**2021 CFA Society Toronto Ethics Challenge Competition**

**Preliminary Case**

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## Metropolitan Group Wealth Management (MGWM)

Metropolitan Group Wealth Management (MGWM) is a diversified wealth and asset management company with approximately $100 billion in total assets under management, with offices in major international cities including New York, Toronto, London, Frankfurt, and Paris. The company has a network of approximately 20,000 financial advisors, offering a suite of investment products including equities, bonds, life insurance, annuities, and mutual funds to both individual and institutional investors.

### Background information:

MGWM has a wide spectrum of financial advisors. Some are licensed to sell only mutual funds; others can sell individual stocks and bonds in addition to mutual funds. All advisors are licensed to sell life insurance and annuity products. Mutual funds consist of in-house managed funds in addition to funds offered by major firms, including Dynamic, Fidelity, AGF, and Mackenzie. Approximately 75% of advisors are CFA charter holders whereas the remaining 25% are certified financial planners (CFPs).

### Joe Gargery, CFA, CEO

Joe Gargery has been the CEO of MGWM since its founding fifteen years ago. While the investment industry has tried to increase transparency in recent years, the average investor is still confused by much of the terminology. In an effort to improve investor education, the marketing department is currently putting together a “dictionary” of standard investment terms, including the price-to-book (P/B) multiple, management expense ratio (MER), and price-to-earnings (P/E) ratio. These descriptions come from a wide variety of Internet sources, but are not cited in the marketing materials. As Joe notes: “There is no need to cite these definitions. It is standard business terminology.”

Gargery is on the board of directors of his children’s Montessori school, which is looking for ways to raise money to fund the expansion of the school to include both a gymnasium as well as a beforeand after-school daycare. The price tag is substantial, at $8.5 million dollars. While racking his head over dinner one night, Gargery comes up with a plan that will likely fund a significant portion of the school's expansion. Specifically, MGWM will donate 30% of MGWM's service fee from new clients referred by the parents of students at the school. At the next board meeting, Gargery brings up this idea for discussion and receives unanimous board approval. This marketing campaign is wildly successful. Three weeks after initiating the campaign, MGWM receives 500 referrals from parents of the school and the school is on-track to receive $4.0 million in funding from MGWM by the end of December 2020, in time for construction to start in the spring of 2021. During each meeting with prospective referred new clients, MGWM advisors are careful to outline the plans for distributing 30% of client fees to the school.

Increasingly, in recent years, there has been a heavy emphasis on philanthropy by large wealth and asset management firms. While Gargery is skeptical whether his competitor's intentions are truly altruistic, there is no doubt that increased philanthropy has a meaningful impact on investors' decisions to transfer their investments to different service providers. Not wanting to be outplayed, Gargery instructs his firm' advisors to change their fee structure for not-for-profits (NFPs). Specifically, as of December 1st, 2020, for all new NFP clients, fees will increase by 20%. However, this fee increase will be more than offset by a donation to the NFP, equal to 30% of total fees. New NFP clients will not be informed about the increase over previous fees, but the 30% donation will be featured prominently in all RFP (request for proposal) presentations. Gargery predicts this will be a win-win for all stakeholders; NFPs will benefit from lower net fee costs, NFPs will receive higher donations, which has been shown to influence other prospective donors' decision to donate, MGWM will benefit from increased media attention to their philanthropic actions, and MGWM's advisors will be motivated to target more NFPs, as the advisor is compensated based on gross fees, not on net fees after donations.

With 20,000 advisors across the world and with approximately 2,000 advisors in various stages of completion of the CFA charter holder at any point in time, Gargery decides to make a foray into the lucrative CFA test preparation business. CFA Prep Squad, wholly owned by MGWM, is a company that produces test-preparation materials for CFA candidates. In an effort to reduce curriculum development costs, CFA Prep Squad actively solicits feedback from test writers immediately after each sitting of the Level 1, 2, and 3 exams. Based on the quality of the information provided, CFA Prep Squad provides various levels of financial/non-financial incentives, ranging from $20 to $50 Starbucks gift cards to discounted enrolment on Level 2 and 3 preparation courses.

