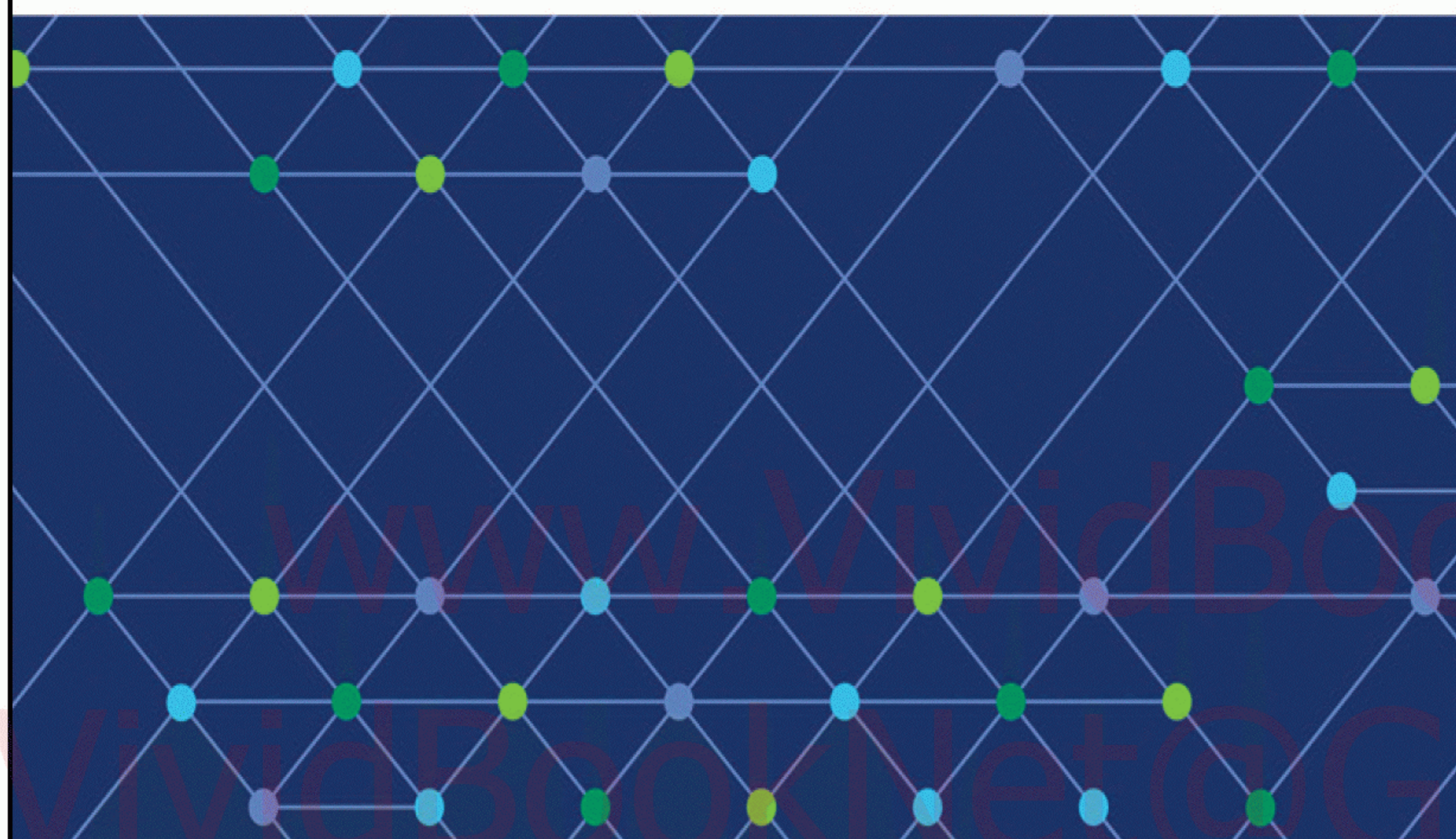




# ETHICAL AND PROFESSIONAL STANDARDS, QUANTITATIVE METHODS, AND ECONOMICS



CFA® Program Curriculum  
2019 • LEVEL II • VOLUME 1



# **ETHICAL AND PROFESSIONAL STANDARDS, QUANTITATIVE METHODS, AND ECONOMICS**

[www.VividBook.org](http://www.VividBook.org)  
[VividBookNet@Gmail.com](mailto:VividBookNet@Gmail.com)



© 2018, 2017, 2016, 2015, 2014, 2013, 2012, 2011, 2010, 2009, 2008, 2007, 2006 by CFA Institute. All rights reserved.

This copyright covers material written expressly for this volume by the editor/s as well as the compilation itself. It does not cover the individual selections herein that first appeared elsewhere. Permission to reprint these has been obtained by CFA Institute for this edition only. Further reproductions by any means, electronic or mechanical, including photocopying and recording, or by any information storage or retrieval systems, must be arranged with the individual copyright holders noted.

