Level III
of the
CFA® Program

Private Markets

THE PRIVATE WEALTH MANAGEMENT INDUSTRY

Learning Outcome Statements

- **LOS :** Discuss the typical **business models** of private wealth management service providers and their segment-based strategies.
- **LOS :** Discuss typical **fee**, **revenue**, and **compensation** structures prevalent in the private wealth management industry.
- **LOS :** Discuss how various **advisers**, **consultants**, and **professionals** support private wealth managers and their clients.
- **LOS :** Describe and evaluate **regulatory and compliance considerations** influencing the private wealth management industry.

Introduction

- **Private Wealth Management** serves wealthy clients needing comprehensive financial advice.
- **Services** extend beyond investments to include tax, legal, philanthropy, and estate planning.
- Firms often **collaborate** with lawyers, tax specialists, and other professionals for holistic management.



Brief History of the Private Wealth Management Industry



Ancient Civilizations: Early wealth management practices.

Post-WWII: Global expansion of private banks, rise of offshore financial centers.



Late 20th Century: Growth driven by globalization and emerging markets.

2008 Financial Crisis: Led to regulatory reforms like Dodd-Frank and MiFID II.



Swiss Banking Secrecy: Major reforms post-2008, aligned with global transparency norms.

Current Trends: Emphasis on transparency, compliance, and comprehensive services.

LOS : Discuss the typical business models of private wealth management service providers and their segment-based strategies.

Typical Business Models of Private Wealth Management



Universal Banks: Offer a **wide range of financial services**, including wealth management, under one brand.

Private Banks: Independent entities focusing solely on wealth management for **high-net-worth clients**.

Local Banks and Trusts: Provide region-specific **wealth management** and retail banking services.

Investment Banks: Serve **ultra-high-net-worth** individuals with specialized services like mergers and acquisitions.

Digital and Direct Banks: Use **digital platforms** to offer low-cost, automated investment advice.

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Typical Business Models of Private Wealth Management



Brokerage Firms: Facilitate **market transactions** and provide investment management at competitive fees.

Asset Managers: Focus on managing investments through **dedicated funds**, not full wealth management services.

Independent Advisers: Operate **autonomously**, offering personalized advice without product ties.

Family Offices: Manage **comprehensive financial needs** for single or multiple wealthy families.

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Segment-Based Strategies



Retail Segment: Focuses on **savings accounts** and inexpensive investment solutions.



Affluent Segment: Offers basic financial planning and **digital tools** for investment management.



High Net Worth (HNW): Provides customized **investment solutions** and **wealth-transfer assistance**.



Ultra-High Net Worth (UHNW): Delivers **highly personalized services** with a diverse asset mix, involving senior management.

LOS : Discuss the typical business models of private wealth management service providers and their segment-based strategies.

