2021 CFA Society Toronto Ethics Challenge

Preliminary Round

ANALYSIS REPORT

Metropolitan Group Wealth Management (MGWM)

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EXECUTIVE SUMMARY

In this analysis report, the authors will discuss potential ethical infractions and provide the appropriate recommendations for each situation pertaining to five individuals in the case of Metropolitan Group Wealth Management (MGWM), which is broken down into the five following sections.

I. CASE 1 - JOE GARGERY, CFA

1. Plagiarism

a. Ethical Infraction: MGWM's marketing department, by not citing Internet sources from which the descriptions of investment terms are derived, and Mr. Gargery, by defending the activity, have violated multiple standards of the Standards of Practice Handbook:

- I(C): Misrepresentation because the sources of the materials are not acknowledged.
- V(A): Diligence and Reasonable Basis because the sources are not recognized, making it impossible to ensure the soundness of the materials (CFA Institute, 2014).

b. Recommendation: Properly recognize the authors behind the terms' definitions by including the Internet sources in the citation list. Ensure that the sources are reliable and accurate.

2. Selective Disclosure

a. Ethical Infraction: By featuring only the 30% donations in all RFP presentations to improve MGWM's philanthropy and not disclosing the 20% increase in fees for NFPs, Mr. Gargery and the advisors have violated multiple standards:

- I(B): Independence and Objectivity and VI(A): Disclosure of Conflicts because the advisors are compensated based on gross fees (before donations) and are compensated even more now that there is a 20% increase in fees, making it possible for their objectivity to be impaired.
- V(B): Communication with Clients and Prospective Clients because the information regarding the new fee structure for NFPs is not fully communicated to the clients (CFA Institute, 2014).

b. Recommendation: Fully disclose the information regarding the increase in fees and donations to NFPs. Develop a policy guiding the advisors to fully disclose any material facts in future engagements.

3. CFA Exam Feedback

a. Ethical Infraction: CFA Prep Squad, by not specifying what types of feedback are solicited, and test writers, who may have disclosed confidential exam materials, could violate the following standards:

- I(A): Knowledge of the Law because confidential exam contents cannot be shared with anyone, per the CFA Institute's Disciplinary Sanction Guidelines (CFA Institute, 2017).
- VII(A): Conduct as Participants in CFA Institute Programs because confidential materials gained during the exam process are not to be distributed to anyone (CFA Institute, 2014).

b. Recommendation: Detail what types of feedback are solicited or discontinue the incentive program to prevent the company from potential violations of the Standards of Practice Handbook.

II. CASE 2 - ELIZABETH PFEIFER, CFA

1. IPO Participation

a. Ethical Infraction: By purchasing 10,000 IPO shares, Ms. Pfeifer has violated multiple standards:

- I(A): Knowledge of the Law because she does not follow German securities law.
- III(B): Fair Dealing because she utilizes the IPOs to gain benefit before the clients do.
- VI(B): Priority of Transactions because there's no evidence of approval for her IPO participation (CFA Institute, 2014).

b. Recommendation: Report this activity to the appropriate authorities within her organization, seek an independent legal opinion, and determine whether to inform the regulator(s) of this event.

2. Secondary Employment

a. Ethical Infraction: By not discussing her employment at the university with MGWM, Ms. Pfeifer has violated the following standards:

- I(B): Independence and Objectivity and VI(A): Disclosure of Conflicts because her employment at the university might present a conflict of interest with MGWM and impair her independence.
- IV(B): Additional Compensation Arrangements because she has not obtained permission from MGWM prior to accepting compensation from the university (CFA Institute, 2014).

b. Recommendation: Inform the university about her ethical infraction, suspend her contract as a professor, and only return to employment at the university after obtaining permission from MGWM.

III. CASE 3 - NIGEL MOLESWORTH, CFA

1. SEO Shares Allocation

a. Ethical infraction: By unreasonably and unfairly excluding the five family member clients from the allocation of 10,000 SEO shares, Mr. Molesworth has violated the following standards:

- III(B): Fair Dealing because the allocation is also deemed suitable for them.
- III(C): Suitability because no investment action is taken even though the allocation suits the five family member clients' stated objectives and mandates (CFA Institute, 2014).

b. Recommendation: Fairly allocate the shares to the family member clients on a pro-rated basis.

2. Acceptance of Client's Gift

a. Ethical infraction: By accepting five NHL tickets from the client (Mr. Kratz) as a gift without written consents from all parties involved, Mr. Molesworth has violated the following standards:

- I(B): Independence and Objectivity because accepting the gift could compromise his objectivity.
- III(C): Suitability because his actual rate of return for the client is significantly higher than the target benchmark, indicating that more risks might have been assumed than necessary.
- IV(B): Additional Compensation Arrangements because he should not accept gifts that can compete or create a conflict of interest with his employer (CFA Institute, 2014).

b. Recommendation: Refuse to sell the tickets to his supervisor at MGWM and return the gift in order to avoid any potential conflict of interest.