CFA<sup>®</sup>, Chartered Financial Analyst<sup>®</sup>, AIMR-PPS<sup>®</sup>, and GIPS<sup>®</sup> are just a few of the trademarks owned by CFA Institute. To view a list of CFA Institute trademarks and the Guide for Use of CFA Institute Marks, please visit our website at [www.cfainstitute.org](http://www.cfainstitute.org).

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

All trademarks, service marks, registered trademarks, and registered service marks are the property of their respective owners and are used herein for identification purposes only.

ISBN 978-1-946442-13-0 (paper)

ISBN 978-1-946442-37-6 (ebk)

[www.VividBook.org](http://www.VividBook.org)  
[VividBookNet@Gmail.com](mailto:VividBookNet@Gmail.com)



---

# TABLE OF CONTENTS

- Title Page
- Copyright Page
- Table of Contents
- How to Use the CFA Program Curriculum
  - Curriculum Development Process
  - Organization of the Curriculum
  - Features of the Curriculum
    - Required vs. Optional Segments [OPTIONAL]
    - Practice Problems/Solutions
    - Glossary and Index
    - LOS Self-Check
    - Source Material
  - Designing Your Personal Study Program
    - Create a Schedule
    - CFA Institute Practice Questions
    - CFA Institute Mock Exams
    - Preparatory Providers
  - Feedback
- Ethical and Professional Standards
  - Study Sessions
  - Topic Level Learning Outcome
- Study Session 1. Ethical and Professional Standards (1)
  - Reading Assignments
  - Reading 1. Code of Ethics and Standards of Professional Conduct
    - Learning Outcomes
    - Preface
      - Evolution of the CFA Institute Code of Ethics and Standards of Professional Conduct
      - Standards of Practice Handbook*
      - Summary of Changes in the Eleventh Edition
      - CFA Institute Professional Conduct Program
      - Adoption of the Code and Standards
      - Acknowledgments
    - Ethics and the Investment Industry
      - Why Ethics Matters
    - CFA Institute Code of Ethics and Standards of Professional Conduct
      - Preamble
      - The Code of Ethics
      - Standards of Professional Conduct
  - Reading 2. Guidance for Standards I–VII
    - Learning Outcomes
    - Standard I: Professionalism
      - Standard I(A) Knowledge of the Law
        - Guidance
        - Recommended Procedures for Compliance
        - Application of the Standard
      - Standard I(B) Independence and Objectivity
        - Guidance



Recommended Procedures for Compliance  
Application of the Standard  
Standard I(C) Misrepresentation  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard I(D) Misconduct  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard II: Integrity of Capital Markets  
Standard II(A) Material Nonpublic Information  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard II(B) Market Manipulation  
Guidance  
Application of the Standard  
Standard III: Duties to Clients  
Standard III(A) Loyalty, Prudence, and Care  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard III(B) Fair Dealing  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard III(C) Suitability  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard III(D) Performance Presentation  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard III(E) Preservation of Confidentiality  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard IV: Duties to Employers  
Standard IV(A) Loyalty  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard IV(B) Additional Compensation Arrangements  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard IV(C) Responsibilities of Supervisors  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard V: Investment Analysis, Recommendations, and Actions



Standard V(A) Diligence and Reasonable Basis  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard V(B) Communication with Clients and Prospective Clients  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard V(C) Record Retention  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard VI: Conflicts of Interest  
Standard VI(A) Disclosure of Conflicts  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard VI(B) Priority of Transactions  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard VI(C) Referral Fees  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Standard VII: Responsibilities as a CFA Institute Member or CFA  
Candidate  
Standard VII(A) Conduct as Participants in CFA Institute Programs  
Guidance  
Application of the Standard  
Standard VII(B) Reference to CFA Institute, the CFA Designation,  
and the CFA Program  
Guidance  
Recommended Procedures for Compliance  
Application of the Standard  
Practice Problems  
Solutions

Study Session 2. Ethical and Professional Standards (2)  
Reading Assignments  
Reading 3. **Application of the Code and Standards**  
Learning Outcomes  
Introduction  
1. Edvard Stark  
Duties to Clients  
Duties to Employers  
Investment Analysis, Recommendations, and Actions  
Conflicts of Interest  
2. Subath Agarway  
Professionalism  
Conflicts of Interest  
3. Peter Sherman  
Loyalty to One's Employer  
Solicitation of Clients and Prospects



