

# CFA Society of Los Angeles CFA Review Program

## Level III CFA Exam

## Essay Writing Workshop

**Exam Test Taking Skills and Pointers**

January 7, 2023

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# 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 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

Caitlin Topkis of the CFA Society of Los Angeles will be managing the Zoom Room today and recording the Workshop. She will also be providing a copy of this presentation to participants.

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. There are examples in the Essay Writing section slides, as well as another piece where the case does not conveniently fit on a slide.

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”. Caitlin will be doing so. Please submit any questions you have through the Chat function. They should be specific questions, not general “hypotheticals”. Caitlin will combine similar questions to be addressed and answered after the formal presentation.

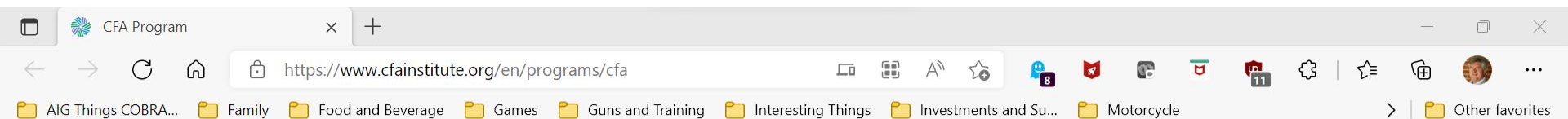
We are scheduled for two hours. The presentation should run an hour and a half, with about thirty minutes for the Q&A. You can sign off and still receive the content.

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 happy to stay on to answer questions.



# 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 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. The amount of technical reading required at each level is daunting, especially at Level III, and the page count is around 2,500 pages. 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.



# CFA Program

Achieve one of the highest distinctions in the investment management profession: Become a Chartered Financial Analyst® (CFA®). As a CFA charterholder, you will have the knowledge and the skills to thrive in the competitive investing industry.

The CFA charter gives you expertise and real-world skills in investment analysis. Join more than 170,000 professionals who have been recognized globally for their commitment to ethics and professionalism.



CFA Program

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AIG Things COBRA... Family Food and Beverage Games Guns and Training Interesting Things Investments and Su... Motorcycle

Other favorites

1 of 13

# THE CFA<sup>®</sup> PROGRAM

## WHERE THEORY MEETS PRACTICE



## THE CFA PROGRAM

On 15 June 1963, 284 senior analysts sat for the first CFA<sup>®</sup> Program exam in various cities throughout the United States and Canada. During the initial year, the equivalent of the current CFA Program Level III exam was the only examination

## 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.

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).

# Exams That Evolve in Complexity

Each level of the curriculum builds on the prior level and becomes increasingly complex. The chart below explains the differences between each exam so you can prepare accordingly. **For details on computer-based exams, visit our [exam information page](#).**

[Learn more about the study tools and resources you will have access to as part of CFA Program](#) >

	Level I	Level II	Level III
Level Requirement	<a href="#">Meet CFA Program enrollment requirements</a>	Pass Level I CFA exam	Pass Level II CFA exam
Question Format	Multiple choice questions	Vignette-supported	Vignette-supported essay questions and

in the past two exams, you were asked to describe and analyze. In this exam, you will need to justify your thinking by synthesizing information and applying solutions. Portfolio management and wealth planning will be heavily featured.

### BE MINDFUL OF TIME

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.

## UNDERSTAND THE FORMAT OF ESSAY QUESTIONS

Plan how much time you can give each answer and stick with it. If you are stumped by a question, move on to one you are more comfortable with and complete that one. You can go back to your skipped question later if you have time.

4<sup>2</sup> ÷ 6  
ANSWERING  
CALCULATION  
QUESTIONS

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.

**PROVIDE EXACTLY  
WHAT IS ASKED FOR  
(AND NO MORE)**

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 otherwise fully correct.

**1**  
LEARNING  
ECOSYSTEM  
**400**  
EXAM  
LOCATIONS

**7**  
TOPICS COVERED  
**10-**  
ITEM SET  
QUESTIONS

**38**  
READINGS  
INCLUDED

**2**  
EXAMS OFF  
YEARLY





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# CFA Exam Eligibility Policy

Candidates are permitted to take the exam a maximum of two times per calendar year (when applicable), but not in consecutive windows or windows that are six months or less apart. Candidates will have a total of six maximum attempts per exam level. This policy is in effect beginning with the 2021 exams.

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# 1963 - 2022 CANDIDATE EXAMINATION RESULTS

