




### Question #1 of 47

Mary Kim, CFA, practices in the established country of Oldasia as well as in the emerging country of Newasia. By regulation, Oldasia prohibits licensed investment advisors from trading in securities ahead of their clients. Newasia has no laws or regulations in this area. Mary Kim may:

- A) not trade ahead of her clients in either country. 
- B) trade ahead of her clients in Newasia only. 
- C) trade ahead of her clients in Newasia only, as long as she has made full disclosure to her clients that she reserves the right to do this. 

#### Explanation




Under Standard I(A), Mary Kim, as a CFA charterholder, must apply the CFA Institute Code and Standards or the controlling law, whichever is stricter. Because Standard VI(B) requires members to put client trades ahead of their own transactions, Mary Kim must follow the standard in the absence of governing law, or where the law is less strict than the standard.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #2 of 47

Mary White, CFA, sits on the board of directors of XYZ Manufacturing, Inc. She discovers that management has knowingly participated in an activity she knows is illegal. According to the CFA Institute Standards of Professional Conduct, White is *least likely* to be required to:

- A) report the violation to the CFA Institute Professional Conduct Program. 
- B) disassociate herself from the activity. 
- C) seek legal advice to determine what actions should be taken. 

#### Explanation


Members are encouraged -- but not required -- to report violations of others. Standard I(A), Knowledge of the Law. Prohibition against knowingly practicing or assisting in violation of laws, rules, and regulations. If White knows that someone has engaged in a possible illegal activity, she should: (1) report the finding to the appropriate supervisory person at her firm, (2) if the situation is not remedied, disassociate herself from the situation, and (3) seek legal advice to see what other actions, such as notifying the proper regulatory agency, should be taken.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #3 of 47

The Standards of Professional Conduct explicitly outlines responsibilities to four groups. Which of the following is NOT a group mentioned in that list?

- A) The profession. 
- B) The investing public. 
- C) The Federal Reserve. 

### Explanation

The Standards explicitly mention responsibilities to the profession, employers, clients, prospects, and the investing public. The Federal Reserve is not mentioned.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #4 of 47

CFA Institute believes:

- A) that a minimum level of professional responsibility and conduct dictates that members be aware of and comply with laws, rules, and regulations governing their conduct. 
- B) that firms should comply with all domestic laws and regulations and that these laws also govern behavior in foreign markets, regardless of foreign laws and requirements. 
- C) that a maximum level of professional responsibility and conduct dictates that members be aware of and comply with laws, rules, and regulations governing their conduct. 

### Explanation




CFA Institute's Code and Standards dictate a *minimum* level of conduct. Standards should not be based on ethics of upper management and the board of directors of a company. Firms must comply with the strictest applicable standards, whether they be foreign or domestic laws and regulations.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #5 of 47

Jane Dawson, CFA, an analyst at a New York brokerage firm, suspects that Bob Boatman, CFA, another analyst at the same firm, has violated a state securities law. According to the CFA Institute Standards of Professional Conduct, Dawson is:

- A) required to report the suspected violation to the appropriate state regulatory agency. 
- B) **NOT** required to report the violation to the appropriate governmental or regulatory organizations. 
- C) required to report the suspected violation to CFA Institute. 

### Explanation

The Code and Standards **do not** require that members report legal violations to the appropriate governmental or regulatory organizations, but such disclosure may be prudent in certain circumstances. Dawson should consult legal counsel and disassociate from the activity.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #6 of 47

Benito Salvatore, CFA, is licensed in the established country of Oldworld but has clients and makes investments in the emerging country of Newworld. The regulations of Oldworld prohibit licensed investment professionals from taking gifts or gratuities in any amount from vendors or persons connected with potential investments. The laws of Newworld are silent on this issue. Unsolicited, Salvatore is offered a vase worth US \$75 by a Newworld trust company and a bronze statue worth US \$200 by a Newworld company that Salvatore is considering as a potential investment.