	Misappropriation of Employer Property
	Disclosure of Additional Compensation and Conflicts
4.	Preston Partners
	Responsibilities to Clients and Interactions with Clients
	Allocation of Trades
	Responsibilities of Supervisors
5.	Super Selection
	Responsibilities of Supervisors
	Employees and the Employer/Supervisor
	Reasonable Basis
	Duties to Clients
	Investment Recommendations and Actions
	Priority of Transactions
Reading 4.	Trade Allocation: Fair Dealing and Disclosure
	Learning Outcomes
Reading 5.	Changing Investment Objectives
	Learning Outcomes
Quantitative Methods	
	Study Session
	Topic Level Learning Outcome
Study Session 3.	Quantitative Methods
	Reading Assignments
Reading 6.	Fintech in Investment Management
	Learning Outcomes
	1. Introduction
	2. What Is Fintech?
	3. Big Data
	3.1. Sources of Big Data
	3.2. Big Data Challenges
	4. Advanced Analytical Tools: Artificial Intelligence and Machine Learning
	4.1. Types of Machine Learning
	5. Data Science: Extracting Information from Big Data
	5.1. Data Processing Methods
	5.2. Data Visualization
	6. Selected Applications of Fintech to Investment Management
	6.1. Text Analytics and Natural Language Processing
	6.2. Robo-Advisory Services
	6.3. Risk Analysis
	6.4. Algorithmic Trading
	7. Distributed Ledger Technology
	7.1. Permissioned and Permissionless Networks
	7.2. Applications of Distributed Ledger Technology to Investment Management
	Summary
	Practice Problems
	Solutions
Reading 7.	Correlation and Regression
	Learning Outcomes
	1. Introduction
	2. Correlation Analysis
	2.1. Scatter Plots
	2.2. Correlation Analysis
	2.3. Calculating and Interpreting the Correlation Coefficient



- 2.4. Limitations of Correlation Analysis
- 2.5. Uses of Correlation Analysis
- 2.6. Testing the Significance of the Correlation Coefficient
- 3. Linear Regression
  - 3.1. Linear Regression with One Independent Variable
  - 3.2. Assumptions of the Linear Regression Model
  - 3.3. The Standard Error of Estimate
  - 3.4. The Coefficient of Determination
  - 3.5. Hypothesis Testing
  - 3.6. Analysis of Variance in a Regression with One Independent Variable
  - 3.7. Prediction Intervals
  - 3.8. Limitations of Regression Analysis

Summary

References

Practice Problems

Solutions

## Reading 8. Multiple Regression and Machine Learning

Learning Outcomes

- 1. Introduction
- 2. Multiple Linear Regression
  - 2.1. Assumptions of the Multiple Linear Regression Model
  - 2.2. Predicting the Dependent Variable in a Multiple Regression Model
  - 2.3. Testing whether All Population Regression Coefficients Equal Zero
  - 2.4. Adjusted  $R^2$
- 3. Using Dummy Variables in Regressions
- 4. Violations of Regression Assumptions
  - 4.1. Heteroskedasticity
  - 4.2. Serial Correlation
  - 4.3. Multicollinearity
  - 4.4. Heteroskedasticity, Serial Correlation, Multicollinearity: Summarizing the Issues
- 5. Model Specification and Errors in Specification
  - 5.1. Principles of Model Specification
  - 5.2. Misspecified Functional Form
  - 5.3. Time-Series Misspecification (Independent Variables Correlated with Errors)
  - 5.4. Other Types of Time-Series Misspecification
- 6. Models with Qualitative Dependent Variables
- 7. Machine Learning
  - 7.1. Major Focuses of Data Analytics
  - 7.2. What Is Machine Learning?
  - 7.3. Types of Machine Learning
  - 7.4. Machine Learning Algorithms
  - 7.5. Supervised Machine Learning: Training

Summary

References

Practice Problems

Solutions

## Reading 9. Time-Series Analysis

Learning Outcomes



1. Introduction to Time-Series Analysis
  2. Challenges of Working with Time Series
  3. Trend Models
    - 3.1. Linear Trend Models
    - 3.2. Log-Linear Trend Models
    - 3.3. Trend Models and Testing for Correlated Errors
  4. Autoregressive (AR) Time-Series Models
    - 4.1. Covariance-Stationary Series
    - 4.2. Detecting Serially Correlated Errors in an Autoregressive Model
    - 4.3. Mean Reversion
    - 4.4. Multiperiod Forecasts and the Chain Rule of Forecasting
    - 4.5. Comparing Forecast Model Performance
    - 4.6. Instability of Regression Coefficients
  5. Random Walks and Unit Roots
    - 5.1. Random Walks
    - 5.2. The Unit Root Test of Nonstationarity
  6. Moving-Average Time-Series Models
    - 6.1. Smoothing Past Values with an  $n$ -Period Moving Average
    - 6.2. Moving-Average Time-Series Models for Forecasting
  7. Seasonality in Time-Series Models
  8. Autoregressive Moving-Average Models
  9. Autoregressive Conditional Heteroskedasticity Models
  10. Regressions with More than One Time Series
  11. Other Issues in Time Series
  12. Suggested Steps in Time-Series Forecasting
- Summary
- References
- Practice Problems
- Solutions

Reading 10. Excerpt from “Probabilistic Approaches: Scenario Analysis, Decision Trees, and Simulations”

Learning Outcomes

1. Introduction
2. Simulations
  - 2.1. Steps in Simulation
  - 2.2. An Example of a Simulation
  - 2.3. Use in Decision Making
  - 2.4. Simulations with Constraints
  - 2.5. Issues
  - 2.6. Risk-Adjusted Value and Simulations
3. An Overall Assessment of Probabilistic Risk Assessment Approaches
  - 3.1. Comparing the Approaches
  - 3.2. Complement or Replacement for Risk-Adjusted Value
  - 3.3. In Practice
4. Conclusion

