








**Level III  
of the  
CFA® Program**

## **Ethics and Professional Standards**

**GUIDANCE FOR STANDARDS I–VII &  
APPLICATION OF THE CODE AND STANDARDS: LEVEL III**

# Standards of Professional Conduct

-  **Standard I – Professionalism**
  - (A) Knowledge of the Law**
  - (B) Independence and Objectivity**
  - (C) Misrepresentation**
  - (D) Misconduct**
-  Standard II – Integrity of Capital Markets
-  Standard III – Duties to Clients and Prospective Clients
-  Standard IV – Duties to Employers
-  Standard V – Investment Analysis, Recommendations, and Action
-  Standard VI – Conflicts of Interest
-  Standard VII – Responsibilities as a CFA Institute Member or CFA Candidate

## *Learning Outcome Statements*

**LOS : Demonstrate** a thorough knowledge of the CFA Institute Code of Ethics and Standards of Professional Conduct by **interpreting the Code and Standards** in various situations involving **issues of professional integrity**

**LOS : Recommend practices and procedures** designed to **prevent violations** of the Code and Standards.

**LOS : Evaluate practices, policies, and conduct** relative to the CFA Institute Code of Ethics and Standards of Professional Conduct.

**LOS :** Explain how the practices, policies, or conduct **does or does *not* violate** the CFA Institute Code of Ethics and Standards of Professional Conduct.

## Standard I(A) – Knowledge of the Law

### *Example Question*

Which of the following is a **correct statement** of a member's or candidate's duty under the Code and Standards?

- A. In the **absence of specific applicable law** or other regulatory requirements, the **Code and Standards govern the member's or candidate's actions.**
- B. A member or candidate is **required to comply only with applicable local laws, rules, regulations, or customs**, even though the **Code and Standards may impose a higher degree of responsibility** or a higher duty on the member or candidate.
- C. A member or candidate who trades securities in a securities market where **no applicable local laws** or stock exchange rules regulate the use of material nonpublic information may take investment action **based on material nonpublic information.**

**Solution**

## Standard I(A) – Knowledge of the Law

### *Example Question*

#### *Solution*

Which of the following is a **correct statement** of a member's or candidate's duty under the Code and Standards?

- A. In the absence of specific applicable law or other regulatory requirements, the Code and Standards govern the member's or candidate's actions.**

If applicable law is more strict than the requirements of the Code and Standards, members and candidates must adhere to **applicable law; otherwise**, members and candidates must adhere to the **Code and Standards**.

Answer B is incorrect because members and candidates must adhere to the **higher standard set** by the Code and Standards if local applicable law is less strict.

Answer C is incorrect because when no applicable law exists, members and candidates are required to adhere to the Code and Standards, and the Code and Standards **prohibit the use of material nonpublic information**.

## Standard I(A) – Knowledge of the Law

### According to the Standards of Practice Handbook:

*Members and Candidates must understand and **comply with all applicable laws, rules, and regulations** (including the CFA Institute Code of Ethics and Standards of Professional Conduct) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, Members and Candidates 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 of such laws, rules, or regulations.*



## Standard I(A) – Knowledge of the Law

### Guidance

#### Members and Candidates must:



Understand the laws and regulations of the **jurisdictions in which they work**.



**Comply with the laws and regulations** that directly govern their professional activities, on the basis of their reasonable and good faith understanding.



Acquaint themselves with **changes in laws or regulations** whenever such changes occur.



Comply with **new local or international communication requirements**.

## Standard I(A) – Knowledge of the Law

### Guidance

#### Relationship between the Code and Standards and Applicable Law

- “**Applicable law**” is the law that governs the member’s or candidate’s conduct.
- “**More strict law**” is the law that imposes greater restrictions of the action of member or candidate or requires greater measures aimed at protecting the client’s interest.
- Whenever the applicable law is **stricter** than the Code and Standards, members and candidates **must** abide by the applicable law.



## Standard I(A) – Knowledge of the Law

### Guidance

#### Relationship between the Code and Standards and Applicable Law

- Whenever the Code and Standards is **stricter** than the applicable law, members and candidates **must** abide by the Code and Standards.
- Whenever there's no applicable law or regulation, members **must** abide by the Code and Standards.
- Members **must not** engage in conduct that violates the Code and Standards **even if such conduct happens to be legal** in the jurisdiction in which they work.

