LM03 · ETHICAL AND PROFESSIONAL STANDARDS · CFA LEVEL I

Guidance for Standards I–VII

The seven Standards of Professional Conduct — purpose, guidance, recommended procedures, and application

What This Reading Covers

This learning module walks through each of the seven Standards of Professional Conduct and their sub-sections. For every standard you learn **the purpose**, **CFA Institute guidance**, **recommended procedures for compliance**, and **application to common scenarios**. Candidates are *not* required to know the standards by Roman numeral — but you must recognize violations and proper behavior from fact patterns.

The Seven Standards at a Glance

STANDARDS OF PROFESSIONAL CONDUCT

I · PROFESSIONALISM
A. Knowledge of Law
B. Independence/Objectivity
C. Misrepresentation · D. Misconduct

II · CAPITAL MARKETS INTEGRITY
A. Material Nonpublic Info
B. Market Manipulation

III · DUTIES TO CLIENTS
A. Loyalty/Prudence/Care
B. Fair Dealing · C. Suitability
D. Performance · E. Confidentiality

IV · DUTIES TO EMPLOYERS
A. Loyalty · B. Additional Comp
C. Supervisor Responsibilities

V · ANALYSIS & ACTIONS
A. Diligence/Reasonable Basis
B. Communication · C. Records

VI · CONFLICTS OF INTEREST
A. Disclosure · B. Priority
C. Referral Fees

VII · RESPONSIBILITIES AS A CFA MEMBER OR CANDIDATE
A. Conduct as Participants in CFA Institute Programs
B. Reference to CFA Institute, the CFA Designation, and the CFA Program

How the Exam Tests This LM

Almost every question is an **application** question: you get a fact pattern about a member or candidate and must decide (i) whether a violation occurred, (ii) which standard was violated, or (iii) what the proper course of action is. You do *not* need to know the standards by number — only by name. Distractors often describe actions that are "true but not the best answer." Read carefully.

Exam Tip: Ethics is 15%–20% of the Level I exam. You can fail a topic area and still pass — but failing Ethics is extremely risky because of the "ethics adjustment": borderline candidates who score well on Ethics are more likely to pass.

STANDARD I · PROFESSIONALISM

I(A) Knowledge of the Law

THE STANDARD

Members and Candidates must understand and comply with all applicable laws, rules, and regulations (including the CFA Institute Code and Standards) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, they must comply with the more strict law, rule, or regulation. Members and Candidates must not knowingly participate or assist in — and must dissociate from — any violation.

Guidance

1. **Most-strict rule wins.** When local law, a host country's law, and the Code and Standards conflict, follow whichever is strictest.
2. **Disassociate from ongoing violations.** First notify your supervisor or compliance. You may also confront the wrongdoer directly. If the activity continues, you must dissociate.
3. **Inaction may be construed as participation.** Simply staying silent and continuing to benefit is not acceptable.
4. **No duty to report** violations to governmental authorities, but this may be appropriate in certain cases (whistleblowing is permitted to protect market integrity).

Recommended Procedures for Compliance

- Stay informed: review applicable laws and the Code/Standards at least annually.
- Review the firm's written compliance procedures regularly.
- Keep current files of applicable statutes, regulations, and professional-conduct rules.
- When in doubt, consult compliance, legal counsel, or your supervisor.

Application Scenarios

VIOLATION

A portfolio manager in Country A works for a firm incorporated in Country B. Country A has no restriction on trading on material nonpublic information; Country B and the Code prohibit it. The manager trades on

COMPLIANCE

An analyst discovers that a colleague is falsifying research to favor an investment-banking client. The analyst first reports it to compliance. When the firm takes no action, the analyst dissociates from the research product and declines to be cited as a co-author.

MNPI and argues "it's legal here." *The strictest standard (the Code) applies.*	

Exam Tip: "Disassociate" at a minimum means refusing to continue work on the tainted project. It does *not* automatically require resignation or reporting to regulators — but staying silent and benefiting is a violation.

STANDARD I · PROFESSIONALISM

I(B) Independence and Objectivity

THE STANDARD

Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. They must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another's independence and objectivity.

Guidance

Modest, token gifts are acceptable. A gift from a *client* (who already pays fees) is less problematic than a gift from an *entity trying to influence future business* (e.g., a company the analyst covers). Anything that could cloud judgment — lavish travel, oversized event tickets, investment banking pressure — must be refused.