Economics

Study Session

Topic Level Learning Outcome

Study Session 4. Economics

Reading Assignments

Reading 11. Currency Exchange Rates: Understanding Equilibrium Value

Learning Outcomes



1. Introduction
2. Foreign Exchange Market Concepts
  - 2.1. Arbitrage Constraints on Spot Exchange Rate Quotes
  - 2.2. Forward Markets
  - 2.3. The Mark-to-Market Value of a Forward Contract
3. A Long-Term Framework for Exchange Rates
  - 3.1. International Parity Conditions
4. The Carry Trade
5. The Impact of Balance of Payments Flows
  - 5.1. Current Account Imbalances and the Determination of Exchange Rates
  - 5.2. Capital Flows and the Determination of Exchange Rates
6. Monetary and Fiscal Policies
  - 6.1. The Mundell–Fleming Model
  - 6.2. Monetary Models of Exchange Rate Determination
  - 6.3. The Portfolio Balance Approach
7. Exchange Rate Management: Intervention and Controls
8. Warning Signs of a Currency Crisis
- Summary
- References
- Appendix
- Practice Problems
- Solutions

## Reading 12. Economic Growth and the Investment Decision

### Learning Outcomes

1. Introduction
2. Growth in the Global Economy: Developed vs. Developing Economies
  - 2.1. Savings and Investment
  - 2.2. Financial Markets and Intermediaries
  - 2.3. Political Stability, Rule of Law, and Property Rights
  - 2.4. Education and Health Care Systems
  - 2.5. Tax and Regulatory Systems
  - 2.6. Free Trade and Unrestricted Capital Flows
  - 2.7. Summary of Factors Limiting Growth in Developing Countries
3. Why Potential Growth Matters to Investors
4. Determinants of Economic Growth
  - 4.1. Production Function
  - 4.2. Capital Deepening vs. Technological Progress
  - 4.3. Growth Accounting
  - 4.4. Extending the Production Function
  - 4.5. Natural Resources
  - 4.6. Labor Supply
  - 4.7. Labor Quality: Human Capital
  - 4.8. Capital: ICT and Non-ICT
  - 4.9. Technology
  - 4.10. Public Infrastructure
  - 4.11. Summary
5. Theories of Growth
  - 5.1. Classical Model
  - 5.2. Neoclassical Model
  - 5.3. Endogenous Growth Theory
  - 5.4. Convergence Debate
6. Growth in an Open Economy



- Summary
- References
- Practice Problems
- Solutions
- Reading 13. Economics of Regulation
  - Learning Outcomes
  - 1. Introduction
  - 2. Overview of Regulation
    - 2.1. Classification of Regulations and Regulators
    - 2.2. Economic Rationale for Regulation
    - 2.3. Regulatory Tools
  - 3. Regulation of Commerce
  - 4. Regulation of Financial Markets
  - 5. Cost–Benefit Analysis of Regulation
  - 6. Analysis of Regulation
    - 6.1. Effects of Regulations
- Summary
- References
- Practice Problems
- Solutions

Appendices

Glossary

A  
B  
C  
D  
E  
F  
G  
H  
I  
J  
K  
L  
M  
N  
O  
P  
Q  
R  
S  
T  
U  
V  
W  
Y  
Z

www.VividBook.org  
VividBookNet@Gmail.com

---

## PAGE LIST



# How to Use the CFA Program Curriculum

© 2018 CFA Institute. All rights reserved.

Show/Hide Paragraph Numbers

Congratulations on reaching Level II of the Chartered Financial Analyst<sup>®</sup> (CFA<sup>®</sup>) Program. This exciting and rewarding program of study reflects your desire to become a serious investment professional. You are embarking on a program noted for its high ethical standards and the breadth of knowledge, skills, and abilities (competencies) it develops. Your commitment to the CFA Program should be educationally and professionally rewarding.

The credential you seek is respected around the world as a mark of accomplishment and dedication. Each level of the program represents a distinct achievement in professional development. Successful completion of the program is rewarded with membership in a prestigious global community of investment professionals. CFA charterholders are dedicated to life-long learning and maintaining currency with the ever-changing dynamics of a challenging profession. The CFA Program represents the first step toward a career-long commitment to professional education.

The CFA examination measures your mastery of the core knowledge and skills required to succeed as an investment professional. These core knowledge and skills are the basis for the Candidate Body of Knowledge (CBOK<sup>™</sup>). The CBOK consists of four components:

- A broad outline that lists the major topic areas covered in the CFA Program ([www.cfainstitute.org/cbok](http://www.cfainstitute.org/cbok));
- Topic area weights that indicate the relative exam weightings of the top-level topic areas ([www.cfainstitute.org/level\\_II](http://www.cfainstitute.org/level_II));
- Learning outcome statements (LOS) that advise candidates about the specific knowledge, skills, and abilities they should acquire from readings covering a topic area (LOS are provided in candidate study sessions and at the beginning of each reading); and
- The CFA Program curriculum that candidates receive upon exam registration.

