

LM01 The Private Wealth Management Industry

1. Introduction.....	2
2. Industry Segments, Business Models, Strategies	2
3. Fee, Revenue, and Compensation Structures	11
4. The Role of Other Advisers and Consultants	18
5. Global Regulatory Principles.....	25
Summary.....	37

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1. Introduction

Wealth management is becoming an increasingly important segment of the global financial sector. This learning module provides an overview of the wealth management industry. It covers:

- The different categories of clients served
- The various types of advisors practicing wealth management
- The various business models used in the wealth management industry
- CFA Asset Manager Code and other regulatory and compliance considerations

2. Industry Segments, Business Models, Strategies

In this section we will discuss the typical business models used by private wealth management service providers and their segment-based strategies.

A Brief History of Private Wealth Management

Private wealth management has evolved to address the needs of affluent clients. The industry expanded internationally post-World War II due to globalization and the growth of emerging markets.

During this time, the quality of services and ethical standards in wealth management also improved. Many regulatory reforms like the Sarbanes-Oxley Act increased transparency. In particular, the 2008 Global Financial Crisis served as a catalyst for significant reforms such as the Dood-Frank Wall Street Reform in the US, and MiFID II in the European Union. Today, transparency is an industry standard, driven by global regulatory bodies like the Financial Action Task Force (FATF). The industry continues to evolve, and offers many opportunities for wealth management professionals.

THE SO-CALLED END OF SWISS BANKING SECRECY

If you see a Swiss banker jump out of a window, jump after him. There's bound to be money in it. - Voltaire (1694–1778)

Switzerland's private banking sector has been a cornerstone of the global financial system since the mid-18th century, with institutions like Wegelin & Co. founded in 1741, Lombard Odier in 1796, and Pictet in 1805. While banking secrecy was once a long-standing tradition, codified by the 1934 Swiss Banking Act, it exists today under highly restrictive legal frameworks. The sector underwent significant changes, especially after the 2008 financial crisis. In 2014, Switzerland became a signatory to the Organization for Economic Co-operation and Development (OECD) Common Reporting Standard (CRS), aligning itself with global transparency norms. This adaptation has implications for both clients and financial institutions, as it necessitates more rigorous reporting and compliance measures, thereby

affecting the attractiveness of Swiss banks for certain types of asset protection that require confidentiality.

The Wealth Management Industry Today

The wealth management industry is influenced by history, demographics, geography, culture, and capital markets. A country's social infrastructure (health care, unemployment, and retirement benefits) also affects the services offered by the wealth management industry. The following exhibit from the curriculum lists the key services in private wealth.

KEY SERVICES IN PRIVATE WEALTH

- *Private Wealth*: Refers to assets owned by wealthy individuals or families, often managed by financial professionals. It includes various forms of capital such as real estate, equities, and bonds.
- *Wealth Management*: A comprehensive service that combines financial and investment advice, accounting and tax services, and legal or estate planning. Often used interchangeably with "private wealth management."
- *Private Banking*: A personalized financial and banking service that is traditionally offered to high-net-worth individuals. It includes a range of services such as investment management, tax planning, and estate planning, in addition to banking.
- *Asset Management*: More focused than wealth management and sometimes also referred to as portfolio management, this involves managing a client's investments and providing specialized investment strategies. Usually a firm but can also refer to a specific role within a larger financial institution.
- *Wealth Manager/Adviser*: An individual who offers a combination of financial planning, investment portfolio management, and other aggregated financial services to clients. This role may also be referred to as a private banker, client adviser, or wealth adviser.

Governments offer retirement schemes like defined benefit (DB) and defined contribution (DC) plans alongside individual savings options.

- In countries with developed capital markets, such as the US, the wealth management industry is diverse and fragmented with many providers offering a range of services.
- In contrast, in many European countries like France, Italy, and Spain, the industry is more concentrated, dominated by a few large banks and focused on DB plans and public health systems.
- Meanwhile, in the UK and Asia, the industry is varied, with no uniform structure despite some dominant players.

Offshore versus onshore:

"Onshore" financial services are provided within a client's home country, corresponding to their tax residency, whereas "offshore" services are outside their home country.

Offshore services are often chosen for benefits like political stability and tax incentives. For example, Singapore has emerged as a leading offshore hub in Asia due to its political stability and financial robustness.

The terms "offshore center" and "cross-border financial center" are similar and are sometimes used interchangeably. Cross-border financial centers, such as the United States, United Kingdom, and Switzerland, serve both domestic and international investors, whereas offshore centers, such as the Isle of Man, primarily serve foreign investors.