## Standard I(A) – Knowledge of the Law

### Guidance

#### Participation in or Association with Violations by Others

Standard I(A) applies when members and candidates **know or should know** that their conduct may contribute to a **violation of applicable laws** or the **Code and Standards**.

Whenever a member or candidate has reasonable grounds to believe that a client or employer is engaging in illegal/unethical behavior, the member must ***immediately dissociate*** from the activity.

## Standard I(A) – Knowledge of the Law

### Guidance

#### Participation in or Association with Violations by Others

When the perpetrator is a **colleague**, dissociation may entail:

- Direct **discussions** with the colleague.
- Bringing the issue to the **employer's attention** in case direct discussion fails.

When the perpetrator is a **client**, dissociation may entail:

- Direct **discussion** with the client.
- **Refusal to continue advising** the client if discussions fail.
- Asking for a **new assignment**.

When the perpetrator is the **employer**, dissociation may entail:

- Direct **discussions** employer.
- **Removing one's name** from reports or recommendations.
- **Leaving the employer.**

## Standard I(A) – Knowledge of the Law

### Guidance

#### Participation in or Association with Violations by Others

- ▶ In addition, the CFA Institute **encourages members report potential violations** of the Code and Standards by members or fellow candidates.
- ▶ One can submit a written report to the CFA Institute Professional Conduct Program via e-mail ([pcprogram@cfainstitute.org](mailto:pcprogram@cfainstitute.org)) or the CFA Institute website ([www.cfainstitute.org](http://www.cfainstitute.org)).



## Standard I(A) – Knowledge of the Law

### Guidance

#### Investment Products and Applicable Laws



**Investment products** should always be in compliance with applicable laws.



Members or candidates must ensure that **business partners** involved in product distribution also abide by the applicable laws.



Members or candidates must acquaint themselves with **cross-border laws** when doing business internationally.



To abide by all such laws, members or candidates should **seek guidance from the legal/compliance department** at their place of work.

## Standard I(A) – Knowledge of the Law

### Recommended Procedures for Compliance with Standard I(A)

#### **Stay Informed**

Members and candidates should **initiate or encourage** their employers to set up a procedure to regularly inform the employees on the **changes** in applicable laws, rules, regulations, and case law.

#### **Review Procedures**

Members and candidates should review or encourage their employers to review the firm's compliance procedures regularly – to capture current law and provide adequate guidance.

#### **Maintain Copies of Current Files**

Members and candidates should maintain or encourage their employers to maintain accessible current references of applicable statutes, rules, regulations and important cases.

## Standard I(A) – Knowledge of the Law

### *Example Question*

**Samantha Brown**, CFA, is the **CFO of Delta Investments**, a corporate finance firm headquartered in **Germany**. Brown is leading **the IPO underwriting** process for a major client. German regulation forbids managers from participating in IPO for their accounts. The underwriting process is **split** between **Delta Investments** and **Omega Capital**, headquartered in Tokyo, Japan. Japanese has **no regulations** regarding executives participating in IPOs for their investment accounts.

Brown allocates a percentage of the **IPO issuance to herself via Omega Capital**.

Has Brown violated **Standard I(A) – Knowledge of the Law**?

- A. No, because the Standard does not forbid managers from participating in IPOs.
- B. Yes, because Brown does not follow the stricter rule of no participation in IPOs in Germany.
- C. No, because the underwriting process is shared between Omega Capital and Delta Investments, and Brown is free to choose which laws and regulations to follow.

**Solution**

## Standard I(A) – Knowledge of the Law

### *Example Question*

### *Solution*

Has Brown violated Standard I(A) – Knowledge of the Law?

- A. No, because the Standard does not forbid managers from participating in IPOs.
- B. Yes, because Brown does not follow the stricter rule of no participation in IPOs in Germany.**
- C. No, because the underwriting process is shared between Omega Capital and Delta Investments, and Brown is free to choose which laws and regulations to follow.

Brown has violated Standard I(A) – Knowledge of the Law because she **did not** comply with the **stricter rule** that forbids managers from participating in IPOs in Germany. While Japanese have no regulations on executives participating in IPOs, Brown should have followed the **more strict law of Germany**.