Therefore, the key to your success on the CFA examinations is studying and understanding the CBOK. The following sections provide background on the CBOK, the organization of the curriculum, and tips for developing an effective study program.



---

# CURRICULUM DEVELOPMENT PROCESS

The CFA Program is grounded in the practice of the investment profession. Beginning with the Global Body of Investment Knowledge (GBIK), CFA Institute performs a continuous practice analysis with investment professionals around the world to determine the competencies that are relevant to the profession. Regional expert panels and targeted surveys are conducted annually to verify and reinforce the continuous feedback from the GBIK collaborative website. The practice analysis process ultimately defines the CBOK. The CBOK reflects the competencies that are generally accepted and applied by investment professionals. These competencies are used in practice in a generalist context and are expected to be demonstrated by a recently qualified CFA charterholder.

The Education Advisory Committee, consisting of practicing charterholders, in conjunction with CFA Institute staff, designs the CFA Program curriculum in order to deliver the CBOK to candidates. The examinations, also written by charterholders, are designed to allow you to demonstrate your mastery of the CBOK as set forth in the CFA Program curriculum. As you structure your personal study program, you should emphasize mastery of the CBOK and the practical application of that knowledge. For more information on the practice analysis, CBOK, and development of the CFA Program curriculum, please visit [www.cfainstitute.org](http://www.cfainstitute.org).

---

## ORGANIZATION OF THE CURRICULUM

The Level II CFA Program curriculum is organized into 10 topic areas. Each topic area begins with a brief statement of the material and the depth of knowledge expected.

Each topic area is then divided into one or more study sessions. These study sessions—17 sessions in the Level II curriculum—should form the basic structure of your reading and preparation.

Each study session includes a statement of its structure and objective and is further divided into specific reading assignments. An outline illustrating the organization of these 17 study sessions can be found at the front of each volume of the curriculum.

These readings are drawn from content commissioned by CFA Institute, textbook chapters, professional journal articles, research analyst reports, and cases. Each reading includes LOS and the core material to be studied, often a combination of text, exhibits, and in-text examples and questions. A reading typically ends with practice problems followed by solutions to these problems to help you understand and master the topic areas. The LOS indicate what you should be able to accomplish after studying the material. The LOS, core material, and the practice problems are dependent on each other, with the core material and practice problems providing context for understanding the scope of the LOS and enabling you to apply a principle or concept in a variety of scenarios.



*The entire readings, including the practice problems at the end of the readings, are the basis for all examination questions and are selected or developed specifically to teach the knowledge and skills reflected in the CBOK.*

You should use the LOS to guide and focus your study because each examination question is based on one or more LOS and the core material and practice problems associated with the LOS. As a candidate, you are responsible for the entirety of the required material in a study session.

We encourage you to review the information about the LOS on our website ([www.cfainstitute.org/programs/cfaprogram/courseofstudy/Pages/study\\_sessions.aspx](http://www.cfainstitute.org/programs/cfaprogram/courseofstudy/Pages/study_sessions.aspx)), including the descriptions of LOS “command words” ([www.cfainstitute.org/programs/Documents/cfa\\_and\\_cipm\\_los\\_command\\_words.pdf](http://www.cfainstitute.org/programs/Documents/cfa_and_cipm_los_command_words.pdf)).

---

## FEATURES OF THE CURRICULUM

### Begin optional segment

#### Required vs. Optional Segments

You should read all of an assigned reading. In some cases, though, we have reprinted an entire chapter or article and marked certain parts of the reading as “optional.” The CFA examination is based only on the required segments, and the optional segments are included only when it is determined that they might help you to better understand the required segments (by seeing the required material in its full context). When an optional segment begins, you will see an icon and a dashed vertical bar in the outside margin that will continue until the optional segment ends, accompanied by another icon. *Unless the material is specifically marked as optional, you should assume it is required.* You should rely on the required segments and the reading-specific LOS in preparing for the examination.

### End optional segment

#### Practice Problems/Solutions

*All practice problems at the end of the readings as well as their solutions are part of the curriculum and are required material for the exam.* In addition to the in-text examples and questions, these practice problems should help demonstrate practical applications and reinforce your understanding of the concepts presented. Many of these practice problems are adapted from past CFA examinations and/or may serve as a basis for exam questions.

#### Glossary and Index

For your convenience, we have printed a comprehensive glossary in each volume. Throughout the curriculum, a **bolded** word in a reading denotes a term defined in the glossary. The curriculum eBook is searchable, but we also publish an index that can be found on the CFA Institute website with the Level II study sessions.



## LOS Self-Check

We have inserted checkboxes next to each LOS that you can use to track your progress in mastering the concepts in each reading.

## Source Material

The authorship, publisher, and copyright owners are given for each reading for your reference. We recommend that you use the CFA Institute curriculum rather than the original source materials because the curriculum may include only selected pages from outside readings, updated sections within the readings, and problems and solutions tailored to the CFA Program. Note that some readings may contain a web address or URL. The referenced sites were live at the time the reading was written but may have been deactivated since then.

