

Private Wealth Pathway

The Private Wealth Management Industry



Exam Focus

- Typical business models of PWM service providers and their segment-based strategies
- Typical fee, revenue, and compensation structures
- Specialist advice and support for wealth managers and clients
- Regulatory and compliance considerations influencing the private wealth management industry

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History of Private Wealth Management

- **Offshore financial centers (OFCs):** offer legal asset protection and tax planning
- Quality of services and ethical standards improved over time
- Increased transparency (e.g., Switzerland)
 - Sarbanes-Oxley, Markets in Financial Instruments Directive (MiFID)
 - Hong Kong Banking Rules

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Wealth Management Industry

Key services in private wealth

- **Wealth management:** comprising investment advice, banking services, accounting, as well as tax, legal, and estate planning
- **Private banking:** personalized financial and banking service offered to HNW clients; may include investment management, tax, and estate planning
- **Asset management:** managing a client's assets; providing specialist investment strategies
- **Wealth manager/advisor:** financial planning and portfolio management

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Onshore vs. Offshore

Onshore services

- Provided within the client's primary country of residence for tax purposes

Why invest offshore?

- Political stability, legal advantages, tax incentives, access investment products

Cross-border financial centers serve domestic and international investors (e.g., U.S., U.K., and Switzerland).

Offshore centers primarily serve international clients (e.g., Bermuda, Panama).

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Question: Investing Offshore

Which of the following factors would not reliably attract global clients offshore?

- A. Recourse to the courts and a lack of confidence in one's local authorities.
- B. Political stability and improved tax regimes.
- C. Lower transaction fees.

The primary factors that attract offshore clients are _____, _____, and access to _____ that _____. _____, although attractive, are not among the primary factors.

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Question: Islamic Finance

Which of the following jurisdictions is known for its significant role in Islamic finance and is also a major financial hub in the Middle East?

- A. Singapore.
- B. Bahrain.
- C. Cayman.

_____ is a major financial hub in the Middle East and is significant in the field of Islamic finance. _____ is a financial hub, but it is not specifically known for Islamic finance. The _____ are recognized for hedge funds, but not for Islamic finance.

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Wealth Management Participants

Infrastructure of wealth management

- **Universal banks:** global presence, both onshore and offshore
- **Local banks & trust departments:** local, state, regional, and private banks
- **Investment banks:** institutional services, M&A, capital raising, UHNW clients
- **Digital & direct banks:** smaller clients, digital platforms, automated advice
- **Brokerage firms:** intermediaries between buyers and sellers
- **Asset managers:** dedicated funds, building blocks for clients' portfolios
- **Independent advisors:** manage assets using their own strategies
- **Family office:** single or multifamily offices (UHNW clients), all-in services

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Competitive and Strategic Drivers

Factors influencing a wealth management firm's strategy

- In-house expertise, differentiate from competitors
- Firm's reputation
- Target specific market segments
- Technology capacity for mass market or niche market
- Sophistication of clients and markets
- Degree of regulation within the jurisdiction
- Distribution network?
- Physical branches or offices?

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Competitive and Strategic Drivers

Legal, licensing, and technology

- Firm's license within the regulatory landscape
- Compliance framework
- Role of technology to acquire and manage client relationships

Client acquisition and retention

1. *Client acquisition*: attract new clients cost effectively, referrals
2. *Development*: deepen client relationships, cross-selling
3. *Retention*: maintaining profitable growth-oriented relationships

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Competitive and Strategic Drivers

Implementation strategies (Porter's three core approaches)

- **Cost leadership**: broad customer base, operational efficiency, automation
- **Differentiation**: target HNWIs/mass affluent; comprehensive wealth planning, exclusive opportunities not available to retail investors
- **Focus/niche**: target a specific segment of HNWI or UHNWIs in specialized markets or regions; personalized services, premium pricing

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Question: Implementation Strategies

Which of the following *best* describes the main implementation strategy for brokerages such as Charles Schwab and Interactive Brokers?

- A. Cost leadership.
- B. Differentiation strategy.
- C. Niche strategy.