Allowed

- Small token gifts (mug, modest meal)
- Gifts from existing clients — but **disclose to employer**
- Client gifts tied to *future* performance require **written consent** from employer in advance
- Accepting issuer-paid research, *if* flat-fee structure and relationship is disclosed

Violates the Standard

- Lavish travel or entertainment from a company being covered
- Bowing to investment-banking pressure for a favorable rating
- Accepting a performance bonus from a client without employer consent
- Performance-linked pay from a covered issuer

Common Conflict Situations

SOURCE OF PRESSURE	PROPER RESPONSE
Buy-side pressure from a large client	Firewall between recommendations and sales; rotate analysts; do not let the client vet the rating
Investment-banking pressure to issue a favorable report	Segregate research from IB; prevent analysts from reporting to IB; base compensation on quality of research, not IB deal flow
Issuer-paid research	Prefer a **flat fee** (not contingent on conclusions) and fully disclose the relationship
Public-company pressure not to downgrade	Rely on facts; conclusions must reflect research

Credit-rating agency conflicts	Establish firewalls between analysts and the issuer paying the fee

VIOLATION — FERRARI TRIP

A sell-side analyst accepts a two-day all-expenses-paid trip (flights, luxury hotel, gala dinner) to a manufacturing plant operated by a company she covers. She issues a "buy" shortly afterward. The travel exceeds a "modest" gift and could compromise objectivity.

COMPLIANCE — PAID FOR OWN TRAVEL

The same analyst attends the plant tour but books flights and hotel at the firm's expense. She accepts only the plant-site meal provided to all attendees. Objectivity is preserved and independence is maintained.

STANDARD I · PROFESSIONALISM

I(C) Misrepresentation

THE STANDARD

Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

Guidance

1. Applies to **oral, written, and electronic** communications (including social media, chat messages, and websites).
2. Do not misrepresent qualifications or credentials, services offered by you or your firm, performance record, or the characteristics of an investment.
3. **No guarantees of return.** You can note that Treasury securities are without default risk, but you cannot guarantee future returns on a risky investment.
4. **Do not omit** information that would materially change a reasonable investor's view.

Plagiarism

Plagiarism = copying someone else's words, ideas, charts, tables, or models without attribution. This covers research notes, spreadsheet templates, slide decks, and "cut-and-paste" sections of reports. You *can* use information from **recognized statistical sources** (e.g., Bloomberg, IMF tables) without attribution. Models created by others require attribution.

Recommended Procedures

- Maintain accurate records of the sources of all research.
- Have each employee list qualifications, services they can provide, and the firm's resources.
- Produce a summary of the firm's methodologies that can be reviewed by compliance.

VIOLATION — COPIED REPORT

An analyst downloads a research piece on a biotech firm from a competing bank's website, lightly edits the wording, puts his firm's logo on it, and distributes it to clients. He also tells a prospective client, "In this

COMPLIANCE — PROPERLY ATTRIBUTED

Same analyst quotes the competing bank's charts but credits them in the footnote, references IMF macro data without citation (recognized statistical source), and states the strategy's *actual* performance including the monthly drawdowns.

strategy we have never had a down year" when the strategy has only been live for 18 months.	

Exam Tip: "I'm not sure, but I heard…" repeated as fact is still misrepresentation. And guaranteeing a *range* of returns on a risky investment is just as wrong as guaranteeing a point value.

STANDARD I · PROFESSIONALISM

I(D) Misconduct · I(E) Competence

I(D) MISCONDUCT — THE STANDARD

Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit, or commit any act that reflects adversely on their professional reputation, integrity, or competence.

Guidance — I(D)

This standard covers conduct that *may not be illegal* but could adversely affect a member's ability to perform professional duties. Examples: lying on a resume, falsifying time sheets, abusing expense accounts, committing fraud or theft.

Personal behaviour unrelated to work is generally **outside** the standard — you can get drunk off the job and commit minor misdemeanours that don't involve fraud, theft, or deceit. Civil disobedience (e.g., protest arrests) is **not** automatically a violation.

I(E) COMPETENCE — THE STANDARD

Members and Candidates must have and maintain the abilities, skills, and knowledge necessary to fulfil their professional responsibilities.

Guidance — I(E)

Needs for complying with this standard vary with a member's duties and may change over time or with new/expanded roles. If you take on a new responsibility (e.g., cover a new asset class), you must get competent in it. **Negative investment outcomes alone do not imply a lack of competence** — the test is whether the member had the skills and knowledge reasonably expected for the role.

VIOLATION — MISCONDUCT

A candidate is convicted of tax fraud on his personal returns. Tax fraud involves deceit and reflects on his integrity as an investment professional — it is a violation of I(D) regardless of whether it happened outside work.

COMPLIANCE — COMPETENCE

A fixed-income manager is asked to take on a small commodities futures sleeve. Before taking the role she completes internal training, reviews curriculum on futures, and pairs with a senior commodities PM for 90 days — becoming competent before acting.

QUIZ 1 · STANDARD I PROFESSIONALISM

Test Your Understanding: Standard I

Q1. A CFA charterholder works in Country X where local law allows a lower disclosure standard than the CFA Code. In handling conflicts of interest, she *must*:

Q2. An analyst's colleague asks her to accept a four-day ski trip plus tickets to a championship game from a company the analyst covers. Accepting:

Q3. Which of the following is *most likely* a violation of Standard I(C) Misrepresentation?