Salvatore is:

**A)** permitted to accept the vase but not the statue.



**B)** not permitted to accept either gift.



**C)** permitted to accept both gifts.



#### Explanation

Under Standard I(A), Salvatore must, as a CFA charterholder, apply the CFA Institute Code and Standards or the controlling law, whichever is stricter. In this instance the stricter laws of Oldworld, where Salvatore is licensed, apply to prohibit the gifts, even though the gifts are offered in Newworld.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #7 of 47

Ernesto Vivaldo is a CFA candidate. He is working in the branch office of an American-based investment company in Belgium. Vivaldo is a citizen of Venezuela. In his country, a portfolio manager is not required to disclose referral fees. Belgian law does not allow referral fees for portfolio managers. Vivaldo has been offered a deal that involves a referral fee. Vivaldo should follow the requirements of:

**A)** Belgium.



**B)** Venezuela.



**C)** CFA Institute.



#### Explanation

According to Standard I(A) Knowledge of the Law, CFA candidates and current CFA Institute members must follow whichever law is stricter. In this case, the strictest laws are those of Belgium.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #8 of 47

The CFA Institute Standards of Practice Handbook requires CFA Institute members to do all the following EXCEPT:

**A)** receive written permission from both their employer and outside clients to engage in investment consulting outside the firm.



**B)** to inform employer, clients, and potential clients of benefits received for recommending products or services.



**C)** to disclose in writing to the proper regulatory authority all observed violations of the securities laws and regulations.



**Explanation**

Members are not required to report violations of others to regulatory authorities, either verbally or in writing, but such reporting may be prudent.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

**Question #9 of 47**

Shortly after becoming employed by Valco & Co., an investment banking firm, Stan McDowell, CFA, learns that most of Valco's initial public offerings (IPO) are really effected in order to profit management via price manipulation of the shares. McDowell observes an illegal act, sanctioned by senior management, in progress and refuses to sign off on his responsibility. Instead, McDowell takes the documentation to his supervisor and tells him he should sign it in his place. This action is:

**A)** a suitable reaction, and he is in compliance with the Code and Standards.



**B)** an overreaction. Senior management's sanctioning of the act absolves McDowell from his ordinary responsibility as a CFA Institute member.



**C)** a violation of the Code and Standards since he is required not to knowingly participate or assist in such an act.



**Explanation**

McDowell, by his action in taking the documentation to his supervisor, is knowingly participating in and/or assisting in an illegal act. This is clearly prohibited under Standard I(A), and he is in violation of the Standard.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

**Question #10 of 47**

Which of the following is a CORRECT statement of a member's duty under the Code and Standards?

**A)** In the absence of specific applicable law or other regulatory requirements, the Code and Standards govern the member's actions.



**B)** A member who trades securities in a country with less strict laws, rules, regulations, or customs may follow those laws if he discloses this information to his client.



**C)** A member is required to comply only with applicable local laws, rules, regulations, or customs even though the CFA Institute code and Standards may impose a higher degree of responsibility



**Explanation**




Members are always, at a minimum, subject to the Code and Standards.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #11 of 47

The Securities and Exchange Board of India (SEBI) has just enacted a new stock-trading rule. SEBI will give brokers a 10-day grace period, during which violators of the rule will be immediately notified and given a chance to remedy their situation to comply with the new rule. If a CFA Institute member located in India or doing business in India unknowingly violates the rule and then remedies the situation within the 10-day grace period, has the member violated Standard I(A)?

- A) No, because the member remedied the situation. 
- B) No, because the member unknowingly broke the rule. 
- C) Yes, because the member did not maintain knowledge and know of the rule. 

#### Explanation




Standard I(A) explicitly says that a member shall maintain knowledge and comply with laws, rules, and regulations. By not knowing of the rule, the member broke the standard.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #12 of 47

Luis Rodriguez, CFA, is an analyst at XYZ Investments. He covers a company that is located in a region that is not easily accessible. The company invites analysts for their annual analyst meeting and pays for the transportation to the remote location. Rodriguez is:

- A) allowed to accept the payment for transportation because the trip was all business and was out of the way. 
- B) not allowed to accept the payment for transportation because this is considered a "perk" and may influence his independent judgment. 
- C) allowed to accept the payment for transportation as long as it does not exceed \$100. 

#### Explanation

Standard I(B) Independence and Objectivity. Analysts should pay for their own travel accommodations if the location is accessible by normal means. In this situation payment is acceptable because the location is out of the way and the purpose of the trip is all business.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #13 of 47

Jason Blackwell, CFA, works as an investment manager for Mega Capital, a large multinational brokerage firm. Mega Capital is based in a country whose applicable law is stricter than the CFA Institute Code and Standards, but does business with clients in a country whose applicable law is less strict than the Code and Standards. Blackwell decides to follow the requirements of the Code and Standards for clients in the less strict country, which is sufficient to also comply with that less-strict country's local laws. While Blackwell is still employed at Mega, Lego Associates verbally asks Blackwell to review client portfolios during evenings and weekends for a fee. Blackwell gets written consent from his immediate supervisor at Mega to undertake this independent activity for a one-month trial basis.