Some readings in the curriculum cite articles published in the *Financial Analysts Journal*®, which is the flagship publication of CFA Institute. Since its launch in 1945, the *Financial Analysts Journal* has established itself as the leading practitioner-oriented journal in the investment management community. Over the years, it has advanced the knowledge and understanding of the practice of investment management through the publication of peer-reviewed practitioner-relevant research from leading academics and practitioners. It has also featured thought-provoking opinion pieces that advance the common level of discourse within the investment management profession. Some of the most influential research in the area of investment management has appeared in the pages of the *Financial Analysts Journal*, and 12 Nobel laureates have contributed more than 40 articles.

Candidates are not responsible for familiarity with *Financial Analysts Journal* articles that are cited in the curriculum. But, as your time and studies allow, we strongly encourage you to begin supplementing your understanding of key investment management issues by reading this practice-oriented publication. Candidates have full online access to the *Financial Analysts Journal* and associated resources. All you need is to log in on [www.cfapubs.org](http://www.cfapubs.org) using your candidate credentials.

---

## DESIGNING YOUR PERSONAL STUDY PROGRAM



## **Create a Schedule**

An orderly, systematic approach to exam preparation is critical. You should dedicate a consistent block of time every week to reading and studying. Complete all reading assignments and the associated problems and solutions in each study session. Review the LOS both before and after you study each reading to ensure that you have mastered the applicable content and can demonstrate the knowledge and skills described by the LOS and the assigned reading. Use the LOS self-check to track your progress and highlight areas of weakness for later review.

As you prepare for your exam, we will e-mail you important exam updates, testing policies, and study tips. Be sure to read these carefully. Curriculum errata are periodically updated and posted on the study session page at [www.cfainstitute.org](http://www.cfainstitute.org).

Successful candidates report an average of more than 300 hours preparing for each exam. Your preparation time will vary based on your prior education and experience, and you will probably spend more time on some study sessions than on others. As the Level II curriculum includes 17 study sessions, a good plan is to devote 15–20 hours per week for 17 weeks to studying the material and use the final four to six weeks before the exam to review what you have learned and practice with practice questions and mock exams. This recommendation, however, may underestimate the hours needed for appropriate examination preparation depending on your individual circumstances, relevant experience, and academic background. You will undoubtedly adjust your study time to conform to your own strengths and weaknesses and to your educational and professional background.

You should allow ample time for both in-depth study of all topic areas and additional concentration on those topic areas for which you feel the least prepared.

An interactive study planner is provided along with your practice questions and mock exams to help you plan your study time. The interactive study planner calculates your study progress and pace based on the time remaining until examination.

### **CFA Institute Practice Questions**

The CFA Institute practice questions are intended to assess your mastery of individual topic areas as you progress through your studies. After each practice question set, you will receive immediate feedback noting the correct responses and indicating the relevant assigned reading so you can identify areas of weakness for further study. For more information on the practice question sets, please visit [www.cfainstitute.org](http://www.cfainstitute.org).

### **CFA Institute Mock Exams**

The three-hour mock exams simulate the morning and afternoon sessions of the actual CFA examination, and are intended to be taken after you complete your study of the full curriculum so you can test your understanding of the curriculum and your readiness for the exam. You will receive feedback at the end of the mock exam, noting the correct responses and indicating the relevant assigned readings so you can assess areas of weakness for further study during your review period. We recommend that you take mock exams during the final stages of your preparation for the actual CFA examination. For more information on the mock examinations, please visit [www.cfainstitute.org](http://www.cfainstitute.org).



## Preparatory Providers

After you enroll in the CFA Program, you may receive numerous solicitations for preparatory courses and review materials. When considering a prep course, make sure the provider is in compliance with the CFA Institute Approved Prep Provider Program ([www.cfainstitute.org/utility/examprep/Pages/index.aspx](http://www.cfainstitute.org/utility/examprep/Pages/index.aspx)). Just remember, there are no shortcuts to success on the CFA examinations; reading and studying the CFA curriculum is the key to success on the examination. The CFA examinations reference only the CFA Institute assigned curriculum—no preparatory course or review course materials are consulted or referenced.

### SUMMARY

Every question on the CFA examination is based on the content contained in the required readings and on one or more LOS. Frequently, an examination question is based on a specific example highlighted within a reading or on a specific practice problem and its solution. To make effective use of the CFA Program curriculum, please remember these key points:

1. All pages of the curriculum are required reading for the examination except for occasional sections marked as optional. You may read optional pages as background, but you will not be tested on them.
2. All questions, problems, and their solutions—found at the end of readings—are part of the curriculum and are required study material for the examination.
3. You should make appropriate use of the topic tests and mock examinations and other resources available at [www.cfainstitute.org](http://www.cfainstitute.org).
4. Use the interactive study planner to create a schedule and commit sufficient study time to cover the 17 study sessions, review the materials, and take topic tests and mock examinations.
5. Some of the concepts in the study sessions may be superseded by updated rulings and/or pronouncements issued after a reading was published. Candidates are expected to be familiar with the overall analytical framework contained in the assigned readings. Candidates are not responsible for changes that occur after the material was written.



