Sean O'Brien, CFA, works for Paradigm Portfolios as a portfolio manager. He manages a high-yield (junk bond) fund as well as 14 large private accounts. O'Brien's compensation for the high-yield fund is performance based, while the private-account compensation is based upon a percentage of assets. The company's compensation packages are a closely guarded secret, and kept in-house.

When placing trades, O'Brien often uses the services of Junk Specialist Securities. The firm has the reputation for the best high-yield research on the Street, high trading commissions, and best execution. O'Brien sometimes "pays up" on trades to obtain research. He uses the research in managing all accounts under his purview. These trades are allocated equitably over all accounts.

O'Brien routinely takes personal positions in securities held in the high-yield fund, a practice allowed by Paradigm. On his way to work, he learns over the radio that a hurricane is heading toward the location of Villa Real Resorts in Mexico. Landfall is expected by Dec. 23, which could potentially ruin the lucrative Christmas vacation season. If the hurricane hits as expected, it will have a devastating affect on cash flows, and O'Brien believes Villa Real might default on its bonds. Both O'Brien and the high-yield fund hold Villa Real bonds. After arriving at the office, O'Brien sells off the fund's Villa Real holdings, then immediately liquidates his own position.

Periodically O'Brien buys convertible bonds in the high-yield fund. When these are converted into common equity he typically does not vote the proxies, saying, "the fund is not an equity fund, and the equities are usually sold within the year."

Before accepting a new account, O'Brien conducts a thorough investigation into his client's financial situation, investment experience, and investment objectives. The information is updated annually through a survey mailed to the client and returned to Paradigm, and O'Brien follows up with a telephone call to the client. Judy Smith's portfolio was deemed suitable for the inclusion of high-yield bonds based upon the initial investigation, and reaffirmed at the last three annual updates. It is three months since Smith's last annual update, and the high-yield market has been weak. Smith files a lawsuit alleging malfeasance on the part of O'Brien.

O'Brien regularly attends analyst meetings. During the course of many of these meetings, he is observed consuming several highballs. On afternoons following the meetings he is easily angered and at times belligerent. However, his investment prowess does not seem to diminish.

In the course of effecting money-market transactions for the accounts, O'Brien routinely places numerous trades, allocating the paper with marginally higher yields to the high-yield fund and the remainder to the private accounts.

Question #1 of 47

With regard to the Smith account, O'Brien's actions are *best* described as being in:

A) violation of Standard III(A) - Loyalty, Prudence, and Care.

B) violation of Standard V(B) - Communication with Clients and Prospective Clients.

C) compliance with all applicable CFA Institute Standards.

Question #2 of 47

O'Brien's drinking at analyst meetings and subsequent conduct is:

A) in violation of Standard I(D): Misconduct because it reflects adversely on his professional competence.

B) in violation of Standard IV(A): Loyalty to Employer, because his drinking deprives the company of quality work.

C) in violation of Standard I(B): Independence and Objectivity.

Question #3 of 47

Which of the following statements about O'Brien's use of convertible bonds is *CORRECT*?

A) Unless O'Brien makes arrangements for someone else to vote the proxies, he is in violation of Standard III(A): Loyalty, Prudence, and Care.

B) The use of convertible bonds in O'Brien's high-yield fund violates Standard V(A): Diligence and Reasonable Basis.

C) O'Brien's lack of expertise in equity analysis, despite usage of the CFA mark, represents a violation of Standard VII(A): Conduct as Members and Candidates in the CFA Program.

Question #4 of 47

With regard to the Villa Real investment, O'Brien's actions:

A) violate neither the reasonable-basis Standard nor the priority-of-transactions Standard.

B) do not violate the fiduciary-duties Standard but do violate the priority-of-transactions Standard.

C) violate the reasonable-basis Standard and the fiduciary-duties Standard.

Question #5 of 47

O'Brien's money-market allocations represent:

A) a violation of Standard III(B): Fair Dealing.

B) a breach of his fiduciary duty to mutual-fund account owners.

C) reasonable actions, as they simply reflect the nature of his compensation.

