

INSIGHTS FROM CFA SOCIETY SINGAPORE

By CFA Society Singapore Advocacy Team

# Handling a family member's account

In such an instance, an investment professional needs to take note of assessment aspects including suitability of products

SOME people prefer that their personal matters including investment management be handled by individuals or groups who are not family members, relatives or friends. They are well aware of the downsides involved.

Nevertheless, there are also individuals who are open to family members or someone they know handling their personal investment matters. This is probably more common in developing Asia and perhaps Singapore. It is not unusual for a wealth manager to manage his or her parents' funds, for example. And in such instances, there are assessment aspects to take note of including suitability of investment products and related issues.

## The Suitability Standard

CFA Institute is the global association of investment professionals that sets standards for professional excellence and credentials. As an association for investment professionals, the institute, under its Suitability Standard, requires that finance professionals who are in an investment advisory relationship with clients (including fee-paying family members) consider carefully the needs, circumstances, and objectives of the clients when determining the appropriateness and suitability of an investment or course of investment action.

In judging the suitability of a potential investment, the finance professional should review many aspects of the client's knowledge, experience related to investing, and financial situation. These aspects include, but are not limited to, the risk profile of the investment as compared with the constraints of the client, the impact of the investment on the diversity of the portfolio, and whether the client has the means or net worth to assume the associated risk.

The investment professional's assessment of suitability should reflect only the investment recommendations or actions that a prudent person would be willing to undertake. Not every investment opportunity will be suitable for every portfolio, regardless of the potential return being offered.

The responsibilities of the finance professionals to gather information and make a suitability analysis prior to making a recommendation or taking investment action fall on those finance professionals who provide investment advice in the course of an advisory relationship with a client.

Other finance professionals may be simply executing specific instructions for retail clients when buying or selling securities, such as shares



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in unit trust funds. These finance professionals and some others, such as sell-side analysts, may not have the opportunity to judge the suitability of a particular investment for the client.

## Suitability test policies

With the increase in regulatory-required suitability tests, finance professionals should encourage their firms to develop related policies and procedures. The procedures will differ according to the size of the firm and the scope of the services offered to its clients.

The test procedures should require the investment professional to look beyond the potential return of the investment and include the following:

- 1) An analysis of the impact on the portfolio's diversification
- 2) A comparison of the investment risks with the client's assessed risk tolerance
- 3) The fit of the investment with the required investment strategy

## Ethics in action: practise, practise, practise

Today's case is based on and adapted from a CFA Institute Professional Conduct enforcement action. As a guide, the desired ethical behaviour required is based on the CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards).

## Case study

Aaron Rosario, CFA, is a registered representative with a broker/dealer who has a number of individual clients, including his mother. Rosario trades unit trust fund shares for his mother's account, which has a long-term investment horizon. All of these funds have similar long-term risk and return objectives.

Rosario splits \$731,265 in investment funds in his mother's account among 42 different unit trust funds in 11 fund families. For the majority of unit trust fund purchases, he sold the funds within 92 to 274 days of purchasing them. Rosario earned \$24,747 in sales charges for these trades but discounted the fees by 10 per cent because it was his mother's account. Are Rosario's actions acceptable?

## Analysis

Clients can be charged different fees. They do not have to be equal for all accounts. Fee discounts can be made for many reasons, and Rosario may have given other clients similar or even more generous discounts. A discounted fee does not necessarily mean that some clients are being treated unfairly.

This case, however, relates to the CFA Institute Suitability Standard, which requires charterholders to determine that an investment is suitable for a client's financial objectives, mandates, and constraints before taking any investment action.

In this case, Rosario is trading unit trust fund shares in funds with a similar long-term risk and return objectives as his mother's account, which would seem to make these investments suitable for his mother's account.

But although unit trust funds are generally safe and conservative investments, the short-term nature of the trades conflicts with his mother's long-term investment horizon. In addition, the new unit trust funds' objectives and risks were similar to the funds that were sold, such that the \$24,747 in sales charges, even discounted by 10 per cent, outweighed any marginal benefit from the new unit trust funds.

Finally, splitting his mother's investment funds into 42 different unit trust funds in 11 fund families generated higher sales charges because his mother was unable to take advantage of savings from breakpoints that likely were available for larger investments.

For all these reasons, Rosario's investments for his mother's account were unsuitable.

**The writers are CFA charterholders who volunteer with the Singapore chapter of CFA Society on advocacy issues with a view to promoting financial literacy among retail investors and improving overall standards and integrity in the industry. If you have comments or feedback, please write to the CFA Society Singapore Advocacy Committee: [advocacy@cfasocietysingapore.org](mailto:advocacy@cfasocietysingapore.org)**