Q4. A CFA candidate pleads guilty to personal income-tax fraud — committed off the job. This:

Q5. An analyst suspects her firm is engaged in illegal activity but reporting to compliance has produced no action. To comply with Standard I(A), she *must*:

STANDARD II · INTEGRITY OF CAPITAL MARKETS

II(A) Material Nonpublic Information

THE STANDARD

Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information.

What Is "Material"? What Is "Nonpublic"?

MATERIAL

Information is **material** if its disclosure would likely affect the security's price, *or* if reasonable investors would want it before making an investment decision. Examples: earnings surprises, major M&A, regulatory actions, new major contracts, bankruptcy, changes in senior management.

NONPUBLIC

Information is **nonpublic** until it has been disseminated to the marketplace. Information given only to analysts is nonpublic until made available to investors generally. Selective disclosure in a private call is still nonpublic.

Mosaic Theory (The Safe Harbor)

Using a combination of **material public information** and **nonmaterial nonpublic information** to reach an investment conclusion is *not* a violation — this is the **mosaic theory**. It is how good fundamental research gets done: industry checks, supply-chain color, management body language in a public event. Each piece is either public or not price-moving on its own; the analyst's synthesis is what adds value.

Recommended Procedures for Compliance

1. **Information barriers ("Chinese walls")** between departments that naturally possess MNPI (investment banking, M&A) and those that trade or research (asset management, retail).
2. **Restricted & watch lists** — a restricted list suspends research and trading in names; a watch list is for internal monitoring.
3. If you accidentally receive MNPI, **do not trade**, notify compliance, and encourage public disclosure by the issuer.
4. Keep detailed research files so mosaic-theory conclusions can be defended.

VIOLATION — TIPPED OFF AT A GOLF GAME

At a charity tournament, a CFO confides in an analyst that his firm will miss quarterly earnings by 40%. The analyst sells the stock short the next morning. She acted on material, nonpublic information — a clear II(A) violation, even though the disclosure was casual.

COMPLIANCE — MOSAIC THEORY

Another analyst visits three independent distributors and the firm's public guidance to conclude the firm is likely to miss earnings. No single data point from the channel checks is material on its own. Publishing the "sell" report is *not* a violation — mosaic theory applies.

Exam Tip: Mosaic-theory questions are common. If an analyst combines **public** + **nonmaterial nonpublic** pieces, it is allowed. If even one piece is **material nonpublic**, the conclusion is tainted and trading is forbidden.

STANDARD II · INTEGRITY OF CAPITAL MARKETS

II(B) Market Manipulation

THE STANDARD

Members and Candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.

Two Flavors of Manipulation

INFORMATION-BASED

Spreading false or misleading rumors about a company to move its stock (a pump-and-dump, or posting fake news on social media to short into). Also: issuing research you do not believe in.

TRANSACTION-BASED

Trading to create a *false impression* of activity — wash trades, painting the tape, cornering a market, or gaining a dominant position to manipulate the price of an asset or a related derivative.

What Is NOT Manipulation

You can execute **large legitimate trades** that move the market, provided the intent is not to mislead. A hedge fund rebalancing, a pension plan taking a sizable position, or an arbitrageur closing out a mispricing all move prices — but none are done with intent to mislead. **Intent** is the hinge.

VIOLATION — PUMP AND DUMP

A trader amasses a position in a thinly traded small cap, posts bullish rumors on several online forums, and sells as retail investors rush in. Both information-based (false rumor) and transaction-based (designed to mislead) manipulation — a clear II(B) violation.

COMPLIANCE — LEGITIMATE LARGE TRADE

A pension fund manager rebalances a $5bn portfolio, which temporarily pushes a mid-cap price 3% higher. The trade is not designed to mislead — it is a standard rebalancing consistent with the IPS. No manipulation.

Exam Tip: "Spreading rumors" on social media — even forwarding someone else's false claim "as a joke" — violates II(B) if the intent (or obvious effect) is market-moving.

STANDARD III · DUTIES TO CLIENTS

III(A) Loyalty, Prudence, and Care

THE STANDARD

Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. They must act for the benefit of their clients and place their clients' interests before their employer's or their own interests.

Guidance

1. Identify **who the client is** — for pension/trust accounts, the client is the *beneficiary*, not the plan sponsor.
2. Manage pools of client assets according to the **terms of the governing documents** (IPS, trust agreement, fund prospectus).
3. Make investment decisions in the context of the **total portfolio**.
4. **Seek best execution** — the combination of trading costs and execution quality that maximizes client value.
5. **Soft dollars** (commissions paid to brokers in exchange for research) must be used only for services that benefit the client.
6. **Vote proxies responsibly** and disclose proxy-voting policies. Routine proxies need not always be voted if cost exceeds benefit, but non-trivial proxies must be voted in clients' interest.

