2025 CFA®
Exam Prep

SchweserNotes™
Private Wealth

Level III

KAPLAN SCHWESER

Private Wealth

SchweserNotes™ 2025

Level III CFA®

SCHWESERNOTES™ 2025 LEVEL III CFA® PRIVATE WEALTH

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Learning Outcome Statements (LOS)

W1. The Private Wealth Management Industry

The candidate should be able to:

a. discuss the typical business models of private wealth management service providers and their segment-based strategies.
b. discuss typical fee, revenue, and compensation structures prevalent in the private wealth management industry.
c. discuss how various advisers, consultants, and professionals support private wealth managers and their clients.
d. describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

W2. Working With the Wealthy

The candidate should be able to:

a. describe how family and human dynamics relate to wealth and its management.
b. describe skills needed in profiling, acquiring, advising, communicating with, and educating private clients.
c. describe the unique characteristics of ultra-high-net-worth individuals and how these characteristics distinguish them from other private wealth management clients.
d. recommend appropriate approaches to the development, implementation, adherence, and amendment of a common, long-term framework for joint family decision making.

W3. Wealth Planning

The candidate should be able to:

a. formulate goals-based financial plans and recommend appropriate strategies to achieve an individual's goals-based financial plans.
b. recommend and justify methods to manage a family's financial exposures holistically across their lifetime and retirement.
c. evaluate how the principles of taxation and taxes influence goals-based planning and holistic financial plans for individual investors.
d. recommend appropriate liquidity strategies for goal-based planning and holistic financial plans.

W4. Investment Planning

The candidate should be able to:

a. recommend and justify portfolio allocations and investments for a private client.
b. discuss the tax efficiency of investment across various asset types and recommend various tax management strategies for asset allocation.
c. discuss and recommend appropriate wealth management planning approaches for retirement from legal, taxation, and jurisdictional perspectives.
d. evaluate the success of an investment program for a private client based on portfolio reporting and review.

W5. Preserving the Wealth

The candidate should be able to:

a. analyze the types of risks relevant to human capital.
b. describe and recommend strategies to manage risks to human capital.
c. recommend planning and investment strategies to mitigate the corrosive influence of inflation on preserving purchasing power.
d. describe how exchange rates influence asset allocation and planning as well as approaches to mitigate the exchange rate risk.

W6. Advising the Wealthy

The candidate should be able to:

a. discuss and recommend appropriate citizenship, nationality, and legal residency approaches for private clients.
b. discuss and recommend appropriate private wealth management approaches that maximize the human capital, financial capital, and economic net worth of complex family situations.
c. discuss and recommend appropriate private wealth management approaches that maximize the human capital, financial capital, and economic net worth of entrepreneurs and business owners.
d. discuss and recommend appropriate private wealth management approaches that maximize the human capital, financial capital, and economic net worth of professionals, executives, and others.

W7. Transferring the Wealth

The candidate should be able to:

a. discuss and recommend appropriate wealth management planning approaches for transferring wealth during the lifetime of the giver through gifts.
b. discuss and recommend appropriate wealth management planning approaches for transferring wealth at death through bequests and inheritance.
c. discuss and recommend appropriate wealth management planning approaches for the preservation of wealth across multiple generations through charitable giving and philanthropy.

READING W1

THE PRIVATE WEALTH MANAGEMENT INDUSTRY

EXAM FOCUS

This introductory reading in the Private Wealth pathway discusses the private wealth management industry. It focuses on the participants in the industry, categories of clients, specialist advisers, business models and fee structures, and regulation and compliance considerations, including the CFA Institute Asset Manager Code.

Much of the background information in this module may be familiar to you if you work in the industry, but it is always worth checking that your version of terminology is consistent with that used in the exam. If you are new to the industry, this module will demystify a lot of the jargon and will help put local experience into an international context.

MODULE W1.1: BUSINESS MODELS OF PRIVATE WEALTH MANAGEMENT SERVICE PROVIDERS

Video covering this content is available online.

LOS W1.a: Discuss the typical business models of private wealth management service providers and their segment-based strategies.

Figure W1.1 is a list of the key terminology around services provided in the wealth management industry.

Figure W1.1: Private Wealth Management Services

Private wealth	Refers to assets owned by wealthy individuals or families, across various asset classes (e.g., real estate, equities, and bonds)
Wealth management, or private wealth management	A comprehensive service combining financial and investment advice, accounting, and tax services, and legal or estate planning
Private banking	A personalized financial and banking service offered to high-net-worth individuals, encompassing investment management, tax/estate planning, as well as the provision of banking facilities
Asset management, or portfolio management	Managing a client's investments and providing specialized investment strategies
Wealth manager/adviser	An individual offering a combination of financial planning, portfolio management, or other financial services to clients
Onshore services	Services provided within the client's primary country of residence
Offshore/cross-border services	Services provided outside the client's primary country of residence (these may be attractive due to political stability, legal advantages, or tax incentives)

Candidates should also understand how clients can be categorized, because not all services are available to all types of clients. The usual segmentation is based on wealth, but the complexity of the client's needs is also a factor.

Retail clients typically have net investable assets up to USD 250,000 and usually stick to savings account vehicles and passive vehicles such as exchange-traded funds (ETFs).

Affluent clients (net investable assets up to USD 1 million) may require more financial planning and tax advice. Investment products are dominated by standard, accessible products such as mutual funds or ETFs. Given the high number of potential clients in this segment, it is sometimes referred to as the "mass affluent."

High-net-worth (HNW) clients have assets between approximately USD 1 million and 30 million, and they may require tailor-made solutions with less reliance on standard investment options.

Ultra-high-net-worth (UHNW) clients have assets exceeding around USD 30 million. Their needs may be highly complex, requiring additional specialized advisers. The asset mix may be diverse, covering liquid and illiquid investments. We will discuss UHNW clients further in a later module.

