete presentation (i.e., there were no stocks omitted that did not perform in the double digits).

Explanation

Standard III(D) requires fair representations concerning past and potential future performance. Unless the list of the "winners" includes all the positions that the firm held, the manager is misrepresenting past performance. The following statement is questionable: "Their double-digit returns indicate the type of returns I can earn for you," but the action of submitting a partial list is clearly a violation. The manager should have information on past performance in writing.

Question #27 of 55

Question ID: 412405

An analyst with his own money management firm trades on behalf of several large pension funds. The analyst now performs all trades through a particular brokerage firm because the brokerage provides his firm with a no-interest line of credit if paid within 60 days. The line of credit is available to all brokerage clients. The brokerage provides the analyst with personal account privileges that he would not otherwise be eligible for. The brokerage also provides the analyst with free research reports on many companies. Which of these benefits are violations of Standard III(A), Loyalty, Prudence, and Care?

✗ **A)** **The research reports.**

✗ **B)** Neither of these.

✓ **C)** The personal account privileges.

Explanation

The personal account privileges are clearly a violation. The no-interest line of credit could be a violation if the analyst does not factor in the benefits when determining the fees of the clients, but it is not a per se violation. Research reports are least likely to be a violation.

Question #28 of 55

Question ID: 412453

Greg Stiles, CFA, keeps a list of his clients' birthdays and has personally sent them a birthday card each year at the appropriate time. With respect to this action, which of the following may be a violation of Standard III(E), Preservation of Confidentiality?

✗ **A)** **The mere act of sending a birthday card each year.**

✓ **B)** Hiring a company outside the firm to perform the task.

✗ **C)** Sending a gift along with the card.

Explanation

According to Standard III(E), an analyst should limit the number of persons who have access to clients' personal information. Allowing a company outside the firm to send birthday cards could be a violation. Sending a birthday card is not a violation, nor is sending a gift of reasonable value.

Question #29 of 55

Question ID: 412430

Procedures for compliance with Standard III(C), Suitability, include determining all of the following with respect to a client EXCEPT:

✗ **A)** **return objectives.**

✗ **B)** liquidity needs.

✓ **C)** social habits and interests.

Explanation

The procedures for compliance with Standard III(C) include determining all of the aspects of a client's investment objectives and constraints mentioned above, but do not include gathering information about the client's social habits and interests.

Question #30 of 55

Question ID: 412420

In securing the shares for all accounts under her management, Linda Kammel of Northwest Futures purchased three blocks of shares at three different prices. She then allocated these shares by placing shares from the first block in accounts with surnames beginning with A-G. The second was allocated over accounts H-P, and the third over Q-Z. This action is:

✗ **A)** **consistent with her responsibilities under the Code and Standards.**

✗ **B)** permissible only if the clients are informed of the allocation procedure.

✓ **C)** not permissible under the Code and Standards.

Explanation

Standard III(B) requires a member to deal fairly with all clients when taking investment actions. Since she knew at the outset that she was going to place shares in all accounts, regardless of the first letter of the surname, all accounts must participate on a pro-rata basis in each block in order to conform to the Standard. Her actions constitute a violation of the Standard concerning fair dealing.

Question #31 of 55

Question ID: 412450

Trude Front, CFA, is a portfolio manager and works extensive hours. To give her a more flexible work environment, she often works from home on her personal computer and keeps client account information there – in violation of company policy. While away on travel, her home is burglarized and her computer is taken. Rather than disclose the policy violation, she does not notify her company or her clients of the contents of her computer files. Two months later the client account information is used to commit identity theft, costing her clients a total of $58,000 in fraudulent charges. Front is *most likely*:

✗ **A)** **not in violation of any Standard because the disclosure of confidential information was accidental and unavoidable.**

✓ **B)** in violation of Standard III(E) "Preservation of Confidentiality" for failing to follow company policies and procedures relating to electronic information and security resulting in accidental disclosure of confidential information.

