Standards of Professional Conduct & Guidance: Conflicts of Interest

Test ID: 7440159

Question #1 of 25

Question ID: 412576

Will Lambert, CFA, is a financial analyst for Offshore Investments. He is preparing a purchase recommendation on Burch Corporation. According to CFA Institute Standards of Professional Conduct, which of the following statements about disclosure of conflicts is *most correct*? Lambert would have to disclose that:

✗ **A)** **he has a material beneficial ownership of Burch Corporation through a family trust.**

✓ **B)** both of these choices require disclosure.

✗ **C)** his wife owns 2,000 shares of Burch Corporation.

Explanation

Standard VI(A) requires that Members and Candidates fully disclose all matters which may impair their independence or objectivity or interfere with their duties to their employer, clients and prospects.

Question #2 of 25

Question ID: 412601

Wes Smith, CFA, refers many of his clients to Bill Towers, CPA, for accounting services. In return, Towers performs routine services for Smith, such as his tax returns, for no charge. Towers has just become a member of CFA Institute. With this development, Towers must:

✓ **A)** **reveal to the prospects referred by Smith that he performs services for Smith, along with the estimated value of those services.**

✗ **B)** only reveal to the prospects referred by Smith that he performs services for Smith.

✗ **C)** discontinue his services for Smith.

Explanation

According to VI(C), Referral Fees, as a member of CFA Institute, Towers must tell his clients about the payment in kind to Smith along with an estimate of the value of those services.

Question #3 of 25

Question ID: 412563

Lee Hurst, CFA, is an equity research analyst for a long-term investment fund. His annual bonus is linked to quarterly trading profits. Under a new policy, the quarterly assessment period is switched to a monthly assessment period. According to the Code and Standards, best practices dictate:

✗ **A)** **keeping the policy change private as a trade secret.**

✓ **B)** updating disclosures when the policy change is implemented.

✗ **C)** requiring Hurst to obtain permission from each client prior to implementation of the new policy.

Explanation

Standard VI(A) "Disclosures of Conflicts" recognizes this policy as a potential conflict of interest as members and candidates could be incentivized to favor short-term trading gains over long-term value creation. Best practices dictate updating disclosures when the policy change is implemented. The long-term investors should know how members and candidates are compensated, especially when there is the potential for conflicts of interest.

Question #4 of 25

Question ID: 412586

An analyst has the opportunity to offer his clients shares in a "hot new issue." One of the analyst's clients is his brother. When the new issue comes out, for those clients he deems it would be appropriate, he offers them an equal share. He includes his brother in that group. With respect to Standard VI(B), Priority of Transactions, this is:

✗ **A)** **congruent with the Standard even if he has a direct personal interest in his brother's account.**

✓ **B)** congruent with the Standard as long as he does not have a direct personal interest in his brother's account.

✗ **C)** congruent with the Standard if his brother is not a 'covered person'.

Explanation

Client accounts that belong to family members should be treated like any other account so long as there is no direct interest on the part of the analyst. In other words, these types of accounts should not be at a disadvantage relative to other client accounts when there is no direct interest on the part of the analyst overseeing the account.

Question #5 of 25

Question ID: 461226

Questions 1 through 18 relate to Ethical and Professional Standards.

Ralph Reed, CFA, is a portfolio manager who invests in U.S. equities. Reed refers clients with an interest in international equities to Global Advisors and receives $1,000 for each referral. Which of the following statements *best* describes the disclosures Reed must make to clients?

✓ **A)** **At the time he makes a referral to Global, Reed must disclose the referral arrangement with Global and the amount of the referral fee he receives from Global.**

✗ **B)** At the time he makes a referral, Reed must disclose that he will receive a referral fee from Global.

✗ **C)** Reed must disclose the arrangement with Global only to a client he refers who opens an account with Global.

Explanation

Standard VI(C) Referral Fees requires that members who expect to receive anything of value from making a referral disclose that fact and the amount and nature (one-time payment, ongoing fee) of any referral fee so that potential and existing clients can make their own determination of how the referral arrangement may affect the member's objectivity.

(Study Session 1, LOS 1.b,c; Study Session 1, LOS 2.a,b,c)

Question #6 of 25

Question ID: 461225

Toni Florence, CFA, CAIA, leases office space to her best friend, Tom Rigs. Florence is an independent investment advisor specializing in high net worth clients and Rigs is a licensed real estate broker. In lieu of paying rent, Rigs refers his real estate clients to Florence, but only with the clients' permission.

