

## Sample Level III Item-Set Questions

**Questions 1 through 6 relate to Ethical and Professional Standards.**

### Weiying Shao Scenario

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Weiying Shao, CFA, is an investment officer employed by Zhang Financial Services. Zhang provides wealth management services solely to high net worth individuals and has adopted the CFA Institute Standards and Asset Manager Code of Conduct.

Shao receives a request from a client asking for an itemized accounting of the actual fees and other costs charged to them for the year. Shao sends the client a document itemizing management fees paid by the client along with an explanation as to how the fees were derived.

Zhang has expanded its services recently to include proprietary mutual funds. Two experienced and respected research analysts were promoted to manage the new mutual funds.

Shao meets with Guohua Xu, a client who holds a diversified portfolio of funds. Traditionally, Shao has invested client assets in long-established funds with strong performance and management continuity. Because he has great respect for Zhang's new products and their portfolio managers, Shao suggests investing a portion of Xu's portfolio in one of the new Zhang funds. He recommends a fund with investment objectives similar to those of Xu. Shao provides performance data based on a simulated application of the fund's approach over the past 18 months. He adds, "The new fund's simulated performance is comparable to the performance of your current holdings over that period."

Several clients ask Shao about hedge funds. After carefully screening for risk and return characteristics, Shao recommends selected hedge funds he finds appropriate for even conservative clients. The funds have had excellent performance so Shao believes they are appropriate despite their three year lock out provision. He discusses his research and recommendations with a colleague who responds "I don't believe hedge funds are appropriate for any of our conservative clients, especially those with short-term liquidity needs."

Periodically Shao reviews Zhang's confidential proxy voting policy that is disclosed to clients only upon request. The policy directs investment officers to be selective when reviewing proxies, and to avoid spending time reviewing and voting routine proxies. In such cases, Zhang considers the cost involved for the client to be greater than the benefit that the client would receive.

Zhang has strict trade allocation procedures developed in accordance with the CFA Institute Standards and Asset Manager Code of Conduct. The firm distributes copies of the procedures to clients annually. Occasionally, Shao receives notice from the trading desk at the close of the day informing him that his block trades were only partially filled. Recently, when the trading desk could not execute the full \$750,000 in stock that he had requested for two accounts, he allocated

\$100,000 of the stock to the \$5 million dollar private account and the remaining \$500,000 of stock to a \$25 million dollar institutional account.

During the next month, Zhang's founder is accused by regulatory authorities of a number of violations including misappropriation of client funds. The same day, a team of senior portfolio managers leave Zhang to start their own firm. Zhang instructs its personnel not to discuss either of these developments with current or prospective clients.

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1. Are the fee disclosures made by Shao to his client consistent with the CFA Institute Asset Manager Code of Professional Conduct?
  - A. No.
  - B. Yes, because Shao disclosed how fees are derived.
  - C. Yes, because Shao itemized the management fees paid on the client's behalf.
  
2. By recommending that Xu switch a portion of his portfolio to a new Zhang fund, does Shao violate any CFA Institute Standards of Professional Conduct?
  - A. No.
  - B. Yes, because he has a conflict of interest as the new funds are proprietary.
  - C. Yes, because the fund data used in the performance comparison was simulated.
  
3. By recommending hedge funds, does Shao violate any CFA Institute Standards?
  - A. No.
  - B. Yes, because hedge funds have risk characteristics that are not suitable for conservative investors.
  - C. Yes, because the hedge funds recommended are not suitable for conservative investors with short-term liquidity requirements.
  
4. Is Zhang's proxy voting policy consistent with the requirements and recommendations of CFA Institute Standards and the Asset Manager Code of Conduct?
  - A. Yes.
  - B. No, because the proxy voting policy should be disclosed to all clients.
  - C. No, because voting of all proxies is a part of the management of client investments.
  