✗ **C)** not in violation of any Standard because the confidential information was stored on her personal computer for use for work during her personal time.

Explanation

Front violated Standard III(E) "Preservation of Confidentiality" by failing to follow company policies and procedures relating to electronic information and security resulting in accidental disclosure of confidential information.

Question #32 of 55

Question ID: 412454

Greg Stiles, CFA, CAIA, has recently liquidated most of a client's portfolio because the client is planning to buy a house. Stiles informs one of the brokers in his office who has his real estate license about the plans of his client. With respect to Standard III(E), Preservation of Confidentiality, this action:

✓ **A)** **violates the Standard unless the client asks Stiles to tell the licensed salesman.**

✗ **B)** is appropriate since Stiles only tells a licensed salesman.

✗ **C)** is appropriate since Stiles keeps the information in the firm.

Explanation

According to Standard III(E), Preservation of Confidentiality, Stiles must keep client information confidential and limit the information to those people directly related to servicing the client. Merely working in the same firm does not qualify a person for learning about the client of a fellow analyst.

Question #33 of 55

Question ID: 412451

While servicing his clients' accounts, an analyst who is a CFA charterholder, determines that one client is probably involved in illegal activities. According to Standard III(E), Preservation of Confidentiality, the analyst may NOT do which of the following?

✗ **A)** **Contact the appropriate governmental authorities about the determination.**

✗ **B)** Contact CFA Institute about the determination.

✓ **C)** There are no exceptions in this list.

Explanation

Standard III(E) allows an analyst to reveal information about a client to CFA Institute since CFA Institute will keep the information confidential. If the analyst is reasonably certain a law has been violated, an analyst may have an obligation to report the activities to the appropriate authorities. Therefore, neither of the listed actions are exceptions from the analyst's options.

Question #34 of 55

Question ID: 454913

Lance Tuipulotu, CFA, manages investments for 400 individuals and families and often finds his resources stretched. When his largest investors petition him to include a 5% to 7% allocation of non-investment-grade bonds in their portfolios, he decides he needs additional help to meet the request. He considers various independent advisors to use as submanagers, but determines that the most qualified advisors would be too expensive. Reasoning that a lower-cost provider would enable him to pass the savings along to his clients, he chooses that provider to invest the new bond allocation. Tuipulotu has violated:

✗ **A)** **Standard V(A) Diligence and Reasonable Basis by letting fee structure determine the selection of the submanager.**

✓ **B)** Both Standard III(C) Suitability and Standard V(A) Diligence and Reasonable Basis.

✗ **C)** Standard III(C) Suitability by failing to consider the appropriateness of the non-investment-grade bonds.

Explanation

Both Standard III(C) Suitability and Standard V(A) Diligence and Reasonable Basis were violated. Tuipulotu must perform a full IPS review to determine the appropriateness of the new portfolio allocations. Submanagers should not be selected by cost structure alone, as the quality and appropriateness of the submanager is Tuipulotu's responsibility.

Question #35 of 55

Question ID: 412448

Paul Salyer,a portfolio manager, is making a presentation to a prospective client. Paul says that as a new portfolio manager, he made an average annual rate of return of 50% in the last two years at his previous firm and that based on this, he can guarantee a 50% return to the client. Which of the following statements is in accordance with Standard III(D), Performance Presentation?

✗ **A)** **Implying that he can guarantee a return.**

✗ **B)** Imputing his past performance to future performance.

✓ **C)** Stating his past performance as long as it is fact.

Explanation

There is no evidence that he's lying about his past performance. He is in violation for implying that he can guarantee performance, for using short-term performance, and for imputing the manager's past performance to future performance.

Question #36 of 55

Question ID: 412413

Jason Reynolds meets Jack Parker, CFA, at a social engagement and asks for some "hot stock tips." Parker declines, but sets up an appointment to review Reynolds' risk and return objectives and financial constraints. At the conclusion of their appointment, Parker recommends three securities he has thoroughly researched: ACK, D-Wing, and Ophus-Littbinger. Parker is *least likely*:

✓ **A)** **not in violation.**

✗ **B)** in violation of Standard III(A) "Loyalty, Prudence, and Care" for failing to consider the three securities in the context of the whole portfolio.

