

CFA – Level 1, 2 & 3

ETHICS

The following examples are based on more than 600 examples and questions. For every standard, various situations are classified as 'Violation' and 'Not Violation'. Please note that the following depends on the way the question and case has been presented. Hence please practice well and add your notes to the following reference material.

1. Professionalism:

A. Knowledge of the law:

Violations:

- Doing something allowed by local laws overseas but not CFA institute standards.
- Knowingly participating or assisting in unethical activity done by others.

Not violations:

- Informing supervisors/firm's compliance department for an appropriate action to be taken.
- Reporting a legal violation to govt. or regulatory official is appropriate but not always required.
- Instances where the supervisor believes that an employee has violated the written policies regarding trading in personal accounts, the supervisor then should limit the trading activity and increase monitoring of the employee's trades.

Note: follow the strictest law of the following:

- Where member resides
- Where member does business
- Code & standards

B. Independence & Objectivity:

Violations:

- Yielding to pressure from other departments.
- Accepting expensive gifts & offers and using them for their own business marketing.
- Allocation of shares of oversubscribed IPO to personal accounts.
- Following instructions without using own judgment.
- Accepting Fee for an issuer pay research report, based on the conclusion of the report.
- Accepting tickets of a sold out concert as they have significant material value.
- Gifts from entities like brokers to use their services
- Issuing recommendations as per the instructions of supervisor and not based on independent judgment.
- Accepting any form of expensive gifts.

Not violations:

- Independently research credit ratings by agencies to evaluate their soundness.
- Issuer paid research if conclusion is unbiased, compensation disclosed to employee & compensation preferably in the form of a flat fee without regard to the conclusion.
- Accepting gifts from clients after disclosure to the employer.
 - -for past performance – disclosure
 - -for future performance – written permission
- Paying travel expenses or arrangements for visit to remote locations.
- Not disclosing about gifts to other clients in case the gift was not based on future performance, (i.e. gifts based on future performance needs to be disclosed to other clients).
- Subscription of IPO based on prospectus and not insider information
- Modest gifts from clients.(nominal value)
- Getting bonus based on performance by employer.
- Gift received after the opinion has been given since it cannot affect judgment now.

C. Misrepresentation:

Violation:

- No specific reference to source of information.
- Citing assurance of consistency in future performance based on past. Ex: “we have outperformed in past & will continue to do so” , “Continue to benefit clients”, “Generate future results”

- Data taken from any source to support one's own investigation requires source citing.
- Not giving credit to same one else's innovative thinking or idea.
- Claiming 3rd party research as own.
- Misrepresenting an analyst's qualification.
- Using someone else's work & not acknowledging the same.
- Statement of guarantee
- Plagiarism
- Copying proprietary information without authorization of owner.

Not Violations

- Unintentional error while preparing material
- Informing clients of the guarantee of products built into this structure. Ex senior tranche of CDO has more credit standing than junior.
- Using information from recognized financial/ statistical data & reporting without citing sources. Ex: US Treasury website.
- Stating that US Treasury fund contains "guaranteed securities".
- Mentioned "we provide all services" and assist clients with financial & investigating services & making arrangements for services not given in-house.

D. Misconduct:

Violations:

- Being intoxicated while making financial decisions.
- Including receipt that is not part of company trip as expense.
- Being dishonest, altering facts of a situation.
- Neglecting to perform due diligence when required as it is a professional obligation.
- Reporting to CFA institute to settle disputes unrelated to professional ethics.
- Stating vague statements about a company's financial conditions to mislead investors.

Not Violations:

- Being arrested for non-violent protest supporting personal beliefs; Civil disobedience.
- Violation of law that does not reflect on member's honesty, integrity or competence.
- Working as a bar tender part-time

Note: Firm should adopt code of ethics informing employees of violations & consequences

2. Integrity of capital markets:

A. Material nonpublic information:

Violations:

- Using material nonpublic information
- Meeting for analysts, not for general public- Any information given here cannot be used for Client or Personal A/C.
- Contacted internal counsel before planning trade based on material nonpublic information
- Failure to prevent transfer of material nonpublic info to others in a firm.
- Trading on insider information.
- Trading on stock based on advance copy of stock recommendation received.
- CFO tells analyst that earnings may fall below his estimates. Analyst changes recommendation to 'sell'.
- CFA overhears information and tells her senior but does not trade- Violation because others might act on it.

Note: "Material nonpublic information – can't trade, recommend or disclose."

- Receiving information from friends in previous company in chat rooms (online).
- Few people hearing the information along with you doesn't make it public information. Thus one cannot trade on the same.
- Urging another person to accept shares based on insider information one possesses.
- Using material non-public information & using public information to cover up for it.
- Analyst working in investment banking division & sharing information with colleagues.

Note: One should not act or cause others to act but should urge disclosure to public at large.

Not Violations:

- Mosaic theory - non material nonpublic + material public, own analysis etc.
- One should keep detailed documents of one's own analysis to prove the same.
- Information could be material nonpublic but if the source is unreliable, then using it is not a violation.

Ex: Doctor tells you Company A may be taken over by Company B.

B. Market Manipulation:

Violations:

- Intentional misleading or manipulation of price or data.
- Spreading false rumors to induce trading
- Creating price volatility artificially
- Manipulating participants by creating artificial liquidity.
- Posting false information on social media to increase/ decrease price.
- Simultaneous buying & selling of its subsidiaries, citing volume as evidence of market liquidity.
- Manipulating options transactions to drive up prices.
- Generating false trading volumes so as to sell left over shares in future.
- Giving 'buy' recommendation and then selling client shares when prices have gone up due to the recommendation.
- Giving a company less number of shares than what it has subscribed, only to get that company's goodwill attached. This goodwill will help to increase demand of unsubscribed shares.

Not Violation:

- Low cost transactions through competitive advantage.
- Hedging any potential loss from a decline in price of a stock prior to completion of the sale transaction.
- Transactions meant for minimizing tax liabilities.
- Trading strategies used to benefit investors. (May not be manipulation – Sell Call and Buy Stock)
- Arbitrage opportunities between stock and options.
- Prices may change due to exploiting of arbitrage opportunities.

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