5. When allocating the shares on the partially filled block order does Shao violate any CFA Institute Standards?
  - A. No.
  - B. Yes, because he fails to disclose the firm's trade allocation policies.
  - C. Yes, because he should allocate shares to client accounts only after the order is completely filled.

6. According to the CFA Institute Asset Manager Code of Conduct, Zhang must disclose the information regarding its:
- A. founder only.
  - B. team of senior portfolio managers only.
  - C. both the founder and the team of senior portfolio managers.

**Questions 7 through 12 relate to Risk Management Applications of Derivatives.**

**Joenia Dantas Case Scenario**

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Joenia Dantas is a financial risk manager for Alimentos Serra (AS), a Brazilian manufacturer and exporter of soybean-based food products. AS is a privately held corporation, wholly owned by Cesar Serra. Recently, AS took out a R25,000,000, four-year, floating-rate bank loan requiring semi-annual payments of interest based on SELIC (Banco Central do Brasil’s overnight lending rate) plus a spread of 4.50 percent and repayment of principal at maturity. Serra believes that interest rates will rise in the near future and worries that AS will be unable to absorb the higher loan costs associated with an increase in rates. Dantas tells him that she will convert the loan to a 10.80 percent fixed rate by entering into the pay-fixed side of a four-year, R25,000,000 notional principal interest rate swap with semi-annual payments that exchanges SELIC for a fixed rate of 10.80 percent. She explains that the swap will act as a hedge for the loan, reducing the company’s net cash flow risk and net market value risk.

Discussions with Dantas about using interest rate swaps to reduce risk cause Serra to think about the fixed income portion of his personal investment portfolio, which includes R12.0 million in bonds that have a modified duration of 5.50 years. Serra’s beliefs about rising interest rates make him want to reduce the bond portfolio’s modified duration to 2.00 years using interest rate swaps. In order to determine the correct swap position, he needs to learn how to calculate the modified duration of a swap. He asks Dantas how to do this. She explains it to him, using the example described in Exhibit 1.

Exhibit 1  
Data for Swap Example

Maturity of swap	4 years
Payment structure	semiannual
Fixed rate on swap	10.8%
Duration of 4-year, 10.8% coupon bond	2.91 years

Serra decides to use a swap that has a modified duration of -2.40 years for the pay-fixed side to reduce his bond portfolio’s duration to the desired level.

Dantas knows that AS currently needs to borrow an additional R30,000,000 for 5 years to fund its growth. Brazilian credit markets have tightened and it would cost 17.70 percent per year to borrow this amount locally, but AS can obtain a yen-denominated loan at a fixed rate of 9.50 percent. This would expose it to substantial currency risk. A 5-year currency swap is available

in which AS would pay interest in real to the counterparty at 12.20 percent and receive interest in yen from the counterparty at 7.10 percent. The current exchange rate is ¥40/R.

In addition to the current needs, in six months AS will enter into a four-year, quarterly payment, R50,000,000 loan to fund local projects. Dantas expects to borrow these funds at a floating rate and convert the loan to fixed using an interest rate swap. She explains to Serra that AS can commit to a fixed rate of 14.3 percent for the future loan by buying a payer swaption today with an exercise rate of 14.3 percent for a four-year swap with quarterly payments and a notional principal amount of R50,000,000.

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7. Dantas' explanation of her plan to convert the four-year loan from floating to fixed is *most likely*:
  - A. correct.
  - B. incorrect, because the fixed loan rate will be 15.30%.
  - C. incorrect, because the swap should be entered to pay SELIC.
  
8. Dantas' characterization of the interest rate swap as a hedge for the bank loan is *most likely*:
  - A. correct.
  - B. incorrect, because the swap increases the cash flow risk of AS.
  - C. incorrect, because the swap increases the market value risk of AS.
  
9. The duration of the interest rate swap described in Exhibit 1 is *closest* to:
  - A. -2.41 years.
  - B. -2.66 years.
  - C. -2.91 years.
  