CFA Candidates			LEVEL I				LEVEL II				LEVEL III			
Year	Total	% Pass	Total	Pass	Fail	% Pass	Total	Pass	Fail	% Pass	Total	Pass	Fail	% Pass
1963	284	94%	-	-	-	0%	-	-	-	0%	284	268	16	94%
1964	1,732	84%	1,241	986	255	79%	302	283	19	94%	189	179	10	95%
1965	1,993	83%	767	649	118	85%	865	678	187	78%	361	329	32	91%
1966	2,010	75%	621	481	140	77%	708	469	239	66%	681	563	118	83%
1967	1,693	83%	594	423	171	71%	556	496	60	89%	543	491	52	90%
1968	1,579	73%	592	412	180	70%	447	334	113	75%	540	414	126	77%
1969	1,316	74%	556	409	147	74%	413	322	91	78%	347	237	110	68%
1970	1,409	67%	644	424	220	66%	372	285	87	77%	393	238	155	61%
1971	1,458	69%	755	464	291	61%	341	253	88	74%	362	288	74	80%
1972	1,486	70%	731	466	265	64%	461	354	107	77%	294	214	80	73%
1973	1,630	60%	721	432	289	60%	565	324	241	57%	344	222	122	65%
1974	1,797	74%	862	604	258	70%	511	377	134	74%	424	355	69	84%
1975	1,841	75%	808	568	240	70%	563	421	142	75%	470	393	77	84%
1976	1,706	76%	634	457	177	72%	641	477	164	74%	431	363	68	84%
1977	1,993	74%	667	421	246	63%	632	510	122	81%	694	540	154	78%
1978	2,008	73%	925	596	329	64%	444	379	65	85%	639	481	158	75%
1979	1,876	76%	824	522	302	63%	550	460	90	84%	502	441	61	88%
1980	1,985	73%	949	602	347	63%	528	407	121	77%	508	437	71	86%
1981	2,253	71%	1,107	677	430	61%	684	580	104	85%	462	340	122	74%
1982	2,886	64%	1,532	903	629	59%	714	489	225	68%	640	469	171	73%
1983	3,243	65%	1,655	1,082	573	65%	978	637	341	65%	610	392	218	64%

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Document content (Table):

1982	2,880	64%	1,532	903	629	59%	714	489	225	68%	640	409	171	73%
1983	3,243	65%	1,655	1,082	573	65%	978	637	341	65%	610	392	218	64%
1984	4,030	63%	2,075	1,199	876	58%	1,147	701	446	61%	808	658	150	81%
1985	4,285	67%	2,186	1,317	869	60%	1,309	965	344	74%	790	579	211	73%
1986	4,837	65%	2,366	1,405	961	59%	1,379	884	495	64%	1,092	845	247	77%
1987	5,702	62%	3,095	1,782	1,313	58%	1,555	995	560	64%	1,052	755	297	72%
1988	7,091	59%	3,927	2,174	1,753	55%	1,946	1,163	783	60%	1,218	864	354	71%
1989	8,064	62%	4,149	2,237	1,912	54%	2,484	1,590	894	64%	1,431	1,133	298	79%
1990	8,760	64%	4,415	2,658	1,757	60%	2,522	1,594	928	63%	1,823	1,360	463	75%
1991	9,868	62%	4,950	3,087	1,863	62%	3,002	1,618	1,384	54%	1,916	1,436	480	75%
1992	10,518	65%	5,002	2,928	2,074	59%	3,503	2,258	1,245	64%	2,013	1,658	355	82%
1993	12,809	59%	6,588	3,616	2,972	55%	3,679	2,061	1,618	56%	2,542	1,936	606	76%
1994	15,413	52%	8,445	4,087	4,358	48%	4,418	2,109	2,309	48%	2,550	1,859	691	73%
1995	19,517	52%	11,341	5,750	5,591	51%	5,518	2,535	2,983	46%	2,658	1,860	798	70%
1996	24,600	58%	14,381	7,627	6,754	53%	7,098	4,596	2,502	65%	3,121	1,999	1,122	64%
1997	30,642	55%	16,833	8,847	7,986	53%	8,493	5,011	3,482	59%	5,316	3,119	2,197	59%
1998	38,689	60%	21,744	12,855	8,889	59%	10,295	6,433	3,862	62%	6,650	3,895	2,755	59%
1999	45,143	60%	23,199	14,757	8,442	64%	13,496	7,329	6,167	54%	8,448	5,015	3,433	59%
2000	53,345	55%	27,625	14,314	13,311	52%	16,036	8,636	7,400	54%	9,684	6,274	3,410	65%
2001	65,707	54%	36,317	17,726	18,591	49%	17,897	8,322	9,575	46%	11,493	9,410	2,083	82%
2002	76,231	47%	43,882	19,106	24,776	44%	22,163	10,418	11,745	47%	10,186	5,924	4,262	58%
2003A	67,279	49%	32,027	13,478	18,549	42%	22,232	10,432	11,800	47%	13,020	8,816	4,204	68%
2003B	20,657	40%	20,657	8,214	12,443	40%								
2004A	61,559	40%	24,211	8,262	15,949	34%	23,896	7,649	16,247	32%	13,452	8,669	4,783	64%
2004B	19,566	36%	19,566	7,128	12,438	36%								
2005A	58,908	48%	22,915	8,138	14,777	36%	24,891	13,938	10,953	56%	11,102	6,083	5,019	55%
2005B	21,127	34%	21,127	7,276	13,851	34%								
2006A	63,249	52%	26,467	10,602	15,865	40%	20,499	9,751	10,748	48%	16,283	12,314	3,969	76%
2006B	28,082	39%	28,082	10,905	17,177	39%								
2007A	71,897	42%	33,599	13,294	20,305	40%	25,521	10,156	15,365	40%	12,777	6,399	6,378	50%
2007B	37,573	39%	37,573	14,831	22,742	39%								
2008A	92,081	42%	44,063	15,311	28,752	35%	33,449	15,243	18,206	46%	14,569	7,720	6,849	53%
2008B	49,797	35%	49,797	17,612	32,185	35%								
2009A	104,116	45%	45,682	21,034	24,648	46%	38,998	15,892	23,106	41%	19,436	9,597	9,839	49%
2009B	44,209	34%	44,209	14,884	29,325	34%								
2010A	111,731	42%	46,863	19,656	27,207	42%	43,406	16,995	26,411	39%	21,462	9,881	11,581	46%

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## 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 seven topic areas for Level III, in order of their weightings: Portfolio Management; Equity; Fixed Income; Ethics; Economics; Derivatives; and, Alternative Investments. The pages and links from the CFA Institute I have used in preparing this are included on the final slide. Anything in my presentation that appears to be redundant is purposeful or a matter of not being able to take CFA Institute materials without the entire context.

