ETHICS IN PRACTICE

ETHICS IN INVESTMENT MANAGEMENT CASEBOOK

CFA Institute

ETHICS IN PRACTICE
Ethics in Investment Management Casebook

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CFA INSTITUTE

ETHICS IN PRACTICE:
Just Protecting Client's Assets.

CASE STUDY

Mary Mwangi's firm offered its clients several different insurance products. Three of Mwangi's clients initially purchased one type of product (Class A), but later changed their mind and asked to swap the product for another, less expensive type (Class B). To complete the transaction, the law required the clients to execute new sale and purchase documents for the Class B product. The clients wanted to sign the necessary documents at the time they met with Mwangi to switch to Class B, but the documents were not ready. Mwangi advised her clients to wait until all of the paperwork was complete. But when the time came to complete the transaction, Mwangi was unsuccessful in reaching the clients for their signatures. Without the signatures, Mwangi's firm threatened to cancel the swap, which because of other investment purchases, would have placed the clients' accounts into an overdraft position. Under the firm's policies, such shortfalls were to be covered by selling account assets once the debit had been outstanding for two weeks. To keep this from happening, Mwangi forged the clients' signatures on the necessary documents to put the swap into effect. Mwangi's actions were

A. unacceptable.

B. acceptable because the clients had already given their permission for the swap.

C. acceptable with approval from her supervisor.

D. acceptable if the clients gave her explicit permission to sign the documents on their behalf.

ANALYSIS

This case involves Standard I(A): Knowledge of the Law, which requires CFA Institute members to "comply with all applicable laws, rules, and regulations … governing their professional activities." To complete the swap from the Class A to the Class B product, Mwangi's clients were legally required to execute new sale and purchase documents, which did not happen because Mwangi forged their signatures. General approval of the transaction by the clients is insufficient to meet the legal requirement for client signatures. Obviously, approval of a supervisor to engage in illegal activities does not relieve Mwangi of her obligation to follow the law. Finally, even if the clients fully understand the circumstances and explicitly approve of Mwangi signing the forms on their behalf, the law requires that actual signatures of the clients must be on the documents. While the intent of the law is meant to protect the clients and the clients are waiving their rights, that still does not allow Mwangi to circumvent the legal requirements. The best response is A.

This case is based on a disciplinary action by the CFA Institute Professional Conduct Program. Before this incident, the member had an unblemished career in financial services for more than 15 years. The firm confronted the member about the forgeries and she readily admitted what she had done. The member was terminated by her employer for cause and they reported her to the regulatory body. The regulator determined that the member had engaged in conduct unbecoming or detrimental to the public interest and in violation of the regulatory body's member rules. She was suspended, fined, and re-take an exam. CFA Institute investigated and imposed a Nine-Month Suspension on the member for violation of Standard I(A): Knowledge of the Law and Standard I(C): Misrepresentation.

CFA INSTITUTE

ETHICS IN PRACTICE:
Raising Capital with Digital Assets?

CASE STUDY

Munchee is a US-based business that created an iPhone application (App) for users to review restaurants. The company initiated an initial coin offering (ICO) to sell digital tokens to raise $15 million in capital to invest in improving the App. The company advertised and promoted the offering on its website, in a white paper, and on social medial channels and message boards, such as Twitter and Facebook, particularly in forums aimed at those interested in investing in Bitcoin and other digital assets. In the communications about the offering, Munchee said it would use the proceeds to create an "ecosystem" in which the company, its App users, restaurants, and others could use the tokens to buy and sell goods and services. Munchee explained that it expects the tokens to increase in value as a result of the company's efforts. In addition, increased participation in the ecosystem and the use, or "burning," of tokens would also help increase the value of the tokens. Finally, Munchee stated that it intended for the tokens to trade on a secondary market. Munchee's ICO was

A. unacceptable because it promoted a virtual and highly speculative investment unsuitable for investors.

B. unacceptable because it promoted the investment through social media, blog posts, and brief tweets that did not describe the significant limitations and risks associated with buying the tokens.

C. unacceptable because the tokens were an unregistered security under US securities laws.

D. acceptable.

ANALYSIS

This case involves Standard I(A): Knowledge of the Law, which requires CFA Institute members to "comply with all applicable laws, rules, and regulations . . . governing their professional activities." The fact that that the tokens are a virtual currency, highly speculative, and thus unsuitable for many investors does not make it unethical for Munchee to offer them as investments. Munchee is not an investment adviser but an investment issuer. It would be up to investors and their advisers to determine whether an investment was suitable for their portfolio. Similarly, from an ethical standpoint, Munchee is free to promote the tokens in a variety of ways as long as the company provides full and complete information about the investment, responds to inquiries from potential investors, and does not provide any fraudulent or misleading information about the tokens. Munchee can direct those who see brief promotional material about the tokens on social media or Twitter to the company's white paper that presumably contains full and complete information about the tokens. Again, it would be up to an investment adviser, not the issuer, to describe the significant limitations and risks associated with buying the tokens from an investor's perspective.

This case turns on whether the tokens are a security and thus need to be registered according to the US securities laws (US law would applicable because Munchee is a US-based company selling the products in the United States). In its 11 December 2017 cease-and-desist order against Munchee, the US Securities and Exchange Commission (SEC) found that the tokens were securities as defined by Section 2(a)(1) of the Securities Act and must be registered. According to the test applied by the SEC, a product is a security if it involves the investment of money in a common enterprise with a reasonable expectation of profits that are derived from the entrepreneurial or managerial efforts of others. Upon being contacted by the SEC, the company immediately canceled the sale and refunded the money of buyers who had bought tokens. Because of this prompt action and Munchee's cooperation, the SEC imposed no additional sanctions. In this case, the best answer is C because Munchee is a US company that violated US Securities laws. The laws of another jurisdiction may not require registration of this type of virtual currency as a security. In that case, Answer A could be appropriate.

CFA INSTITUTE

ETHICS IN PRACTICE:
Doing Too Much to Make Investments a Success?

CASE STUDY

Corrales manages a hedge fund that seeks out investment opportunities in developing markets. Using assets of the fund's investors, the fund hires local companies to serve as "sub-advisers" to explore and obtain promising investment opportunities and navigate local laws and regulation. The sub-advisers often have very limited experience as financial consultants or advisers but do have close relationships and connections with local high-ranking government officials. The payments made by Corrales, through the sub-advisers, often cover substantial "deal fees" and other expenses that facilitate governmental support of each investment. Corrales does not require the local business partners to provide details of their activities or what specific expenses are covered by the fees. Corrales reports these expenditures to fund investors as operating expenses necessary to the success of the investment. Over several years, the hedge fund is very successful producing an 18% annual rate of return for its investors. Did Corrales actions violate the CFA Institute Code of Ethics and Standards of Professional Conduct?

A. Yes.

B. No because it is acceptable to hire sub-advisers and business consultants to assist in procuring investment opportunities and managing specialized assets.

C. No because the payments to the sub-advisers represent legitimate expenses to ensure the success of investments and protect the interest of investors.

D. No, as long as the sub-advisers provide more detail about the nature and purpose of the payments and this information is disclosed to the hedge fund investors.

ANALYSIS

To better serve clients, investment professionals may choose to delegate to third parties work that requires particular specialization, knowledge, or expertise. For example, an investment adviser may hire sub-advisers to handle a particular strategy or investment style outside the scope of the adviser's ability or experience. A global adviser may hire a sub-adviser to manage an asset allocation invested in a particular market, and the payments to the sub-adviser would be legitimate investment expenses that could properly be passed on to investors in the fund.

But the facts of this case indicate that Corrales is not hiring a true sub-adviser but essentially paying locally connected officials to secure access to investment deals to ensure the success of the fund's investments. The "sub-advisers" have no financial experience but are close to the government officials, and the "deal fees" are not supported by any documentation that details legitimate investment expenses. The "operating expenses" charged by Corrales to the fund are most likely funding corrupt transactions and bribes through local intermediaries. This practice violates multiple standards:

- I(A): Knowledge of the Law because the conduct would violate any type of anti-bribery laws.
- I(C): Misrepresentation because he is improperly labeling the expenditures as investment fees.
- V(A): Diligence and Reasonable Basis because no reasonable and adequate basis for the "investment" action exists.
- V(C): Record Retention because no appropriate records are being kept to support the action.
- VII(A): Conduct as Participants in CFA Institute Programs because assuming Corrales is a charterholder, his conduct compromises the integrity to the CFA designation.

This case is based on a US SEC enforcement action from 2017.

ABOUT CFA INSTITUTE

CFA Institute is a global not-for-profit organization and the world's largest association of investment professionals. We are dedicated to developing and promoting the highest standards of ethics, education, and professional excellence in the investment industry, for the ultimate benefit of society. Our goal is to create an environment where investors' interests come first, markets function at their best, and economies grow.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD I(B)

INDEPENDENCE AND OBJECTIVITY

CFA INSTITUTE

ETHICS IN PRACTICE:

Going to Dinner and Karaoke after Investor Presentation Is OK, Right?

CASE STUDY

David, an analyst for an asset management firm, attends a presentation for securities analysts at the headquarters of a manufacturing company. The analysts are very impressed with the presentation and ask the CEO many questions. After the meeting, the Head of Investor Relations invites all analysts to a club house for dinner and karaoke. Most of other analysts accept the invitation. Of the choices below, what do you believe David should do?

A. Accept the invitation.

B. Accept the dinner but not karaoke.

C. Accept the invitation but disclose the invitation to his supervisor.

D. Reject the invitation.

ANALYSIS

The ethical principle at issue in this case is independence and objectivity. The question turns on whether David compromises his independence and objectivity as an analyst by accepting an invitation to dinner and karaoke from representatives of the manufacturing company that he is researching. CFA Institute professional conduct Standard I(B) states that CFA Institute members "must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities" and must not "accept any gift, benefit…or consideration that reasonably could be expected to compromise their…independence and objectivity." So, would dinner and a night of karaoke reasonably be expected to compromise David's independence and objectivity? The appropriate course of action turns on how extravagant the benefit might be. Modest gifts and entertainment in the ordinary course of sociable business interaction may be unlikely to sway an analyst's opinion.

Choice A assumes that the dinner and karaoke is not extravagant and would have no impact on David's opinion of the company. But we need more facts to ensure that is the case. Cultural context should also be considered when making a decision. Dinner and karaoke may be modest and tame in some cultures but more extensive and extravagant in other settings. Awareness of cultural sensitivities and expectations are very important, especially for those who may be working outside of their familiar home region. Choice B attempts to steer a middle ground by having David only accept part of the entertainment, which may lessen the threat of a compromised analysis by reducing the benefit. In practice, this may be awkward to do and the dinner itself could still be extravagant.

Choice C also attempts to compromise by suggesting David could accept the dinner/entertainment as long as the gift/benefit is disclosed to the employer, seemingly mitigating the potentially problematic conflict of interest. But for disclosure to be effective it must be adequate. There is no indication that David will disclose the benefit to the clients who will read David's research report. They will therefore have no indication that the analyst writing the report was given a nice dinner and potentially fun-filled night on the town by the subject of the report. Best practice would suggest that David reject the invitation (Choice D) to avoid any question about his honesty and integrity.

CFA INSTITUTE

ETHICS IN PRACTICE:
Side Job in a Comedy Club is Fine, Right?

CASE STUDY

Gary Stansfield, CFA, works as a portfolio manager at Pitt Asset Management (PAM) based in New York. He has been actively involved with theatre since his college days and performs occasionally as a stand-up comedian at a comedy club after work hours. He is not compensated for his performances, but he is hoping to leave his job to launch an entertainment career. Audience members often show their appreciation for Stansfield's act by giving him nominal tips. One night, Elaine Bennet, a broker at Newman Brokers, a firm that PAM often trades with and in sizeable volumes, stops at the comedy club with a group of friends while Stansfield is performing. Bennet and her friends thoroughly enjoy Stansfield's comic routine and, as a token of appreciation, the group tips him $5,000. Stansfield should

A. accept the money and thank Bennet and her friends for their generosity.

B. accept the money but disclose it to his supervisor at PAM.

C. accept the money but seek approval from his supervisor before continuing to perform at the club if he anticipates further additional compensation.

D. not accept the money but thank Bennet and her friends for their compliments on his performance.

ANALYSIS

This case potentially involves violations of the CFA Institute standards related to independence and objectivity and/or conflicts of interest. If Stansfield accepts the tip, it could be construed as gift to influence his conduct because some may find it implausible that an audience member would give such a generous tip irrespective of how much he or she might have enjoyed the comic sketch. The large tip he receives from Bennet and her friends after they attend his performance could be seen as an attempt by Bennet to influence Stansfield's/PAM's choice of brokers. But a key step of the CFA Institute Ethical Decision-Making Framework asks those facing an ethical dilemma to identify relevant facts.

A number of relevant facts need to be determined to make an informed decision about the appropriate course of action for Stansfield. Does Bennet know Stansfield and know that Stansfield works for PAM or are they strangers? Does Stansfield have decision-making authority in choosing brokers on behalf of PAM (and if so does Bennet know this) or is Stansfield not involved in the decision about which brokerage firm to use? Does Stansfield know Bennet and who she works for? Was the tip primarily from Bennet or did it represent a collection from the whole group of friends? Do her friends work at Newman as well? Is one of them particularly wealthy and generous with struggling new entertainers?

