CHARTA LEARNING · LESSON NOTES

Suitability, performance presentation and confidentiality

CFA Level I · Ethical and Professional Standards

You will learn: Apply Standards III(C) Suitability, III(D) Performance Presentation and III(E) Preservation of Confidentiality to short cases, asking each time: violation, or not?

Running example: Examples use made-up people and firms (the adviser Maya Okafor, the analyst Sunita Rao and others) and made-up figures.

1. III(C) Suitability: what the Standard requires

- In an advisory relationship, make reasonable inquiry into the client's investment experience, risk and return objectives, and financial constraints before any recommendation or action. Then check the investment suits the client's financial situation and is consistent with the written objectives and constraints.
- Four links: ask about the client; put it in writing (an investment policy statement records the client's goals and limits); check the fit against the total portfolio, not the holding alone; update at least annually, and sooner if something big happens.
- Ask about experience, risk objective (how much loss can they accept), return objective (what must the money earn), and constraints (cash needs, horizon, tax, legal, unique wishes such as exclusions).
- Two yardsticks: for an individual, their written objectives judged against the total portfolio; for a pooled fund run to a stated mandate, the mandate itself. A better idea is never a reason to depart from it.

2. III(C) in cases

- Case 1: Maya recommends a growth fund to Ernesto Vance, 70, retired, living off savings, after ten minutes and with no inquiry. Breach, however good the fund.
- Case 3: Owen runs the Granite Small-Cap Fund (mandate: small companies) and moves 30% of 200m into large companies because he believes it helps. Breach: suitability is judged against the mandate.
- Case 4: Tomas's written plan (moderate risk, 70% in shares) was never reviewed after he retired and began spending the portfolio. Breach, even though Maya followed the file. Waiting for the client to ask for a review is wrong; the duty sits with the member.

CASE 2: LENA, 35, GROWTH OBJECTIVE, 800,000 PORTFOLIO, SPECULATIVE FUND

Maya recommends	40,000 ÷ 800,000	**5% of portfolio: suitable**
Same fund at 400,000	400,000 ÷ 800,000	**50%: a concentration, not suitable**
Case 3: Owen's switch	30% of 200m	**60m**
Case 4: Tomas's shares	70% of 500,000	**350,000**

Watch out: Judging a risky security on its own instead of in the total portfolio; letting a manager depart from a mandate for a better idea; waiting for the client to ask for a review.

3. III(D) Performance Presentation: fair, accurate, complete

- When communicating investment performance information, members must make reasonable efforts to ensure that it is fair, accurate and complete. Performance means past results. The test is what the reader ends up believing: every number can be true and the picture still false.
- Fair: does not favour the member (a selected best account is not a fair stand-in for the firm). Accurate: figures correct and labelled (before-fee figures labelled as such). Complete: nothing important left out, such as accounts that ended after poor results. Brief is allowed if it does not mislead.
- Misleading: best account as typical, terminated accounts left out, unlabelled back-test or gross returns. Fair once corrected: labelled gross, labelled simulated, and a composite (one combined record for all accounts run the same way) including every account.
- GIPS (global investment performance standards): complying satisfies III(D), but the Standard does not require GIPS. A firm with no GIPS claim can comply by presenting fairly.

CASE 5: 10 EQUAL ACCOUNTS, 8 STAY AT 9% AVERAGE, 2 TERMINATED AT −4%

True composite	(8 × 9 − 2 × 4) ÷ 10	**6.4%**
Brochure showed	9.0% − 6.4% too high	**2.6 points**
Verdict	terminated accounts omitted (survivorship)	**III(D) breach**

4. III(D) in cases: gross, simulated and star accounts

- Case 6: an 8% return before a 1.2% fee may be shown if plainly labelled gross of fees. Unlabelled, the reader assumes it is what they kept, which is misleading.
- Case 7: a back-test is a simulated record. Simulated results are allowed but must be labelled as simulated. Calling a back-test the track record breaches III(D); this one also assumed no trading costs.
- Case 8: presenting one selected best account as what the strategy delivers is not fair or complete. The honest version shows the composite, and may mention the best account as one example, clearly described as the best.

CASES 6 TO 8 (100,000 INVESTED)

Case 6: gain before fees	8.0% of 100,000	**8,000**
Fee and amount kept	1.2% of 100,000 = 1,200; 8,000 − 1,200	**6,800**
Case 7: back-test, no costs	100,000 × 1.12^10	**310,585**
With 1.5% a year costs	100,000 × 1.105^10	**271,408**
Case 8: star account vs composite	18.0% − 6.4%	**11.6 points**

Watch out: Thinking any true number is fine; thinking GIPS is required.

5. III(E) Preservation of Confidentiality

- Members must keep information about current, former and prospective clients confidential. The duty survives the end of the relationship, and the information may not be used at a new employer.
- Narrow exceptions: the information concerns illegal activities by the client; disclosure is required by law; the client permits it, ideally in writing. Convenience, curiosity, a friendly employer or a former client are not exceptions.
- Cooperating with a CFA Institute Professional Conduct Program investigation is not a breach, so a member cannot refuse by citing confidentiality.
- Only suspecting illegal activity: do not decide the law alone. Consult counsel and act on the advice. If the law requires disclosure, disclose what is required.
- Test: would the information identify the client? A story about an unnamed client in a small town can still be a disclosure.

CASES 9 TO 11

Dana asked about former client Marcus Hale by her new manager	no exception applies	**breach**
Sunil refuses records to the Professional Conduct Program	cooperating is not a breach	**he should answer**
Lena's accountant / Lena's brother / panel story	written permission / none / client identifiable	**allowed / not / not**

Key takeaways

- Suitability: ask, write it down, judge the fit against the total portfolio, update at least annually.
- For a pooled fund the stated mandate is the yardstick; a better idea is never a reason to depart.
- Performance presentation must be fair, accurate and complete: true numbers can still give a false picture.
- Label gross and simulated results, include terminated accounts, and do not show the best account as typical.
- GIPS compliance satisfies III(D) but is not required by it.
- Confidentiality survives the relationship; exceptions are illegal activity, legal requirement, client permission, and cooperating with a CFA Institute investigation.

Quick check

1. Fund mandate is small companies; manager moves into large ones. Allowed?
   Answer: No: suitability is judged against the mandate.
2. Ten year back-test shown with no 'simulated' label. Violation?
   Answer: Yes: it must be labelled, and calling it a track record misleads.
3. Adviser at a new firm is asked about a former client. May she tell?
   Answer: No: the duty survives the relationship and no exception applies.