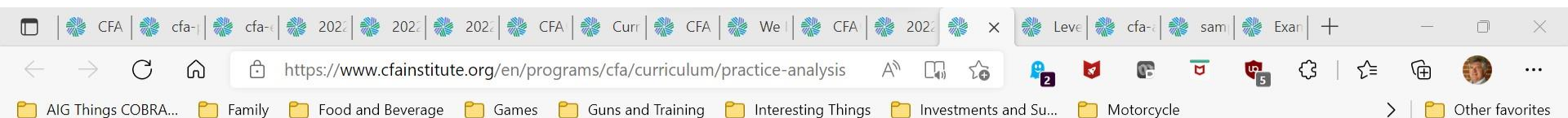
# Candidate Body of Knowledge (CBOK)

The Candidate Body Of Knowledge (CBOK) represents the core knowledge, skills, and abilities generally accepted and applied by investment professionals globally.

The CBOK is grounded in practice, meaning that panels and surveys of thousands of investment professionals have had input into the curriculum through our practice analysis.

[Learn more about our practice analysis process and updates to the curriculum >](#)

[View the Candidate Body of Knowledge \(CBOK\) >](#)



# CFA® Program Practice Analysis

## Keeping the Curriculum Current and Relevant

We continuously evolve the CFA Program by connecting with practicing investment management professionals, university faculty, and regulators to determine the critical knowledge, skills, and abilities that are needed in an investment role today. Getting direct feedback, insight, and perspective from industry practitioners is the most effective way to prepare the next generation of investment managers for the demands of global capital markets.

We refer to this process as practice analysis. The primary goal of our global practice analysis is to assess and update the [Global Body of Investment Knowledge](#) (PDF) and [Candidate Body of Knowledge](#), which identifies knowledge, skills, and abilities that investment professionals need to perform successfully throughout their career. The dynamic assessment of the competencies required of investment management professionals is designed to establish the blueprint for the CFA Program curriculum and exams. Industry experts consider the practice analysis process as the key reason the CFA Program is regarded as the global “gold standard” of investment credentials.

In order to maintain the CFA charter as the preferred designation of investment practitioners, CFA Institute needs your input.

# 2022 Candidate Body of Knowledge (CBOK)

The CBOK represents the core knowledge, skills, and abilities (competencies) generally accepted and applied by investment professionals globally. The CBOK is grounded in practice as the output of panels and surveys of thousands of investment professionals serves as input into the curriculum through our practice analysis process.

## CBOK Topic Areas

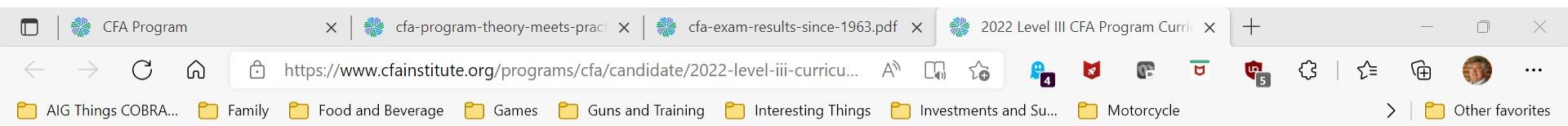
### I. Ethical and Professional Standards

- A. Professional Standards of Practice
- B. Ethical Practices
- C. Asset Manager Code of Professional Conduct
- D. Presentation of Performance Results (GIPS)

### II. Quantitative Methods

- A. Time Value of Money





# Level III Curriculum Changes


The CFA® Program curriculum equips candidates with relevant knowledge and skills that reflect current investment management practice.

As part of our commitment to prioritizing the interests of our candidates and helping minimize the impact of pandemic-related disruptions, CFA Institute froze the 2020 CFA Program curriculum for 2021 exam administrations. This meant that all candidates who took exams in 2021 were tested on the 2020 CFA Program curriculum. Despite this freeze for candidates, the curriculum continued to evolve. Extensive work through practice analysis and curriculum development has resulted in revisions across all levels of the curriculum.

When you register for your CFA Program exam, you receive the curriculum aligned with the exam you will take. Exam questions will be based solely on the current curriculum year readings.


Refer to the key and tables below to see what has changed in Level III of the CFA Program curriculum over the past two years, and download our [Level III infographic \(pdf\)](#) and [Guide to 2022 CFA Program Curriculum Changes \(pdf\)](#) for more information.





# WHAT HAS CHANGED IN THE CFA PROGRAM CURRICULUM?

## LEVEL III



**The CFA® Program curriculum equips candidates with current, relevant knowledge and skills that reflect investment management practice.**

As part of our commitment to prioritizing the interests of our candidates and helping minimize the impact of pandemic-related disruptions, CFA

Despite this freeze for candidates, the curriculum continued to evolve. Extensive work through practice analysis and curriculum development has resulted in revisions across all levels of the curriculum. We have updated data exhibits, added new cases, streamlined readings to

Browser tabs: CFA Program, cfa-program-theory, cfa-exam-results-sir, 2022 Level III CFA P, 2022-level-iii-curricu, 2022-cfa-program-...