Recommended Procedures

- Keep client assets separate from your own / the firm's assets.
- Submit client transactions through the same (best-execution) process as other client transactions.
- Regularly review compliance with client investment objectives.
- Maintain records of client correspondence, transactions, and proxy-voting decisions.

VIOLATION — CROSS-SUBSIDY

A portfolio manager directs trades to a high-commission broker in exchange for luxury-box seats used for the firm's marketing events. The "soft dollars" are paid with

COMPLIANCE — RESEARCH-FOR-SOFT-DOLLARS

The same PM routes trades through a broker whose research is used to make better stock picks for the same clients. The research directly benefits those clients — permissible use of soft dollars.

client commissions but used to benefit the firm, not the client. Violation of III(A).	

STANDARD III · DUTIES TO CLIENTS

III(B) Fair Dealing

THE STANDARD

Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

Guidance

"Fair" does not mean "equal." Different levels of service are permitted provided: (i) the differences are **disclosed** to all clients and prospects, and (ii) no client is materially disadvantaged. What is prohibited is discriminating *against* clients when disseminating recommendations or taking investment action.

Recommended Procedures — Disseminating Recommendations

- Limit the number of people who know about an upcoming recommendation before publication.
- Shorten the time between decision and dissemination.
- Publish recommendations simultaneously to all clients on the distribution list.
- Establish written procedures; maintain a client list and the type of services each client receives.
- Disclose the firm's allocation procedures in advance.

IPO / Oversubscribed Offering Procedures

Allocations in oversubscribed offerings raise fair-dealing concerns. Best practice:

1. Allocate **pro rata** to all suitable subscribers based on their indicated size.
2. Disclose the firm's allocation policy to clients in advance.
3. Do **not** personally take shares in oversubscribed IPOs (see Standard VI(B) Priority of Transactions).

VIOLATION — FRIENDS FIRST

After deciding to downgrade a large-cap stock, the analyst phones three of her biggest clients the night before the report is released, letting them sell at stale prices. Smaller clients sell later at lower prices. Violation of III(B).

COMPLIANCE — SIMULTANEOUS DISSEMINATION

The firm publishes the downgrade at 7:00 a.m. via a portal all clients access. After publication, the analyst calls her largest clients to answer questions. Calling the largest clients **after** fair dissemination is permissible.

> **Exam Tip:** Differential service levels are OK *if disclosed*. But all clients must have a fair opportunity to act on a recommendation before premium-service clients get further discussion.

STANDARD III · DUTIES TO CLIENTS

III(C) Suitability

THE STANDARD

When in an advisory relationship with a client, Members and Candidates must (1) make reasonable inquiry into a client's investment experience, risk and return objectives, and constraints prior to making recommendations; (2) determine that an investment is suitable to the client's financial situation and consistent with the client's objectives; and (3) judge the suitability of investments in the context of the client's total portfolio. When managing a portfolio to a specific mandate, strategy, or style, they must make investment recommendations consistent with the stated objectives.

Two Regimes

ADVISORY RELATIONSHIP

- Gather client information at the outset.
- Prepare a written **Investment Policy Statement (IPS)**.
- **Update the IPS at least annually** (and after life events).
- Assess suitability in a **total-portfolio context**, not on a single-security basis.
- Consider whether leverage / derivatives are suitable for this client.

FUND / MANDATE MANAGEMENT

- Manage to the **stated mandate** (prospectus / strategy document).
- Suitability is evaluated against the fund's strategy, not an individual investor's IPS.
- Style drift is a violation.

Key IPS Contents

CATEGORY	COMPONENTS
Objectives	Risk tolerance (ability + willingness), return requirement
Constraints	Liquidity, time horizon, taxes, legal/regulatory, unique circumstances
Asset allocation	Strategic allocation ranges; permitted asset classes; rebalancing policy

VIOLATION — STYLE DRIFT

A small-cap value fund manager begins buying large-cap growth names because he expects them to outperform. Even if he is right, he has violated III(C): he must invest consistent with the stated mandate, not his personal market view.

COMPLIANCE — IPS UPDATE TRIGGERS REVIEW

An adviser learns a retired client has received a $2m inheritance. The adviser updates the IPS (higher return capacity, possibly longer horizon) and rebalances the portfolio to match the revised objectives and constraints.

STANDARD III · DUTIES TO CLIENTS

III(D) Performance Presentation · III(E) Confidentiality

III(D) — THE STANDARD

When communicating investment performance information, Members and Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.

Guidance — III(D)

1. **Do not misstate** performance — no cherry-picked accounts, favorable periods, or excluded terminations.
2. **Do not imply** that past results will be repeated.
3. Make **detailed information available on request**.
4. GIPS compliance is a strong way to meet the spirit of III(D), though not required.