PROFESSOR'S NOTE

The money amounts given here are only a guideline. These may vary by region, and investment firms may use their own guidelines.

Wealth Management Participants

The wealth management sector includes many different sizes and forms of service providers. This reflects the differing structures of the industry around the world. For example, the U.S. market is relatively fragmented, with many institutions of differing types and sizes, whereas in Europe, wealth management services are typically dominated by a few large banks. This could be due to the higher level of government provision of health care and retirement support in Europe, meaning that client needs are less diverse.

Key service providers include **banks**, ranging from international universal and investment banks offering a wide range of services to an extensive client base, down to independent private banks and trusts. Key service providers also include specialized firms such as **brokerage firms**, which act as intermediaries between buyers and sellers in market transactions. Larger brokerage firms often add investment management and planning to their transactional services.

On a smaller scale, **independent advisers** (also known as **financial advisers**) provide advice and sometimes manage assets using their own strategies.

Family offices manage a wide range of financial matters (investments, tax planning, administration) for UHNW families. A family office may serve one or more families, and depending on the scale, it may manage portfolios directly or delegate to banks and fund managers.

Competitive and Strategic Drivers of the Industry

Using Porter's five forces, we can understand the competitive nature of the wealth management industry. Recall from earlier studies that high forces restrict a firm's profitability.

Force	Discussion	Level
Threat of new entrants	Regulatory barriers and the importance of reputation reduce the threat of new entrants. Larger players and established firms enjoy economies of scale. However, family and multi-family offices have gained market share in the HNW and UHNW spaces, and robo-advisers (automated platforms that use algorithms for financial planning and investment) have penetrated the mass affluent sector.	Moderate
Buyer power	The buyers are the clients. UHNW individuals possess the most buyer power as they demand a high level of service and can switch providers easily.	Moderate to high
Supplier power	Wealth managers rely on specialist advisers (discussed later) and asset managers. Their bargaining power is limited, except when the suppliers are larger banks or are highly specialized.	Moderate
Threat of substitutes	Alternative options include self-directed investment platforms, robo-advisers, and family offices (for those wishing more specialized services).	Moderate, increasing with technology
Competitive rivalry	Competition is high on service and performance, with reputation and expertise being the key differentiators.	High

To be successful in this industry, wealth managers can adopt strategies in line with Porter's three core approaches, as discussed in earlier levels of the CFA Program:

- *Cost leadership*. This requires a firm to provide a service at a lower cost than competitors. Therefore, it can earn higher margins if it charges the market price. This strategy is geared toward serving a broad customer base, using automation to achieve economies of scale and operational efficiency. Universal banks and specialized services apply this strategy.

- *Differentiation*. This seeks to provide unique offerings valued by the clients. It aims to achieve higher margins by offering tailored investment services and opportunities, often targeted at the HNW and UHNW sectors. These are likely to be products and services beyond those required by or suitable for retail investors.
- *Focus/niche*. This involves targeting a specific segment of clients in particular markets or regions, prioritizing personalized service, and being able to charge premium prices.

Service and Product Range

Wealth management firms offer a wide range of services. Some of these are provided in house, while others are outsourced due to their specialized or regulated nature. Figure W1.2 summarizes the key services and products.

Figure W1.2: Wealth Management Products

Core Services	Lending	Asset Management
Deposit management	Mortgages	Portfolio management
Liquidity oversight	Lombard loans (secured on assets)	Discretionary and advisory mandates
Client reporting		Asset allocation advice
Account administration		Investment products (third party or in house)

Wealth Planning	Insurance and Wealth Protection
Financial planning	Life insurance
Wealth structuring	Trusts and global fiduciary services
Legal and tax guidance	
Estate planning	
Philanthropy advice	

MODULE QUIZ W1.1

1. Which of the following statements regarding client types is *most accurate*?
    A. A retail client normally has assets between USD 250,000 and USD 500,000 and prefers passive investment vehicles.
    B. A UHNW individual is likely to have assets of more than USD 30 million and will probably need additional specialized advisers.
    C. An HNW client will mostly prefer ETFs and other standard investment options to keep the fees low.
2. A new employee at an investment firm makes the following statements regarding the competitive nature of the industry:

    Statement I: Both buyer and supplier power are high when dealing with retail clients, which puts pressure on margins.

    Statement II: Robo-advisers present an increasing threat of substitutes, putting pressure on margins.

    How many of these statements are correct?
    A. None.

B. One.
C. Two.

MODULE W1.2: FEE, REVENUE, AND COMPENSATION STRUCTURES

Video covering this content is available online.

LOS W1.b: Discuss typical fee, revenue, and compensation structures prevalent in the private wealth management industry.

Fee, Revenue, and Compensation Structures

The private wealth management sector typically charges higher fees than retail banking, although organizations need to be mindful of the global regulatory trend toward requiring transparency on fees.

Revenues can be grouped as recurring or nonrecurring. **Recurring revenues** are usually derived from portfolio management, custody, and tax planning. **Nonrecurring revenues** may arise from "one-off" events such as death or divorce, or from custom work requested by clients.

Revenues can also be seen as **fixed revenues** such as periodic service fees, or **variable/direct revenues** such as transaction-based or assets under management (AUM) fees. Regardless of how fees are levied, it is important'and, indeed, mandatory in many jurisdictions'to present a fee schedule to clients at the beginning of a client relationship. This should be updated periodically, or when fees change.

PROFESSOR'S NOTE
Disclosures about the cost of services provided are also required by Standard V(B): Communication with Clients and Prospective Clients.

Revenues and margins are subject to significant external pressures:

- Technology, such as robo-advisers and online trading platforms, is reducing costs for clients, but is also putting pressure on industry revenues. Cost-cutting technology may also enable small investors to access wealth management services for the first time.
- Environmental, social, and governance (ESG) awareness is increasing, and is often a client expectation within the service offered. This adds to firms' costs, which may depress margins.
- Growing connectivity of global capital markets increases investment opportunities for clients, but also increases the sensitivity of client assets to global risks.