✗ **C)** in violation of Standard III(A) "Loyalty, Prudence, and Care" for failing to make a reasonable inquiry into the client's investment experience.

Explanation

Standard III(A) "Loyalty, Prudence, and Care" requires Parker to make a reasonable inquiry into the client's investment experience, risk and return objectives, and financial constraints. Investment decisions must be made based on a total portfolio approach, rather than the quality of an individual investment in isolation.

Question #37 of 55

Question ID: 412455

Andrew Mader, CFA, is an analyst with Metro Investment Services. During lunch with some of Metro's managers, Mader is told, "There are going to be major problems at Gebco (a firm that Metro had brought public last year). I was just over there and the place is just crawling with government inspectors." Mader had just issued a report with a "buy" recommendation on Gebco last week. Mader should:

✓ **A) not do anything because to do so would violate his obligation to preserve confidentiality.**

✗ **B)** not do anything to avoid a violation of fair dealing.

✗ **C)** immediately issue a new report, but only after stopping by Gebco himself to corroborate the story.

Explanation

Under Standard III(E), members are bound to preserve the confidentiality of information that they receive in the scope of their employment. There is nothing in the information to suggest that any illegal act had occurred. He is, therefore, obligated not to disclose the information to others until it becomes public.

Question #38 of 55

Question ID: 412422

Concerning Standard III(B), Fair Dealing, which of the following actions is NOT a valid procedure for compliance with the Standard?

✓ **A) Communicate investment recommendations to all customers including those accounts for which the securities are not eligible for purchase.**

✗ **B)** Communicate investment recommendations simultaneously within the firm and to customers, where possible.

✗ **C)** Limit the number of people that are involved and are privy to the fact that an investment recommendation is going to be disseminated.

Explanation

To ensure compliance with the Standard, members should seek to communicate investment recommendations to all clients who have indicated an interest and also those for whom the securities are suitable. There is no need to communicate recommendations to clients for whom the securities are deemed unsuitable.

Question #39 of 55

Question ID: 460634

The Standard concerning preservation of confidentiality states that members and candidates must keep information confidential about:

- ✗ **A)** **current clients, former clients, and competitors.**
- ✓ **B)** current clients, former clients, and prospective clients.
- ✗ **C)** members and candidates.

Explanation

Standard III(E) Preservation of Confidentiality applies to information about current, former, and prospective clients.

Question #40 of 55

Question ID: 412443

Paula Munson, CFA, manages a mutual fund with an objective to emphasize income over capital gains. Magic Technologies is a growth stock that pays no dividend, but Republic's research department believes the stock will dramatically outperform the S&P 500 over the next 12 to 18 months. Based on this strong recommendation, Munson adds Magic stock to her fund's portfolio. Munson has:

- ✗ **A)** **not violated the Standards and improved the diversification of the fund.**
- ✓ **B)** violated the Standards by failing to comply with her portfolio's style mandate.
- ✗ **C)** violated the Standards by relying on research that she did not perform herself.

Explanation

Standard III(C) Suitability requires that members managing portfolios take investment actions that are consistent with their portfolio's stated objectives and constraints. The fund's mandate emphasizes income over capital gains. Adding a non-dividend paying stock to the portfolio is a departure from that mandate.

Question #41 of 55

Question ID: 454912

Millie Walker, CFA, established an aggressive growth portfolio for her client, Jesse Wilmer, over three years ago. Wilmer was placed on Walker's employer's client mailing list, and received monthly account statements and the firm's newsletter, which regularly informed clients that they should contact their account representative with any change in their personal circumstances or investment objectives. As of January, of this year, Walker had not spoken to Wilmer nor received any correspondence from Wilmer since the account was established. Walker has:

- ✗ **A)** **not violated the Code and Standards because Wilmer has been reminded regularly about the opportunity to inform Walker about any changes.**
- ✓ **B)** violated the Code and Standards because the manager has not performed an update of Wilmer's financial situation and investment objectives.
- ✗ **C)** not violated the Code and Standards because there has been regular correspondence from Walker's firm to Wilmer.