Interactive Brokers and Charles Schwab offer a

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Question: Technological Impact in Private Wealth

Which of the following statements *best* describes the impact of technology on client acquisition and retention strategies in private wealth management?

- A. Technology has limited the reach of firms to potential clients.
- B. Technology has made wealth management services less accessible and affordable.
- C. Technology has enabled firms to reach a broader audience and made wealth management services more accessible and affordable.

Technology has enabled firms to reach a _____ at a _____ cost.
_____ and _____ platforms are the technologies that enable these changes.

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Services and Product Range

Core services: deposit management, liquidity and payment oversight, client reporting, account administration

Lending services: mortgages, credit cards, loans secured on investment assets (Lombard loans), specialized lending (e.g., artwork)

Wealth planning and advice: wealth structuring, legal and tax guidance, estate planning, financial planning, retirement planning, philanthropy advice

Insurance and wealth protection: life insurance, trusts, and fiduciary services

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Private Client Segmentation

Wealth-based segmentation

- **Retail:** <USD 250,000
- **Affluent:** >USD 250,000–USD 1 million
- **HNW:** >USD 1 million–USD 30 million
- **UHNW:** >USD 30 million

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Private Client Segmentation

Wealth-based segmentation

- **Retail:** minimal dedicated service, inexpensive passive ETFs
- **Affluent:** technology and digital tools, standard in-house products, basic financial planning
- **HNW:** longer time horizon, wealth transfer planning, tailor-made solutions, exclusive access to wider range of investment products
- **UHNW:** network of internal and external advisors, highly complex financial needs, senior managers involved in client relationships, and liquid and nonliquid investments

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Fees and Revenues

Fee categories

- **Recurring fees:** portfolio management activities such as investment fund management fees, custody, and tax planning
- **Nonrecurring fees:** linked to services prompted by various life events

Revenues

- **Fixed revenues:** periodic service charges
- **Variable revenues:** assets under management (AUM) fees, transaction costs
- **Net new money (NNM)** and **net new business volume (NNBV)**

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Internal Drivers Impacting Revenues

Revenue drivers

1. Higher **AUM** leads to higher revenue
 - Higher fees in up-markets
2. Firms can increase their **fees**
 - Difficult in a competitive market, easier with differentiated services
3. Firms can attract **new clients**
 - Focus on specific client segments, monitor efficiency and service
4. Clients **may leave** the firm
 - Focus on client retention, satisfied clients

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Churning

Churning

- Excessive, or inappropriate, trading in a client's account to generate income for the firm
 - Trading without considering client's investment objectives
 - Excessive transactions
 - Violates client agreement and is unlawful

Warning signs

- Unusually high trading frequency
- Excessive fees
- Excessive cross-selling of financial and insurance products

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Acquisition of Business Volume

Payment for order flow (PFOF)

- Brokerage firms earn fees by sending customer trade orders to market makers or trading firms
- Associated with retail brokerage firms in stock and options markets
- Controversial practice that may compromise best execution and create a conflict of interest
- **Fairness** and **transparency** of PFOF practices is closely monitored by regulators

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Acquisition of New Clients: Retrocessions

Retrocessions

- Wealth advisor receives a fee from a mutual fund for recommending it to their clients

Advantages

- Retrocessions incentivize advisors to offer wide range of products

Disadvantages

- Fees earned can create conflicts of interest, and could impact the quality and suitability of the products recommended to their clients
- Recommended products may have higher costs

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Compensation Models for Wealth Managers

Compensation models

- Depend upon the firm's size, ownership (public or private), global presence, complexity of its business model, and annual financial performance
- Driven by key performance indicators (KPIs) and key risk indicators (KRIs)

Wealth manager remuneration

- Welcome bonus
- Fixed salary and variable remuneration
- Long-term incentives, deferred pay, or equity participation
- Fringe benefits

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Question: Bargaining Power of Wealth Management Clients

Which of the following is the biggest driver of the bargaining power of wealth management clients?

- A. The formation of "buyer's groups" for such services.
- B. Heavy reliance on suppliers of specialized services (tax, legal, etc.).
- C. Widespread availability of providers via traditional and non-traditional engagement (e.g., virtual, low-touch).