Question #6 of 47

The practice of "paying up" for the research is:

A) OK for the fund but not OK for the private accounts.

B) OK for the fund and OK for the private accounts.

C) not OK for the fund and not OK for the private accounts.

Question #7 of 47

An internal audit of Vega Fund has determined that the fund is out of compliance with its investment policy statement as disclosed in the prospectus. Vega should do all of the following EXCEPT:

A) seek authorization should it be determined that the investment policy requires alteration.

B) revise the internal audit procedure to allow such occurrences in the future.

C) revise the investment process in order to be consistent with the investment policy statement.

Question #8 of 47

Concerning Standard III(B), Fair Dealing, which of the following statements is CORRECT? The Standard:

A) concerns the dissemination of investment recommendations but is not concerned with the taking of investment action.

B) concerns the dissemination of investment recommendations and the taking of investment action.

C) is not concerned with the dissemination of investment recommendations so long as the taking of investment action is inherently fair.

Jacques Claudel, a CFA Institute member, represents Vector Funds, a U.S.-based fund manager, in Canada. Although Vector Funds is properly licensed to deal in all Canadian and U.S. securities, its primary objective is to sell United States funds to Canadian institutional investors seeking diversification into the U.S. dollar. While it would be willing to do so if requested by its clients, Vector has not placed trades in Canadian securities since Claudel began working there two years ago.

Prior to joining Vector's Canadian operations, Claudel was an independent asset manager handling the funds of wealthy individuals and small institutions. Most of these accounts remain under his management, under the business name Coup de Gras. Claudel is unclear as to whether his consulting work is in competition with his new employer, as the accounts under his management are invested strictly in Canadian securities, while Vector has not traded Canadian securities. However, just to be on the safe side, he obtained written permission from Vector to continue serving his former clients. His former clients were not notified.

Claudel receives cash compensation for most of the accounts he handles independently, but for one he receives a new car for his personal use every two years, and for another he is compensated with a one-week, expenses-paid holiday in the European country of his choice.

As part of his responsibility, Claudel makes trades for some of his Canadian clients. He runs all of his trades through two brokers, Ace Equity Traders and the Parlay Group. Ace offers some of the best research available on health-care stocks, but charges fairly hefty commissions. Parley has some of the cheapest commissions in Toronto, but provides no research of value to Claudel. Vector claims compliance with the CFA Institute Soft Dollar Standards.

Henri Bonnet, CFA, a friend of Claudel's, works on the floor of the Vancouver Stock Exchange. He asks Claudel to establish an account for him at Coup de Gras. Claudel learns that it is Bonnet's intention to manipulate the prices of penny stocks he trades on the exchange, and profit from the price movements in the account at Coup de Gras. Claudel sets up the account, but advises Bonnet that he "will have nothing to do" with the manipulation scheme beyond placing trades as Bonnet directs.

Claudel is currently pursuing a master's degree in financial economics in the evenings. During the interview with Vector and on his resume he indicated that he "attended Victoria University," giving his estimated date of graduation. He is not sure whether Vector understood that he did not have his master's degree.

Question #9 of 47

Which of the following statements about consulting work is CORRECT?

A) In all cases the employee must receive the employer's written permission prior to receiving additional compensation from parties other than the firm. This requirement

B) In some circumstances the employee must receive the employer's written permission prior to receiving additional compensation from parties other than the firm. This

C) In some circumstances the employee must receive the employer's written permission prior to receiving additional compensation from parties other than the firm. This

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Question #10 of 47

Should Claudel decide to terminate his relationship with Vector, which of the following items can he NOT take with him?

A) His Rolodex full of contacts in the brokerage and money-management business.

B) A list of consulting clients, with addresses and phone numbers.

C) A marketing presentation he developed for Vector, but uses primarily in his side business.

Question #11 of 47

Claudel's statement about his education background is:

A) truthful, and in accord with the Code and Standards.

B) truthful, but not in accord with the Code and Standards.

C) not truthful, and not in accord with the Code and Standards.

Question #12 of 47

Which of the following statements is CORRECT?