Assuming that the tip came primarily from Bennet, Bennet knew Stansfield worked at PAM and believed Stansfield to have influence over PAM's brokerage decisions, and Stansfield knew Bennet and who she worked for, then best practice would be for Stansfield to politely reject the tip because it could be perceived to influence his fairness and objectivity when allocating trades. Although the information is incomplete, with these assumptions, the best response would be D. In working at the comedy club, Stansfield did not violate Standard IV(B): Additional Compensation Arrangements, which states that CFA Institute members must not accept any "compensation… that competes with or might reasonably be expected to create a conflict of interest with their employer's interest" without written consent. Stansfield's appearances at the comedy club did not interfere or compete with his day job at PAM, and he normally received tips that were minimal in value.

This case is based on facts provided by Tanuj Khosla, CFA, CAIA.

CFA INSTITUTE

ETHICS IN PRACTICE:
Just Building Client Relationships?

CASE STUDY

Soto is a founding partner and CEO of JPA, a large wealth management firm with offices throughout the world. The firm has many global institutional clients that include state-owned entities run by government officials. In an effort to build client relationships, Soto initiates a "Client Internship Program" that allows clients to refer candidates for internships at JPA. Referrals from this program are considered for employment outside of the firm's normal rigorous and competitive hiring process. The larger the JPA client, the more likely a referral from that client would be hired into a lucrative, career-building internship position. JPA hires more than 200 relatives and friends of the key executives of many JPA clients, including relatives and friends from many government agencies that JPA has investment banking or asset management relationships with. JPA generates more than $100 billion in revenue from these investments and uses the connections generated with these clients to assist other clients and navigate complicated regulatory landscapes. Soto's actions in establishing the JPA "Client Internship Program" are

A. appropriate because the internship program benefits clients.

B. appropriate because the program is an incentive for clients that hire JPA, similar to discounted fees.

C. appropriate because the program creates a mutually beneficial business relationship between JPA and its clients.

D. a violation of the CFA Institute Code and Standards.

ANALYSIS

This case related to CFA Institute Standard I(B): Independence and Objectivity, which states that CFA Institute members "must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise…another's independence and objectivity." JPA uses the internship opportunity to personally benefit the relatives and friends of certain key individuals, including government officials, with the intent to corruptly influence those decision-making officials and executives. So, response D is the correct choice because this practice is a violation of Standard I(B), and there are likely legal and regulatory provisions relating to anti-bribery, such as the US Foreign Corrupt Practices Act, that may be relevant depending on the legal regime(s) applicable to JPA.

Modest gifts and entertainment in the ordinary course of business may be acceptable in the context of promoting professional services. Similarly, firms may offer large or significant clients discounts or incentives commensurate with their position. But this does not extend to offering what amounts to bribes to individual executives or government officials to influence the hiring process or look favorably on investment transactions. In this case the benefits were not to JPA's investment clients but were personal to the individual decision makers.

This case is based on a US SEC enforcement action from 2016.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD I(C)

MISREPRESENTATION

CFA INSTITUTE

ETHICS IN PRACTICE:

Do What I Do for Investment Success!

CASE STUDY

Svetlana works for a publishing company writing an online financial newsletter that describes her investment philosophy and identifies intriguing investment opportunities. She is paid a salary plus incentive bonuses for every new subscriber. Svetlana routinely states that she makes $5,000 in investment returns every week, and that if readers followed her advice, they could too. Svetlana often includes success stories from readers, including the story of a reader who turned $200 into $1 million in six months using Svetlana's investment techniques. Svetlana's actions are

A. acceptable because subscribers to her newsletter are not clients.

B. acceptable because she is not guaranteeing investment success.

C. unacceptable unless she includes stories of readers who followed her investing philosophy and were not successful.

D. unacceptable if the investments are unsuitable for her subscribers.

ANALYSIS

This case involves potential misrepresentation. CFA Institute Standard I(C): Misrepresentation states that members "must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities." This includes statements relating to past investment performance history. Does Svetlana misrepresent her past performance record and the success of her investments? That is not clear. Her statements regarding her weekly investment returns and the success stories of readers who follow her advice may be true. More facts are necessary. Assuming those statements are true, it is irrelevant whether she is making the statements to clients, potential clients, subscribers to her newsletter, or the investing public. Standard I(C) prohibits any misinformation regardless of the audience, so Answer A is not correct. There is also no requirement that Svetlana include statements in her articles that counterbalance her claims (Answer C). It would be up to the interested person to inquire more deeply about her performance record to gauge its veracity.

Svetlana would be required to respond truthfully to probing questions, such as "how many readers using your investment techniques have lost money?" And because there is no investment advisory relationship between Svetlana and those who may read her articles, she is not required to conduct a suitability analysis of the investments for anyone reading her newsletter (Answer D). (Although best practice would dictate that Svetlana include some general cautionary language in her articles recommending that readers ensure any investments they make are suitable to their financial goals, constraints, and circumstances). Finally, Standard I(C) prohibits members from guaranteeing clients any specific return on investments because most investments contain some element of risk that makes their return inherently unpredictable. But Svetlana does not provide guarantees because she qualifies her statements about expected performance by asserting that readers following her investment philosophy "could" earn regular returns; she doesn't guarantee that they will. Answer B is correct.

This case is based on facts from a CFA Institute Professional Conduct enforcement action.

ETHICS IN PRACTICE:
Is It OK to Just Quietly Fix Error in Model?

CASE STUDY

Roger Foss is an institutional money manager specializing in a quantitative investment strategy. He developed his own quantitative model that he uses exclusively as the investment decision-making tool for client accounts. Foss heavily markets his "comprehensive and exclusive" model to clients and prospective clients as being an effective tool to manage risk. After using the model for several years, Foss discovers an error that inadvertently eliminated one of the key components for managing risk, leading to underperformance as a result of industry overexposure. During that time, several clients raised questions about their portfolio performance, but Foss attributed it to market volatility. Foss revises the model to address the error and begins to promote his "new and improved exclusive and comprehensive quantitative model." Foss's conduct is

A. unacceptable because the original model resulted in underperformance.

B. acceptable because factors in quantitative models are proprietary and do not need to be disclosed.

C. unacceptable because he failed to disclose the error in the model and its impact on client performance.

D. acceptable because Foss corrected the error and uses the new model.

ANALYSIS

This case involves CFA Institute Standard I(C): Misrepresentation, which states that CFA Institute members and candidates must not knowingly make any misrepresentation relating to investment analysis, recommendations, or actions. A misrepresentation is any untrue statement or omission of fact that is otherwise false or misleading. Although investment professionals are not required to divulge the proprietary elements of their investment decision-making model, they are prohibited from making statements about the model that are not true. In this case, Foss claimed that his "comprehensive model" would effectively manage risk while at the same time, because of an error, the model omitted a key factor for managing risk. Foss also made misrepresentations to clients by failing to disclose the error and its impact on performance and attributing the model's underperformance to market volatility rather than the error. Correcting the error and using a new model does not address the misrepresentations. Underperforming the market or benchmark is not necessarily of indicative unethical behavior. But the fact that the original model did not effectively manage risk and led to underperformance also may lead to a violation of the CFA Institute Standard V(A): Diligence and Reasonable Basis, which requires CFA members to exercise diligence and thoroughness in analyzing investments and taking investment action. Choice C is the best response.

This case is based on a US SEC enforcement action.

CFA INSTITUTE

ETHICS IN PRACTICE:
Good Advice to Move Retirement Funds?

CASE STUDY

Urquhart is a financial planner for AKC, which runs a large network of financial planners. AKC compensates its planners based on the number of sales of AKC products. Urquhart advises a husband and wife to roll their retirement funds, which combined are worth $125,000, from one service provider into a single AKC investment fund that follows a large-cap equity strategy. Urquhart discloses to the couple that they will have to pay a penalty totaling $30,000 for closing their accounts, but they will make up this loss with better investment returns from the AKC product. Urquart's actions are

A. acceptable if the AKC product is suitable for the couple.

B. unacceptable because he is promising a specific rate of return.

C. acceptable because he fully disclosed the negative consequences of closing their accounts.

D. unacceptable unless the performance history of the AKC product supports his statement about future returns.

ANALYSIS

This case involves CFA Institute Standard I(C): Misrepresentation, which states that CFA Institute members and candidates must not knowingly make any misrepresentation related to investment analysis, recommendations, or actions. This standard prohibits making any statements promising or guaranteeing a specific rate of return on volatile investments. Even if the AKC product is suitable for the couple, it is an equity-based investment that is inherently volatile. Urquhart cannot make promises about future returns, even if the historical performance return would have reached the performance goal. Although he fully discloses the negative consequences of transferring their assets to the AKC product, that disclosure does not mitigate the inappropriate statement about future expected returns. Therefore, the best answer is B. As an aside, this case also raises questions about whether advising the couple to take such a significant loss in their retirement savings would be in their best interest and whether Urquhart's independence and objectivity is compromised because he is influenced to make such a recommendation by the compensation scheme of his employer.

This case is based on details coming out of a 2018 regulatory inquiry into the practices of financial services company AMP in Australia.

CFA INSTITUTE

ETHICS IN PRACTICE:

Comment on Facebook Your Responsibility?

CASE STUDY

Wieters runs an investment advisory firm that specializes in equity only asset management. For clients and prospective clients seeking to follow a balanced or fixed-income strategy, Wieters posts on her firm's Facebook page the names of a number of firms that she is familiar with that provide these services. One of the firms replies in the comment section of the post, providing basic performance history information and claiming compliance with the GIPS® standards. Unknown to Wieters, the performance history is misleading and the claim of compliance with the GIPS standards is inaccurate. Has Wieters violated the CFA Institute Code of Ethics and Standards of Professional Conduct?

A. Yes because Wieters must exercise diligence and have a reasonable and adequate basis for every statement made on her firm's Facebook page.

B. No, as long as Wieters does not receive referral fees from the adviser for including the adviser's information in the original post.

C. Yes, if Wieters "likes" the post by the adviser containing the erroneous information.

D. No because Wieters is not responsible for any information posted by third parties in the comment sections of her firm's Facebook page.

ANALYSIS

This case involves CFA Institute Standard I(C): Misrepresentation, which states that CFA Institute members and candidates must not knowingly make any misrepresentation relating to investment analysis, recommendations, or actions. Wieters has the responsibility under Standard I(C) to make sure that any professional communications she puts out are not misleading, whether or not the statements are verbal, written, or posted on social media. In this case, although the misleading statements are posted on the social media platform that Wieters controls, the misleading statement is clearly made by someone else because it is in a comment written by another person.

Therefore, Wieters may not be considered responsible under the CFA Institute Code and Standards for verifying the truthfulness of others information. In providing a list of potential service providers for a style of investment she does not provide, it is not clear whether she is recommending the services of those firms in her post. A recommendation of services would be a step that moves Wieters closer to endorsing the misleading information rather than passively allowing comments by others on her social media account. The payment of referral fees (or no payment of referral fees) is not relevant to the misrepresentation issue. Wieters would be in danger of violating the Code and Standards if she knows the adviser's information to be false and allows it to remain on her Facebook page. It is, therefore, not the case that Wieters is never responsible of any information posted by another person on her page. (In this scenario, the facts are clear that she does not know that the performance history and claim of compliance with the GIPS standards are false.)

Answer C is actually the best answer because if Wieters "likes" the adviser's comment or responds in another way that indicates she explicitly or implicitly endorses, adopts, or approves the content of the comment, that would effectively be a communication made by Wieters. She would then become responsible for the content. By "liking" the adviser's misleading performance information, Wieters becomes the author of a separate and distinct communication that includes misleading statements. To be safe, best practice would be for Wieters to remove from her Facebook page any potentially problematic or unverified statements or comments made by others until she can determine the veracity of those statements.

CFA INSTITUTE

ETHICS IN PRACTICE:

Doing Too Much to Make Investments a Success?

CASE STUDY

Corrales manages a hedge fund that seeks out investment opportunities in developing markets. Using assets of the fund's investors, the fund hires local companies to serve as "sub-advisers" to explore and obtain promising investment opportunities and navigate local laws and regulation. The sub-advisers often have very limited experience as financial consultants or advisers but do have close relationships and connections with local high-ranking government officials. The payments made by Corrales, through the sub-advisers, often cover substantial "deal fees" and other expenses that facilitate governmental support of each investment. Corrales does not require the local business partners to provide details of their activities or what specific expenses are covered by the fees. Corrales reports these expenditures to fund investors as operating expenses necessary to the success of the investment. Over several years, the hedge fund is very successful producing an 18% annual rate of return for its investors. Did Corrales actions violate the CFA Institute Code of Ethics and Standards of Professional Conduct?

A. Yes.

B. No because it is acceptable to hire sub-advisers and business consultants to assist in procuring investment opportunities and managing specialized assets.

C. No because the payments to the sub-advisers represent legitimate expenses to ensure the success of investments and protect the interest of investors.

D. No, as long as the sub-advisers provide more detail about the nature and purpose of the payments and this information is disclosed to the hedge fund investors.