3. Meeting Client's IPS

a. Ethical Infraction: By investing in Bursky Corp., Mr. Molesworth violates these standards:

- III(C): Suitability because Analogy Inc. has better financial risk metrics, which is more aligned with the primary objective of the client's IPS (mitigation of downside risk), and because choosing Bursky Corp. will expose the client to more risks than necessary due to longer time horizon.
- V(A): Diligence and Reasonable Basis because basing his investment decision solely on recent empirical research is not sufficient to ensure the authenticity and thoroughness of his investment actions (CFA Institute, 2014).

b. Recommendation: Invest in Analogy Inc. instead because it is more suitable for the client. Valid and sound research reports (on the company itself, for example) should also be provided as a support.

IV. CASE 4 - PHILIP MARLOWE, CFA

1. Lack of Research and Private Placements

a. Ethical Infraction: By investing in small, biotech start-ups through private placements without in-depth research about the companies, Mr. Marlowe has violated the following standards:

- V(A): Diligence and Reasonable Basis because the information gained from his calls with the people he met at past conferences is not adequately sound to base his investment decision on.
- VI(A): Disclosure of Conflicts because he does not disclose his conflict of interest that can be reasonably expected to arise from participating in private placements.
- VI(B): Priority of Transactions because participating in private placements can present an immediate conflict of interest and can be perceived to affect future judgment, especially when the investments later go public (CFA Institute, 2014).

b. Recommendation: Conduct in-depth and thorough research of the firms' financial standing. Ensure that the manager is not benefited from the private placements before the clients or at all.

2. Suitability of Investments

a. Ethical Infraction: By making large investments of small-cap startups into the firm's Canadian equity balanced fund, and unless the investments are qualified as allowable investments in the fund's mandate, Mr. Marlowe has breached standard III(C): Suitability (CFA Institute, 2014).

b. Recommendation: Dispose of unsuitable investments if not allowed under the fund's mandate.

3. Market Manipulation

a. Ethical Infraction: By trading stock in large blocks between the funds to raise trading volumes and stimulate interest in the stock, Mr. Marlowe has breached the following standards:

- I(A): Knowledge of the Law because market manipulation is a criminal offense in Canada (Government of Canada, 1985).
- II(B): Market Manipulation because the trading volumes have been artificially inflated (CFA Institute, 2014).
- Code of Ethics because all members and candidates must "promote the integrity and viability of the global capital markets for the ultimate benefit of society" (CFA Institute, 2014, p. 7)

b. Recommendation: Cease such activity. Disclose the violation to the regulators and investors.

V. CASE 5 - HARRIET WELSH, CFA

1. Trading Mistake

a. Ethical Infraction: By not rectifying the situation regarding the $100,000 loss after having investigated and reported to the Board of Directors, the following standards have been violated:

- III(A): Loyalty, Prudence, and Care because the firm and Ms. Welsh are expected to act for the clients' benefits and ensure clients' interests are prioritized - in this case, rectifying the mistake.
- V(B): Communication with Clients and Prospective Clients because the unitholders are not informed of the trading mistake (CFA Institute, 2014).

b. Recommendation: Immediately rectify the situation and disclose to the investors.

2. False Rumours

a. Ethical Infraction: By creating fake accounts to spread false rumours regarding Mr. Marlowe's portfolio, Ms. Welsh has violated the following standards:

- I(C): Misrepresentation because she intentionally distributes misleading market information.
- I(D): Misconduct because her action can be considered as dishonesty and fraud.
- II(B): Market Manipulation because spreading rumours of an acquisition can distort share prices.
- VII(A): Conduct as Participants in CFA Institute Programs because she has compromised the integrity of the CFA designation as a CFA Charterholder (CFA Institute, 2014).

b. Recommendation: Disclose the violation to the appropriate authorities at MGWM and the IIROC.

3. One-Sided Analysis

a. Ethical Infraction: By encouraging Ms. Welsh to only include comments that support her conclusion without presenting both sides of the argument, the supervisor violates these standards:

- I(B): Independence and Objectivity because Ms. Welsh will be unable to maintain her objectivity and independence in her duties due to the risk of being punished by the supervisor.
- V(A): Diligence and Reasonable Basis because not providing a full consideration of all available information will make the investment analysis inadequate and biased (CFA Institute, 2014).

b. Recommendation: Discuss with the supervisor that this is a violation. Seek an independent legal opinion and inform the appropriate authorities if needed.

REFERENCES

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