Offshore vs. Onshore Services

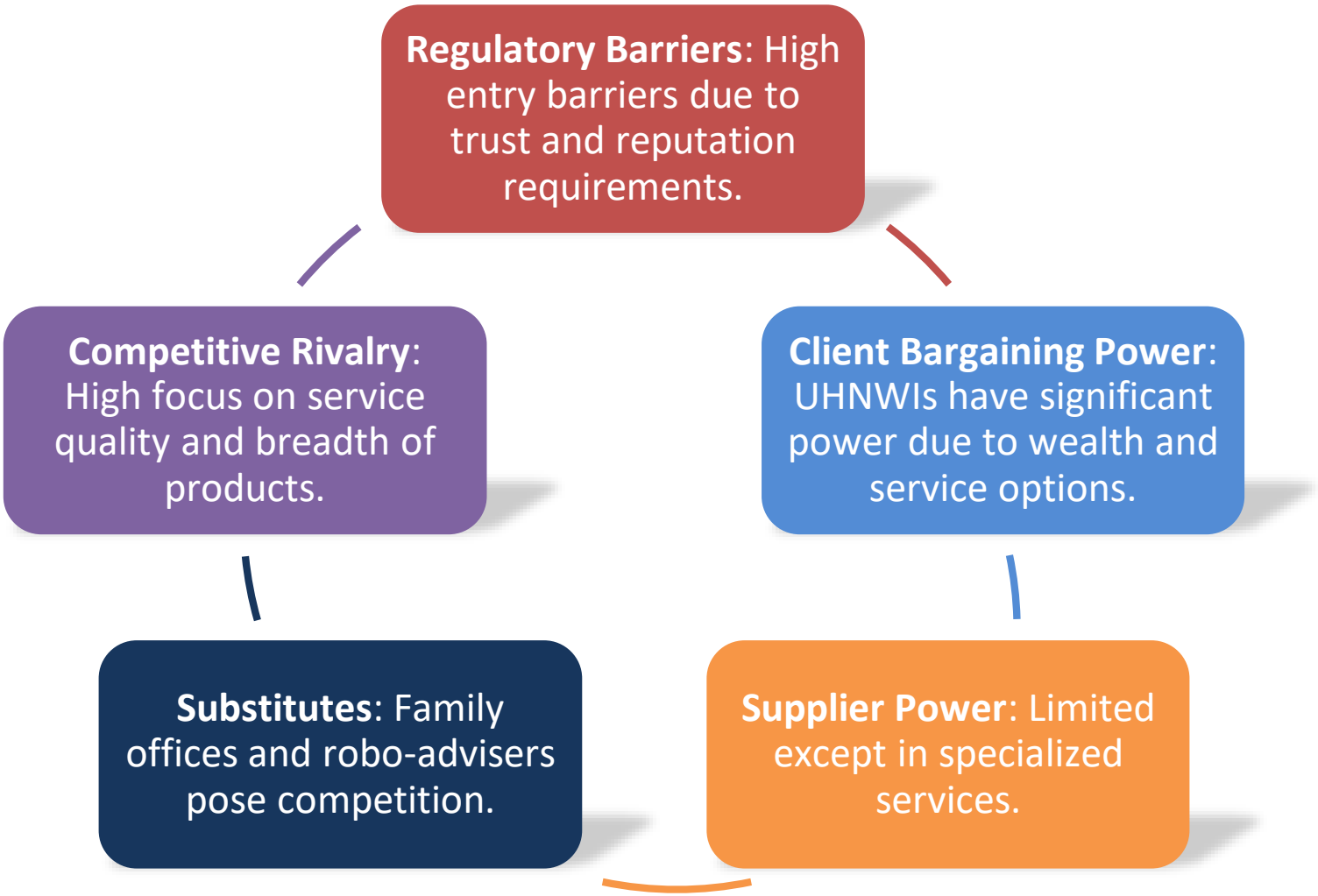


Popular Offshore Financial Centers

- **Onshore Services**: Provided within the client's country of residence, complying with local tax regulations.
- **Offshore Services**: Offered in foreign jurisdictions for benefits like tax incentives and political stability.
- Clients may choose offshore for **legal advantages** and **diverse investment opportunities**.

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Competitive and Strategic Drivers

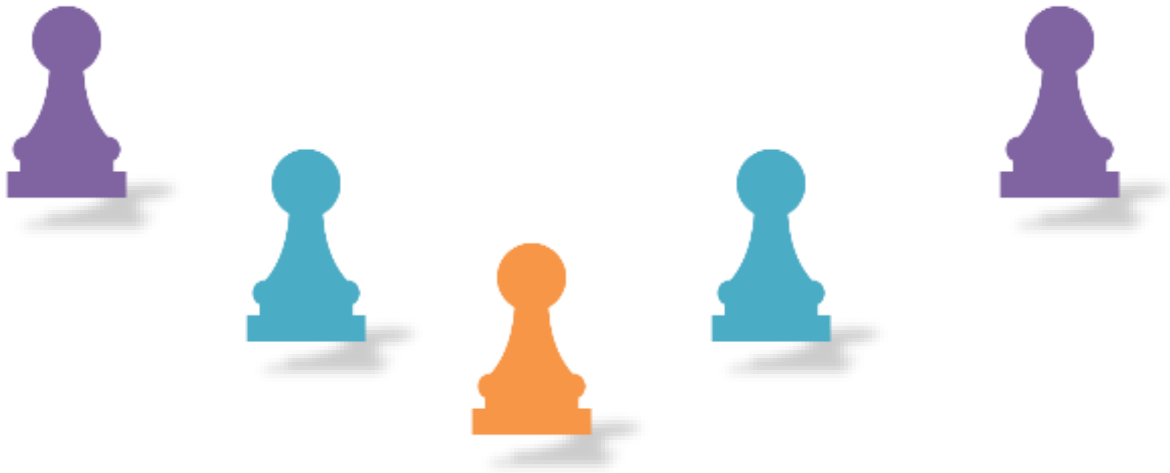


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Strategies for Competitive Advantage