**Elizabeth Pfeifer, CFA, Financial Advisor**

Elizabeth Pfeifer, CFA, works in the company's Frankfurt office on secondment. German securities laws state that no financial advisors working in Germany can participate in IPOs for their own personal account. As a Canadian citizen working for a Canadian-based firm, she believes that she is not subject to these German rules and has recently purchased 10,000 shares in a new IPO, attractively priced at $10.00 per share. Yesterday, she sold these 10,000 shares @ $25.00 per share, using the $150,000 in profits to purchase a new Porsche SUV.

While on secondment at MGWM's Frankfurt office, Elizabeth works part time as an adjunct finance professor at a local university, teaching two courses per year to executive MBA students. The time commitment for teaching and preparation is approximately 200 hours per year and she receives 15,000 euros in compensation. Since Elizabeth does this teaching after regular business hours and on weekends, she decides not to discuss this outside employment contract with MGWM.

Pfeifer soon realizes that to be successful, she needs to have 300 clients to make an amount of money commensurate with what she was making in her former role. As such, she spends 80% of his time soliciting and attracting new clients and 20% of her time on managing existing clients with net worth greater than $2.0 million. She hires Joe Krupali, CFP, to manage her existing clients with a net worth less than $2.0 million. During his first year of employment, Joe has done a great job under Pfeifer's tutelage. All of Pfeifer's clients are extremely satisfied with Joe's level of professionalism and attention to detail. In fact, Joe has referred 10 new clients to Pfeifer in the past six months.

**Nigel Molesworth, CFA, Financial Advisor**

Nigel Molesworth is a relatively new addition to the MGWM team in its Toronto office. To help Nigel build his book of business, 25 members of his extended family opened new accounts by transferring their existing portfolios from other institutions. Consistent with his other clients, Nigel meets with each of these 25 extended family members on an annual basis to update their investment policy statements, if required, and charges the same fee structure. It is now two years since Nigel joined the firm and he now has a total of 200 clients. Nigel is fortunate to have been allotted 10,000 shares in a secondary equity offering (SEO) of Translogistics Inc., an up and coming AI logistics software firm with current annual sales of $300 million. This SEO is a suitable investment for 20 of Nigel's clients, including 5 family members. On the day the SEO closes, Translogistics Inc. issues a press release announcing the securement of three new multi-national customers and the stock price increases by 50%. In order to avoid any appearance of conflict of interest, Nigel only allocates the 10,000 shares to the 15 non-family member clients.

Nigel manages the portfolio of Terry Kratz, a wealthy investor with an approximate $25 million portfolio. Nigel, for the past five years, has achieved a compounded annual return of 12.5% for his client, which is significantly higher than the target benchmark of 8.0% agreed to in the IPS. As a token of his appreciation for Nigel's excellent investment skills, Kratz gives Molesworth five tickets to the 2021 NHL finals to be held in Toronto, Ontario. Molesworth discloses this gift to Jason Kenny, his supervisor at MGWM, who immediately offers Molesworth $800 for the tickets which approximates fair value.

Nigel is a weekly subscriber to the Toronto Star, a local newspaper. In a recent Saturday edition, Nigel reads that Sarah Trebenski, one of his clients, won $18.2 million in the April 20th, 2020 lottery. At the next annual meeting in December 2020, Nigel reviews Sarah's current financial situation and in so doing, updates her investment policy statement (IPS). After discussion and approval by Sarah, Nigel increases her exposure to emerging market equity stocks by $2.5 million.

Nigel recently secured a new client with $13.8 million of investable assets. The client's IPS primary objective includes mitigation of downside risk. Nigel is considering two investments in the pharmaceutical industry: Analogy Inc. and Bursky Corp. While Analogy Inc. seems a better choice based solely on financial risk metrics, Bursky Corp. scores higher on environmental, social, and governance (ESG) criteria. Recent empirical research shows that companies scoring higher on ESG criteria outperform other firms on a long-term basis. As this particular client has a 25 year investing horizon, Nigel decides to invest in Burksy Corp.

