

Mock Exam 1 Session 1

◀ ▶ Question 1 of 90

Q. Joy Nash, CFA, resides in Country 1, where applicable law is less strict than the Standards. Nash does business in Country 2, where applicable law is less strict than in Country 1. According to the Standards, when doing business in Country 2, Nash must follow:

- A.** the Code and Standards.
- B.** applicable law of Country 1.
- C.** applicable law of Country 2.

Solution

- A. Correct** because applicable law states that the law of the locality where the business is conducted governs and local law is less strict than the Code and Standards, member must adhere to the Code and Standards.
- B. Incorrect** because if applicable law is stricter than the requirements of the Code and Standards, members and candidates must adhere to applicable law; otherwise, they must adhere to the Code and Standards.
- C. Incorrect** because applicable law states that the law of the locality where the business is conducted governs and local law is less strict than the Code and Standards, member must adhere to the Code and Standards.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Discuss ⓘ

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Mock Exam 1 Session 1

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Q. Which of the following situations *most likely* helps to explain why the GIPS standards were created?

- A.** Firms were including only top performing funds to represent their performance history.
- B.** Asset managers were including the performance of all portfolios, including those no longer managed in their performance history.
- C.** Consistency among fund managers were needed when making investment performance presentations.

Solution

- A. Correct** because the GIPS standards were created to help prevent misleading practices, such as representative accounts, whereby firms select top-performing portfolios to represent the firm's overall investment results for a specific mandate.
- B. Incorrect** because including all portfolios a manager no longer manages, any survivorship bias is eliminated. Survivorship bias is a misleading practice that the GIPS standards aim to eliminate.
- C. Incorrect** because having consistent reporting styles for performance measurement between asset managers, valid comparisons are easier for the client and potential client to obtain. This was one of the objectives of the GIPS standards.

Introduction to the Global Investment Performance Standards (GIPS)

- explain why the GIPS standards were created, who can claim compliance, and who benefits from compliance

Mock Exam 1 Session 1

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Q. Daniel Morgan is a Level III candidate in the CFA Program. After taking the exam, Morgan signs into a CFA-candidate-only Internet forum and writes a post expressing the opinion that the CFA Program and examination policies are unfair. Has Morgan *most likely* violated the Standards?

- A. No.
- B. Yes, by providing confidential program information.
- C. Yes, by compromising the reputation of CFA Institute.

Solution

- A. Correct** because Standard VII (A), Conduct as Members and Candidates in the CFA Program does not cover expressing opinions regarding CFA Institute, the CFA Program, or other CFA Institute programs. Morgan has not violated the Standard by expressing his opinion in an Internet forum.
- B. Incorrect** because according to Standard VII (A), candidates may express opinions, as described in the justification for the correct answer. Morgan has not provided any confidential program information in his post and is not in violation of this Standard.
- C. Incorrect** because according to Standard VII (A), candidates may express opinions, as described in the justification for the correct answer.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Mock Exam 1 Session 1

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Q. Which of the following should a GIPS-compliant firm *most likely* provide to each prospective client?

- A. A list of composite descriptions upon request
- B. A copy of the GIPS standards
- C. A compliant presentation every six months

Solution

- A. **Correct** because GIPS-compliant firms must provide a complete list of composite descriptions to any prospective client that makes such a request. The list must include terminated composites for a minimum of five years after the composite termination date.
- B. Incorrect because a firm is not required to give a copy of the GIPS standards to prospective clients.
- C. Incorrect because firms must make every reasonable effort to provide a compliant presentation to all prospective clients. A firm meets this requirement if the firm gives the prospective client a compliant presentation every 12 months, not every 6 months.

Introduction to the Global Investment Performance Standards (GIPS)

- describe the fundamentals of compliance, including the recommendations of the GIPS standards with respect to the definition of the firm and the firm's definition of discretion

Discuss ⓘ

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Mock Exam 1 Session 1

◀ ▶ Question 5 of 90

Q. Which of the following is permitted according to the Standards? A member:

- A.** exploits market inefficiencies for personal trades.
- B.** disseminates information to give the impression of increased liquidity of an asset.
- C.** secures a dominant position in an underlying asset to control the price of its derivative.