A) Bonnet has violated Standard IV(A): Loyalty to Employer, and Claudel has violated Standard I(A): Knowledge of the Law.

B) Bonnet has violated Standard III(B): Fair Dealing, and Claudel has violated Standard I(B): Independence and Objectivity.

C) Bonnet has violated Standard II(A): Material Nonpublic Information, and Claudel has not violated Standard III(A): Loyalty, Prudence, and Care.

Question #13 of 47

With regard to his consulting work, Claudel is:

A) in competition with Vector because he advises individual investors, and in compliance with the Code and Standards.

B) in competition with Vector because he advises individual investors, and not in compliance with the Code and Standards.

C) not in competition with Vector because Vector doesn’t trade Canadian securities, and in compliance with the Code and Standards.

Question #14 of 47

Assuming that both Ace Equity Traders and the Parlay Group offer best execution, Claudel:

A) must disclose to clients whether client-directed brokerage will prevent him from getting the best execution.

B) can select the broker that refers the most business back to him, as long as any research purchased benefits the client whose account is being traded.

C) must direct all the trades for clients who do not wish to own health-care stocks to the Parlay Group.

Question #15 of 47

Karen Jackson is a portfolio manager. Jackson is friendly with David James, president of Acme Medical, a rapidly growing biotech company. James has provided Jackson with recommendations in the biotech industry, which she buys for her own portfolio before buying them for her clients. For three years, Jackson has also served on Acme Medical's board of directors. She has received options and fees as compensation.

Recently, the board of Acme Medical decided to raise capital by voting to issue shares to the public. This was attractive to board members (including Jackson) who wanted to exercise their stock options and sell their shares to get cash. When the demand for initial public offerings (IPO) diminished, just before Acme Medical's public offering, James asked Jackson to commit to a large purchase of the offering for her portfolios. Jackson had previously determined that Acme Medical was a questionable investment but agreed to reconsider at James' request. Her reevaluation confirmed the stock to be overpriced, but she nevertheless decided to purchase Acme Medical for her clients' portfolios.

Did Jackson violate Standard III(C) Suitability concerning portfolio recommendations and actions?

A) Yes, because she did not consider the appropriateness and suitability of investment recommendations or actions for each portfolio or client.

B) Yes, because she did not deal fairly with all clients.

C) No.

Question #16 of 47

Pro rata allocation on the basis of an advance indication of interest means each account for which the shares are suitable:

A) and which has expressed an advance indication of interest, shall receive m/n fraction of their indication, where there are m shares available and indications of interest for n

B) shall receive m/n shares, where there are m shares available and n such accounts.

C) and which has expressed an advance indication of interest, shall receive w*m shares, where w is the account's proportional value of all such accounts and there are m shares

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Glenarm Case Study (Refer to CFA Institute Standards of Practice Casebook for details.)

Peter Sherman, CFA, has recently joined Glenarm Company after spending 5 years at Pearl Investment Management. He is responsible for identifying potential Latin American investments. Previously, Sherman held jobs as a consultant for many Latin American companies and had plans to continue such consulting jobs without disclosing anything to Glenarm.

After resigning, but before leaving his employment at Pearl, Sherman had encouraged Pearl customers to move their accounts to Glenarm. He contacted accounts Pearl had been soliciting for business. He also contacted potential clients that Pearl had rejected in the past as too small or incompatible with the firm's business. Furthermore, he convinced several of Pearl's clients and prospects to hire Glenarm after he joined Glenarm. He also identified materials from Pearl to take with him, such as:

1. Sample marketing presentations he had prepared.
2. Computer program models for stock selection.
3. Research materials on companies he had been following.
4. A list of companies recommended by Sherman for potential investment which were rejected by Pearl.
5. News articles for potential research ideas.

Question #17 of 47

Which of the following statements concerning Sherman's actions is CORRECT?

A) Sherman did not violate Standard IV(A) since members can engage in independent consulting practice as long as their employer policy does not specifically prohibit it.

B) Sherman did not violate any Standard by taking away the news articles from his previous employer, Pearl, for potential research ideas.