Which of the following statements about Blackwell's actions involving Standard I, Professionalism, and Standard IV(A), Loyalty is *most* accurate? Blackwell:

**A)** violated Standard I but did not violate Standard IV(A).



**B)** did not violate either Standard I or Standard IV(A).



**C)** violated both Standard I and Standard IV(A).



#### Explanation

Blackwell violated Standard I, Professionalism. Jameson must comply with the strictest requirements among the laws of the country where his firm is based, the CFA Institute Code and Standards, and the laws of the country where he is doing business. Because the applicable laws in Mega Capital's home country are stricter than the Code and Standards, Jameson must additionally adhere to that more strict law.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #14 of 47

Maria Valdes, CFA, is an analyst for Venture Investments in the country of Newamerica, which has laws prohibiting the acceptance of any gift from a vendor if the gift exceeds US \$250. Valdes has evidence that her Venture Investments colleague, Ernesto Martinez, CFA, has been receiving gifts from vendors in excess of US \$250.

Valdes is obligated to:

**A)** disassociate herself from the activity, urge Venture to persuade Martinez to cease the activity, and inform CFA Institute of the violation.



**B)** disassociate herself from the activity, urge Venture to persuade Martinez to cease the activity, and inform CFA Institute and regulatory authorities of the violation.



**C)** disassociate herself from the activity, and urge Venture to persuade Martinez to cease the activity.



#### Explanation




Standard I(A), Knowledge of the Law requires members who have knowledge of colleagues engaging in illegal activities to disassociate from the activity and urge their firms to persuade the individual to cease such activity. Reporting to regulatory authorities may be prudent in certain circumstances, but is not required. Reporting to CFA Institute is not required.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #15 of 47

If a member does business in a country with stricter securities laws and regulations than the Code and Standards, but the member's home country has less strict securities laws or regulations than the Code and Standards, the member must abide by the:

- A) laws and regulations of the country with stricter securities laws. 
- B) home country's securities laws and regulations only. 
- C) Code and Standards only. 

#### Explanation

The member must abide by the laws and regulations of the country in which he is doing business if these laws are stricter than his home country's laws or the Code and Standards. A member must adhere to the strictest applicable law or regulation.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #16 of 47

Which of the following is a CORRECT statement of a member's duty under the Code and Standards?

- A) A member is required to comply only with applicable local laws, rules, regulations, or customs even though the CFA Institute Code and Standards may impose a higher degree of responsibility 
- B) In the absence of specific applicable law or other regulatory requirements, the Code and Standards govern the member's actions. 
- C) A member who trades securities in a foreign securities market where no applicable local laws or stock exchange rules regulate the use of material nonpublic information may take investment 

#### Explanation




The Code and Standards represent a minimum level of guidance for members' actions, not a maximum level. The key to remember here is that whether the local area does or does not have standards governing member's actions, one must follow the stricter standard environment.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #17 of 47

WEB, an investment-banking firm, is the principal underwriter for MTEX's upcoming debenture issue. Wendy Berry, CFA, an analyst with WEB, has found out from an employee in MTEX's programming department that a serious glitch was recently discovered in the software program of their major new product line. In fact, the glitch is so bad that most of their orders have been canceled. Berry checked the debenture's prospectus and found no mention of this development. The red herring prospectus has already been distributed. Berry's best course of action is to:

- A) inform her immediate supervisor at WEB of her discovery. 
- B) notify potential investors of the omission on a fair and equitable basis. 
- C) keep quiet since this is material non-public inside information. 

### Explanation

Berry should report this information only to her immediate supervisor. Subsequently, she and her supervisor may consult with legal counsel concerning the competing issues in this situation. For the present, she should avoid disclosure to colleagues who do not need to know the information and she should also avoid disclosure to clients.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #18 of 47

Bob Blanford, CFA, is an investment analyst for a large global brokerage firm. He recently moved to Ragatan, a developing country with few securities laws and regulations. As part of conducting a company analysis, Blanford interviews Ravi Shanti, vice-president of finance at Starr Industries. Starr is a major industrial firm in Ragatan and a client at Blanford's firm. Based on his analysis, Blanford suspects that Shanti may have deliberately overstated Starr's current earnings and its earnings for the past several quarters. If this information becomes public, Blanford believes that Starr's stock price will drop substantially. Blanford suspects that Shanti may have violated Ragatan's securities laws. Which of the following statements is *least likely* to comply with Standard I, Professionalism? Blanford should:

- A) determine the legality of the activity, possibly by consulting counsel.
- B) take no action.
- C) disassociate himself from the client, if the activity is illegal or unethical.