Solution

- A. Correct** because Standard II(B) is not intended to preclude transactions undertaken on legitimate trading strategies based on perceived market inefficiencies. The intent of the action is critical to determining whether it is a violation of this standard. Therefore, a member is permitted to exploit market inefficiencies for personal trades.
- B. Incorrect** because information-based market manipulation includes transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market. Therefore, a member is not permitted to disseminate information to give the impression of increased liquidity of an asset.
- C. Incorrect** because information-based market manipulation includes securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset. Therefore, a member is not permitted to secure a dominant position in an underlying asset to control the price of its derivative.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Mock Exam 1 Session 1

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Ashley Brown, CFA, applies for a new job. In her application letter, she states, "As a CFA charterholder, I provide the best value in trade execution." Further, she states, "I passed all three CFA Program examinations in three consecutive years." Has Brown violated the Standards?

- A. No
- B. Yes, by stating, "As a CFA charterholder, I provide the best value in trade execution"
- C. Yes, by stating, "As a CFA charterholder, I provide the best value in trade execution" and by stating, "I passed all three CFA Program examinations in three consecutive years"

Solution

- A. Incorrect because according to Standard VII (B), Reference to CFA Institute, the CFA Designation, and the CFA Program, Brown violated the Standards by directly implying that superior performance can be expected of someone with the CFA designation.
- B. **Correct** because according to Standard VII (B), Reference to CFA Institute, the CFA Designation, and the CFA Program, Brown violated the Standards by directly implying that superior performance in trade execution can be expected of someone with the CFA designation. Statements referring to CFA Institute, the CFA designation, or the CFA Program that overstate the competency of an individual or imply, either directly or indirectly, that superior performance can be expected from someone with the CFA designation are not allowed under the standard.
- C. Incorrect because according to Standard VII (B), Reference to CFA Institute, the CFA Designation, and the CFA Program, the second statement is allowed. member may state that all principals passed the three examinations on the first try as long as this statement is true, but it must not be linked to performance or imply superior ability.

Guidance for Standards I–VII

Mock Exam 1 Session 1

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Q. Yip Wai Yin, a CFA candidate, is an independent mutual fund sales agent. For every front-end load product she promotes, Yip receives a portion of the front-end fee as commission at the time of sale. For every back-end load fund she sells, Yip receives a smaller commission paid at the end of the year. Yip always informs her clients that she is paid a commission as an agent, but does not provide details of the compensation structure. When pitching her favored front-end load product line she tells clients 20% of her commission is always invested in the same fund as proof of her confidence in the fund she recommends. Which Standard does Yip *least likely* violate?

- A. Referral Fees
- B. Priority of Transactions
- C. Avoid or Disclose Conflicts

Solution

- A.** Incorrect because by not detailing the commission structure to her clients, Yip does not disclose the potential reason for her favoring front-end load funds over back-end load as the commission is higher and is paid immediately, rather than at the end of the year.
- B. Correct** because Yip's investments do not adversely affect the interest of the clients and therefore do not violate the Priority of Transactions requirement. A candidate having the same investment positions does not always create a conflict of interest, and in some instances having an aligned investment portfolio can be beneficial to the client. By not detailing the commission structure to her clients, Yip does not disclose the potential reason for her favoring front-end load funds over back-end load as the commission is higher and is paid immediately rather than at the end of the year and is in violation of Standard VI(A), Avoid or Disclose Conflicts. Yip also does not disclose the commission structure in detail, which could impair her independence when recommending front-load mutual funds rather than back-end load mutual funds to her clients, a violation of Standard VI(C), Referral Fees.

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a commission as an agent, but does not provide details of the compensation structure. When pitching her favored front-end load product line she tells clients 20% of her commission is always invested in the same fund as proof of her confidence in the fund she recommends. Which Standard does Yip *least likely* violate?