Buyers can _____ between a _____ of wealth management providers.
The ability to _____ between wealth management firms is relatively easy.

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Question: Investment Mandates

How are advisory and execution-only investment mandates similar?

- A. Similar relative cost structure.
- B. Same underlying decision makers.
- C. Legal contracting.

Ultimately, the _____ is the _____ in both advisory and execution-only mandates.

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Question: Net New Money

A firm making a strong push for NNM is trying to increase which of the following?

- A. Interest income.
- B. Recurring revenue.
- C. Transaction revenue.

Increases in net new money (NNM) result in higher _____ such as higher _____. A firm seeking more NNM is seeking a larger _____ while planning to maintain or increase _____.

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Role of Other Advisors and Consultants

Advisors supporting wealth managers

- Legal, tax, and accountancy advisors
- Custodians for the safekeeping and reporting of client assets
- Insurance providers of high-value property insurance, art, and collectibles
- Property and logistics managers
- Security providers for physical and asset security
- Education and health care
- Well-being and lifestyle of HNW and UHNW clients

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Professional Services in Wealth Planning

Professional services

- Specialized estate planning, trusts, and wills
- Expatriation and relocation services (“golden visas”)
- Mitigation of taxes and tax efficiency, complex tax planning vehicles
- Personal banking services, multicurrency, credit lines, premium credit cards
- Commercial banking for entrepreneurs, business exit strategies
- Investment banking, mergers and acquisitions, capital raising
- Investment opportunities, access to specialist investment consultants
- Custody services to segregate assets from the wealth manager

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Insurance Specialists

Specialized liability and high-value asset insurance

- Umbrella policies cover a range of risks (e.g., multiple properties, personal liabilities, luxury assets)
- Unique risks such as kidnap and ransom insurance for high-profile individuals

Private placement life insurance

- Combines benefits of life insurance with investment opportunities
- Policyholder invests in a wide range of assets

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Support Professionals for the Wealthy

Health and well-being

- Access to premier medical services, private hospitals, personalized care plans
- Concierge medicine provides 24/7 health care teams
- Doctors and health care consultants collaborate with wealth managers
- Handle financial logistics of medical care and specialist treatments

Property and lifestyle management

- Family support staff: property managers, nannies, personal assistants
- Physical and digital security

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Question: Investment Bankers

Sarah a high-net-worth individual owns a tech start-up. The parent company of Sarah's wealth manager is a large financial services firm that also has an investment banking division. How could investment bankers specifically add value to Sarah's overall financial and wealth strategy in a way that her wealth manager along might not.

- A. Investment bankers could help Sarah manage her personal investment portfolio, focusing on stocks and bonds.
- B. Investment bankers could guide Sarah through the process of selling her start-up, including business valuation and negotiations.
- C. Investment bankers could assist Sarah in setting up a retirement saving account like a 401(k) or an IRA.

Investment bankers' services would be able to guide Sarah in the valuation and the potential sale of her start-up. Services such as business valuation and setting up a retirement saving account are typical core services provided by investment bankers, rather than those typically provided by wealth managers within a large financial services firm.

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Question: Evaluating Custodians

Ahmed, a wealth manager is tasked with shortlisting potential custodians for his high-net-worth clients, many of whom invest solely in listed shares and bonds. What should be a top priority for Ahmed when evaluating these custodians?

- A. A custodian that offers the lowest fees for asset safekeeping.
- B. A custodian that continuously invests in technology and provides 24/7 access to financial data.
- C. A custodian that specializes only in traditional assets like equities and bonds.

A custodian's ability to provide 24/7 access to financial data is crucial for adapting to client needs. Choosing the custodian with the lowest fees may indicate a low level of service. Many HNW clients also have investments in technology and digital assets in addition to traditional equities and bonds.