10. In order to reduce the duration of his bond portfolio to the desired level, Serra will enter into a pay-fixed swap position with a notional principal *closest* to:
  - A. R17.5 million.
  - B. R27.5 million.
  - C. R42.0 million.
  
11. If AS enters into the yen-real currency swap with a notional principal of ¥1.2 billion (R40.0 million), net yen interest expense for each year is *closest* to:
  - A. ¥28.80 million.
  - B. ¥85.20 million.
  - C. ¥114.00 million.

12. Dantas' description of the use of a swaption in anticipation of future borrowing is:

- A. correct.
- B. incorrect, because AS should enter into a receiver swaption.
- C. incorrect, because the fixed rate paid on the loan may be less than 14.3%.

**Questions 13 through 18 relate to GIPS.**

### **Redlands Case Scenario**

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Redlands Asset Management (RAM) is an active equity manager specializing in the Asian Pacific region. The firm was founded by Carol Schroeder, CFA at the beginning of 2006, with several members of her family serving as the firm's first clients providing the initial managed assets for the firm.

Schroeder has compiled the information in Exhibit 1 and plans to use it to market RAM to institutional investors.

**Exhibit 1**  
**Redlands Asset Management GIPS Compliant Performance**  
**Asia-Pacific Composite. (1/Jan/2006 thru 31/Dec/2008)**

<b>Year</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
<b>Return Gross of Fees</b>	44.8%	66.9%	80.7%
<b>Benchmark Return</b>	43.1%	60.2%	85.6%
<b># of Portfolios</b>	5	15	33
<b>Composite Dispersion</b>		6.7%	5.1%
<b>Period Ending Total Assets (\$ millions)</b>	350	760	1,630
<b>% of Firm Assets</b>	14%	25%	52%

Notes:

1. Performance results are presented gross-of fee so that they represent the return on assets reduced by any trading expenses incurred during the period.
2. The Asia-Pacific composite includes two non-fee-paying accounts of the Schroeder family.
3. A complete list and description of composites and their strategies, including any that have been discontinued within the last five years, is available upon request.
4. Portfolio valuations are computed monthly and are denominated in US dollars.
5. RAM uses cash-basis accounting for the recognition of interest income on its holdings of preferred stock.
6. The pricing source was changed prior to the end of the reporting period because, in management's opinion, performance was not fairly represented. The new source has significantly improved the firm's results.

7. RAM trades securities in illiquid markets with substantial political and economic risks so trades are recorded on a settlement date basis to ensure that these trades have been completed before they are included in performance calculations.
  8. The composite presented above has been GIPS verified.
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13. Which of the following performance presentation notes contains an error or omission that is *most likely* to prevent RAM from being in compliance with the GIPS standards?

- A. Composite list availability.
- B. Non-fee paying accounts disclosure.
- C. Disclosure concerning discontinued composites.

14. Which of the following performance presentation notes *most likely* comply with the recommendations and requirements of the GIPS standards?

- A. Pricing source.
- B. Cash-basis accounting.
- C. Returns calculated gross of fees.

15. Which of the following performance presentation notes would *least likely* prevent RAM from being in compliance with the GIPS standards?

- A. Monthly valuations.
- B. Non-fee paying accounts.
- C. Settlement-date accounting.

16. Which of the following concerning fees in RAM's performance presentation *most likely* meets GIPS standards?

- A. Gross of fee labeling.
- B. The firm's fee schedule.
- C. The deduction of any other fees.

17. Does RAM's performance presentation *most likely* meet GIPS standards concerning dispersion?

- A. Yes.
- B. No, the method chosen must be disclosed.
- C. No, the standard deviation must be presented.

18. RAM's verification *most likely* does not meet GIPS standards concerning verification because:

- A. composite verification is not allowed.
- B. the minimum time period has not been met.
- C. the calculation methodology must be disclosed.