For clients referred by Rigs, Florence:

✗ **A)** **need not disclose the referral fee if Rigs discloses the lease arrangement to the clients first.**

✗ **B)** need not disclose the terms of the lease arrangement because Rigs obtained the clients' permission for the referral.

✓ **C)** must disclose the terms of the lease arrangement.

Explanation

Standard VI(C), Referral Fees, requires members to disclose to clients and prospects any consideration or benefit received by the member or delivered to others for the recommendation of any services to the client or prospect. Florence has delivered a benefit (free rent) to Rigs, which must be disclosed to the clients referred by Rigs. Florence must not rely on Rigs to make the disclosure.

Question #7 of 25

Question ID: 412583

An analyst, who is a CFA Institute member, manages a high-grade bond mutual fund. This is his only professional responsibility. When the analyst comes across a speculative stock investment that he feels is a good investment for his personal portfolio, the analyst:

✗ **A)** **is in violation of Standard IV(A), Loyalty to Employer, by spending time analyzing stocks when he should only analyze bonds.**

✓ **B)** may invest in the stock because the analyst would not purchase the stock for the bond portfolio he manages.

✗ **C)** must notify his supervisor about the stock according to Standard VI(B), Priority of Transactions, to see if it is appropriate for the portfolio that he manages.

Explanation

The problem says the analyst "came across" the speculative stock investment. We do not know if the analyst neglected his duties. Since such an investment is clearly not appropriate for a high-grade bond fund, the analyst may invest in the stock without any restrictions relating to the fund.

Question #8 of 25

Question ID: 461223

A CFA Institute member makes a recommendation of a stock in which his firm has a material ownership, but neglects to inform clients of that ownership. The candidate has most clearly violated:

✗ **A) Standard III(B) - Fair Dealing.**

✗ **B)** Standard V(B) - Communication with Clients and Prospective Clients.

✓ **C)** Standard VI(A) - Disclosure of Conflicts.

Explanation

Standard VI(A)requires that members fully disclose all potential conflicts of interest, including ownership of stock in companies that the member recommends or that clients hold. Standard III(B), Fair Dealing, forbids members and Candidates from discriminating against any clients when disseminating recommendations or taking investment action. Standard V(B), Communication with Clients and Prospective Clients, requires that members disclose the general principles of the investment processes used, and distinguish between opinions and facts.

Question #9 of 25

Question ID: 412577

Phil Trobb, CFA, is preparing a purchase recommendation on Aneas Lumber for his research firm. All of the following are potential conflicts of interest EXCEPT:

✓ **A) Trobb's cousin repairs machines for Aneas.**

✗ **B)** Aneas hires Trobb as a consultant to analyze Aneas' financial statements.

✗ **C)** Trobb's research firm has a large stake of ownership in Aneas Lumber.

Explanation

Standard VI(A) defines what constitutes a conflict of interest with regard to clients, prospective clients, and employers. All of these represent potential conflicts of interest with the exception of the cousin working for Aneas Lumber in a job that is unrelated to the Aneas' financing.

Question #10 of 25

Question ID: 412581

Abner Flome, CFA, is writing a research report on Paulsen Group, an investment advisory firm. Flome's brother-in-law holds shares of Paulsen stock. Flome has recently interviewed for a position with Paulsen and expects a second interview. According to the Standards, Flome's *most* appropriate action is to disclose in the research report:

✗ **A) his brother-in-law's holding of Paulsen stock.**

✗ **B)** his brother-in-law's holding of Paulsen stock and that he is being considered for a job at Paulsen.

✓ **C)** that he is being considered for a job at Paulsen.

Explanation

The possibility of employment with Paulsen creates a potential conflict of interest which Flome must disclose. Standard VI(A) Disclosure of Conflicts does not require disclosure of his brother-in-law's ownership of Paulsen stock.

Question #11 of 25

Question ID: 412591

Gordon McKinney, CFA, works in the trust department of a bank. The bank's trust account holds a large block of a particular company. McKinney learns that this company is going to buy back one million shares at a 15% premium to the market price on a first-come-first-served basis. McKinney immediately tells his mother-in-law to tender her shares but waits until the end of the day to tender the trust's shares. McKinney has *most* likely violated:

- ✗ **A)** **Standard IV(A), Loyalty to Employer.**
- ✓ **B)** Standard VI(B), Priority of Transactions.
- ✗ **C)** Standard II(A), Material Nonpublic Information.