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Global Regulatory Principles

Ethics, laws, and regulations

- Regulation of wealth advisors: licensing, registration, disclosure, fiduciary duty, regulatory supervision, enforcement, and cooperation with regulators
- HNWI and UHNWI often involve multiple jurisdictions

Vulnerability to money laundering

- *Private banking relationships*: may create intense loyalty, ignore warning signs
- *Powerful clients*: politically exposed persons, risk of bribery and corruption
- *Culture of discretion, privacy, and secrecy*: shell companies to conceal identity
- *Intense competition*: high profitability

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Financial Crises and Financial Crimes

Need for greater regulatory oversight

- 1997–1998: Asian financial crisis, started by unexpected currency devaluation
- 2001: 9/11 terrorist attack on U.S.
- 2007–2009: global financial crisis, high systemic leverage, weak regulation
- 2008: Madoff Ponzi scheme, concealed fraudulent activities
- 2015: 1Malaysia Development Berhad scandal, corruption, AML
- 2016: The Panama Papers, leaked documents exposing offshore clients
- 2017–2018: Danske Bank AML scandal

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Financial Regulatory Reform

Multilateral organizations and reforms

- **Organization for Economic Co-operation and Development (OECD):** sets standards on transparency and exchange of information
- **Common Reporting Standard (CRS):** calls on jurisdictions to obtain information from their financial institutions, and exchange with other jurisdictions on an annual basis
- **Foreign Account Tax Compliance Act (FACTA):** requires reporting by foreign institutions of foreign assets held by U.S. persons
- **Financial Action Task Force (FATF):** intergovernmental organization taking global action to tackle money laundering and terrorist financing

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Financial Regulatory Reform

International Organization of Securities Commissions (IOSCO): comprises securities regulators from over 120 jurisdictions

- Facilitates cooperation and information exchange
- Fair and efficient markets, reducing systemic risk, published principles

Basel Committee on Banking Supervision (BCBS): sets minimum capital standards for global banks

- Credit risk, market risk, operational risk, liquidity risk, emerging risk
- BCBS has no legal authority over banks, publishes guidelines
- Local jurisdictions create local country laws based upon BCBS principles

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Question: CRS and FACTA

Which of these statements about the CRS and FATCA are true?

- A. FATCA is primarily concerned with the actions of US financial institutions outside of the United States, while CRS is multilateral.
- B. Under CRS, US banks agree to collect and share information on their residents' financial accounts with other jurisdictions.
- C. FATCA requires financial institutions to report only those customers who qualify as US persons.

requires financial institutions to report only those customers who qualify as . The was developed by the , is similar to , and involves countries.

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CFA Ethics and the CFA Institute Asset Manager Code

CFA Institute Asset Manager Code (AMC)

- *Voluntary* code of conduct, comprising ethical and professional standards for **asset managers**

General Principles of Conduct

- Act in a professional and ethical manner, and act for the benefit of clients
- Act with independence and objectivity, and act with skill, competence, and diligence
- Communicate with clients in a timely and accurate manner
- Uphold applicable rules governing capital markets

CFA Ethics and the CFA Institute Asset Manager Code

Ethical and Professional Responsibilities of Firms

- Loyalty to clients
- Investment process and actions
- Trading
- Risk management, compliance, and support
- Performance and valuation
- Disclosures

The AMC is closely aligned with laws governing asset managers in many world markets.

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CFA Ethics and the CFA Institute Asset Manager Code

A. Loyalty to Clients

Managers must:

1. Place client interests before their own.
2. Preserve the confidentiality of client information.
3. Refuse to participate in any business relationship or accept any gift that could be expected to affect their independence, objectivity, or loyalty to clients.

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B. Investment Process and Actions

Managers must:

1. Use reasonable care and prudent judgment when managing client assets.
2. Not engage in practices designed to distort prices or artificially inflate trading volume with the intent to mislead participants.
3. Deal fairly and objectively with all clients.
4. Have reasonable and adequate basis for investment decisions.
5. Take only investment actions that are consistent with the stated objectives and constraints; provide adequate disclosures of changes in style/strategy.
6. Evaluate and understand the client's objectives; determine suitability.

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C. Trading

Managers must:

1. Not act on material nonpublic information.
2. Give priority to client investments over their own interests.
3. Use commissions generated from client trades to only pay for investment-related products that directly assist in investment decision-making.
4. Maximize client portfolio value by seeking best execution for all transactions.
5. Establish fair and equitable trade allocation policies among client accounts.

