

**2. INTRODUCTION AND PRIVATE CLIENTS VERSUS INSTITUTIONAL CLIENTS**

Private wealth management refers to investment strategy and financial planning for individual investors.

Private wealth managers assist individuals in their investment decision making process considering a variety of concerns and preferences. Private clients include individuals/families looking for advisors to manage their personal wealth.

**1.1 Private Clients versus Institutional Clients**

The concerns of private clients differ from institutional clients in terms of various perspectives such as:

- i) Investment objectives
- ii) Constraints (time horizon, investment scale, tax considerations)
- iii) Other differences (behavioral issues, regulatory bodies, governance structure)

**1.1.1 Institutional Objectives**

Some common objectives for private clients include financial stability, financial security at later age, financial support to family members, charity goals, etc.

Sometimes goals of private clients are not discrete or may change with the passage of time. Unlike private clients, investment objectives of institutional clients are more discrete and rarely change with the time.

**1.1.2 Constraints**

1. **Time horizon:** Compared to institutions, private clients have a shorter time horizon and their time horizon often depends on the investment goals. Shorter time horizon limits individual investors' capacity to take a risk and to invest in illiquid securities.
2. **Scale:** Compared to institutions, portfolios of private clients are typically smaller in size, therefore, it is challenging to invest in certain risky asset classes such as hedge funds, real estate, private equities.
3. **Taxes:** Many institutions qualify for tax exemption whereas the income of individual clients is typically taxable, therefore tax-efficient investments are an important consideration for individual investors.

**1.1.3 Other Distinctions**

1. **Investment Governance:** Individual investors have less formal investment governance and investment decision-making systems. The governance structure of institutions is highly formal, often comprises of board of directors, investment committee and independent directors (investment experts).

	<b>Investment Sophistication</b>	
	<b>Private Clients</b>	<b>Institutions</b>
Degree of investment sophistication	lower	higher
Investment resources	less	more
Investment decisions	more exposed to emotional decision making	follow formal investment governance framework

2. **Regulation:** The regulatory systems for individual and institutional clients vary with jurisdiction. For example, in some jurisdictions a common regulatory system oversees individual and institutional clients. In other jurisdictions, individual and institutional clients are regulated by different regulatory authorities.
3. **Uniqueness & Complexity:** Compared to institutional investors, individual investors are unique and complex in nature and their investment preferences are determined by various factors such as their sources of wealth, background, profession, behavioral biases, preferences etc.

	<b>Private Clients</b>	<b>Institutional Clients</b>
For similar financial consideration and objectives	More likely to pursue <b>different</b> strategies	More likely to pursue <b>similar</b> strategies

**Practice:** Example 1 Curriculum, Reading 21.



**2. UNDERSTANDING PRIVATE CLIENTS: INFORMATION NEEDED IN ADVISING PRIVATE CLIENTS**

**2.1 Information Needed in Advising Private Clients**

Financial advisors of private clients require the client's pertinent data, financial records and other information for proper consultation.

**2.1.1 Personal Information**

- **Introductory conversation** (one on one meeting or via phone call)  
The first meeting between the wealth manager and the prospective client provides useful information to both parties.

Clients learn about the wealth manager's investment style, service offerings etc. Wealth managers learn about the client's personality, preferences, the purpose of investment, etc.

- **Understanding of client's situation:** The wealth manager then set up a meeting with the client to examine the client's situation and position such as:
  - client's family status - marital status, children, grandchildren, ages of family members, etc.
  - client's identification evidence
  - employment, career information, retirement planning
  - sources of the client's wealth
  - return objectives (absolute/relative, explicit goals)
  - risk tolerances
  - liquidity preferences and ESG (environment, social, & governance) considerations

**2.1.2 Financial Information**

Comprehending the client's financial condition is significant for a wealth manager. The managers assess the clients' assets and liabilities through various reports and information provided by the clients. Following are the typical assets and liabilities of a private client:

Sample Elements of a Private Client's Balance Sheet	
Assets	Liabilities
Cash and deposit accounts	Consumer debt (credit card, outstanding loan)
Brokerage accounts	Automobile loans
Retirement accounts (DB/DC plans)	Student loans

Sample Elements of a Private Client's Balance Sheet	
Assets	Liabilities
Other employee benefits (stocks, options)	Mortgages/home equity loans
Ownership interests	Margin obligation in a brokerage account
Life insurance (cash value)	
Real Estate (residential, rental, land)	
Other personal assets (art, auto, jewelry)	

In addition to clients' assets and liabilities, wealth managers take into consideration the clients' cash flows, sources of cash flows, expense information, etc.