Explanation

Standard VI(B), Priority of Transactions, applies. If an analyst decides to make a recommendation about the purchase or sale of a security, he must give his customers or employer adequate opportunity to act on this recommendation before acting on his own behalf. Personal transactions include those made for the member's own account and family accounts. Here, McKinney violated Standard VI(B) by acting on his mother-in-law's behalf and then waiting until the end of the day to act on his employer's behalf.

Explanations for other responses:

- Standard IV(A), Loyalty to Employer, does not apply. This standard concerns a member competing with his/her employer (independent practice), for example a member who engages in outside consulting.
- Standard II(A), Material Nonpublic Information, does not apply. The question does not indicate that the information is not public.

Question #12 of 25

Question ID: 412592

An analyst likes to trade options in her own account. She does not deem any of her client accounts suitable for option trading. When she finds a favorable options position, in accordance to Standard VI(B), Priority of Transactions, she should:

- ✗ **A)** **first tell her clients about it before acting herself.**
- ✗ **B)** refrain from acting until she notifies her supervisor.
- ✓ **C)** act on it on her own behalf as she sees fit.

Explanation

This is not a violation of Standard VI(B), Priority of Transactions, because the investment is not suitable for her clients. If the analyst believes that none of her clients should trade options, she is not obligated to advise them in this instance.

Question #13 of 25

Question ID: 412578

The following scenarios involve two analysts at Dupree Asset Management, a small New York-based company with about $150 million in assets under management. Dupree restricts personal trading of stocks analyzed, corporate directorships, trustee positions, and other special relationships that could reasonably be considered a conflict of interest with their responsibilities to their employer.

- Ray Bolt, CFA, is a senior investment analyst. Bolt was recently elected to the board of trustees of his alma mater, Midwest University, and was appointed as the chairman of the University's endowment committee. Midwest has more than $2 billion in its endowment. Bolt must travel from New York to Chicago eight times a year to attend meetings of the board of trustees and endowment committee. Bolt did not inform Dupree of his involvement with Midwest University.

- Wanda Delvecco, a candidate in the CFA Program, is a junior investment analyst. She recently wrote a research report on Aveco Communications and recommended the stock for Dupree's "buy" list. Delvecco bought 200 shares of Aveco stock for her personal account 12 months before she wrote her research report. Over the past 12 months, the stock's price has been in the $20-42 price range. Delvecco has not informed Dupree of her ownership of Aveco stock.

According to CFA Institute Standards of Professional Conduct, which the following statements about Bolt and Delvecco's actions is CORRECT?

✗ **A)** **Delvecco violated the Standards, but Bolt did not.**

✗ **B)** Neither Bolt nor Delvecco violated the Standards.

✓ **C)** Both Bolt and Delvecco violated the Standards.

Explanation

Standard VI(A), Disclosure of Conflicts, requires that Bolt inform Dupree of his involvement with Midwest University given that Bolt's new role can be expected to be time consuming and possibly affect his responsibilities at Dupree. Delvecco is required to disclose her ownership of Aveco stock before conducting the research report because such ownership could bias her objectivity in making a recommendation. She should have discussed owning the stock with her supervisor before beginning to write the research report on Aveco.

Question #14 of 25

Question ID: 412590

A firm produces regular proprietary research reports on various companies. According to Standard VI(B), Priority of Transactions, which of the following would be an "access person?"

✗ **A)** **A person working in the mail room.**

✗ **B)** An independent auditor with access to material, non-public information on a company being analyzed.

✓ **C)** A supervisory analyst who reviews all research reports prior to dissemination.

Explanation

Persons with access to information during the normal preparation of research recommendations are subject to Standard VI(B). An independent auditor is not involved in the normal preparation of research recommendations.

Question #15 of 25

Question ID: 412589

Standard VI(B), Priority of Transactions, applies to transactions an analyst takes on behalf of:

✗ **A)** **his clients.**

✗ **B)** his employer.

✓ **C)** both of these.

Explanation

Standard VI(B) addresses the treatment of both these accounts. The accounts of clients and employers have priority over personal accounts.

Question #16 of 25

Question ID: 412596

Standard VI(C), Referral Fees, requires the member to do all of the following EXCEPT:

✗ **A) disclose to the referred client how much the referral source was paid to refer the client.**

✓ **B)** disclose to the referred client the percentage of the member's business that comes from referrals.

✗ **C)** make required disclosures to the referred client before an agreement is made to provide services to the referred client.

Explanation

The applicable Standard, VI(C), *does not require* a member to disclose the percentage of their business that comes from referrals.