Address bar: <https://www.cfainstitute.org/-/media/documents/support/programs/cfa/2022-cfa-pro...>

Bookmarks: AIG Things COBRA..., Family, Food and Beverage, Games, Guns and Training, Interesting Things, Investments and Su..., Motorcycle, Other favorites

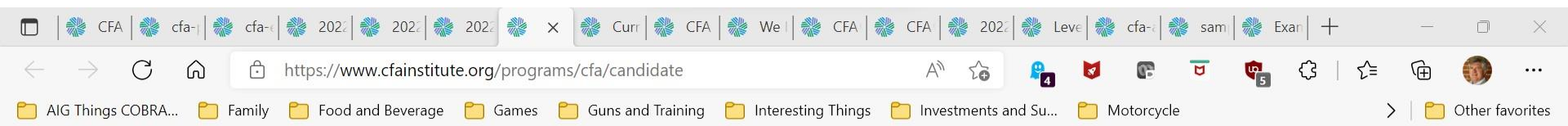
Page indicator: 1 of 25

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CFA Institute

# Guide to 2022 CFA<sup>®</sup> Program Curriculum Changes



# CFA® Program Registered Candidate Resources

CFA candidates: Login to access your study materials and exam-related tasks, such as changing your test center location and accessing your result.

[Login \(candidates only\)](#)

## CFA Exam Study Materials

When you register for the CFA Program, you will gain access to a variety of study tools and resources to help you prepare for the exam. We will support you with our learning ecosystem and community along your path to become a CFA charterholder.

- Official program curriculum
- Study sessions for each level
- Custom study plans designed just for you

# Curriculum & Exam Topics

Gain the advantage of knowledge developed by one of the world's leading associations of investment professionals. We enlist the investment industry's brightest minds to continually improve the CFA® Program, ensuring that it's always relevant. And the recognition that comes with becoming a charterholder can benefit you throughout your entire career.



Topic Emphasis	CFA Level I	CFA Level II	CFA Level III
Ethical and Professional Standards	15-20%	10-15%	10-15%
Quantitative Methods	8-12%	5-10%	--
Economics	8-12%	5-10%	5-10%
Financial Reporting & Analysis	13-15%	5-10%	--
Corporate Finance	8-12%	5-10%	--
Equity Investments	10-12%	10-15%	10-15%
Fixed Income	10-12%	10-15%	15-20%
Derivatives	5-8%	5-10%	5-10%
Alternative Investments	5-8%	5-10%	5-10%
Portfolio Management & Wealth Planning	5-8%	10-15%	35-40%
Total	100%	100%	100%



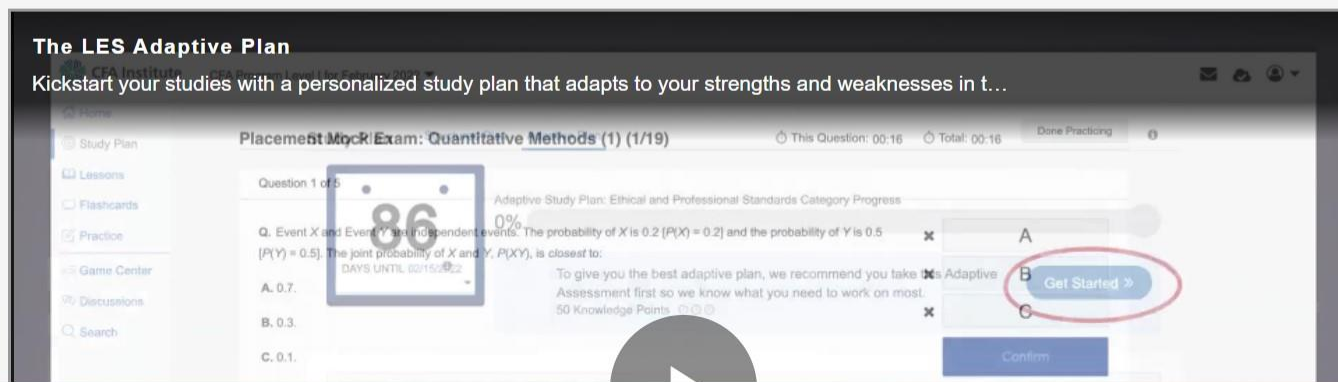
# Reasons Why Candidates Fail Level III

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.

# CFA Exam Study Tips

## Study Smart with the CFA Institute Learning Ecosystem

The CFA Institute Learning Ecosystem contains the full CFA Program curriculum, personalized study plans, practice questions and mock exams, flashcards, moderated message boards, curriculum-based games with leader boards, and more. Check out these videos to learn more about how the Learning Ecosystem can help you prepare for exam day.



## Reasons Why Candidates Fail Level III, (ctd.)

After the reading of the material assigned in the Study Sessions, the practice questions and 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 Study Sessions that are your personal or professional interest should be fine, but the feedback from the LES may expose a need for more study.



# We Invest in Your Success

Becoming a CFA® charterholder takes hard work, but when you are a candidate, you'll have our complete support. We'll provide you with access to a wealth of information to help you pass our exams and excel in your career.

Registered candidates can access these tools through their candidate resources.



# Unlock Helpful Study Tools through the Learning Ecosystem

CFA Institute offers the support you need to become a CFA charterholder through our Learning Ecosystem, including an official program curriculum, study sessions for each level, and custom study plans to keep you on track for success. The Learning Ecosystem is available online, via the Apple® App Store, and the Google Play store.

[Learn more about the learning ecosystem >](#)



## Curriculum

Registered candidates can access the complete curriculum online for free.