ANALYSIS

To better serve clients, investment professionals may choose to delegate to third parties work that requires particular specialization, knowledge, or expertise. For example, an investment adviser may hire sub-advisers to handle a particular strategy or investment style outside the scope of the adviser's ability or experience. A global adviser may hire a sub-adviser to manage an asset allocation invested in a particular market, and the payments to the sub-adviser would be legitimate investment expenses that could properly be passed on to investors in the fund.

But the facts of this case indicate that Corrales is not hiring a true sub-adviser but essentially paying locally connected officials to secure access to investment deals to ensure the success of the fund's investments. The "sub-advisers" have no financial experience but are close to the government officials, and the "deal fees" are not supported by any documentation that details legitimate investment expenses. The "operating expenses" charged by Corrales to the fund are most likely funding corrupt transactions and bribes through local intermediaries. This practice violates multiple standards:

- I(A): Knowledge of the Law because the conduct would violate any type of anti-bribery laws.
- I(C): Misrepresentation because he is improperly labeling the expenditures as investment fees.
- V(A): Diligence and Reasonable Basis because no reasonable and adequate basis for the "investment" action exists.
- V(C): Record Retention because no appropriate records are being kept to support the action.
- VII(A): Conduct as Participants in CFA Institute Programs because assuming Corrales is a charterholder, his conduct compromises the integrity to the CFA designation.

This case is based on a US SEC enforcement action from 2017.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD I(D)

MISCONDUCT

COMING SOON

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD II(A)

MATERIAL NONPUBLIC INFORMATION

CFA INSTITUTE

ETHICS IN PRACTICE:
Just Being a Shrewd Investor.

CASE STUDY

Sung Kook "Bill" Hwang is the founder and lead portfolio manager of Tiger Asia Partners (TAP) and Raymond Park is a trader for the firm. TAP is participating in private placements for both Bank of China and China Construction Bank stock, and the placement agents shared confidential information with Hwang and Park about both companies. In the days prior to the private placement, Hwang directed Park to make short sales in each stock. TAP earned $16.2 million by using the discounted private placement shares they received to cover the short sales. Park's actions were

A. acceptable because he was following the orders of his superior.

B. acceptable because he used a short position rather than trading in the bank stock itself.

C. acceptable if the placement agents did not require a confidentiality agreement covering information about the private placements.

D. unacceptable because the trade was based on material nonpublic information.

ANALYSIS

This case relates to trading based on material nonpublic information (MNPI). CFA Standard II(A): Material Nonpublic Information prohibits members who have MNPI that could affect the value of an investment from acting or causing others to act on that information. Hwang and Park received MNPI about the bank stocks from the placement agents as part of the offering process. Park is not exempted from the requirements of the standards simply because his boss directs that he violate laws or ethical standards, so Answer A is not correct. Park should have advised Hwang that the actions he was being asked to take were unethical and likely illegal and refused the directive to trade. The prohibition on using MNPI goes beyond the direct buying and selling of individual securities and extends to any related derivatives (e.g., swaps or option contracts), mutual funds, other alternative investments, so Answer B is not correct. It would have been advisable for the private placement agents to ask Hwang and Park to sign a confidentiality agreement, establish a "fire wall" around the disclosure of that information, and agree not to trade on the information. But even absent such an agreement, Park is prohibited from trading on MNPI, therefore C is incorrect. Because the trading was based on MNPI, the trade was improper and Park's conduct is unacceptable — Answer D.

This case is based on an enforcement action by both the US SEC and the Securities and Futures Commission of Hong Kong.

CFA INSTITUTE

ETHICS IN PRACTICE:
Oh No! Accidental Facebook Post!

CASE STUDY

John Walsh, CFA, is the Chief Financial Officer of TrueTech Corporation, a leading semiconductor manufacturer in the United States. For the past few months, Walsh has led the TrueTech team in talks to buy a majority stake in Veridy Corporation, a smaller, privately owned semiconductor company that has a patented technology that could potentially cut the chip manufacturing costs of TrueTech by almost 40%. After intense negotiations, TrueTech is able to close the deal with Veridy late on a Friday night. Walsh wants to share the good news with his wife, so he takes out his phone and types "Finally! TrueTech has acquired a majority stake in Veridy. The deal is sealed!" But instead of sending the message to his wife, he accidentally posts it on his personal Facebook page. The next morning (a Saturday), he wakes up and discovers the blunder. Did Walsh violate any part of the CFA Institute Code of Ethics or Standards of Professional Conduct?

A. No, this was an honest mistake.

B. Yes, but Walsh does not need to do anything to rectify the matter because the posting was unintentional.

C. Yes, Walsh should immediately disclose his actions to TrueTech and Veridy.

D. Yes, Walsh should post the merger information on the company website and make a public announcement about the transaction.

ANALYSIS

This case is involves Standard IV(A): Duties to Employers – Loyalty, which states that CFA Institute members must not "divulge confidential information or otherwise cause harm to their employer." Even though his action was unintentional, Walsh violated his duty of loyalty to his employer because he disclosed confidential information about TrueTech outside the company. The honest mistake does not exonerate him from violation. Walsh is also in danger of violating Standard II(A): Material Nonpublic Information, which states that CFA Institute members must "not act or cause others to act" on material nonpublic information. Walsh inadvertently leaked material nonpublic information to the select group of people who are his friends on Facebook. But there is no indication from the facts given that any of Walsh's Facebook friends who received the merger information tried to take advantage of that information. Walsh should take steps to attempt to rectify his mistake. Although Walsh should notify TrueTech and Veridy of his error, that does not go far enough. The most appropriate course of action is for Walsh to publicly disseminate the news of the merger as quickly as possible so that the information is available to all investors. Answer D is the best choice.

This case was written by Tanuj Kholsa, CFA, CAIA, and the facts are not based on any particular case.

CFA INSTITUTE

ETHICS IN PRACTICE:
Material and Nonpublic Info or Not?

CASE STUDY

Robles, a fund manager, visits the main manufacturing plant of a large international cement company. During his visit, the management of the company discloses that the company has purchased additional land and resources at this location that can easily be put to use for low-cost expansion in the future. Management claims that the expansion would result in a capital cost per unit of production nearly 30% cheaper than industry norms. Management tells Robles "confidentially" that the company may consider expansion when the global economic climate improves sufficiently to boost demand for their product. Based on this information, Robles buys stock in the cement company for the fund he manages. Did Robles act unethically?

A. Yes because Robles traded based on material nonpublic information

B. No because Robles did not trade on material nonpublic information

ANALYSIS

CFA Insitute Standard II(A): Material Nonpublic Information prohibits members who are in possession of material nonpublic information that could affect the value of an investment from acting on that information. Information is material if it would significantly alter the total mix of information currently available in such a way that the price of the security would be affected. The nature, specificity, exclusivity, and reliability of the source of the information helps determine materiality. Information is nonpublic until it has been disseminated or is available to the marketplace in general. There are three pieces of information that are described in the case that are relevant to Robles's decision to trade: (1) the purchase of excess land and resources at the site of the company's main plant, (2) the calculation that using this additional capacity would reduce the company's production costs to less than industry norms, and (3) the company's expansion plans. Are any of these three pieces of information material nonpublic information?

The first piece of information about acquiring additional production assets would likely be considered material. But it is not clear when the purchase occurred. Was it recent? Is the purchase in the public record? It is possible that the purchase is already publicly known, and the management's disclosure to Robles is nothing new. It is also possible that the purchase just occurred or is imminent and has not been announced publicly, which would make the information nonpublic. The second piece of information about being to produce at much lower costs would be material information. But it is unclear whether this information is known only to the company. Certainly, confidential proprietary manufacturing cost calculations would be nonpublic, but astute analysts with knowledge of the industry may be able to easily make this type of evaluation. In that case, the information may not be confidential. Finally the third piece about the company's expansion plans are very likely to affect the price of the company's stock and would thus be material information. But again, the information is not specific enough. Management tells Robles that the company "may consider" expansion when the global economic conditions "improve sufficiently." The possibility that the company "may consider" expanding is vague and ambiguous. When the economy "improves sufficiently" is also subjective and indefinite. Even if this information is disclosed "confidentially" only to Robles and is not publicly available, it is not clear that general plans about possible expansion at some unknown point in the future rises to the level of material information.

In sum, a portion of the information disclosed to Robles by company management has the potential to be material. It is unclear from the facts of the case that the information is nonpublic. An argument could be made either way. We would need more information to make a determination about whether Robles violated the prohibition against trading on material nonpublic information.

The facts for this case were submitted by Shreenivas Kunte, CFA Institute Director of Continuing Education and Advocacy, India, Asia-Pacific Region.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD II(B)

MARKET MANIPULATION

CFA INSTITUTE

ETHICS IN PRACTICE:
Buying and Selling at Same Time OK?

CASE STUDY

Meyers Associates is an investment firm providing both advisory and investment banking services. One of Meyers investment banking clients, IWEB (which manufactures and markets data storage products and cloud based software), wants to raise its stock price to facilitate a private offering, for which it will be using Meyers as its placement agent. George works for Meyers Associates as an investment adviser. To assist IWEB with its plans, George solicits several of his advisory clients to buy IWEB stock, and at the same time solicits other clients to sell IWEB stock, frequently effecting matched orders among his customers. For a 10-day period, these trades represented 48% of the total market volume of IWEB, and the price of the stock increased from $0.12 to $0.19 and then stabilized at $0.18 for the next several days. George's actions are

A. acceptable if the purchase and sale of IWEB stock fit within each of his advisory clients' Investment Policy Statements.

B. acceptable because he was acting to promote the interests of his client, IWEB.

C. acceptable as long as he discloses to his advisory clients Meyer Associates' investment banking relationship with IWEB.

D. unacceptable.

ANALYSIS

This case is about market manipulation. Market manipulation damages the interests of all investors and lowers investor confidence in capital markets by disrupting the smooth functioning and efficiency of those markets. CFA Institute Standard II(B): Market Manipulation prohibits members from "engaging in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants." George's trading of IWEB stock for clients is distorting both the trading volume and the market's price-setting mechanism for that stock for the purpose of misleading investors in IWEB stock. George engages in the trading to assist IWEB with its private offering, not to benefit his advisory clients. Therefore, even if the trades fit within the respective IPS of his clients, the trading is unethical, making Choice A incorrect.

One element of the CFA Institute Ethical Decision-Making Framework is identifying to whom a duty is owed. Oftentimes, there are conflicting duties that must be sorted out. Although George is attempting to benefit one client (IWEB) through the trading, he cannot do so at the expense of his advisory clients because he has a duty to all his clients to treat them fairly. And although investment professionals have a duty to work on behalf of clients, they have a greater duty to protect the integrity of financial markets. Engaging in market manipulation, even to assist clients, is unethical, making choice B incorrect. Choice C is also incorrect. While oftentimes investment professionals can mitigate conflicts of interest through disclosure, disclosure of the potential conflict in working for IWEB in an investment banking capacity, does not allow George to use his advisory client accounts to engage in market manipulation. George's actions are unacceptable, Choice D.

This case is based on a Financial Industry Regulatory Authority (FINRA) enforcement case from 2016.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD III(A)

LOYALTY, PRUDENCE, AND CARE

CFA INSTITUTE

ETHICS IN PRACTICE:
Using Erasable Ink Is Fine, Right?

CASE STUDY

Huang is a newly hired client account representative for GWC Asset Management, an investment adviser for high-net-worth clients. Part of Huang's responsibility is to assist each new client complete the extensive documentation needed to open an account. These documents give GWC access to client assets and the discretion to trade on behalf of the client. Because Huang is new to GWC, he is not completely familiar with firm procedures and is afraid of making mistakes with the documents. He uses erasable ink in completing the documentation so he can easily fix any mistakes without having to go back to the client for additional signatures. Huang's actions are

A. unacceptable under any circumstances.

B. unacceptable unless disclosed to the clients.

C. acceptable because he is providing efficient client service.

D. acceptable if GWC is aware of this practice.

ANALYSIS

This case involves the duty of loyalty to both clients and employer. By using erasable ink, Huang is rendering the key client documents changeable and thus unreliable. Once signed, anyone with access can go back and alter the terms or provisions of the documents. CFA Institute Standard III(A): Loyalty, Prudence, and Care requires members to "act with reasonable care and exercise prudent judgment" and "act for the benefit of their clients." Using erasable ink for legally binding financial documents does not constitute reasonable care and prudent judgment, and it potentially causes harm to the clients. Even if Huang engages in this conduct to try to provide efficient client service (Choice C), he is really trying to protect his own interests and make his job easier while opening the client up to potential harm. Even if he discloses to clients that their documentation can be changed after the fact, he (or anyone with access to the documents) would still have free rein to make any changes. Huang must get client permission regarding the specifics of any changes to these important legal documents to make them effective, making Choice B incorrect.