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

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

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

Source: Zakrzewski et al. (2023)

Switzerland is known for its traditional private banking, Monaco and Dubai for their tax-free environments, Portugal for its golden visas (residency permits granted in exchange for investments). Luxembourg is a specialized center known for its fund and insurance industries. The Isle of Man specializes in trusts, and the Cayman Islands serve hedge funds.

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

Exhibit 2: Selected Offshore Centers and the Main Clients Served

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

Wealth Management Participants

The main types of service providers in the wealth management industry are:

- Universal Banks: Provide global wealth management alongside other financial services.
- Local Banks and Trust Departments: Offer localized retail banking or wealth management.
- Private Banks and Trusts: Specialize in wealth management, potentially with added services.
- Investment Banks: Serve ultra-wealthy clients with specialized financial services.
- Digital and Direct Banks: Deliver automated investment advice via digital platforms.
- Brokerage Firms: Facilitate market transactions and might offer investment management. Their low-fee structure mirrors that of digital and direct banks. Interactive Brokers and Charles Schwab are well-known US firms.
- Asset Managers and Fund Managers: Focus on asset management without broad wealth management services.
- Independent Advisers: Offer independent financial advice, maintaining autonomy despite possible affiliations.
- Family Offices: Handle comprehensive financial affairs for wealthy families, managing investments directly or through other institutions.

Competitive and Strategic Drivers

Porter's Analysis:

Porter's Five Forces analysis of the wealth management industry reveals:

- *Threat of New Entrants*: Entry barriers are high due to regulatory requirements and the need for established trust, though niche providers like family offices and robo-advisers are making inroads with unique offerings into UHNW/HNW and mass affluent segments respectively.
- *Bargaining Power of Buyers*: Wealthy clients have considerable bargaining power, specially UHNW, enabling them to demand customized services and switch providers easily.
- *Bargaining Power of Suppliers*: While typically low, suppliers gain leverage when providing specialized or technologically advanced services to large firms.
- *Threat of Substitutes*: Alternatives such as robo-advisers and family offices offer competitive services that challenge traditional firms, particularly appealing to those seeking personalized asset management.

- *Intensity of Competitive Rivalry*: Strong competition exists in providing high-quality services and a diverse product portfolio, with firms vying to stand out through specialized expertise and comprehensive offerings.

Factors Influencing Specific Strategic Decisions:

Key factors shaping a wealth management firm's strategy include:

- *Unique Expertise*: Specialization that sets the firm apart.
- *Reputation*: Acts as a strategic asset or liability.
- *Financial Resources*: Determines investment in technology and market targeting.
- *Target Markets*: Focus on specific client segments.
- *Client and Market Complexity*: Considerations of client needs and market sophistication in operational regions.
- *Regulatory Environment*: Influence of regional regulations.
- *Distribution Network*: Impact of an existing network for service distribution.
- *Physical Presence*: Decision between physical offices or virtual operations.

Location choices, such as onshore versus offshore services and whether to establish local branches, require careful consideration of regulatory requirements, cultural preferences, and client expectations. For example, a U.S. firm planning to expand into Switzerland must account for local banking laws, risk appetites, and the importance of privacy to Swiss clients, before deciding whether to open local offices or operate remotely.

Legal, Licensing, and Technology:

A wealth management firm's strategy is fundamentally influenced by its licensing, which directs its compliance with local regulations and target market choices.

Legal expertise is readily available and vital for understanding different regulatory landscapes.

Technology is crucial in acquiring and managing clients. While traditional methods like personal connections and referrals remain key, technology is increasingly integral in managing these relationships. The extent of technology and automation used varies depending on the firm's focus and the financial status of its clients.

Client Acquisition and Retention:

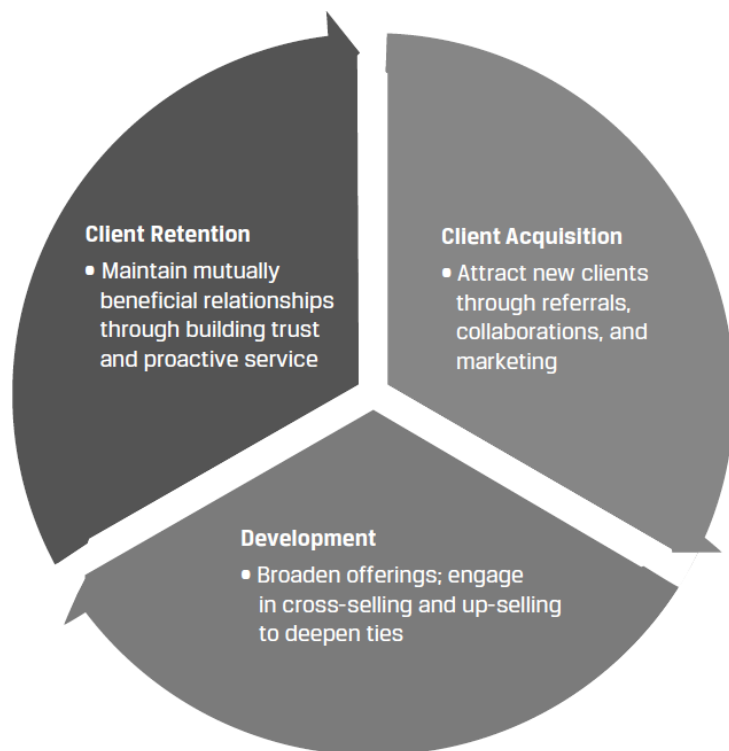
Wealth management firms build their business through three stages: (1) client acquisition, (2) development, and (3) client retention.