## Mock Exam

Practice with tests designed to mimic the exam-day experience.



## Custom Study Plans

Get personalized study plans that prepare you for the exams.



## Curriculum

Registered candidates can access the complete curriculum online for free.

- Learn from financial thought leaders
- Access market-relevant instruction
- Gain critical knowledge and skills



## Mock Exam

Practice with tests designed to mimic the exam-day experience.

- Timed and structured like the real exam
- Cover the same topic areas at the same difficulty level
- Use questions based on the current curriculum



## Custom Study Plans

Get personalized study plans that prepare you for the exams.

- Analyze your strengths and weaknesses
- Get a plan designed just for you
- Perform better on the exams

# CFA® Program Mock Exam and Practice Questions

To help you prepare for the exam, we offer different types of practice, including practice questions and a mock exam, with our Learning Ecosystem. As you work your way through the curriculum, we recommend pausing to answer practice questions, assessing your level of confidence and accuracy along the way. Then, in advance of the exam, take a mock exam, which mimics the exam-day experience as closely as possible.

[Registered candidates: Access your mock exams and practice questions through the Learning Ecosystem \(login required\).](#)>

## Practice Questions

After taking the adaptive placement test to determine the most critical areas for you to focus your studies, use the practice questions within each topic to confirm your understanding based on the study session.

Practice questions are based on lessons in the curriculum to help you evaluate your topic-level strengths

## 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 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 Study Sessions 15 and 16 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. You get the concept, I’m sure.

# Level III CFA Exam Structure

## Exam Structure and Duration

**NEW IN FEBRUARY 2023:** 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. Previously, the first session was all essay sets and the second session was all item sets. Level III overall will not change: 11 essay sets and 11 item sets, for 12 points each.

- As candidates have consistently had difficulty finishing the essay session but often finished the item set session early, this change should improve candidates' ability to finish each session in the allowed time.

**Structure:** The Level III exam consists of item sets comprised of vignettes with accompanying multiple-choice items and constructed response (essay) questions.

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 to the vignette before answering each item.

The CFA<sup>®</sup> Program curriculum topic areas for Level III will be randomly placed on the exam. All topics may

# CFA Level III Exam Question Format

## Constructed Response (Essay) Format

The first session will be vignette-supported essay sets that have items with three different methods of entering a response: essay, numerical entry, multiple choice.

- Essay questions
  - 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 note – 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.
- A calculation could be presented as an essay or a numerical entry.



## Important Information on Essay Question Structure

There may be multiple questions within one essay item. It is important to understand how many answers a candidate is expected to provide. Three examples are presented:

### Example 1

*Determine which bond best meets the advisor's objective.*

*(Bond X, Bond Y, Bond Z)*

*Justify your response.*

For this question, a candidate is expected to type two answers in the response box: the name of the bond that best meets the objective, and a reason why it meets the objective.

### Example 2

*Determine, based on the client's IPS, the most appropriate index to use as a benchmark.*

*(Index 1, Index 2, Index 3)*

## Item Set Format

The second session of the CFA Level III exam is comprised of 44 multiple choice items, each worth 3 points. Each item set on the CFA exam consists of a vignette followed by 4 multiple-choice questions.

- Item set vignettes will begin with a statement of the topic and total point value, for example:

TOPIC: QUANTITATIVE METHODS

TOTAL POINT VALUE OF THIS QUESTION SET IS 12 POINTS

- Each item set will have four multiple-choice items in the set and each one is worth 3 points

## CFA Level III Exam Tips

- Exam questions referring to Financial Statement Analysis are based on International Financial Reporting Standards (IFRS) unless otherwise specified. When a question is based on US GAAP, it will be stated in the question.
- Be comfortable with your calculator. Make sure you know how to use the calculator features needed to

# Level III CFA Exam Structure and Duration

**Structure:** The Level III exam consists of item sets comprised of vignettes with accompanying multiple-choice items and constructed response (essay) questions.

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 to the vignette before answering each item.

The CFA<sup>®</sup> Program curriculum topic areas for Level III will be randomly placed on the exam. All topics may be covered in either the first or second sessions, and possibly both sessions. Each vignette will begin with a statement of the topic and total point value. For example:

TOPIC: ECONOMICS

TOTAL POINT VALUE OF THIS QUESTION SET IS 15 POINTS

# The Level III Exam

There will be two sessions 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, the morning session. 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.

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. If you can take the questions/vignettes out of order in the computer-based exam, 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.)

One of the reference points from the CFA Institute that you will see in a slide below 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 exam materials talk about 11 vignettes. The point range will be between 10 points (or minutes) and 25 points (or minutes) – if the portfolio management topic area gets 40% of the weight of the exam and half is addressed in the morning session, then 20% of 132 minutes equals 26.4 minutes. I would round down 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.



# Level III CFA Exam Structure

**NEW IN FEBRUARY 2023:** 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. Previously, the first session was all essay sets and the second session was all item sets. Level III overall will not change: 11 essay sets and 11 item sets, for 12 points each.

As candidates have consistently had difficulty finishing the essay session but often finished the item set session early, this change should improve candidates' ability to finish each session in the allowed time.

## Formatting Conventions Used for Level III Exam, Essay Portion

At Level III, part of the first session will be vignette-supported essay sets that have items with three different methods of entering a response: essay, numerical entry, and multiple choice.

# CFA Level III Exam Question Format

## CFA Exam Constructed Response (Essay) Format

The first session of the CFA Level III exam is comprised of 5 or 6 vignettes followed by several questions that require a written response. There will be some multiple-choice questions in this session, as well. 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 majority of the questions, though, will be traditional essay.

