

CFA Society of Los Angeles CFA Review Program

CFA Exam - Level III

Essay Writing Workshop

Exam Study, Test Taking Skills and Essay Pointers

January 3, 2026

Glen A. Holden, Jr., CFA
 [\(805\) 320-3240;](tel:8053203240) glenaholdenjr@aol.com

My Background

Why am I qualified to talk about this subject? I spent five years on the Ethics Subcommittee of the Candidate Curriculum Committee (now the Education Advisory Committee), creating the Ethics Curriculum and participating as one of the authors of the Standards of Practice Casebook, which was retired in 2018 after 25 years in service and used as the template for the Essay and Item Set methodology. I graded Level III exams for the CFA Institute for twelve years, as well. I served on the Disciplinary Review Committee for six years, the final three as Chair.

I served as President and on the Board of Governors of the CFA Society of Los Angeles, the Board of Governors of the Association of Investment Management and Research (the entity created to combine the ICFA and the FAF), the Board of Trustees of the Institute of Chartered Financial Analysts (“ICFA”), the Board of Governors of the Financial Analysts Federation (“FAF”), and the Board of Governors of the CFA Institute. I was an instructor for the 2020 and 2022 USC/CFALA Review Program for Level III Ethics.

Ground Rules for Today's Workshop

James Lewis, CFA of the CFA Society of Los Angeles will be managing the Zoom Room today and recording the Workshop. Thank you, James. Thanks also to Kate Freeman, CFA and Max Seeget, CFA who reviewed the Computer Based Testing (“CBT”) sections. This presentation and the supporting materials, such as, examples in the Workshop and cases that don't fit on a slide will be sent to participants by the CFALA office.

There are many slides and a lot of material to cover. I have included screenshots of pages from the CFA Institute's website and included the “links” on the final slides, so I won't spend much time on them.

In the section on Essay Writing where there are examples, I will pause briefly for the Command Word question to give you a moment to consider what your response might be and then proceed to the presentation for the response. You don't have to respond; it is meant to provide a mental opportunity for “how would I approach this”?

Ground Rules for Today's Workshop, (ctd.)

I intend to cover the pressing issues in the workshop.

With the number of participants that are expected on the Zoom call, I will not have the chance to monitor "Chat". James will be doing so. Please submit any questions you have through the Chat function. They should be specific questions, not general "hypotheticals". James will combine similar questions to be addressed and answered after the formal presentation.

We are scheduled for two hours. The presentation should run an hour and a half, with about thirty minutes for the Q&A. You can sign off and still receive the content.

The time allotted for the Q&A section at the end of the workshop should be sufficient, however, if there are other questions to address, I will be available either by my mobile phone or email as on the first slide.

General Comments, (ctd.)

The screenshot displays the CFA Institute website's 'CFA Program' overview page. The browser's address bar shows the URL <https://www.cfainstitute.org/programs/cfa-program#overview>. The website's navigation bar includes links for 'Employers', 'Universities', and 'University students', along with 'Sign In' and 'Create Account' buttons. The main header features the CFA Institute logo and a menu with 'Programs', 'Membership', 'Insights', 'Standards', and 'About'. A large banner image with a blue and orange abstract pattern is visible. Below the banner, the text 'CFA® Program' is prominently displayed. A sidebar on the right highlights the program cost: 'From USD 1,140 /exam*', with a note '*See dates & fees page for details.' and a yellow box stating 'Save USD 350 when you register by 21 January for the August 2026 exams.' Below this, there are two buttons: 'Enroll and register' and 'Download brochure'. At the bottom, a horizontal menu lists various sections: 'Overview', 'Dates & fees', 'Curriculum', 'Learning Ecosystem', 'Career prospects', and 'Policies'.

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General Comments

The CFA Institute is very direct in telling the Candidates all they need to know to pass each level of the exam: curriculum and reading, studying and preparation, and, now, a personal study program called the Program Learning Ecosystem (“LES”), where there are enormous candidate resources. The amount of technical reading required at each level is daunting, especially at Level III, and the page count is 2,200 +/- pages.

The Learning Outcome Statement is used to tie the area of the reading on which the CFAI wants to focus attention to the possible area of questioning on the exam – these are the road maps. Use the LOS to your advantage and focus on what it is suggesting. Pay attention to the End of Reading Questions – it is a refinement of the LOS.

Taking the “Mock Exams” will give you an immediate “grade” and potentially expose areas of personal weakness in your knowledge of the curriculum.

General Comments, (ctd.)

In 2021, with the advent of Computer Based Testing (“CBT”), the CFA Institute went to a shorter exam of 180 items from 240. All Topic Areas are included and the weightings have remained the same. This has been evaluated by an independent psychometric testing organization to ensure total exam reliability, that is, to ensure the consistency and degree of difficulty remain the same from year to year.

In 2024, the CFA Institute changed the manner of studying the curriculum to be “Learning Modules” that keep the Topic Areas intact and are recommended to be studied module by module. There were minor changes in the Candidate Body of Knowledge and, thus, the curriculum. The Learning Outcome Statement is still the road map to focus attention on the reading for questions on the exam.

For 2025, the Learning Modules segued into what is now a Specialization track, with three distinct “Pathways”.

General Comments, (ctd.)

Learning Modules

“The inclusion of learning modules marks a significant change in the curriculum. These modules enhance the learning design of the curriculum to align with best practice in meeting adult learners’ needs. Each module emphasizes the practical relevance of the content, is designed to be completed in one sitting, and incorporates practice questions. We also have included more visuals and examples, along with increased opportunities for CFA® Program candidates to practice the skills.”

For 2025 and 2026 Level III exams (and Levels I and II), the CFA Institute has introduced specialized pathways – Private Wealth and Private Markets while also keeping the traditional Portfolio Management path. Candidates will be able to select a path that teaches content more directly related to their interests and aspirations. The three versions will have a 'common core' of curriculum at Level III, supplemented by specialized content for each pathway.

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Level III specialized pathways

Discover specialized pathways for the CFA® Program Level III exam that align with your career goals.

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General Comments, (ctd.)

Use the Personal Study Program (LES) as an “orderly, systematic approach to exam preparation”. There is an enormous amount of reading and material to absorb – use the tools that are made available to concentrate your study efforts. The Candidate Body of Knowledge (CBOK) is very broad, and that breadth makes the reading and studying a daunting task. Use the tools that the CFA Institute provides to aid your studying, breaking the readings into more manageable portions.

When I took the CFA exams, each Level was essay only. There were no multiple-choice questions. There were very few review courses, and none were offered by the CFA Society of LA at that time. Passing Rates on the Exam have been dropping over the course of time, and there are many theories about this trend or reasons given. The CFA Institute is very careful to maintain and ensure that the degree of difficulty of the Examination remains the same each year, at each Level, however, the breadth of the CBOK has expanded as practitioners feel CFA Members should be fully prepared for newer techniques and investment areas.

General Comments, (ctd.)

The CFA Exams and the material from the Candidate Body of Knowledge (CBOK) develop from Level to Level. While not tested on the prior Level's reading and information, it is expected that the Candidate retain the knowledge and be able to use it in the investment decision-making process. As one of the slides expresses, these are Exams that evolve in complexity.

Pass rates for all levels have dropped each year as you will note. Preparation is the key to passing the exam, both studying and addressing how to “score” points.

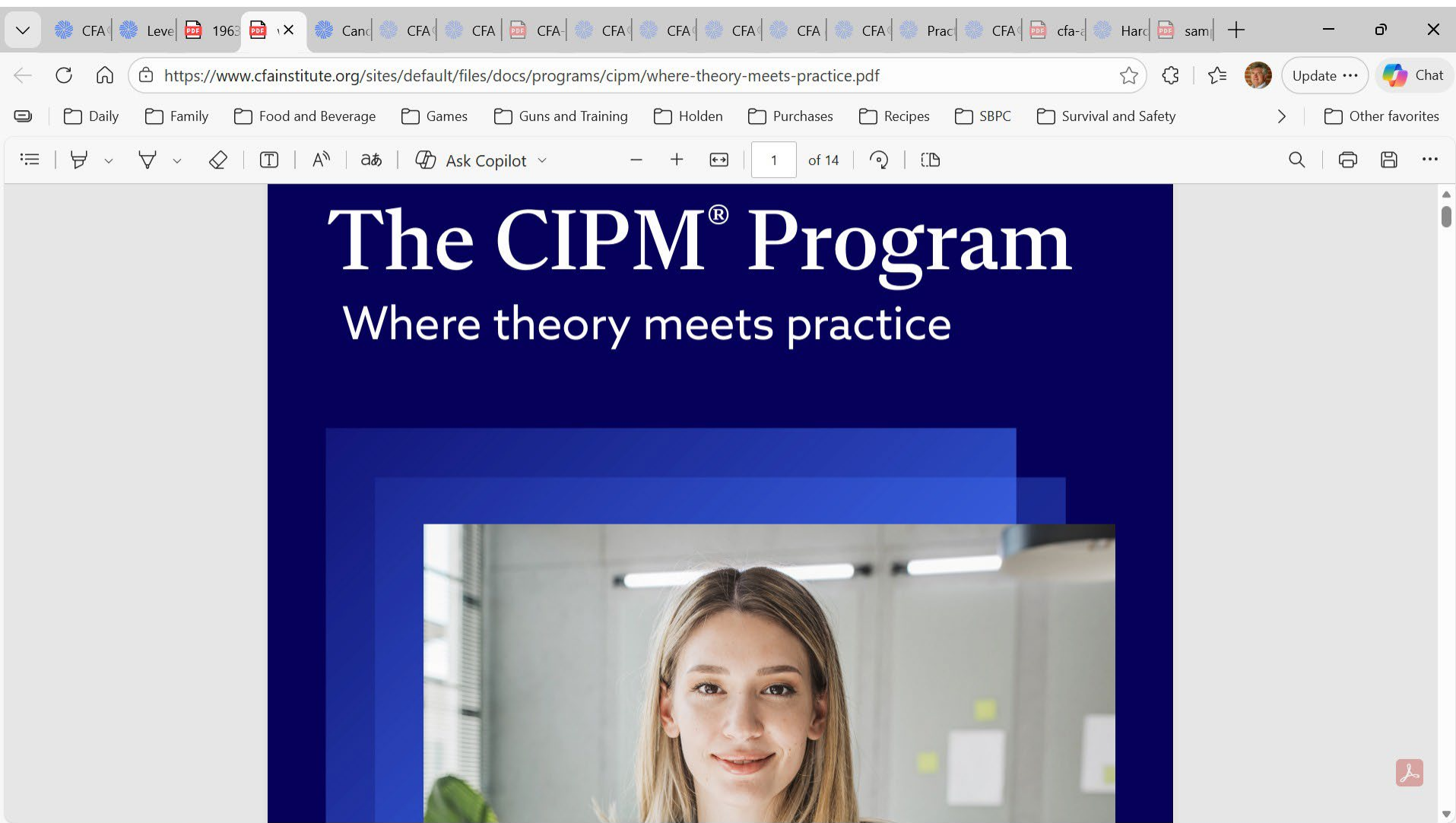
In a new policy, the CFA Institute has restricted the Candidate's ability to continuously retake a Level Exam after failing. The new policy gives the Candidate six attempts to pass at each Level before removing the Candidate from the CFA Examination Program. It is more important than ever to pass the Level III Exam (and the others, as well, but our workshop today is discussing Level III only).