III(E) — THE STANDARD

Members and Candidates must keep information about current, former, and prospective clients confidential unless: (1) the information concerns illegal activities on the part of the client; (2) disclosure is required by law; or (3) the client or prospective client permits disclosure of the information.

Guidance — III(E)

The duty extends to **former** and **prospective** clients, not just current clients. If confidential information concerns *illegal activity*, in some jurisdictions the member may be required by law to report it. A member may always provide confidential information **to CFA Institute** as part of a Professional Conduct Program investigation — this is not a breach of III(E).

Three Exceptions to Confidentiality

Required by law

Subpoena, court order

Illegal activity

By the client

Client permission

Explicit consent

VIOLATION — CHERRY-PICKED TRACK RECORD

A PM's marketing deck shows composite returns "net of fees" but quietly excludes two accounts that fired the

COMPLIANCE — RESPONDING TO CFA INQUIRY

A member receives a letter from CFA Institute Professional Conduct about a former client. Responding

firm after a 30% drawdown. The survivorship-biased track record is misleading — III(D) violation.	fully and providing client information *is permitted* under III(E) — it is an explicit exception.

QUIZ 2 · STANDARDS II & III

Test Your Understanding: Capital Markets & Duties to Clients

Q6. An analyst combines publicly available financial filings with contacts at several of a firm's distributors to conclude the firm will miss earnings. None of the distributor contacts knows anything material nonpublic about the issuer. Her short recommendation based on this analysis is:

Q7. An investment-banking client tells a small trader to place and cancel rapid-fire orders in a thinly traded stock to create the appearance of demand. Executing this:

Q8. A PM uses a portion of soft dollars from a high-commission broker to subscribe to macro research the firm uses across all accounts. This use:

Q9. Before publishing a downgrade, an analyst calls her three largest institutional clients to give them a heads-up so they can sell. Smaller clients see the downgrade an hour later. This:

Q10. The manager of a small-cap value fund, believing mega-cap tech will rally, shifts 15% of the portfolio into large-cap tech names. This:

Q11. A member is contacted by CFA Institute Professional Conduct staff regarding a client complaint. Responding with confidential client records:

STANDARD IV · DUTIES TO EMPLOYERS

IV(A) Loyalty

THE STANDARD

In matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer.

Three Common Fact Patterns

Independent practice

Before starting outside work, notify the employer in writing of (i) the type of services provided, (ii) the expected duration, and (iii) the expected compensation. Do not proceed without the employer's consent.

Leaving an employer

Until resignation is effective, act in the employer's best interest — no soliciting clients or colleagues for the new firm. Do not take records, files, client lists, models, or research; knowledge in your head is yours.

Whistleblowing

Permitted only to protect clients or the integrity of capital markets — never for personal gain or revenge. An employee may break confidentiality in that narrow circumstance without violating IV(A).

What You CAN Do

- Use experience and general knowledge acquired at the former employer.
- Remember client names (simple recall is not "taking records").
- Prepare for a new position on **personal time**, provided the prep does not compete with current duties.
- Recruit at your new firm *after* resignation is effective.

VIOLATION — TAKING MODELS ON THE WAY OUT

A quantitative analyst copies proprietary models, backtests, and client lists to a personal drive the week before resignation and uses them at a competitor. Taking firm property — even intellectual property — violates IV(A).

COMPLIANCE — CLEAN DEPARTURE

An equity PM resigns on Friday. He does no prospecting until his employment end date. From memory (and LinkedIn), he reconnects with former contacts at the new firm. No records, files, or digital copies were taken. Permissible.

STANDARD IV · DUTIES TO EMPLOYERS

IV(B) Additional Compensation · IV(C) Responsibilities of Supervisors

IV(B) — THE STANDARD

Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with — or might reasonably be expected to create a conflict of interest with — their employer's interest, unless they obtain written consent from all parties involved.

Guidance — IV(B)

"Compensation" is broad — direct payment, bonuses, stock, travel, anything of value. "Written consent" can be email. Classic example: a client offers a hedge-fund PM a bonus if the portfolio beats its benchmark by 200 bps next year. The PM must get the employer's advance written consent before accepting.

IV(C) — THE STANDARD

Members and Candidates 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.

Guidance — IV(C)

1. A supervisor's duty is to **both prevent and detect** violations — written procedures alone are not enough; they must be enforced.
2. If compliance procedures are **inadequate**, decline in writing to accept supervisory responsibility until they are fixed.
3. When a violation is detected, promptly investigate, suspend the employee's activity as needed, and increase supervision.

Recommended Procedures — Supervisors

- Build a compliance program distributed in writing to all covered employees.
- Designate a compliance officer; establish escalation procedures.
- Periodically audit for compliance; track and resolve complaints.
- Enforce consequences consistently — inconsistent discipline itself undermines compliance.