**2.1.3 Private Client Tax Considerations**

Tax returns provide useful information about clients' tax situations. Common types and strategies of taxes are provided in this section.

**a) Common Tax Categories:** Taxes on individuals vary by jurisdiction. Some common types include:

- i) **Taxes on income** (e.g. tax on salaries, interest, dividends, rental income)
- ii) **Wealth-based taxes** (e.g. taxes on holding property, inheritance, transfer of wealth)
- iii) **Taxes on consumption/spending** (e.g. sales tax, value-added taxes)

**Note:** Application of capital gain taxes is complex and varies considerably in various jurisdictions.

**b) Basic Tax Strategies:** Basic strategies of managing taxes, when devising asset allocation decisions for private clients are:

- i) **Tax avoidance:** Individuals naturally tend to avoid taxes and therefore find ways to do so. Some jurisdictions offer tax-free earnings and withdrawals for certain types of accounts. Some offer different wealth transfer methods to avoid heavy taxes. Some allow a limited amount of tax-free gift transfer.

**Note:** Tax avoidance should not be misinterpreted as *illegal tax evasion*.

- ii) **Tax reduction:** Wealth managers tend to find appropriate client-specific tax strategies to

increase the value of the portfolio on an after-tax basis. For example, for clients:

- with the highest tax brackets, the investment advisor may focus on tax minimization by investing in assets that experience future capital gains rather than current taxable income.
- who are tax-exempt, it will NOT be appropriate to invest in tax-exempt investments (e.g. Municipal bonds).

iii) **Tax deferral:** Tax deferral strategies are those that seek to defer (postpone) taxes to take advantage of compounding portfolio returns. Such strategies are suitable for investors

- who are in the progressive tax regime and they anticipate lower future tax rates
- focus on lower portfolio turnover
- defer their higher marginal tax rate until retirement (when they believe they will be in lower tax bracket)

**Practice:** Example 2 Curriculum, Reading 21.



### 2.1.3 Other Relevant Information

Other relevant information wealth managers may require from individuals for more suitable financial planning include:

- Legal or governing documents such as wills and trust
- Insurance-related information (life insurance, insurance coverage, etc.)
- Decision-making parameters and guidelines such as authorization, primary contact
- Portfolio reporting practices (frequency, format, method)
- Consent regarding information shared to other professionals (accountants, lawyers)

## 3. Client GOALS

Wealth managers help private clients in setting up and prioritizing their goals and objectives so that they can bring into line an appropriate investment strategy.

Two common types of goals for private clients are:

- Planned goals
- Unplanned goals

### 3.1 Planned Goals

Goals that can be assessed or measured reasonably within a specified time horizon are referred to as **planned goals**. Some examples of **planned goals** are:

- *Retirement*
- *Specific purchases* (primary house, vacation home, luxury items)
- *Education* (funding children's education)
- *Family events* (wedding)
- *Wealth transfer* (inheritance goals)
- *Philanthropy* (donations, charities)

### 3.2 Unplanned Goals

Goals that are difficult to assess or measure are called unplanned goals, such as unexpected financial needs.

Some examples of **unplanned goals** are:

- Property repairs
- Medical expenditures (not covered under health insurance, varies by jurisdiction)
- Other unexpected spending

### 3.3 The Wealth Manager's Role

When articulating clients' goals, wealth manager's three main concerns are:

- i) **Goal quantification** - as private client's' goals are often not well articulated
- ii) **Goal prioritization** - as private clients often have multiple and competing goals.
- iii) **Goal changes** - as private clients' goals vary when their ongoing needs or circumstances change.

Wealth managers should help clients in quantifying, prioritizing and reconsidering their goals.

**Practice:** Example 3 Curriculum, Reading 21.



## 4. PRIVATE CLIENT RISK TOLERANCE

Recognizing the client's risk tolerance is substantial for successful investment policy. Key risk-related concepts may include:

- i) **Risk tolerance** is an investor's willingness to take the risk (opposite of risk aversion)
- ii) **Risk capacity** is an investor's capacity to take financial risk. Risk capacity is often determined by objective factors such as level of wealth, income, liquidity requirements, etc.
- iii) **Risk perception** is an investor's attitude towards risk (his perception about the riskiness of investment decision). This is a subjective concept and it varies significantly among clients.