C) Sherman did not violate Standard IV(A) by soliciting clients that were rejected by Pearl either because they were too small or unsuitable as long as winning their business did

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Question #18 of 47

Sherman's attempt to lure away clients from Pearl while he was still employed at Pearl is:

A) not a violation of Standard IV(A) because they would have followed Sherman to his new firm anyway, and no harm to Pearl was done as a result.

B) a violation of Standard IV(A) because it undermined Pearl's business and its profit opportunities and caused damage to Pearl's business.

C) not a violation of Standard V(A) because it was conducted "after hours" on Sherman's own time.

Question #19 of 47

Patricia Spraetz is the chief financial officer and compliance officer at Super Selection Investment Advisors. Super Selection is a medium-sized money management firm which has incorporated the CFA Institute Code of Ethics and Standards of Practice into the firm's compliance manual.

Karen Jackson is a portfolio manager for Super Selection. She is not a CFA charterholder. Jackson is friendly with David James, president of AMD, a rapidly growing biotech company. James has provided Jackson with recommendations in the biotech industry, which she buys for her own portfolio before buying them for her clients. For three years, Jackson has also served on AMD's board of directors. She has received options and fees as compensation.

Recently, the board of AMD decided to raise capital by voting to issue shares to the public. This was attractive to board members (including Jackson) who wanted to exercise their stock options and sell their shares to get cash. When the demand for initial public offerings (IPO) diminished, just before AMD's public offering, James asked Jackson to commit to a large purchase of the offering for her portfolios. Jackson had previously determined that AMD was a questionable investment but agreed to reconsider at James' request. Her reevaluation confirmed the stock to be overpriced, but she nevertheless decided to purchase AMD for her clients' portfolios.

Which of the following statements concerning Super Selection is CORRECT?

A) Jackson did not violate the CFA Institute Code of Ethics and Standards since she is not a CFA charterholder.

B) Spraetz, in her capacity as a supervisor, violated Standard IV(C) by not preventing violations by Jackson.

C) All employees of a firm are bound by CFA Institute's Code and Standards if they are incorporated in the company's policies manual, and the firm subscribes to them

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Question #20 of 47

Glenarm Case Study (Refer to CFA Institute Standards of Practice Casebook for details.)

Peter Sherman, CFA, has recently joined Glenarm Company after spending 5 years at Pearl Investment Management. He is responsible for identifying potential Latin American investments. Previously, Sherman held jobs as consultant for many Latin American companies and had plans to continue such consulting jobs without disclosing anything to Glenarm.

After resigning, but before leaving his employment at Pearl, Sherman had encouraged Pearl customers to move their accounts to Glenarm. He contacted accounts Pearl had been soliciting for business. He also contacted potential clients that Pearl had rejected in the past as too small or incompatible with the firm's business. Furthermore, he convinced several of Pearl's clients and prospects to hire Glenarm after he joined the company. He also identified materials from Pearl to take with him, such as:

1. sample marketing presentations he had prepared
2. computer program models for stock selection
3. research materials on companies he had been following
4. a list of companies recommended by Sherman for potential investment, but which were rejected by Pearl
5. news articles for potential research ideas

Upon Sherman's joining Glenarm, which of the following acts did NOT violate the standards?

A) He allowed Glenarm to advertise the fact that they had hired a portfolio manager who was a CFA charterholder.

B) He misappropriated news articles from his old employer.

C) He did not give Glenarm a written statement disclosing his independent consulting practice and details of activities that resulted in compensation since they had already

Question #21 of 47

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

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

Question #22 of 47

Glenarm Case Study (Refer to CFA Institute's Standards of Practice Casebook for details.)

Peter Sherman, CFA, has recently joined Glenarm Company after spending 5 years at Pearl Investment Management. He is responsible for identifying potential Latin American investments. Previously, Sherman held jobs as consultant for many Latin American companies and had plans to continue such consulting jobs without disclosing anything to Glenarm.