Regulatory change has also affected the way that advisers can earn revenue. As an example, in 2013, the Financial Conduct Authority (or FCA, the U.K. regulator) implemented the Retail Distribution Review (RDR) that aimed to reduce conflicts of interest by eliminating commission-based payments. These were often hidden costs taken from the end investment product and paid to the advisers for recommending a particular investment. In their place, clients are charged for advice through a transparent fee to enhance their understanding of the costs.

Within the context of providing clients with suitable investment products and services at a reasonable price, wealth management firms need to generate revenues and profits. Revenue can generally be increased through four methods:

1. *Clients can hold investments with higher returns*, which feed through as higher AUM fees. This leads to pro-cyclical revenues, as fees decrease in downturns. This is also a passive and unreliable approach to revenue growth in a competitive market.
2. *Firms can increase their fees*, but this is difficult to do in a competitive and transparent industry. To increase fees, firms may need to develop differentiated products, or deliver a higher mandate penetration rate (i.e., move more clients from advisory to discretionary, where accounts may be less cost sensitive).
3. *Soliciting new clients* should increase net assets, but small- or medium-sized firms may not be able to cater to all market segments.
4. *Retaining existing clients* may appear a defensive strategy, but it prevents loss of business and may result in referrals of new clients.

Two common metrics related to revenue management are **net new money (NNM)**, which focuses on money from new clients, or **net new business volume (NNBV)**, which reflects the volume of new business from new and existing clients. Figure W1.3 describes categories into which fees can usually be grouped.

Figure W1.3: Fee Structures

Fee Type	Description
Asset-based fees	These are recurring fees applied to the market value of the client's portfolio. The fee rate in basis points is multiplied by the average or period-end portfolio value. The rate is often *degressive*, meaning that the marginal fee for additional assets decreases as total assets increase. The rate applied for custody is usually lower than that for asset management, despite the significant administration involved. Asset-based fees charged at the investment level can be expressed as the **total expense ratio (TER)**. Asset managers may prefer using less expensive ETFs to reduce the overall cost for clients when investing in liquid assets.
Transaction-based fees	These are charges, including commission, for transactions (i.e., buying or selling securities), either as a percentage of the transaction size or as a fixed amount. A decreasing scale is often applied to adjust fees based on the size of the transaction and the asset class involved. It is easy to provide clear advance fees on equity security transactions, but the fees may be less well defined on OTC transactions. Despite this, efforts should always be made to provide clarity to clients. When dealing with investment funds, fees may also appear at the fund level as subscription or redemption costs, distributor's fees, or as discounts or premiums applied to the trading price.
Interest-based and margin-based fees	These derive from lending programs. The ability to lend to clients depends on whether the financial intermediary has a banking license or equivalent. Lombard loans are loans issued with the client's securities pledged as collateral. For the firm, lending activities offer a considerable boost to revenues.
Service and maintenance fees	These are fixed charges linked to the upkeep and functionalities of an account. These include administrative fees, charges for transfers, or initiating new services like loans. These fees are not based on the size of the assets, but on the volume of transactions. There may be a minimum fee applied.
Additional fees	There may be fees for services outside the traditional private wealth offering, such as taxation or legal support. These fees can be significant, especially if specialists, such as lawyers with high hourly rates, are involved (e.g., in succession planning).

The following are possible areas where conflicts of interest may arise regarding the charging of fees:

1. **Churning.** This is the practice of undertaking unnecessary transactions in a client's account to earn additional transaction-based fees. This is unlawful, as it is acting against the client's best interests.
2. **Payment for order flow (PFOF).** Brokers earn money by sending client orders to specific market makers or trading firms. This is more common in the retail market for stocks and options. The practice is controversial because it may create conflicts of interest for the brokers and may compromise best execution of the client trades. The counterargument is that these PFOF receipts help cover the brokerage costs; hence, they keep overall fees low. Regulators closely monitor PFOF practices.
3. **Referral fees.** Also known as *retrocessions*, these are payments from the provider of underlying investment products to the adviser. This has historically been a widespread practice in the investment industry, but creates conflicts of interest and reduces transparency because clients may not know that their adviser is being paid to recommend a particular product. Regulators take differing approaches to referral

fees and retrocessions’in some cases, they are banning or severely restricting them for investment advice (United Kingdom, Europe, Australia). However, in the United States and Canada, the practice remains allowed but must be disclosed.

Compensation Models for Wealth Managers

Compensation models may differ depending on the structure of the firm, but there will generally be four elements to a wealth manager’s ongoing compensation:

- *Fixed remuneration.* The level of fixed salary will depend upon the employee’s role, status, experience, and network. Traditional firms may prioritize the stability of their personnel by making a large proportion of the compensation fixed. On the other hand, a partnership may make a smaller proportion fixed and more linked to financial results.
- *Variable remuneration.* This usually comprises an annual bonus, paid at the end of the year and based in differing degrees on the financial results of the individual, the department, and the firm. A firm with a culture focused on growth and a high appetite for risk may favor a high proportion of variable remuneration, although there may be regulatory limits on the ratio of variable to fixed compensation. Bonuses may be subject to clawback provisions, in which they can be withheld or rescinded in cases of misconduct.
- *Long-term incentives.* Senior relationship managers may be offered equity through long-term incentive plans (LTIPs), designed to retain managers and encourage loyalty. There are typically vesting periods (three to five years) through which the manager must stay at the firm to receive the benefits.
- *Fringe benefits.* These can vary, but examples include pensions, insurance, subsidized loan rates, and training.