Candidate Body of Knowledge (CBOK)

Explore the core competencies that shape the CFA® Program curriculum.






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Tools: Ask Copilot, 1 of 1




Understand the format of essay questions

There are two types—constructed responses (word-based) and calculation-based responses. Get started right away framing your study around these formats. Use the practice quizzes and mock exams available in the [Learning Ecosystem](#) to gauge your exam readiness.




Provide exactly what is asked for (and no more)

You do not get extra credit for producing a lot of words. Meandering prose can potentially hurt your score. Answer succinctly and to the point. Use bullet points if you would like to.



Answering calculation questions

For calculation-based questions, you are not required to show your work. If you choose to show your work, it will be evaluated as part of the response and could conceptually result in partial credit in cases where the answer is not fully correct.



Get practical

All Level III candidates must complete one [Practical Skills Module \(PSM\)](#).^{*} This is practical, relevant skills training that will provide you with on-the-job application of what you are learning in the curriculum. Although PSM content won't be tested, your result will only be released once you've completed your PSM. When making your study plan, be sure to plan 10-20 hours to complete your PSM.

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Adobe PDF icon

Candidates may take the [CFA® Program exam](#) a maximum of two times per calendar year (when applicable), but not in consecutive testing windows or in windows less than six months apart. Each candidate is allowed up to six total attempts per exam level. Candidates who are unsuccessful after six attempts at the same level are no longer eligible to register —this applies to attempts under both existing and newly created accounts. Partially completed exams (e.g., completing only one session) count toward the maximum attempt limit.

Only individuals who meet all admission requirements—including professional conduct standards—and are not currently suspended or prohibited from participating in CFA Institute exam programs are eligible to register.

General Comments, (ctd.)

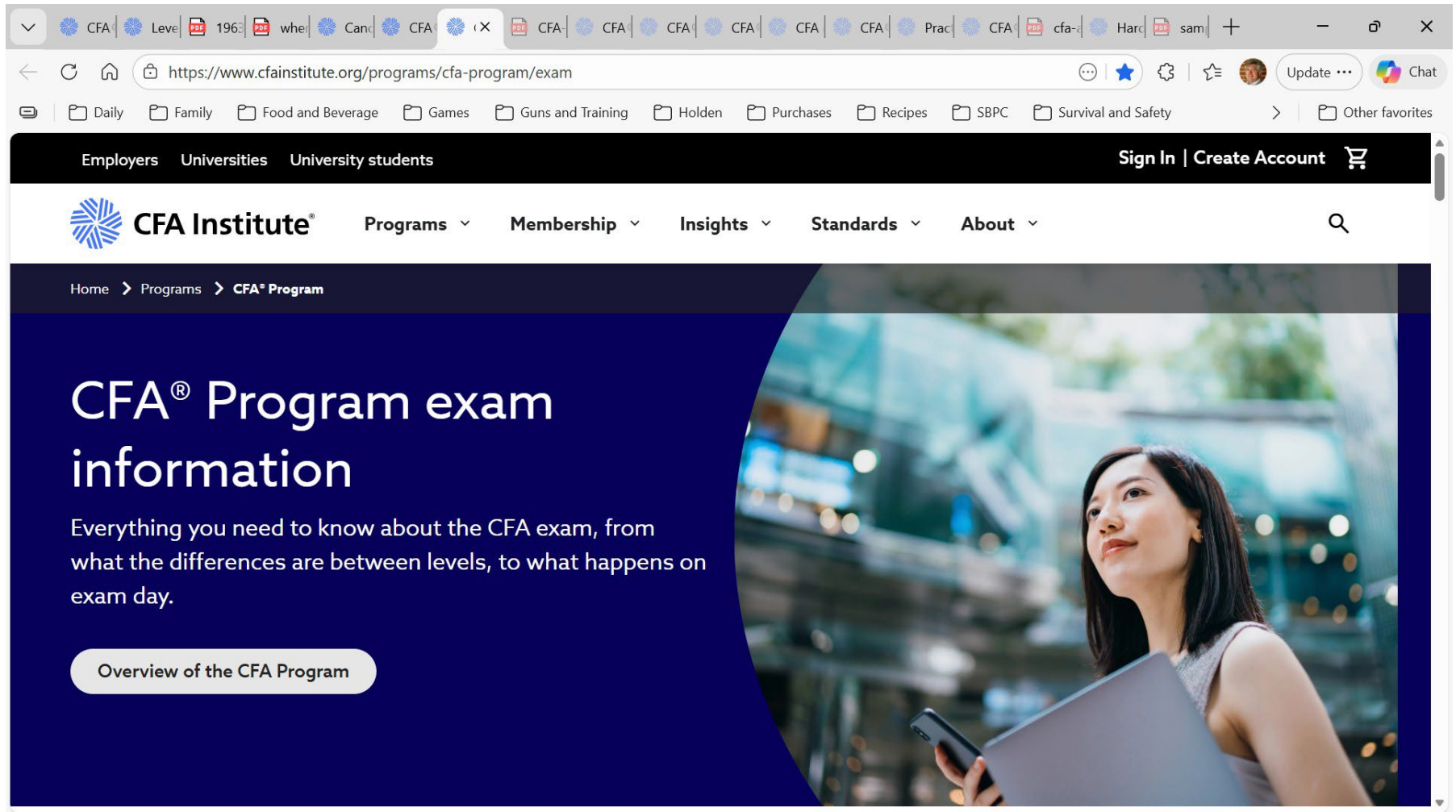
The topic area weights are given in the Study Guides. These will be used to determine the quantity of questions on the Level III Exam. A question may start in one topic area and then segue into another, so be prepared to adapt to a new topic area. There are five Core topic areas for Level III, in order of their weightings: Asset Allocation; Portfolio Construction; Derivatives and Risk Management; Ethics and Professional Standards; and, Performance Measurement. The “Pathways” will be 30-35% of the Exam. The pages and links from the CFA Institute I have used in preparing this are included on the final slide.

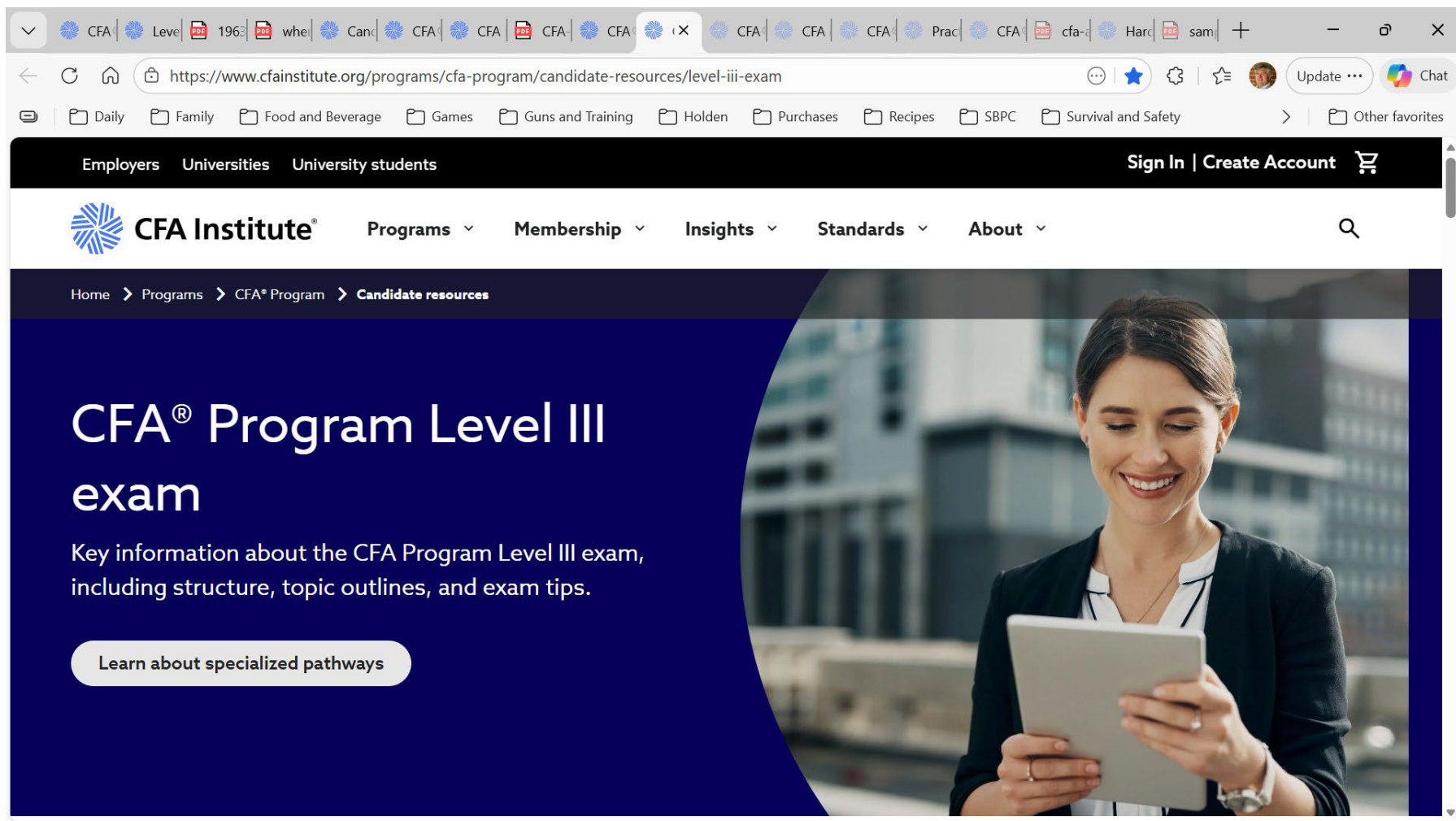
Addressing the Minimum Passing Score: is 70% a good guideline? The Candidate should be getting 70% or better in nearly all topic areas in order to pass. While a “Compensatory Exam”, there isn’t a substitute for knowledge across all topics. Chris Wiese of the CFA Institute suggests hitting proficiency at about 80% in each topic area in order to be fully assured of a passing score. I agree with him.

CFA Level III

There are plenty of resources available from the CFA Institute to aid the study efforts of Level III Candidates. I suppose that it can be intimidating or overwhelming to try to use all of the tools available, however, just start through the process and familiarity will come.

The links are all on the website and included as part of this presentation, which will be sent to you.