### Explanation

Because Blanford suspects Shanti of engaging in ongoing illegal activities, Blanford should take action by determining the legality of the suspected action, disassociating from any illegal activity, and urging his firm to attempt to persuade Shanti to cease such conduct if such an activity is illegal or unethical.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #19 of 47

A CFA Institute member works for Secure Securities, Inc., and plays rugby on the firm's rugby team. Secure Securities' team recently played the team of a rival firm. During the game, a fight broke out and the CFA Institute member was the instigator, but no one was seriously hurt. Is this a violation of I(A) concerning maintaining knowledge and complying with laws, rules, and regulations?

- A) No, because a fight at a rugby game is not a professional activity.
- B) Yes, because the member could have hurt someone in the fight.
- C) Yes, because the member is bound by the Code of Ethics.



### Explanation

Standard I(A) covers members' professional activity only. Violations outside professional activity that involve fraud, theft or deceit would potentially be violations.




(Study Session 1, Module 3.1, LOS 3-I.(A))

---



### Question #20 of 47

In order to comply with the CFA Institute Standards, an analyst should:

- A) use outside research only after verifying its accuracy. 
- B) use only his company's research when making investment recommendations and use outside research for reports and analysis on stocks. 
- C) use only his own research in making investment recommendations, because anything else would violate Standard I(B), Independence and Objectivity. 

#### Explanation




Standard I(B), Independence and Objectivity: the analyst is allowed to use outside research only after an insightful review. There are no restrictions regarding the exclusive use of outside information or in-house information.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #21 of 47

What is the rule of thumb for members, CFA charterholders and candidates in the CFA program when weighing the requirements of the CFA Institute Code and Standards and the requirements of local laws? If the applicable laws are:

- A) less strict, they should make a judgment call on which to follow, the Code and Standards or the local laws and requirements. 
- B) more strict, they must still follow the Code and Standards. 
- C) more strict, they must adhere to the applicable laws. 

#### Explanation




The rule of thumb for members, CFA charterholders and candidates in the CFA program requires that they adhere to the applicable laws if the applicable laws are more strict than the requirements of the Code and Standards. If there are no laws or the laws are less strict, they must adhere to the Code and Standards.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #22 of 47

An analyst is told by his supervisor that when he feels he should write a buy recommendation he is free to do so, and when he feels he should write a sell recommendation he should check with the supervisor first. This practice is *most likely*:

- A) in violation of Standard I(B) Independence and Objectivity. 
- B) consistent with the Code of Ethics and Standards of Professional Conduct. 
- C) in violation of Standard V(B), Communications with Clients and Prospective Clients. 

#### Explanation

The policy dictated by the supervisor would infringe upon the analyst's independence and objectivity. It may discourage the analyst from making sell recommendations and, furthermore, present the opportunity for the supervisor to try and change the analyst's mind.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #23 of 47

Which of the following statements about the responsibilities of CFA charterholders is CORRECT? CFA charterholders:

- A) are only obligated to comply with securities laws in the U.S. ✗
- B) need not comply with the laws and rules governing their profession or must not engage in any individual behavior that reflects adversely on the entire profession. ✗
- C) must comply with the laws and rules governing their profession and must not engage in any individual behavior that reflects adversely on the entire profession. ✓

#### Explanation

CFA charterholders must comply with the laws and rules governing their profession and must not engage in any individual behavior that reflects adversely on the entire profession. While they should act honorably and follow U.S. securities laws, they are obligated to more than that, as set forth in the Code and Standards.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #24 of 47

Mega Securities, a multinational investment advisor based in the United States, employs the following analysts who practice in multiple jurisdictions.

- Melissa Black, CFA, resides in Country N, which has no securities laws or regulations, but does business in Country L, which has securities laws and regulations that are less strict than the Code and Standards.
- Tom White, a CFA Institute member, resides in Country L, but does business in Country S, which has securities laws and regulations that are stricter than the Code and Standards.

According to the CFA Institute Code and Standards, which of the following statements about Black and White is *CORRECT*?