## Standard I(B) – Independence and Objectivity

### Example Question

Long has been asked to be the keynote speaker at an upcoming investment conference. The event is being hosted by one of the **third-party investment managers** currently used by his pension fund. The manager offers to **cover all conference and travel costs** for Long and make the conference registrations free for three additional members of his investment management team. To ensure that the conference obtains the best speakers, the host firm has arranged for an **exclusive golf outing for the day following the conference on a local championship-caliber course**.

Which of the following is *least likely* to violate Standard I(B)?

- A. Long may accept only the offer to have his **conference-related expenses** paid by the host firm.
- B. Long may accept the offer to have his conference-related expenses paid and **may attend the exclusive golf** outing at the expense of the hosting firm.
- C. Long may accept the **entire package of incentives** offered to speak at this conference.

Solution

## Standard I(B) – Independence and Objectivity

### *Example Question*

### *Solution*

**The correct answer is A.**

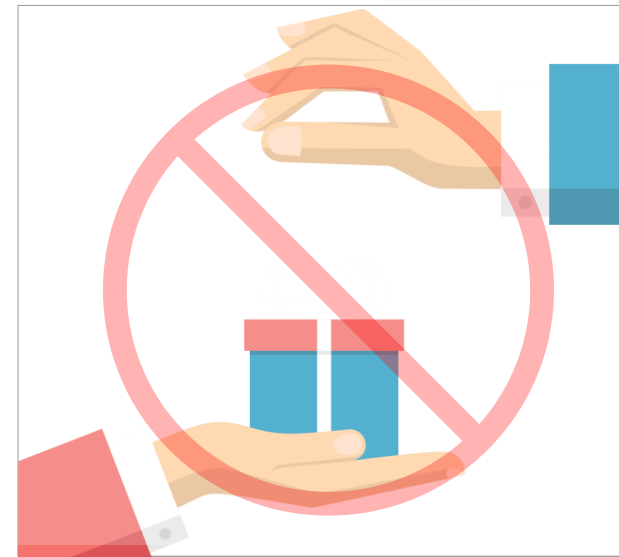
Standard I(B)—Independence and Objectivity emphasizes the need for members and candidates to maintain their independence and objectivity. Best practices dictate that firms adopt a strict policy not to accept compensation for travel arrangements. **At times, however, accepting paid travel would not compromise one's independence and objectivity.**

Answers B and C are incorrect because the added benefits—free conference admission for additional staff members and an exclusive golf retreat for the speaker—could be viewed as inducements related to the firm's working arrangements and not solely related to the speaking engagement. Should Long wish to bring other team members or participate in the golf outing, he or his firm should be responsible for the associated fees.

## Standard I(B) – Independence and Objectivity

### According to the Standards of Practice Handbook:

*Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and Candidates **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.***



## Standard I(B) – Independence and Objectivity

### Guidance

#### Members and candidates should:

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Maintain their independence and objectivity so that that clients receive benefit of their work and opinions – not influenced by potential conflicts of interest or other circumstances

- External sources of influence may include **gifts, invitation** to lavish function, **job referrals**, etc. from clients such as corporations seeking expanded research coverage.
- Internal sources may come from members and candidate's firms – for example issue a **favorable reports**.
- Before accepting a gift or bonuses from their clients, members should **disclose it to their employers**.
- If notification is not possible before accepting the gift, members and candidates should **disclose to the employer previously received gifts**.

## Standard I(B) – Independence and Objectivity

### Guidance

1

#### **Buy-Side Clients & Public Companies**

- **Buy-side clients** are a major source of business for sell-side research firms.
- **Sell-side research analysts** may be pressured into altering their recommendations or tone down views that differ from (buy-side) portfolio managers.
- Portfolio managers should refrain from putting **undue pressure on sell-side research analysts**.
- Sell-side analysts and firms ***must*** maintain their independence.

## Standard I(B) – Independence and Objectivity

### Guidance

2

#### **Fund Managers & Custodial Relationships**

Members and Candidates who are tasked with the selection of **hiring third-party custodians** or external managers ***should not*** accept gifts as this **may** appear to impact their independence

3

#### **Performance Measurement & Attribution**

Members and Candidates who work within the **performance measurement department** must maintain their **independence and objectivity**.

## Standard I(B) – Independence and Objectivity

### Guidance

4

#### Manager Selection & Procurement Process

Members and Candidates that are involved in the management selection process ***should not*** accept gifts, contributions, or any other compensation when **hiring investment managers**.