It is irrelevant whether his employer, GWC, is aware of and acquiesces in the practice because the harm to the client remains (Choice D). In fact, engaging in this conduct without the knowledge of GWC would be a violation of CFA Institute Standard IV(A): Duties to Employers – Loyalty, which prohibits member form causing harm to their employer. Huang's actions, if discovered, would cause great reputational damage for GWC with both the regulator and clients because the firm would have to go back through the process to redo all documentation. Finally, even if a client was aware of and gave permission to use erasable ink (or otherwise gave Huang or GWC permission to make changes to their documents without informing the client of what those changes were going to be), engaging in this conduct would make these documents ineffective and of no value. Huang would be violating the CFA Insitute Code of Ethics that requires members to act with integrity, competence, and diligence. Therefore, using erasable ink for client documents is inappropriate under any circumstances (Choice A).

This case is based on facts provided by Nick Pollard, Managing Director of Asia Pacific for CFA Institute, gathered from his industry experiences.

CFA INSTITUTE

ETHICS IN PRACTICE:
Stick to IPS during Volatile Markets?

CASE STUDY

Barry Van Wagenen manages the portfolios of high-net-worth clients. He completes an individualized IPS for each client when opening their account. He then develops a personal asset allocation formula based on each client's risk tolerance, financial goals, and so forth. Over the past two days, the domestic and global equity securities markets fell more than 6%. Fearing a continued drop in the markets, Van Wagenen liquidates his personal investments and moves to cash until the financial markets stabilize. But he keeps his clients' portfolios fully invested pursuant to the directives in their IPS. Van Wagenen's actions are

A. unacceptable because he is trading ahead of his clients for his personal account.

B. unacceptable because his personal investment decisions do not match the investment recommendations he has made to his clients.

C. unacceptable because he is not acting in a diligent and reasonable manner by leaving his clients assets fully invested in a rapidly declining securities market.

D. acceptable because he is following his client's directives, as detailed in their IPS, by keeping them fully invested.

ANALYSIS

The CFA Institute Ethical Decision-Making Framework provides guidance to investment professionals facing ethical dilemmas. The framework calls for identifying the ethical principle at issue, to whom a duty is owed, the relevant facts, and whether there is a conflict of interest to assist in choosing the appropriate course of conduct. In this case, we need more facts before we can properly analyze whether Van Wagenen's actions are acceptable. Specifically, what level of investment discretion have Van Wagenen's clients given him regarding investment decisions and whether the clients' IPSs address how investment decisions are to be made in the face of rapidly changing market conditions. If Van Wagenen has full investment discretion, failing to adjust his client's portfolio in a timely manner means Van Wagenen could be in violation of his duty to act with diligence and a reasonable basis — CFA Institute Standard V(A) — and in violation of his duty to his clients of loyalty, prudence, and care — CFA Institute Standard III(A).

Similarly, if the IPS states that in the event of a significant market downturn, Van Wagenen has the authority to alter the agreed on asset allocation formula prior to formally revising the IPS, that would also be a strong indicator for Van Wagenen to take action. Under those circumstances, Answer C would be the best choice. But if Van Wagenen has limited discretion or the IPS was silent about "emergency" powers to make changes in the portfolio, Van Wagenen's hands may be tied (Answer D). It is also not clear whether Van Wagenen acted diligently in attempting to contact his clients in the face of the volatile markets to determine whether they had any changes to their investment instructions. CFA Institute Standard VI(B): Priority of Transactions states that investment transactions of clients must have priority over personal transactions. This standard does not require that an investment professional's personal investments match those of his clients because there may be differences in the risk tolerances, financial goals, and so on between the adviser and his or her clients (Answer B). Finally, it is not clear that Van Wagenen is "front running" his client accounts because the price of the securities at issue may not be affected by the trades on his personal account (Answer A).

The facts for this case are not based on a particular case but reflective of current market volatility.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD III(B)

FAIR DEALING

CFA INSTITUTE

ETHICS IN PRACTICE:

Different Service for Different Clients?

CASE STUDY

Korloff is a money manager for several clients. One of the clients, a pension fund, accounts for 35% of the assets under management at Korloff's firm. The fund pays more management fees to the firm than any other client. The executive director of the pension fund has made it clear that, because of this dominant position, she expects Korloff to give the pension fund "enhanced service" service in the form of advance information on investment recommendations, priority position for initial public offerings, supplemental research reports on potential investments, and daily personal contact. Korloff should

A. refuse to comply with the request.

B. comply with the request only if his preferential treatment does not disadvantage other clients.

C. comply with the request because the fund is such a large and important client.

D. comply with the request because the fund is paying for the preferential treatment with the higher fees.

ANALYSIS

This case relates to Standard III(B): Fair Dealing, which states that CFA Institute members and candidates "must deal fairly and objective with all clients when providing investment analysis, making investment recommendations, and taking investment action." Treating clients "fairly" means not favoring one client over another or discriminating against clients when disseminating investment recommendations or actions. Differentiated service to clients, in the form of personal, specialized, or in-depth service to clients who are willing to pay for premium service, is acceptable under the standard. Fair dealing also dictates that recommendations be distributed in way that all clients for whom the investment is appropriate for have a fair opportunity to act on the recommendation. Korloff may provide preferential treatment (reflecting the amount and level of fees paid by the pension fund) in the form of supplemental research and daily contact to the pension fund without disadvantaging other clients.

But different levels of service cannot disadvantage or negatively affect other clients and should be disclosed and made available to all clients and potential clients. So, in this case, providing "enhanced service" to the pension fund is acceptable as long as the preferential treatment does not disadvantage other clients and it has been disclosed to them that they can also receive enhanced service along with the pension fund. Two aspects of the request — providing advanced recommendations to the fund and giving the fund priority position for initial public offerings — would disadvantage other clients by systematically benefiting the pension fund at the expense of other clients. With all of this in mind, choice B is the best response.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD III(C)

SUITABILITY

CFA INSTITUTE

ETHICS IN PRACTICE:
Capitalizing on Tax Benefits Is OK, Right?

CASE STUDY

Marte is an asset manager in Puerto Rico, a US territory. Residents of Puerto Rico receive significant tax advantages by investing in local securities. To capitalize on this advantage, Marte's firm offers clients shares in a closed-end investment fund, organized under Puerto Rico's financial laws and regulations, that holds at least 67% local securities and is permitted to borrow against up to 50% of its assets. The fund is usually leveraged to the extent legally permitted. Many of Marte's clients have a modest net worth and conservative or moderate investment objectives. Marte convinces them to invest 85% or more of their assets in shares of the closed-end fund. Marte's actions are

A. appropriate because they take advantage of the fund's unique tax benefits for his clients.

B. inappropriate because the fund uses leverage to boost returns.

C. appropriate as long as Marte fully discloses the risks and benefits of the fund to his clients.

D. inappropriate because the fund is an unsuitable investment for his retail clients.

ANALYSIS

CFA Institute Standard III(C): Suitability states that CFA Institute members and candidates in an advisory relationship with clients must "determine that an investment is suitable to the client's financial situation and consistent with the client's written objectives, mandates, and constraints before making investment recommendations or taking investment action." In this case, given the favorable tax advantages of the investment vehicle, investment in shares of the closed-end fund may be suitable and appropriate for his clients at some level. In addition, the fund's use of leverage may not be inappropriate or make the investment unsuitable. That said, Marte should always fully disclose the risks and benefits of his recommendations to his clients.

But choice D is actually the best response. Given the financial circumstances and investment objectives of his clients, the high concentration of the fund's shares in his clients' accounts combined with the leverage make the weighty investment in the fund unsuitable. Despite the favorable tax advantages, highly concentrated clients bear the increased risk that a single market event affecting the value of the fund's shares would significantly decrease their total account value. This risk is exacerbated by the fact that the closed-end fund is internally leveraged, which could magnify the fund's loss during a market event that causes share values to drop steeply.

This case is based on a FINRA (Financial Industry Regulatory Authority) enforcement action from 2015.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD III(D)

PERFORMANCE PRESENATION

CFA INSTITUTE

ETHICS IN PRACTICE:
Performance, Footnotes, and Benchmarks.

CASE STUDY

Howard Young is CEO, portfolio manager, and sole owner of Stewardship Investment Advisers (SIA), a registered investment adviser with more than $154 million assets under management and over 250 discretionary accounts. For several years, Young has distributed marketing materials to clients and potential clients that contain gross-of-fee performance for returns on SIA's managed portfolios. Young believes that gross-of-fees calculations are the most relevant because management fees are negotiable and can vary by client. Young includes a footnote at the end of the brochure disclosing that advisory fees would have to be netted out to show actual performance. The marketing material also includes a table that compares percentage increases in the S&P 500 Index with percentage increases in SIA's performance. SIA's performance includes the reinvestment of dividends. Young believes that the S&P 500 is the most appropriate and understandable benchmark because it is commonly reported in the financial press and recognizable by his clients. Has Young engaged in misconduct by using gross-of-fee returns or showing the S&P 500 performance? Decide what you believe is the correct answer and use the Ethical Decision-Making Framework to help explain your choice.

A. Young is guilty of misconduct in showing gross-of-fee performance.

B. Young is NOT guilty of misconduct in showing gross-of-fee performance.

C. Young is guilty of misconduct in providing the S&P 500 as a benchmark.

D. Young is NOT guilty of misconduct in providing the S&P 500 as a benchmark.

ANALYSIS

This case involves the presentation of performance history. CFA Institute Standard III(D): Performance Presentation states that "when communicating investment performance information, members must make reasonable efforts to ensure that it is fair, accurate, and complete." The goal is to provide credible performance information to clients and prospective clients and to avoid misstating performance or providing misleading performance information. Absent legal or regulatory provisions prohibiting such conduct, presenting gross-of-fee performance results is acceptable as long as there is clear disclosure that relevant fees must be deducted to get the actual performance history. It is unclear from the facts presented whether Young's footnote is prominent or clear enough to be sufficient to meet this standard. Best practice would be to present both gross and net-of-fee performance history, or in some other way, prominently show the effect of the fees so that the performance information meets the "fair, accurate, and complete" requirement of Standard III(D).

Similarly, presenting a table that includes the S&P 500 performance as a benchmark for returns may be appropriate under certain circumstances. But when it is used as a benchmark for firm performance history that includes reinvested dividends, as in this case, it would not be an "apples-to-apples" comparison and would likely be misleading because the S&P 500 performance history does not include reinvested dividends. If Young wants to use the commonly reported S&P 500 returns over time as his benchmark, he should ensure the SIA's returns are calculated in a comparable way. At minimum, there should be prominent disclosures of any differences between the benchmark's and the firm's returns. It is unclear from the facts presented whether Young has made the necessary disclosures regarding the benchmark. So, to judge whether there has been any misconduct, a thorough examination of the presentation material would be necessary to determine whether Young is presenting performance that is fair, accurate, and complete or whether his presentation misstates performance and is misleading.

This case is based on CFA Institute Professional Conduct enforcement action.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD III(E)

PRESERVATION OF CONFIDENTIALITY

CFA INSTITUTE

ETHICS IN PRACTICE:

Doing Enough to Protect Clients?

CASE STUDY

Giddings is responsible for compliance at GWH, a large broker/dealer and investment adviser. In connection with GWH's wealth management business, the company maintains the personally identifiable information (names, addresses, phone numbers, account numbers, balances, and holdings) of hundreds of clients. Giddings adopted a number of policies and restrictions, including a Code of Conduct, that address employees' access to and handling of this confidential information. Marsh, who works for GWH as a client service associate, downloads client data to his personal server located at his residence to facilitate his telecommuting. Marsh's server is hacked and portions of the personal client information downloaded by Marsh are posted for sale on the internet. Did either Marsh or Giddings violate the CFA Institute Standards of Professional Conduct with respect to confidentiality?

A. Marsh violated the CFA Institute Standards of Professional Conduct.

B. Marsh did not violate the CFA Institute Standards of Professional Conduct.

C. Giddings violated the CFA Institute Standards of Professional Conduct.

D. Giddings did not violate the CFA Institute Standards of Professional Conduct.

ANALYSIS

CFA Institute Professional Standard III(E): Preservation of Confidentiality requires that CFA Institute members and candidates keep information about current, former, and prospective clients confidential unless the information concerns illegal activities, disclosure is required by law, or the client permits disclosure. Although Standard III(E) does not require investment professionals to become experts in information security technology, they must make reasonable efforts to ensure that communication methods and compliance procedures follow practices designed to prevent accidental distribution of confidential information. In this case, the facts presented do not provide enough information to determine whether Marsh or Giddings acted inappropriately to allow confidential GWH client information to end up for sale on the internet.

As you think about your answer choice, there are two main questions that need to be addressed. The first issue is whether Marsh had permission to download client data to his personal server. If he did not, his misappropriation of client information for his own purposes constitutes a violation of Standard III(E). Even if he was not responsible for the distribution of the information, his misconduct facilitated the publication of the information. If Marsh did have permission from GWH to download and use the information from home, the second issue is whether Giddings adopted sufficient compliance policies and procedures reasonably designed to protect client information.

As the compliance officer, Giddings is charged with ensuring the confidentiality of customer information by protecting against any anticipated threats or hazards to the security or integrity of the records. Giddings and GWH must work to protect against unauthorized access or use of client information that could result in substantial harm to clients. Although the facts state that GWH policies and Code of Conduct restricted access and handling of client information, the nature and extent of those safeguards are not provided. The fact that client information was able to be accessed and published calls into question the effectiveness of Giddings compliance efforts. Even if the policies were sufficient, there appears to have been insufficient auditing and/or testing of the effectiveness of the safeguards to keep client information confidential.