They attract new clients using cost-effective strategies such as referrals and collaborations with professionals like lawyers and accountants. Marketing strategies such as digital outreach and events also play a role.

Next, they deepen relationships by cross-selling services and persuading clients to allocate a greater share of their investable assets to the firm.

Finally, they retain clients by adapting services to their needs, building trust, and providing expert advice, ensuring long-term engagement.

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



Implementation strategies:

Wealth managers utilize Porter's strategies of cost leadership, differentiation, and focus/niche to compete effectively.

Cost leadership focuses on low-cost services to a broad audience, differentiation provides unique, high-value services to wealthy clients, and focus/niche targets very specific, wealthy segments with personalized services.

The strategies are not mutually exclusive. Combining these strategies helps wealth managers tailor their services to diverse client needs and market demands, strengthening their competitive position.

To demonstrate how some wealth management firms are tailoring their strategies to meet the complex needs of HNWIs and UHNWIs, consider Pi R-Squared Investors (PRS), a newly established firm that leverages long-standing industry relationships and specialized investment opportunities.

CASE STUDY**Pi R-Squared Investors**

Motivated by the opportunity for greater innovation and personalized service, a group of experienced partners from a leading international financial institution founded Pi R-Squared Investors (PRS), a newly established wealth management firm. These partners were confident that their loyal client base would follow them to the new venture.

PRS allows the team to leverage their long-standing relationships with asset managers to offer clients truly exceptional investment opportunities. Through diligent research and risk assessment, they identify and access high-caliber alternative investments. This is particularly appealing to their clients, eager for better investment options.

While PRS may not have the scale to compete purely on cost, they strategically partner with independent service providers to deliver top-quality services at reasonable prices. As a result, clients might encounter slightly higher fees and fewer conveniences, but they benefit from better risk-adjusted returns and more personalized attention.

Services and Product Range:

Wealth management firms offer a broad array of services that vary by client and may be provided in-house or outsourced.

- Core services include deposit management, liquidity oversight, client reporting, and account administration.
- Lending services encompass mortgages, credit cards, Lombard loans, and specialized loans for high-value assets.
- Brokerage services cover trade execution for various financial instruments.
- Asset management involves portfolio management, advisory services, and investment product offerings.
- Wealth planning includes legal and tax advice, estate and financial planning, and retirement strategies.
- Additionally, firms offer insurance and fiduciary services like life insurance and trusts.

EXAMPLE 1**The Success of External Asset Managers: A Look at Switzerland and Beyond**

Swiss External Asset Managers (EAMs), also known as independent asset managers or independent wealth managers, have carved out a unique space in Switzerland's financial system and offer a distinct alternative to larger financial institutions.

The EAM landscape is diverse, ranging from specialized asset managers to client-focused wealth managers. With more than 1,500 firms, the average EAM employs between three and four people and manages a median of around CHF100 million in assets. Collectively, they

oversee CHF600–700 billion, making up 10% to 15% of the total assets held in Swiss banks that offer services to EAMs.

For their clients, who are primarily HNW and UHNW, EAMs focused on wealth management offer several advantages. Their smaller size often translates to greater agility and flexibility, allowing for more personalized services. Clients may also benefit from better access to specific markets and sectors, as well as specialized expertise. Additionally, the legal separation between asset ownership and management can offer an extra layer of security that some clients find appealing. The success of the EAM model in Switzerland has inspired similar regulatory changes in other countries, including Singapore, resulting in the emergence of more than 1,000 EAM firms there.

Private Client Segmentation

After understanding the various services provided by wealth management firms, it is essential to understand how these firms segment their client base in order to tailor these services effectively. Most wealth management firms' serve clients that fall into one or more wealth-based segments determined by client assets.

Wealth management classifies clients into four groups based on assets:

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

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

WHAT IS HNW AND UHNW?

Classifications and categorizations vary by region and by firm. However, the following could be used as a general guideline in the United States:

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

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