<u>Black must adhere to the</u>	<u>White must adhere to the</u>
---------------------------------	---------------------------------

- |                       |                  |   |
|-----------------------|------------------|---|
| A) law of Country L   | law of Country S | ✗ |
| B) law of Country N   | law of Country L | ✗ |
| C) Code and Standards | law of Country S | ✓ |

#### Explanation




Because the applicable law in Country L is *less* strict than the Code and Standards, Black must adhere to the Code and Standards. Because the applicable law is *stricter* than the Code and Standards, White must adhere to the more strict applicable law of Country S.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #25 of 47

Francisco Perez, CFA, CPA, is a portfolio manager for an investment advisory firm. Due to the prominence of his position, he is often invited to attend free marketing and educational events hosted by firms which seek to inform the investment community about their investment processes. One such firm, Unlimited Horizons, has invited Perez to attend free educational events which qualify for Continuing Education credits which could help Perez maintain his CPA designation. Perez should *most likely*:

- A)** decline to attend the event as it could result in a violation of Standard I(B) "Independence and Objectivity." 
- B)** decline to attend the event as it could result in a violation of Standard I(A) "Knowledge of the Law." 
- C)** accept the invitation as no cash compensation is involved and the primary intent is to educate and inform the investment community. 

#### Explanation




Perez should decline the invitation as it creates the impression of lack of independence. If he does not accept the free continuing education courses, he would have to pay for them some other way so the free courses are a form of compensation. Nothing in the vignette suggests the free classes are illegal.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #26 of 47

Deloris Johnson, CFA, observed that her supervisor has violated a federal securities regulation. Johnson discussed the matter with her company's compliance department but they have taken no action. According to the CFA Institute Code and Standards of Professional Conduct, Johnson is required to:

- A)** dissociate from the supervisor's activity 
- B)** report the violation to securities regulators. 
- C)** confront the supervisor and attempt to stop the violation. 

#### Explanation

Johnson must dissociate herself from her supervisor's activity, for example by asking to be reassigned. The Code and Standards do not require Johnson to report the violation to governmental or regulatory organizations unless doing so is required by applicable law. Johnson has attempted to stop the violation by discussing it with her compliance department. She is not required by the Code and Standards to confront the supervisor.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #27 of 47

According to the CFA Institute Standards of Professional Conduct, Standard I(A), Knowledge of the Law, members shall not knowingly participate or assist in any violations of laws, rules, or regulations. An analyst:

- A) is held responsible for participating in illegal acts when the law is evident to anyone knowing the law and is held responsible for violations by others when the analyst is unaware of the facts ✗
- B) must report all legal violations to the proper regulatory commission and is held responsible for participating in illegal acts when the law is evident to anyone knowing the law. ✗
- C) is held responsible for participating in illegal acts when the law is evident to anyone knowing the law and can participate in a violation by having knowledge of the violation and taking no action ✓

#### Explanation

If you suspect someone is planning or engaging in illegal activities, you should:

1. Determine the legality of the activities. Consult your supervisor and legal counsel.
2. Take appropriate action. Disassociate, attempt to persuade the perpetrator to stop. CFA Institute does not require you to report them to the authorities, but the law might.

(Study Session 1, Module 3.1, LOS 3-I.(A))

### Question #28 of 47

Josh LeBlanc, a CFA charterholder, is an investment analyst for a small stock brokerage firm. He wants to acquire and maintain knowledge about applicable laws, rules, and regulations relating to his professional activities. According to the CFA Institute Standards of Professional Conduct, which of the following ways is *least likely* to meet compliance procedures?

- A) Keep informed about changes in applicable laws, rules, and regulations. ✗
- B) Review written compliance procedures on a regular basis. ✗
- C) Rely on past practices followed within his firm. ✓

#### Explanation

LeBlanc should follow the compliance procedures under Standard IA -- Knowledge of the law. Relying on his firm's past practices may be insufficient for LeBlanc to stay current with changes in applicable laws, rules, and regulations.

(Study Session 1, Module 3.1, LOS 3-I.(A))

### Question #29 of 47

If a CFA Institute member knows that a fellow member has violated the Code and Standards, according to Standard I(A) the member is:

- A) strongly encouraged to dissociate from the activity. ✗
- B) required to dissociate from the activity and strongly encouraged to report it. ✓
- C) required to report the activity. ✗

### Explanation

Standard I(A) does not require a CFA Institute member to report potential violations by others, but "strongly encourages members and candidates to report potential violations of the Code and Standards committed by fellow members and candidates."

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #30 of 47

A CFA Institute member conscientiously maintains records of changes in security regulations. The member notices that his colleagues do not, and does NOT say anything. Is this a violation of Standard I(A)?

- A) Yes, and the member should disassociate from these colleagues.
- B) No, as long as the colleagues do not violate the new rules.
- C) Yes, because the member is bound by the Code of Ethics.