After resigning, but before leaving his employment at Pearl, Sherman had encouraged Pearl customers to move their accounts to Glenarm. He contacted accounts Pearl had been soliciting for business. He also contacted potential clients that Pearl had rejected in the past as too small or incompatible with the firm's business. Furthermore, he convinced several of Pearl's clients and prospects to hire Glenarm after he joined the company. He also identified materials from Pearl to take with him, such as:

1. sample marketing presentations he had prepared
2. computer program models for stock selection
3. research materials on companies he had been following
4. a list of companies recommended by Sherman for potential investment, but which were rejected by Pearl
5. news articles for potential research ideas

Under the obligation to act in the best interest of the employer while still an employee, Sherman's actions constitute the following violations except:

A) solicitation of clients while still employed by Pearl—violation of Standard IV(A).

B) leaving Pearl to join a possible competitor—violation of Standard IV(A), Loyalty to Employer.

C) solicitation of potential clients of Pearl—violation of Standard IV(A).

Question #23 of 47

Which of the following statements is *least* accurate? It is permissible under the Standards to allocate trades:

A) on a pro rata basis over all suitable accounts on the basis of an advance indication of interest and indicated order size.

B) on a pro rata basis over all accounts.

C) on a pro rata basis over all suitable accounts based upon account value.

Question #24 of 47

Patricia Spraetz is the chief financial officer and compliance officer at Super Selection Investment Advisors. Super Selection is a medium-sized money management firm which has incorporated the CFA Institute Code of Ethics and Standards of Practice into the firm's compliance manual.

Karen Jackson is a portfolio manager for Super Selection. She is not a CFA charterholder. Jackson is friendly with David James, president of AMD, a rapidly growing biotech company. James has provided Jackson with recommendations in the biotech industry, which she buys for her own portfolio before buying them for her clients. For three years, Jackson has also served on AMD's board of directors but has never notified Super Selection of this fact. She has received options and fees as compensation.

Recently, the board of AMD decided to raise capital by voting to issue shares to the public. This was attractive to board members (including Jackson) who wanted to exercise their stock options and sell their shares to get cash. When the demand for initial public offerings (IPO) diminished, just before AMD's public offering, James asked Jackson to commit to a large purchase of the offering for her portfolios. Jackson had previously determined that AMD was a questionable investment but agreed to reconsider at James' request. Her reevaluation confirmed the stock to be overpriced, but she nevertheless decided to purchase AMD for her clients' portfolios.

Which of the following statements is NOT correct?

A) Jackson did not violate Standard III(A) on Fiduciary Duty to clients because she was bound by her fiduciary duty to AMD and its stockholders as a board member.

B) Jackson violated Standard VI(A) regarding Conflicts of interest by not disclosing her board membership and ownership of stock options to her employer.

C) Jackson violated Standard IV(B) regarding Disclosure of Additional Compensation by not disclosing additional compensation in the form of cash and stock options received from

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Question #25 of 47

Preston Partners Case Study (Refer to CFA Institute Standards of Practice Casebook for details).

Preston partners is a medium-sized investment management firm which adopted the Code and Standards as part of its policy manual. Gerald Smithson, CFA, a portfolio manager, had recently added the stock of Utah Biochemical Company and Norgood PLC to all his clients' investment portfolios. Smithson had a personal relationship with the president of Utah Biochemical. Shortly afterwards Utah Biochemicals and Norgood announced a merger which increased the share prices of both companies.

Smithson contends that he saw the president of Utah Biochemical dining with the chairman of Norgood but did not overhear their conversation. Smithson researched both companies extensively and determined that each company was a good investment. He also pondered whether there would be a merger as they seemed to complement each other. He put in block trades for shares of each company which were executed over a period of two weeks at various prices. Preston's policies were not clear in this area so he allocated the shares by starting with his largest client and working down to small accounts. Some of Smithson's clients were very conservative personal trust accounts; others were pension funds which had aggressive investment objectives.

Which of the following statements is CORRECT?

A) Smithson failed to comply with Standard III(C) regarding suitability of investments for clients portfolios.

B) Utah Biochemical was an appropriate investment for Preston's personal trust accounts.

