

Level III of the CFA® Exam

Item-Set Questions with Answers - Private Wealth Pathway -
Volume 1

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Case 16: The Lee Family Wealth Management Plan

The Lee family consists of Ivy and Charles Lee, successful entrepreneurs in their early 50s, with three children aged 20, 18, and 15. They have accumulated significant wealth through their business ventures and investments. Their primary goals include securing their retirement, providing for their children's education, and establishing a legacy for future generations. They also have a strong interest in philanthropy.

The Lee family owns a diversified portfolio of assets, including a private business, real estate holdings, stocks, bonds, and various other investments. They have significant exposure to their private business, representing about 40% of their net worth. The rest of their assets are split between publicly traded securities and real estate. They are concerned about the risk associated with their concentrated stock position in the private business and want to ensure that their portfolio is well-diversified to manage this risk.

Ivy and Charles have engaged a wealth manager to develop a comprehensive wealth management plan. They are particularly concerned about tax efficiency, investment, risk management, and estate planning. Additionally, they want to ensure that their investment strategy aligns with their risk tolerance and time horizon while also considering the potential for charitable giving through a donor-advised fund.

Financial Goals:

1. Retirement Planning: Ivy and Charles aim to retire at 65 and maintain their current lifestyle. They estimate they will need \$200,000 annually in today's dollars.
 2. Education Funding: They plan to fully fund the college education of their three children, with an estimated cost of \$50,000 per year per child for four years.
 3. Philanthropy: They wish to establish a donor-advised fund with an initial contribution of \$1 million to support various charitable causes.
 4. Legacy Planning: Ivy and Charles want to ensure a smooth transfer of wealth to their children and minimize estate taxes.
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Q.1 Which of the following statements *best* describes the primary role of a private wealth manager?

- A. To manage the client's investment portfolio exclusively.
- B. To provide comprehensive financial advice that includes investment management, tax planning, estate planning, and other financial services.
- C. To focus on high-frequency trading strategies to maximize short-term gains.

The correct answer is **B**.

Private wealth managers offer many services beyond just managing an investment portfolio. Their role includes comprehensive financial planning, which involves tax planning, estate planning, philanthropy advice, and more, tailored to the specific needs of high-net-worth individuals.

A is incorrect. This option is too narrow. While managing investments is crucial, private wealth management encompasses various financial planning services.

C is incorrect. High-frequency trading is a specialized strategy often employed by hedge funds and is not typically the primary focus of private wealth managers who aim for long-term financial goals.

CFA Level III, Private Wealth Pathway, Volume 1: Learning Module 1: The Private Wealth Management Industry: LOS 1(c): Discuss how various advisers, consultants, and professionals support private wealth managers and their clients;

Q.2 Which of the following characteristics is *most likely* to be unique to ultra-high-net-worth (UHNW) clients compared to high-net-worth (HNW) clients?

- A. The use of robo-advisors for financial advice.
- B. There is a need for specialized family governance structures, such as family offices and family constitutions.
- C. A preference for low-cost index funds over actively managed portfolios.

The correct answer is **B**.

UHNW clients, typically those with over \$30 million in investable assets, often require more complex and specialized services, such as family offices and constitutions, to manage their wealth and ensure smooth succession planning. This contrasts with HNW clients, who may not require such extensive structures.

A is incorrect. Mass affluent clients more commonly use robo-advisors than UHNW clients, who generally prefer personalized, high-touch advisory services. Robo-advisors are digital platforms that provide automated, algorithm-driven financial planning services with little to no human supervision.

C is incorrect. While some UHNW clients may use low-cost index funds, their wealth allows them to access a broader range of investment options, including bespoke and actively managed strategies.

CFA Level III, Private Wealth Pathway, Volume 1: Learning Module 2: Working With the Wealthy: LOS 2(c): Describe the unique characteristics of ultra-high-net-worth individuals and how these characteristics distinguish them from other private wealth management clients;

Q.3 Which step is the *least likely* part of the goals-based planning process?

- A. Defining and prioritizing financial goals.
- B. Developing a single portfolio that addresses all goals collectively.
- C. Structuring sub-portfolios for each specific goal.

The correct answer is **B**.

Goals-based planning involves defining and prioritizing financial goals, structuring sub-portfolios for each specific goal, and managing the aggregate portfolio. It does not involve developing a single portfolio to address all goals collectively because different goals often have different time horizons and risk tolerances.