VIOLATION — IGNORED WARNINGS

A supervisor receives three separate complaints that a trader may be front-running client orders. The supervisor issues a verbal warning but does not investigate or limit trading. When the front-running later surfaces, the supervisor has violated IV(C): supervisors must detect *and* act.

COMPLIANCE — DECLINING RESPONSIBILITY

A newly appointed supervisor reviews the compliance manual and finds it outdated and under-enforced. She tells senior management in writing that she cannot accept supervisory duty until the program is strengthened. This is the IV(C)-compliant action.

STANDARD V · INVESTMENT ANALYSIS, RECOMMENDATIONS, AND ACTIONS

V(A) Diligence · V(B) Communication · V(C) Records

V(A) DILIGENCE AND REASONABLE BASIS — THE STANDARD

Members and Candidates must (1) exercise diligence, independence, and thoroughness in analyzing investments, making recommendations, and taking actions; and (2) have a reasonable and adequate basis, supported by appropriate research and investigation, for any analysis, recommendation, or action.

Guidance — V(A)

1. Make reasonable efforts to cover **all relevant issues** before forming a recommendation.
2. **Review the quality of third-party research** before relying on it. You are still responsible even if the underlying work was done by someone else.
3. For **group research**, a member need not personally agree with every opinion — but the group conclusion must have a reasonable basis.
4. For **quantitative models**, consider what happens when inputs fall *outside* the normal range. Stress tests matter.
5. You **can be wrong** — as long as you had a reasonable basis at the time of the recommendation.

V(B) COMMUNICATION WITH CLIENTS AND PROSPECTIVE CLIENTS — THE STANDARD

Members and Candidates must (1) disclose to clients and prospective clients the basic format and general principles of the investment processes they use; (2) promptly disclose any material changes; (3) identify limitations and risks inherent to the investment; and (4) distinguish between fact and opinion.

Guidance — V(B)

- Tell clients **what services** will and will not be provided, and the costs.
- Describe the **investment process**, its risks, and its limitations (e.g., "this strategy uses a two-factor quant model that can fail in regime shifts").
- Include **basic characteristics** of the security recommended (e.g., sector, liquidity).
- Inform clients of any **change** in investment processes.
- Distinguish between **fact** and **opinion** — "our price target of $100''(opinion)versus''trailingEPSwas$4.20" (fact).

V(C) RECORD RETENTION — THE STANDARD

> Members and Candidates must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients.

Guidance — V(C)

Maintain records that support the research, the rationale for conclusions, and the actions taken. **Records are the firm's property** and cannot be taken when a member leaves without the firm's consent. If there is no local regulation or firm policy, CFA Institute recommends a retention period of **at least 7 years**.

VIOLATION — COPY-AND-PASTE THESIS

An analyst publishes a buy recommendation on a biotech after reading one sell-side report and a press release. He does not read the clinical-trial data, does not evaluate the sell-side firm's reputation, and does not flag risks. This is a V(A) violation regardless of whether the recommendation happens to be correct.

COMPLIANCE — REASONABLE BASIS, RECORD-KEPT

A second analyst builds her thesis on primary research: trial readouts, competitor pipeline, interviews with two independent doctors, and a DCF model. She keeps all source files for 7+ years, clearly separates facts from opinion in the report, and flags the model's regime assumptions. Compliant with V(A), V(B), and V(C).

QUIZ 3 · STANDARDS IV & V

Test Your Understanding: Duties to Employers + Analysis

Q12. A portfolio manager plans to teach a part-time night class on investing. Which action best complies with IV(A)?

Q13. A client offers the PM a performance bonus if the portfolio beats its benchmark next year. The PM may accept this bonus only if:

Q14. A new branch head discovers the office's compliance procedures are outdated and ineffective. Under IV(C), he *should*:

Q15. An analyst bases her buy recommendation largely on a white paper from an external research firm. To comply with V(A), she should *most likely*:

Q16. According to V(C), in the absence of regulatory or firm-specific requirements, investment records should be retained for at least:

STANDARD VI · CONFLICTS OF INTEREST

VI(A) Disclosure · VI(B) Priority of Transactions · VI(C) Referral Fees

VI(A) DISCLOSURE OF CONFLICTS — THE STANDARD

Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Disclosures must be prominent, in plain language, and communicated effectively.

Guidance — VI(A)

1. **Avoid conflicts** where reasonably possible; otherwise, **disclose fully**.
2. To **clients and prospects**, disclose: firm-issuer relationships, investment-banking relationships, broker-dealer market-making activities, significant stock ownership, board service.
3. To **employers**, disclose: ownership of stock analyzed/recommended, board participation, financial and other pressures that may influence decisions.
4. Use **plain language**. Burying a conflict in dense fine print does not discharge the duty.