C) Smithson acted on inside information because he had observed senior executives of Norgood and Utah Biochemical having lunch together, in violation of Standard II(A).

Question #26 of 47

BlueRock Fund uses a proprietary asset selection model that it believes gives the firm a competitive advantage. The model is applied to a universe of all small-cap domestic equities and all publicly-traded corporate bonds. The asset allocations generated by this model range from +200 percent in small-cap equities/-100 percent in bonds to +200 percent in bonds/-100 percent in small-cap equities. Since the fund can invest in both equities and bonds, it is classified as a balanced fund. In the prospectus BlueRock describes the fund's investment policy as "a balanced fund, with 50 percent of the assets invested in bonds and 50 percent in equities, on average." On this basis, BlueRock is:

A) in violation of CFA Institute Standards concerning the disclosure of security selection and portfolio construction processes.

B) in violation of the CFA Institute Standard concerning Fiduciary Duty.

C) not in violation of any CFA Institute Standard.

Question #27 of 47

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

C) based upon compensation arrangements.

Question #28 of 47

Rickard Advisors recently had a trading error in a customer account that was subsequently discovered by Rickard. The firm felt embarrassed by the disclosure of this error, and, in order to induce the client to continue its relationship, Rickard offers the client preferential access to a new issue that is expected to be "hot." Which Standard is violated, if any?

A) The Standard concerning Fiduciary Duty.

B) The Standard concerning Independence and Objectivity.

C) The Standard concerning Fair Dealing.

Question #29 of 47

In order to remain in compliance when managing private client accounts, members must do all of the following EXCEPT:

A) Conduct regular reviews of client circumstances.

B) Use a risk-factor model to assess the client's risk tolerance.

C) Seek authorization for changes in investment policy.

Preston Partners Case Study (Refer to CFA Institute Standards of Practice Casebook for details).

Preston Partners is a medium-sized investment management firm which adopted the Code and Standards as part of its policy manual. Gerald Smithson, CFA, a portfolio manager, had recently added the stock of Utah Biochemical Company and Norgood PLC to all his clients' investment portfolios. Smithson had a personal relationship with the president of Utah Biochemical. Shortly afterwards Utah Biochemicals and Norgood announced a merger which increased the share prices of both companies.

Smithson contends that he saw the president of Utah Biochemical dining with the chairman of Norgood but did not overhear their conversation. Smithson researched both companies extensively and determined that each company was a good investment. He also pondered whether there would be a merger as they seemed to complement each other. He put in block trades for shares of each company which were executed over a period of two weeks at various prices. Preston's policies were not clear in this area so he allocated the shares by starting with his largest client and working down to small accounts. Some of Smithson's clients were very conservative personal trust accounts; others were pension funds which had aggressive investment objectives.

Question #30 of 47

Regarding their supervisory duties, which of the following elements of Preston's behavior was NOT a violation of the CFA Institute Standards of Practice? Preston did not violate:

A) Standard IV(C) when he put in place a procedure that uncovers violations of Standards by employees but does not prevent violations.

B) Standard III(B) when he allowed portfolio managers to place block trades at different prices.

C) Standard IV(C) when he failed to have complete and proper supervisory procedures in place.

Question #31 of 47

Which of the following statements concerning the actions of Smithson or Preston Partners is *least* accurate?

A) Preston violated Standard IV(C) for not putting into place adequate supervisory procedures.

B) Smithson did not violate Standard II(A) prohibition against the use of material nonpublic information.

C) Smithson did not violate any Standards since he consulted with the Preston company manual for allocating trades.

Question #32 of 47

A manager of pooled funds must do all of the following to remain in compliance with the Standards EXCEPT:

A) Disclose basic security selection processes.

B) Print the investment policy statement in all quarterly reports.

C) Notify potential investors of any changes in investment policy.

Question #33 of 47

Mohawk Asset Management buys on-the-run Treasuries at auction for its standard fee accounts. When these move off-the-run, they are placed in performance-based accounts via in-house cross-trades at prevailing market prices, and replaced in the standard fee accounts with new on-the-run issues. Which standard is violated, if any?

