

INSIGHTS FROM CFA SOCIETY SINGAPORE

By CFA Society Singapore Advocacy Team

Communicating changes in billing and fees

It is critical to providing high-quality financial services to clients

IN PREPARING a recommendation about, for example, an asset allocation strategy or investment product, the analyst should include factors that are relevant to the asset classes or investment products being discussed. They are also required to follow up and communicate any significant changes in the risk characteristics of a security or asset strategy. In these respects, investors are generally more familiar with what information they may require, and the obligations of finance professionals in this area.

But what about less-discussed areas such as fees? Are fees disclosed and communicated to clients and potential investors? What are some best practices to which finance professionals need to adhere when communicating with investors?

The standard for communicating with clients and prospective clients

The CFA Institute is the global association of investment professionals that sets standards for professional excellence and credentials. It addresses the issue of how finance professionals should communicate in its Communication with Clients and Prospective Clients Standard.

Developing and maintaining clear, frequent, and thorough communication practices is critical to providing high-quality financial services to clients. When clients understand the information communicated to them, they also can understand exactly how finance professionals are acting on their behalf, giving them the opportunity to make well-informed decisions about their investments. Such understanding can be accomplished only through clear communication.

Finance professionals must thus:

- Disclose to clients and prospective clients the basic format and general principles of the investment processes they use to analyse investments, select securities and construct portfolios, and must promptly disclose any changes that might materially affect those processes.
- Disclose to clients and prospective clients significant limitations and risks associated with the investment process.
- Use reasonable judgment in identifying which factors are important to their investment analyses, recommendations or actions and include those factors in communications with clients and prospective clients.
- Distinguish between fact and opinion in the presentation of investment analyses and recommendations.

Different forms of communication

For the purposes of the standard, communica-



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tion is not confined to a written report of the type traditionally generated by an analyst researching a security, company or industry. A presentation of information can be made via any means of communication, including in-person recommendation or description; telephone conversation; media broadcast; or transmission by computer, such as on the Internet.

Computer and mobile device communications have rapidly evolved. When using any social media service to communicate business information, finance professionals must be diligent in their efforts to avoid unintended problems, because these services may not be available to all clients. When providing information to clients through new technologies, finance professionals should take reasonable steps to ensure that such delivery would treat all clients fairly and, if necessary, be considered publicly disseminated.

Ethics in action: practise, practise, practise

Consider this case study, based on a United States Securities and Exchange Commission Office of Compliance Inspections and Examinations Risk Alert. 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).

Maalouf works in a branch office for a large wealth management firm. The firm's fees are based on a percentage of the value of the assets managed in each client account. The firm has a standard method for valuing assets and calculating fees for all of its clients, which is disclosed to each client at the outset of the relationship.

Over time, the firm transitions to, firstly, using the market value of client assets at the end of the billing cycle instead of the average daily balance of the account; secondly, including assets in the fee calculation, such as cash or cash equivalents, that were previously excluded; and third-

ly, charging clients for a full billing period, rather than prorating fees for clients that start or terminate accounts in the middle of a billing period.

Can Maalouf change the valuation and fee calculation methodology as long as actual fees charged to clients are lower?

Under the Communication with Clients and Prospective Clients Standard, finance professionals must disclose to clients the basic format and general principles of the investment process. Advisory fees are a critical part of the investment management process.

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If the methods for valuing assets or calculating fees change, such that they are different from the process set out and agreed to by the client, this must be disclosed. It is improper to change fee calculation methodology without disclosure, even if it results in lower fees.

Using end-of-cycle valuations, including cash equivalents, or not pro-rating fees for newly acquired or terminated clients are possible methods for calculating fees – as long as those policies are disclosed and agreed to by the client.

It is also permissible to change valuation methodology and fee calculation policies over time for existing accounts. Maalouf and his firm can negotiate with their clients about changing the methods for calculating fees that were originally disclosed. Hence, Maalouf must notify his clients of the changes in the valuation and fee calculation methods.

The writers are CFA charterholders who volunteer with the Singapore chapter on advocacy issues, with a view towards promoting financial literacy among retail investors and improving overall standards and integrity in the industry.