**Note:** Compared to risk tolerance:

- risk capacity is a more objective concept
- risk perception depends on investor's circumstances

### 4.1 Risk Tolerance Questionnaire

For efficient investment planning and to address client-specific goals, wealth managers often use **risk tolerance questionnaires** as input (typically numerical values) in the investment planning process.

However, these questionnaires are not perfect, are highly subjective and greatly rely on the structural design of the questionnaire and the investment manager's judgment.

For Sample Risk Tolerance Questionnaire, refer to Exhibit 2, Reading 21, CFA Institute's Programs curriculum.

### 4.2 Risk Tolerance Conversation

Advisors meet with clients to gather additional useful information such as investor's personality type, the influence of family/friends, wealth accumulation sources, sensitivity to losses, early experiences with money, etc. Moreover, such meetings allow advisors to educate clients for setting realistic goals.

### 4.3 Risk Tolerance with Multiple Goals

Sometimes clients' risk tolerance varies for various goals. Advisors should carefully handle such issues by individually handling the risk tolerance for each goal.

## 5. TECHNICAL AND SOFT SKILLS FOR WEALTH MANAGERS

Wealth managers require both technical and soft skills for successful portfolio management.

### 5.1 Technical Skills

Technical skills are professional qualifications, necessary skills and proficiencies to provide investment advice to private clients. Technical skills may include:

- **Capital market proficiency** (understanding of capital markets and asset classes)
- **Portfolio construction ability** (understanding portfolio risks, returns, asset classes' correlations, etc.)
- **Financial planning knowledge** (basic understanding of related professions e.g. laws, taxation, insurance)
- **Quantitative skills**
- **Technical skills** (application of various high-tech software, portfolio optimization, simulation/modeling tools, etc.)

- **Language fluency** (multiple language skills)

### 5.2 Soft Skills

The ability to effectively communicate with clients is referred to be a part of soft skill. Soft skills are typically subjective in nature. Some common examples of soft skills include:

- Communication skills
- Social skills
- Education and coaching skills
- Business development and sales skills

**Practice:** Example 4 Curriculum, Reading 21.



## 6. INVESTMENT PLANNING, AND CAPITAL SUFFICIENCY ANALYSIS

After obtaining the basic knowledge about the private client, the advisor then reviews the client's strategic investment planning approaches. Three main concepts include capital sufficient analysis, retirement planning, the client's IPS.

### 6.1 Capital Sufficiency Analysis

Capital sufficiency analysis, also referred to as capital needs analysis, is a method by which wealth managers analyze whether clients' financial resources are adequate to meet their objectives.

#### 6.1.1 Methods for Evaluating Capital Sufficiency

Two primary methods for capital sufficiency analysis are:

1. **Deterministic forecasting** – is a simple (but unrealistic) forecasting method where the manager assumes a single linear annual compound rate that the portfolio is expected to earn over the investment horizon.
2. **Monte Carlo simulation** – considers mean return and standard deviation. This allows variation in annual expected return which is randomly generated from the analyst's input of possible return ranges (distribution). The process is repeated to identify the possible paths of annual returns. Summation of investment results gives the analyst an understanding of the probable future portfolio returns.

### 6.2 Inputs to Capital Sufficiency Analysis

For **capital sufficiency analysis**, analysts must state the following inputs:

- expected portfolio return
- current portfolio value
- expected future contributions into the portfolio
- expected cash outflows from the portfolio
- tax, inflation, management fees

For the **Monte Carlo simulation**, inputs are more complex and involve many variables. Depending on the software, assumptions can be at the portfolio level or at the asset class level such as average return, standard deviation, correlation of asset classes, etc. Some software allows flexibility in the portfolio's time horizon based on the investor's life expectancy.

#### Note:

Regardless of the method used, analysts should be careful about the historical return values as input and should give more emphasis to the anticipated capital market expectations.

### 6.3 Interpreting Monte Carlo Simulation Results

Analysts should provide a useful interpretation of the analysis (especially the outcomes of Monte Carlo simulation) to their clients and guide them with the potential solutions keeping in view the clients' objectives and risk tolerances.