MODULE QUIZ W1.2

1. Which of the following is *least accurate* regarding fee structures?
   A. Custody fees are an example of recurring revenue.
   B. AUM fees are an example of variable fees.
   C. Tax planning is an example of nonrecurring revenue.
2. If a firm wishes to grow revenue, which of the following statements is *most accurate*?
   A. With a focus on NNM, a firm will aim to increase the mandate for existing clients.
   B. To avoid regulatory concerns, firms in the EU should avoid retrocessions.
   C. Firms must avoid PFOF arrangements because they are unlawful.
3. In deciding the mix of asset manager remuneration, a firm with a low appetite for risk is *most likely* to favor a higher proportion of:
   A. fixed remuneration to variable remuneration.
   B. variable remuneration to fixed remuneration, with no clawback provisions.
   C. variable remuneration to fixed remuneration, with clawback provisions.

MODULE W1.3: SUPPORT FOR PRIVATE WEALTH MANAGERS AND CLIENTS, AND

Video covering this content is available online.

LOS W1.c: Discuss how various advisers, consultants, and professionals support private wealth managers and their clients.

The Role of Other Advisers and Consultants

Clients are increasingly looking for solutions to be planned and executed based on their unique needs and circumstances. These circumstances may become highly complex and sensitive when dealing with UHNW clients, particularly those of a high-profile nature. It is important, therefore, to have a wide range of supporting professionals available to offer specialized expertise as required:

- *Lawyers* provide advice around estate and succession planning, trusts, legal documentation, and conflict resolution.
- *Expatriation and relocation services* assist in immigration and investment law. Some countries allow foreign investors to gain residency in return for a qualifying capital investment (known as a **golden visa**). The top three issuers of such visas globally in 2021 were Panama, Australia, and Spain.
- While basic tax advice should be in the remit of a wealth manager, specialist *tax advisers* can assist with more complex areas of tax such as offshore trusts and charitable giving.
- *Personal and commercial banking* provides access to multicurrency accounts, overseas property financing, and other tailored services.
- HNW clients who own businesses may have need for *investment banking* services such as M&A advisory, capital raising, or exit route advice.
- *Accountants* help with financial recordkeeping, budgeting, and cash flow forecasting.
- *Custodians* ensure the safekeeping of assets, accurate recordkeeping, and performance analytics. Although local regulations may differ in detail, the principle is that client assets need to be kept secure'with third-party custodians acting as a safeguard between the asset manager and client'to protect the client's interests. Custodians can also add powerful analytics and real-time reporting over and above their compliance functions.
- *Insurance specialists* provide access to investment-linked insurance products as well as specialized liability insurance (e.g., covering kidnap and ransom risk for high-profile individuals). If a client chooses to bear some of this risk themselves (i.e., self-insure), the wealth manager needs to ensure that is the portfolio has a higher level of liquidity.
- *Additional support professionals* may offer health, well-being, lifestyle management, security, and administrative support for wealthy and busy clients.

The wealth manager may play a pivotal role in orchestrating this complex ensemble of advisers in line with the client's overall aims and strategies.

LOS W1.d: Describe and evaluate regulatory and compliance considerations influencing the private wealth management industry.

Global Regulatory Principles

Private wealth managers operate in a highly regulated environment. It is important to understand the interplay between ethics, law, and regulation, and to appreciate how adherence to the CFA Institute Asset Manager Code can help with compliance. In this section, we look first at money laundering, then at broader financial crises, and conclude with a discussion of global regulatory initiatives that affect wealth management.

While historically, the industry may have been viewed as secretive (with client confidentially a core aim), regulatory reform has shifted the focus toward transparency and exchange of information. A key reason for this is to combat money laundering, which can be linked to terrorist activity or other organized crime. Some aspects of the industry are particularly vulnerable to money laundering:

- Private bankers and advisers may develop strong relationships with clients, and that familiarity and loyalty may cause them to overlook warning signs.
- Clients may be powerful, and a firm may not wish to cause offense. If a client is a **politically exposed person (PEP)**, the client may be at greater risk of bribery or corruption. Firms, therefore, need to be extra vigilant when offering services to such clients.
- The traditional culture of discretion, privacy, and secrecy may facilitate the concealment of the beneficial owners of accounts. Shell companies and strong secrecy laws in some countries can make it very hard to trace ultimate ownership.
- The industry is competitive and potentially profitable, therefore making client managers less inclined to impose tough anti-money laundering (AML) controls on new or existing clients. Regulations are acting to encourage more adherence to AML controls, and failure to meet the requirements could result in reputational damage that far exceeds the short-term gains of retaining clients exposed to these types of activities.

Financial crises and crimes in the last few decades have also highlighted regulatory weaknesses. Tighter regulations have had implications for the wealth management industry. A few examples are provided in Figure W1.4.

PROFESSOR'S NOTE

Anyone working in this industry should be aware of the recent history and how things can go wrong for clients and the wider investing public. There is a lot of reading that can and should be done around each of these examples, but for the exam, focus on an awareness of how the crisis triggered a regulatory response in a particular area.

Figure W1.4: Regulatory Responses to Crimes and Crises

Date	Crisis/Crime	Regulatory Impact
2001	Terrorist attacks on the United States, exposing vulnerability of global financial system to abuse by terrorist groups and their financiers	Expansion of Financial Action Task Force (FATF), an intergovernmental organization that sets standards and monitors compliance with AML and counterterrorism financing (CTF) policies
2007–2009	Global financial crisis, where high systemic leverage and opaque financial products such as subprime loan securitizations caused many financial institutions to fail	Crisis exposed weaknesses in the private wealth management sector, which had invested heavily in complex, risky products and eroded trust and loyalty of many clients
2008	Madoff Ponzi scheme, in which Madoff concealed fraudulent activities in his investment fund from regulators and auditors for years	SEC implemented many reforms to enhance investor protection, increase transparency, and strengthen oversight (e.g., use of qualified custodians, improved information sharing, surprise examination of advisers)
2015	1Malaysia Development Berhad, one of the largest cases of corruption and money laundering in history, with more than $5.4 billion being siphoned from a state investment vehicle to fund lavish lifestyles, bribe officials, and influence elections	Increased scrutiny by regulators on the source and flow of funds; several banks were closed or fined for facilitating or concealing illicit transactions, and it also highlighted increased need for AML controls when dealing with PEPs
2016–2017	The Panama and Paradise Papers, where leaked information showed the extensive use of offshore shell companies, often facilitating illegal activities	Greater disclosure of clients, sources of funds, and beneficial ownership of shell companies (however, regulatory response varied across different jurisdictions)
2017–2018	Danske Bank, a Danish bank, was discovered to have enabled flow of EUR 200 billion of suspicious transactions through its Estonia-based branch	Criminal investigations into the bank and its executives, and the revision and harmonization of AML and CTF standards at the European Union level