A is incorrect. Describing and quantifying the goal are the first two steps in goals based financial planning. Describing the goal involves identifying the goal, establishing a time frame for each goal, assessing the relative importance of each goal. Quantifying the goal involves identifying its financial costs, the minimum acceptable probability of success for each goal, the risks associated with each goal, and the required resources.

C is incorrect. Structuring sub-portfolios for each specific goal in goals-based financial planning involves creating distinct investment portfolios tailored to the unique characteristics, timelines, and risk tolerances associated with each goal.

CFA Level III, Private Wealth Pathway, Volume 1: Learning Module 3: Wealth Planning: LOS 3(a): Formulate goals-based financial plans and recommend appropriate strategies to achieve an individual's goals-based financial plans;

Q.4 How can Ivy and Charles Lee *most likely* maximize the tax efficiency of their investment portfolio?

- A. By focusing solely on high-yield bonds.
- B. By strategically placing tax-inefficient investments in tax-advantaged accounts.
- C. By investing primarily in real estate.

The correct answer is **B**.

Tax efficiency can be maximized by placing tax-inefficient investments, such as high-yield bonds or actively managed funds that generate significant taxable income, in tax-advantaged accounts like IRAs or 401(k)s. This strategy helps defer or eliminate taxes on investment income.

A is incorrect. High-yield bonds can generate significant taxable income, making them less tax-efficient unless held in tax-advantaged accounts.

C is incorrect. While real estate can have tax advantages, it is not necessarily the most tax-efficient investment option for every situation. It does not address the need for diversification.

CFA Level III, Private Wealth Pathway, Volume 1: Learning Module 3: Wealth Planning: LOS 3(c): Evaluate how the principles of taxation and taxes influence goals-based planning and holistic financial plans for individual investors;

Q.5 Which strategies are *most appropriate* for managing the risk associated with the Lee family's concentrated stock position in their private business?

- A. Buying more shares of the same stock to increase their control.
- B. Utilizing hedging strategies such as options or collars.
- C. Liquidating all shares immediately, regardless of market conditions.

The correct answer is **B**.

Hedging strategies, such as options or collars, allow the Lees to manage the risk associated with their concentrated stock position without liquidating their shares immediately. This approach helps mitigate potential downside risk while maintaining some upside potential.

A is incorrect. Buying more shares of the same stock would exacerbate the concentration risk increasing their exposure to the same risk factors.

C is incorrect. Selling a large position immediately can lead to a significant decline in the stock price, especially in a private business where liquidity might be limited. This could result in a lower realized value for their shares. Additionally, it would likely trigger substantial capital gains taxes.

CFA Level III, Private Wealth Pathway, Volume 1: Learning Module 4: Investment Planning; LOS 4(a): Evaluate how the principles of taxation and taxes influence goals-based planning and holistic financial plans for individual investors;

Q.6 Which estate planning tool can *most likely* help Ivy and Charles ensure their wealth is transferred according to their wishes while minimizing estate taxes?

- A. A simple will.
- B. A revocable living trust.
- C. An informal letter of instruction.

The correct answer is **B**.

A revocable living trust can help Ivy and Charles manage their assets during their lifetime and ensure that their wealth is transferred according to their wishes after their death. It also offers advantages such as avoiding probate and potentially reducing estate taxes.

A is incorrect. While a will is essential, it does not provide the same level of control or tax benefits as a trust and requires probate. Additionally, it only becomes effective after death and does not provide any provisions for managing assets in case of the grantors' incapacity.

C is incorrect. This is not a legally binding document and does not substitute for a will or trust.

CFA Level III, Private Wealth Pathway, Volume 1: Learning Module 2: Working With the Wealthy; LOS 2(a): Describe how family and human dynamics relate to wealth and its management;

Case 17: The Li Family Wealth Management

The Li family consists of David Li, a successful biotechnology entrepreneur, his wife Helen, and their two children, Amy and Eric. David recently sold his biotech company for \$75 million and seeks comprehensive private wealth management services to ensure his family's financial future. The Li family has multiple goals, including securing their children's education, planning for retirement, philanthropy, and preserving wealth for future generations. They also want to ensure tax efficiency and manage their investments wisely.

In his late 50s, David has been an astute businessman, but now he wants to focus on enjoying life and ensuring his family's secure financial future. Helen has been a supportive partner, managing the household and participating in various charitable activities. Their children, Amy (20) and Eric (17) are both in their educational phases, with Amy pursuing a degree in finance and Eric still in high school. The family resides in San Francisco, where they enjoy an affluent lifestyle, including a second home in Lake Tahoe, and interests in various art collections.