---

# FEEDBACK

At CFA Institute, we are committed to delivering a comprehensive and rigorous curriculum for the development of competent, ethically grounded investment professionals. We rely on candidate and member feedback as we work to incorporate content, design, and packaging improvements. You can be assured that we will continue to listen to your suggestions. Please send any comments or feedback to [info@cfainstitute.org](mailto:info@cfainstitute.org). Ongoing improvements in the curriculum will help you prepare for success on the upcoming examinations and for a lifetime of learning as a serious investment professional.

[www.VividBook.org](http://www.VividBook.org)  
[VividBookNet@Gmail.com](mailto:VividBookNet@Gmail.com)



# Ethical and Professional Standards

© 2018 CFA Institute. All rights reserved.

Show/Hide Paragraph Numbers

---

## STUDY SESSIONS

- Study Session 1** Ethical and Professional Standards (1)  
**Study Session 2** Ethical and Professional Standards (2)

---

## TOPIC LEVEL LEARNING OUTCOME

The candidate should be able to demonstrate a thorough knowledge of the CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards), identify violations of the Code and Standards, and recommend appropriate corrective measures.

The topic of ethics is one of fundamental importance to the investment profession. Acting responsibly with high levels of integrity builds trust, upon which the investment profession is built. Behaving ethically, and in the best interest of clients, is critical to the long-term success of the investment profession and those choosing a career within it.

The Code and Standards form the ethical foundation for the CFA Institute self-regulatory program. The *Standards of Practice Handbook* provides practical guidance in the interpretation and implementation of the Code and Standards. Together these seek to hold CFA Institute members and CFA Program candidates to the highest levels of professional behavior.



---

# Study Session 1

## Ethical and Professional Standards (1)

© 2018 CFA Institute. All rights reserved.

---

Show/Hide Paragraph Numbers

The readings in this study session address the CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards). The Code and Standards provide guidance to help identify and resolve ethical conflicts present in everyday activities in the investment profession. “Guidance” in the *Standards of Practice Handbook* addresses the practical application of the Code and Standards by reviewing the purpose and scope of each Standard, presenting recommended procedures for compliance, and providing examples of the Standard in practice.

---

## READING ASSIGNMENTS

**Reading 1** Code of Ethics and Standards of Professional Conduct  
*Standards of Practice Handbook*, Eleventh Edition

**Reading 2** Guidance for Standards I–VII  
*Standards of Practice Handbook*, Eleventh Edition

VividBookNet@Gmail.com



# Reading 1

## Code of Ethics and Standards of Professional Conduct

© 2014 CFA Institute. All rights reserved.

Show/Hide Paragraph Numbers

---

### LEARNING OUTCOMES

The candidate should be able to:

- a. describe the six components of the Code of Ethics and the seven Standards of Professional Conduct;
- b. explain the ethical responsibilities required of CFA Institute members and candidates in the CFA Program by the Code and Standards.

---

### PREFACE

The *Standards of Practice Handbook (Handbook)* provides guidance to the people who grapple with real ethical dilemmas in the investment profession on a daily basis; the *Handbook* addresses the professional intersection where theory meets practice and where the concept of ethical behavior crosses from the abstract to the concrete. The *Handbook* is intended for a diverse and global audience: CFA Institute members navigating ambiguous ethical situations; supervisors and direct/indirect reports determining the nature of their responsibilities to each other, to existing and potential clients, and to the broader financial markets; and candidates preparing for the Chartered Financial Analyst (CFA) examinations.

Recent events in the global financial markets have tested the ethical mettle of financial market participants, including CFA Institute members. The standards taught in the CFA Program and by which CFA Institute members and candidates must abide represent timeless ethical principles and professional conduct for all market conditions. Through adherence to these standards, which continue to serve as the model for ethical behavior in the investment profession globally, each market participant does his or her part to improve the integrity and efficient operations of the financial markets.



The *Handbook* provides guidance in understanding the interconnectedness of the aspirational and practical principles and provisions of the Code of Ethics and Standards of Professional Conduct (Code and Standards). The Code contains high-level aspirational ethical principles that drive members and candidates to create a positive and reputable investment profession. The Standards contain practical ethical principles of conduct that members and candidates must follow to achieve the broader industry expectations. However, applying the principles individually may not capture the complexity of ethical requirements related to the investment industry. The Code and Standards should be viewed and interpreted as an interwoven tapestry of ethical requirements. Through members' and candidates' adherence to these principles as a whole, the integrity of and trust in the capital markets are improved.

## **Evolution of the CFA Institute Code of Ethics and Standards of Professional Conduct**

Generally, changes to the Code and Standards over the years have been minor. CFA Institute has revised the language of the Code and Standards and occasionally added a new standard to address a prominent issue of the day. For instance, in 1992, CFA Institute added the standard addressing performance presentation to the existing list of standards.