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D. Risk Management, Compliance, and Support

Managers must:

1. Develop and maintain policies and procedures.
2. Appoint a compliance officer to administer the policies and enforce conduct.
3. Arrange for independent third-party review of portfolio information to clients.
4. Maintain records for an appropriate period of time in an accessible format.

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E. Performance and Valuation

Managers must:

1. Present performance information that is fair, accurate, relevant, timely, and complete. Managers must not misrepresent the performance of individual portfolios or of their firm.
2. Use fair-market prices to value client holdings and apply, in good faith methods to determine the fair value of any securities for which no independent third-party market quotation is readily available.

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CFA Ethics and the CFA Institute Asset Manager Code

F. Disclosures

Managers must:

1. Communicate with clients on an ongoing and timely basis.
2. Ensure disclosures are truthful, accurate, complete, and understandable.
3. Include any material facts when making disclosures to clients.

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Solutions

Question: Investing Offshore

Which of the following factors would not reliably attract global clients offshore?

- A. Recourse to the courts and a lack of confidence in one's local authorities.
- B. Political stability and improved tax regimes.
- ☒ C. Lower transaction fees.

The primary factors that attract offshore clients are political stability, legal advantages, tax incentives, and access to investment products that are available locally. Lower transaction fees, although attractive, are not among the primary factors.

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Question: Islamic Finance

Which of the following jurisdictions is known for its significant role in Islamic finance and is also a major financial hub in the Middle East?

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Bahrain is a major financial hub in the Middle East and is significant in the field of Islamic finance. Singapore is a financial hub, but it is not specifically known for Islamic finance.

The Cayman Islands are recognized for hedge funds, but not for Islamic finance.

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Question: Implementation Strategies

Which of the following *best* describes the main implementation strategy for brokerages such as Charles Schwab and Interactive Brokers?

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Interactive Brokers and Charles Schwab offer a low-fee structure.

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Which of the following statements *best* describes the impact of technology on client acquisition and retention strategies in private wealth management?

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- ☐ B. Technology has made wealth management services less accessible and affordable.
- ☒ C. Technology has enabled firms to reach a broader audience and made wealth management services more accessible and affordable.

Technology has enabled firms to reach a broader audience at a lower cost. Digital marketing and social media platforms are the technologies that enable these changes.

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Question: Bargaining Power of Wealth Management Clients

Which of the following is the biggest driver of the bargaining power of wealth management clients?

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Buyers can choose between a wide range of wealth management providers. The ability to switch between wealth management firms is relatively easy.

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Question: Investment Mandates

How are advisory and execution-only investment mandates similar?

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Ultimately, the client is the decision maker in both advisory and execution-only mandates.

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Question: Net New Money

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Increases in net new money (NNM) result in higher recurring revenues such as higher management fees. A firm seeking more NNM is seeking a larger revenue base while planning to maintain or increase revenue assets.

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- ☒ C. FATCA requires financial institutions to report only those customers who qualify as US persons.

FATCA requires financial institutions to report only those customers who qualify as US persons. The Common Reporting Standard (CRS) was developed by the OECD, is similar to FATCA, and involves 90 countries.

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Working With the Wealthy



Exam Focus

- Describe how family and human dynamics relate to wealth and its management.
- Describe the skills needed in profiling, acquiring, advising, communicating with, and educating private clients.
- Describe the unique characteristics of ultra-high-net-worth individuals.
- Recommend approaches to the development and implementation of long-term family decision-making frameworks.

Family and Human Dynamics

Human dynamics is the study of relationships:

- *Wealth in human dynamics* is a framework to understand how families operate in response to wealth.

Family operating system

- Family norms and rituals
- Family roles and decision-making
- Families and change

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Socioemotional Wealth

With **socioemotional wealth (SEW)**, family businessowners are not solely influenced by profit:

- *Social goals*: wanting to take an active part in the local community
- *Emotional goals*: wanting to continue the family legacy

Socioemotional wealth suggests a family business often means far more to family members than purely financial returns.

Business decisions may be based on **nonfinancial considerations**.

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