5

#### Issuer Paid Research

- If a Member or Candidate is hired as an **independent analyst**, they must perform thorough, unbiased analysis and must also ***disclose the nature of their compensation***.
- Members and Candidates should strictly limit their compensation to a ***flat fee***.
- Any compensation that is tied to the result of the analysis, e.g., **stock warrants or company equity**, may influence the Member to write a favorable recommendation.

## Standard I(B) – Independence and Objectivity

### Guidance

6

#### Travel Funding

- It is recommended that **analysts refuse paid travel** by the companies they cover.
- Accepting paid travel, e.g., privately chartered flights and lavish accommodations, **may** appear to influence their objectivity.
- To avoid any **appearance** of compromised independence, Members and Candidates or their firms should **cover all necessary travel expenses**.



## Standard I(B) – Independence and Objectivity

### Recommended Procedures for Compliance with Standard I(B)

#### **Protect the Integrity of Opinions**

Members and candidates should **establish policies** that indicate that a report on securities of a corporate client should reflect the unbiased opinion of the analyst.

#### **Create a Restricted List**

If a firm is not willing to release adverse opinions about a corporate client, members and candidates should advise the firm to remove the controversial company from the research universe and put it in a restricted list so that the firm can only release only factual information about the company.

#### **Restrict Special Cost Arrangement**

- Members should pay for the commercial transportation and hotel charges, when attending meetings.
- For instance, no issuer should reimburse members or candidates for air transportation

## Standard I(B) – Independence and Objectivity

### Recommended Procedures for Compliance with Standard I(B)

#### Limit Gifts

- Members and candidates should limit accepting gifts.
- Standard I(B) **does not** prevent ordinary **business-related entertainment** as long as it **does not influence**, or rewards members or candidates.

#### Restrict Investments

- Members and candidates should encourage their firms to establish **official policies** that govern employees purchases of **equity or equity related IPOs**.
- Employees should **seek prior approval before participating in an IPO**.

#### Review Procedures

Members and candidates should advice their firms to establish **proper supervisory and review procedure** – to guarantee compliance by portfolio managers, relating to **personal investment activities**.

## Standard I(B) – Independence and Objectivity

### Recommended Procedures for Compliance with Standard I(B)

#### **Independence Policy**

Members or candidates and their firms should establish a **formal written policy** concerning **independence and objectivity of research** – to ensure that research analysts are not controlled by any department of the firm.

#### **Appointment of Compliance Officer**

Firms should appoint a senior officer whose responsibility is to **ensure compliance** with the firm's codes and ethics and any other regulation governing its business activities.

## Standard I(B) – Independence and Objectivity

### *Example Question*

**Emily Rodriguez**, CFA, receives a tip from a friend that **XYZ Pension Fund** is searching for a new **external fund manager**. Her friend tells her that the selection manager is an avid tennis player and frequently visits his local tennis club. Rodriguez intends to establish a close rapport with the **selection manager, Peter Lee**. Lee and Rodriguez knew each other since campus days. In her attempt to gain XYZ Pension Fund's business, Rodriguez gifts Lee **an expensive membership** to the tennis club and **pays for several lunches** at the tennis club.

Which of the following individuals has violated Standard I(B) – Independence and Objectivity?

- A. Rodriguez.
- B. Lee.
- C. Both Rodriguez and Lee

**Solution**

## Standard I(B) – Independence and Objectivity

### *Example Question*

### *Solution*

Which of the following individuals has violated Standard I(B) – Independence and Objectivity?

- A. Rodriguez.
- B. Lee.
- C. Both Rodriguez and Lee**

**Both Rodriguez and Lee** are in violation of Standard I(B) – Independence and Objectivity. Rodriguez is **knowingly** trying to influence Lee's selection decision, while Lee should **not accept** gifts because it may **impair** his independence and objectivity.

## Standard I(C) – Misrepresentation

### *Example Question*

Grey recommends the purchase of a mutual fund that invests solely in long-term US Treasury bonds. He makes the following statements to his clients:

- I. “The payment of the bonds is **guaranteed by the US government**; therefore, the **default risk of the bonds is virtually zero.**”
- II. “If you invest in the mutual fund, you will **earn a 10% rate of return each year** for the next several years based on historical performance of the market.”

Did Grey’s statements violate the CFA Institute Code and Standards?

- A. Neither statement violated the Code and Standards.
- B. Only statement I violated the Code and Standards.
- C. Only statement II violated the Code and Standards.