*Answers are provided beginning on the next page.*

## Answers to Sample Level III Item-Set Questions

### **Weiying Shao Scenario**

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1. Are the fee disclosures made by Shao to his client consistent with the CFA Institute Asset Manager Code of Professional Conduct?
  - A. No.
  - B. Yes, because Shao disclosed how fees are derived.
  - C. Yes, because Shao itemized the management fees paid on the client's behalf.

**Answer: A**

Asset Manager Code of Professional Conduct, CFA Institute  
2009 Modular Level III, Volume 1, p. 215  
Study Session 2-6-b

Interpret the Asset Manager Code in situations presenting issues of compliance, disclosure, or professional conduct.

The Asset Manager Code of Conduct requires that managers disclose to each client the actual fees and other costs charged to them, together with itemizations of such charges, when requested by clients. The disclosure should include the specific management fee, incentive fee, and the amount of commissions the manager has paid on the client's behalf during the period plus any other costs such as custodian fees. The Asset Manager Code of Conduct also requires managers to use plain language in presenting information to clients. Shao did not disclose all fees as commissions were left out and a description using plain language was also not used.

2. By recommending that Xu switch a portion of his portfolio to a new Zhang fund, does Shao violate any CFA Institute Standards of Professional Conduct?
  - A. No.
  - B. Yes, because he has a conflict of interest as the new funds are proprietary.
  - C. Yes, because the fund data used in the performance comparison was simulated.

**Answer: A**

“Guidance for Standards I-VII,” CFA Institute  
2009 Modular Level III, Volume 1, pp. 64-66, example 4  
Study Session 1-2-a

Demonstrate a thorough knowledge of the Code of Ethics and Standards of Professional Conduct by interpreting the Code and Standards in various situations involving issues of professional integrity.



Shao does not violate the Standards. He recommends a fund with similar investment objectives and discloses the use of simulated data in accordance with Standard III (D). The Standard requires members and candidates to avoid misstating performance or misleading clients. The Code does not prohibit the use of proprietary funds for clients.

3. By recommending hedge funds, does Shao violate any CFA Institute Standards?
  - A. No.
  - B. Yes, because hedge funds have risk characteristics that are not suitable for conservative investors.
  - C. Yes, because the hedge funds recommended are not suitable for conservative investors with short-term liquidity requirements.

**Answer: C**

“Guidance for Standards I-VII,” CFA Institute  
2009 Modular Level III, Volume 1, pp. 60-64  
Study Session 1-2-a

Demonstrate a thorough knowledge of the Code of Ethics and Standards of Professional Conduct by interpreting the Code and Standards in various situations involving issues of professional integrity.

A member or candidate’s duty under Standard III(C) is satisfied with respect to a particular investment if they have thoroughly considered the investment’s place in the overall portfolio. Although Shao has performed appropriate due diligence prior to making his recommendation in regards to the return/risk characteristics he has not taken into consideration the particular short-term liquidity restrictions posed by the three-year lock up.

4. Is Zhang’s proxy voting policy consistent with the requirements and recommendations of CFA Institute Standards and the Asset Manager Code of Conduct?
  - A. Yes.
  - B. No, because the proxy voting policy should be disclosed to all clients.
  - C. No, because voting of all proxies is a part of the management of client investments.

**Answer: B**

“Guidance for Standards I-VII,” CFA Institute  
Asset Manager Code of Professional Conduct, CFA Institute  
2009 Modular Level III, Volume 1, pp. 51, 203-204, 216.  
Study Session 1-2-a and 1-6-b

Demonstrate a thorough knowledge of the Code of Ethics and Standards of Professional Conduct by interpreting the Code and Standards in various situations involving issues of professional integrity.

Interpret the Asset Manager Code in situations presenting issues of compliance, disclosure, or professional conduct.

Zhang's policy should be disclosed to all clients. Standard III (A) and the Asset Manager Code of Conduct (Section F.4.h) require members to disclose proxy-voting policies to all clients.