**Practice:** Example 5 Curriculum, Reading 21.



## 7. RETIREMENT PLANNING

Financial planning for individuals' retirement has gained attention as the global average life expectancy of senior people has increased steadily especially in developed countries.

Three main principles of retirement planning involve:

1. Retirement stage of life
2. Retirement goals' analysis
3. Retired clients' behavioral considerations

### 7.1 Retirement Stage of Life

Wealth managers help individuals in evaluating their retirement planning e.g. when to retire, how much to save for retirement, ongoing cashflow needs following retirement, etc.

The table below demonstrates the typical financial stages of individuals and their relevant concerns for each stage.

**7.1.2.2) Annuities**

<b>Individuals' financial stages</b>	<b>Individuals key interest/pursuits</b>
Education	<ul style="list-style-type: none"> <li>• building human capital.</li> </ul>
Early career	<ul style="list-style-type: none"> <li>• conflicting financial priorities (family concerns, housing, education)</li> <li>• start saving for retirement</li> </ul>
Career-development	<ul style="list-style-type: none"> <li>• significance of retirement increases gradually</li> <li>• work and save for retirement</li> </ul>
Peak-accumulation	<ul style="list-style-type: none"> <li>• convert human capital to financial capital progressively</li> <li>• gradually build financial benefits (pension, retirement income) and reduce financial liabilities (loans)</li> </ul>
Pre-retirement	
Early retirement	<ul style="list-style-type: none"> <li>• rely on cashflows from their income sources (pension, job) and investment portfolio</li> </ul>
Late retirement	<ul style="list-style-type: none"> <li>• typically, expenditures on                             <ul style="list-style-type: none"> <li>◦ travel/recreation decrease</li> <li>◦ medical /health increase</li> </ul> </li> </ul>

**Annuities** – By pricing an annuity, a wealth manager estimates the present value of the retirement spending needs of a client. Some basic types of annuities include:

**Immediate annuity** - is an annuity contract that is purchased with a single lump-sum payment and in exchange, pays a guaranteed income that starts almost immediately.

**Deferred annuity** - is an annuity where the payments received will start sometime in the future.

**Life annuities** - pay benefits only as long as the individual is alive. Life annuities alleviate longevity risk.

**7.1.2.3) Monte Carlo Simulation Revisited**

Monte Carlo simulations can be used to plan retirement goals especially when clients do not want annuities.

**Advantages of Monte Carlo simulation include:**

- flexibility
- using client's actual asset allocation
- capturing the effects of multiple situations and clients' concerns

**Limitations of Monte Carlo simulation:**

- The output is not always accurate, depends on the accuracy of inputs used and is very sensitive to small changes in inputs.
- Monte Carlo simulation does not take into account shortfall magnitude (the amount by which the investment portfolio falls short of the targeted value)

Wealth managers play an important role for individuals (especially in early and late retirement stages) in generating a sustainable income from their investment portfolio.

**7.1.2 Analyzing Retirement Goals**

Three common ways to evaluate client's retirement goals are:

1. Mortality table
2. Annuities
3. Monte Carlo Simulation

**Practice:** Example 7 Curriculum, Reading 21.



**7.1.2.1) Mortality Tables**

**Mortality table** – Mortality tables enable advisors to estimate clients' future expected cash needs based on their current age, life expectancy, and survival probabilities.

One drawback is that the mortality table is based on averages only i.e. an investor may live longer than expected which implies that an investor's portfolio may suffer from **longevity risk**.

**Practice:** Example 6 Curriculum, Reading 21.



**7.1.3 Behavioral Consideration in Retirement Planning**

Some common behavioral biases related to retirees are as follows:

- **High degree of loss aversion:** Retirees demonstrate high loss aversion bias (as compared to young individuals), which influences their investment planning by affecting their asset allocation and return expectations.
- **Consumption gaps:** Retirees typically spend less than expected. The high consumption gap is often attributed to loss aversion bias and uncertain future spending needs.

- **The “annuity puzzle”:** Retirees rarely prefer to invest in annuities. This is called annuity puzzle and is usually caused by factors such as:
  - hopes to acquire funds for retirement
  - not losing control over the assets
  - cost of annuities

- **Favoring investment income over capital appreciation:** Individuals typically tend to separate investment income from capital appreciation and feel comfortable spending income/dividends rather than the proceeds from the capital appreciation. This is a kind of self-control bias.