Explanation

Standard III(C) Suitability requires members to update a client's financial situation and investment objectives at least annually.

Wilmer's account has existed for more than three years, and an update is long overdue. Generally offering to do an update is not sufficient to comply with the Standard.

Question #42 of 55

Question ID: 412408

All of the following are required by fiduciaries under Standard III(A), Loyalty, Prudence, and Care, EXCEPT:

- ✗ **A) act solely in the interest of the ultimate beneficiaries.**
- ✓ **B)** support the sponsor's management during proxy fights.
- ✗ **C)** place the client's interest before the employer's interest.

Explanation

Members are required to act in the interest of their clients. In voting proxies, the client's interest must prevail over management's interest.

Question #43 of 55

Question ID: 412440

The O'Douls (husband and wife) have decided to work with Jane Mack, CFA, to have her recommend an investment portfolio for them. The O'Douls are novice investors and Mack has determined their asset allocation model falls into the conservative category. After researching various investment options for the O'Douls, Mack has made a recommendation that they divide their account on a 25%/75% basis between shares of a computer peripherals manufacturing company her brokerage firm is underwriting and investment grade corporate bonds. The O'Douls are not aware that Mack's firm is underwriting an offering of the company in question. Which CFA Institute Standard(s) has Mack violated given her actions?

- ✗ **A) Standard III(B), Fair Dealing, and III(A), Loyalty, Prudence, and Care.**
- ✗ **B)** Standard V(A), Diligence and Reasonable Basis, and I(D), Misconduct.
- ✓ **C)** Standard VI(A), Disclosure of Conflicts, and III(C), Suitability.

Explanation

Mack is obliged to disclose the conflict of interest regarding her company's IPO and to consider both the appropriateness and the suitability of the investment for her client. She has apparently failed in both respects.

Question #44 of 55

Question ID: 412418

Which of the following statements is *least* accurate regarding being a part of Standard III(B), Fair Dealing?

- ✗ **A) Shorten the time between decision and dissemination.**
- ✗ **B)** Maintain a list of clients and their holdings.
- ✓ **C)** At the same time notify clients for whom an investment is suitable of a new investment recommendation.

Explanation

All of these are part of Standard III(B) except notifying clients at the same time. Standard III(B) states that clients for whom the investment is suitable should be notified at *approximately* the same time.

Question #45 of 55

Question ID: 412414

All of the following are violations of Standard III(B), Fair Dealing, EXCEPT a member:

✓ **A)** **telephones clients in distant cities the day after a buy recommendation is mailed to all clients because their mail service is later than the member's local clients.**

✗ **B)** places a trade for the firm account before issuing a buy recommendation.

✗ **C)** places a trade for her discretionary accounts before placing a trade for her non-discretionary accounts.

Explanation

Standard III(B) states, "*Members shall deal fairly and objectively with all clients* and prospects *when providing investment analysis, making investment recommendations, taking investment action, or in other professional activities."*

The term "fairly" implies that members should take care not to discriminate against a client when disseminating investment recommendations. All the responses, except for the telephoning of distant clients (which has the effect of putting them in the same position as local clients), describe a situation in which a client or group of clients is receiving preferential or detrimental treatment that is unfair.

Question #46 of 55

Question ID: 412458

Calvin Doggett, CFA, has been contacted by the CFA Institute Professional Conduct Program (PCP) regarding allegations that he has taken investment actions that were unsuitable for his clients. Doggett is questioned by PCP concerning the identity of his clients he considered suitable for investing in a very risky start-up company that eventually went bankrupt.