5. When allocating the shares on the partially filled block order does Shao violate any CFA Institute Standards?
- A. No.
  - B. Yes, because he fails to disclose the firm's trade allocation policies.
  - C. Yes, because he should allocate shares to client accounts only after the order is completely filled.

**Answer: A**

"Guidance for Standards I-VII," CFA Institute

2009 Modular Level III, Volume 1, p. 57.

Study Session 1-2-a

Demonstrate a thorough knowledge of the Code of Ethics and Standards of Professional Conduct by interpreting the Code and Standards in various situations involving issues of professional integrity.

Shao allocates the shares on a pro rata basis such that each account receives a 2% allocation to the portfolio. To meet the fair dealing requirements of Standard III (B) shares must be allocated among participating client accounts pro rata on the basis of order size.

6. According to the CFA Institute Asset Manager Code of Conduct, Zhang must disclose the information regarding its:
- A. founder only.
  - B. team of senior portfolio managers only.
  - C. both the founder and the team of senior portfolio managers.

**Answer: C**

Asset Manager Code of Professional Conduct, CFA Institute

2009 Modular Level III, Volume 1, pp. 214-217.

Study Session 2-6-a, b

Summarize the ethical responsibilities required by the six components of the Asset Manager Code.

Interpret the Asset Manager Code in situations presenting issues of compliance, disclosure, or professional conduct.

Zhang must disclose both the information concerning the regulatory authorities and the information regarding the team of senior portfolio managers. The Asset Manager Code of Conduct requires that managers disclose material information that reasonable investors would want to know relative to whether or not they would choose to use or continue to use the Manager. In this regard, possible regulatory or disciplinary action taken against the manager or its personnel related to professional conduct would be considered “material”. The Code also requires that managers disclose significant personnel or organizational changes that have occurred.

### **Joenia Dantas Case Scenario**

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7. Dantas’ explanation of her plan to convert the four-year loan from floating to fixed is *most likely*:
- A. correct.
  - B. incorrect, because the fixed loan rate will be 15.30%.
  - C. incorrect, because the swap should be entered to pay SELIC.

**Answer: B**

“Risk Management Applications of Swap Strategies,” Don M. Chance, CFA  
2009 Modular Level III, Volume 5, pp. 444-445

Study Session 15-44-a

Demonstrate how an interest rate swap can be used to convert a floating-rate (fixed-rate) loan to a fixed-rate (floating-rate) loan.

Converting a floating-rate loan to a fixed-rate loan requires entering into a plain-vanilla (fixed-for-floating) interest rate swap on the pay-fixed side. The swap should have the same maturity, the same payment frequency, and the same floating interest rate index as the loan and its notional principal should be equal to principal balance of the loan. The borrower will pay the fixed rate on the swap (here 10.80%) and receive the index (SELIC) from the swap counterparty. The borrower will pay the index (SELIC) plus any spread (4.50%) to the lender. The net, fixed interest rate on the swapped loan is the fixed rate on the swap plus any spread over index on the loan or  $10.80\% + 4.50\% = 15.30\%$  in this situation.

8. Dantas' characterization of the interest rate swap as a hedge for the bank loan is *most likely*:
- A. correct.
  - B. incorrect, because the swap increases the cash flow risk of AS.
  - C. incorrect, because the swap increases the market value risk of AS.

**Answer: C**

“Risk Management Applications of Swap Strategies,” Don M. Chance, CFA  
2009 Modular Level III, Volume 5, pp. 445-446

Study Session 15-44-c

Explain the impact to cash flow risk and market value risk when a borrower converts a fixed-rate loan to a floating rate loan.

The original loan is floating rate. A floating rate loan has very low duration and therefore little market value risk. It might, as Serra suggests, pose a cash flow risk if the firm is not able to handle the increase in loan payments associated with an increase in market interest rates. Using an interest rate swap to convert the loan from a floating rate to a fixed rate reduces the cash flow risk. However, the resulting fixed rate loan has a much higher duration and its market value will therefore fluctuate much more drastically as market interest rates change.