This case is based on a US SEC enforcement case from 2016 against Morgan Stanley Smith Barney and Galen March, an MSSB employee.

ABOUT CFA INSTITUTE
CFA Institute is a global not-for-profit organization and the world's largest association of investment professionals. We are dedicated to developing and promoting the highest standards of ethics, education, and professional excellence in the investment industry, for the ultimate benefit of society. Our goal is to create an environment where investors' interests come first, markets function at their best, and economies grow.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD IV

DUTIES TO EMPLOYERS

CFA INSTITUTE

ETHICS IN PRACTICE:
Oh No! Accidental Facebook Post!

CASE STUDY

John Walsh, CFA, is the Chief Financial Officer of TrueTech Corporation, a leading semiconductor manufacturer in the United States. For the past few months, Walsh has led the TrueTech team in talks to buy a majority stake in Veridy Corporation, a smaller, privately owned semiconductor company that has a patented technology that could potentially cut the chip manufacturing costs of TrueTech by almost 40%. After intense negotiations, TrueTech is able to close the deal with Veridy late on a Friday night. Walsh wants to share the good news with his wife, so he takes out his phone and types "Finally! TrueTech has acquired a majority stake in Veridy. The deal is sealed!" But instead of sending the message to his wife, he accidentally posts it on his personal Facebook page. The next morning (a Saturday), he wakes up and discovers the blunder. Did Walsh violate any part of the CFA Institute Code of Ethics or Standards of Professional Conduct?

A. No, this was an honest mistake.

B. Yes, but Walsh does not need to do anything to rectify the matter because the posting was unintentional.

C. Yes, Walsh should immediately disclose his actions to TrueTech and Veridy.

D. Yes, Walsh should post the merger information on the company website and make a public announcement about the transaction.

ANALYSIS

This case is involves Standard IV(A): Duties to Employers – Loyalty, which states that CFA Institute members must not "divulge confidential information or otherwise cause harm to their employer." Even though his action was unintentional, Walsh violated his duty of loyalty to his employer because he disclosed confidential information about TrueTech outside the company. The honest mistake does not exonerate him from violation. Walsh is also in danger of violating Standard II(A): Material Nonpublic Information, which states that CFA Institute members must "not act or cause others to act" on material nonpublic information. Walsh inadvertently leaked material nonpublic information to the select group of people who are his friends on Facebook. But there is no indication from the facts given that any of Walsh's Facebook friends who received the merger information tried to take advantage of that information. Walsh should take steps to attempt to rectify his mistake. Although Walsh should notify TrueTech and Veridy of his error, that does not go far enough. The most appropriate course of action is for Walsh to publicly disseminate the news of the merger as quickly as possible so that the information is available to all investors. Answer D is the best choice.

This case was written by Tanuj Kholsa, CFA, CAIA, and the facts are not based on any particular case.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD IV(A)

LOYALTY

CFA INSTITUTE

ETHICS IN PRACTICE:

Just Taking Care of a Relative's Investment Account.

CASE STUDY

Elizabeth is an investment manager at a wealth management firm with high-net-worth clients. When Elizabeth was hired a few years ago, her sister opened an investment account with the firm. Elizabeth has decided to leave the firm to set up her own boutique hedge fund with her colleagues. She asks her sister to close her existing account and put that money in the new hedge fund. Elizabeth's request is

A. acceptable since she has no obligation to keep her sister's account at the wealth management firm.

B. unacceptable because she should not solicit her employer's client to join the new fund.

C. unacceptable if she signed a non-compete agreement with her employer.

D. unacceptable if her hedge fund strategy is not suitable to her sister.

ANALYSIS

The main ethical principle at issue in this case is Duty to Employer. CFA Institute Standard IV(A): Duty to Employers – Loyalty, states that CFA Institute members "must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities" and must not "cause harm to their employer." In this case, Elizabeth could potentially cause harm to her employer by causing her sister to move her assets away from the wealth management adviser. But this case also highlights a key element of the CFA Institute Ethical Decision-Making Framework — to identify relevant facts before choosing a course of action. Sometimes not all the relevant facts are known. Is Elizabeth still working for her employer when she asks her sister to leave the firm? The facts are not clear. If so, her actions are unacceptable because she would be causing harm to her employer (choice B). The fact that the client is a close relation is irrelevant, Elizabeth's sister is still a client of the firm.

If Elizabeth is no longer employed by the firm, soliciting former clients may not pose a problem. But if she has left, does Elizabeth have a non-compete agreement with her employer prohibiting her from soliciting clients of her employer? If so, she would be prohibited from soliciting clients, including her sister, to the new hedge fund. Choice D brings up the issue of suitability of investments. Even if Elizabeth has already left the firm and a non-compete agreement is not in force, she should only be soliciting clients for whom the investment is suitable under Standard III(C): Suitability, which states that members must "determine that an investment is suitable to the client's financial situation" before making a recommendation or taking action. Is the hedge fund a suitable investment for Elizabeth's sister? The question does not provide any clues. Even if the hedge fund is a suitable investment, Choice D still does not address the main issue of whether Elizabeth his harming her employer. There may be no "obligation" to keep her sister's investments at the wealth management firm (Choice A), but depending on the facts, it would be unethical for her to do so. Properly applying the Ethical Decision-Making Framework calls for identifying the relevant facts. All the choices could be correct, depending on facts that are not provided in the question. We need to know more.

CFA INSTITUTE

ETHICS IN PRACTICE:
Leaving Firm and Telling People Why!

CASE STUDY

Nickoli is an investment counselor with HHI Capital Management. A colleague at her local CFA Society encourages Nickoli to leave HHI and join her at Vesuvius Asset Advisers. Nickoli eventually agrees and determines to leave at the beginning of the new year. Over the course of a few weeks prior to tendering her resignation, she mentions to her clients that they will likely be working with a new investment counselor in the new year because she will be leaving HHI in the coming weeks. Her clients express their surprise, and when pressed for details about why she's leaving, Nickoli shares that she is frustrated by and disagrees with the structure and direction of the firm, she disagrees with and does not have confidence in the current leadership, she does not believe the firm will be able to attract and retain good people, and other HHI employees have been mistreated and will also be leaving soon. Several of Nickoli's HHI clients indicate that they would like information about Vesuvius and may be interested in switching their accounts. After submitting her resignation, Nickoli immediately relays the names of those clients to Vesuvius, and after the first of the year, she begins soliciting them to transfer their accounts from HHI to her new firm. Nickoli's conduct is

A. acceptable because she is looking out for her clients' best interest and believes Vesuvius provides better service.

B. acceptable because she provides her opinion of HHI in response to questions from clients.

C. acceptable because she did not solicit clients until after she left HHI.

D. unacceptable because she made disparaging remarks about HHI to clients while she was still with the firm.

ANALYSIS

Answer D is the best response because this case relates to CFA Institute Standard IV(A): Duty to Employer – Loyalty, which states that CFA Institute members and candidates "must act for the benefit of their employer and not…otherwise cause harm to their employer." Although a departing employee is generally free to make arrangements or preparations to change firms before terminating the relationship, those preparations must not conflict with the employee's continuing duty to act in the best interests of the current employer and not otherwise undermine, disparage, or cause harm to the current employer. In this case, Nickoli decided to leave HHI and join Vesuvius several weeks before she submitted her resignation and notified the firm. During that time, Standard IV(A) obligated her to continue to act in the employer's best interest and not engage in any activities that would conflict with this duty until her resignation became effective.

Nickoli violated her duty of loyalty to HHI by making disparaging and harmful statements about the firm to its clients in the weeks prior to submitting her resignation and by promoting Vesuvius to HHI clients while she was still employed by HHI. Although she did not make actual solicitations until after she left HHI, Nickoli used the final weeks of her employment with HHI to contact and gauge which of the firm's clients may be interested in receiving information about Vesuvius and possibly transferring their accounts from HHI. And although an investment professional should protect the client's best interest, even if Nickoli believes the clients will be better off with her at Vesuvius, the clients' relationship is with HHI. She is a representative of HHI, so she cannot malign the firm while still employed, even in response to questions.

This case was based on a disciplinary case by the CFA Institute Professional Conduct Program. The member in question received a Private Censure.

CFA INSTITUTE

ETHICS IN PRACTICE:
Loyalty to Firm or Clients' Interests First?

CASE STUDY

Kuznetsov is a portfolio manager for a large investment firm that encourages its employees to sell proprietary investment products to their clients. Kuznetsov complies with this directive and within a year becomes the firm's top seller of these investment vehicles. He receives stellar performance reviews and a large bonus. But Kuznetsov eventually determines that the firm's investment products are underperforming and more expensive than other outside investment options that are suitable for his clients and present a better chance for growth.

So, he sharply cuts back on purchasing the firm's investment products for his clients. Although his supervisor puts increasing pressure on him to resume selling the firm's products, Kuznetsov refuses. He complains several times to management that he is being pressured to place the firm's interest above his client's interests. He surreptitiously records several conversations with his supervisor and makes copies of client records that document what he considers to be his supervisor's inappropriate conduct. When management ignores his complaints and his supervisor begins giving Kuznetsov poor performance reviews, he files a complaint with the local regulator against his supervisor and his firm, providing the recordings and copies of client files as evidence. After the firm becomes aware of Kuznetsov's actions, he is fired. Kuznetsov's actions are

A. inappropriate because he failed to keep client information confidential.

B. appropriate because he is protecting client interests.

C. inappropriate because he violated his duty of loyalty to his employer by taking his dispute with his supervisor to the regulator, exposing the employer to financial and reputational harm.

D. inappropriate because he could have met his ethical obligation by dissociating from the unethical activity of his supervisor.

ANALYSIS

This case involves CFA Institute Standard IV(A): Duties to Employer – Loyalty, which states that CFA Institute members "must act for the benefit of their employer and not…divulge confidential information or otherwise cause harm to their employer." But the interests of an investment professional's employer are secondary to protecting the interests of clients. Circumstances may arise in which investment professionals can engage in conduct contrary to their employer's interests in order to comply with their duties to clients. In pressuring Kuznetsov to sell more expensive and less profitable investment products to his clients, the employer is acting contrary to client interests.

In general, Kuznetsov's conduct in recording his conversations with his supervisor, copying client records, and reporting the employer to the regulator are justified because he is attempting to protect his clients' interests by calling out his employer's unethical (and possibly illegal) conduct. (However, certain jurisdictions may have laws against surreptitiously recording conversations without the other party's consent.) Dissociating from the conduct may have removed him from the situation, but it would not be effective in this case because it would not necessarily prevent Kuznetsov's employer from taking advantage of its clients and reassigning their accounts to employees who would engage in the misconduct. His "whistleblowing" activity is not a violation of the CFA Institute Code of Ethics and Standards of Professional Conduct in these circumstances (Answer B).

This case is based on a US SEC enforcement action from 2015.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD IV(B)

ADDITIONAL COMPENSATION ARRANGEMENTS

COMING SOON

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD IV(C)

RESPONSIBILITIES OF SUPERVISORS

CFA INSTITUTE

ETHICS IN PRACTICE:
Futures, Feed Yards, and Furtive Actions.

CASE STUDY

Rosenthal Collins Group (RCG) is a registered futures commission merchant with a number of branch offices, including one in Memphis, Tennessee. Phillips is hired to be the branch manager of the Memphis office, supervising a number of employees, including Lewis. Phillips allows Lewis to work from home, and as a result, Lewis has no physical office in the Memphis branch of RCG or even access to the building. Unknown to Phillips or RCG, Lewis also works for another futures commission merchant (AFCM). Lewis arranges swap agreements for AFCM, including orders with several cattle feed yards. And through another employee at RCG, he helps open new futures accounts for the feed yards RCG represents. Although the other employee at RCG receives all the commissions for the feed yard accounts, she surreptitiously splits these commissions with Lewis. This commission sharing arrangement is also unknown to Phillips. Phillips actions as a supervisor are

A. acceptable if RCG did not develop adequate policies and procedures for the detection and deterrence of possible misconduct by its employees.

B. acceptable if Phillips was not provided adequate training from RCG on its compliance policies and procedures.

C. acceptable if RGC home office conducted regular audits of the Memphis branch.

D. unacceptable because Phillips did not diligently perform his supervisory responsibilities.

ANALYSIS

This case is about adequately exercising supervisory responsibility. CFA Institute Standard IV(C): Responsibilities of Supervisors states that "[CFA Institute] members must make reasonable efforts to ensure that anyone subject to their supervision or authority complies with applicable laws, rules, regulations, and the Code and Standards." At a minimum, supervisors must make reasonable efforts to detect and prevent legal, regulatory, and policy violations by ensuring that effective compliance systems have been established. They must also understand what constitutes an adequate compliance system and make reasonable efforts to see that appropriate compliance procedures are established, documented, communicated to covered personnel, and followed. Supervisors must alert their superiors and firm management if there is an inadequate compliance system in place and work with them to develop and implement effective compliance tools. If the absence of or inadequacy of the compliance system prevents effective supervisory control, an investment professional should decline to accept supervisory responsibility until the firm adopts reasonable procedures to allow the effective exercise of supervisory responsibility.