### Explanation

The last bullet point of the Code says that a member shall "Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals." Ignoring the neglect of rule changes of others would clearly be incongruent with this component. As long as the colleagues do not violate the laws, the member does not have to disassociate himself from the colleagues.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #31 of 47

Nicholas Brynne, CFA, is a fixed-income analyst who trades in mortgage-backed securities (MBS). The MBS industry has seen sweeping regulatory changes since Brynne took his current position, and he now feels his understanding of applicable laws and regulatory standards is dated. Brynne must:

- A) rely on his firm's policies and procedures for guidance on legal and regulatory standards.
- B) update his understanding of applicable laws and regulatory standards relating to his position.
- C) have all trades reviewed by his compliance department until he has obtained an expert level of knowledge in compliance.



### Explanation

See Standard I(A) "Knowledge of the Law." Brynne should update his understanding of applicable laws and regulatory standards relating to his position, although he is not required to be an expert in compliance. Relying only on firm policies and procedures is not sufficient.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #32 of 47

A member or candidate who produces issuer-paid research should *most appropriately* negotiate a:

A) fee based on the performance of the issuer's shares.



B) fee that may include equity or warrants.



C) flat fee prior to writing the report.



#### Explanation

Standard I(B) Independence and Objectivity states that the best practice for issuer-paid research is to negotiate a flat fee before writing the report. Compensation that depends on the performance of the issuer's securities can compromise an analyst's objectivity by creating an incentive to write a positive recommendation.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #33 of 47

Bob Smith, CFA, is an independent board member of Atlantic Technologies, but is not paid by the firm for his services. An employee at Atlantic informs Smith that Atlantic has improperly timed the booking of contracts to achieve the desired quarterly financial results. The misleading financial statements would turn losses into profits. Smith confers with the firm's legal counsel who indicates that this conduct is, in fact, illegal. Smith urges Sharon White, Atlantic's chief financial executive, to change the financial statements, but she refuses to do so and indicates the firm's external auditors have approved the method of revenue recognition she has used. According to CFA Institute Standards of Professional Conduct, which of the following actions is *least likely* appropriate for Smith: in this situation?

A) Report the illegal activity to CFA Institute.



B) Bring his concerns to the other board members.



C) Dissociate from the activity by resigning as a director or by reporting the activities to the appropriate authorities.



#### Explanation

Reporting violations of the Standards to the CFA Institute may be appropriate for concerns about a member's conduct, but is not the proper avenue for reporting corporate malfeasance in general. Members must dissociate from any activity they know is illegal and if Smith cannot get his firm to correct the misleading financial report he must leave the board. There are intermediate steps that Smith can take in order to remedy the situation. Smith may bring his concerns to the other board members in order to get the firm to stop the illegal activity. If the board will not remedy the situation, dissociating from the board may be Smith's only way to remain in compliance with the Code and Standards.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #34 of 47

An analyst, who is a CFA charterholder, is working in a foreign country. Which of the following statements is CORRECT? The analyst is:

A) covered by the strictest of the following laws and rules: his own country's, the foreign country's or CFA Institute's Code and Standards.



B) governed by the laws and standards of the country in which he is living and working.



C) governed by CFA Institute's Code and Standards.



### Explanation




The analyst is covered by the strictest of the following laws and rules: his own country's, the foreign country's or CFA Institute's Code and Standards.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #35 of 47

CFA Institute members should encourage their employers to do all of the following EXCEPT:

- A) conduct background checks on potential employees to ensure that they are of good character and eligible to work in the investment industry. 
- B) require employees to write personal ethics statements. 
- C) make clear that dishonest personal behavior reflects poorly on the profession. 

### Explanation




There is no reason to have employees write personal ethics statements. CFA Institute encourages all of the other actions.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #36 of 47

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

- A) restrictions on all types business entertainment. 
- B) a requirement to disclose the gift. 
- C) a formal value limit based on local customs. 

### Explanation




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

(Study Session 1, Module 3.1, LOS 3.a, 3.b, 3.c)

---

### Question #37 of 47

Joshua Rosenberg, CFA, is an equity analyst who covers Northwest Implements, a farm implement manufacturer. Northwest's main factory is located in a sparsely inhabited region six hours by automobile from the nearest airport. Northwest has its own corporate jet and a landing strip is located near the facility. When Rosenberg contacts Northwest's management to gather information for a report he is preparing on the company, Northwest's chief financial officer, Thomas Blake, invites Rosenberg to visit Northwest's headquarters and meet with management. Blake offers to send Northwest's corporate jet to pick up Rosenberg from an airport near Rosenberg's home and to return him home the same evening. Rosenberg estimates that it would require three days for him to make the visit using commercial travel. If Rosenberg accepts Blake's offer and makes the trip to Northwest's headquarters on the corporate jet, Rosenberg:

- A) has violated the Code and Standards unless he discloses the trip and the payment of his travel expenses in his report on Northwest. 
- B) has violated the Code and Standards unless he reimburses Northwest for the cost of the trip. 
- C) has not violated the Code and Standards. 