- A. Referral Fees
- B. Priority of Transactions
- C. Avoid or Disclose Conflicts

Solution

- A. Incorrect because by not detailing the commission structure to her clients, Yip does not disclose the potential reason for her favoring front-end load funds over back-end load as the commission is higher and is paid immediately, rather than at the end of the year.
- B. **Correct** because Yip's investments do not adversely affect the interest of the clients and therefore do not violate the Priority of Transactions requirement. A candidate having the same investment positions does not always create a conflict of interest, and in some instances having an aligned investment portfolio can be beneficial to the client. By not detailing the commission structure to her clients, Yip does not disclose the potential reason for her favoring front-end load funds over back-end load as the commission is higher and is paid immediately rather than at the end of the year and is in violation of Standard VI(A), Avoid or Disclose Conflicts. Yip also does not disclose the commission structure in detail, which could impair her independence when recommending front-load mutual funds rather than back-end load mutual funds to her clients, a violation of Standard VI(C), Referral Fees.
- C. Incorrect because Yip does not disclose the commission structure in detail, which could impair her independence when recommending front-load mutual funds rather than back-end load mutual funds to her clients.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

◀ ▶ | Question 8 of 90

Q. After a firm presents a minimum required number of years of GIPS-compliant performance, the firm must present an additional year of performance each year, building up to a minimum of:

- A.** 5 years of GIPS-compliant performance.
- B.** 10 years of GIPS-compliant performance.
- C.** 15 years of GIPS-compliant performance.

Solution

- A.** Incorrect because the initial period is five years of GIPS-compliant performance, building up to a minimum of 10 years of GIPS-compliant performance.
- B. Correct** because after a firm presents a minimum of five years of GIPS-compliant performance, the firm must present an additional year of performance each year, building up to a minimum of 10 years of GIPS-compliant performance.
- C.** Incorrect because an additional year of performance each year is added building up to a minimum of 10 years of GIPS-compliant performance.

Introduction to the Global Investment Performance Standards (GIPS)

- describe the key concepts of the GIPS Standards for Firms

Discuss ⓘ

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Discussion

What do you want to discuss... (required)

◀ ▶ | **Question 9 of 90**

Q. Which of the following is a violation according to the Standard relating to preservation of confidentiality?

- A.** Members share details relating to former clients with third party service providers
- B.** Members convey to clients that not all firm-sponsored resources may be appropriate for communicating confidential information
- C.** When allowed under the law, members share confidential client information to defend themselves in an investigation by the CFA Institute Professional Conduct Program

Solution

- A. Correct** because Standard III(E), Preservation of Confidentiality, requires that members and candidates preserve the confidentiality of information communicated to them by their clients, prospective clients, and former clients. Details of former clients cannot be shared with third party service providers and this is a violation of the Standard.
- B. Incorrect** because according to Standard III(E), Preservation of Confidentiality, it is important to convey to clients that not all firm-sponsored resources may be appropriate for communicating confidential information.
- C. Incorrect** because according to Standard III(E), Preservation of Confidentiality, when permissible under applicable law, members and candidates shall consider the PCP an extension of themselves when requested to provide information about a client in support of a PCP investigation into their own conduct. This is not a violation of the Standards when permitted by law.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Discuss ⓘ

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◀ ▶ | **Question 10 of 90**

Q. Which of the following is a recommended procedure for compliance with the standard relating to responsibilities of supervisors? Once a violation in the form of wrongdoing from an employee is discovered, a supervisor should do which of the following?

- A.** Avoid increasing supervision of the wrongdoer until the investigation is concluded
- B.** Place appropriate limitations on the wrongdoer pending the outcome of the investigation
- C.** Rely on an employee's statement about the extent of a violation of the law if the employee gives written assurance that the wrongdoing will not reoccur

