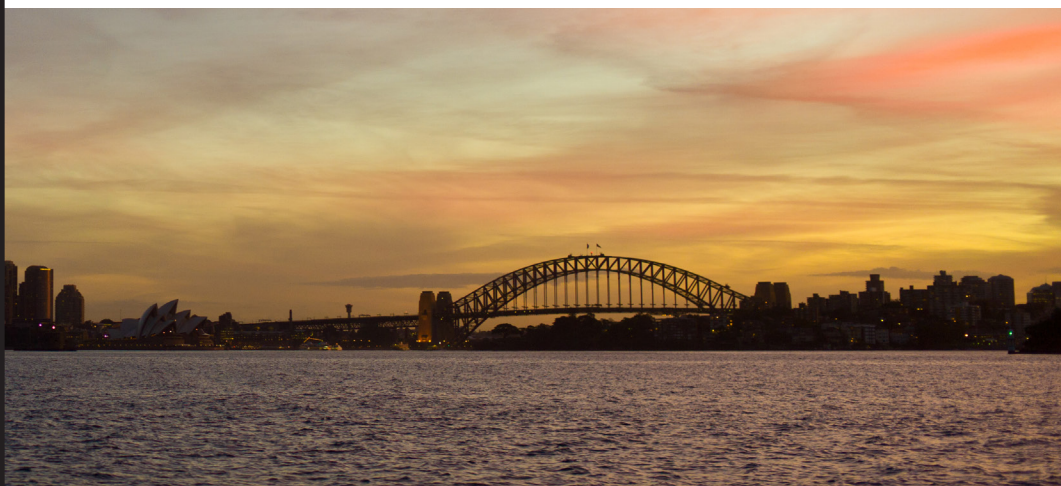


# CFA PROGRAM CURRICULUM 2017 LEVEL II VOLUMES 1-6





# ETHICAL AND PROFESSIONAL STANDARDS, QUANTITATIVE METHODS, AND ECONOMICS

CFA<sup>®</sup> Program Curriculum  
2017 • LEVEL II • VOLUME 1



CFA Institute | WILEY

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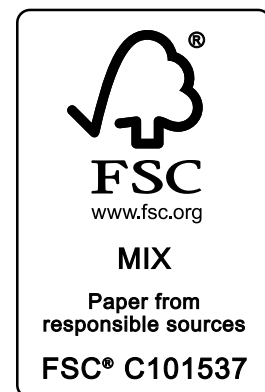
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# How to Use the CFA Program Curriculum

Congratulations on reaching Level II of the Chartered Financial Analyst® (CFA®) 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 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 skills required to succeed as an investment professional. These core skills are the basis for the Candidate Body of Knowledge (CBOK™). 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, which contains the readings and end-of-reading questions, 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.

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## 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 knowledge, skills, and abilities (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).

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## 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 18 study sessions can be found at the front of each volume of the curriculum.

*The readings and end-of-reading questions are the basis for all examination questions and are selected or developed specifically to teach the knowledge, skills, and abilities reflected in the CBOK.* These readings are drawn from content commissioned by CFA Institute, textbook chapters, professional journal articles, research analyst reports, and cases. All readings include problems and solutions to help you understand and master the topic areas.

Reading-specific Learning Outcome Statements (LOS) are listed at the beginning of each reading. These LOS indicate what you should be able to accomplish after studying the reading. The LOS, the reading, and the end-of-reading questions are dependent on each other, with the reading and questions providing context for understanding the scope of the LOS.

You should use the LOS to guide and focus your study because each examination question is based on the assigned readings and one or more LOS. The readings provide context for the LOS and enable you to apply a principle or concept in a variety of scenarios. The candidate is responsible for the entirety of the required material in a study session, which includes the assigned readings as well as the end-of-reading questions and problems.

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)).

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## FEATURES OF THE CURRICULUM

**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

**End-of-Reading Problems/Solutions** *All problems in the readings as well as their solutions (which are provided directly following the problems) are part of the curriculum and are required material for the exam.* When appropriate, we have included problems within and after the readings to demonstrate practical application and reinforce your understanding of the concepts presented. The problems are designed to help you learn these concepts and may serve as a basis for exam questions. Many of these questions are adapted from past CFA examinations.

**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.

**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.

**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.

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## 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, skill, or ability 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. The 2017 Level II curriculum has 17 study sessions, so a good plan is to devote 15–20 hours per week for 17 weeks to studying the material. Use the final four to six weeks before the exam to review what you have learned and practice with topic tests 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 will probably spend more time on some study sessions than on others, but on average you should plan on devoting 15–20 hours per study session. 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 available in the candidate resources area of our website to help you plan your study time. The interactive study planner recommends completion dates for each topic of the curriculum. Dates are determined based on study time available, exam topic weights, and curriculum weights. As you progress through the curriculum, the interactive study planner dynamically adjusts your study plan when you are running off schedule to help you stay on track for completion prior to the examination.

**CFA Institute Topic Tests** The CFA Institute topic tests are intended to assess your mastery of individual topic areas as you progress through your studies. After each test, 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 topic tests, 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 Prep Provider Guidelines 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 end-of-reading question and/or 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.

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## 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.



# Ethical and Professional Standards

## STUDY SESSIONS

**Study Session 1**

Ethical and Professional Standards

**Study Session 2**

Application

## 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, identify violations of the Code and Standards, and recommend appropriate corrective measures.



# ETHICAL AND PROFESSIONAL STANDARDS STUDY SESSION

# 1

## Ethical and Professional Standards

The readings in this study session focus on the CFA Institute Code of Ethics and Standards of Professional Conduct (the Code and Standards) and the CFA Institute Research Objectivity Standards as guides to ethical conduct in the investment profession.

The principles and guidance presented in the CFA Institute *Standards of Practice Handbook (Handbook)* form the basis for the CFA Institute self-regulatory program to maintain the highest professional standards among investment practitioners. A clear understanding of the CFA Institute Code of Ethics and Standards of Professional Conduct (both found in the *Handbook*) should allow the practitioner to identify and appropriately resolve ethical conflicts. The resulting recognition for integrity should benefit both the individual and the profession. “Guidance” in the *Handbook* addresses the practical application of the Code of Ethics and Standards of Professional Conduct. The guidance reviews the purpose and scope of each Standard, presents recommended procedures for compliance, and provides examples of the Standard in practice.

The CFA Institute Research Objectivity Standards address issues that CFA Institute believes merit more specific guidance. They are consistent with and a complement to the CFA Institute Code of Ethics and Standards of Professional Conduct.

### READING ASSIGNMENTS

<b>Reading 1</b>	Code of Ethics and Standards of Professional Conduct <i>Standards of Practice Handbook</i> , Eleventh Edition
<b>Reading 2</b>	Guidance for Standards I–VII <i>Standards of Practice Handbook</i> , Eleventh Edition
<b>Reading 3</b>	CFA Institute Research Objectivity Standards



## READING

# 1

## Code of Ethics and Standards of Professional Conduct

### LEARNING OUTCOMES

<i>Mastery</i>	<i>The candidate should be able to:</i>
<input type="checkbox"/>	a. describe the six components of the Code of Ethics and the seven Standards of Professional Conduct;
<input type="checkbox"/>	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.

***Modification to Standard VII(A)***

Since this standard was developed, CFA Institute has launched additional educational programs. The updated standard not only maintains the integrity of the CFA Program but also expands the same ethical considerations when members or candidates participate in such programs as the CIPM Program and the Claritas Investment Certificate. Whether participating as a member assisting with the curriculum or an examination or as a sitting candidate within a program, we expect them to engage in these programs as they would participate in the CFA Program.

**Old:**

Conduct as Members and Candidates in the CFA Program

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 the CFA examinations.

**New:**

Conduct as Participants in CFA Institute Programs

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.

### ***General Guidance and Example Revision***

The guidance and examples were updated to reflect practices and scenarios applicable to today's investment industry. Two concepts that appear frequently in the updates in this edition relate to the increased use of social media for business communications and the use of and reliance on the output of quantitative models. The use of social media platforms has increased significantly since the publication of the tenth edition. And although financial modeling is not new to the industry, this update reflects upon actions that are viewed as possible contributing factors to the financial crises of the past decade.

## **CFA Institute Professional Conduct Program**

All CFA Institute members and candidates enrolled in the CFA Program are required to comply with the Code and Standards. The CFA Institute Board of Governors maintains oversight and responsibility for the Professional Conduct Program (PCP), which, in conjunction with the Disciplinary Review Committee (DRC), is responsible for enforcement of the Code and Standards. The DRC is a volunteer committee of CFA charterholders who serve on panels to review conduct and partner with Professional Conduct staff to establish and review professional conduct policies. The CFA Institute Bylaws and Rules of Procedure for Professional Conduct (Rules of Procedure) form the basic structure for enforcing the Code and Standards. The Professional Conduct division is also responsible for enforcing testing policies of other CFA Institute education programs as well as the professional conduct of Certificate in Investment Performance Measurement (CIPM) certificants.

Professional Conduct inquiries come from a number of sources. First, members and candidates must self-disclose on the annual Professional Conduct Statement all matters that question their professional conduct, such as involvement in civil litigation or a criminal investigation or being the subject of a written complaint. Second, written complaints received by Professional Conduct staff can bring about an investigation. Third, CFA Institute staff may become aware of questionable conduct by a member or candidate through the media, regulatory notices, or another public source. Fourth, candidate conduct is monitored by proctors who complete reports on candidates suspected to have violated testing rules on exam day. Lastly, CFA Institute may also conduct analyses of scores and exam materials after the exam, as well as monitor online and social media to detect disclosure of confidential exam information.

When an inquiry is initiated, the Professional Conduct staff conducts an investigation that may include requesting a written explanation from the member or candidate; interviewing the member or candidate, complaining parties, and third parties; and collecting documents and records relevant to the investigation. Upon reviewing the material obtained during the investigation, the Professional Conduct staff may conclude the inquiry with no disciplinary sanction, issue a cautionary letter, or continue proceedings to discipline the member or candidate. If the Professional Conduct staff believes a violation of the Code and Standards or testing policies has occurred, the member or candidate has the opportunity to reject or accept any charges and the proposed sanctions.

If the member or candidate does not accept the charges and proposed sanction, the matter is referred to a panel composed of DRC members. Panels review materials and presentations from Professional Conduct staff and from the member or candidate. The panel's task is to determine whether a violation of the Code and Standards or testing policies occurred and, if so, what sanction should be imposed.

Sanctions imposed by CFA Institute may have significant consequences; they include public censure, suspension of membership and use of the CFA designation, and revocation of the CFA charter. Candidates enrolled in the CFA Program who have violated the Code and Standards or testing policies may be suspended or prohibited from further participation in the CFA Program.

## Adoption of the Code and Standards

The Code and Standards apply to individual members of CFA Institute and candidates in the CFA Program. CFA Institute does encourage firms to adopt the Code and Standards, however, as part of their code of ethics. Those who claim compliance should fully understand the requirements of each of the principles of the Code and Standards.

Once a party—nonmember or firm—ensures its code of ethics meets the principles of the Code and Standards, that party should make the following statement whenever claiming compliance:

“[Insert name of party] claims compliance with the CFA Institute Code of Ethics and Standards of Professional Conduct. This claim has not been verified by CFA Institute.”

CFA Institute welcomes public acknowledgement, when appropriate, that firms are complying with the CFA Institute Code of Ethics and Standards of Professional Conduct and encourages firms to notify us of the adoption plans. For firms that would like to distribute the Code and Standards to clients and potential clients, attractive one-page copies of the Code and Standards, including translations, are available on the CFA Institute website ([www.cfainstitute.org](http://www.cfainstitute.org)).

CFA Institute has also published the Asset Manager Code of Professional Conduct, which is designed, in part, to help asset managers comply with the regulations mandating codes of ethics for investment advisers. Whereas the Code and Standards are aimed at individual investment professionals who are members of CFA Institute or candidates in the CFA Program, the Asset Manager Code was drafted specifically for firms. The Asset Manager Code provides specific, practical guidelines for asset managers in six areas: loyalty to clients, the investment process, trading, compliance, performance evaluation, and disclosure. The Asset Manager Code and the appropriate steps to acknowledge adoption or compliance can be found on the CFA Institute website ([www.cfainstitute.org](http://www.cfainstitute.org)).

## Acknowledgments

CFA Institute is a not-for-profit organization that is heavily dependent on the expertise and intellectual contributions of member volunteers. Members devote their time because they share a mutual interest in the organization’s mission to promote and achieve ethical practice in the investment profession. CFA Institute owes much to the volunteers’ abundant generosity and energy in extending ethical integrity.

The CFA Institute Standards of Practice Council (SPC), a group consisting of CFA charterholder volunteers from many different countries, is charged with maintaining and interpreting the Code and Standards and ensuring that they are effective. The SPC draws its membership from a broad spectrum of organizations in the securities field, including brokers, investment advisers, banks, and insurance companies. In most instances, the SPC members have important supervisory responsibilities within their firms.

The SPC continually evaluates the Code and Standards, as well as the guidance in the *Handbook*, to ensure that they are

- representative of high standards of professional conduct,
- relevant to the changing nature of the investment profession,
- globally applicable,
- sufficiently comprehensive, practical, and specific,
- enforceable, and
- testable for the CFA Program.

The SPC has spent countless hours reviewing and discussing revisions to the Code and Standards and updates to the guidance that make up the eleventh edition of the *Handbook*. Following is a list of the current and former members of the SPC who generously donated their time and energy to this effort.

James E. Hollis III, CFA, Chair

Rik Albrecht, CFA

Terence E. Burns, CFA

Laura Dagan, CFA

Samuel B. Jones, Jr., CFA

Ulrike Kaiser-Boeing, CFA

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James M. Meeth, CFA

Guy G. Rutherford, Jr., CFA

Edouard Senechal, CFA

Wenliang (Richard) Wang, CFA

Peng Lian Wee, CFA

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## ETHICS AND THE INVESTMENT INDUSTRY

Society ultimately benefits from efficient markets where capital can freely flow to the most productive or innovative destination. Well-functioning capital markets efficiently match those needing capital with those seeking to invest their assets in revenue-generating ventures. In order for capital markets to be efficient, investors must be able to trust that the markets are fair and transparent and offer them the opportunity to be rewarded for the risk they choose to take. Laws, regulations, and enforcement play a vital role but are insufficient alone to guarantee fair and transparent markets. The markets depend on an ethical foundation to guide participants' judgment and behavior. CFA Institute maintains and promotes the Code of Ethics and Standards of Professional Conduct in order to create a culture of ethics for the ultimate benefit of society.

### Why Ethics Matters

Ethics can be defined as a set of moral principles or rules of conduct that provide guidance for our behavior when it affects others. Widely acknowledged fundamental ethical principles include honesty, fairness, diligence, and care and respect for others. Ethical conduct follows those principles and balances self-interest with both the direct and the indirect consequences of that behavior for other people.

Not only does unethical behavior by individuals have serious personal consequences—ranging from job loss and reputational damage to fines and even jail—but unethical conduct from market participants, investment professionals, and those who service investors can damage investor trust and thereby impair the sustainability of the global capital markets as a whole. Unfortunately, there seems to be an unending parade of stories bringing to light accounting frauds and manipulations, Ponzi schemes, insider-trading scandals, and other misdeeds. Not surprisingly, this has led to erosion

in public confidence in investment professionals. Empirical evidence from numerous surveys documents the low standing in the eyes of the investing public of banks and financial services firms—the very institutions that are entrusted with the economic well-being and retirement security of society.

Governments and regulators have historically tried to combat misconduct in the industry through regulatory reform, with various levels of success. Global capital markets are highly regulated to protect investors and other market participants. However, compliance with regulation alone is insufficient to fully earn investor trust. Individuals and firms must develop a “culture of integrity” that permeates all levels of operations and promotes the ethical principles of stewardship of investor assets and working in the best interests of clients, above and beyond strict compliance with the law. A strong ethical culture that helps honest, ethical people engage in ethical behavior will foster the trust of investors, lead to robust global capital markets, and ultimately benefit society. That is why ethics matters.

### ***Ethics, Society, and the Capital Markets***

CFA Institute recently added the concept “for the ultimate benefit of society” to its mission. The premise is that we want to live in a socially, politically, and financially stable society that fosters individual well-being and welfare of the public. A key ingredient for this goal is global capital markets that facilitate the efficient allocation of resources so that the available capital finds its way to places where it most benefits that society. These investments are then used to produce goods and services, to fund innovation and jobs, and to promote improvements in standards of living. Indeed, such a function serves the interests of the society. Efficient capital markets, in turn, provide a host of benefits to those providing the investment capital. Investors are provided the opportunity to transfer and transform risk because the capital markets serve as an information exchange, create investment products, provide liquidity, and limit transaction costs.

However, a well-functioning and efficient capital market system is dependent on trust of the participants. If investors believe that capital market participants—investment professionals and firms—cannot be trusted with their financial assets or that the capital markets are unfair such that only insiders can be successful, they will be unlikely to invest or, at the very least, will require a higher risk premium. Decreased investment capital can reduce innovation and job creation and hurt the economy and society as a whole. Reduced trust in capital markets can also result in a less vibrant, if not smaller, investment industry.

Ethics for a global investment industry should be universal and ultimately support trust and integrity above acceptable local or regional customs and culture. Universal ethics for a global industry strongly supports the efficiency, values, and mission of the industry as a whole. Different countries may be at different stages of development in establishing standards of practice, but the end goal must be to achieve rules, regulations, and standards that support and promote fundamental ethical principles on a global basis.

### ***Capital Market Sustainability and the Actions of One***

Individuals and firms also have to look at the indirect impacts of their actions on the broader investment community. The increasingly interconnected nature of global finance brings to the fore an added consideration of market sustainability that was, perhaps, less appreciated in years past. In addition to committing to the highest levels of ethical behavior, today’s investment professionals and their employers should consider the long-term health of the market as a whole.

As recent events have demonstrated, apparently isolated and unrelated decisions, however innocuous when considered on an individual basis, in aggregate can precipitate a market crisis. In an interconnected global economy and marketplace, each