Multilateral organizations can play a major role in coordinating policy responses to major crimes and crises like those listed as follows:

- *Organization for Economic Co-operation and Development (OECD)*. This sets standards on transparency and exchange of information between governments to fight money laundering, tax evasion, and terrorist financing. It created the Common Reporting Standard (CRS), an information-gathering and reporting regime used by financial institutions in over 90 countries. The Foreign Account Tax Compliance Act (FATCA) is a more limited version of the CRS, being a U.S. program focusing on reporting back on U.S. persons only, for U.S. tax compliance purposes.
- *Financial Action Task Force (FATF)*. This is an intergovernmental organization that designs and promotes policies to combat financial crime, AML, and CTF.
- *International Organization of Securities Commissions (IOSCO)*. This is an association of securities regulators from more than 120 jurisdictions. The IOSCO facilitates cooperation and information exchange among its members and provides guidance on protecting investors and the role of regulation in asset management.

- *Basel Committee on Banking Supervision (BCBS)*. This sets standards on banking regulation. Financial advisers who work with banks or advise on banking products and services should be aware of how BCBS standards may affect their professional obligations.

Overall, the level of regulation has increased in recent years in terms of scope and complexity. Modern wealth managers should be aware of how these regulations apply to their business in the countries in which they operate, and to know their clients well so that they understand what these clients are doing at home and abroad and can see the potential risk factors from their clients' activities.

Code and Standards and the CFA Institute Asset Manager Code

The need for individuals to adhere to the CFA Institute Code and Standards has been reinforced throughout the CFA Program. In addition, asset manager firms are guided by the CFA Institute Asset Manager Code (AMC). In line with the CFA Institute mission to set standards to guide the investment industry and place client interests first, CFA Institute strongly encourages that firms participate in the voluntary AMC.

PROFESSOR'S NOTE

The AMC has been covered elsewhere in the CFA curriculum. The purpose of its inclusion here is to link the AMC to examples of global regulations rather than to require you to learn the details of the AMC.

The following section reproduces the main responsibilities under the AMC and links those to examples of corresponding laws and regulations in developed nations. The list is by no means exhaustive, but it shows how closely aligned the AMC is with laws governing asset managers in many of the world's largest public and private wealth markets.1

A. Loyalty To Clients

Managers must:

1. Place client interests before their own.
2. Preserve the confidentiality of information communicated by clients within the scope of the Manager–client relationship.
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.

Example Laws and Regulations

The concept of loyalty to clients is embedded in the United States through the **Investment Advisers Act of 1940**, and in Europe through **MiFID II**, which both impose fiduciary duties on advisers.

Client confidentiality is fundamental in most jurisdictions, with the EU's **General Data Protection Regulation** and Singapore's **Personal Data Protection Act** mandating the protection of client data.

Advisers need to be wary of undue influence through gifts and retrocessions, as discussed earlier in the module.

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 market participants.
3. Deal fairly and objectively with all clients when providing investment information, making investment recommendations, or taking investment action.
4. Have a reasonable and adequate basis for investment decisions.
5. When managing a portfolio or pooled fund according to a specific mandate, strategy, or style:
   a. Take only investment actions that are consistent with the stated objectives and constraints of that portfolio or fund.
   b. Provide adequate disclosures and information so investors can consider whether any proposed changes in the investment style or strategy meet their investment needs.
6. When managing separate accounts and before providing investment advice or taking investment action on behalf of the client:
   a. Evaluate and understand the client's investment objectives, tolerance for risk, time horizon, liquidity needs, financial constraints, any unique circumstances (including tax considerations, legal or regulatory constraints, etc.), and any other relevant information that would affect investment policy.
   b. Determine that an investment is suitable to a client's financial situation.

Example Laws and Regulations

Many laws address the issues of market manipulation, including the **SFO in Hong Kong**, which prohibits false trading, price rigging, and disclosure of false or misleading information. Similarly, in the EU, there is the **Market Abuse Regulation**.

The reasonable and adequate basis requirements fall under the SEC's **Care Obligation of Regulation of Best Interest** for broker-dealers, and the **Investment Advisers Act of 1940** for investment advisers. Similar provisions exist under **MiFID II**.

For portfolio management, U.S. regulations are set by **ERISA** for fiduciary duties toward pension plans. In Europe, **UCITS** laws govern retail open-ended funds and the **Alternative Investment Fund Managers Directive (AIFMD)** regulates alternative investment funds like hedge funds and private equity.

C. Trading

Managers must:

1. Not act or cause others to act on material nonpublic information that could affect the value of a publicly traded investment.

2. Give priority to investments made on behalf of the client over those that benefit the Managers’ own interests.
3. Use commissions generated from client trades to pay for only investment-related products or services that directly assist the Manager in its investment decision-making process and not in the management of the firm.
4. Maximize client portfolio value by seeking the best execution for all client transactions.
5. Establish policies to ensure fair and equitable trade allocation among client accounts.

Example Laws and Regulations

Rules against the use of material nonpublic information (i.e., inside information) exist in most developed markets. As an illustration, these rules are enforced by the **SEC** in the United States, the **Financial Conduct Authority (FCA)** in the United Kingdom, and the provincial securities regulators in Canada.