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Topic weights Core curriculum topics

Topic	Exam weight
Asset Allocation	15-20%
Portfolio Construction	15-20%
Performance Measurement	5-10%
Derivatives and Risk Management	10-15%
Ethical and Professional Standards	10-15%
Pathways (Portfolio Management or Private Markets or Private Wealth)	30-35%


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Study tools and resources



Access the Learning Ecosystem (LES)

Explore the curriculum, practice questions, mock exams, study planner, flashcards, and Practical Skills Modules. The CFA Program Learning Ecosystem has been updated for the February 2026 exam. Log in to your account to access the correct version.

CFA Program exam outlines

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New Requirement for Levels I, II, and III

In addition to the segue to the Specialized Pathways with Learning Modules, the CFA Institute has put in place another ancillary program that is a requirement for obtaining your CFA Designation. It is called the Practical Skills Modules or PSM. The year-by-year PSM is required in order to get your exam results, otherwise, the result will be voided, forcing the Candidate to retake that level of the CFA Exam. Each yearly PSM must be distinct (not one taken previously).

While the page count for the readings and curriculum was shortened, this will add another 10-20 hours of study and certification at each level. “A Practical Skills Module (PSM) uses a combination of videos, multiple-choice questions, guided practice, and case studies to develop your practical skills. In order to receive your exam result, you will be required to complete at least one PSM at each level. You may begin your PSM topic at any time after registration. Each PSM takes 10-20 hours to complete. Ensure your PSM is completed by clicking the 'Continue' or 'Finish Task' button within the module. Please review the [PSM Policy](#) for more details.”

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Reasons Why Candidates Fail Level III

The CFA Institute is very honest in addressing this issue, but the major reasons are: 1) not enough time is spent on reading the material and paying attention to the LOS (some Candidates recommend a study course which condenses and highlights the readings); 2) there isn't a personal study plan to allocate study hours and that addresses the most difficult topic areas; 3) not enough time is spent taking the practice exams under timed conditions (emulating the stress and time management that the Exam creates) and having three or four weeks to spend on topic areas where your knowledge is weaker, and, especially, using the tools that the LES provides; and, 4) the candidate is sleep-deprived or trying to balance work and study hours.

Reasons Why Candidates Fail Level III, (ctd.)

After the reading of the material assigned in the Learning Modules, studying the practice questions and taking the mock exams are a huge help – there is a bank of practice questions, and these and the mock exams can “provide immediate feedback so you can assess areas of weakness”. Spend time using the feedback from the Mock Exams and the LES to sharpen your knowledge in areas of difficulty. The topic areas and the Learning Modules that are your personal or professional interest should be fine, but the feedback from the LES may expose a need for more study.

Chris Wiese, from the CFA Institute has a number of videos on the website that address various topics related to the CFA Program. On the videos in the Candidate Resources section, he speaks to four factors that improve one’s chance at passing: Time; Progress; Practice; and, Proficiency. If you as a Candidate aren’t scoring above 70% in ALL topic areas, the chance of success is very slim. Again, I suggest using 80% as a guideline.

Reasons Why Candidates Fail Level III, (ctd.)

After the first three reasons (who among the Candidates is not sleep-deprived and trying to balance their work and study schedules), I should add a fifth, and the reason most Candidates have trouble on Level III Exam day, assuming the candidate has mastered the reading.

Have you heard the phrase “time is of the essence” before? It may be true on legal documents, but it is REALLY TRUE on the CFA Exam. Time wasted equates to points lost, since the Exam – questions and responses – is measured in minutes per question. The allocation of minutes is equal to the award of points, and accumulated points lead to your score. You can’t get any more points from your response to a question than what are assigned to that question. It may be that you are an expert on that particular subject, but try to SAVE minutes by having brief but complete answers.

Reasons Why Candidates Fail Level III, (ctd.)

One pointer that I have given for over thirty years is my “pet project”: study the Ethics area completely and become VERY familiar with it. When you think of the Minimum Passing Score, would another 2% make a difference in terms of passing the Exam? Another 3%, another 4%? There are some nuances in the Ethics area, but the readings and the material are straightforward, and these nuances can be resolved by knowledge of the Code of Ethics and the Standards of Professional Conduct. The CFA Institute has placed the Ethics in Volume 5, Modules 1-4 for a reason – it is at the end so that on Exam day, retention of the readings and the problems are more current.

Pick up points in Ethics to boost your overall score. There are 264 minutes on the Exam. The Ethics topic area weightings range from 10% to 15%; 10% is 27 minutes, 15% is 40, therefore, the 2% I refer to above is just less than six minutes – the right answer on a six-minute question or two parts of a question and you gain a couple of percentage points. You get the concept, I’m sure.

Reasons Why Candidates Fail Level III, (ctd.)

Does the Candidate need to know the Standard and Subsection numbers of each of the Professional Standards to get credit for the answer? It might help show complete knowledge and recall, but the ability to show comprehension of the subject and the ability to describe it or use it in an answer is more important – using the major heading of the section, such as, “Conflicts of Interest, Priority of Transactions/Frontrunning” or “Duty to Clients, Suitability” should receive full credit.

Can customary acronyms be used? Yes, where there is widespread recognition of the acronym, such as, GDP for Gross Domestic Product or PCE for the Federal Reserves favorite measure of Inflation rather than Personal Consumption Expenditures. Make sure you are using a very common one.

The Level III Exam

There will be two sessions of two hours and 12 minutes that are equal in terms of the time allotted and degree of difficulty, roughly equal in terms of the subject weightings. The intent of this presentation is to predominantly address the “Constructed Response” or “Essay” half of the morning and afternoon sessions. The “Item Set” or “Multiple Choice” will be discussed below briefly, and the material will be on slides where we may or may not have time to go over the content.

Previously, the first session was all essay sets and the second session was all item sets. As candidates consistently had difficulty finishing the essay session but often finished the item set session early, this change was made to improve the candidates’ ability to finish each session in the allotted time. When a multiple-choice question format is used in the essay portion of the exam, it is possible that there may be more or less than 3 answer choices. I believe there are no bolded command words used in multiple-choice questions.

The Level III Exam, (ctd.)

The exam materials talk about 11 vignettes, in both the morning and afternoon sessions. The point range will be between 10 points (or minutes) and 25 points (or minutes) – if the portfolio management topic area gets 35% of the weight of the exam and half is addressed in the morning session, then 18% of 132 minutes equals 24 minutes. I would round up to 25. There probably is not an essay question with a point value below 10 – if it is a question, it fits better into the Item-Set session.

Minutes are points and vice versa. Don't spend more than the allotted minutes on any question unless one more minute will finish the answer and complete it. Spending more than the allotted minutes takes time away from another question being answered. You can take the questions/vignettes out of order in the computer-based exam, so do the questions/topic areas/vignettes that you know best first to gain some time (minutes) which can be "spent" later to answer a question that you don't know as well. It's like the triage in an emergency room in opposite order, taking the hardest to remember or least familiar cases last.

The Level III Exam, (ctd.)

Item sets and constructed response (essay) sets will be mixed within each of the two exam sessions, so each session will have either 6 item sets and 5 essay sets or 5 item sets and 6 essay sets. Level III overall will not change: 11 essay sets and 11 item sets, for 12 points each, morning and afternoon. There are three different methods of entering a response: essay, numerical entry, and multiple choice.

The vignettes are followed by several questions that require a written response, some “item Set” or multiple-choice and some “essay”. In the traditional essay question, for example, you may be asked a multiple-choice question to select the portfolio (A, B or C) that meets a particular objective, followed by an essay question to justify that response. There also may be some numerical entry questions, where only a number is required, with no opportunity to show work. The vignettes for both essay and item set questions are about the same length and degree of difficulty.

Skip forward to read the question(s) so you have an idea of what you are looking for in the vignette.

The Level III Exam, (ctd.)

An essay text box will accept typed words and numbers. Note that a correct numerical value typed in the essay box by itself receives full credit – formulas and explanations are not required. If a candidate chooses to do so, they may describe steps used in the calculation or show values using either a math editor function or typing out variables in an equation. Partial credit is given for a formula entered even if the calculation is wrong. Don't take too long to input the formula.

One of the reference points from the CFA Institute that you will see suggests the break between the morning and afternoon sessions is optional. While it may be optional, my suggestion is to take the break – you will need it to refresh and restore your memory. The Exam rarely addresses the same subject twice, therefore, what topic areas you experienced in the morning session will, most likely, not be repeated in the afternoon session, giving the Candidate an opportunity to focus attention on the topic areas not covered.

The Level III Exam, (ctd.)

In the question stem, command words will be used and will be bolded. A text box is available for the response. If more than one answer is requested, (for example, “**Explain**, with *two* reasons...”), the following note is included: “Provide *each* response in a separate paragraph”. Bullet points are acceptable, as well.

An important message to pay attention to – when asked to provide more than one response, the responses will be evaluated up to the number requested, and in the order presented by the candidate. Anything more than the number requested will NOT be evaluated.

If there are two or three command words, address each command word as a separate question with an appropriate response. Don’t combine answers which may not get full credit.

The Level III Exam – LOS Command Words

The reading specific Learning Outcome Statements (LOS) contained in the Learning Modules are carefully designed to indicate what you should learn from each assignment. There are seventeen (17) official command words in the LOS and their definitions explain only those senses in which the command word may be used in the CFA Program, such as,

- Explain – to make clear and intelligible ...
- Justify – to provide good reasons for, to show to be valid or appropriate
- Compare – to state the similarities and differences between (of two or more things)
- Contrast – to state the differences between
- Describe – to state characteristic features of something, to portray it in words
- Evaluate – to reach a conclusion about something by application of knowledge and judgement
- Recommend – to advise as suitable or fit for purpose

Essay Writing Skills

Pay close attention to the 17 Command Words used in the CFA Program, both in your preparation utilizing the LOS and on Exam day. Review these as much as practicable and as part of your final review. Concentrate on the specific meaning and intent with which the Command Words are used when composing your response. I would suggest printing these out and review them each time you review your notes before the Exam.

Also, pay attention to what the question asks for as a response. Read the question first, quickly and carefully, and have it in your mind when reading through the vignette. If it asks for two “Compare” and two “Contrast” responses, give two (and only two) Compare responses and two (and only two) Contrast responses. The Contrast responses are meant to show the differences but may be similar in terms of the context. The answers should be unique and distinct. In many instances, Compare and Contrast are nearly mirror images: Compare is from a certain perspective and Contrast from the opposite perspective.

Essay Writing Skills, (ctd.)

The next few slides will “Compare and Contrast” the idea of using a Paragraph versus Bullet Points. In its materials, the CFA Institute offers the Candidates a choice of using a paragraph-style response or “bullet points”. See the Johansson problem below for an example.

Remember, saving time in your responses makes a huge difference. I recommend using bullet points to save yourself time in your response – every minute you gain can be put to use in a more difficult question or in your final review of the exam.