- 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. There are no bolded command words used in multiple-choice questions.

A calculation could be presented as an essay or a numerical entry.

- 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.

- 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. There are no bolded command words used in multiple-choice questions.



- A numerical entry response box will only accept numbers, commas and a decimal point. There is no room to show work. A question may contain a note with specific guidance on how to format the answer, such as:

Provide your answer as a percentage, rounded to one decimal place.

10.8 %

- Items within an essay set may be related to each other. Two examples are presented:

- Example 1

Item 1 is a multiple-choice question:

The bond that *best* meets the advisor's objective is:  
(You will be asked to justify this response when  
answering the  
next question.)

A: Bond X.

B: Bond Y.

C: Bond Z.

- Item 2 is the related essay question:

**Justify** your previous response with two reasons.

*Note: Each justification should be in a separate  
paragraph. Or a separate bullet point!*

- Example 2

Item 1 is a multiple-choice question:

Select the strategy that best meets the client's requirements.

(You will be asked to explain why the other two strategies are *less* appropriate in the next question.)

A: Put spread

B: Covered call

C: Cashless collar

Item 2 is the related essay question:

**Explain** why the two strategies not selected in the previous question are *less* appropriate, referencing two characteristics for *each*. Note: Each strategy explanation, with its two characteristics, should be in a separate paragraph or bullet point.

## Essay questions

- 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.



## Essay questions

- 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 note – 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.**

# LOS Command Words

The reading specific Learning Outcome Statements (LOS) contained in the study sessions 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, that is, they are specific to the CFA and CIPM Programs.

**Definition:** to examine the constituent parts of something and how the parts relate to each other and to the whole

**Explanation:** **Analyze** asks you to be able to take apart something for study (e.g., a financial statement or an investment strategy) in order to understand the whole in full detail. In the first example of use below, the phrase “including ...” highlights points that must be included in an analysis.

- analyze bottom-up active strategies, including their rationale and associated processes
- analyze the effects of currency movements on portfolio risk and return

**Definition:** to compute, to determine by mathematical processes

*Explanation:* This command word asks you to be able to show that you can find a correct

## Command Words (not a complete list)

- 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. If it asks for two “Compare” and “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.)

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 Johannson problem below for an example. Remember, saving time in your responses makes a huge difference.

## 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.)

I have not experienced the new computer-based system from the CFA Institute, but I am familiar with SEC and FINRA exams which are computer-based. However, if there is the opportunity to take five minutes (or less) and read through 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.

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 wonderful 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.

## 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. There may be instances where there can be more potential answers than the question calls for, and all are valid responses. Choose 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 ("-") or the equals sign ("=") 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. The computer-based exam environment will alleviate handwriting issues. Help them (and yourself) by highlighting a response that is the essence of the answer. There is a comment about highlighting on the slides. 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.

## 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 the question continues along these lines, 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 question. 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.

## 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 more than is required to answer the question, however, 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 take time to write down and are not going to give you more points. See the Mason Dixon and Langhorne case for an example of this.

In regard to the vignettes, there isn't any highlighting available for the questions on the Exam, just 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.

# Computer-Based Exam Information

All CFA exams are administered through computer-based testing.

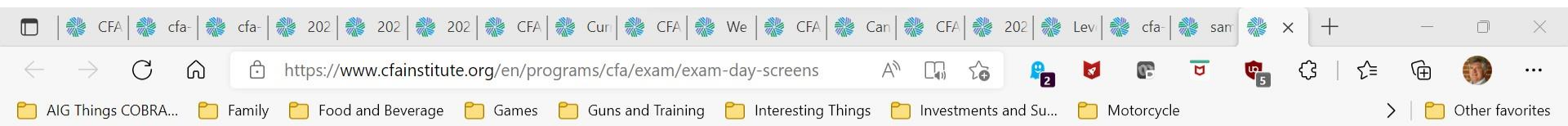
Registering for your CFA exam is a two-step process.

- **Step 1:** Enroll in the CFA exam through the CFA [website](#).
- **Step 2:** After you complete the registration process and your payment is processed, you will see the “schedule your exam” option in your [CFA Program tile](#). This will take you to the Prometric scheduling tool where you will be presented with available testing centers with dates and times. You must complete this step by the scheduling deadline. If you do not receive a confirmed date and time, you are not yet successfully scheduled for an exam.

[View our scheduling tool instruction sheet \(PDF\).](#)

Exams in 2022 will be offered:

- For Level I in February, May, August, and November



# Exam Day – Screen Sizes and Functionality

Your CFA exam will be given at one of over 400 test centers around the world. We have worked hard to make the exam experience as consistent as possible at each test center.

You will be provided with the same tools, timeframe, and exam questions wherever you sit for your exam. However, there are a few elements that will be useful to know before taking the exam.

## Screen Size

You may find that computer equipment may vary slightly, sometimes within the same test center. One of these variations may be the monitor size of the equipment that you will use. Resolution is set by the administrator to ensure a sharp view of the material.

Level I exams are presented in a multiple-choice format and will appear in the same way on all screen sizes. However, you may notice that Level II and Level III exam questions are formatted in a slightly different way from screen to screen.



## Screen Size

You may find that computer equipment may vary slightly, sometimes within the same test center. One of these variations may be the monitor size of the equipment that you will use. Resolution is set by the administrator to ensure a sharp view of the material.

You may notice that Level III exam questions are formatted in a slightly different way from screen to screen.