VI(B) PRIORITY OF TRANSACTIONS — THE STANDARD

Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner.

Guidance — VI(B)

- **Client → Employer → Personal.** That is the transaction-priority order.
- "Beneficial owner" means you have direct or indirect personal interest in the securities.
- **No front-running.** Never trade ahead of a client recommendation or order.
- **Fee-paying family accounts** that are client accounts must be treated like any other client account — no worse, no better.
- Do **not** take shares in **oversubscribed IPOs** for your own account.

VI(C) REFERRAL FEES — THE STANDARD

Members and Candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from — or paid to — others for the recommendation of products or services.

Guidance — VI(C)

Disclosure of referral fees helps clients evaluate any possible partiality in the recommendation of a service and to assess the *full cost* of the service. Disclosure must be made **before** entering into any formal agreement for services and must include the **nature of the consideration** (cash, flat fee, % of assets, soft dollars, etc.).

VIOLATION — FRONT-RUNNING + HIDDEN REFERRAL

A PM sees a large client is about to place a buy order in an illiquid stock. She buys the stock for her personal account first, then executes the client order at the now-higher price. She also recommends a custodian that secretly pays her a 25 bp kickback. Violations of VI(B) (priority / front-running) and VI(C) (undisclosed referral fee).

COMPLIANCE — DISCLOSED REFERRAL + PRIORITY RULES

Same PM sets a personal-account pre-clearance rule: she can trade only 48 hours *after* a client order is filled. She discloses in writing the 25 bp referral arrangement to prospective clients *before* signing them up, allowing them to weigh the cost. Both VI(B) and VI(C) satisfied.

Exam Tip: On VI(B), the mantra is **C > E > P** (Client → Employer → Personal). Family accounts that pay fees sit at the Client level.

STANDARD VII · RESPONSIBILITIES AS MEMBER/CANDIDATE

VII(A) CFA Institute Programs · VII(B) Reference to CFA

VII(A) CONDUCT AS PARTICIPANTS IN CFA INSTITUTE PROGRAMS — THE STANDARD

Members and Candidates must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation, or the integrity, validity, or security of CFA Institute programs.

Guidance — VII(A)

1. **Don't cheat on exams.** Don't bring unauthorized materials. Don't continue writing after time is called.
2. Don't reveal **exam questions**, topics tested or not tested, or any confidential exam content.
3. Don't use a CFA Institute / Society position to further personal or professional goals improperly.
4. Don't misrepresent the Professional Development Program or the Professional Conduct Statement.

VII(B) REFERENCE TO CFA INSTITUTE, THE CFA DESIGNATION, AND THE CFA PROGRAM — THE STANDARD

When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, Members and Candidates must not misrepresent or exaggerate the meaning or implications of membership, the designation, or candidacy.

Three Topics in VII(B)

Membership

To be an active member you must (i) complete the **Professional Conduct Statement** annually and (ii) pay **membership dues** annually. Failure = inactive status — and you cannot claim active membership.

Using the designation

Use "CFA" or "Chartered Financial Analyst" as an **adjective after the name**, never as a noun. Don't bold "CFA" or put it in a larger font than your name. Don't imply the designation produces better results.

Candidacy / Program

You may say you *passed* Level I/II/III. There is no such thing as a "CFA Level I" (partial designation). You can describe the exam's nature and requirements to earn the right to use the designation.

Proper vs Improper Use Examples

IMPROPER	PROPER

"I am a CFA."	"I am a CFA charterholder."
"I am a CFA Level II."	"I have passed Level II of the CFA Program."
"**CFA** charterholders deliver better returns."	"I am a CFA charterholder." (no implied performance superiority)
"Jane Smith, **CFA**" (CFA bolder/bigger than the name)	"Jane Smith, CFA" (equal visual weight)
"@SuperInvestorCFA" (pseudonym hiding identity)	"@JaneSmithCFA" (identified charterholder)

VIOLATION — PARTIAL DESIGNATION

A candidate who passed Level I adds "CFA Level I" to a LinkedIn headline and says in a pitch deck, "Holders of the CFA designation consistently outperform." Both pieces violate VII(B) — there's no partial designation, and claiming superior results is prohibited.

COMPLIANCE — ACCURATE REFERENCE

The same candidate updates her profile: "CFA Level III Candidate" (valid: registered for next exam), "Passed Levels I and II of the CFA Program," and describes the CFA Program's requirements accurately. Compliant with VII(B).

Exam Tip: Only say "CFA candidate" if you are **registered for the next exam or awaiting results**. If you took Level III last August and are waiting for results, you can still say "candidate." If you failed and haven't re-registered, you cannot.