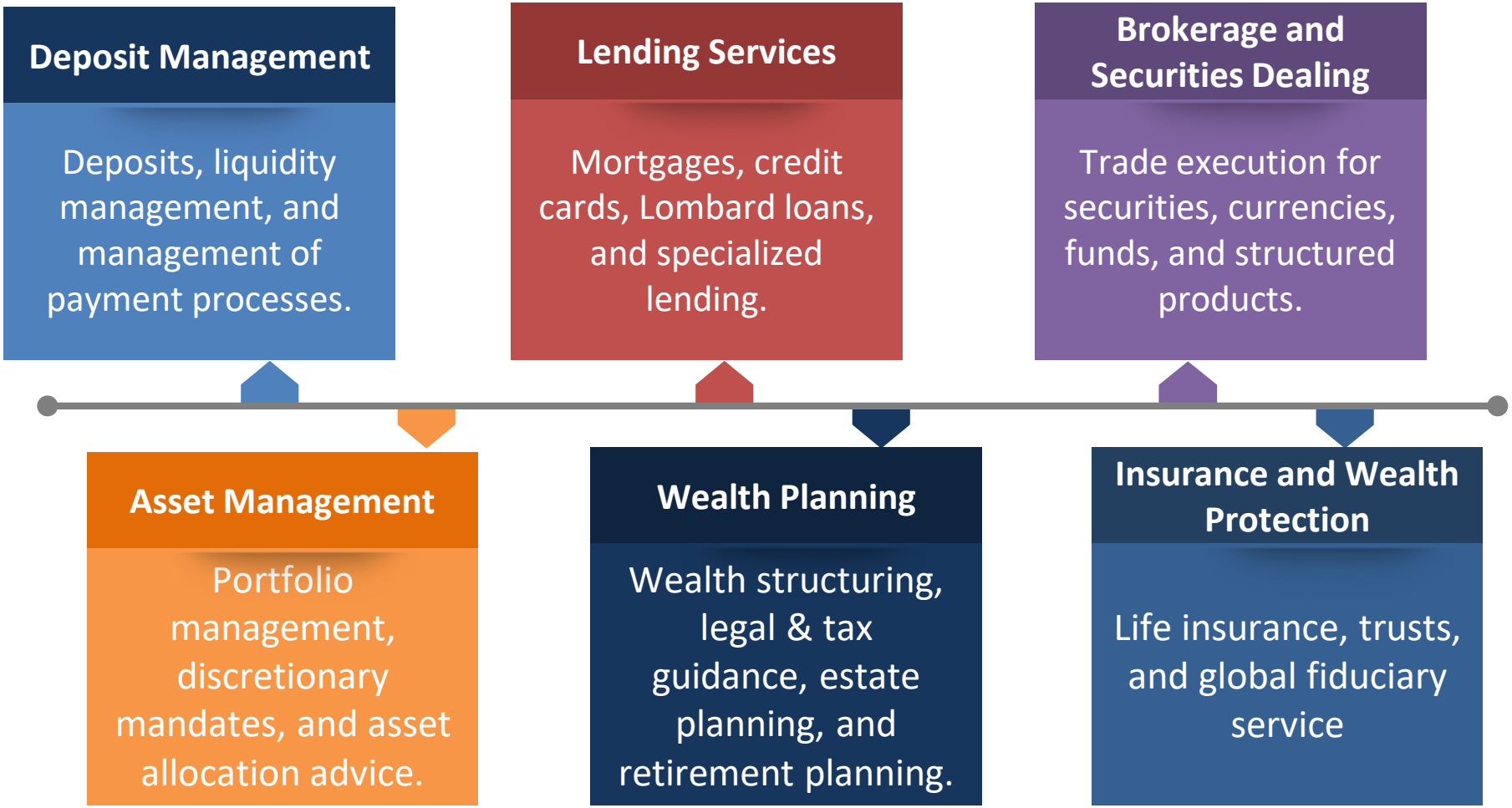
- **Cost Leadership**: Focuses on economies of scale and operational efficiency for broad market appeal.
- **Differentiation**: Offers unique, valued services for higher margins, targeting HNWIs.
- **Focus/Niche**: Targets specific segments with highly personalized services, often at premium prices.