For Level III exams, a standard screen (19" monitor) will present the case scenario side-by-side with the answer screen. The answer screen will provide either multiple-choice options or a text box for essay responses.

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If you have a smaller screen, you will see a single view of the case scenario. After reading it, you may close the case scenario and proceed to the questions.

If you wish to refer back to the case at any time, simply click the “Case Scenario” icon that appears above each question to bring it back to the front.

Nicola Bancroft, a performance analyst for a global equity investment manager, is responsible for multi-currency portfolios in which the base currency of the portfolio is different from the local currency. She compiles the inputs required to calculate the unhedged returns, shown in Exhibit 1.

**Exhibit 1 Market Value in Local (USD) Currency and Spot Rates (US\$ millions)**

Period	Market Value in USD (m)	USD/GBP Spot Exchange Rate	GBP/USD Spot Exchange Rate
Start	100	1.53	0.65
End of Month 1	115	1.52	0.65
End of Month 2	110	1.57	0.64
End of Month 3	105	1.56	0.64

The following day in a team meeting, Bancroft is asked to explain why hedged returns are different from perfectly hedged returns. She makes the following statements:

1. If residual positions caused by market movement are perfectly hedged, then the only difference between the local return and the hedged return will be attributable to the spot rate.
2. During a period when there is no underlying market movement, the hedged return and perfectly hedged return should be equal
3. If only the initial currency position is hedged and there are residual positions in the following months, hedged returns will not be perfectly hedged.

After the meeting, a peer approaches Bancroft to inquire about considerations when calculating returns for currency overlay portfolios. She responds that there are several considerations, including the following:

**Consideration 1:** Currency overlay is a source of excess returns with little or no capital allocation, which is often held in a separate underlay portfolio that results in zero or negative market values.

**Consideration 2:** The overlay manager is periodically informed of the value of the assets to be overlaid. Although the portfolios are managed separately, the profits of each are reinvested in the other.

**Consideration 3:** Investment decisions of the currency overlay portfolio are taken in the context of the small amount of allocated capital, which is used in the denominator when calculating returns.

Bancroft also explains that these portfolios often have problems that result in a prior-period return requiring adjustment, including the following:

**Issue 1:** A currency forward trade was recorded in the firm's accounting system; however, when reconciliation occurred at month end, it was found to be a duplicate and needed to be canceled.

**Issue 2:** A corporate action was not applied to the underlying portfolio, resulting in the residuals provided being incorrect.

**Issue 3:** Incorrect spot prices were used to calculate base returns and were found when comparing returns with the custodian.

## Case Scenario

Nicola Bancroft, a performance analyst for a global equity investment manager, is responsible for multi-currency portfolios in which the base currency of the portfolio is different from the local currency. She compiles the inputs required to calculate the unhedged returns, shown in Exhibit 1.

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**Issue 3:** Incorrect spot prices were used to calculate base returns and were found when comparing returns with the custodian.

Question: 2.3  
Section: 1

Section Time Remaining:  
00:02:51

Progress 0%

Finish Test

Test: CFA Online Tutorial

Candidate: USER Demo

- 1
- 2
- 2.1
- 2.2
- 2.3
- 2.4
- 3
- 4
- 4.1
- 4.2
- 4.3
- 4.4
- 5
- 5.1
- 5.2
- 5.3
- 5.4

Which consideration mentioned by Bancroft regarding overlay calculations is *most likely* correct?

Case Scenario

A Consideration 1

B Consideration 2

C Consideration 3



< Back

Next >

Question: 2.3  
Section: 1

Section Time Remaining:  
00:13:47

Progress 0%

Finish Test

Test: CFA Online Tutorial

Candidate: USER Demo



1

2

2.1

2.2

2.3

2.4

3

4

4.1

4.2

4.3



Which consideration mentioned by Bancroft regarding overlay calculations is *most likely* correct?



Case Scenario

A Consideration 1

B Consideration 2

C Consideration 3



< Back

Next >



## Questions That Require a Numerical Answer

A question that requires a numerical answer will be presented in one of two ways, either as an essay or a numerical entry.

An essay text box will accept typed words and numbers. A correct numerical value typed in the essay box 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 by typing out variables in an equation.

A numerical entry box will accept only numbers, commas and a decimal point, with no additional words or formulas. There is no room to show your work and the math editor function is not available.

Note that you will be allowed to use either of the exam-approved calculators for doing your calculations.

## Math Editor Tool

Use the multiplication sign when in the Math Editor Tool, not an asterisk. Using the asterisk will result in a deletion of text or converting the text to italics.

**Incorrect:**  $1.085*1.025$

**Correct:**  $1.085 \times 1.025$

**Incorrect:** Portfolio OAS =  $(OASA * wA) + (OASB * wB)$

**Correct:** Portfolio OAS =  $(OASA \times wA) + (OASB \times wB)$

## Highlighter

The highlighting function cannot be used to highlight elements within the case scenario. The highlighter does work within the question box.

# PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION

## (STUDY SESSION 3, Pages 382, 389)

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.

# PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION

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%

## PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION

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

**Justify** your response.

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## PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION

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

**Justify** your response.

# PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION – 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.

## PRINCIPLES OF ASSET ALLOCATION – APPROACHES TO LIABILITY-RELATIVE ASSET ALLOCATION – 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.

## QUINCO CASE: BACKGROUND (STUDY SESSION 14, Pages 338-367)

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.*

## QUINCO CASE: BACKGROUND

(STUDY SESSION 14, Pages 338-367)

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.