Standard VI(C) states, "*Members shall disclose to clients and prospects any consideration or benefit received by the member or delivered to others for the recommendation of any services to the client or prospect."* Appropriate disclosure means telling the client or prospect, before agreeing to perform services, of any benefit given or received for recommending the member's services.

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Question ID: 412598

If a CFA charterholder receives a referral fee, he must:

✗ **A) disclose the fee to the supervisor, in written form, as an additional benefit.**

✓ **B)** disclose the nature of the fee arrangement to the client before entering into a formal agreement.

✗ **C)** consult with the firm's compliance officer, and follow his or her instructions concerning disclosure.

Explanation

According to Standard VI(C), the nature as well as the value of the fee must be disclosed to the client before entering into a formal agreement. The compliance officer and/or the employee's supervisor should be contacted for consultation.

Question #18 of 25

Question ID: 412584

An analyst routinely has the opportunity to offer his clients the opportunity to purchase "hot new issues." He tells his clients that he will distribute each issue equally among those interested, with himself included in the distribution. The clients do not object to this. With respect to Standard VI(B), Priority of Transactions, this:

✗ **A) may be a violation because it is impossible to distribute hot new issues equally.**

✗ **B)** cannot be a violation because the clients know of the practice and agree.

✓ **C)** may be a violation despite the clients' approval.

Explanation

Just because the clients know of a practice does not make it right. The analyst must put the clients first. It is a violation for the analyst to participate in a "hot new issue" which can lower the allocation to any given client below what that client would prefer. This is tantamount to putting the analyst's interests ahead of the clients' interests.

Question #19 of 25

Question ID: 412574

When an analyst makes an investment recommendation, which of the following statements *must* be disclosed to clients?

✗ **A) An employee of the firm holds a directorship with the recommended company.**

✓ **B)** Both of these statements must be disclosed to clients.

✗ **C)** The firm is a market maker in the stock of the recommended company.

Explanation

Both of these items are explicitly listed in the discussion of Standard VI(A), Disclosure of Conflicts.

Question #20 of 25

Question ID: 412571

Dwight Dawson, a CFA charterholder and portfolio manager at Ascott Investments, was recently appointed to the investments committee at Brightwood College. He will receive no compensation from Brightwood for serving on this committee. Another person at Ascott manages part of Brightwood's endowment. Dawson does not inform Ascott's compliance office of his involvement with Brightwood, because he does not believe doing so is necessary.

Brenda Hamilton, a CFA candidate, also works for Ascott as an investment analyst. Procedures established at Ascott prohibit personal trading in securities analyzed or recommended by Ascott. One of these securities is Horizon, a telecommunications firm. Hamilton buys 10 shares of Horizon for her infant son's trust account. She believes that reporting this purchase to Ascott's compliance officer is unnecessary because the amount of the transaction is small and is not for her own personal account.

Did Dawson or Hamilton's actions violate CFA Institute Standards of Professional Conduct?

✗ **A) Dawson: No, Hamilton: Yes.**

✗ **B)** Dawson: No, Hamilton: No.

✓ **C)** Dawson: Yes, Hamilton: Yes.

Explanation

Dawson violated Standard VI(A), Disclosure of Conflicts, by failing to inform Ascott of her involvement with Brightwood College. Dawson could reasonably be expected to be involved with investment policy decisions at Brightwood that could affect Ascott because Ascott manages a portion of Brightwood's endowment. Hamilton also violated Standard VI(A), because she ignored a directive of her employer. Her purchase of Horizon stock has an appearance of impropriety. Hamilton could discuss the purchase of Horizon stock with her firm's compliance officer and request an exception to the prohibition against personal trading in securities analyzed or recommended by Ascott.

Question #21 of 25

Question ID: 434182

The following scenarios refer to two analysts who are employed at Global Securities, a large brokerage firm.

- Paula Linstrom, CFA, is instructed by her supervisor to write a research report on Delta Enterprises. Delta's stock is widely held by institutional and individual investors. Although Linstrom does not own any of Delta's stocks, she believes that one of her friends may own 10 shares of Delta. The stock currently sells for $25 per share. Linstrom does not believe that informing her employer about her friend's possible ownership of Delta shares is necessary.
- Hershel Wadel, a member of CFA Institute, is asked by his supervisor to write a research report on Gamma Company. Wadel's wife inherited 500 shares of Gamma Company from her father when he died five years ago. Gamma stock currently sells for $35 per share. Wadel does not believe that informing his employer about his wife's ownership of Gamma shares is necessary.

According to CFA Institute Standards of Professional Conduct, which the following statements about Linstrom and Wadel's conduct is *most* accurate?