**Philip Marlowe, CFA, Canadian Equity Small-cap Fund Manager**

Philip is the fund manager for the firm's in-house Canadian equity small-cap fund. Philip takes a keen interest in small, biotech start-ups in the area of COVID-19 detection and prevention. Through various Zoom calls with contacts he has met at medical and investment conferences over the years, Philip improves his understanding of the science behind the COVID-19 innovations, as well as their prospects for commercial success. Philip uses this information to strategically invest $300 million in private placements for three Canadian firms that he feels are "best in breed" ($100 million each). These three firms include Zocota Inc., Methusda Corp., and Janista Co.

In addition to the Canadian equity small-cap fund, Philip is also the fund manager for the firm's Canadian equity balanced fund. Both the small-cap and the balanced fund hold $150 million each ($50 million per firm) in the three companies noted above. According to the model used to determine equity portfolio allocation for the two funds, the funds' holdings in the three stocks is now excessive due to significant price appreciation for each of these three companies. Since these companies are small cap firms with relatively low liquidity, it will be difficult for Philip to reduce the funds' holdings in the companies without significant downward price pressure. In an effort to reduce the funds' overweight position without inducing significant decreases in price, Philip initiates a four week strategy of trading large blocks of stock in the three companies between the two funds to inflate trading volumes and thereby increase the interest of other market participants. By the end of the four weeks, Philip is successful in reducing the funds' overweight position, while keeping the stock price in the three firms stable.

**Harriet Welsh, CFA, North American Fixed Income Fund Manager**

Prior to Harriet's role as the firm's North American fixed income fund manager, she worked in the firm's compliance department. In this role, she identified a trading error in some of the client accounts. Specifically, the in-house trading desk did not properly follow the trading instructions from one of the firm's fund managers; rather than buying an additional 10,000 shares in ABC Corp., the trading desk sold the fund's existing holding of 10,000 shares. Due to the subsequent run-up in share price of ABC Corp., this trading mistake resulted in a loss of $100,000 for the holders of the fund's units. When she brought this issue up to her boss, an investigation was launched and a report was presented to MGWM's board of directors. While Harriet was not privy to the board's discussions, she subsequently learned by means of a colleague that nothing was done to rectify the situation i.e. the unit holders were not informed of the trading mistake and the unit holders were not compensated for the loss in fund value.

Welsh believes that Philip Marlowe dislikes him because she is the only MGWM employee who has not been invited to Philip's annual Christmas party for the past three years. To get back at Marlowe for his lack of comradery, Welsh creates user profiles on several online stock forums using Philip's name and writes rumors that one of the firms in Marlowe's portfolio is about to be acquired at a 200% premium to the current stock price. As the price of this company's stock increases, Marlowe reduces his fund's ownership in this stock by 50%, leading to an investigation by IIROC.

Prior to joining MGWM in the summer of 2012, Welsh was employed by the Totley Fool, an independent, web based research company which sells stock advice to retail investors. The position requires the publication of a recommendation and report on five companies per month. Initially, Welsh writes reports that are objective and incorporate a careful consideration of all publicly available information, both positive and negative, to come to a reasoned buy/sell/hold recommendation. As part of her 3 month performance review, her supervisor tells her that she needs to change her writing style. More specifically, she is told to be more "sensational" in her writing, coming to the same reasoned conclusions she previously did, but including only those comments which support her conclusion (as opposed to presenting both sides of the argument). While initially opposed to her supervisor's guidance, the supervisor goes on: "our customers are not finance experts and have no interest in reading the "nitty-gritty". They just want to know whether to buy, sell or hold a stock so we are doing them a favor by keeping our recommendations clear and concise. As noted on our webpage in clause 12.2 of the subscription agreement, any customer can phone our 1-800 hotline if they would like to learn more about the basis for our recommendations."