Solution

- A.** Incorrect because according to Standard IV (C), Responsibilities of Supervisors, once a violation is discovered, a supervisor should increase supervision or place appropriate limitations on the wrongdoer pending the outcome of the investigation.
- B. Correct** because according to Standard IV (C), Responsibilities of Supervisors, once a supervisor learns that an employee has violated or may have violated the law or the Code and Standards, the supervisor must promptly initiate an assessment to determine the extent of the wrongdoing. Relying on an employee's statements about the extent of the violation or assurances that the wrongdoing will not reoccur is not enough. Reporting the misconduct up the chain of command and warning the employee to cease the activity are also not enough. Pending the outcome of the investigation, a supervisor should take steps to ensure that the violation will not be repeated, such as placing limits on the employee's activities or increasing the monitoring of the employee's activities.
- C.** Incorrect because according to Standard IV (C), Responsibilities of Supervisors, Relying on an employee's statements about the extent of the violation or assurances that the wrongdoing will not reoccur is not enough.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

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Q. Dimitri Kuznetsov, CFA, is a portfolio manager and holds shares of Barnikoff Limited and Matric Ventures in all client portfolios. Both companies have upcoming annual general meetings scheduled for the same day. The management of Barnikoff proposes to change its financial year-end from September to December, while Matric Ventures proposes to enter into a high-risk venture. The proxy voting policy clause in all client investment management agreements managed by Kuznetsov states, "When voting proxies provides a cost benefit to the client, the manager must vote a proxy." With regard to the proxy votes for Matric and Barnikoff, Kuznetsov would *least likely* violate CFA Institute Standard III(A)—Loyalty, Prudence, and Care if he votes:

- A. with management.
- B. only the Matric proxy.
- C. only the Barnikoff proxy.

Solution

- A. Incorrect because Standard III(A)—Loyalty, Prudence, and Care states that it is a member or candidate's duty to vote proxies on behalf of clients in an informed and responsible manner. A manager must not blindly vote with management without first considering the impact of the issue at hand and its benefit to the client.
- B. **Correct** because Standard III(A)—Loyalty, Prudence, and Care states that it is a member or candidate's duty to vote proxies on behalf of clients in an informed and responsible manner. However, if a cost–benefit analysis shows voting all proxies may not benefit the client, voting all proxies may not be necessary. The member or candidate is responsible for informing all clients if this is the policy of the fund manager. The member or candidate must take steps to disclose this proxy voting policy to clients. Voting the Barnikoff proxy does not appear to offer a benefit because the issue is not of a critical nature, but voting the proxy for Matric involves a material issue and is a benefit that should be voted on.
- C. Incorrect because while Standard III(A)—Loyalty, Prudence, and Care states that it is a member or candidate's duty to vote proxies on behalf of clients in an informed and responsible manner, if a cost–benefit analysis shows voting all proxies may not benefit the client, voting all proxies may not be necessary.

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Q. Umi Grabbo, CFA, is a highly regarded portfolio manager for Atlantic Advisors, a mid-sized mutual fund firm investing in domestic securities. She has watched the hedge fund boom and on numerous occasions suggested that her firm create such a fund. Senior management has refused to commit resources to hedge funds. Attracted by potential higher fees associated with hedge funds, Grabbo and several other employees begin development of their own hedge fund to invest in international securities. Grabbo and her colleagues are careful to work on the fund development only on their own time. Because Atlantic management thinks hedge funds are a fad, she does not inform her supervisor about the hedge fund creation. According to the Standards of Practice Handbook, Grabbo should *most likely* address which of the Standards immediately?

- A. Priority of transactions
- B. Avoid or disclose conflicts
- C. Additional compensation arrangements

Solution

- A. Incorrect because the hedge fund will trade in international securities while Atlantic trades in domestic securities so it is unlikely their investments will conflict with each other. Additionally, policies and procedures needed to address Standard VI(B), Priority of Transactions, will be required in the future, but are not needed at the present time, as the fund is not trading.
- B. **Correct** because according to Standard VI(A), Avoid or Disclose Conflicts, Grabbo must disclose to her employer her hedge fund development as this activity could possibly interfere with her responsibilities at Atlantic. In setting up a hedge fund, Grabbo was not acting for the benefit of her employer. She should have informed Atlantic that she wanted to organize the hedge fund and come to some mutual agreement on how this would occur.
- C. Incorrect because Grabbo is not receiving additional compensation as the fund is still in development, and thus there is no violation of Standard IV(B), Additional Compensation Arrangements. However, there could be compensation in the future, so this will need to be addressed at some point.