Advisers must not favor their own interests over those of their clients’for example, by trading on their own account before executing client trades. This practice is prohibited by many rules, including **MiFID** and the **Asset Management Association of China Code of Conduct**.

The use of commissions is known as *soft dollars* in the United States and *inducements* in the United Kingdom and Europe. CFA Institute maintains the **Soft Dollar Standards**, and **MiFID II** governs the practice in Europe.

D. Risk Management, Compliance, and Support

Managers must:

1. Develop and maintain policies and procedures to ensure that their activities comply with the provisions of this Code and all applicable legal and regulatory requirements.
2. Appoint a compliance officer responsible for administering the policies and procedures and for investigating complaints regarding the conduct of the Manager or its personnel.
3. Ensure that portfolio information provided to clients by the Manager is accurate and complete and arrange for independent third-party confirmation or review of such information.
4. Maintain records for an appropriate period of time in an easily accessible format.
5. Employ qualified staff and sufficient human and technological resources to thoroughly investigate, analyze, implement, and monitor investment decisions and actions.
6. Establish a business continuity plan to address disaster recovery or periodic disruptions of the financial markets.
7. Establish a firmwide risk management process that identifies, measures, and manages the risk position of the Manager and its investments, including the sources, nature, and degree of risk exposure.

Example Laws and Regulations

In the United States, the **Investment Advisers Act of 1940** requires investment advisers to register with the SEC and to adopt a code of ethics, a compliance program, and a business continuity plan.

Another example is **MiFID II** in the EU, which imposes various obligations on investment firms, such as ensuring the suitability and appropriateness of their services for their clients; disclosing conflicts of interest, costs, and charges; providing best execution and fair allocation; and reporting transactions and positions to regulators.

In Singapore, the **Securities and Futures Act** regulates fund management companies and requires them to obtain a license from the Monetary Authority of Singapore and to comply with various rules on capital adequacy, risk management, disclosure, reporting, and recordkeeping.

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.

Example Laws and Regulations

CFA Institute Global Investment Performance Standards (GIPS®) are voluntary standards for firms when calculating and presenting investment performance. These standards are widely adopted and seen as a global benchmark for performance reporting.

In addition, many individual jurisdictions have statutory reporting requirements, such as the **Investment Advisers Act of 1940** and **MiFID II**. Among other requirements, these cover the frequency and content of reports to clients.

F. Disclosures

Managers must:

1. Communicate with clients on an ongoing and timely basis.
2. Ensure that disclosures are truthful, accurate, complete, and understandable and are presented in a format that communicates the information effectively.
3. Include any material facts when making disclosures or providing information to clients regarding themselves, their personnel, investments, or the investment process.
4. Disclose the following:
   a. Conflicts of interests generated by any relationships with brokers or other entities, other client accounts, fee structures, or other matters.

b. Regulatory or disciplinary action taken against the Manager or its personnel related to professional conduct.
c. The investment process, including information regarding lock-up periods, strategies, risk factors, and use of derivatives and leverage.
d. Management fees and other investment costs charged to investors, including what costs are included in the fees and the methodologies for determining fees and costs.
e. The amount of any soft or bundled commissions, the goods and/or services received in return, and how those goods and/or services benefit the client.
f. The performance of clients' investments on a regular and timely basis.
g. Valuation methods used to make investment decisions and value client holdings.
h. Shareholder voting policies.
i. Trade allocation policies.
j. Results of the review or audit of the fund or account.
k. Significant personnel or organizational changes that have occurred at the Manager level.
l. Risk management processes.

Example Laws and Regulations

In this final section of the AMC, many of these requirements are similar to those in established regulation. For example, under the **SEC's 2023 rules for private fund advisers**, the advisers are required to provide investors with quarterly statements detailing certain information regarding fund fees, expenses, and performance.

The **Investment Advisers Act of 1940** mandates advisers to provide a comprehensive brochure to clients. Similarly, the SEC's 2023 rules for private fund advisers require the disclosure of material facts important for investor decision-making.

As mentioned earlier in this module, there is a global shift toward transparency in both public and private investment sectors.

MODULE QUIZ W1.3

1. Which of the following statements regarding custodians is *most accurate*?
   A. The primary purpose of using a custodian is to enhance the performance analytics for the client.
   B. Custodians acts as third parties to ensure that the firm's assets are safeguarded.
   C. The Madoff Ponzi scheme is an example of how a lack of qualified, independent custodians can allow a fraudulent scheme to evade detection.
2. Reasons why the wealth management industry is vulnerable to money laundering *least likely* include the:
   A. traditional culture of secrecy and confidentiality within the industry.
   B. presence of organizations such as the FATF that allow criminal networks to exchange information.
   C. competitive nature of the industry leading to firms not wishing to jeopardize client relationships.
3. The events around 1Malaysia Development Board had the regulatory effect of:

   A. highlighting the need for increased AML controls when dealing with PEPs.
   B. increasing the requirements for the use of third-party qualified custodians.
   C. increasing the disclosure of the beneficial owners of shell companies.

4. Which of the following is *least likely* within the remit of IOSCO?
   A. Preventing tax evasion by individuals who hide their assets or income in offshore accounts through the CRS regime.
   B. Facilitating cooperation and information exchange among its members and other stakeholders.
   C. Setting principles regarding protecting investors, ensuring fair and efficient markets, and reducing systemic risk.

5. Which of the following statements about ethical standards in the asset management industry is *most accurate*?
   A. MiFID II is a set of voluntary EU standards covering, among other things, suitability requirements for asset managers.
   B. AIFMD and UCITS directives govern fund managers in Europe, with AIFMD covering alternative investments and UCITS covering retail open-ended funds.
   C. The AMC and GIPS are both mandatory CFA Institute guidance that must be adopted to ensure compliance with global regulations.