If Philips knew that RCG had not developed adequate policies and procedures for the detection and deterrence of potential misconduct by RCG employees, it would be incumbent on him to bring this to the attention of RCG, help develop adequate compliance policies, or decline supervisory responsibility. In the absence of adequate compliance policies, it would not be acceptable for Phillips to act as branch manager. A lack of adequate policies would also not be an excuse for failing to detect potential misconduct by RCG employees, including Lewis, which means Answer A would not be correct. Similarly, if RCG did not properly train Phillips on RCG compliance policies that did exist, Phillips should decline supervisory responsibility until he adequately understands RCG policies and procedures and expectations for maintaining his subordinates' compliance with those policies. Lack of training on how to supervise should not be an excuse for inadequate supervision but a catalyst to seek out that training, thus making Answer B not the right choice.

A regular audit of the Memphis branch by RCG home office compliance personnel could be an excellent way to ensure that branch employees are complying with applicable law, regulations, and RCG policies. But it is not a substitute for effective and regular supervision by Phillips, the onsite branch manager, making Answer C incorrect. Although it is not clear from the case what steps Phillips did take to diligently exercise supervisory responsibility, the fact that Lewis worked from home and did not have access to the branch office, suggests that Phillip's "hands on" supervision was minimal at best and obviously ineffective. Answer D is the best choice.

This case is based on an enforcement action by the US Commodity Futures Trading Commission from 2014.

CFA INSTITUTE

ETHICS IN PRACTICE:
Violated Professional Standards or Not?

CASE STUDY

Manley, Head of Research at a long-short equity fund, leads a team of four analysts. One of the fund's portfolio managers asks Manley to look at a particular small-cap company as a possible investment target. Because there is little information available on the company, Manley assigns the challenging task to Chang, one of the fund's top junior analysts, who spends a week conducting research. Chang builds a cash flow projection model that shows the company is deeply undervalued. Manley briefly reviews the model and publishes a research report on the company with the author listed as the Research Department that recommends a "Buy" at the current price. The fund makes a substantial investment in the company's stock. Later, several brokerage houses come out with research pieces on the company that include cash flow projections that are considerably lower than Chang's model. Over the course of six months, the investment loses 25% of its value. Manley thoroughly reviews Chang's model and discovers two assumptions that eventually proved erroneous as well as an arithmetic mistake. Did either Manley or Chang violate the CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards)?

A. Manley violated the CFA Institute Code and Standards.

B. Chang violated the CFA Institute Code and Standards.

C. Manley did not violate the CFA Institute Code and Standards.

D. Chang did not violate the CFA Institute Code and Standards.

ANALYSIS

Many people choose response A, which is the easy answer; the subordinate's work was flawed, so the supervisor must be responsible. And that can be true under some circumstances. But response C — no supervisor violation — could be just as correct given the right facts and circumstances. This case shows how you must identify all the relevant facts before making a decision to analyze a decision from an ethical perspective. Read on for arguments that could be made for each answer.

Case for Response A. Manley violated Standard V(A): Diligence and Reasonable Basis by relying on the erroneous work done by Chang. In addition, as Head of Research, Manley violated Standard IV(C): Responsibilities of Supervisors by failing to supervise Chang, who himself violated the standards (See Response B analysis). Manley only briefly reviewed Chang's work. Finally, Manley misrepresented the author of the research report as that of "the Research Department" when Chang conducted the research.

Case for Response B. Chang violated Standard V(A): Diligence and Reasonable Basis. Chang included two erroneous assumptions in his model. It is not clear from the facts that he had a reasonable and adequate basis or that he thoroughly analyzed the information to create his model. Furthermore, he did not thoroughly check his model because he made an arithmetic mistake that contributed to skewing the model results.

Case for Response C. Manley did not violate the standards because he reasonably relied on the work of one of his colleagues, who had a track record of exercising diligence and thoroughness and conducting appropriate research. Furthermore, there is no indication from the facts that Manley failed to adequately supervise Chang. The facts of the case do not indicate the supervisory steps Manley or the fund have in place to monitor Chang's work. A "brief" review by Manley of the research may be appropriate if other steps are in place (peer review, for example) to check the appropriateness of Chang's analysis. And there is no indication that Chang violated the standards. (See Response D analysis). Finally, it is proper to have the author of the research report listed as the "Research Department" because the work is that of the firm.

Case for Response D. Chang did not violate the standards because there is no indication from the facts that he failed to exercise diligence and thoroughness or that his research was not supported by appropriate research and investigation. Although the two assumptions ultimately proved erroneous, that does not automatically mean that they were inappropriate when initially made by Chang given the facts he was aware of at the time. Being incorrect about an investment recommendation or prediction is common. An inaccurate prediction is not sufficient evidence that a violation of the CFA Institute Code and Standards occurred. It is also not clear from the facts that the arithmetic mistake was material or affected the outcome of the model.

This case is based on facts written by Tanuj Khosla, CFA, CAIA.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD V(A)

DILIGENCE AND REASONABLE BASIS

CFA INSTITUTE

ETHICS IN PRACTICE:
Guilty or Not Guilty Is the Question!

CASE STUDY

Sunset Financial Services is a broker/dealer that has historically sold mutual funds and insurance products to individual investors. In 2011, the firm began selling private placements to clients as well. Norma Desmond, vice president of Sunset, is responsible for conducting due diligence on the private placements and placing them on an approved list that Sunset investment advisers can view on the firm's internal website. Desmond relies on third-party due diligence reports to assess the viability and appropriateness of the private placements for Sunset's clients. Tom Gillis is one of Sunset's investment advisers that reviews the internal list of approved private placements and sells several of these investments to his clients. Gillis does not create any sales materials for these private placements but instead relies on sponsor-created sales materials to give to his clients. Has Desmond or Gillis engaged in any misconduct? Decide what you believe is the correct answer and use the Ethical Decision-Making Framework to help explain your choice.

A. Desmond is guilty of misconduct in selecting the private placements for Sunset to sell.

B. Desmond is NOT guilty of misconduct in selecting the private placements for Sunset to sell.

C. Gillis is guilty of misconduct in providing sponsor-created sales material to clients.

D. Gillis is NOT guilty of misconduct in providing sponsor-created sales material to clients.

ANALYSIS

The Ethical Decision-Making Framework includes questions — such as What is the ethical issue involved? To whom is a duty owed? What are the important Facts? — that help investment professionals analyze situations from an ethical standpoint. The ethical issue involved in this case for both Desmond and Gillis relate to diligence and reasonable basis. Desmond bases her evaluation of private placements on third-party due diligence reports without conducting the analysis herself. Gillis gives sponsor-created sales material to clients without producing his own information on the private placements for his clients. Both Desmond and Gillis owe a duty to the clients of Sunset Financial to act with diligence and reasonable basis in investigating the private placement investments and recommending them to clients. CFA Institute Standard V(A): Diligence and Reasonable Basis states that CFA Institute members "must exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions." Determining whether Desmond and Gillis met their responsibilities under Standard V(A) requires examining the relevant facts.

In this case, not much background is provided, making it difficult to tell whether either engaged in misconduct. It is acceptable for Desmond to rely on third-party due diligence reports to evaluate investments as long as she take steps to ensure those reports are from a reputable source and have a reasonable and sound basis. It is not clear what steps Desmond took to evaluate the quality of the third-party due diligence provider. Without a critical evaluation of the third-party due diligence provider, she may have violated Standard V(A). Similarly, it is acceptable for Gillis to rely on Desmond to fulfill her responsibilities to conduct thorough due diligence of potential client investments. Gillis can assume that investments listed on Sunset's approved private placement list have been thoroughly vetted by the firm through Desmond without having to go back and conduct the due diligence himself unless he has reason to question the validity of the process.

It is also not necessarily improper for Gillis to rely on sponsor-created marketing material to provide information to clients, as long as Gillis, compliance, or other personnel at Sunset have thoroughly reviewed the material to ensure that it meets all applicable disclosure requirements and contains no misrepresentations. If Gillis simply forwards the material to clients without such a review, then he could be violating his duty of diligence to clients by potentially disseminating inaccurate or misleading materials to clients. Because of the lack of information provided in the case, an argument could be made that under certain circumstances, any of the responses could be chosen.

This case is based on a Financial Industry Regulatory Authority (FINRA) enforcement action from 2013.

ABOUT CFA INSTITUTE
CFA Institute is a global not-for-profit organization and the world's largest association of investment professionals. We are dedicated to developing and promoting the highest standards of ethics, education, and professional excellence in the investment industry, for the ultimate benefit of society. Our goal is to create an environment where investors' interests come first, markets function at their best, and economies grow.

CFA INSTITUTE

ETHICS IN PRACTICE:
Stick to IPS during Volatile Markets?

CASE STUDY

Barry Van Wagenen manages the portfolios of high-net-worth clients. He completes an individualized IPS for each client when opening their account. He then develops a personal asset allocation formula based on each client's risk tolerance, financial goals, and so forth. Over the past two days, the domestic and global equity securities markets fell more than 6%. Fearing a continued drop in the markets, Van Wagenen liquidates his personal investments and moves to cash until the financial markets stabilize. But he keeps his clients' portfolios fully invested pursuant to the directives in their IPS. Van Wagenen's actions are

A. unacceptable because he is trading ahead of his clients for his personal account.

B. unacceptable because his personal investment decisions do not match the investment recommendations he has made to his clients.

C. unacceptable because he is not acting in a diligent and reasonable manner by leaving his clients assets fully invested in a rapidly declining securities market.

D. acceptable because he is following his client's directives, as detailed in their IPS, by keeping them fully invested.

ANALYSIS

The CFA Institute Ethical Decision-Making Framework provides guidance to investment professionals facing ethical dilemmas. The framework calls for identifying the ethical principle at issue, to whom a duty is owed, the relevant facts, and whether there is a conflict of interest to assist in choosing the appropriate course of conduct. In this case, we need more facts before we can properly analyze whether Van Wagenen's actions are acceptable. Specifically, what level of investment discretion have Van Wagenen's clients given him regarding investment decisions and whether the clients' IPSs address how investment decisions are to be made in the face of rapidly changing market conditions. If Van Wagenen has full investment discretion, failing to adjust his client's portfolio in a timely manner means Van Wagenen could be in violation of his duty to act with diligence and a reasonable basis — CFA Institute Standard V(A) — and in violation of his duty to his clients of loyalty, prudence, and care — CFA Institute Standard III(A).

Similarly, if the IPS states that in the event of a significant market downturn, Van Wagenen has the authority to alter the agreed on asset allocation formula prior to formally revising the IPS, that would also be a strong indicator for Van Wagenen to take action. Under those circumstances, Answer C would be the best choice. But if Van Wagenen has limited discretion or the IPS was silent about "emergency" powers to make changes in the portfolio, Van Wagenen's hands may be tied (Answer D). It is also not clear whether Van Wagenen acted diligently in attempting to contact his clients in the face of the volatile markets to determine whether they had any changes to their investment instructions. CFA Institute Standard VI(B): Priority of Transactions states that investment transactions of clients must have priority over personal transactions. This standard does not require that an investment professional's personal investments match those of his clients because there may be differences in the risk tolerances, financial goals, and so on between the adviser and his or her clients (Answer B). Finally, it is not clear that Van Wagenen is "front running" his client accounts because the price of the securities at issue may not be affected by the trades on his personal account (Answer A).

The facts for this case are not based on a particular case but reflective of current market volatility.

CFA INSTITUTE

ETHICS IN PRACTICE:
When Is Scrutinizing Risk Not Enough?

CASE STUDY

Aaron Bouchard is a portfolio manager with discretionary control over the portfolios of more than 400 clients. Bouchard pursues a "medium risk, value" strategy for his clients, and they hire him on that basis. After scrutinizing the risk of potential investments, he makes a risk assessment for each of the securities he recommends based on the risks facing the issuer's business. The majority of securities Bouchard invests his clients' assets in are small-cap companies in the oil and gas sector and in commodities that he considers "medium" risk. As a result, Bouchard's client accounts are concentrated in those sectors. Bouchard's actions are

A. acceptable if he discloses his investment strategy to his clients.

B. unacceptable because he does not exercise diligence and thoroughness in executing his investment strategy.

C. acceptable if he maintains appropriate records to support his investment recommendations and actions.

D. unacceptable because he does not have a reasonable and adequate basis to support his investment recommendations and actions.

ANALYSIS

This case involves CFA Institute Standard V(A): Diligence and Reasonable Basis, which states that members and candidates "must exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions." Under this standard, members must also "have a reasonable and adequate basis, supported by appropriate research and investigation" for making investment recommendations and taking investment action. In this case, there is nothing to indicate that Bouchard's investigation and analysis of the individual securities that he chooses for his clients' accounts is insufficient or inadequate.

The facts state that he "scrutinizes" the risk of potential investment on an individual basis. But in making the investment decisions, he does not appear to exercise diligence or thoroughness because he does not give sufficient weight to factors that go beyond long-term risk of the individual securities themselves. Bouchard does not consider such factors as security concentration in client portfolios, price volatility in the short term, or liquidity risk. Without considering all these factors in their entirety, Bouchard's actions underweight the risk of the securities, likely making them a more risky investment for his clients than the "medium" risk that he has assigned. Because he does not exercise diligence and thoroughness when implementing his investment strategy, disclosing his strategy to his clients or maintaining adequate records for a faulty strategy will not cure the misconduct. In this case, the best choice is B.