Guidance for Standards I–VII

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Which of the following member actions violates the Standard relating to misconduct?

- **Action 1:** Declaring personal bankruptcy because of a large loss from investing in a startup company.
 - **Action 2:** Allocating for her personal account shares from an oversubscribed IPO that is suitable for her firm's clients.
- A. Action 1 only
B. Action 2 only
C. Both Action 1 and Action 2

Solution

- A. Incorrect because according to Standard I(D), Misconduct, the Code and Standards are primarily aimed at conduct and actions related to a member's or candidate's professional life. Also, personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy, but if the circumstances of the bankruptcy involve fraudulent or deceitful business conduct, the bankruptcy may be a violation of this standard. Therefore, a member does not violate Standard I(D), Misconduct, by declaring personal bankruptcy because of a large loss from investing in a startup company.
- B. **Correct** because Standard I(D), Misconduct, addresses all conduct that reflects poorly on the professional integrity, good reputation, or competence of members and candidates. Any act that involves lying, cheating, stealing, or other dishonest conduct is a violation of this standard if the offense reflects adversely on a member's or candidate's professional activities. Accepting allocation of shares from an issuer in an oversubscribed IPO for her personal account reflects poorly on the member's professional integrity. Therefore, the member violates Standard I(D).

The member's conduct also violates Standard I(B), Independence and Objectivity. One type of benefit is the allocation of shares in oversubscribed IPOs to investment managers for their personal accounts. This practice affords managers the opportunity to make quick profits that may not be available to their clients. Such a practice is prohibited under Standard I(B).

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A. Incorrect because according to Standard I(D), Misconduct, the Code and Standards are primarily aimed at conduct and actions related to a member's or candidate's professional life. Also, personal bankruptcy may not reflect on the integrity or trustworthiness of the person declaring bankruptcy, but if the circumstances of the bankruptcy involve fraudulent or deceitful business conduct, the bankruptcy may be a violation of this standard. Therefore, a member does not violate Standard I(D), Misconduct, by declaring personal bankruptcy because of a large loss from investing in a startup company.

B. Correct because Standard I(D), Misconduct, addresses all conduct that reflects poorly on the professional integrity, good reputation, or competence of members and candidates. Any act that involves lying, cheating, stealing, or other dishonest conduct is a violation of this standard if the offense reflects adversely on a member's or candidate's professional activities. Accepting allocation of shares from an issuer in an oversubscribed IPO for her personal account reflects poorly on the member's professional integrity. Therefore, the member violates Standard I(D).

The member's conduct also violates Standard I(B), Independence and Objectivity. One type of benefit is the allocation of shares in oversubscribed IPOs to investment managers for their personal accounts. This practice affords managers the opportunity to make quick profits that may not be available to their clients. Such a practice is prohibited under Standard I(B).

C. Incorrect because Standard I(D), Misconduct, addresses all conduct that reflects poorly on the professional integrity, good reputation, or competence of members and candidates. Any act that involves lying, cheating, stealing, or other dishonest conduct is a violation of this standard if the offense reflects adversely on a member's or candidate's professional activities. Accepting allocation of shares from an issuer in an oversubscribed IPO for her personal accounts reflects poorly on the member's professional integrity but declaring personal bankruptcy does not relate to the member's professional life. Therefore, the former is a violation of Standard I(D), Misconduct, while the latter is not.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

◀ ▶ | **Question 14 of 90**

Q. According to the Standards, a member who manages an index fund is:

- A.** only required to invest in a manner consistent with the fund's stated mandate.
- B.** only required to determine the suitability of the fund for those who invest in the fund.
- C.** both required to invest in a manner consistent with the fund's stated mandate and to determine the suitability of the fund for those who invest in the fund.