A) The Standard concerning Priority of Transactions.

B) No Standard is violated.

C) The Standard concerning Fiduciary Duty.

Question #34 of 47

When a firm seeks to allocate a disproportionate number of shares of a hot IPO to performance-based fee accounts this constitutes a violation of the Standard concerning:

A) fiduciary duty.

B) priority of transactions.

C) additional compensation arrangements.

Question #35 of 47

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.

Question #36 of 47

Alba Vasquez allocates trades of hot new IPOs as follows: m×p/(p+s) shares to performance-based fee accounts, m×s/(p+s) shares to standard fee accounts, where there are p suitable performance based fee accounts, s suitable standard fee accounts, and m shares available. This action is:

A) not permissible since it is based upon a formula that is not inherently fair.

B) permissible since it effectively amounts to a strict pro rata basis of allocation.

C) not permissible since it effectively favors the performance-based fee accounts.

Preston Partners Case Study (Refer to CFA Institute Standards of Practice Casebook for details).

Preston partners is a medium-sized investment management firm which adopted the Code and Standards as part of its policy manual. Gerald Smithson, CFA, a portfolio manager, had recently added the stock of Utah Biochemical Company and Norgood PLC to all his clients' investment portfolios. Smithson had a personal relationship with the president of Utah Biochemical. Shortly afterwards Utah Biochemicals and Norgood announced a merger which increased the share prices of both companies.

Smithson contends that he saw the president of Utah Biochemical dining with the chairman of Norgood but did not overhear their conversation. Smithson researched both companies extensively and determined that each company was a good investment. He also pondered whether there would be a merger as they seemed to complement each other. He put in block trades for shares of each company which were executed over a period of two weeks at various prices. Preston's policies were not clear in this area so he allocated the shares by starting with his largest client and working down to small accounts. Some of Smithson's clients were very conservative personal trust accounts; others were pension funds which had aggressive investment objectives.

Question #37 of 47

Select the most appropriate policy statement for Preston regarding Standard IV(C) concerning Responsibilities of Supervisors.

A) "Preston employees who are in supervisory roles will be held accountable for the actions of those who report to them in matters of compliance with the policies and

B) "Preston employees who are in supervisory roles will be held accountable for the actions of those who report to them in matters of compliance with the policies and

C) "Preston employees who are in supervisory roles will not be accountable for the actions of those who report to them in matters of compliance with the policies and procedures

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Question #38 of 47

Select the *most* appropriate policy statement for Preston regarding Standard III(B) concerning Fair Dealing for allocation of block trades.

A) "Preston shall not discriminate against any client account, and all clients will receive the same price for order execution and will be charged the same commission, if applicable.

B) "Preston shall not discriminate against any client account, and all clients will receive the same price, adjusted for quantity discounts, for order execution and will be charged

C) "Preston shall not discriminate against any client account, and all clients will receive the same price for order execution and will be charged the same commission, if applicable.

Question #39 of 47

Alpha Asset Management manages portfolios for clients with more than $10 million in assets. Bob Smith, a portfolio manager at Alpha, is planning to leave Alpha to set up company Beta Investment Management, to focus exclusively on clients with less than $10 million in assets. While he is still employed at Alpha, Smith begins to solicit (on his own time) potential clients with less than $10 million in assets – clients that Alpha has previously rejected for being too small. According to the Standards of Professional Conduct IV(A) related to duties to employer, Smith's solicitation of these clients is:

A) acceptable as he is not in competition with his current employer.

B) unacceptable since the fact the Beta will not be in competition with Alpha is irrelevant.

C) unacceptable as he may not engage in any activities to go into business while he is still employed by Alpha.

Question #40 of 47

Jim Jones is an equity research analyst at Gamma funds. Because of his expertise in the telecommunications field, a Chinese telecommunications provider hires Jones as a consultant to help them identify potential investors. According to the Standards of Professional Conduct IV(A) related to duties to employer, Jones must:

A) refuse this consulting arrangement.

B) describe to his employer in detail the activities related to this consulting arrangement.