Writing “full” answers like the CFA Institute provides in its material is just too time-consuming, using up minutes. The Institute’s answers also take in all possible combinations of an answer, which may end up being 125-140% of the possible responses. The candidate only needs to answer what is required for full credit.

Essay Writing Skills, (ctd.)

As an example of this in paragraph form:

To compare, the two are nearly similar and convey the same information. Each response should be in a paragraph of its own. In contrast, however, bullet points can be structured so that each response is on its own, and it takes much less time to put down an answer. (WORD COUNT = 49)

As an example of using bullet points:

Compare:

- The two are nearly similar
- They convey the same information

Contrast:

- Each response can be on its own
- Bullet points take less time

(WORD COUNT = 24)

Essay Writing Skills, (ctd.)

For the computer-based testing system, take the opportunity to spend five minutes (or less) and read through all of the questions for the morning session (and afternoon session later). Do it quickly and set priorities in terms of questions that should be answered first, mentally deciding which you can answer best, quickest, easiest. Familiarizing yourself with the topic areas on that session will start to focus your thoughts. Highlighting key words is now available on the exam.

Take the questions out of order or skip a question to come back later. Pick up minutes on questions/topic areas that you know better. Don't get bogged down or have your confidence shaken by trying to answer questions that you don't know well enough. Pick up points, minutes, and, particularly, gain confidence by answering questions you know at the beginning. Picking up time is a question-by-question part of managing the Exam. Once you have answered the easier ones, then move to the remainder of the questions in that session. To reiterate my earlier statement, time is of the essence on the Level III CFA Exam.

Essay Writing Skills, (ctd.)

In contrast, time wasted on trying to dive deep on an answer is minutes and points lost. The Exam, questions and responses, is measured in minutes. The allocation of minutes is equal to the maximum points to be awarded for correct responses – you can't get any more points than are designated for the question or that section. My seventh-grade English teacher was a wonderful woman from Charleston, South Carolina. She had an amazing vocabulary, a fabulous way of using words, and an awesome Southern lilt to her voice. She started each class with the saying “Clarity, Brevity and Quality” are the essential elements to English as a language and the important characteristics in your writing. You want to convey “hard” information that will answer the question, not a lot of filler or excess verbiage, since it takes too much time. Be clear, be brief, and have a high-quality answer that addresses the question asked.

If you have time to “polish” a response or modify your answer to improve it, you can jump back to that question. If you can only think of one answer out of two requested, put it down and return to that question later.

Essay Writing Skills, (ctd.)

Since it is a computer-based Exam, if you think of another, better response, be sure to erase the less-than-optimal response from the answer box. Right-clicking on a response will strike it. There may be instances where there are more potential answers than the question calls for – all are valid. Choose only the required number from among them.

All major topical subjects will be covered in both the morning and afternoon sessions. Choose which ones you can answer more quickly, where you are more familiar, or because you have studied that topic more. The intent is to pick up some time, save some minutes for topic areas that are more challenging to your knowledge or memory. “Best guess” is not really an answer, nor is the “spaghetti on the wall” or shotgun approach. If the question wants two answers, that is all it requires. If you are spewing information, it’s taking time and only the first two answers will count – “the order presented by the Candidate”. Remember to put each response in a separate paragraph where more than one answer is required. *Or a separate bullet point!*

Essay Writing Skills, (ctd.)

In the computer-based system, if there isn't a function allowing the entry of "bullet points", I suggest using the hyphen or dash ("-"), the equals sign ("="), a colon, or, even better, a number and a period after it as an alternative to your bullet point.

Please note that the Graders are instructed to "cut off" grading when they reach the required number for the response. If the question asks for "two" give two responses. If it asks for "three", give three responses. Any more responses, or a fuller detail, will not earn any extra points and will burn "time". The Graders for Level III are looking for knowledge and comprehension of the subject matter. Help them (and yourself) by highlighting a response that is the essence of the answer. Be as brief as possible but complete.

Essay Writing Skills, (ctd.)

Red Herrings and Dead Ends. At times there is extraneous information in a vignette, something that is a distraction, or some background that can be useful under certain circumstances but doesn't provide insight as to the answer. Be aware of what is needed to respond and what is interesting but not useful. Additionally, there are some instances where an action appears to be problematic and it isn't, or it can be alleviated through proper disclosure. The Exam is not written to always provide a direct path to the answer; it is testing knowledge, comprehension, and judgement. The Lionsgate case is a good example of this. We will review it later in the workshop.

Candidates have asked if spelling and grammar mistakes are marked down. Perfect English is nice but not essential, since 60% of Candidates do not speak English as a primary language. The concepts are the important part of an answer, and if the Candidate uses bullet points (another shameless hint), spelling and grammar are more abbreviated. The computer-based exam environment should alleviate handwriting issues.

Essay Writing Skills, (ctd.)

Some of the Constructed Response or Essay questions will be in two or more parts, such as, “**Recommend** the portfolio that best suits the Jones’ current financial situation and **Justify** your choice with three examples of how the portfolio meets their needs”. This Waterfall or Cascading Concept can be tricky because there may be two answers that are satisfactory, however, one will be preferable or optimal over the other. If you choose the secondary answer, as the question continues it becomes more difficult to get points. Choose the most optimal answer at the onset to get full points.

The secondary choice will not receive full credit, either initially (“Recommend”) or along the way (“Justify”). Referring to the Johansson case again, the “Recommend” answer is critical – if the wrong portfolio is chosen, there will be no way to receive any points. The Moose case has four funds to choose from, but one is inappropriate – if chosen, there will be no points for the choice and fewer points for the asset allocation question.

Essay Writing Skills, (ctd.)

Full Credit – what does it mean? There are going to be nuances implied by the question that a Level III candidate should be able to pick up from the context of the vignette. Easter Eggs, small nuggets to mine, or whatever you want to call them are going to add a point to your score. I have highlighted three in the Moose/Albright case later. You as the candidate are expected to consider all important aspects from your reading and studying in giving a response to the question, *AND* from all three Levels.

These are not identified – you have to think of different facets while developing your response. “What other elements might be imbedded in this vignette” is a good way of proceeding, but do it quickly while you are formulating the response. Your time will be better spent getting the most important “points”, but if these come up, another point or two is important to your overall score.

Essay Writing Skills, (ctd.)

Guideline Answers: How much do I need to put in to get full credit? The CFA Institute's Guideline Answers are generally 125-140%, more than required to answer the question. When graders are looking at your response, there may be extra answers, such as, there are four valid reasons for an answer, but the question only asks for three. All four are correct, so pick the three that first come to your mind. In the Ethics area, there may be a number of Standards that are violated by one action – choose the one that is primary and use it. The secondary Standards are also violations, but these take time to write down and are not going to give you more points. The Mason-Dixon/Langhorne case for an example.

In regard to the vignettes, there is now “highlighting” available for the questions on the Exam, as well as the responses. There is a way to flip back and forth from the vignette to the response area. The responses are directed to questions about one part of the vignette, even though all the parts are related or follow one another in the sense of developing a story. Refer back to the section of the vignette that allows you to answer the question or questions.

Essay Writing Skills, ctd.

You will encounter nuances, red herrings, and dead ends, however, being aware that these are included, focus on the question and your response. As a Level III Candidate, you are expected to show a mastery of the Curriculum and be able to look for the nuances that might give you additional points.

Read the question carefully and have it in your mind when reading through the vignette. Pay close attention to the Command Words in the question, and use them to formulate your response, and you have to do this when “time is of the essence”. Also, pay attention to what the question asks for as a response. The answers should be unique and distinct.

So, let’s go through six cases where you will be writing an essay answer. Some are here in the presentation, the remainder will be in a separate handout provided by CFALA.

ASSET ALLOCATION, – PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION (V1, LM 4, Pages 292-293; 300)

Rationale: to describe and evaluate characteristics of liabilities that are relevant to asset allocation; to discuss approaches to liability-relative asset allocation; and, to recommend and justify a liability-relative asset allocation.

Viktoria Johansson is newly appointed as manager of ABC Corporation's pension fund. The current market value of the fund's assets is \$10 billion, and the present value of the fund's liabilities is \$8.5 billion. The fund has historically been managed using an asset-only approach, but Johansson recommends to ABC's board of directors that they adopt a liability-relative approach, specifically the hedging/return-seeking portfolios approach. Johansson assumes that the returns of the fund's liabilities are driven by changes in the returns of index-linked government bonds. Exhibit 1 presents three potential asset allocation choices for the fund.

ASSET ALLOCATION,– PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION (V1, LM 4, Pages 292-293; 300)

Asset Class	Allocation 1	Allocation 2	Allocation 3
Cash	15%	5%	0%
Index-linked Gov't bonds	70%	15%	85%
Corporate bonds	0%	30%	5%
Equities	15%	50%	10%
Portfolio Statistics			
Expected return	3.4%	6.2%	3.6%
Expected standard deviation	7.0%	12.0%	8.5%

ASSET ALLOCATION,– PRINCIPLES OF ASSET ALLOCATION –
APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION
(V1, LM 4, Pages 292-293; 300)

Determine which asset allocation in Exhibit 1 would be most appropriate for Johansson given her recommendation.

Justify your response.

ASSET ALLOCATION,– PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION (V1, LM 4, Pages 292-293; 300)

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Determine which **asset allocation** in Exhibit 1 would be most appropriate for Johansson given her recommendation.

Justify your response.

ASSET ALLOCATION,– PRINCIPLES OF ASSET ALLOCATION –
APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION
(V1, LM 4, Pages 292-293; 300) – **BULLET POINTS – 50 WORDS**

Determine which **asset allocation** in Exhibit 1 would be most appropriate for Johansson given her recommendation.

- Allocation 3 is most appropriate. {Have to get this right to get Points}

Justify your response.

- To fully hedge the fund's liabilities, 85% (\$8.5 billion/\$10.0 billion) of the fund's assets would be linked to index-linked government bonds, assets whose returns are driven by the same factors that drive the returns of the liabilities.
- Residual \$1.5 billion surplus would be invested into a return-seeking portfolio, consisting of corporate bonds and equities.

ASSET ALLOCATION – PRINCIPLES OF ASSET ALLOCATION –
APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION
(V1, LM 4, Pages 282-283, 290) – **PARAGRAPH STYLE – 78 WORDS**

Determine which **asset allocation** in Exhibit 1 would be most appropriate for Johansson given her recommendation.

Allocation 3 is most appropriate.

Justify your response.

To adopt a hedging/return-seeking portfolios approach, Johansson would first hedge the liabilities by allocating an amount equal to the present value of the fund's liabilities, \$8.5 billion, to a hedging portfolio, which must include assets whose returns are driven by the same factors that drive the returns of the liabilities – index-linked government bonds.

The residual \$1.5 billion surplus would then be invested into a return-seeking portfolio, consisting of corporate bonds and equities.