Solution

- A. Correct** because according to Standard III(C), Suitability, some members are responsible for managing a fund to an index or an expected mandate. The responsibility of these members and candidates is to invest in a manner consistent with the stated mandate. Members and candidates who manage pooled assets to a specific mandate are not responsible for determining the suitability of the *fund* as an investment for investors who may be purchasing shares in the fund.
- B. Incorrect** because according to Standard III(C), Suitability, members and candidates who manage pooled assets to a specific mandate are not responsible for determining the suitability of the *fund* as an investment for investors who may be purchasing shares in the fund.
- C. Incorrect** because according to Standard III(C), Suitability, members and candidates who manage pooled assets to a specific mandate are not responsible for determining the suitability of the *fund* as an investment for investors who may be purchasing shares in the fund.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Discuss ⓘ

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◀ ▶ | **Question 15 of 90**

Q. Which of the following is **not** among the recommended procedures for compliance with the Standard relating to performance presentation?

- A.** Excluding terminated accounts as part of the performance history
- B.** Presenting performance of the weighted composite of similar portfolios
- C.** Considering the sophistication of the audience to whom a performance presentation is addressed

Solution

- A. Correct** because according to the recommended procedures for compliance with Standard III (D), Performance Presentation, members and candidates can also meet their obligations under Standard III (D) by including terminated accounts as part of performance history with a clear indication of when the accounts were terminated. Therefore, including (not excluding) terminated accounts is recommended.
- B. Incorrect** because according to the recommended procedures for compliance with Standard III (D), Performance Presentation, members and candidates can also meet their obligations under Standard III (D) by presenting the performance of the weighted composite of similar portfolios rather than using a single representative account.
- C. Incorrect** because according to the recommended procedures for compliance with Standard III (D), Performance Presentation, members and candidates can also meet their obligations under Standard III (D) by considering the knowledge and sophistication of the audience to whom a performance presentation is addressed.

Guidance for Standards I–VII

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Discuss ⓘ

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◀ ▶ | **Question 16 of 90**

Q. Holly Baker, CFA is explaining CFA Institute Code of Ethics to a client. Which of the following statements could Baker make to *most likely* reflect disciplinary sanctions the CFA Institute may impose? Sanctions include:

- A. fines for violations.
- B. revocation of membership.
- C. banishment from the industry.

Solution

- A. Incorrect because CFA Institute Bylaws do not include fines as a sanction.
- B. **Correct** because CFA Institute may revoke membership for violations of the Institute Code of Ethics.
- C. Incorrect because CFA Institute does not have the authority to ban an individual from the business and does not always apply sanctions to every violation of its Code.

Code of Ethics and Standards of Professional Conduct

- describe the structure of the CFA Institute Professional Conduct Program and the process for the enforcement of the Code and Standards

Discuss ⓘ

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Discussion

What do you want to discuss... (required)

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Q. Lawrence Hall, CFA, and Nancy Bishop, CFA, began a joint research report on Stamper Corporation. Bishop visited Stamper's corporate headquarters for several days and met with all company officers. Prior to the completion of the report, Bishop was reassigned to another project. Hall utilized his and Bishop's research to write the report but did not include Bishop's name on the report because he did not agree with and changed Bishop's conclusion included in the final report. According to the CFA Institute Standards of Practice Handbook, did Hall *most likely* violate any CFA Institute Standards of Professional Conduct?

- A. No
- B. Yes, with respect to misrepresentation
- C. Yes, with respect to diligence and reasonable basis

Solution

- A. Correct** because members are in compliance with Standard V (A)—Diligence and Reasonable Basis if they rely on the research of another party who exercised diligence and thoroughness. Because Bishop's opinion did not agree with the final report, disassociating her from the report is one way to handle this difference between the analysts.
- B. Incorrect because Hall did not make any misrepresentation.
- C. Incorrect because Hall is allowed to rely on a third party who exercised diligence and thoroughness.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

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Q. According to the Standard relating to referral fees, members should disclose to employers the amount and nature of compensation received at least:

- A. monthly.
- B. quarterly.
- C. annually.