## 8. INVESTMENT POLICY STATEMENT (IPS)

Before constructing the client's portfolio, wealth managers prepare the client's investment policy statement (IPS). A well-constructed IPS documents the client's financial objectives, risk tolerance, and investment constraints.

IPS should be reviewed regularly, and must be revised whenever the client's financial situation and/or capital market expectations change.

### Advantages:

- An IPS sets operational guidelines for constructing a portfolio and assures coherence between the client's guidelines and the client's portfolio.
- An IPS facilitates investment advisors to better know their clients, provides guidance for investment decision making and render their fiduciary responsibilities.

- **Information about other cashflows** that can affect the investment objectives (significant contributions or withdrawals, substantial liquidity needs).

Wealth managers should provide support to clients in case they face difficulty in

- prioritizing their goals amid multiple goals
- defining specific goals
- assigning pertinent amounts to certain goals

Wealth managers often use capital sufficiency analysis and their judgement to align investors' goals with their current assets and risk tolerance level.

**Practice:** Example 8 Curriculum, Reading 21.



### 8.1 Parts of the Investment Policy Statement

#### Key parts of an IPS are:

- Client's background and investment objectives
- Chief investment parameters
- Portfolio asset allocation
- Duties and responsibilities of parties involved

#### 8.1.1 Background and Investment Objectives

#### Key elements of the client's background include:

- **Personal information** (name, age)
- **Financial information** (market value of the portfolio, types of assets, tax information, finances outside the portfolio or managed by any other advisor, other cashflow sources)
- **Investment objectives**, which may be general or detailed/quantified, ongoing (retirement goals, supporting family) or one time (buying home, traveling), primary or secondary in case of multiple objectives.

### 8.1.2 Investment Parameters

The investment parameter section of the IPS indicates key client's preferences that can affect his investment plan and should be considered by wealth managers.

#### 8.1.2.1) Risk tolerance

In this section wealth manager assesses the client's risk tolerance i.e. his ability and willingness to take the risk. The manager specifies his conclusion along with all the supported elements (subjective, objective, questionnaire) used in the process.

#### 8.1.2.2) Investment time horizon:

In this section, wealth managers plot the client's investment horizon typically as a range. The client's time horizon may have a single stage or multiple stages, long-term (>15 years) or short-term (< 10 years).

#### 8.1.2.3) Asset class preferences

Wealth managers should state (with reference to a client):

- o suitable asset classes and asset classes not allowed by the client
- o short description of asset allocation prominence and procedure
- o risk-return characteristics of asset classes
- o client's risk-return settlements/trade-off

#### 8.1.2.4) Other investment preferences:

Other investment preferences section handles additional investment settings such as guidelines for social or special purpose investing, ESG considerations, retaining shares of a particular company, etc.

#### 8.1.2.5) Liquidity preferences:

In this section, the manager states those liquidity needs not specified in the background and investment objectives section, such as the client's liquidity preference for ongoing expenses, emergency reserves, negative liquidity events.

#### 8.1.2.6) Constraints:

Client's preference or restriction for certain investment strategies for example options, investments that can cause significant tax liabilities, strategies involving large unrealized capital gains as well as ESG related restrictions.

**Practice:** Example 9 Curriculum, Reading 21.



### 8.1.3 Portfolio Asset Allocation

In this section, wealth managers define the target allocation of each asset class. Managers who tend to follow:

- o **strategic asset allocation** usually state target allocation plus upper & lower bounds.
- o **tactical allocation** usually state asset class target ranges.

### 8.1.4 Portfolio Management

This IPS section stipulates instructions about the following ongoing management matters.

#### 8.1.4.1) Discretionary Authority –

**Discretionary Authority** investment manager's authority (given by the client) to take action without the client's consent.

**Full discretion (non-discretion)** means the manager **does not require (requires)** the client's approval before

implementing any change to the portfolio such as portfolio rebalancing, changing fund managers.

#### 8.1.4.2) Rebalancing

This IPS section demonstrates the rebalancing policies used by the wealth managers.

- o **Time-based approach** - portfolio is rebalanced at a certain time frame (quarterly, semi-annually).
- o **Threshold-based approach** - portfolio is rebalanced when asset class weights deviate from their target levels by a pre-determined percentage.