KEY CONCEPTS

LOS W1.a

Private wealth management firms can take many forms, from divisions of large universal banks down to individual advisers. Clients are usually categorized by wealth into retail (AUM below USD 250,000), affluent (AUM up to USD 1 million), high net worth (AUM up to around USD 30 million), and ultra-high net worth (AUM above around USD 30 million).

Services offered can range greatly, from core services such as deposit management to portfolio management, estate planning, and life insurance. The market is competitive, and pressure on margins comes in part from clients' higher expectations regarding technology and ESG, along with increasing requirements for clarity and transparency of fees.

LOS W1.b

The private wealth industry has typically charged high fees, earning good rewards for industry participants'but to ensure that client needs are met in a transparent way, there is increasing regulatory pressure on fees. This results in firms competing for new clients, and to increase the mandates and value added for existing clients.

Fees can be based on assets, transactions, or lending activities, or they can be service based and maintenance based. Churning, payment for order flow, and retrocessions are examples where fees may present conflicts of interest.

LOS W1.c

In addition to the core services provided by a wealth manager, the complex needs of clients may necessitate the use of additional professionals. This need will be greater for ultra-high net worth clients who may have personal and business interests spanning many geographical areas. Examples of additional professional services include tax advisers, custodians, and insurance specialists.

LOS W1.d

Global regulations have been developing in response to recent financial crimes and crises (e.g., global financial crisis, Madoff Ponzi scheme, Panama Papers). The focus is on increasing transparency and allowing for the flow of information between countries. Wealth managers should be aware of how these regulations affect client activities in various jurisdictions'and understand how, in most cases, adherence to the CFA Institute Code of Standards, Asset Manager Code, and Global Investment Performance Standards will be consistent with local regulations.

ANSWER KEY FOR MODULE QUIZZES

Module Quiz W1.1

1. **B** Assets of over USD 30 million are the correct wealth band for UHNW. The wealth level for retail clients is typically below USD 250,000, and HNW clients are likely to be more focused on customized investments to meet their personal needs. (LOS W1.a)

2. **B** Statement I is incorrect because the supplier power (advisers, professional, fund providers) is not high for retail client services. Retail clients require standard services and products rather than specialized professionals. Statement II is correct in that the increasing use of robo-advisers provides an alternative route to investment advice for clients, particularly retail clients. Hence, it presents a threat of substitutes in the wealth management space. (LOS W1.a)

Module Quiz W1.2

1. **C** Custody fees and tax planning are both examples of recurring revenue. Dealing with one-off events such as death or divorce is separate from ongoing tax planning and would represent nonrecurring revenue. AUM fees are based on the value of assets invested, so they are variable in nature. (LOS W1.b)

2. **B** Increasing the mandate means moving clients toward more services, such as moving from advisory to discretionary'and, hence, increasing the fees from those clients. NNM is a metric that focuses on bringing money from new clients to the firm. While PFOF arrangements may attract regulatory scrutiny, they are not necessarily unlawful; indeed, it can be argued that they reduce overall brokerage costs for clients. (LOS W1.b)

3. **A** Low appetite to risk suggests a firm is likely to reduce the variable element of remuneration and have a higher relative weighting of fixed remuneration. A firm with a higher appetite for risk is likely to use performance bonuses to a greater extent to encourage investment managers to focus on returns rather than providing a large stable salary for staff. Clawback provisions allow the firm to recover a bonus in the case of subsequent poor performance or disciplinary issues. (LOS W1.b)

Module Quiz W1.3

1. **C** The lack of qualified third-party custodians enabled Bernie Madoff to perpetrate a fraud for many years, misstating returns and falsifying asset records. The primary purpose of custodians is to ensure that client money is safeguarded. Custodians may also offer added value services such as reporting or analytics, but that is not their core function. Custodians need to safeguard client assets, not firm assets. (LOS W1.c)
2. **B** FATF is an intergovernmental organization that designs and promotes policies and standards to combat financial crime. (LOS W1.d)
3. **A** The 1MDB scandal exposed the need to increase AML controls when dealing with politically exposed persons (PEPs). The other choices refer to the fallout from the Madoff Ponzi scheme and the Panama and Paradise Papers. (LOS W1.d)
4. **A** CRS is a regime set up by FATF. The other answer choices are both part of the remit of IOSCO, which is an association of securities regulators from more than 120 jurisdictions. (LOS W1.d)
5. **B** AIFMD and UCITS directives govern fund managers in Europe, with AIFMD covering alternative investments and UCITS covering retail open-ended funds. EU directives such as MiFID are binding, not voluntary standards. The AMC and GIPS are voluntary, although adoption should result in compliance with most global regulations. (LOS W1.d)

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[1] CFA Institute Asset Manager Code, https://rpc.cfainstitute.org/-/media/documents/code/amc/asset-manager-code.pdf

READING W2

WORKING WITH THE WEALTHY

EXAM FOCUS

This reading focuses on working with wealthy families from the perspective of a private wealth manager. We use a range of models from the field of human dynamics to explore how wealthy families operate their family and business interests. Key models include socioemotional wealth (SEW), the FIBER scale, behavioral biases, and the concept of wealth identity. The reading also focuses on working with ultra-high-net-worth (UHNW) clients. Candidates must know the purpose and application of organizational structures that UHNW families use such as family offices, family constitutions, family councils, family boards, and family foundations. Understand the holistic needs of UHNW clients and ways to structure the services they require. Finally, know the challenges faced by private wealth managers in building trust and navigating the human dynamics of wealthy families.

W2.1: FAMILY AND HUMAN DYNAMICS

Video covering this content is available online.

LOS W2.a: Describe how family and human dynamics relate to wealth and its management.

Human dynamics is the study of relationships. Wealth in human dynamics is a framework to understand how families make decisions regarding their wealth.