PORTFOLIO MANAGEMENT PATHWAY– CASE STUDY IN PORTFOLIO
MANAGEMENT: INSTITUTIONAL – QUADRIUM UNIVERSITY (QUINCO)
INVESTMENT COMPANY CASE: BACKGROUND
(Portfolio Management Pathway, V2, LM8; Pages 504-535)

Rationale: to analyze asset allocation and portfolio construction in relation to liquidity needs and risk and return requirements and recommend actions to address identified needs.

Quadrivium University (QU) is an independent liberal arts college located in a vibrant mid-sized city with a growing and diverse population. The university was founded in 1916 by James Greaves and Colin Healey, two entrepreneurs with a passion for astronomy and mathematics who settled in the area in the early 1900s. Over time, the university has built an outstanding reputation as one of the top schools in the country. Consistent with the founders' interests, the programs in astronomy and mathematics are highly regarded, attracting applicants from all over the world.

PORTFOLIO MANAGEMENT PATHWAY– CASE STUDY IN PORTFOLIO
MANAGEMENT: INSTITUTIONAL – QUADRIUM UNIVERSITY (QUINCO)
INVESTMENT COMPANY CASE: BACKGROUND
(Portfolio Management Pathway, V2, LM8; Pages 504-535)

This case is one of the “big” portfolio management cases in the Study Guide, however, it is cumbersome to break it down and turn it into a Portfolio Management Essay question. I suggest reviewing the case in the book and familiarizing yourself with all of the parts and pieces. Note how the case progresses from one topic to the next, which will mimic how a case on the Exam will be presented.

THE NEXT FOUR DECONSTRUCTED CASES ARE EXAMPLES OF APPROACHING THE ESSAY QUESTIONS

To go through the cases presented in the Workshop in the same format as the Johansson case (with the scenario laid out without highlighting and then given a second time with the highlighting), simply takes up presentation time. It also had two styles of response or answers, bullet points and paragraphs and the word count for each, respectively. It is useful, however, to see the steps involved.

We will go through the Lionsgate case the same way.

In the interest of time (remember, “Time is of the Essence”), the three other cases presented here will be highlighted as we go along from the beginning: Moose, Sebastian Riser, and Shepard/Washington. Having gone through the thought process and the methodology for addressing and answering an essay question twice, you should be familiar with your own system for processing the reading and considering answers as you read.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM (V5, LM 3: Pages 234-239)

Rationale: evaluate practices, policies, and conduct relative to the CFA Institute Code of Ethics and Standards of Professional Conduct, and, explain how the practices, policies, or conduct does or does not violate the CFA Institute Code of Ethics and Standards of Professional Conduct.

Lionsgate Limited (LL) is a publicly listed Australian fund manager.¹ The firm has benefited greatly from the “Superannuation Guarantee” program that was created in 1992. This program requires all the country’s employees ages 18 to 70 to contribute a percentage of their earnings to a tax-advantaged retirement account or superannuation fund. In addition, legislation enacted in 2005 gives all employees the right to select a superannuation fund administered by a retail financial services company, such as LL. LL offers a range of mutual funds.

¹ Lionsgate Limited & Bank of Australia: Susan Morey and Michael G. McMillan, PhD, CFA. Ethics Cases. “ 2018 CFA Institute. All rights reserved. Consistent with the 11th Edition of the Standards of Practice Handbook.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
AUSTRALIA CASE: TONY HILL AND TEAM
(V5, LM 3: Pages 234-239)

LL's flagship fund is the Lionsgate Victory Capital Fund (VCF), an equity mutual fund that is managed by Tony Hill and his team of 16 analysts. In LL's marketing material, Hill states, "For the period ending 31 December 2018, the Victory Capital Fund is the best-performing fund in Australian equities over the 10-year period. The VCF has delivered returns of 28.7%, gross of fees over the 1-year period, and 13.2% annually since inception in 2005. During this time, assets under management (AUM) in Australian dollars increased from \$18 million to \$14 billion."

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
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AUSTRALIA CASE: TONY HILL AND TEAM
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Hill has become the main media engagement person for the VCF and LL. He has a half-hour show on “Sky News Business Channel,” writes a weekly financial column for Australian Financial Review, and regularly appears on daytime and evening talk shows, where he talks about the VCF and its holdings. Like the other guests on these shows, Hill does not receive financial compensation for his appearances. Instead, the shows’ sponsors provide him with “thank you gift bags,” containing wine, retail gift cards, restaurant gift certificates, and travel discounts on hotels and airfare. Hill does not disclose the receipt of these gift bags to LL.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
AUSTRALIA CASE: TONY HILL AND TEAM
(V5, LM 3: Pages 234-239)

In 2006, Nicole Martin, CFA, was hired as an intern at LL to cover the paper, chemical, and publishing industries. After graduating at the top of her class from a prestigious university, Nicole accepted a full-time position on Hill's team, covering the metals, mining, and energy industries. As Hill's outside activities increased, Martin assumed more responsibility for security selection and investment decision making for the VCF. For the past three years, the performance of the VCF has been directly attributable to her and the other analysts, although both she and Hill still state publicly that he is in charge of all investment decision making for the VCF. As the VCF's "star stock picker," Hill is often invited to provide a fund update at LL's quarterly board meetings. Hill uses the most recent board meeting to announce his resignation and to notify the board he is starting his own fund management firm.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
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AUSTRALIA CASE: TONY HILL AND TEAM
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Recognizing Hill's departure could have a negative impact on LL's stock price as well as cash flows into the VCF, the board asks Hill to keep his plans to resign confidential until the end of LL's fiscal year (in two weeks) to give them time to find his replacement. Hill agrees. After the board meeting, Hill has a "closed door" meeting with his team and announces his plan to resign and start his own firm. He then asks the team if they want to join him. Ten of the analysts agree to resign with him and work in his new firm. Martin and the five remaining analysts tell him they will remain at LL and leave the meeting. Hill tells the analysts who will join him: "Team, we have a lot of work to do over the next two weeks. We'll need to use time after work and on weekends to lease office space and to individually register with the government authorities in the name of our new firm. Since we have not signed a noncompete agreement with LL, we can begin soliciting former clients the day we open our new firm."

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CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
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Identify two violations of the Code and Standards.

Discuss Tony Hill's actions on starting his new firm in light of the Code and Standards, giving two examples.

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ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
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Identify two violations of the Code and Standards.

Discuss Tony Hill's actions on starting his new firm in light of the Code and Standards, giving two examples.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
AUSTRALIA CASE: TONY HILL AND TEAM
(V5, LM 3: Pages 234-239)

Identify two violations of the Code and Standards.

Martin and Hill have both violated Standard V(B)1: Investment Analysis, Recommendations, and Actions, Communication with Clients and Prospective Clients. Both have failed to disclose to clients and prospective clients that Martin has assumed more responsibility for security selection and investment decision making at the fund and that she and the other analysts—not Hill—are primarily responsible for the fund's performance, a change that has a material effect.

Hill violated the Code and Standards by telling his team about his planned resignation after the board's request that he keep this information strictly confidential until fiscal year end (in two weeks). Despite the board's request, Hill informed his team the same day. Hill's conduct violates Standard IV(A): Duties to Employers, Loyalty. Hill was free to discuss his resignation with his team prior to the board's request for confidentiality.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
AUSTRALIA CASE: TONY HILL AND TEAM
(V5, LM 3: Pages 234-239)

Identify two violations of the Code and Standards.

In speaking about the fund's performance, Hill is stating facts, not false or opinion-based statements. In addition, Hill states the performance is gross of fees or “pre-fees.” According to Standard III(D): Duties to Clients, Performance Presentation, “When communicating investment performance information, Members and Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete. Hill is **not** in violation.

Hill's acceptance of the “thank you gift bags” does not create a conflict of interest between Hill and his employer or between Hill and his clients. Therefore, Hill's independence and objectivity are not compromised and Hill is **not** in violation of Standard I(B): Professionalism, Independence and Objectivity. Since there is no conflict of interest or “compensation” that competes with his employer's interest, he is **not** in violation of Standard IV(B): Duties to Employers, Additional Compensation Arrangements.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
AUSTRALIA CASE: TONY HILL AND TEAM
(V5, LM 3: Pages 234-239)

Discuss Tony Hill’s actions on starting his new firm in light of the Code and Standards, giving two examples.

The Guidance to **Standard IV(A): Duties to Employers, Loyalty** states, “A departing employee is generally free to make arrangements or preparations to go into a competitive business before terminating the relationship with his or her employer as long as such preparations do not breach the employee’s duty of loyalty.” **Hill can resign and asking his team to join him at his new firm is **not** a violation.**

Further, **it is **not** a violation for Hill to make office leasing arrangements and register with the government authorities** under the same Standard, as long as his actions (and those leaving with him) are taking place during non-work hours and on weekends.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE
CODE AND STANDARDS: LEVEL III – LIONSGATE LIMITED & BANK OF
AUSTRALIA CASE: TONY HILL AND TEAM
(V5, LM 3: Pages 234-239)

Discuss Tony Hill’s actions on starting his new firm in light of the Code and Standards, giving two examples.

Finally, the Guidance to Standard IV(A): Duties to Employers, Loyalty states, “When members and candidates are planning to leave their current employer, they must continue to act in the employer’s best interest. They must not engage in any activities that would conflict with this duty until their resignation becomes effective.” The Guidance also states, “A member or candidate who is contemplating seeking other employment must not contact existing clients or potential clients prior to leaving his or her employer for purposes of soliciting their business for the new employer.”

By telling his team to begin solicitation on the new firm’s opening day—not prior to its opening—there is **no conflict of interest or violation of loyalty.**

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Rationale: to evaluate the roles played and the benefits equities provide to an overall portfolio and to discuss equity investment across the passive-active investment spectrum. There are two parts to this question.