#### 8.1.4.3) Tactical Changes:

This section is relevant only if the tactical asset allocation is applicable (as mentioned in the asset allocation section). Portfolio manager should state the circumstances and the extent to which he/she is allowed to go beyond the permissible asset class levels when making tactical shifts.

#### 8.1.4.4) Implementation

This section specifies information regarding the appropriate choice of investment vehicles and associated costs. Such as:

- o whether to prefer in-house or third-party money managers or a combination of both.
- o whether to prefer mutual funds, ETFs or individual securities
- o method and frequency of applying due diligence process

### 8.1.5 Duties and Responsibilities

This section provides information about the general responsibilities of a wealth manager and the frequency of a client's IPS review.

#### 8.1.5.1) Wealth Manager Responsibilities:

This section provides a detail description of wealth manager duties in order to meet client objectives. Some common duties may include:

- o Preparing suitable asset allocation
- o Monitoring and rebalancing the asset allocation
- o Preparing and reviewing IPS
- o Choosing appropriate investment vehicles and strategies, and assessing costs of these strategies
- o Monitoring 3<sup>rd</sup> part service providers
- o Evaluating the use of derivatives, leverage, short sales, etc.
- o Reporting important particulars (such as portfolio performance, taxes, financial statements, voting proxies)

**8.1.5.2) IPS Review**

Wealth managers perceive whether the current frequency of IPS review is serving the purpose of meeting investment objectives.

**8.1.5 IPS Appendix**

This section includes items that require adjustments more frequently than other IPS sections. Two examples of such items are provided below.

**8.1.6.1) Modeled Portfolio Behavior**

In this section, the portfolio manager explains the modeled distribution of returns at various time periods (range of possible outcomes rather than expected compound return value).

**8.1.6.2) Capital Market Expectations:**

In this section, the wealth manager typically describes his modeled portfolio values including expected returns, standard deviation, correlation of asset classes, modeled compound annual return, etc.

**9. SAMPLE INVESTMENT POLICY STATEMENT**

Refer to exhibit 5 for sample IPS for a private Client CFA Institute's program curriculum, Reading 21

**10. PORTFOLIO CONSTRUCTION AND ALLOCATION AND INVESTMENTS FOR PRIVATE WEALTH CLIENTS**

After preparing the IPS, the next phase of a private client's portfolio management process includes portfolio construction and monitoring.

**10.1 Portfolio Allocation and Investments for Private Wealth Clients**

Two main approaches to portfolio construction for a private client are:

1. Traditional approach
2. Goal-based investing approach

**10.1.1 Portfolio Construction – Traditional Approach**

Key steps for portfolio construction using the traditional approach are:

- i) **Identify asset classes:** Selecting suitable asset classes for the clients' portfolio. Asset classes may vary by wealth managers.
- ii) **Develop capital market expectations:** Estimating returns, standard deviation, the correlation among asset classes, changes in financial markets, etc.
- iii) **Determine portfolio allocations:** Wealth managers may apply to mean-variance optimization (MVO). MVO is a risk budgeting tool

to help investors spend their risk budget wisely. MVO provides a structure that maximizes a portfolio's expected return for an expected risk level by determining how much to allocate to each asset class.

- iv) **Assess constraints:** Wealth managers should include and assess the client's constraints when constructing an appropriate portfolio. Constraints might include issues regarding base currency, concentrated position in a single stock, illiquid investment, etc.
- v) **Implement the portfolio:** Wealth managers then consider various selections e.g. active versus passive management, which factors to choose within an asset class, individual securities or pooled investment vehicles, currency hedging, etc.
- vi) **Determine asset location:** Asset location is an important consideration for private clients with multiple accounts. Asset location refers to *locating/placing* investments in appropriate accounts e.g. non-taxable investments should be located in "taxable" accounts whereas taxable investments should be located in "tax-exempt" accounts.

### 10.1.2 Portfolio Construction – Goals-Based Investing Approach

- A goals-based approach involves splitting the investor's portfolio into many sub-portfolios. Each sub-portfolio attempts to attain a specific goal. Wealth managers identify client goals and match each goal with some sub-portfolios of suitable asset size typically by applying mean-variance optimization (MVO) at the sub-portfolio level.
- Dividing goals help individuals in determining their risk tolerance or urgencies at the sub-goal level. A problem with the goals-based approach is that the overall portfolio may lie below the efficient frontier.