QUIZ 4 · STANDARDS VI & VII

Test Your Understanding: Conflicts & Responsibilities

Q17. A PM's brother holds a fee-paying account at the firm. The PM *must* treat this account:

Q18. An adviser receives a 30 bp referral fee from a custodian she recommends to clients. To comply with VI(C), she must disclose:

Q19. A candidate posts on X (Twitter): "Just sat Level II — item set 3 was brutal, all ethics. Hope they cut the curve." This:

Q20. Which of the following business-card formats most likely complies with VII(B)?

Q21. A research analyst sits on the board of a private company whose publicly listed competitor he covers. To comply with VI(A), he *must*:

MODULE COMPLETE

Your Scorecard

0 / 21

LM03 Key Takeaways — Exam-Ready Cheat Sheet

Standard I — Professionalism

1. **I(A) Knowledge of Law.** Follow the stricter rule. First notify supervisor/compliance; if unresolved, **dissociate**. Inaction = participation.
2. **I(B) Independence.** Modest gifts OK. Client gifts for future performance require **written consent** from employer.
3. **I(C) Misrepresentation.** No guarantees of return, no plagiarism, no omissions. Recognized statistical sources = no attribution needed.
4. **I(D) Misconduct / I(E) Competence.** No fraud, theft, deceit — on or off the job. Keep skills current as roles evolve.

Standard II — Integrity of Capital Markets

5. **II(A) MNPI.** Don't trade on material nonpublic info or tip others. **Mosaic theory** (public + nonmaterial nonpublic) is safe.
6. **II(B) Market Manipulation.** No information-based or transaction-based manipulation. Intent to mislead is the hinge — legitimate large trades are fine.

Standard III — Duties to Clients

7. **III(A) Loyalty/Prudence/Care.** Client interest first. Best execution. Soft dollars must benefit the client. Vote non-trivial proxies.

8. **III(B) Fair Dealing.** "Fair" ≠ "equal" — tiered service OK with disclosure, but never tiered access to a recommendation.
9. **III(C) Suitability.** IPS gathered at outset, **updated ≥ annually**. Total-portfolio context. No style drift when managing to a mandate.
10. **III(D) Performance.** Fair, accurate, complete — no cherry picks, no implied repeatability.
11. **III(E) Confidentiality.** Extends to former and prospective clients. Three exceptions: illegal activity, required by law, client consent. CFA Institute inquiries are also an exception.

Standard IV — Duties to Employers

12. **IV(A) Loyalty.** Independent practice: notify employer (services, duration, comp) in writing. Don't take records when leaving. Whistleblowing allowed to protect clients/markets — never for personal gain.
13. **IV(B) Additional Comp.** Written consent from **all parties**.
14. **IV(C) Supervisor.** Prevent *and* detect. If procedures are inadequate, decline supervisory role in writing.

Standard V — Analysis, Recommendations & Actions

15. **V(A) Diligence/Reasonable Basis.** Review third-party research. You can be wrong if you had a reasonable basis.
16. **V(B) Communication.** Disclose process, risks, costs; distinguish fact vs. opinion.
17. **V(C) Records.** CFA recommends **7-year retention** absent other rules. Records belong to the firm.

Standard VI — Conflicts of Interest

18. **VI(A) Disclosure.** Avoid where possible; otherwise disclose fully, in plain language, prominently.
19. **VI(B) Priority.** Client > Employer > Personal. No front-running. No personal IPO participation in oversubscribed deals. Fee-paying family = treated as clients.
20. **VI(C) Referral Fees.** Disclose nature of consideration to employer, clients, and prospects *before* the agreement.

Standard VII — Responsibilities as Member/Candidate

21 **VII(A) CFA Programs.** No cheating. No disclosing exam content — including topics tested.

22 **VII(B) References.** Complete PCS and pay dues annually. "CFA" is an adjective after the name — never a noun, never bigger/bolder than the name, no partial designation. No implied performance superiority.

Last-Minute Exam Checklist

Stricter rule wins (I(A)) · **Modest gifts only**, disclose to employer (I(B))

No guarantees, no plagiarism (I(C)) · **Integrity-reflecting conduct** even off work (I(D))

Mosaic = public + nonmaterial nonpublic (II(A)) · **Intent to mislead** = manipulation (II(B))

Client first (III(A)) · **Tiered service OK, tiered recommendation NOT** (III(B))

IPS annually · **Mandate first for funds** (III(C)) · **Fair/accurate/complete** (III(D))

Exceptions to confidentiality: law · illegal activity · consent · CFA Institute (III(E))

Don't take records when leaving (IV(A)) · **Written consent all parties** (IV(B))

Supervisors prevent AND detect (IV(C)) · **7 years** records retention (V(C))

Client > Employer > Personal (VI(B)) · **Disclose referral fees** before engagement (VI(C))

CFA is an adjective after the name — same weight, no partial designation (VII(B))

Step 1 of 21