Doggett will:

✗ **A)** **not violate the Code and Standards only if he reveals the financial condition and investment objectives of his clients on an anonymous basis and does not reveal the names of his clients to PCP.**

✗ **B)** violate the Code and Standards by fully cooperating with a PCP investigation if it means revealing confidential information.

✓ **C)** not violate the Code and Standards by revealing the names, financial condition and investment objectives of his clients to PCP.

Explanation

Standard III(E) requires members to preserve client confidentiality. An exception to this standard is a PCP investigation. Because PCP will also keep the clients' information confidential, members are expected to fully cooperate with PCP investigations.

Question #47 of 55

Question ID: 412449

Nancy Korthauer, CFA, has launched a new hedge fund called the Korthauer Tautology Fund and is actively soliciting clients from competitor's firms. Client presentations are necessarily brief and often take place with the prospective client's current investment advisor in the room. The Code and Standards require that:

✓ **A) member or candidate provide (on request) additional detail information which supports the abbreviated presentation.**

✗ **B)** a prospective client's current investment advisor not participate in meetings.

✗ **C)** all client presentations provide a thorough review of all elements of the investment management process. Abbreviated presentations are forbidden.

Explanation

See Standard III(D). When presentations are brief, additional detail which supports the abbreviated presentation information must be provided on request. Best practice dictates that the member or candidate should make reference to the abbreviated nature of the presentation.

Question #48 of 55

Question ID: 412407

Tony Calaveccio, CFA, is the manager of the TrustCo Small Cap Venture Fund in Toronto. He places trades for the fund with River City Brokerage. River City provides Calaveccio with soft dollars to purchase research. River City also deals in municipal bonds, some of which Calaveccio holds in his personal portfolio. He periodically uses the soft dollars to request research reports on various small cap stocks and also on the status of the municipal bond market and issues that he holds. These actions are:

✗ **A) in violation of his fiduciary duties regarding both the small cap research and the municipal bond research.**

✓ **B)** in violation of his fiduciary duties regarding the municipal bond research but not so regarding the research on the small cap issues.

✗ **C)** not in violation of the Code and Standards.

Explanation

The issue at hand is the member's fiduciary responsibilities in handling "soft dollars" which are technically the property of the client. Standard III(A), Loyalty, Prudence, and Care, delineates the member's fiduciary responsibilities with regard to soft dollars. Since municipal bond research is clearly not relevant to the Small Cap Fund holders, he is clearly using the soft dollars to obtain research for his personal benefit and is in violation of the Standard.

Question #49 of 55

Question ID: 412402

While trading on behalf of a pension account, an analyst receives special research reports from the brokerage firm with whom she is doing the trades. Such an activity is:

✗ **A) a violation of both Standard III(A), Loyalty, Prudence, and Care, and the Code of Ethics.**

✗ **B)** a violation of only The Code of Ethics.

✓ **C)** not in itself a violation of Standard III(A), Loyalty, Prudence, and Care, nor the Code of Ethics.

Explanation

An analyst can receive research from a brokerage firm with whom she is trading on behalf of a client. The analyst should inform the client of the arrangement. The analyst is more likely to violate Standard III(A) by obtaining non-research services or, worse yet, personal benefits from the brokerage firm.

Question #50 of 55

Question ID: 412415

Which of the following would be a violation of Standard III(B), Fair Dealing?

✗ **A)** **Limiting the number of employees privy to recommendations and changes.**

✓ **B)** Trading for regular accounts before discretionary accounts.

✗ **C)** Having well defined guidelines for pre-dissemination.

Explanation

Do not discriminate against a client when disseminating investment recommendations. If the firm offers different levels of service, this fact must be offered and disclosed to all clients. The other choices are necessary parts of the Standard. The Standard actually says to have published personal guidelines for pre-dissemination, which implies that the guidelines be well-defined.