## EUROLANDIA CASE: BACKGROUND (STUDY SESSION 14, Pages 379-426)

*This case study explores some of the risk management issues for a married couple living in a hypothetical country in the Eurozone, Eurolandia. The case spans several decades and follows the couple through different stages of life from their early career phase, when they are in their late twenties, all the way to retirement. We will show how risk management methods need to change as the family's circumstances evolve. The assumptions used are drawn from what is typical for many countries in Europe. The circumstances and risks that this married couple face are influenced by the environment in which they find themselves. Despite the differences between Europe and other parts of the world, however, their goals, the risks they face, and the assessment of their circumstances, as well as the suggested methods, are by no means unique to the region. The risk analysis methodology and its application would therefore be valid in a much broader context.*

This case is the other of the “big” portfolio management cases in the Study Guide. It, too, 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.

## EUROLANDIA CASE: BACKGROUND (STUDY SESSION 14, Pages 379-426)

Rationale: Giving advice on risk management to individuals and families raises a number of challenges. These challenges include the extent to which identified and evaluated risks can be reduced and/or addressed using insurance policies or self-insurance. Families' financial circumstances and risks evolve over time, and financial advisers should review and update the solutions addressing these risks accordingly. Risk management solutions recommended by advisers should consider the family's overall health, wealth, and long-term goals.



## THE NEXT THREE DECONSTRUCTED CASES USED AS EXAMPLES OF ESSAY QUESTIONS

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”), two other cases presented here will be highlighted as we go along from the beginning: Moose and Sebastian Riser. 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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM (STUDY SESSION 16, Pages 214-219)

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.<sup>1</sup> 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.*

<sup>1</sup> 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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

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."

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

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."

# LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

**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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## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

**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.

# LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

**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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

**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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

**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.

## LIONSGATE LIMITED & BANK OF AUSTRALIA CASE: TONY HILL AND TEAM

**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 using Questions 1-8 as a basis.

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 an Alaska-based, locally-owned construction company, operating primarily above the Arctic Circle. It builds affordable housing and some 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, 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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

The Moose pension plan is managed from this office. 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, 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 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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

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—the Barboa Fund, the Caribou Fund, the DoGood Fund, and the Elmer Fund—to its existing fund offering. Albright's new funds are described below in Exhibit 1. The CIO of Moose likes the fact that there now is a three-year performance record for the funds. Hans Smith, an Albright portfolio manager makes a presentation to the CIO of the Moose pension fund and has convinced her to use Albright's newer funds in the portfolio. Albright will make a final presentation to the Board of the pension fund.

# OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

## Exhibit 1                      Albright Investment Management Company New Funds

### Fund                              Fund Description

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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

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 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.

# OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

**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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

The DoGood fund would also be useful since it excludes companies based on specified activities, which is a process of negative screening, 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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

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.

# OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

**Recommend** an asset allocation for the Moose pension plan using an additional contribution of \$4 million in cash.

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.

# OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

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, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

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. Moose's environmental affinity and its local ownership make the investment in DoGood an easy recommendation that will further diversify its holdings. 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".

# OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

Now that we have deconstructed the answer, if this were a 15-minute question, what might the grading be like?

The answers requested in the “Evaluate which of the new Albright funds are appropriate ...” do not have a specific number. 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 3 points, that is, three minutes for each fund. If you choose the right three and justify the selection, nine points.

Now, the “Recommend an asset allocation ... (for the) ... \$4 million”. Four points for that. 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.

# OVERVIEW OF EQUITY PORTFOLIO MANAGEMENT

(STUDY SESSION 7, Pages 173-174, 175-176 and using Questions 1-8 as a basis.

Finally, time management of the question comes into play. The Evaluate 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.

Now the Recommend an asset allocation comes into play – you have three funds, where do they fit. 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 help alleviate the funding gap over time. The pension plan either has to have more return or an additional contribution because it is a late-stage plan. You have to do it quickly, hence the rounding to the nearest \$1 million. Say Albright should waive its fee, and you get full credit in fifteen minutes.

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.)

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.

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.)

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.



## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.

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.

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.

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.

# APPLICATION OF THE CODE AND STANDARDS

## (STUDY SESSION 16, Pages 247-248, 255-256.)

**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.

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.

**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.

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.)

**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.

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.)

**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..

## APPLICATION OF THE CODE AND STANDARDS (STUDY SESSION 16, Pages 247-248, 255-256.

**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.

## 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.



## Example Level III Exam Questions

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

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

## Sample Level III Item-Set Questions

<https://www.cfainstitute.org/-/media/documents/support/programs/cfa/sample-level-iii-itemset-qu...>

### 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

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**

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.

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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 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 – Member access is restricted since they have gotten their Charter.

## Final Thoughts, (ctd.)

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!



Browser window showing a video player for the CFA Institute. The address bar displays <https://www.cfainstitute.org/programs/cfa/exam/inside-the-cfa-program>. The video player features a man pointing at the text "GRADING THE CFA LEVEL III EXAM". The video title is "CFA Level III Exam Grading Process | Inside the CFA Program". The video description includes: "Find out who grades Level III essays, what they are looking for in your responses, and how they calibrat... Inside the CFA Program:". The video player interface includes a play button, a progress bar, and a volume icon. The browser's taskbar shows various applications and the system clock displays 3:10 PM on 1/4/2023.

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# CFA Program

My Enrollment

## My Enrollment

**Congratulations! You have passed all three levels of the CFA Program exam.**

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