LO.a: Evaluate the practices and policies presented.

LO.b: Explain the appropriate action to take in response to conduct that violates the CFA Institute Code of Ethics and Standards of Professional Conduct.

1. While analyzing and deciding to buy shares of Utah BioChemical and Norgood for his clients, did Smithson violate any CFA Institute Standards?
   A. Yes, relating to material nonpublic information.
   B. Yes, relating to market manipulation.
   C. No.

2. In making the investment decision to purchase shares of Utah BioChemical and Norgood, Smithson *most likely* complied with the CFA Institute Standard relating to:
   A. diligence and reasonable basis.
   B. fair dealing.
   C. disclosure of conflicts.

3. In purchasing shares of Utah BioChemical and Norgood for all his clients and the allocation of trades, Smithson *least likely* violated the CFA Institute Standard relating to:
   A. fair dealing.
   B. misconduct.
   C. suitability.

4. Did Preston Partners violate *any* CFA Institute Standards regarding the trade allocation procedures of the firm?
   A. No.
   B. Yes, relating to responsibilities of supervisors.
   C. Yes, relating to preservation of confidentiality.

5. What action is required by Sheldon Preston in view of the violations committed by Smithson to prevent such actions from recurring? Preston should ensure that the firm has:
   A. written investment objectives and guideline policy statements for all accounts, and detailed trade allocation policies.
   B. a designated compliance officer responsible for overseeing that all procedures, rules, and laws are upheld by employees.
   C. Both A and B.

Solutions

1. C is correct. Smithson while researching and eventually deciding to buy shares of the two companies, Utah BioChemical and Norgood did not violate any CFA Institute Standards.

2. A is correct. Smithson complied with Standard V(A) – Diligence and Reasonable Basis. After he saw the meeting between the two heads of the companies, he carried out due diligence which involved a thorough investigation and found out that both companies were selling at attractive prices. Further, the two businesses were complimentary to each other. Therefore, he concluded that the companies might be heading toward a merger and bought shares.

3. B is correct. Smithson violated the Standard III(C) – Suitability, by purchasing the stock of the two companies for **all** his clients. Utah BioChemical (with high volatility) was not appropriate for his conservative clients (pension funds). Only Norgood with its stable outlook would have been a reasonable fit for such accounts.

4. B is correct. Preston Partners did not have proper supervisory procedures to ensure that those under its supervision complied with applicable laws, rules and the CFA Institute Standards. Preston Partners had adopted the Code and Standards; therefore, the firm should have had proper trade allocation procedures. The manual was also unclear. Hence, it was the responsibility of the firm to have supervisors to ensure that all compliance policies were clearly written and disseminated to staff. Staff training should also have been done periodically.

5. C is correct. Sheldon Preston should ensure that the firm has proper written guidelines and investment policy statements for all clients. It should have clear-cut rules for trade allocations and a designated compliance officer (either himself or someone from the firm) who ensures that the employees comply with all the laws, rules, regulations and the Code and Standards.