Major changes came in 2005 with the ninth edition of the *Handbook*. CFA Institute adopted new standards, revised some existing standards, and reorganized the standards. The revisions were intended to clarify the requirements of the Code and Standards and effectively convey to its global membership what constitutes “best practice” in a number of areas relating to the investment profession.

The Code and Standards must be regularly reviewed and updated if they are to remain effective and continue to represent the highest ethical standards in the global investment industry. CFA Institute strongly believes that revisions of the Code and Standards are not undertaken for cosmetic purposes but to add value by addressing legitimate concerns and improving comprehension.

Changes to the Code and Standards have far-reaching implications for the CFA Institute membership, the CFA Program, and the investment industry as a whole. CFA Institute members and candidates are *required* to adhere to the Code and Standards. In addition, the Code and Standards are increasingly being adopted, in whole or in part, by firms and regulatory authorities. Their relevance goes well beyond CFA Institute members and candidates.

## **Standards of Practice Handbook**

The periodic revisions of the Code and Standards have come in conjunction with updates of the *Standards of Practice Handbook*. The *Handbook* is the fundamental element of the ethics education effort of CFA Institute and the primary resource for guidance in interpreting and implementing the Code and Standards. The *Handbook* seeks to educate members and candidates on how to apply the Code and Standards to their professional lives and thereby benefit their clients, employers, and the investing public in general. The *Handbook* explains the purpose of the Code and Standards and how they apply in a variety of situations. The sections discuss and amplify each standard and suggest procedures to prevent violations.



Examples in the “Application of the Standard” sections are meant to illustrate how the standard applies to hypothetical but factual situations. The names contained in the examples are fictional and are not meant to refer to any actual person or entity. Unless otherwise stated (e.g., one or more people specifically identified), individuals in each example are CFA Institute members and holders of the CFA designation. Because factual circumstances vary so widely and often involve gray areas, the explanatory material and examples are not intended to be all inclusive. Many examples set forth in the application sections involve standards that have legal counterparts; *members are strongly urged to discuss with their supervisors and legal and compliance departments the content of the Code and Standards and the members’ general obligations under the Code and Standards.*

CFA Institute recognizes that the presence of any set of ethical standards may create a false sense of security unless the documents are fully understood, enforced, and made a meaningful part of everyday professional activities. The *Handbook* is intended to provide a useful frame of reference that suggests ethical professional behavior in the investment decision-making process. This book cannot cover every contingency or circumstance, however, and it does not attempt to do so. The development and interpretation of the Code and Standards are evolving processes; the Code and Standards will be subject to continuing refinement.

## **Summary of Changes in the Eleventh Edition**

The comprehensive review of the Code and Standards in 2005 resulted in principle requirements that remain applicable today. The review carried out for the eleventh edition focused on market practices that have evolved since the tenth edition. Along with updates to the guidance and examples within the *Handbook*, the eleventh edition includes an update to the Code of Ethics that embraces the members’ role of maintaining the social contract between the industry and investors. Additionally, there are three changes to the Standards of Professional Conduct, which recognize the importance of proper supervision, clear communications with clients, and the expanding educational programs of CFA Institute.

### ***Inclusion of Updated CFA Institute Mission***

The CFA Institute Board of Governors approved an updated mission for the organization that is included in the Preamble to the Code and Standards. The new mission conveys the organization’s conviction in the investment industry’s role in the betterment of society at large.

#### ***Mission:***

To lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.

### ***Updated Code of Ethics Principle***

One of the bullets in the Code of Ethics was updated to reflect the role that the capital markets have in the greater society. As members work to promote and maintain the integrity of the markets, their actions should also help maintain the social contract with investors.



**Old:**

Promote the integrity of and uphold the rules governing capital markets.

**New:**

Promote the integrity and viability of the global capital markets for the ultimate benefit of society.

***New Standard Regarding Responsibilities of Supervisors [IV(C)]***

The standard for members and candidates with supervision or authority over others within their firms was updated to bring about improvements in preventing illegal and unethical actions from occurring. The prior version of Standard IV(C) focused on the detection and prevention of violations. The updated version stresses broader compliance expectations, which include the detection and prevention aspects of the original version.

**Old:**

Members and Candidates must make reasonable efforts to detect and prevent violations of applicable laws, rules, regulations, and the Code and Standards by anyone subject to their supervision or authority.

**New:**

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.

***Additional Requirement under the Standard for Communication with Clients and Prospective Clients [V(B)]***

Given the constant development of new and exotic financial instruments and strategies, the standard regarding communicating with clients now includes an implicit requirement to discuss the risks and limitations of recommendations being made to clients. The new principle and related guidance take into account the fact that levels of disclosure will differ between products and services. Members and candidates, along with their firms, must determine the specific disclosures their clients should receive while ensuring appropriate transparency of the individual firms' investment processes.

**Addition:**

Disclose to clients and prospective clients significant limitations and risks associated with the investment process.