This case is based on an enforcement action by CFA Institute. The member was reprimanded and fined by the regulator and CFA Institute suspended his or her right to use the CFA designation for a period of time.

CFA INSTITUTE

ETHICS IN PRACTICE:
Violated Professional Standards or Not?

CASE STUDY
Manley, Head of Research at a long–short equity fund, leads a team of four analysts. One of the fund's portfolio managers asks Manley to look at a particular small-cap company as a possible investment target. Because there is little information available on the company, Manley assigns the challenging task to Chang, one of the fund's top junior analysts, who spends a week conducting research. Chang builds a cash flow projection model that shows the company is deeply undervalued. Manley briefly reviews the model and publishes a research report on the company with the author listed as the Research Department that recommends a "Buy" at the current price. The fund makes a substantial investment in the company's stock. Later, several brokerage houses come out with research pieces on the company that include cash flow projections that are considerably lower than Chang's model. Over the course of six months, the investment loses 25% of its value. Manley thoroughly reviews Chang's model and discovers two assumptions that eventually proved erroneous as well as an arithmetic mistake. Did either Manley or Chang violate the CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards)?

A. Manley violated the CFA Institute Code and Standards.

B. Chang violated the CFA Institute Code and Standards.

C. Manley did not violate the CFA Institute Code and Standards.

D. Chang did not violate the CFA Institute Code and Standards.

ANALYSIS

Many people choose response A, which is the easy answer; the subordinate's work was flawed, so the supervisor must be responsible. And that can be true under some circumstances. But response C — no supervisor violation — could be just as correct given the right facts and circumstances. This case shows how you must identify all the relevant facts before making a decision to analyze a decision from an ethical perspective. Read on for arguments that could be made for each answer.

Case for Response A. Manley violated Standard V(A): Diligence and Reasonable Basis by relying on the erroneous work done by Chang. In addition, as Head of Research, Manley violated Standard IV(C): Responsibilities of Supervisors by failing to supervise Chang, who himself violated the standards (See Response B analysis). Manley only briefly reviewed Chang's work. Finally, Manley misrepresented the author of the research report as that of "the Research Department" when Chang conducted the research.

Case for Response B. Chang violated Standard V(A): Diligence and Reasonable Basis. Chang included two erroneous assumptions in his model. It is not clear from the facts that he had a reasonable and adequate basis or that he thoroughly analyzed the information to create his model. Furthermore, he did not thoroughly check his model because he made an arithmetic mistake that contributed to skewing the model results.

Case for Response C. Manley did not violate the standards because he reasonably relied on the work of one of his colleagues, who had a track record of exercising diligence and thoroughness and conducting appropriate research. Furthermore, there is no indication from the facts that Manley failed to adequately supervise Chang. The facts of the case do not indicate the supervisory steps Manley or the fund have in place to monitor Chang's work. A "brief" review by Manley of the research may be appropriate if other steps are in place (peer review, for example) to check the appropriateness of Chang's analysis. And there is no indication that Chang violated the standards. (See Response D analysis). Finally, it is proper to have the author of the research report listed as the "Research Department" because the work is that of the firm.

Case for Response D. Chang did not violate the standards because there is no indication from the facts that he failed to exercise diligence and thoroughness or that his research was not supported by appropriate research and investigation. Although the two assumptions ultimately proved erroneous, that does not automatically mean that they were inappropriate when initially made by Chang given the facts he was aware of at the time. Being incorrect about an investment recommendation or prediction is common. An inaccurate prediction is not sufficient evidence that a violation of the CFA Institute Code and Standards occurred. It is also not clear from the facts that the arithmetic mistake was material or affected the outcome of the model.

This case is based on facts written by Tanuj Khosla, CFA, CAIA.

CFA INSTITUTE

ETHICS IN PRACTICE:
Doing Too Much to Make Investments a Success?

CASE STUDY

Corrales manages a hedge fund that seeks out investment opportunities in developing markets. Using assets of the fund's investors, the fund hires local companies to serve as "sub-advisers" to explore and obtain promising investment opportunities and navigate local laws and regulation. The sub-advisers often have very limited experience as financial consultants or advisers but do have close relationships and connections with local high-ranking government officials. The payments made by Corrales, through the sub-advisers, often cover substantial "deal fees" and other expenses that facilitate governmental support of each investment. Corrales does not require the local business partners to provide details of their activities or what specific expenses are covered by the fees. Corrales reports these expenditures to fund investors as operating expenses necessary to the success of the investment. Over several years, the hedge fund is very successful producing an 18% annual rate of return for its investors. Did Corrales actions violate the CFA Institute Code of Ethics and Standards of Professional Conduct?

A. Yes.

B. No because it is acceptable to hire sub-advisers and business consultants to assist in procuring investment opportunities and managing specialized assets.

C. No because the payments to the sub-advisers represent legitimate expenses to ensure the success of investments and protect the interest of investors.

D. No, as long as the sub-advisers provide more detail about the nature and purpose of the payments and this information is disclosed to the hedge fund investors.

ANALYSIS

To better serve clients, investment professionals may choose to delegate to third parties work that requires particular specialization, knowledge, or expertise. For example, an investment adviser may hire sub-advisers to handle a particular strategy or investment style outside the scope of the adviser's ability or experience. A global adviser may hire a sub-adviser to manage an asset allocation invested in a particular market, and the payments to the sub-adviser would be legitimate investment expenses that could properly be passed on to investors in the fund.

But the facts of this case indicate that Corrales is not hiring a true sub-adviser but essentially paying locally connected officials to secure access to investment deals to ensure the success of the fund's investments. The "sub-advisers" have no financial experience but are close to the government officials, and the "deal fees" are not supported by any documentation that details legitimate investment expenses. The "operating expenses" charged by Corrales to the fund are most likely funding corrupt transactions and bribes through local intermediaries. This practice violates multiple standards:

- I(A): Knowledge of the Law because the conduct would violate any type of anti-bribery laws.
- I(C): Misrepresentation because he is improperly labeling the expenditures as investment fees.
- V(A): Diligence and Reasonable Basis because no reasonable and adequate basis for the "investment" action exists.
- V(C): Record Retention because no appropriate records are being kept to support the action.
- VII(A): Conduct as Participants in CFA Institute Programs because assuming Corrales is a charterholder, his conduct compromises the integrity to the CFA designation.

This case is based on a US SEC enforcement action from 2017.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD V(B)

COMMUNICATION WITH CLIENTS AND PROSPECTIVE CLIENTS

CFA INSTITUTE

ETHICS IN PRACTICE:

Valuing Assets and Calculating Fees.

CASE STUDY

Maalouf works in a branch office for a large wealth management firm. The firm's fees are based on a percentage of the value of the assets managed in each client account. The firm has a standard method for valuing assets and calculating fees for all of its clients, which is disclosed to each client at the outset of the relationship. Over time, the firm transitions to (1) using the market value of client assets at the end of the billing cycle instead of the average daily balance of the account; (2) including assets in the fee calculation, such as cash or cash equivalents, that were previously excluded; and (3) charging clients for a full billing period rather than prorating fees for clients that start or terminate accounts mid billing period. Maalouf

A. cannot use end-of-cycle valuations, include cash equivalents, or charge full fees for a full billing cycle for partial cycle accounts.

B. can change the valuation and fee calculation methodology as long as actual fees charged to clients are lower.

C. must notify clients of the changes in the valuation and fee calculation methods.

D. cannot change fundamental elements of the client relationship, such as valuation and fee calculation methodology, once it is disclosed to the client.

ANALYSIS

This case involves Standard V(B): Communication with Clients and Prospective Clients, which requires CFA Institute members and candidates to disclose to clients the basic format and general principles of the investment process. Advisory fees are a critical part of the investment management process. Developing and maintaining clear, frequent, and thorough communication with clients allows them to make well-informed decisions about their investments, including about whether to engage or retain an investment adviser.

Any changes to the methods for valuing assets or calculating fees that are different from the process set out and agreed to by the client must be disclosed. It is improper to change fee calculation methodology without disclosure even if it results in lower fees. Using end-of-cycle valuations, including cash equivalents, or not pro-rating fees for newly acquired or terminated clients are possible methods for calculating fees as long as those policies are disclosed and agreed to by the client. It is also permissible to change valuation and methodology and fee calculation policies overtime for existing accounts. Maalouf and his firm can negotiate with their clients about changing the methods for calculating fees that were originally disclosed. So, the best answer is C, Maalouf must notify his clients of the changes in the valuation and fee calculation methods.

This case is based on a US SEC Office of Compliance Inspections and Examinations Risk Alert.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD V(C)

RECORD RETENTION

CFA INSTITUTE

ETHICS IN PRACTICE:

Taking Care of Clients Is the Priority.

CASE STUDY

Dougal McDermott is president of Enhanced Investment Strategies (EIS), a small investment firm. Most clients of EIS are longtime associates of McDermott who have had their investment portfolios with EIS for decades. Because of his close personal relationship with his clients, McDermott is very familiar with their investment profile, income and retirement requirements, and tolerance for risk. He keeps abreast of the life changing events (such as health issues, real estate purchases, children's university expenses, and retirement) of all his clients and adjusts their portfolios accordingly. McDermott regularly meets with his clients in EIS offices and sees them on numerous occasions outside the office where he has a chance to give them an update on their investments. EIS clients complete a client agreement and risk profile when opening their account and those profiles are updated as McDermott finds the time to do so. McDermott's business practices are

A. acceptable because he adjusts client investments to ensure that they are suitable for client investment needs given their changes income and risk profile.

B. acceptable because he regularly communicates with clients about their investments.

C. unacceptable because he does not keep adequate written records regarding client investment profiles.

D. unacceptable because his close personal relationship with clients will affect his independence and objectivity when providing investment advice.

ANALYSIS

The issue in this case involves record keeping. CFA Institute Standard V(C): Record Retention states that CFA Institute members must "develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients." The facts make clear that McDermott is personally close to clients. Although this fact may raise fair dealing concerns (McDermott may be benefiting some clients with whom he has a particularly close personal relationship over other clients), it does not necessarily raise questions about the independence and objectivity of McDermott's investment advice (Answer D).

It also appears from the facts provided that McDermott is fulfilling his ethical obligations as an investment manager by communicating regularly with his clients (Answer B) and reviewing and adjusting client portfolios on a timely basis to meet clients' changing financial circumstances (Answer A). But McDermott only updates client records "when he finds the time to do so" and apparently not promptly or on a regular basis. Without necessary, relevant, and up-to-date know your client information, it would be difficult, if challenged, for McDermott to establish and prove that EIS identified the needs and circumstances of the clients and has taken these into account in recommending investments. When client circumstances, investment goals, risk tolerances, or income needs change, records should be promptly updated and reviewed on a regular basis to reflect and document these changes. The correct answer is C.

This case is based on an UK Financial Services Authority enforcement action from 2010.

CFA INSTITUTE

ETHICS IN PRACTICE:

Compliant with Record Retention Standard?

CASE STUDY

Ianetta is the chief compliance officer for Rocky Mountain Investments (RMI). He is responsible for establishing and maintaining appropriate regulatory compliance policies, including a document retention policy. RMI's policies require retaining and archiving the emails of the firm's personnel. RMI has rapidly expanded over the years, and Ianetta determines that the firm should move to a new and less expensive email archive provider. But during the transition, several thousand emails are temporarily inaccessible. In addition, the new system does not capture emails from accounts hosted on an external server, and it does not archive emails sent from a third-party provider's application ("cloud" email). Do Ianetta's actions comply with the CFA Insitute Code and Standards?

A. No because the record retention system Ianetta implemented is inadequate.

B. Yes, as long as the inaccessible emails are able to be recovered.

C. Yes because emails sent and received outside RMI's email system are not required to be retained.

D. Yes, if the emails are more than five years old.

ANALYSIS

The issue in the case involves record keeping. CFA Institute Standard V(C): Record Retention states that CFA Institute members must "develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients." Emails to and from firm personnel are important records of the firm's business. As the firms' chief compliance officer, Ianetta has the responsibility to develop policies and procedures to meet the record retention requirements for RMI. The emails of firm personnel must be preserved regardless of what email service or platform is used to generate them. The requirement is not limited to only emails sent and received through the firm's internal server.

Guidance for Standard V(C) recommends that records be retained up to seven years in the absence of regulatory requirements. It is not clear what regulatory regime RMI is subject to if any, but best practice would be to keep seven years of the email records. The facts state that during the transition to the new email archive service provider, the records (emails) were temporarily unavailable, although it is not clear for how long. But even if the records are not available for a short time, it would be unacceptable. Lack of access to records for any amount of time could certainly cause issues with clients and regulators who may be wanting to review emails to substantiate investment recommendations, confirm communications, examine client/adviser discussions, and so on. Therefore, by not adequately fulfilling his responsibility to maintain appropriate records for RMI, Ianetta is in violation of Standard V(C), so the best answer is A.

The facts of this case are based on a 2013 enforcement action by the US Financial Industry Regulatory Authority.

