

LM01 The Private Wealth Management Industry

Industry segments, business models, strategies

Private wealth management has evolved to address the needs of affluent clients. It has adapted to global changes and regulatory reforms such as the Dodd-Frank Act and MiFID II, which demand increased transparency. Transparency is essential in wealth management today, driven by OECD through CRS and global regulators like the FATF.

The Wealth Management Industry Today

In the US, the wealth management industry is diverse and fragmented with many providers offering a range of services. In many European countries the industry is more concentrated with DB plans & public health systems.

"Onshore" financial services are provided within a client's home country, corresponding to their tax residency, whereas "offshore" services are outside their home country, often chosen for benefits like political stability and tax incentives.

Exhibit 1 from the curriculum lists the major cross-border financial centers.

| | Cross-border financial center wealth 2021 (USD trillions) | Dependency on cross-border wealth (%) | Top source region of cross-border wealth |
|---------------------------------|--|--|---|
| Switzerland | 2.5 | 60 | Western Europe |
| Hong Kong SAR | 2.3 | 51 | Asia |
| Singapore | 1.5 | 73 | Asia |
| US | 1.1 | 1.5 | Latin America |
| Channel Islands and Isle of Man | 0.6 | >90 | Western Europe |
| UAE | 0.6 | 62 | Middle East |
| UK mainland | 0.5 | 13 | Western Europe |
| Luxembourg | 0.4 | 82 | Western Europe |
| Monaco | 0.3 | >90 | Western Europe |
| Liechtenstein | 0.2 | >90 | Western Europe |

Note: Wealth in local currency is converted into US dollars using the 2021 year-end exchange rate across all time periods.

Source: Zakrzewski et al. (2023)

Exhibit 2 from the curriculum shows some selected offshore centers, their areas of specialization, and their level of compliance with international transparency requirements.

Exhibit 2: Selected Offshore Centers and the Main Clients Served

| Jurisdiction | Summary | OECD Transparency Classification |
|---------------------|---|---|
| Hong Kong | One of the world's leading financial hubs with a highly developed financial sector. | Largely Compliant |
| Singapore | Significant Asian financial center with substantial assets under management. | Compliant |
| Cayman Islands | Known for its hedge funds and other investment structures, holds significant financial assets. | Largely Compliant |
| Guernsey | Important center for trusts and funds in Europe. | Compliant |
| Jersey | Significant player in trusts and funds in Europe. | Compliant |
| Isle of Man | Robust financial sector but smaller in terms of assets under management. | Compliant |
| Bermuda | Known for insurance and reinsurance companies, holds substantial financial assets. | Largely Compliant |
| UAE/Dubai | Major financial hub in the Middle East, known for its free zones. | Partially Compliant (2019) |
| Bahrain | Major financial center in the Middle East, particularly in Islamic finance. | Partially Compliant |
| Panama | Known for its banking sector and the Panama Papers, has a significant amount of financial assets. | Non-Compliant |
| Lebanon | Historically a significant OFC in the Middle East, but recent financial instability. | Non-Compliant |
| Mauritius | Emerging financial center, particularly for investments into Africa. | Largely Compliant |
| Philippines | Not traditionally considered an OFC but has a growing financial sector. | Largely Compliant |
| Gibraltar | Smaller European OFC but still noteworthy for its financial activities. | Largely Compliant |
| Bahamas | Known for its trusts and private banking. | Partially Compliant |

Wealth Management Participants

The sector comprises various providers like universal banks, private banks, investment banks, and digital platforms, each targeting specific client segments from retail to ultra-high net worth individuals (UHNWIs). These entities deploy tailored strategies, from basic financial services for retail clients to specialized advisory for UHNWIs, leveraging technology to enhance accessibility and efficiency.

Low-cost & hi-tech brokerage firms like Interactive Brokers and Charles Schwab play integral roles. Together with these brokerage firms: Asset Managers and Fund Managers provide specialized portfolio management expertise. With the rise of UHNW individuals, we are seeing a rise in Independent Advisers and Family Offices.

Competitive and Strategic Drivers

The industry prioritizes client-specific strategies to ensure effective service delivery and long-term client retention, navigating a complex regulatory landscape to maintain competitiveness and meet evolving client expectations.

Exhibit 3 from the curriculum provides a summary of the three stages. These stages are crucial for maintaining a successful business cycle.