C) obtain verbal permission from his employer to engage in this consulting arrangement.

Question #41 of 47

Adequate investment policy disclosure typically means clearly identifying the policy in:

A) an annual letter to all fund shareholders.

B) the annual report.

C) the prospectus.

Question #42 of 47

Wanda Brunner, CFA, is preparing for her first meeting with the Johnsons—her firm's newest clients. She makes notes regarding disclosure of the investment process. These notes *most likely* include reminders to:

A) notify her supervisors of any potential change in the security selection and portfolio construction process.

B) adequately disclose the basic security selection and portfolio construction process.

C) anticipate changes in her clients' investment objectives that could cause them to leave her firm.

Question #43 of 47

Which of the following statements regarding allocating trades is CORRECT? It is:

A) never permissible to deviate from a pro rata basis, unless this is done on the basis of an advance indication of interest in the issue.

B) permissible under the standards to allocate trades on the basis of a predetermined formula that may deviate from a pro rata basis but is inherently fair.

C) never permissible to deviate from a proportional account value weighting method of trade allocation, unless this is done on the basis of an advance indication of interest in

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Which of the following trade allocation procedures is improper? Allocation:

A) on a strict pro rata basis over all suitable accounts.

B) based upon past participation in IPOs.

C) based upon a predetermined formula.

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Patricia Spraetz is the chief financial officer and compliance officer at Super Selection Investment Advisors. Super Selection is a medium-sized money management firm which has incorporated the CFA Institute Code of Ethics and Standards of Practice into the firm's compliance manual.

Karen Jackson is a portfolio manager for Super Selection. She is not a CFA charterholder. Jackson is friendly with David James, president of AMD, a rapidly growing biotech company. James has provided Jackson with recommendations in the biotech industry, which she buys for her own portfolio before buying them for her clients. For three years, Jackson has also served on AMD's board of directors. She has received options and fees as compensation.

Recently, the board of AMD decided to raise capital by voting to issue shares to the public. This was attractive to board members (including Jackson) who wanted to exercise their stock options and sell their shares to get cash. When the demand for initial public offerings (IPO) diminished, just before AMD's public offering, James asked Jackson to commit to a large purchase of the offering for her portfolios. Jackson had previously determined that AMD was a questionable investment but agreed to reconsider at James' request. Her reevaluation confirmed the stock to be overpriced, but she nevertheless decided to purchase AMD for her clients' portfolios.

Which of the following actions are most appropriate for Spraetz?

A) Even though Spraetz does not supervise Jackson, as the compliance officer of the firm she is responsible for identifying violations. Spraetz is not responsible for preventing

B) Spraetz, as the chief compliance officer, must set company policy in clear terms and monitor the actions of the employees. In case of violations, she should investigate

C) If, after her investigation Spraetz finds that Jackson has committed violations, Spraetz must report them to senior management and seek legal counsel for possible legal and

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Wanda Brunner, CFA, is reviewing a draft fund prospectus for her new "Leveraged Long Coffee" (LLC), a closed-end fund. LLC uses a of combination fundamental and technical trading models to evaluate individual securities. She notes the LLC prospectus has several disclosures which cause her to worry that prospective clients will avoid her fund.

- Disclosure 1: "LLC charges a flat 3.00% of assets under management."
- Disclosure 2: "LLC may invest up to 40% of the fund's assets in securities which are not related to coffee or other consumer products."
- Disclosure 3: "LLC relies only on fundamental valuation of individual securities."

Which of the following standards will *most likely* be violated by distribution of the prospectus?

A) Standard III(C) Duties to Clients: Suitability because the fund can hold an excessive portion of the portfolio in non-core assets.

B) Standard III(C) Duties to Clients: Suitability because it misleads the reader as to the process by which securities are selected.

C) Standard III(C) Duties to Clients: Suitability because the fees are exorbitant.

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A manager of pooled funds must do all of the following to remain in compliance with the Standards EXCEPT:

A) disclose portfolio construction processes.

B) seek authorization for any trade that involves more than 1 percent of the fund's assets.

C) seek authorization for any proposed changes.