CFA INSTITUTE

ETHICS IN PRACTICE:
Doing Too Much to Make Investments a Success?

CASE STUDY

Corrales manages a hedge fund that seeks out investment opportunities in developing markets. Using assets of the fund's investors, the fund hires local companies to serve as "sub-advisers" to explore and obtain promising investment opportunities and navigate local laws and regulation. The sub-advisers often have very limited experience as financial consultants or advisers but do have close relationships and connections with local high-ranking government officials. The payments made by Corrales, through the sub-advisers, often cover substantial "deal fees" and other expenses that facilitate governmental support of each investment. Corrales does not require the local business partners to provide details of their activities or what specific expenses are covered by the fees. Corrales reports these expenditures to fund investors as operating expenses necessary to the success of the investment. Over several years, the hedge fund is very successful producing an 18% annual rate of return for its investors. Did Corrales actions violate the CFA Institute Code of Ethics and Standards of Professional Conduct?

A. Yes.

B. No because it is acceptable to hire sub-advisers and business consultants to assist in procuring investment opportunities and managing specialized assets.

C. No because the payments to the sub-advisers represent legitimate expenses to ensure the success of investments and protect the interest of investors.

D. No, as long as the sub-advisers provide more detail about the nature and purpose of the payments and this information is disclosed to the hedge fund investors.

ANALYSIS

To better serve clients, investment professionals may choose to delegate to third parties work that requires particular specialization, knowledge, or expertise. For example, an investment adviser may hire sub-advisers to handle a particular strategy or investment style outside the scope of the adviser's ability or experience. A global adviser may hire a sub-adviser to manage an asset allocation invested in a particular market, and the payments to the sub-adviser would be legitimate investment expenses that could properly be passed on to investors in the fund.

But the facts of this case indicate that Corrales is not hiring a true sub-adviser but essentially paying locally connected officials to secure access to investment deals to ensure the success of the fund's investments. The "sub-advisers" have no financial experience but are close to the government officials, and the "deal fees" are not supported by any documentation that details legitimate investment expenses. The "operating expenses" charged by Corrales to the fund are most likely funding corrupt transactions and bribes through local intermediaries. This practice violates multiple standards:

- I(A): Knowledge of the Law because the conduct would violate any type of anti-bribery laws.
- I(C): Misrepresentation because he is improperly labeling the expenditures as investment fees.
- V(A): Diligence and Reasonable Basis because no reasonable and adequate basis for the "investment" action exists.
- V(C): Record Retention because no appropriate records are being kept to support the action.
- VII(A): Conduct as Participants in CFA Institute Programs because assuming Corrales is a charterholder, his conduct compromises the integrity to the CFA designation.

This case is based on a US SEC enforcement action from 2017.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD VI(A)

DISCLOSURE OF CONFLICTS

CFA INSTITUTE

ETHICS IN PRACTICE:
Firm's Funds Are Best Investment, Right?

CASE STUDY

Miriam works as an investment adviser for JVC Wealth Managers. JVC provides wealth management services to high-net-worth clients through discretionary, diversified, risk-adjusted investment management accounts that hold positions in both mutual funds and hedge funds. On average, Miriam has invested 74% of her clients' mutual fund assets and 63% of her clients' hedge fund assets in JVC proprietary funds, earning JVC and its affiliates additional fees. Miriam's actions are

A. acceptable because clients hiring JVC as an investment manager should expect that the firm will prefer investing in its own funds.

B. acceptable if Miriam indicates her preference for investing client assets in JVC proprietary funds.

C. unacceptable if there are non-proprietary mutual funds and hedge funds that meet the clients' investment needs.

D. unacceptable because the additional fees earned by JVC violate the duty of loyalty, prudence, and care that Miriam owes to her clients.

ANALYSIS

This case involves a potential conflict of interest for Miriam between providing cost efficient investment vehicles for her clients and selling her employer's investment products. CFA Institute Standard VI(A): Disclosure of Conflicts states that CFA Institute members "must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity" or interfere with their duties to their clients. Best practice is to avoid conflicts of interest if possible, otherwise mitigate the conflict of interest through the disclosure called for in Standard VI(A). Although the additional fees earned by JVC from selling proprietary funds present a potential conflict, the fees do not automatically violate Miriam's fiduciary duty to her clients (Answer D).

It is possible that those proprietary funds are the best and most appropriate investment vehicles for Miriam's clients even with the additional fees. But because there is a potential conflict of interest, Miriam must clearly disclose those fees "such that the disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively" according to Standard VI(A). And although Answer C is based on the existence of alternative non-proprietary mutual funds, that response does not say that those funds are superior to JVC funds or have lower costs. Assuming that the clients understand that Miriam, who works for JVC, will sell JVC products at every opportunity, is not sufficient (Answer A). The best answer in this case is Answer B, which calls for Miriam to disclose the conflict. This disclosure should be made at the outset of the relationship and address what investment vehicles will be used by JVC along with their costs.

This case is based on a 2015 SEC enforcement action.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD VI(B)

PRIORITY OF TRANSACTIONS

CFA INSTITUTE

ETHICS IN PRACTICE:
Personal vs. On-the-Job Investments.

CASE STUDY

Yang is a research analyst at BAMCO, a registered broker/dealer and investment adviser. While employed with BAMCO, Yang established Prestige Trade Investments Limited and acts as that firm's investment adviser. Yang is responsible for formulating Prestige's investment strategy and directs all trades on behalf of Prestige. Over the course of several days, Yang purchases 50,000 shares of Zhongpin stock and 1,978 Zhongpin call options for his personal account at BAMCO. Shortly thereafter, Yang uses $29.8 million of Prestige's funds to purchase more than 3 million shares of Zhongpin stock. Yang's actions are

A. acceptable because Yang's personal investments are not in conflict with the investment advice being given to his clients at Prestige.

B. acceptable as long as BAMCO is aware of and consents to Yang establishing and working for Prestige as a separate entity.

C. acceptable as long as Prestige clients are not negatively affected by Yang's prior purchase of Zhongpin securities through his account at BAMCO.

D. unacceptable.

ANALYSIS

This case involves an investment adviser "front-running" client trades. Front-running involves trading for one's personal account before trading for client accounts. In this case, Yang purchased Zhongpin stock and call options in his personal account at BAMCO before directing the Zhongpin trades of clients at Prestige. Standard VI(B): Priority of Transactions states that "investment transactions for clients…must have priority over investment transactions in which a [CFA Institute] member…is the beneficial owner." Yang's personal investments are tracking with his client investments, so there is no conflict between his personal trading and the investment actions/advice for clients. But the timing of the trades is what is at issue in this case, making Answer A incorrect. Also, the fact that Prestige clients are not harmed by Yang's earlier trades for his personnel accounts does not make his actions acceptable.

The issue is Yang's personal benefit derived from trading before his clients, which makes Answer C incorrect. Disclosure is not a cure for front-running. So, even if Yang had told Prestige clients that he would be making personal trades prior to taking investment action on their behalf that would benefit him, the trading in his personal account would not be acceptable. Yang would have to get permission from BAMCO to create and work for Prestige, according to CFA Institute Standard IV(A): Loyalty, but such permission does not allow Yang to engage in unethical activity while at Prestige, making Answer B incorrect. That leaves Answer D as the best answer.

This case is based on a SEC enforcement action from 2014.

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD VI(C)

REFERRAL FEES

CFA INSTITUTE

ETHICS IN PRACTICE:
To Refer or Not Refer?

CASE STUDY

Raphael, an investment adviser for Enright Financial Solutions (EFS), enters into an understanding with a friend who is a lawyer regarding the referral of clients. Raphael will refer EFS clients needing legal services to the lawyer in return for the lawyer recommending clients needing financial advisory services to Raphael and EFS. This arrangement is

A. acceptable because there are no payments involved.

B. acceptable as long as the lawyer discloses the arrangement to the clients he refers to Raphael.

C. acceptable as long as EFS is aware of Raphael's agreement with the lawyer.

D. unacceptable.

ANALYSIS

This case deals with a mutually beneficial referral arrangement whereby service professionals refer clients to one another. Although such an agreement is not necessarily unethical and may ultimately be beneficial for the clients, there is a potential for a conflict of interest that must be disclosed. CFA Institute Standard VI(C): Disclosure of Conflicts, Referral Fees requires members to disclose to their employer, clients, and prospective clients "any compensation, consideration, or benefit received from or paid to others for the recommendation for products of services." This disclosure allows both clients and the employer to evaluate any partiality shown in the recommendation of services and the full cost of those services. Although there is no money changing hands between Raphael and his friend, there is mutual consideration and benefit. The fact that no money is exchanged would not preclude disclosure (Choice A).

Choice B addresses the disclosure issue but places the onus of disclosure on the lawyer and not on Raphael. Standard VI(C) requires Raphael to disclose the referral arrangement to any clients he refers to the lawyer and any potential clients referred to him by his friend. Choice C also addresses the disclosure issue by correctly stating that Raphael must disclose the arrangement to his employer. But this does not go far enough because Standard VI(C) requires disclosure to be made to clients, prospective clients, AND the employer. Does Raphael disclose any information about the arrangement to this clients or EFS? The facts of the case do not mention that he made the appropriate disclosure. The CFA Institute Ethical Decision-Making Framework calls for you to identify all relevant facts before making a decision. Assuming Raphael made no disclosure to his clients or employer, this arrangement would be unacceptable (Choice D).

CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD VII(A)

CONDUCT AS PARTICIPANTS IN CFA INSTITUTE PROGRAMS

CFA INSTITUTE

ETHICS IN PRACTICE:

Doing Too Much to Make Investments a Success?

CASE STUDY

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ANALYSIS

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CASES COVERING CFA INSTITUTE
PROFESSIONAL CONDUCT STANDARD VII(A)

REFERENCE TO CFA INSTITUTE, THE CFA DESIGNATION, AND THE CFA PROGRAM

CFA INSTITUTE

ETHICS IN PRACTICE:
Designation Is Like a Degree, Right?

CASE STUDY

Bilal Ahmed recently earned his CFA designation and joined a medium-sized hedge fund as a senior analyst. His supervisor, Elizabeth Bennett, the founder of the firm, earned her CFA designation 10 years ago. But she has not paid her CFA Institute membership dues for the past four years and no longer participates in the organization's continuing education program. Bennett uses the CFA designation on her business card and on all the marketing materials for the fund. When Ahmed asks Bennett about her using the designation, Bennett tells him that since she passed the exam and earned the charter, the credential is similar to a degree from university that cannot be taken away. Later, during a marketing pitch by Ahmed and Bennett to a potential investor, the investor notes that he has narrowed down his manager search to firms that only employ CFA charterholders in senior positions. He asks Bennett if everyone in the firm on the investment side is a CFA charterholder. Bennett responds "Yes, that is correct." Ahmed does not respond. Did either Ahmed or Bennett violate the CFA Institute Standards of Professional Conduct?

A. Ahmed violated the CFA Institute Standards of Professional Conduct.

B. Ahmed did not violate the CFA Institute Standards of Professional Conduct.

C. Bennet violated the CFA Institute Standards of Professional Conduct.

D. Bennett did not violate the CFA Institute Standards of Professional Conduct.

CFA INSTITUTE
ETHICS IN PRACTICE: Designation Is Like a Degree, Right?

ANALYSIS

This case relates to CFA Institute Standard VII(B): Reference to CFA Institute, the CFA Designation, and the CFA Program, which states that when referring to the CFA designation, CFA Institute members and candidates "must not misrepresent ... holding the designation." The CFA designation is unlike a degree from university in that once granted the right to use the designation, individuals must also satisfy CFA Institute membership requirements (including paying dues) to maintain the right to refer to themselves as CFA charterholders. Although Bennett earned her charter, her membership is considered lapsed because she has not been paying dues to CFA Institute. Until her membership is reactivated, she must not present herself as a charterholder, and by continuing to use the CFA designation and representing herself as a charterholder to a potential client, Bennett has violated Standard VII(B).

Participation in the CFA Institute Continuing Education Program is not mandatory for maintaining your designation, but it is encouraged as a way to meet the CFA Institute Code of Ethics provision that calls for members to maintain and improve their professional competence. Ahmed hears Bennett refer to herself as a charterholder, but knows that Bennett's CFA Institute membership has lapsed. Standard I(A): Knowledge of the Law prohibits members from knowingly participating or assisting in the violations of others and requires members to dissociate from any unethical or illegal conduct. The issue for Ahmed is whether his acquiescence and silence in the face of Bennett's misrepresentation rises to the level of assisting or participating in Bennett's violation of the standard.

It could be argued that Ahmed's participation in a sales meeting in which he knows false information is given to a potential investor, and which could cause harm to that investor, constitutes assisting in the violations of those who provide that false information even if there is no active conduct by Ahmed. Best practice would be for Ahmed to address Bennett directly about her conduct and ask her to reinstate her membership or correct the statement made to the potential investor. If Bennett refuses to take corrective action, Ahmed could bring this conduct to the attention of the fund's compliance department for them to address and dissociate from the activity by not participating in any additional sales meetings with Bennett.

This case was written by Tanuj Khosla, CFA, CAIA

CFA Institute