Solution

- A.** Incorrect because according to the recommended procedures for compliance with Standard VI(C), Referral Fees, employers should have investment professionals provide the employer regular (at least quarterly) updates on the amount and nature of compensation received. Therefore, updates should not be disclosed at least monthly.
- B. Correct** because according to the recommended procedures for compliance with Standard VI(C), Referral Fees, employers should have investment professionals provide the employer regular (at least quarterly) updates on the amount and nature of compensation received.
- C.** Incorrect because according to the recommended procedures for compliance with Standard VI(C), Referral Fees, employers should have investment professionals provide the employer regular (at least quarterly) updates on the amount and nature of compensation received. Therefore, updates should not be disclosed at least annually.

Guidance for Standards I–VII

- identify conduct that conforms to the Code and Standards and conduct that violates the Code and Standards

Discuss ⓘ

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Discussion

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Q. In the absence of regulatory guidance, CFA Institute recommends that members maintain their investment research records for at least:

- A. 3 years.
- B. 5 years.
- C. 7 years.

Solution

- A. Incorrect because according to Standard V (C), as described in the Response Rationale for the answer key, CFA Institute recommends that members maintain their work records for at least 7 years in absence of any regulatory guidance, not 3 or 5 years.
- B. Incorrect because according to Standard V (C), as described in the Response Rationale for the answer key, CFA Institute recommends that members maintain their work records for at least 7 years in absence of any regulatory guidance, not 3 or 5 years.
- C. **Correct** because according to Standard V (C), Record Retention, In the absence of regulatory guidance or firm policies, CFA Institute recommends maintaining records for at least seven years.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Discuss ⓘ

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Discussion

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Q. Dennis Chung, CFA, manages an equity fund for his firm's clients. Chung does comprehensive analysis and concludes that Advance Technology Company (ATC) could announce a substantial stock repurchase program. Chung informs his clients about the analysis by phone, and states "ATC is scheduled to announce a substantial stock repurchase program and its stock price will increase significantly." Chung has violated the Standard(s) relating to:

- A. misrepresentation only.
- B. communication with clients and prospective clients only.
- C. misrepresentation as well as communication with clients and prospective clients.

Solution

- A.** Incorrect because according to Standard V(B), Communication with Clients and Prospective Clients, members and candidates should explicitly discuss with clients and prospective clients the assumptions used in the investment models and processes to generate the analysis. Caution should be used in promoting the perceived accuracy of any model or process to clients because the ultimate output is merely an estimate of future results and not a certainty. Chung states "ATC is scheduled to announce a substantial stock repurchase program and its stock price will increase significantly." and does not clarify that it is based on his opinion. Therefore, Chung has also violated to Standard V(B).
- B.** Incorrect because Standard I(C), Misrepresentation, prohibits members and candidates from guaranteeing clients any specific return on volatile investments. Most investments contain some element of risk that makes their return inherently unpredictable. For such investments, guaranteeing either a particular rate of return or a guaranteed preservation of investment capital (e.g., "I can guarantee that you will earn 8% on equities this year" or "I can guarantee that you will not lose money on this investment") is misleading to investors. Chung states ATC is scheduled to announce a substantial stock repurchase program and its stock price will increase significantly. and does not clarify that it is based on his opinion. Therefore, Chung has also violated to Standard I(C).
- C. Correct** because according to Standard I(C), Misrepresentation, prohibits members and candidates from guaranteeing clients any specific return on volatile investments. Most investments contain some element of risk that makes their return inherently unpredictable. For such investments, guaranteeing either a particular rate of

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any model or process to clients because the ultimate output is merely an estimate of future results and not a certainty. Chung states "ATC is scheduled to announce a substantial stock repurchase program and its stock price will increase significantly." and does not clarify that it is based on his opinion. Therefore, Chung has also violated to Standard V(B).

- B.** Incorrect because Standard I(C), Misrepresentation, prohibits members and candidates from guaranteeing clients any specific return on volatile investments. Most investments contain some element of risk that makes their return inherently unpredictable. For such investments, guaranteeing either a particular rate of return or a guaranteed preservation of investment capital (e.g., "I can guarantee that you will earn 8% on equities this year" or "I can guarantee that you will not lose money on this investment") is misleading to investors. Chung states ATC is scheduled to announce a substantial stock repurchase program and its stock price will increase significantly. and does not clarify that it is based on his opinion. Therefore, Chung has also violated to Standard I(C).
- C. Correct** because according to Standard I(C), Misrepresentation, prohibits members and candidates from guaranteeing clients any specific return on volatile investments. Most investments contain some element of risk that makes their return inherently unpredictable. For such investments, guaranteeing either a particular rate of return or a guaranteed preservation of investment capital (e.g., "I can guarantee that you will earn 8% on equities this year" or "I can guarantee that you will not lose money on this investment") is misleading to investors.