- The goals-based approach follows the same steps as the traditional approach mentioned earlier (e.g., identifying asset class, implementing the portfolio, determining asset location).

**Practice:** Example 10 and 11 Curriculum, Reading 21.



## 11. PORTFOLIO REPORTING AND REVIEW

**Portfolio reporting** – managers provide periodic information about portfolio performance and key milestones through email or other means.

**Portfolio review** – involves meeting with the client to review the client's investment strategy.

communicate and carefully manage the client's expectation about portfolio performance.

In **goals-based investing**, the manager typically reports portfolio performance in pursuance of his plans towards achieving the client's goals.

In **benchmark reporting**, managers typically report the overall portfolio performance relative to some suitable benchmark and the asset class performances relative to some suitable asset class benchmarks.

### 11.1 Portfolio Reporting

A portfolio report usually discloses the following matters:

- Portfolio asset allocation report
- Performance summary report (year-end)
- Detailed performance report (at the asset class and securities level)
- Historical performance report about the client's investment strategy (since inception to date)
- Current period contribution/withdraws
- Current period purchase and sale of securities report
- Impact of exchange rate and currency fluctuations

**Note:** In addition to the portfolio report, sometimes wealth managers provide to the clients some additional information (via email or letter) e.g., commentary on recent economic or financial events.

The portfolio **performance evaluation horizon** typically ranges from one quarter to one year whereas the portfolio **investment horizon** is typically long-term (5-years, 10-years, etc. depending on the client's goals). This gap (mismatch) may impair the client's ability to comprehend the portfolio's efficiency correctly. Therefore, it is imperative for a wealth manager to well

**Practice:** Example 12 Curriculum, Reading 21.



### 11.2 Portfolio Review

Portfolio review process involves

- higher engagement between manager and client
- reviewing client's investment plan and strategies such as:
  - changes in client's objectives, risk tolerance, time frame, liquidity needs, cash flow situation, estate planning
- comparing client's current asset allocation to target allocation

For the portfolio review process, wealth managers typically make use of CRM software and usually deliver a written document to the client to avoid any future confusion and misinterpretation.

## 12. Evaluating the Success of an Investment Program

The following sections highlight the important aspects to be considered when evaluating the success of a private investment program.

### 12.1 Goal Achievement

The success of a private investment plan is measured by the fact that whether the portfolio is likely to meet the investment goals with the resources available and tolerable risk levels, within the time frame and without the significant alterations to the plan.

### 12.2 Process Consistency

Wealth managers typically consider the following questions in evaluating the consistency of the client's investment program.

- Has the portfolio rebalancing according to the recommended IPS instructions?
- Has the wealth manager tended to cut down costs/expenses where possible?
- Has the wealth manager inquired for the client for potential changes in the client's 'objectives, time horizon, risk tolerance'?
- Has the wealth manager considered matters such as taxation, ESG preferences, the client's estate plan, where applicable?

- The impact of tactical positioning on the portfolio performance where applicable.
- Where applicable, 3<sup>rd</sup> party fund managers' performance relative to their benchmarks? And the impact of changes on the portfolio, suggested by the wealth manager to the 3<sup>rd</sup> party fund managers.

### 12.3 Portfolio Performance

Two common portfolio performance benchmarks for a private client are:

- absolute** performance benchmark (e.g., fixed % return plus inflation)
- relative** performance benchmark (e.g., portfolio return relative to an appropriate benchmark)

### 12.4 Definitions of Success

At the beginning of the investment program, wealth managers should coordinate with their clients in defining the measures of success to avoid any confusion later.

**Practice:** Example 13 Curriculum, Reading 21.



## 13. Ethical and Client Considerations in Private Wealth Management

The following sections briefly highlight the ethical and compliance issues for private wealth managers.

### 13.1 Ethical Considerations

CFA Institute's Code of Ethics and Standards of Professional Conduct are the reference point for ethical clarification. Some ethical considerations relevant to private wealth managers are as follows.

#### 13.1.1 Fiduciary Duty and Suitability

Fiduciary duty: obligation of a wealth manager to act in the best interest of the client.

Suitability is considered to be an essential element of a wealth manager's fiduciary duty. Wealth managers should assess the suitability and appropriateness of a portfolio relative to the client's needs and circumstances.