**Solution**

## Standard I(C) – Misrepresentation

### *Example Question*

#### *Solution*

- I. “The payment of the bonds is **guaranteed by the US government**; therefore, the **default risk of the bonds is virtually zero.**”
- II. “If you invest in the mutual fund, you will **earn a 10% rate of return each year** for the next several years based on historical performance of the market.”

#### **The correct answer is C.**

Statement I is a **factual statement** that discloses to clients and prospects accurate information about the terms of the investment instrument.

Statement II, which **guarantees a specific rate of return for a mutual fund**, is an **opinion stated as a fact** and, therefore, violates Standard I(C). If statement II were rephrased to include a qualifying statement, such as “in my opinion, investors may earn..., ” it would not be in violation of the Standards.

## Standard I(C) – Misrepresentation

### According to the Standards of Practice Handbook:

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





## Standard I(C) – Misrepresentation

### Guidance

- Misrepresentation includes the **omissions of information, manipulation of facts** related to securities, and plagiarism.
- Members are **prohibited from guaranteeing returns** on investments that do not have an explicit guarantee.
- **Falsifying of performance records** is also prohibited.
- Social media channels should **not be abused**.
- Plagiarism is strictly **prohibited**.

## Standard I(C) – Misrepresentation

### Guidance

### Impact on Investment Practice

- ◆ Members and candidates ***should not*** misrepresent their academic **qualifications**, personal or firm **performance history**, **credentials**, or **services** offered by their firm.
- ◆ Members should **exercise care** when using third party information.

## Standard I(C) – Misrepresentation

### Guidance

### Performance Reporting

Members and candidates ***should***:

- ◆ Use **appropriate benchmarks** to evaluate performance.
- ◆ Provide reliable and **accurate pricing** to clients.

*Note: Standard I(C) does not require a benchmark to be provided in order to comply.*

## Standard I(C) – Misrepresentation

### Guidance

### Social Media

- ◆ Ensure that they distribute the same information to **all current and potential** clients.
- ◆ Ensure that communications disseminated through social media **comply with the Codes and Standards**.

## Standard I(C) – Misrepresentation

### Guidance

### Social Media

- ◆ Members and Candidates may use the research or models developed by other members or candidates within the firm without violating Standard I(C).
  - **Research and models** developed within the firm by the employees are the **property of the firm**.
- ◆ However, a member or candidate is **prohibited** from **reissuing** previously release **report**, as his or hers.

## Standard I(C) – Misrepresentation

### Guidance

### Plagiarism

- ◆ Copying, presenting other's ideas as you own ***without acknowledging*** the source.

### Examples

- Taking **credit for a research report** that has been written by another analyst or firm.
- Copying excerpts from a report or article ***without acknowledging*** the author.
- Using **graphs or charts** without acknowledging the source.
- Copying **proprietary models** or spreadsheets ***without seeking permission*** from the firm or creators.
- Weak attribution when citing a particular text. For example, the following quote is attributed to ***“a leading expert,” “a financial guru.”*** Members and Candidates should acknowledge the authors directly.

## Standard I(C) – Misrepresentation

### Recommended Procedures for Compliance with Standard I(C)

- Providing a **written list of the firm's services and qualifications** to avoid misrepresentation of facts.
- Listing the **qualifications of each member** and their capabilities.
- Developing procedures for the **verification of third-party information**.
- **Updating webpages** regularly to reflect current factual information.
- Developing a **plagiarism policy**.

## Standard I(C) – Misrepresentation

### *Example Question*

Maxwell Jones is **preparing** an investor **briefing for his clients**. He would like to briefly explain **various financial concepts**, such as price-to-earnings (P/E) and dividend yield. He finds these descriptions on a **finance blog** and **copies** these explanations (**verbatim**) without acknowledging the authors.

Has Jones violated **Standard I(C) – Misrepresentation**?

- A. No, because these concepts are common finance jargon and the explanations are identical regardless of the source.
- B. Yes, because he failed to reference the original authors.
- C. No, because he does not need to acknowledge the original authors.



## Standard I(C) – Misrepresentation

### *Example Question*

Maxwell Jones is **preparing** an investor **briefing for his clients**. He would like to briefly explain **various financial concepts**, such as price-to-earnings (P/E) and dividend yield. He finds these descriptions on a **finance blog** and **copies** these explanations (**verbatim**) without acknowledging the authors.