In addition, Standard V(B), Communication with Clients and Prospective Clients, [m]embers and candidates should explicitly discuss with clients and prospective clients the assumptions used in the investment models and processes to generate the analysis. Caution should be used in promoting the perceived accuracy of any model or process to clients because the ultimate output is merely an estimate of future results and not a certainty.

Chung states "ATC is scheduled to announce a substantial stock repurchase program and its stock price will increase significantly." and does not clarify that it is based on his opinion. Therefore, Chung has violated to both Standard I(C) and Standard V(B).

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving

◀ ▶ | **Question 21 of 90**

Q. Which of the following member actions *most likely* violates the Standard relating to fair dealing?

- A.** Providing premium service levels to clients who pay higher fees
- B.** Selectively offering different service levels to prospective clients
- C.** Using different communication methods to recommend investments to clients

Solution

- A.** Incorrect because according to Standard III (B), members and candidates may provide more personal, specialized, or in-depth service to clients who are willing to pay for premium services through higher management fees or higher levels of brokerage.
- B. Correct** because according to Standard III (B), Fair Dealing, different service levels should be disclosed to clients and prospective clients and should be available to everyone (i.e., different service levels should not be offered selectively). It is therefore a violation of the Standard to selectively offer the firm's different service levels to prospective clients.
- C.** Incorrect because Standard III (B) requires investment recommendations to be communicated fairly, but the Standard does not state 'equally' because members and candidates could not possibly reach all clients at exactly the same time—whether by printed mail, telephone (including text messaging), computer (including internet updates and e-mail distribution), facsimile (fax), or wire. Therefore, using different communication methods to recommend investments to clients is permitted.

Guidance for Standards I–VII

- demonstrate the application of the Code of Ethics and Standards of Professional Conduct to situations involving issues of professional integrity

Discuss 

Filter ▶

◀ ▶ | Question 22 of 90

Q. Zhao Xuan, CFA, is a sell side investment analyst. While at a software industry conference, Zhao hears rumors that Green Run Software may have falsified its financial results. When she returns to her office, Zhao conducts a thorough analysis of Green Run. Based on her research, including discussions with some of Green Run's customers, Zhao is convinced that Green Run's reported 50% increase in net income during recent quarters is completely fictitious. So far, however, Zhao is the only analyst suspicious about Green Run's reported earnings. According to the CFA Institute Code of Ethics and Standards of Professional Conduct, the *least* appropriate action for Zhao is to:

- A. report her suspicions to Green Run's management.
- B. do nothing until other analysts support her analysis.
- C. recommend that her clients sell their Green Run shares immediately.

Solution

- A. Incorrect because members and candidates should make reasonable efforts to achieve public dissemination of information that is material and nonpublic. This effort usually entails encouraging the issuer company to make the information public. In this case the original source is not a reliable one, and the analyst would not be expected to request disclosure based upon the rumor, which is not considered material. However, her thorough research indicates that the company falsified its financial results, and she should request the company address this issue publicly.
- B. **Correct** because the analyst has conducted thorough research that indicates the company falsified its financial results, and she should request the company address this issue publicly as recommended by Standard II(A)—Material Nonpublic Information. If a member or candidate determines that information is material, the member or candidate should make reasonable efforts to achieve public dissemination of the information. This effort usually entails encouraging the issuer company to make the information public. If public dissemination is not possible, the member or candidate must communicate the information only to the designated supervisory and compliance personnel within the member's or candidate's firm and must not take investment action on the basis of the information.
- C. Incorrect because analysts are in the business of formulating opinions and insights that are not obvious to the