Every family is unique, with its own **family operating system** that explains its internal and external interactions. Understanding a family's operating system is a helpful framework for private wealth managers to determine the most effective approach in working with a family.

Figure W2.1: Components of a Family Operating System

Family Dynamics	Description
Family norms	Organizational culture is sometimes described as "the way we do things" and "the personality" of an organization. The same applies to families; these are the unwritten rules and preferences in the ways family members interact with each other.
Role in the family	This is the allocation of family responsibilities and resources. What role does each family member have within the family and the family business?
Family decision-making	How are family decisions made? Families differ in how they share power and authority, especially with younger generations.
Family rituals	Every family has its own routines, rituals, and regular ways of interacting, such as meeting at regular times, common interests, family events, and social activities. Families celebrate and recognize achievements in their own unique ways.
Families and change	How does the family deal with changes and transitions? Births, deaths, children leaving home, marriages, divorce, illness, and the care of elderly family members are all transitions that families face.

Wealthy Families and Family Businesses

Many wealthy families own a family business. This business may have been created by the current generation, the previous generation, or have a longer heritage.

Younger generations do not always share the same entrepreneurial ambitions as their parents or grandparents. There is a saying that states, "The founder creates the wealth, the second generation maintains the wealth, and the third generation depletes the wealth."

Socioemotional Wealth

The concept of **socioemotional wealth (SEW)** is the idea that family businessowners are not solely motivated by profit. Family businessowners are also influenced by social and emotional goals:

- *Social goals*. Family businessowners often enjoy playing an active part in their local community. A common social goal is to maintain and enhance the family's reputation within the community.
- *Emotional goals*. Family businesses may be passed down from generation to generation. Family businessowners identify with the history and tradition of the family business and aspire to continue the family legacy.

The FIBER Scale

The **FIBER scale** identifies five goals of SEW. These goals explain why family businessowners sometimes make decisions that are not motivated solely by profit.

The five goals of socioeconomic wealth are as follows:

1. ***F**amily control*. This is the importance of the family to retain control over the business.
2. ***I**dentification*. Family members identify with the firm and want to contribute to its legacy.
3. ***B**inding social ties*. Family firms build important relationships in the local community.
4. ***E**motional attachment*. The legacy of the family business may influence business decisions.
5. ***R**enewal of family bonds*. Business succession is important within the family.

The FIBER scale suggests that a family business will often mean far more to a family than purely financial returns. This may lead family businessowners to make business decisions based on nonfinancial considerations.

Cultural Influences on Families

Geert Hofstede developed a six-dimension framework to understand how cultural differences influence wealth and financial decision-making.

Figure W2.2: Hofstede's Framework of Six Cultural Dimensions

	Power Distance Index	
Power is shared in society		Authoritarian society
	Individualism vs. Collectivism	
Rely on yourself		Rely on others
	Masculinity vs. Femininity	
Competition and materialism		Caring and cooperation
	Uncertainty Avoidance Index	
Tolerant of risk and ambiguity		Less tolerant of ambiguity and risk
	Long-Term vs. Short-Term Orientation	
Society rewards long-term objectives		Living in the present
	Indulgence vs. Restraint	
Gratification of desires		Self-restraint

Hofstede's Framework of Six Cultural Dimensions

1. *Power distance index*. How equal or unequal is the wealth distribution in a society?
   - Authoritarian approaches hold a monopoly control over society resources, leading to a greater wealth inequality. The higher the wealth inequality, the greater the power distance.
2. *Individualism vs. collectivism*. Do individuals rely upon themselves or on their community?

- Collectivism provides a high level of community support and assistance to everyone. Individualism is an approach to society where individuals need to rely on themselves.

3. *Masculinity vs. femininity*. To what extent does society align with masculine and feminine values?
   - Hofstede defines *masculine values* as ambition, success, wealth, and personal accomplishment, and *feminine values* as caring, cooperation, and a holistic quality of life.
4. *Uncertainty avoidance index*. To what extent does society rely on written rules?
   - Low uncertainty avoidance implies *fewer* written rules and *higher* risk tolerance.
   - High uncertainty avoidance implies *detailed* written rules and *lower* risk tolerance.
5. *Long-term vs. short-term orientation*. To what extent does society focus on the present or the future?
   - Does society encourage and reward the achievement of long-term goals, or living in the present day for material, social, and emotional needs?
6. *Indulgence vs. restraint*. How permissive is the society?
   - Does society have a rigid set of social norms emphasizing caution and restraint, or a permissive approach to the gratification of desires?

EXAMPLE: Case Study Part 1'Vaino and Tarja Korhonen

Vaino and Tarja Korhonen live in Tampere, Finland, and have a large extended family with five children and six grandchildren. Vaino is planning to retire from the family business, Korhonen Transport, at the end of the year; he plans to hand over control to two of his children, Juhani and Eeva. As the founder of the family business, Vaino has found difficulty in delegating authority, preferring to be involved in all aspects of decision-making.

Juhani and Eeva have been learning the operational side of the business from their father over the past year. Eeva is determined to document as many of the operational processes as possible, which annoys her father, who believes she is wasting time and that she should know what to do.

Tarja and her sister, Floor, are each due to inherit a substantial sum in the next month from their late uncle. The sisters were shocked to find their uncle was extremely wealthy, as he never discussed his finances and had a modest lifestyle. Tarja's wealthy friend, Noora, recommends the family meet with Emppu Nieminen, her wealth manager, for an initial consultation about their wealth planning.

1. **Identify** one socioemotional goal displayed by Vaino from the FIBER scale. **Justify** your answer with *one* reason.
2. **Identify** three cultural dimensions of the Korhonen family using Hofstede's framework of cultural dimensions. **Justify** each dimension with *one* reason.

Answer:

1. Socioemotional goals and the FIBER scale *(only one required)*:
   - *Family control*. Vaino has been helping Juhani and Eeva learn the family business over the past year. This shows that keeping the control of the business within the family is an important goal