#### Explanation




Standard I(B) requires members to maintain independence and objectivity. A visit by an analyst to an out-of-the-way site may be paid for by a client company host as long as the analyst can maintain objectivity. Members should encourage clients to limit the use of corporate aircraft, but exceptions can be made if transportation would not otherwise be available or would be inefficient.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #38 of 47

Allen Parsons, a CFA candidate, suspects a colleague at his firm of engaging in an illegal activity. Which of the following statements about procedures for compliance involving Standard I(A), Knowledge of the law is NOT correct? Parsons:

- A) should consult counsel to determine whether the conduct is, in fact, illegal. 
- B) should urge his firm to attempt to persuade the perpetrator to cease such conduct. 
- C) is required to report this legal violation to the appropriate governmental or regulatory organizations. 

#### Explanation



Standard I(A), Knowledge of the law, does not require that Parsons report legal violations to the appropriate governmental or regulatory organizations, but such disclosures may be appropriate under certain circumstances.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #39 of 47

A member or candidate who suspects that a colleague is violating the law should *most* appropriately:

- A) report all illegal activities to the appropriate regulatory agency. 
- B) consult with the company counsel to determine if in fact a law is being violated. 



C) report the illegal activity to CFA Institute Professional Standards Review Board for action.



#### Explanation

According to Standard I(A), Knowledge of the Law, members and candidates shall not knowingly participate or assist in any violation of laws, rules, regulations, or the Code and Standards.

When members suspect a client or a colleague of *planning or engaging in ongoing illegal activities*, members should take the following actions:

- **Consult counsel** to determine if the conduct is, in fact, illegal.
- **Disassociate** from any illegal or unethical activity. When members have reasonable grounds to believe that a client's or employee's activities are illegal or unethical, the members should disassociate from these activities and urge their firm to attempt to persuade the perpetrator to cease such activity.

*Note:* The Code and Standards do not require that members report legal violations to the appropriate governmental or regulatory organizations, but such disclosure may be prudent in certain circumstances.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #40 of 47

Janet Green, CFA, provides investment advice and other services to clients in several countries. She resides in Country A whose securities laws and regulations are less strict than the Code and Standards. She also conducts business with clients in Country B, which has no securities laws or regulations, and in Country C, which has securities laws and regulations that are stricter than the Code and Standards. Which of the following statements is CORRECT? According to CFA Institute Standards of Professional Conduct, Green must adhere to the Code and Standards in:

A) Country A, Country B, and Country C.



B) Country A and Country B but the law in Country C.



C) Country A but the law in Country B and Country C.



#### Explanation

Green needs to follow Standard I(A) -- Knowledge of the law. In Country A, Green must adhere to the Code and Standards because Country A's laws are less strict. In Country B, Green must also adhere to the Code and Standards because Country B has no securities laws. Because Country C's applicable law is stricter than the requirements of the Code and Standards, Green must adhere to the laws of Country C.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #41 of 47

Sometimes a CFA Institute member simply *feels* a law has been violated by his firm, and sometimes the member *knows* a law has been violated. Which of the following pairs of guidelines is CORRECT with respect to the first step a member should take in each case? The member should first contact:

A) his supervisor in the firm if he feels a law has been violated and contact the firm's counsel if he knows a law has been violated.



B) the firm's counsel if he feels a law has been violated and contact his supervisor if he knows a law has been violated.



C) the firm's counsel if he feels a law has been violated and the SEC if he knows a law has been violated.



#### Explanation

Standard I(A) says that when a member feels a law has been broken, the member should seek advice from the firm's counsel. If the member feels the advice is unbiased and competent, the member should follow it. If the member knows a law has been violated, the member should contact a supervisor.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #42 of 47

Don Roberts, a CFA Institute member, resides in Country L, where the securities laws and regulations are less strict than the CFA Institute Code and Standards. Roberts also does business in Country N, which has no securities laws or regulations. Thus, Country N has no laws prohibiting the use of material nonpublic information. Roberts has clients in both Country L and N. Country L's law states that the law of the locality where business is conducted governs. According to CFA Institute Standards of Professional Conduct about the use of material nonpublic information, Roberts may:

A) not take investment action on the basis of this information.