✗ **A)** **Both of these analysts must disclose a potential conflict of interest.**

✗ **B)** Neither of these analysts must disclose a potential conflict of interest.

✓ **C)** Only one of these analysts must disclose a potential conflict of interest.

Explanation

The possibility that Linstrom's friend may own shares of Delta's stock does not create a conflict of interest for Linstrom, who has no beneficial interest in these shares. On the other hand, Wadel has a beneficial interest in his wife's ownership of Gamma shares. Standard VI(A) Disclosure of Conflicts requires that Wadel disclose this information so that his employer can make the proper determination.

Question #22 of 25

Question ID: 412566

Will Lambert, CFA, is a financial analyst for Offshore Investments. He is preparing a purchase recommendation on Burch Corporation for internal use. According to the CFA Institute Standards of Professional Conduct, which of the following statements about disclosure of conflicts is not required? Lambert would NOT need to disclose to his employer that:

✗ **A)** **his wife owns 2,000 shares of Burch Corporation.**

✓ **B)** Offshore is an OTC market maker for Burch Corporation's stock.

✗ **C)** he is a beneficiary of a pension plan of his former employer that owns a large number of shares of Burch's stock.

Explanation

Standard VI(A), Disclosure of Conflicts, requires members to disclose to their employer all matters, including beneficial ownership of securities, that reasonably could be expected to interfere with their duty to their employer or ability to make unbiased and objective recommendations. Disclosure of an employer's own involvement with the security is not necessary in this instance. If the report had been for external use, it would have been necessary to make all of the disclosures given as choices.

Question #23 of 25

Question ID: 412573

Bill Valley has been working for Advisors, Inc., for several years, and he just joined CFA Institute. Valley routinely writes research reports on Pharmaceutical firms. Valley has recently been asked to serve on the board of directors of an organization that promotes the search for a cure of a certain cancer. Serving on the board is an unpaid position without any direct benefits other than meeting new people and potential clients. To comply with Standard VI, Disclosure of Conflicts, Valley needs to:

✗ **A) do nothing.**

✓ **B)** both disclose the position on the board to his supervisor and describe his responsibilities on the board.

✗ **C)** only disclose the position on the board to his supervisor.

Explanation

Valley could be affected by his position on the board because he may tend to favor investments in firms that do cancer research. To comply with Standard VI(A), Disclosure of Conflicts, Valley must inform his supervisor of this relationship and describe his responsibilities on the board. Even if his supervisor does not find the relationship troublesome, any subsequent action that could lead to a conflict of interest should be discussed with the firm's compliance officer.

Question #24 of 25

Question ID: 412570

Arthur Harrow, CFA, is a pharmaceuticals analyst at Dominion Asset Management. His supervisor directs him to prepare separate research reports on Miracle Drug Company and Wonder Drug Company. Harrow's former college roommate and close friend is the president of Miracle. Harrow owns 2000 shares of Wonder, which currently sells for $25 a share. Harrow's supervisor is unaware of these facts. According to CFA Institute Standards of Professional Conduct, which of the following action, if any, is Harrow required to take if he writes the research reports?

✗ **A) Harrow must disclose to Dominion his ownership of shares in Wonder but not his relationship with the president of Miracle.**

✓ **B)** Harrow must disclose to Dominion both his relationship with the president of Miracle and his ownership of shares in Wonder.

✗ **C)** Harrow must disclose to Dominion his relationship with the president of Miracle but not his ownership of shares in Wonder.

Explanation

Standard VI(A) requires that Harrow disclose to Dominion conflicts that reasonably could be expected to interfere with his independence and objectivity. Both Harrow's relationship with the president of Miracle and his ownership of a substantial dollar amount of Wonder's shares represent a potential conflict requiring prompt disclosure to Dominion.

Question #25 of 25

Question ID: 412600

An analyst who is a member of CFA Institute has composed an introductory information packet for her new clients, which includes information on fees she receives for referring clients to other professionals and those she pays for having clients referred to her. With respect to Standard VI(C), Referral Fees, this action:

✗ **A) is not addressed in the Standard.**

- ✓ **B)** may not satisfy the Standard if such information is only provided after the receivers of the information have become clients.
- ✗ **C)** exceeds the requirement of the Standard because she does not need to reveal the fees she pays to those that refer clients to her.

Explanation

Standard VI(C) says that a member must reveal information both on fees she receives for referring clients to other professionals and those she pays for having clients referred to her before a prospect becomes a client. This allows the prospect to evaluate any partiality of a recommendation and the full cost of the services.