Moose Construction is a **locally-owned, native** construction company, **based in Alaska**, operating primarily **above the Arctic Circle**. It builds **affordable, year-round housing** for the native population and oil field workers, in addition to dormitories that are used to house a seasonal workforce in the summer months, when the weather is conducive to its building activity. It has **embraced “green technology”** and makes extensive use of solar energy in its construction, which is handy in summer days that last 20 hours. Typically, site preparation, foundation work, framing, sheathing, and roofing are finished in that order; interior finishing is left until the sheathing is all in place. Moose has a small administrative office in Anchorage that is staffed on a year-round basis.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

The Moose pension plan is managed from the office in Anchorage. It is a **defined benefit plan**, and has been **significantly underfunded** until just recently. Its plan participants are **predominantly middle-aged, having worked for Moose for twenty years or more**. After a series of financially successful years, the management of Moose has decided to add \$4 million to the pension fund, which will increase assets to \$18 million, leaving it **only \$2 million underfunded**. Albright Investment Management Company (Albright) has been its outside investment advisor for many years, and it had expressed concern about the pension fund's status. Currently, the fund has \$8 million in equity investments, \$5 million in fixed income investments, and \$1 million in cash and equivalents. **Its Investment Policy suggests an asset mix of 60% equities, 30% fixed income, 5% "risk" investments, and 5% cash and equivalents** to meet short-term needs.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

The Moose pension plan is going to use Albright to recommend investments for the \$4 million capital infusion and review the overall portfolio in light of its objectives and needs. All of the equities are actively managed currently. Three years ago, Albright added four new funds to their stable of mutual funds—the Barboa Fund, the Caribou Fund, the DoGood Fund, and the Elmer Fund—expanding its mutual fund offerings. Albright’s new funds are described below in Exhibit 1. The CIO of Moose, Ursa White, likes the fact that there now is a three-year performance record for the funds. Hans Smith, CFA, an Albright portfolio manager makes a presentation to her about the Moose pension fund investments and has convinced her to use Albright’s newer funds in the portfolio. On behalf of Albright, Smith will make a final presentation to the Board of the pension fund.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Exhibit 1 Albright Investment Management Company New Funds

<u>Fund</u>	<u>Fund Description</u>
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Barboa Fund	Invests solely in the equity of companies in oil production and transportation industries in many countries.
Caribou Fund	Uses an aggressive strategy focusing on relatively new, fast-growing companies in emerging industries.
DoGood Fund	Fund Investment universe includes all US companies and sectors that have favorable environmental, social, and governance (ESG) ratings and specifically excludes companies with products or services related to aerospace and defense.
Elmer Fund	Investments selected to track the S&P 500 Index. Minimizes trading based on the assumption that markets are efficient.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Smith, the Albright portfolio manager, makes the following notes after examining these funds:

Note 1: The fee on the Caribou Fund is a 15% share of any capital appreciation above a 7% threshold and the use of a high-water mark.

Note 2: The DoGood Fund invests in Fleeker Corporation stock, which is rated high in the ESG space, and Fleeker's pension fund has a significant investment in the DoGood Fund. This dynamic has the potential for a conflict of interest on the part of Fleeker Corporation but not for the DoGood Fund.

Note 3: The DoGood Fund's portfolio manager has written policies stating that the fund does not engage in shareholder activism. Therefore, the DoGood Fund may be a free-rider on the activism by these shareholders.

Note 4: Of the four funds, the Elmer Fund is most likely to appeal to investors who want to minimize fees and believe that the market is efficient.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Smith discusses asset allocation for the pension fund and its basic characteristics with the junior analyst, Kolton Frey so that Frey can assist in the analysis of the portfolio and the selection of assets. Frey tells Smith the following:

Statement 1: All of the equity portion of Moose's portfolio is **actively managed which may be out-of-line with current industry practice**. Since Moose has not been able to keep up with annual funding, **perhaps fund expenses should be a consideration**. Every little bit of savings helps the bottom line.

Statement 2: We should use an asset allocation in our presentation that is **rounded to the nearest \$1 million** so it is easy for the pension Board to understand the recommendation and changes.

Evaluate which three of the new Albright Funds are appropriate to add to the Moose pension fund portfolio.

Recommend an asset allocation for the Moose pension plan using an additional contribution of \$4 million in cash and **Discuss** what other considerations should Smith bring up when recommending Albright funds for the portfolio.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Evaluate which of the new Albright Funds are appropriate to add to the Moose pension fund portfolio.

Three Albright funds that are appropriate for inclusion are the Caribou Fund, the DoGood Fund, and the Elmer Fund.

The Caribou Fund is a good fit because the fund focuses on new companies that are generally classified as small firms, and the fund has a style classified as aggressive. A widely used approach to segment the equity universe incorporates two factors: size and style. It can satisfy the “risk” portion of the asset allocation better than the other choices and the existing portfolio.

The fee for the Caribou Fund is a 15% share of any capital appreciation above a 7% threshold, with the use of a high-water mark, thus, a performance fee. Performance fees serve as an incentive for portfolio managers to achieve or outperform return objectives, to the benefit of both the manager and investors.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

The DoGood fund would also be useful since it excludes companies based on specified activities, which is a process of negative screening, that is, the practice of excluding certain sectors or companies that deviate from accepted standards in areas such as human rights or environmental concerns. The **diversification benefits from a different security selection** and the **environmental and social aspects of the DoGood screening would have appeal to Moose**. Moose appears to be more socially conscious – they build affordable housing, are “locally” owned, located again, above the Arctic Circle, with a native population and environmental concerns.

The Elmer fund is managed assuming that the market is efficient, and investments are selected to mimic an index. Compared with active strategies, **passive strategies generally have lower turnover and generate a higher percentage of long-term gains**. An index fund that replicates its benchmark can have minimal rebalancing. For passively managed portfolios, **management fees are typically low** because of lower direct costs of research and portfolio management relative to actively managed portfolios. This would give **Moose a portion of equity investments that are across all markets**.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

The Barboa Fund would subject the pension fund to additional risk since it invests in the same industry – only oil drilling and their attending companies operate above the Arctic Circle in Alaska – and, as such, it is not a good fit.

359 WORDS IN PARAGRAPH FORM

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Evaluate which of the new Albright Funds are appropriate to add to the Moose pension fund portfolio.

Three Albright funds are appropriate: Caribou Fund, DoGood Fund, and Elmer Fund.

- = Caribou Fund is a good fit because the fund focuses on new companies classified as small firms and has an aggressive style; it satisfies the “risk” portion of the asset allocation, and while it has a performance fee, that is an incentive to achieve or outperform return objectives

- = DoGood fund has diversification benefits from a different security selection, and ESG aspects that appeal to Moose’s management

- = Elmer fund mimics an index, and passive strategies have lower turnover and generate a higher percentage of long-term gains, with low management fees, giving Moose equity investments across all markets

- = Barboa Fund - not a good fit since it invests in the same industry

120 WORDS IN BULLET POINTS

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Recommend an asset allocation for the Moose pension plan using an additional contribution of \$4 million in cash and **Discuss** what other considerations should Smith bring up when recommending Albright funds for the portfolio.

With the existing portfolio of \$8 million in equities, \$5 million in fixed income and \$1 million in cash and equivalents, the asset allocation is near its targets. The contribution to the pension fund would serve the fund best by investing **\$2 million in the Elmer fund, \$1 million in the DoGood fund, and \$1 million in the Caribou fund (which is the “risk” part of the portfolio)**. The existing equity portfolio will be **better diversified** by the additions. The existing fixed income and the cash portfolios would remain the same as they are now.

95 WORDS IN PARAGRAPH FORM

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Recommend an asset allocation for the Moose pension plan using an additional contribution of \$4 million in cash and **Discuss** what other considerations should Smith bring up when recommending Albright funds for the portfolio.

The existing portfolio is \$8 million in equities, \$5 million in fixed income and \$1 million in cash and equivalents, near its targets.

The pension fund would be best served and better diversified by investing:

- = \$2 million in the Elmer fund
- = \$1 million in the DoGood fund, and
- = \$1 million in the Caribou fund (the “risk” part of the portfolio).

Keep the fixed income and the cash the same.

69 WORDS IN BULLET POINTS

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

The asset allocation after the contribution and investment of the funds would be:

Equity

Current	\$8 million		
DoGood	\$1 million		
Elmer	<u>\$2 million</u>		
Total	\$11 million	60%	(currently 57%)

Fixed Income	<u>\$5 million</u>		
Total	\$5 million	28%	(currently 36%)

Risk

Caribou	<u>\$1 million</u>		
Total	\$1 million	6%	(currently 0%)

Cash	<u>\$1 million</u>		
Total	\$1 million	6%	(currently 7%)

	=====		
Grand Total	\$18 million	100%	

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

... and **Discuss** what other considerations should Smith bring up when recommending Albright funds for the portfolio.

The consideration for the Elmer fund is that it is a passively managed portfolio, providing an alternative to the current active management and having a lower expense ratio, that is, a **low-fee instrument, which will help offset the high-fee Caribou fund**. While the plan is closer to being fully-funded, **there still is a gap**, and the lack of contributions for years suggests a business that sometimes does not make profits, therefore, to have the **pension portfolio “work a little harder”** to make up the shortfall is appropriate.

During the Board meeting, **Smith should offer to waive the investment management fee** calculated on the overall portfolio for the Caribou, DoGood and Elmer funds, since Albright is paid a **management fee imbedded in each of the funds and should not “double charge”**.

152 WORDS IN PARAGRAPH FORM

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

The Elmer fund:

- = passively managed portfolio
- = alternative to active management
- = lower expense ratio
- = offsetting the high-fee Caribou fund

Caribou Fund:

- = funding gap
- = pension portfolio “working a little harder”
- = because the business does not make profits

Smith should offer to waive the investment management fee calculated on the overall portfolio for the Caribou, DoGood and Elmer funds:

- = Albright paid imbedded management fee
- = should not “double charge”

63 WORDS IN BULLET POINTS

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Now that we have deconstructed the answer, if this were a 20-minute question, what might the grading be like?

The answers requested in the “Evaluate which three of the new Albright funds are appropriate ...”. There are four to choose from, but only three fit the profile of the pension plan. To me, each of the fund selections would be worth 4 points, that is, four minutes for each fund. If you choose the right three and justify the selection, twelve points.

Finally, time management of the question comes into play. The “Evaluate” question wants three answers because the fourth is a red herring, a dead end. The Barboa fund is not a good choice under any circumstances and should be discarded as an alternative as you are reading the vignette. Three choices and a brief justification. Remember, bullet points are quicker to use.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

Now, the “Recommend an asset allocation ... (for the) ... \$4 million”. Six points for that. You have three funds, where do they fit. You have to do the asset allocation quickly, hence the rounding to the nearest \$1 million. The risk category is easy: \$1 million into it, the Caribou fund. The DoGood satisfies a diversification need that meets the social consciousness of the plan sponsor and its plan participants: \$1 million into it. The last \$2 million goes into the low fee, low turnover Elmer index fund, and the three boost the equity percentage while keeping the fixed income and cash in line with the board’s guideline allocation, hopefully providing returns over the fixed income rate to alleviate the funding gap over time.

The reason for choosing the Elmer Fund for the \$2 million is the low fee, diversification effect, and a broadening of the spectrum of equity exposure. The Do Good Fund operates in a narrower band of equities and has a higher fee. If the Candidate chooses the Do Good Fund for the \$2 million as opposed to the Elmer Fund, I would expect a point to be removed, getting five points credit rather than six.

OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, 2022 CFA LEVEL III STUDY GUIDE, Pages 173-174, 175-176 and Questions 1-8 as a basis. **THIS CASE IS NO LONGER IN THE 2025-2026 CURRICULUM**)

For the last two points, there are bits of information that a Level III candidate should be able to pick out from the vignette. Additionally, Level III is testing your comprehension and ability to use the tools learned through the exam series. There are two other points from three options, gleaned from the story. Offsetting fees, a funding gap, and the waiver of the management fee are these little Easter Eggs, small nuggets to mine, hiding in the story. Find them and get the last two points. This isn't the trick question Chris Wiese references; it is a test of your assimilation and vision.