B) take investment action based on this information only for his clients in Country N but not for his clients in Country L or himself.



C) take investment action based on this information for clients in both Country N and Country L and for himself.



#### Explanation

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, the member must adhere to the Code and Standards. Standard II(A) prohibits the use of material nonpublic information.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #43 of 47

An analyst who is a CFA Institute member receives an invitation from a business associate's firm to spend the weekend in a high-quality resort. In order to abide by the Standards, the analyst should (may):

A) do both of the actions listed here.



B) refuse the invitation if the associate is from a firm he analyzes for his employer.



C) obtain written consent from his supervisor if the offer is contingent on achieving a target investment return.



#### Explanation

According to Standard I(B) Independence and Objectivity, the analyst should refuse the invitation if it is from a firm the analyst covers for his employer. The analyst can accept the invitation if it is from a client but the analyst must get written consent from his employer if the offer is contingent on future performance, to comply with Standard IV(B) Additional Compensation Arrangements.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #44 of 47

A CFA Institute member is also a member and the portfolio manager of an environmentalist group. In its charter, the environmentalist group lists a group of companies its members should boycott. The CFA Institute member would violate Standard I(A) concerning obeying all rules and regulations if the member:

- A) purchases stock of a boycotted firm for the group's portfolio. ✔
- B) actively protests against a publicly traded firm boycotted by the group. ✘
- C) performs either of the activities listed here. ✘

#### Explanation

Standard I(A) says the member must be guided by all applicable rules and regulations of professional associations governing the member's professional activities. Purchasing the stock for the firm would be a violation because it involves the member's professional activities and the rules of a group to which the member belongs and works for. Actively protesting would not be covered by that standard.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #45 of 47

Susan Nielsen, CFA, is an equity research analyst on a fact-finding property tour with 6 other analysts to learn about Just Kittens, Inc. Just Kittens sells tungsten ball-bearings and has 16 warehouses, and 20 manufacturing, research, and wholesale sales outlets scattered over 8 countries – mostly emerging markets. Because of the remote location of some of the facilities, commercial travel is effectively unavailable. Just Kittens charts a jet and various busses to take the research analysts to the properties. If Nielsen accepts these accommodations, she is *most likely*:

- A) not in violation of Standard I(B) "Independence and Objectivity" because commercial travel is effectively unavailable. ✔
- B) in violation of Standard I(B) "Independence and Objectivity." ✘
- C) not in violation of Standard I(B) "Independence and Objectivity" because best practices dictate that better access to company executives is likely to lead to more accurate and timely ✘

#### Explanation

Nielsen is not in violation of Standard I(B) "Independence and Objectivity" because commercial travel is effectively unavailable.

(Study Session 1, Module 3.1, LOS 3-I.(B))

---

### Question #46 of 47

Joan Platt, CFA, operates an investment advisory service in New York but maintains an office in Xania. Xania recently established a stock market, which is not very efficient. None of the Xanian stocks trade in the U.S. market. Xania legally permits the use of material inside information. Platt believes that using inside information would help her compete against other Xanian investment advisors and also help some of her Xanian clients reach their investment objectives. Platt is considering adopting local investment practices in Xania. According to CFA Institute Standards of Professional Conduct, Platt may:

**A)** use material inside information because Xania legally permits this practice.



**B)** not use material inside information.



**C)** use material inside information, but only after notifying CFA Institute.



#### Explanation

Because applicable law involving material inside information is less strict than the Code and Standards, Platt must adhere to the Code and Standards. Standard II(A) prohibits against use of material nonpublic information.

(Study Session 1, Module 3.1, LOS 3-I.(A))

---

### Question #47 of 47

If an analyst suspects a client or a colleague of planning or engaging in ongoing illegal activities, which of the statements about the actions that the analyst should take is *most correct*? According to the CFA Institute Standards of Professional Conduct, the analyst should:

**A)** consult counsel to determine the legality of the activity.



**B)** consult counsel to determine the legality of the activity and disassociate from any illegal or unethical activity if the member has reasonable grounds to believe that the activity is illegal or unethical.



**C)** disassociate from any illegal or unethical activity if the member has reasonable grounds to believe that the activity is illegal or unethical.



#### Explanation

According to the procedures for compliance involving Standard I(A), CFA Institute members should determine legality and disassociate from any illegal or unethical activity.

(Study Session 1, Module 3.1, LOS 3-I.(A))