Private Client Segmentation

Wealth management classifies clients into four groups based on assets:

- Retail
- Affluent
- High net worth (HNW)
- Ultra-high net worth (UHNW)

| Client Type | Net Investable Assets |
|-------------|--|
| Retail | Up to USD250,000 |
| Affluent | Between USD250,000 and USD1 million |
| HNW | Between USD1 million and USD30 million |
| UHNW | Above USD30 million |

Services offered vary by category. Retail clients receive basic, product-focused services; affluent clients benefit from financial planning, including tax considerations and digital tools; HNW clients have access to tailormade investments; and UHNW clients involve complex, high-level advisory.

This method, though common, can be flawed due to clients' privacy concerns and its simplistic approach to diverse client needs.

Fee, revenue, and compensation structures

Business Models and Industry Drivers

Private wealth management firms use a mix of fixed/variable and recurring/one-time fees based on services provided. The sector is moving towards greater transparency under regulatory pressures and market competition.

Revenue metrics used include Net New Money (NNM) and Net New Business Volume (NNBV), which help measure growth from new and existing clients.

Pricing Strategies and Characteristics

Revenue is influenced by external market trends and internal strategies such as adjusting fees, acquiring new clients, and retaining existing ones.

Certain fees are available only to specific entities, such as banks and authorized brokers. Exhibit 4 from the curriculum lists the fees commonly charged by different entities in the wealth management industry.

| | Asset | Transaction | Margin | Service | Additional |
|------------------------|-------|-------------|--------|---------|------------|
| Universal bank | X | X | X | X | X |
| Local bank and trust | X | X | X | X | X |
| Private bank and trust | X | X | X | X | X |
| Commercial bank | | | X | X | X |
| Bank assurance | X | X | X | X | X |
| Investment bank | X | X | X | X | X |
| Digital bank | X | X | | X | |
| Brokers | | X | X | | |
| Asset/fund manager | X | X | | | |
| External asset manager | X | X | | | X |
| Family office | | | | X | X |
| Other players | | | | X | X |

Compensation Models for Wealth Managers

Wealth managers are compensated through a combination of fixed salaries, variable performance-based bonuses, and long-term incentives like equity stakes. Additional benefits include special pensions and reduced rates on loans.

These compensation and fee structures are designed to align the interests of managers with those of their clients while ensuring the firm's profitability and compliance with transparency standards.

UK is inclined more towards fixed while US more towards variable. Larger firms are inclined more towards fixed while smaller firms more towards variable. Managers take approximately 33% of fees home in bigger firms and approx. 66% of fees home in smaller firms.

The role of advisors and consultants

In private wealth management, a broad range of specialists support wealth managers to cater to the complex needs of affluent clients. These include tax advisers, legal consultants, custodians, insurance specialists, and banking services providers. Together, they optimize tax strategies, ensure legal compliance, safeguard assets, and provide tailored financial products.

Other experts like educational advisers and lifestyle managers integrate broader personal and financial planning services. This collaborative ecosystem allows wealth managers to offer comprehensive, customized solutions that align with the intricate financial and personal goals of their clients.

Exhibit 7 from the curriculum shows the various advisers supporting wealth managers.



Engagement and Management of Advisers

The wealth management ecosystem serves affluent clients through a variety of institutions:

- Large Multinational Banks: Such as UBS, JP Morgan, and HSBC, offer comprehensive financial services all in one place.
- Standalone and Boutique Firms: Like Julius Baer and Hoares and firms such as Bessemer Trust, which provide highly personalized services and often use external advisers for specialized needs.
- Family Offices: These provide tailored financial and lifestyle services, including non-traditional offerings like philanthropy and security services.

Global regulator principles

Ethics, Laws, Regulations, and The Practice of Wealth Management

The regulatory framework for private wealth management emphasizes ethical conduct and compliance, guided by the CFA Institute's Asset Manager Code.

International bodies like the OECD, FATF, IOSCO, and BCBS set standards to combat financial crimes and ensure market fairness.

CFA Ethics and the CFA Institute Asset Manager Code

Regulations such as CRS, FATCA, and GDPR enforce global tax compliance, anti-money laundering, and data protection. Securities regulations from IOSCO and banking standards from BCBS protect investors and shape banking practices. Legal requirements from laws like the Investment Advisers Act of 1940 and MiFID II mandate registration and uphold

client care standards, ensuring that wealth managers act in the best interests of their clients under fiduciary responsibilities. Market Abuse Regulation (EU) and Regulation Best Interest (Reg BI) in the US, along with ERISA, uphold standards for market integrity and outline fiduciary duties.

This comprehensive regulatory environment ensures wealth managers operate transparently and ethically, protecting client interests and maintaining market integrity.