The pension plan either has to have more return or an additional contribution because it is a late-stage plan – one or the other gets you a point. Mention the Elmer Fund's lower fees will offset the Caribou's higher fee and get a point. Say Albright should waive its fee, and you get full credit in twenty minutes.

Choose two of the three.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

Rationale: evaluate practices, policies, and conduct relative to the CFA Institute Code of Ethics and Standards of Professional Conduct, and, explain how the practices, policies, or conduct does or does not violate the CFA Institute Code of Ethics and Standards of Professional Conduct.

Sebastian Riser, CFA, works as a portfolio manager for Swibank, a small private bank in Switzerland. Riser manages the accounts of his clients according to best practices, keeping clients' interests before those of the bank and his own. He allocates investments in a fair manner when he deems them consistent with the stated objectives and constraints of clients.

Swibank has a Luxembourg subsidiary, which distributes fund-of-funds products. Riser recently received a request to serve on the board of directors for the subsidiary. In this role, Riser would advise management on business strategies, market opportunities, potential clients, and current and prospective fund managers. For his role on the board, Riser would receive an annual payment directly from the subsidiary equivalent to 5% of his total portfolio manager salary in Switzerland.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

The following month, Riser accepts the position on the board. The subsidiary registers each new fund-of-funds product with regulatory authorities in Luxembourg and discloses Riser's role as a board member in the required filings, which are public and readily available.

Riser serves as the contact person for the subsidiary's institutional clients in Switzerland and participates in the subsidiary's road shows in Switzerland. His role during these road shows varies. On some occasions, he simply attends the presentations while the operating management sells the products; on other occasions, he gives the actual presentation promoting the products. Riser's name does not appear in the promotional material distributed at the road shows.

Alexander Komm, a long-time colleague of Riser, is the founder of Komm Private Management, which provides asset management, advisory, and trust services to high-net-worth individuals. The firm has several well-managed proprietary funds. Komm offers Riser a position with the firm as managing partner. Riser is flattered but declines the offer, explaining that he is very happy working at Swibank.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

That same week, the subsidiary informs Riser that it needs an experienced fund manager to manage a new publicly-traded Japanese equity product. Riser is convinced that Komm Private Management would be qualified and recommends the firm for the new product. After a thorough search process, the subsidiary hires Komm Private Management for the new product.

Six months later, after numerous discussions, Komm finally convinces Riser to join Komm Private Management as a managing partner. The following week, Riser submits his resignation to Swibank. His position on the board of the subsidiary is not dependent on his employment at the bank, and he agrees to serve the remaining three years of his term.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

After signing and submitting his employment contract to Komm, Riser takes three weeks of vacation before starting his new position. During this time, he purchases 2,000 shares of the new Japanese equity product for his private account. When he begins working at Komm Private Management, he purchases a large block of shares in the Japanese equity product, which he allocates according to internal procedures to all accounts for which it is suitable.

Identify four ethical violations that Riser has committed in the course of his activities with Swibank and Komm/Komm Private Management.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

Identify four ethical violations that Riser has committed in the course of his activities with Swibank and Komm/Komm Private Management.

1) According to **Standard IV(B): Additional Compensation Arrangements**, members must not accept compensation that competes with their employer's interest unless they obtain written consent from all parties involved. Thus, **Riser must receive written, not verbal, consent from his employer** before accepting the position on the subsidiary's board. According to the recommended procedures for compliance, Riser should make an immediate written report to his employer specifying the terms of the agreement, the nature of the compensation, the approximate amount of the compensation, and the duration of the agreement. The Standards do not require that members receive permission from clients before accepting board positions.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

Identify four ethical violations that Riser has committed in the course of his activities with Swibank and Komm/Komm Private Management.

2) Riser, in his participation in the Switzerland road shows, may violate **Standard I(B): Independence and Objectivity** and **Standard VI(A): Disclosure of Conflicts**. Standard I(B) require that members use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Riser's **role as board member could jeopardize his objectivity and create a conflict of interest**.

3) In the same instance, **Standard VI(A)** requires that members make **full and fair disclosure of all matters** that could reasonably be expected to impair the independence and objectivity or interfere with respective duties to the clients and prospective clients. Full disclosure allows clients to judge motives and possible biases for themselves. Riser does not appear to make adequate disclosure of his relationship with the Swibank subsidiary.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

Identify four ethical violations that Riser has committed in the course of his activities with Swibank and Komm/Komm Private Management.

4) **Standard VI(A): Disclosure of Conflicts** comes in to play again. All actual and potential conflicts of interest must be disclosed. Although Riser's recommendation of Komm and Komm Private Management for the Japanese equity fund may be based solely on his knowledge of the firm's track record, his **prior relationship with Komm, including the job offer, should be disclosed** so the subsidiary will have all the information needed to evaluate the objectivity of his recommendation.

5) Riser may, however, violate **Standard II(A): Material Nonpublic Information** and possibly **Standard VI(B): Priority of Transactions** when making his original **purchase of 2,000 shares of the Japanese equity product**. If, when trading for his own account, Riser knows that he will place a **large block trade** for Komm clients, he may be in possession of material nonpublic information.

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

Identify four ethical violations that Riser has committed in the course of his activities with Swibank and Komm/Komm Private Management.

6) **Standard VI(A)** requires that members make **full and fair disclosure** of all matters that could reasonably be expected to impair the independence and objectivity or interfere with respective duties to the clients and prospective clients. Riser's **holdings of the Japanese equity product** and his **position on the board** of the Swibank subsidiary could impair his objectivity and must be disclosed to clients.

7) **Standard VI(B) Priority of Transactions** covers the activities of all members who have knowledge of pending transactions that may be made on behalf of their clients or employers. Riser has accepted the position of managing partner, has recommended the manager for the product, and knows, or should know, that he will purchase the product for at least some Komm clients once he begins work at Komm. **His purchase ahead of Komm's clients might be front-running.** Best practice would be to delay his private account purchase until after he purchases shares for clients..

ETHICAL AND PROFESSIONAL STANDARDS – APPLICATION OF THE CODE AND STANDARDS: LEVEL III (V5, LM3; Pages 270-272, 279-280)

Identify four ethical violations that Riser has committed in the course of his activities with Swibank and Komm/Komm Private Management. These are the red herrings, misdirects, and dead ends:

- 8) When participating in the road shows in Switzerland, Riser does NOT violate Standard IV(B): Additional Compensation Arrangements. Standard IV(B) provides guidance regarding the acceptance and disclosure of compensation that might conflict with an employer's interests. Participating in the road shows and receiving compensation from the subsidiary do not appear to conflict with his employer's interests. Riser's compensation from the subsidiary is not a referral fee.
- 9) When Riser resigns from Swibank, no violation occurred. Riser is not required to resign his position with the subsidiary. Riser did not engage in any activities that would conflict with his employer's interest before his resignation became effective.
- 10) Regarding his original purchase of 2,000 shares of the Japanese equity product, Riser does NOT violate Standard III(C): Suitability because he is purchasing shares for his own account.

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING

(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Gary Shepard is a wealth planner working with his client Annie Washington to develop appropriate portfolio allocations. Washington recently turned 50, and in their annual update, she explains that for the last ten years, she was very concerned about saving aggressively and earning strong returns to fund her retirement at age 65, at which time she intends to move to Portugal. She has recently achieved a level of wealth that will likely be sufficient to meet her basic needs and has noticed that each new increment of wealth seems less important to her than it did previously.

Up until now, Washington has invested solely in stocks and bonds. Shepard encourages her to also consider small allocations to commodities and real estate to improve diversification benefits and provide some inflation protection. Being unfamiliar with such investments, Washington agrees to a smaller allocation than was suggested.

Given that Washington still has considerable time before retirement, Shepard approaches asset allocation using a 10-year time horizon. To estimate the return on bonds he considers the current yields on high-grade bonds of various maturities in Exhibit 1.

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING

(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Exhibit 1

Target Duration	Current Yield
5 years	4.5%
10 years	5.2%
20 years	5.4%

Shepard uses a mean–variance analysis to create an optimal portfolio (Portfolio A) and then makes some adjustments to illustrate two other portfolios with the same standard deviation of returns but with different allocations. These are presented in Exhibit 2.

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING
(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Exhibit 2

	Portfolio A	Portfolio B	Portfolio C
High-grade bonds	25%	30%	30%
US equities	35%	45%	30%
European equities	20%	25%	30%
Real estate	10%	0%	5%
Commodities	10%	0%	5%
Expected return	7.3%	7.1%	7.1%

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING

(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Questions

1. Washington's utility function is *best* described as:
 - A. risk averse.
 - B. risk neutral.
 - C. risk seeking.

2. Shepard's suggested allocation to commodities and real estate is *best* supported by Washington's:
 - A. risk capacity.
 - B. risk tolerance.
 - C. risk perception.

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING

(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Questions

3. Over Washington's forecast horizon, the *best* estimate of returns on high-grade bonds is:
- A. 4.5%.
 - B. 5.2%.
 - C. 5.4%.
4. Which portfolio is *most* appropriate for Washington?
- A. Portfolio A
 - B. Portfolio B
 - C. Portfolio C

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING

(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Solutions

1. **A is correct.** A risk-averse investor will have a concave utility function that flattens out as wealth increases so that each additional unit of wealth gives rise to a smaller increment in utility than the prior unit of wealth. **Washington [is at a]** has reached a **stage where each new increment of wealth seems less important** than it did previously.
2. **A is correct.** Clients with greater risk capacity can tolerate greater financial losses without compromising current or future consumption goals. As **Washington** now likely **has enough to meet her basic needs and** has 15 years to recover from any losses, she **has adequate risk capacity.** Her reduced utility from additional wealth suggests limited risk tolerance, and her lack of familiarity with these asset classes indicates a risk perception that is not aligned with their inclusion.

PRIVATE WEALTH PATHWAY– INVESTMENT PLANNING

(Private Wealth Pathway, V1, LM4; Pages 292-293; 298)

Solutions

3. **A is correct.** Over a period equal to twice its modified duration, the **total return of an index is well approximated by its initial yield**. Therefore, the best estimate for a 10-year horizon is the initial five-year yield, in this case, 4.5%.
4. **C is correct.** Although Portfolios B and C have lower returns for the same expected standard deviation compared to the mean variance optimization (MVO) portfolio, Washington's other preferences argue for some modest adjustments. Specifically, she will be **retiring in Portugal**, so her lifetime expenses will be **denominated in Euro**, and she perceives real estate and commodities to be high risk. Furthermore, **her risk-averse utility function argues in favor of conservatism**. Portfolio C has modest allocations to real estate and commodities, is **underweight US stocks, and overweight bonds and European stocks**. All of these positions are aligned with Washington's preferences. Although Portfolio B avoids real estate and commodities entirely, it is significantly overweight US stocks and is only slightly overweight European stocks, suggesting a possible mismatch. **[a better match]**

CFA Exam Item Set Format

The other part of both the morning and afternoon sessions of the CFA Level III exam is comprised of 44 multiple choice items, each worth 3 points (132 minutes, or two hours and 12 minutes). Each item set on the CFA exam consists of a vignette followed by either 4 or 6 multiple-choice questions.

