Question #1 of 23

Question ID: 1574853

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.

(Module 91.4, LOS 91: III(B))

Question #2 of 23

Question ID: 1574854

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

A) Clients should not be discriminated against when disseminating investment recommendations.

B) Referral fees may be disclosed after proceeding with an agreement for service.

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.

(Module 91.4, LOS 91: III(B))

Question #3 of 23

Question ID: 1581444

Regarding (1) not voting all client proxies, and (2) using a directed brokerage arrangement, a member would violate the Standards by:

A) engaging in neither of these practices. ✓

B) not voting all proxies for client stocks. ✗

C) using a directed brokerage arrangement. ✗

Explanation

Proxies have economic value to the client. To comply with Standard III(A) Loyalty, Prudence, and Care, 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 #4 of 23

Question ID: 1581451

With regard to disseminating investment recommendations, the recommended procedures for compliance with the Standard concerning fair dealing *least likely* state that members and candidates should:

A) shorten the time frame between the decision to make an investment recommendation and its dissemination. ✗

B) maintain a list of clients and their holdings, to facilitate notifying them of changes in investment recommendations. ✗

C) maximize the number of people who know an investment recommendation is going to be disseminated. ✓

Explanation

Recommended procedures for compliance with Standard III(B) Fair Dealing include *limiting* the number of people who know an investment recommendation is going to be disseminated

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Question #5 of 23

Question ID: 1581442

Ed Staples, CFA, manages a pension fund sponsored by Hill Corporation. The Code and Standards *most likely* require Staples to:

A) act solely in the interest of the ultimate beneficiaries.

B) support the sponsor's management during proxy fights.

C) base investment decisions on each beneficiary's return requirements and risk tolerance.

Explanation

Standard III(A) Loyalty, Prudence, and Care requires members and candidates who manage investment funds to act in the interest of the beneficiaries. However, the Standard states that fund managers' investment decisions are not required to be based on the investment needs of each fund investor, but rather should benefit the investors as a whole. In voting proxies, the beneficiaries' interest must prevail over management's interest.

Question #6 of 23

Question ID: 1574838

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) delegate her proxy vote to another member of her firm due to the conflict of interest created when she was contacted by management.

B) vote for the takeover if it is in the best interest of Danube's shareholders, regardless of the consequences to current management.

C) vote for the takeover if she can get assurance that Danube's management team will remain in place.

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.

(Module 91.4, LOS 91: III(A))

Question #7 of 23

Question ID: 1581443

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) not in violation of the Code and Standards.

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

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

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 #8 of 23

Question ID: 1574855

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

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

(Module 91.4, LOS 91: III(B))

Question #9 of 23

Question ID: 1581441

According to the Standard concerning loyalty, prudence, and care, brokerage is an asset of the:

A) brokerage firm conducting the trades.

B) managing firm.

C) client.

Explanation

Brokerage is an asset of the client.

Question #10 of 23

Question ID: 1581440

A member would *most likely* violate the Standard regarding duties to clients by:

A) adding a risky derivative security to the portfolio of a client with moderate risk tolerance.

B) executing a client order for a security the member believes is greatly overvalued.

C) recommending purchase of securities without a reasonable inquiry into the investment experience of the client.

Explanation

Standard III(A) Loyalty, Prudence, and Care requires members acting as advisors to make a reasonable inquiry into the client's investment experience, risk and return objectives, and financial constraints before making investment recommendations. Investment decisions must be made based on a total portfolio approach, rather than the quality of an individual investment in isolation. Some members are not acting as investment advisors and may only have a duty to provide best execution of client orders.

Question #11 of 23

Question ID: 1574856

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 simultaneously within the firm and to customers, where possible.

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

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.

(Module 91.4, LOS 91: III(B))

Question #12 of 23

Question ID: 1581446

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 duty to his employer. ✗

B) a violation of Calaveccio's fiduciary duties. ✗

C) permissible under CFA Institute Standards. ✓

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 #13 of 23

Question ID: 1581449

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) not permissible under the Code and Standards. ✓

C) permissible only if the clients are informed of the allocation procedure.

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 #14 of 23

Question ID: 1581452

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) both of these.

B) Standard III(B), Fair Dealing.

C) Standard III(C), Suitability.

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 #15 of 23

Question ID: 1574843

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) Neither of these.

B) The personal account privileges.

C) The research reports.

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.

(Module 91.4, LOS 91: III(A))

Question #16 of 23

Question ID: 1574852

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) prepare a written report to the CEO describing the problem.

B) disassociate himself from the problem and seek legal advice.

C) do nothing since there is no breach with the Standards.

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.

(Module 91.4, LOS 91: III(B))

Question #17 of 23

Question ID: 1574839

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

A) Supporting the sponsor's management during proxy fights.

B) Judging investments in the context of the total portfolio.

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.

(Module 91.4, LOS 91: III(A))

Question #18 of 23

Question ID: 1574846

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.

(Module 91.4, LOS 91: III(A))

Question #19 of 23

Question ID: 1581447

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

B) 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. ✗

C) 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. ✗

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 #20 of 23

Question ID: 1581450

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 have signed the consent form.

B) a violation of the standard.

C) not a violation because the clients are aware of the policy.

Explanation

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

Question #21 of 23

Question ID: 1581445

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) discloses the relationship to the client.

B) does both of the actions listed here.

C) uses the resources to help manage the client's account.

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 #22 of 23

Question ID: 1581448

In accordance with Standard III (A) Loyalty, Prudence and Care, which of the following statements is *NOT* a required or recommended action?

A) Utilize client brokerage to the sole benefit of the client.

B) Submit to clients, at least quarterly, itemized statements detailing all of the period's transactions.

C) Vote all proxies on behalf of clients in a responsible manner.

Explanation

Because of the time and expense involved in voting a proxy, Members and Candidates are not required to vote every proxy. A cost benefit analysis can be performed to determine if it is necessary to vote a proxy. Standard III(A) requires that client brokerage be used to benefit the client. Quarterly statements to clients are recommended.

Question #23 of 23

Question ID: 1574857

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

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

B) based upon compensation arrangements.

C) on a pro-rata basis over all suitable accounts.

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.

(Module 91.4, LOS 91: III(B))