9. The duration of the interest rate swap described in Exhibit 1 is *closest* to:
- A. -2.41 years.
  - B. -2.66 years.
  - C. -2.91 years.

**Answer: B**

“Risk Management Applications of Swap Strategies,” Don M. Chance, CFA  
2009 Modular Level III, Volume 5, pp. 445-446

Study Session 15-44-b

Calculate and interpret the duration of an interest rate swap.

The duration of the pay-fixed position in an interest rate swap is equal to the duration of a floating rate bond with the same payment frequency minus the duration of a fixed rate bond with coupon rate equal to the fixed rate and maturity equal to the swap maturity. The duration of the floating rate bond is, on average, half of the time interval between payments (in this case, half of 0.5 years or 0.25 years.) The duration of the fixed rate bond is given as 2.91 years.  $0.25 \text{ years} - 2.91 \text{ years} = -2.66 \text{ years}$ .

10. In order to reduce the duration of his bond portfolio to the desired level, Serra will enter into a pay-fixed swap position with a notional principal *closest* to:
- A. R17.5 million.
  - B. R27.5 million.
  - C. R42.0 million.

**Answer: A**

“Risk Management Applications of Swap Strategies,” Don M. Chance, CFA  
2009 Modular Level III, Volume 5, pp. 447-450

Study Session 15-44-d

Determine the notional principal value needed on an interest rate swap to achieve a desired level of duration in a fixed income portfolio.

When the current duration (DB), the target duration (DT), and the value (B) of the bond portfolio are known and the duration of the swap has been calculated, the notional principal of the appropriate swap (NP) is found as:

$$NP = B \left( \frac{MDUR_T - MDUR_B}{MDUR_S} \right).$$

In this case, the notional principal is:

$$12,000,000 \left( \frac{2.00 - 5.50}{-2.40} \right) = 17,500,000.$$

11. If AS enters into the yen-real currency swap with a notional principal of ¥1.2 billion (R40.0 million), net yen interest expense for each year is *closest* to:
- A. ¥28.80 million.
  - B. ¥85.20 million.
  - C. ¥114.00 million.

**Answer: A**

“Risk Management Applications of Swap Strategies,” Don M. Chance, CFA  
2009 Modular Level III, Volume 5, pp. 455-458

Study Session 15-44-e

Explain how a company can generate savings by issuing a loan or bond in its own currency and using a currency swap to convert the obligation into another currency.

If AS borrows in yen, it will borrow ¥1.2 billion (=R30,000,000 × ¥40/R). In order to hedge this, it will enter into a currency swap with a notional principal of ¥1.2

billion/R30,000,000. It will receive 7.10% in yen from the swap and pay 9.50% in yen on the loan, for a net payment of 2.40% (on ¥1.2 billion) or ¥28.80 million.

12. Dantas' description of the use of a swaption in anticipation of future borrowing is:

- A. correct.
- B. incorrect, because AS should enter into a receiver swaption.
- C. incorrect, because the fixed rate paid on the loan may be less than 14.3%.

**Answer: C**

“Risk Management Applications of Swap Strategies,” Don M. Chance, CFA  
2009 Modular Level III, Volume 5, pp. 475-478  
Study Session 15-44-h

Demonstrate the use of an interest rate swaption (1) to change the payment pattern of an anticipated future loan and (2) to terminate a swap.

The payer swaption gives AS the right (but not the obligation) to enter into the desired swap position at a fixed rate of 14.3%. In six months, the market (fixed) rate on a four-year swap may be less than 14.3%, in which case the swaption will be out-of-the-money and will expire worthless. In such case, AS will enter into the desired swap at a rate of less than 14.3%.

### **Redlands Case Scenario**

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13. Which of the following performance presentation notes contains an error or omission that is *most likely* to prevent RAM from being in compliance with the GIPS standards?

- A. Composite list availability.
- B. Non-fee paying accounts disclosure.
- C. Disclosure concerning discontinued composites.