The essay half and the item set half are now split between the morning and afternoon sessions, so the time allotments are easier. All questions must be answered based on the information in the vignette. Hence, the items are not free-standing, as in the [CFA Level I exam](#). You will need to refer back to vignette before answering each item.

Below is a link to examples of Level III item set questions.

- [Level III item set questions](#) (PDF)

Sample Level III Item-Set Questions

TOPIC: ETHICAL AND PROFESSIONAL STANDARDS
TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS

Edgar Somer, CFA, was recently hired as a portfolio manager at Karibe Investment Management. Somer previously worked at a rival firm where he produced an average annual return of 11% using a small-cap value strategy.

On his first day at Karibe, the firm asks Somer to approve marketing materials that present the following performance disclosures.

- Text which states: "Somer has generated average annual returns of 11%"
- The 3-year performance of a composite of Karibe client accounts that follow a similar small-cap value strategy
- A disclosure that the assumptions and calculations underlying the returns presented are publicly available on Karibe's public website

To maintain relationships with clients and to attract prospective clients, Somer is active on social media. He posts a link to a news story about a famous athlete who recently paid substantial tax penalties after failing to properly report investment gains. In addition to the link Somer writes the comment: "A client of mine had similar gains, but because I kept proper records he faced no penalties. #HireAProfessional". Some responses to the post suggest that readers mistakenly believe the athlete is Somer's client. Somer does not post a clarifying comment.

Somer develops a new quantitative investment strategy that he describes in marketing materials. The description states that "the strategy is based on eight proven fundamental and technical factors, including well-known factors such as value and momentum as well as certain proprietary factors that have been back-tested. The strategy includes a dynamic weighting component to adjust the amount allocated to each factor based on prevailing market conditions." The materials also highlight risks such as "the possibility that the model or its underlying factors may not work out of sample," and "because the weight placed on various

large gains in the shares, Somer now recommends that clients place limit orders when

Sample Level III Item-Set Questions

Questions 1 through 4 relate to Ethical and Professional Standards.

Edgar Somer and Karibe Investment Management

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Somer develops a new quantitative investment strategy that he describes in marketing materials. The description states that “the strategy is based on eight proven fundamental and technical factors, including well-known factors such as value and momentum as well as certain proprietary factors that have been back-tested. The strategy includes a dynamic weighting component to adjust the amount allocated to each factor based on prevailing market conditions.” The materials also highlight risks such as “the possibility that the model or its underlying factors may not work out of sample,” and “because the weight placed on various factors is dynamic, it may not be suitable for clients who seek steady exposure to certain factors.” One of Somer’s clients agrees to use this strategy. When preparing the first performance report for this client, Somer discovers a coding error that reversed the client’s weightings assigned to the value and momentum factors.

Prior to joining Karibe, Somer purchased shares in a small-cap technology firm for his personal portfolio. When he started his new role Somers disclosed the position, which had quadrupled in value since the initial purchase and represented more than 5% of his personal holdings. He had no intention to sell the shares and he recommended them to clients at Karibe, to whom he disclosed his ownership. After the successful launch of a new product resulted in additional large gains in the shares, Somer now recommends that clients place limit orders when purchasing the shares. Though he remains bullish on the stock he is concerned about the size of his personal position, which is now more than 15% of his portfolio. One of his clients recently placed a limit order at \$50 per share, which represents the highest bid in the market. The lowest offer is \$52. Somer considers filling the client’s order with some of his own shares at the \$50 bid price.

Questions

1. To best comply with the CFA Institute Standards of Professional Conduct (the Standards) related to performance presentation, Somer should modify the:
 - A. text regarding Somer's investment returns.
 - B. presentation of the performance for Karibe's representative composite.
 - C. content of the disclosure statement related to assumptions and calculations.

Answer: A

A is correct because Somer's returns are not clearly explained as being generated at his prior firm. If a firm is not claiming GIPS compliance, "Members and candidates can also meet their obligations under Standard III(D) by including disclosures that fully explain the performance being reported." B is incorrect because the marketing materials present the performance of a composite of similar portfolios. C is incorrect because the materials direct prospective clients to the website where a full disclosure of the assumptions and calculations are available.

Questions

2. Does Somer's social media post result in a violation of the Standards?

- A. No
- B. Yes, he violates the standard related to preservation of confidentiality
- C. Yes, he violates the standard related to communication with clients and prospective clients

Answer: A

A is correct because Somer did not reveal the identity of his client (Standard III(E)). The context of the comment (he helped his client avoid penalties) contradicts the mistaken conclusion of the readers of the social media post (the athlete in question had to pay penalties so obviously was not his client). He also does not violate the standard related to communication (Standard V(B)) because it applies to 1) disclosure of the format and general principles of the investment process; 2) significant limitations and risks of the investment process; 3) identifying important factors for their analysis and recommendations; and 4) distinguishing between fact and opinion in investment analyses and recommendations. His post did not relate to any of these and thus is not a potential violation of the standard.

B is incorrect because Somer does not violate the standard related to confidentiality because the athlete in the news story is not his client, and the information that he helped his own client avoid tax penalties by keeping good records does not provide enough information to disclose the client's identity.

C is incorrect because Somer does not violate the standard related to communication (Standard V(B)) because it applies to 1) disclosure of the format and general principles of the investment process; 2) significant limitations and risks of the investment process; 3) identifying important factors for their analysis and recommendations; and 4) distinguishing between fact and opinion in investment analyses and recommendations. His post did not relate to any of these and thus is not a potential violation of the standard, but certain candidates and/or exam team writers who think that communications with clients includes a duty to correct everyone who misunderstands you may choose this answer.

Questions

3. When preparing the marketing materials for the quantitative strategy, did Somer comply with the standard related to communication with clients and prospective clients?

- A. Yes
- B. No, because he did not identify the risk of coding errors
- C. No, because he did not describe the investment process in detail

Answer: A

A is correct because he did not violate Standard V(B). With respect to informing clients of the investment process, the guidance stipulates that when explaining the process one “need not describe the investment system in detail... but must inform clients of (the) basic process and logic.” The explanation of Somer’s process as factor-based with weights dynamically allocated meets this criterion. Regarding risk identification, “members and candidates cannot be expected to disclose risks they are unaware of at the time.... Having no knowledge of a risk or limitation that subsequently triggers a loss may reveal a deficiency in the diligence and reasonable basis... but may not reveal a breach of Standard V(B).”

B is incorrect because “members and candidates cannot be expected to disclose risks they are unaware of at the time.... Having no knowledge of a risk or limitation that subsequently triggers a loss may reveal a deficiency in the diligence and reasonable basis... but may not reveal a breach of Standard V(B).”

C is incorrect because when explaining the process one “need not describe the investment system in detail... but must inform clients of (the) basic process and logic.” (Example 1 p. 141) The explanation of Somer’s process as factor-based with weights dynamically allocated meets this criterion.

Questions

4. If he fills the client's order for shares of the technology firm, would Somer violate the standard related to priority of transactions?

- A. No
- B. Yes, because the client would be disadvantaged by the trade
- C. Yes, because he would benefit personally from a trade undertaken for a client

Answer: C

C is correct because the guidance for Standard VI(B) specifies that “nothing is inherently unethical about... making money from personal investments as long as (1) the client is not disadvantaged by the trade, (2) the investment professional does not personally benefit from trades undertaken for clients, and (3) the investment professional complies with applicable regulatory requirements.” In this case, Somer would personally benefit from a trade undertaken for a client by realizing a large gain and reducing the portfolio risk arising from his large position, which results in several potential conflicts of interest. At a minimum he would need to disclose to the client that he was filling the order from his own account and seek permission from Karibe to do so.

A is incorrect because Somer would personally benefit from a trade undertaken for a client by realizing a large gain and reducing the portfolio risk arising from his large position, which results in several potential conflicts of interest. At a minimum he would need to disclose to the client that he was filling the order from his own account and seek permission from Karibe to do so.

B is incorrect because the client is not disadvantaged by the trade (and in fact gets the order filled at a discount to the prevailing market price).

Final Thoughts

The CFA Institute has put up a page on their site which has a series of short YouTube videos of Chris Wiese talking about the Level III Exam. The couple of pointers that I gleaned from reviewing them are: 1) exam scores within a bell curve distribution that are on the “minimum passing score margin” are re-graded by a different grader - if there is a difference, that exam is reevaluated a third time by still another grader to ensure fairness; 2) formulas are not required but partial credit can be gained by using the equation editor to show your work; 3) multi-part questions on the computer-based test will be placed on the same screen so that the entire question is available to you; and 4) the distribution of exam results is not the center of the bell curve.

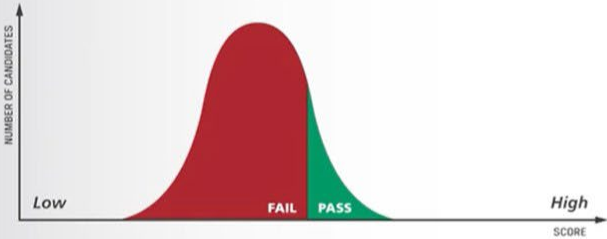
Other than having worked for the CFA Institute for twenty years, I don't have any insight to the current process except for what I have read in the CFAI materials. You, as a candidate, have access to full information that is reserved for Candidates and many more CFAI resources than I have – my Member access is restricted since I have gotten my Charter (long ago).

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FIXED BAR
CANDIDATE SCORE DISTRIBUTION



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CFA Institute uses a fixed bar, rather than a forced curve methodology.

-1:49

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DEFERRED vs NON-DEFERRED

CANDIDATE SCORE DISTRIBUTION

NUMBER OF CANDIDATES

Low High

SCORE

DEFERRED CANDIDATES

NON-DEFERRED CANDIDATES

For use as a directional, not exact, representation of exam data.

-1:22

Final Thoughts, (ctd.)

The Bell Curves in the previous slides show the distribution of all Candidate scores, and the middle one shows the Minimum Passing Score skewed to the right. The Minimum Passing Score is roughly 70% of the potential points available on the exam. The third slide highlights the experience that Candidates who proceed through the exams series without taking a break seem to have a better chance of passing because they are in the mode of studying and taking the exam, being more familiar with the curriculum and readings.

You are welcome to call or text me if you have additional questions about this presentation. My contact information is on the first slide, and I will try to respond quickly.

The final slide is what you are hoping to achieve.

Thanks for joining me today. Good luck to you on the Exam!

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