Has Jones violated **Standard I(C) – Misrepresentation**?

- A. No, because these concepts are common finance jargon and the explanations are identical regardless of the source.
- B. Yes, because he failed to reference the original authors.**
- C. No, because he does not need to acknowledge the original authors.

### *Solution*

Klein has violated Standard I(C) – Misrepresentation. For Klein to be compliant, she should always acknowledge the original author of any reference material.

## Standard I(D) – Misconduct

### *Example Question*

Simon Sasserman is a trust investment officer at a bank in a small affluent town. He **enjoys lunching every day** with friends at the country club, where his clients have observed him having **numerous drinks**. Back at work after lunch, he clearly is **intoxicated while making investment decisions**. His colleagues make a point of handling any business with Sasserman in the morning because they **distrust his judgment after lunch**.

Does Sasserman's actions violate the Code and Standards?

**Solution**

## Standard I(D) – Misconduct

### *Example Question*

Simon Sasserman is a trust investment officer at a bank in a small affluent town. He **enjoys lunching every day** with friends at the country club, where his clients have observed him having **numerous drinks**. Back at work after lunch, he clearly is **intoxicated while making investment decisions**. His colleagues make a point of handling any business with Sasserman in the morning because they **distrust his judgment after lunch**.

Does Sasserman's actions violate the Code and Standards?

**Yes.** Sasserman's excessive drinking at lunch and subsequent intoxication at work constitute a violation of Standard I(D) because this conduct has **raised questions about his professionalism and competence**.

His behavior reflects poorly on **him**, his **employer**, and the **investment industry**.

## Standard I(D) – Misconduct

### According to the Standards of Practice Handbook:

*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.***



## Standard I(D) – Misconduct

### Guidance

- Standard I(D) addresses all **conducts that paints a bad picture** on the professional integrity, good reputation, or competence of members and candidates.
  - Primarily targets conducts and actions **related** to the **member's or candidates professional life**.
- Conducts that reflect poorly on member's or candidates profession **may not be illegal** – for example consuming alcohol during business hours.
- Absence of appropriate conduct or lack of sufficient effort may constitute violation of Standard I(D).
  - For example, a member or candidate issuing an **investment recommendation without proper due diligence** may violate their client's trust – reflects negatively on reputation and financial market as a whole.

## Standard I(D) – Misconduct

### Recommended Procedures for Compliance with Standard I(D)



Development of a code of ethics



Dissemination of a list of potential violations



Conducting background checks on each potential employee to establish their character



## Standard I(D) – Misconduct

### *Example Question*

Emily Chen, CFA, is an **investment analyst** at Finco Investments. Chen is a member of **Green Earth Organization**, which champions environmental protection. In her free time, Chen organizes a rally to protest the government's increase in the use of plastic bags and environmental pollution.

During the rally, Chen was **arrested and fined €200**. In the contract signed with Finco Investments, any employee arrested for committing offenses within the company is immediately terminated.

Under the **CFA Institute Code and Standards**, do Emily's actions violate the Code and Standards?

- A. Yes, because she was arrested and fined.
- B. No, Chen did not violate any CFA Institute Code and Standards.
- C. Yes, because she violates her employment contract with Finco Investments.

**Solution**

## Standard I(D) – Misconduct

### *Example Question*

### *Solution*

Under the **CFA Institute Code and Standards**, do Emily's actions violate the Code and Standards?

- A. Yes, because she was arrested and fined.
- B. No, Chen did not violate any CFA Institute Code and Standards.**
- C. Yes, because she violated her employment contract with Finco Investments.

The actions of Emily Chen, CFA, **do not** violate the CFA Institute Code and Standards.

- The Code and Standards recognize that members may **have personal convictions** and engage in **lawful acts of civil disobedience** that **do not** harm their professional **reputation, integrity, or competence**.
  - Employers may have the right to terminate an employee's employment contract **if they get a criminal record**, but this is at the employer's discretion.
-



# Standards of Professional Conduct

- Standard I – Professionalism
- Standard II – Integrity of Capital Markets**
  - (A) Material non-public information**
  - (B) Market manipulation**
- Standard III – Duties to Clients and Prospective Clients
- Standard IV – Duties to Employers
- Standard V – Investment Analysis, Recommendations, and Action
- Standard VI – Conflicts of Interest
- Standard VII – Responsibilities as a CFA Institute Member or CFA Candidate