**Suitability and fiduciary duty are covered in standard:**

- I(B): Independence and Objectivity
- III(A) Loyalty, Prudence and Care
- III(C): Suitability
- V(A): Diligence and Reasonable Basis

#### 13.1.2 Know Your Customer (KYC)

Know your customer KYC rule requires wealth managers to obtain information about their clients such as sources

of their wealth, risk and return objectives, etc. KYC document help authorities to uncover fraudulent activities.

**Practice: Example 14 Curriculum, Reading 21.**



**13.1.3 Confidentiality**

It is wealth managers' primary responsibility to secure and protect their clients' personal and confidential information. This issue becomes highly sensitive when multiple family members/friends are the wealth manager's clients.

Wealth managers should properly understand their employer's written confidentiality policies and procedures. Confidentiality has been discussed in *Standard III(E): Preservation of Confidentiality*.

**13.1.4 Conflicts of Interest**

Wealth managers fee and compensation arrangements may raise potential conflicts of interest. Controlling and managing such conflicts is an integral part of the asset management industry. This subject is covered under Standard:

- I(B) Independence and Objectivity
- VI: Conflicts of Interest

**13.2 Compliance Considerations**

Wealth managers are required to follow various regulatory rules. Some globally enacted regulations related to compliance include:

- MiFID II (Markets in Financial Instruments Directive)
- Common Reporting Standard
- FATCA (the Foreign Account Tax Compliance Act)

To increase investor protection, in the United States, **fiduciary rule** and **best interest rule** are two additional proposed regulations related to wealth managers.

**Refer to Exhibit 13 for detail description of key compliance regulations listed above. CFA Institute's program curriculum, Reading 21**

**14. PRIVATE CLIENT SEGMENTS**

This section illustrates the major categories of private wealth clients and the levels of services and solutions provided to them by the private wealth management firms.

**14.1 Mass Affluent Segment**

Mass Affluent segment	
<b>Primary focus of investors</b>	building investment portfolio, accomplishing investment planning needs, saving/investing for retirement etc.
<b>Clients per wealth manager</b>	Higher number of clients per wealth managers
<b>Service</b>	Wealth managers: <ul style="list-style-type: none"> <li>o often make use of technology/software in service delivery</li> <li>o do not apply customized strategies for clients</li> </ul>
<b>Manager Compensation</b>	Asset managers either earn commission on investment transactions or charge fee as a % of the asset under management

**14.2 High-Net-Worth Segment**

High-Net-Worth Segment	
<b>Primary focus of investors</b>	Customized investment management, tax and wealth transfer matters, estate planning.
<b>Clients per wealth manager</b>	Lower number of clients per wealth managers as compared to the mass affluent segment.
<b>Service</b>	Wealth managers apply custom-build strategies. Handling portfolios of high-net-worth clients demand financial and investment expertise.

**8.3 Ultra-High-Net-Worth Segment**

Ultra-High-Net-Worth Segment	
<b>Primary focus of investors</b>	broader range of service requirements, intricate tax and estate planning concerns
<b>Clients per wealth manager</b>	multi-generational time horizons Few clients per wealth managers

**Service**

Wealth managers provide personalized investment solutions.

Other services may include: concierge, bill payment, travel preparation, assistance on purchasing assets such as artwork, jet etc.

Wealth managers often manage multiple family members accounts, therefore, should deal with issues such as family authority, inheritance, etc.

Sometimes, wealth manager is required to set up a team of multiple service providers with highly specialized skills (such as tax consultant, legal advisor, investment specialist etc.)

Some wealthy individuals hire a **family office**. A family office is a unique asset management firm that works exclusively for such clients.

**14.4****Robo-Advisors**

Robo-advisory services provide digital programs and client interface for investment solutions without direct interaction with financial advisors.

First, a client digitally enters his assets, liabilities, risk preferences, target investment returns in a web-based investor questionnaire. Then the robo-advisor software composes recommendations based on the client's stated parameters and historical market data using algorithmic rules, MVO or some other advanced system.

Robo-advisors are offering services such as ongoing portfolio monitoring and managing, periodic rebalancing, regular portfolio performance reporting, etc.

Robo-advisors technology is offering cost-effective financial guidance for less wealthy investors.

Robo-advisors are contributing to providing services in other private investment management activities, for example, integrating ESG considerations into portfolios, understanding investor behavior, developing tax-efficient techniques.

**Practice:** