The Private Wealth Management Industry - Answers

Reading 1

Q1.1–Q1.4

Chris Thompson is the wealth manager for Howard Stein, a high-net-worth individual. Stein's assets are managed by a variety of managers, but Hamlin & Co. provides centralized safekeeping, record keeping, performance analytics, and trade processing. Legal assistance on asset structure, estate plans, and other related services are provided by Carol Dufresne, Esq.

Stein tells Thompson that he has substantially increased his liability insurance coverage and asks whether this purchase has implications for his investment portfolio.

Stein would like to generate higher returns on his fixed-income investments. Thompson suggests private placements and offers to connect Stein with a banker.

Question 1.1

Hamlin & Co is *best* described as a:

A. custodian. ✓

B. tax adviser.

C. property manager.

Correct Answer: A

EXPLANATION

A is correct. Custodians' role involves safekeeping assets, record keeping, performance analytics, and trade processing that ensures managed assets are legally separated from the assets of the manager.

Question 1.2

Dufresne is *best* categorized as a:

A. custodian.

B. support professional.

C. wealth planning professional. ✓

Correct Answer: C

EXPLANATION

C is correct. Legal experts and tax advisers are considered foundational for the protection and preservation of wealth and, as such, are best classified as wealth management professionals.

Question 1.3

Does Stein’s change in insurance coverage justify changes to his investment portfolio?

A. No.

B. Yes, it reduces his need to hold cash and short-term bonds. ✓

C. Yes, it increases his need to hold cash and short-term bonds.

Correct Answer: B

EXPLANATION

B is correct. A client who opts for more insurance coverage would not need to maintain as much liquidity to self-insure against potential risks. This could point to a lower allocation in cash or short-term bonds. However, it may also indicate a higher degree of risk aversion on the part of the client and, thus, a lower willingness (rather than ability) to take risk. Thus, while the need is lower, a conversation with the client regarding risk preferences would still be in order.

Question 1.4

For the desired purpose, it would be *most* appropriate to refer Stein to:

A. a private banker.

B. a commercial banker.

C. an investment banker. ✓

Correct Answer: C

EXPLANATION

C is correct. Investment bankers may identify investments that align with a client's financial objectives. This could range from private placements (on the buy side) to specialized investment funds that offer attractive growth or income potential.

Reading 2

Q2.1–Q2.4

James Beauregard is a senior wealth manager for Prudent Investments, a wealth management firm based in the Bahamas that has adopted the CFA Institute Asset Manager Code (AMC). He manages both separate client accounts and a pooled investment fund that has a mandate to hold at least 90% of its assets in the shares of technology stocks.

Beauregard has been analyzing the shares of Superfrack, a shale oil company. He believes it is well positioned in the industry, will grow its profits considerably over the next several years, and is attractively valued. He makes the shares a 5% holding in all the accounts he manages. It marks the first time he has ever placed a non-technology stock in the pooled fund.

For the pooled fund, Beauregard directs a great deal of trades through TechBroker, as they specialize in trading technology stocks and therefore usually offer tighter spreads and better access to less liquid shares. Because of the high volume of his trades, TechBroker offers to pay for his attendance at an industry conference that Beauregard believes will generate investment insights. Beauregard accepts the offer.

In a meeting of senior management, Prudent's compliance officer shares an update of the firm's policies, including:

- Portfolio information provided to clients is verified by the firm's custodian rather than its auditor.
- The risk-management process covers market-related risks firmwide.
- The business continuity plan provides contingency measures for key functions like portfolio management and trading but not for some areas such as marketing and staff recruitment.

When reporting performance, Prudent presents information that is fair, accurate, relevant, timely, and complete but does not fully comply with the GIPS Standards. Securities that do not have readily available third-party quotations are valued using models. Prudent's management believes the resulting valuations are reasonable estimates but have no way of knowing whether they are completely accurate.

Question 2.1

Are Beauregard's actions regarding Superfrack consistent with the AMC with respect to investment process and actions?

A. Yes.

B. No, it is not consistent with the objectives and constraints of the pooled fund.

C. No, he does not consider the investment objectives and constraints of each client. ✓

Correct Answer: C

EXPLANATION

C is correct. Beauregard places the shares in all of his accounts, which include both the pooled technology fund and separate accounts. The 5% stake is within the mandate of the pooled fund because the mandate is for at least 90% in technology stocks, which is not violated by the 5% stake in Superfrack. However, for separate accounts, the AMC requires him to "Evaluate and understand the client's investment objectives, tolerance for risk, time horizon, liquidity needs, financial constraints, any unique circumstances." It is unlikely that such an evaluation would result in the same portfolio weight in Superfrack for every client.

Question 2.2

Is Beauregard's decision to accept TechBroker's offer consistent with the AMC with respect to trading?

A. Yes. ✓

B. No, he is required to seek best execution.

C. No, he should not use client commission dollars to attend the conference.

Correct Answer: A

EXPLANATION

A is correct. Beauregards trade volume with TradeBroker is made because they offer best execution in the form of tight spreads and superior access to illiquid shares. As the conference is expected to provide information that directly assist Beauregard in his investment decision-making process, it is an acceptable use of client commission dollars.

Question 2.3

Prudent's policies are *least* consistent with the AMC's guidelines for risk management, compliance, and support regarding:

A. client reporting.

B. risk management. ✓

C. business continuity.

Correct Answer: B

EXPLANATION

B is correct. The AMC specifies a firmwide risk management process covering market and non-market risks, and Prudent's policies cover only market-related risks. The custodian is an acceptable third-party verifier for client reports, and the business continuity plans cover key functions.

Question 2.4

Are Prudent’s performance reports consistent with the performance and valuation guidelines of the AMC?

A. Yes. ✓

B. No, they are not fully compliant with the GIPS Standards.

C. No, they are insufficient with respect to securities without readily available quotations.

Correct Answer: A

EXPLANATION

A is correct. Under the AMC, Managers must: 1. Present performance information that is fair, accurate, relevant, timely, and complete. Managers must not misrepresent the performance of individual portfolios or of their firm. 2. Use fair-market prices to value client holdings and apply, in good faith, methods to determine the fair value of any securities for which no independent, third-party market quotation is readily available. The GIPS Standards are voluntary, and Prudent’s is consistent with AMC.