Question #51 of 55

Question ID: 412425

Bjorn Sandvik, CFA, completes a research report with a buy recommendation for Acorn Properties. In the early afternoon, Sandvik e-mails this recommendation to his clients who had responded to his request that they provide Sandvik with their e-mail addresses. Later that afternoon, the printed recommendation is forwarded to the postal service for normal delivery to all customers, who receive the mailing 1 to 3 days later. Sandvik has:

✓ **A)** **not violated the Code and Standards because he acted fairly in disseminating research information to his clients.**

✗ **B)** violated the Code and Standards by sending the e-mail recommendation in advance of the printed report.

✗ **C)** violated the Code and Standards by sending the e-mail recommendation to only some of his clients.

Explanation

Standard III(B) Fair Dealing requires that members deal fairly with all clients in disseminating investment recommendations. It does not require uniform or equal treatment. Sandvik's approach in sending e-mail correspondence to those of his clients who had given him their e-mail addresses, having made the request to all of his clients, and sending regular mail correspondence the same day, is fair to all of his clients.

Question #52 of 55

Question ID: 412436

Bob Hatfield, CFA, has his own money management firm with two clients. The accounts of the two clients are equal in value. One of the clients gets married and the assets of the new spouse and the client are combined. With the larger portfolio of the now married client, Hatfield determines that they can assume a higher level of risk and begins a change in the policy concerning that portfolio. Which of the following would violate Standard III(C), Suitability?

✗ **A) Assess the return objectives of the newly married client and his spouse.**

✓ **B)** Implement a similar policy for the other client who did not just get married.

✗ **C)** Assess the time horizon of the newly married client and his spouse.

Explanation

According to Standard III(C), Suitability, the analyst must assess the time horizon, return objectives, tax considerations, and liquidity needs of a client before changing an investment policy. The analyst must notify the client of the new policy. Implementing the policy for the other client may be a violation of the Standard unless that client's needs are totally reassessed and determined to be identical to the needs of the newly married client.

Question #53 of 55

Question ID: 472405

James Bush, CFA, is meeting with an investor, George Stephan, for the first time. During their first meeting, Bush, before making any inquiry regarding the client's circumstances, outlines several investment strategies and also describes a specific stock with what Bush believes offers a high potential for large gains, and recommends that Stephan include this stock in his portfolio. With regard to suitability, Bush's actions:

✗ **A) violate the Standards because Bush must obtain information on which securities the client has invested in previously, in order to make appropriate investment recommendations.**

✗ **B)** comply with the Standards.

✓ **C)** violate the Standards because Bush must determine Stephan's risk tolerance, objectives and needs before making any investment recommendations.

Explanation

In accordance with Standard III(C) Suitability, a member or candidate acting as an investment advisor must make a reasonable inquiry into the client's objectives, constraints, and investment experience prior to making any investment recommendation. The Standard recommends preparing an Investment Policy Statement (IPS) for the client. Investments the client has made previously may be relevant to the client's investment experience, but Standard III(C) does not require the advisor to obtain specific information about which securities the client has previously invested in, although current holdings may be quite relevant.

Question #54 of 55

Question ID: 412404

An independent analyst has only one client. One of the client's largest holdings is a brokerage firm. Because of the large holding by his client, the brokerage firm recently began allowing the analyst to tap into the firm's computer network to use the firm's research facilities. This is allowable as long as the analyst:

✗ **A) uses the resources to help manage the client's account.**

✗ **B)** discloses the relationship to the client.

✓ **C)** does both of the actions listed here.

Explanation

According to Standard III(A), Loyalty, Prudence, and Care, the analyst must put the client first and inform the client of any possible conflicts of interest. The analyst must channel any benefits derived from his service to the client, back to the client, and inform the client of the benefits.

Question #55 of 55

Question ID: 412456

Standard III(E), Preservation of Confidentiality, applies to the information that an analyst learns from:

✓ **A) current clients, former clients, and prospects.**

✗ **B)** current clients and prospects only.

✗ **C)** current clients and former clients only.

Explanation

According to Standard III(E), Preservation of Confidentiality, an analyst must preserve the confidentiality of information communicated by clients, former clients, and prospects.