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Key Services in Private Wealth Management



LOS : Discuss typical fee, revenue, and compensation structures prevalent in the private wealth management industry.

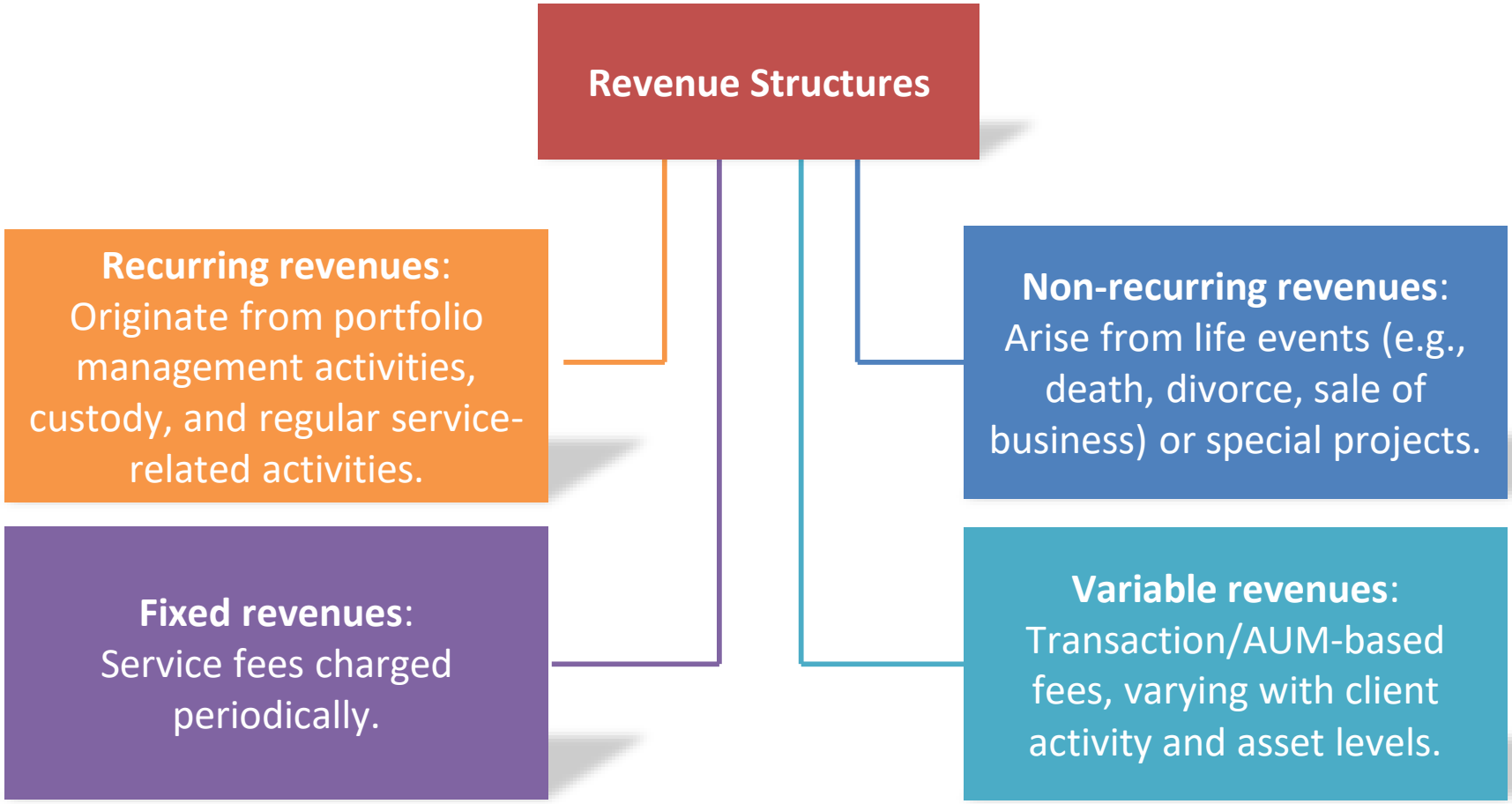
Fee Structures in Private Wealth Management

- **Asset-based fees**: Calculated as a percentage of the client's assets under management (**AUM**), typically invoiced quarterly.
- **Transaction-based fees**: Charges per transaction, applied to trades involving securities, funds, and structured products.
- **Interest and margin-based fees**: Associated with lending programs, applied to **negative cash balances**, **mortgages**, and **securities lending**.
- **Service and maintenance**: Fixed charges related to account upkeep, such as **administrative fees** and charges for **payments and transfers**.
- **Additional fees**: May include **accounting**, taxation, **legal** support, and **technological** support fees.



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Revenue Structures in Private Wealth Management



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External Drivers Impacting Revenues

Global Capital Markets

Increased connectivity and **sensitivity to macroeconomic** and **geopolitical** developments affect market valuations and revenue stability.

Private Markets Investments

Growing use of private equity, real estate, and venture capital provides diversification and return premiums but **introduces liquidity challenges**.

Technology Adoption

Robo-advisors and **low-cost trading platforms** can reduce client costs but may also lower industry revenues; however, they can attract new small investors.

ESG Awareness

Environmental, social, and governance factors are **increasingly integrated into services** but can compress net revenue if costs can't be transferred to clients.

Regulatory Changes

Initiatives like the **Retail Distribution Review** (RDR) and **Financial Advice Market Review** (FAMR) in the UK emphasize fee transparency, potentially reducing revenues.

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Internal Drivers Impacting Revenues

Client Portfolio Returns

Higher returns on client portfolios increase assets under management (AUM) and revenue.

Fee Increases

Firms can raise fees, especially with unique or differentiated products, though it's challenging in a **competitive market**.

New Client Acquisition

Attracting new clients and growing net assets **boosts firm revenue**.

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Internal Drivers Impacting Revenues

Client Retention

Focusing on client satisfaction and retention minimizes revenue losses.

Net New Money (NNM)

Focuses on **bringing in new client assets**.

Net New Business Volume (NNBV)

Measures the volume of **new business across new** and **existing clients**.

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Compensation Structures in Private Wealth Management



Fixed Remuneration: Base salary determined by role, experience, and firm-specific factors.



Variable Remuneration: Includes annual bonuses, often tied to individual, team, and firm performance.



Long-Term Incentives: Equity or stock ownership in the firm, typically with vesting periods.



Fringe Benefits: Includes insurance packages, retirement perks, and access to exclusive training programs.

LOS : Discuss how various advisers, consultants, and professionals support private wealth managers and their clients.

Role of Legal Experts in Private Wealth Management

Estate planning: Lawyers specialize in estate planning, trusts, and wills to ensure efficient asset transfer and legal protection.

Conflict mediation: They mediate family disputes and provide legal solutions during conflicts.

Regulatory compliance: Ensure compliance with local and international laws, protecting client interests in complex jurisdictions.

Legal documentation: Draft and review legal documents to secure asset ownership and facilitate transactions.

Example: The Rockefeller Trust

The Rockefeller family used a complex trust structure to preserve wealth across generations, **minimizing estate taxes and ensuring philanthropic endeavors continued**. Legal experts were crucial in setting up and maintaining this structure to adapt to changing laws.

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Role of Tax Advisers and Accountants

Tax planning: Develop strategies for income splitting, charitable giving, and investment in tax-efficient vehicles.

Compliance: Ensure accurate and timely tax filings to avoid penalties.

Financial records: Maintain financial records for budgeting, forecasting, and compliance.

Complex tax structures: Advise on family limited partnerships, investment companies, and offshore trusts for tax efficiency.



Example: Apple, Inc.

Apple has over the years used tax advisers to establish an international structure, **channeling profits through countries with favorable tax laws**, significantly reducing the company's tax burden. This allowed more funds to be **reinvested in innovation and growth**.

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Role of Custodians

Asset safekeeping: Ensure the safekeeping and segregation of client assets.

Transaction verification: Verify and record transactions post-settlement for compliance.

Performance analytics: Provide real-time analytics for portfolio assessment and strategy formulation.

Global expertise: Navigate diverse regulatory frameworks for seamless operation.



Example: Northern Trust

Northern Trust acts as a custodian for **numerous high-net-worth individuals** and institutions, providing **secure storage and management of diverse assets**, including art collections, real estate, and digital assets.

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Role of Specialized Insurance Providers

Risk mitigation: Offer high-value property, liability, and kidnap and ransom insurance.

Investment products: Provide private placement life insurance and variable annuities for investment opportunities.

Customized coverage: Create tailored insurance packages for high-risk environments and unique assets.

Crisis management: Include crisis management and negotiation services in kidnap and ransom policies.



LLOYD'S Example: Lloyd's of London

Lloyd's provides tailored **kidnap and ransom insurance to high-profile executives** working in a high-risk country. The policy includes negotiation services, which can successfully secure the executive's safe release without significant financial loss.

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Role of Support Professionals

Property management: Maintain and manage client properties, impacting investment portfolios and cash flows.

Healthcare consultants: Facilitate access to top medical care and specialized treatments, integrating health and financial planning.

Educational consultants: Prepare the next generation for wealth management through educational trusts and savings plans.

Administrative support: Ensure the smooth operation of family offices and personal businesses with IT and security consultants.



Example: The Gates Family Office

The Gates family office employs a range of support professionals, including **property managers** to handle real estate investments, **healthcare consultants** to ensure top medical care, and **educational consultants** to manage educational trusts.

LOS : Describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

Major Issues in Private Wealth Management

Complex Regulation: Wealth advisers face complex regulatory landscapes involving licensing, registration, disclosure, fiduciary duty, supervision, and cooperation with authorities.

Multiple Jurisdictions: Operating in various markets necessitates compliance with diverse laws and regulations.

Evolving Environment: Advisers navigate an increasingly challenging legal and regulatory environment amid changing economic and market conditions.

Privacy vs. Compliance: Historically, wealth management valued privacy and confidentiality, which can benefit legitimate activities but also shield illicit ones like tax evasion and money laundering.

Risks and Responsibilities: Advisers must balance client advocacy and the risks of money laundering, especially with powerful clients or Politically Exposed Persons (PEPs).

AML Controls: Intense competition and the need to stay highly profitable force companies to keep strict anti-money laundering measures in place, even if it might affect their business.

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Examples of Regulatory and Compliance Impacts

Years	Crisis	Description	Impact
1997–98	Asian Financial Crisis	Unexpected currency devaluation in **Thailand** triggered regional banking and financial crises.	Demonstrated need for transparent, **accountable institutions** and **consistent international rules**.
2007–09	Global Financial Crisis (GFC)	High leverage from **subprime** loan securitizations revealed weaknesses in global financial regulation.	Prompted major reforms like **Dodd-Frank Act**, increasing interest in responsible investing.
2008	Madoff Ponzi Scheme	Massive fraud concealed for years, exposed by losses from GFC, highlighting **regulatory failures**.	Led to **enhanced investor protection**, transparency, and stronger regulatory oversight.
2015	1MDB Scandal	Corruption and **money laundering involving $4.5bn** siphoned through shell companies.	Increased scrutiny and tighter **AML requirements**, fines for involved banks.
2016	Panama Papers	**Leak exposed offshore shell companies** facilitating illegal activities.	Triggered **global reforms for greater disclosure** and enhanced due diligence in wealth management.

LOS : Describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

Regulatory Considerations in Private Wealth Management

Global Standards:

Compliance with international standards like **FATCA** and **CRS** for reporting financial accounts across borders.

Anti-Money Laundering (AML):

Strict AML regulations prevent illicit activities, requiring thorough client due diligence and transaction monitoring.

Fiduciary Duty:

Advisers must act in the best interests of their clients, **prioritizing client needs** over their own.

Disclosure Requirements:

Mandates transparency in fees, **conflicts of interest**, and investment strategies to protect clients.

Licensing and Registration:

Wealth advisers must be **licensed and registered in the jurisdictions** where they operate, ensuring compliance with local laws.

LOS : Describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

Notable Tools/Regulations

FATCA (Foreign Account Tax Compliance Act)	**Enactment**: 2010
	Focus: Requires foreign financial institutions to report information on accounts held by US citizens and residents to the IRS.
	Impact: Enhanced transparency, reduced tax evasion, and increased global cooperation on tax matters.
CRS (Common Reporting Standard)	**Enactment:** 2014 by the OECD.
	Focus: Annual information exchange on residents' financial accounts among participating jurisdictions to combat tax evasion.
	Impact: Global standardization of tax reporting, promoting transparency and accountability.

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Notable Tools/Regulations

MiFID II (Markets in Financial Instruments Directive II)	**Enactment:** 2018 in the EU.
	Focus: Ensures investor protection through enhanced transparency, suitability assessments, and best execution policies.
	Impact: Improved market integrity, greater transparency in investment services, and enhanced client protection.
AML (Anti-Money Laundering) Regulations	**Enactment:** Various stages, enhanced post-9/11.
	Focus: Prevent money laundering and terrorist financing through stringent customer due diligence, transaction monitoring, and reporting requirements.
	Impact: Increased scrutiny of financial transactions, improved risk management, and global regulatory alignment.