**Answer: B**

Global Investment Performance Standards, Philip Lawton, CFA, and W. Bruce Remington, CFA  
2009 Level III, Volume 6, pp. 274, 281, 311  
Study Session 18-49-s

Identify errors and omissions in given performance presentations, including real estate and private equity performance presentations.

The percentage of the composite which non-fee paying accounts represent should be disclosed, (Provision II.5A.7).

14. Which of the following performance presentation notes *most likely* comply with the recommendations and requirements of the GIPS standards?
- A. Pricing source.
  - B. Cash-basis accounting.
  - C. Returns calculated gross of fees.

**Answer: C**

Global Investment Performance Standards, Philip Lawton, CFA, and W. Bruce Remington, CFA  
2009 Level III, Volume 6, pp. 246, 274  
Study Session 18-49-1, s

State the requirements and recommendations of the GIPS standards with respect to presentation and reporting, including the required timeframe of compliant performance records, annual returns, composite market values, and benchmarks.

Identify errors and omissions in given performance presentations, including real estate and private equity performance presentations.

Returns must be clearly labeled as gross of fees or net of fees (Provision II.4.A.6).

15. Which of the following performance presentation notes would *least likely* prevent RAM from being in compliance with the GIPS standards?
- A. Monthly valuations.
  - B. Non-fee paying accounts.
  - C. Settlement-date accounting.

**Answer: A**

Global Investment Performance Standards, Philip Lawton, CFA, and W. Bruce Remington, CFA  
2009 Level III, Volume 6, pp. 246, 247, 281  
Study Session 18-49-d, s

State the requirements and recommendations of the GIPS standards with respect to input data, including accounting policies related to asset valuation and performance measurement.

Identify errors and omissions in given performance presentations, including real estate and private equity performance presentations.

GIPS recommends performance presentations include returns for quarterly and/or shorter time periods (Provisions II.1.A.3-4).

16. Which of the following concerning fees in RAM's performance presentation *most likely* meets GIPS standards?

- A. Gross of fee labeling.
- B. The firm's fee schedule.
- C. The deduction of any other fees.

**Answer: A**

Global Investment Performance Standards, Philip Lawton, CFA, and W. Bruce Remington, CFA

2009 Level III, Volume 6, p. 274

Study Session 18-49-k

State the requirements and recommendations of the GIPS standards with respect to disclosures, including fees; the use of leverage and derivatives; conformity with local laws and regulations that conflict with the GIPS standards; and non-compliant performance records.

The GIPS standards requires that returns be clearly labeled as gross of fees or net of fees (Provision II.4.A.6).

17. Does RAM's performance presentation *most likely* meet GIPS standards concerning dispersion?

- A. Yes.
- B. No, the method chosen must be disclosed.
- C. No, the standard deviation must be presented.

**Answer: B**

Global Investment Performance Standards, Philip Lawton, CFA, and W. Bruce Remington, CFA

2009 Level III, Volume 6, p. 275

Study Session 18-49-n

Evaluate the relative merits of high/low, interquartile range, and standard deviation as measures of the dispersion of portfolio returns within a composite.

The GIPS standards require firms to disclose which dispersion measure is presented. (Provision II.4.A.26).

18. RAM's verification *most likely* does not meet GIPS standards concerning verification because:

- A. composite verification is not allowed.
- B. the minimum time period has not been met.
- C. the calculation methodology must be disclosed.



**Answer: A**

Global Investment Performance Standards, Philip Lawton, CFA, and W. Bruce Remington, CFA  
2009 Level III, Volume 6, p. 294  
Study Session 18-49-t  
Explain the purpose, scope, and process of verification.

The GIPS standards specifically prohibit firms from stating that a particular composite presentation has been “GIPS verified,” (Provision III.C).

*CFA Candidates, click here for more information on sample and mock exams:*  
<http://www.cfainstitute.org/cfaprogram/resources/sampleandmockexams.html>