LOS : Describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

Notable Tools/Regulations

Basel III	**Enactment:** 2010 by the Basel Committee on Banking Supervision.
	Focus: Strengthens bank capital requirements, risk management, and liquidity coverage ratios.
	Impact: Enhanced financial stability, reduced risk of banking crises, and improved resilience of financial institutions.
AML (Anti-Money Laundering) Regulations	**Enactment:** Established in 1983.
	Focus: Develops, implements, and promotes adherence to internationally recognized standards for securities regulation.
	Impact: Protects investors, ensures fair, efficient, and transparent markets, and reduces systemic risk.

LOS : Describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

Notable Tools/Regulations



CFA Institute Asset Manager Code (AMC)	**Enactment:** Voluntary adherence encouraged by CFA Institute.
	Focus: Promotes ethical behavior and professional standards in asset management.
	Impact: Builds trust in the investment industry, aligns practices with investor interests, and ensures compliance with regulatory standards.

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CFA Institute Asset Manager Code (AMC) in Focus

Purpose: The CFA Institute Asset Manager Code (AMC) establishes ethical and professional standards for asset managers.

Voluntary compliance: Participation is voluntary but highly encouraged to promote high standards of conduct.

Alignment with laws: Requirements often align with existing laws and regulations in many developed countries.

General Principles

Ethical Conduct: Act professionally and ethically at all times.

Client Benefit: Prioritize client interests above personal or firm interests.

Independence: Maintain independence and objectivity in all actions.

Competence: Perform duties with skill, competence, and diligence.

Communication: Communicate accurately and timely with clients.

Regulatory Compliance: Adhere to applicable rules governing capital markets.

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Key Areas

1. Loyalty to Clients

Client Interests: Always place client interests before personal or firm interests.

Confidentiality: Preserve the confidentiality of client information.

Avoid Conflicts: Refuse any business relationships or gifts that could impair independence and objectivity.

2. Investment Process and Actions

Prudent Judgment: Use reasonable care and judgment when managing client assets.

Fair Dealing: Deal fairly and objectively with all clients.

Adequate Basis: Ensure investment decisions are based on thorough research and analysis.

Consistency with Mandates: Ensure investment actions are consistent with the client's objectives and constraints.

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Key Areas

3. Trading Practices

Best Execution:
Seek the best execution for all client transactions.

Fair Trade Allocation:
Ensure fair and equitable allocation of trades among client accounts.

Avoid Manipulation:
Prohibit practices that distort prices or artificially inflate trading volumes.



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Key Areas

4. Risk Management, Compliance, and Support

Compliance Programs: Develop and maintain robust compliance programs.

Appoint Compliance Officer: Designate a compliance officer to oversee adherence to policies and procedures.

Accurate Information: Ensure accurate and complete client information with third-party verification.

Record Keeping: Maintain detailed records for an appropriate period.

Qualified Staff: Employ qualified staff and maintain necessary resources.

Business Continuity: Establish a business continuity plan for disaster recovery.



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Key Areas

5. Performance and Valuation

Fair Presentation: Present performance information that is fair, accurate, relevant, and complete.

Fair Value: Use fair-market prices to value client holdings and apply appropriate methods for securities without market quotations.

6. Disclosures

Ongoing Communication: Regularly communicate with clients in a timely manner.

Complete Disclosures: Ensure all disclosures are truthful, accurate, complete, and understandable.

Material Facts: Disclose material facts regarding relationships, conflicts of interest, fees, and investment processes.

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Impact of Regulatory Changes on Wealth Management

Increased Transparency: Regulations like **MiFID II** in the EU and **Dodd-Frank** in the US require detailed disclosures, impacting client relations and operational practices.

Cost of Compliance: Higher compliance costs due to stringent regulations can impact profitability.

Global Coordination: Multilateral organizations, like **OECD** and **FATF**, promote harmonized regulations to combat financial crimes, affecting global operations.

Technology and Automation: Compliance drives the adoption of technology for efficient **reporting** and **monitoring**, enhancing accuracy and reducing manual errors.

Client Trust: Strong regulatory frameworks enhance client trust and confidence in wealth management services.



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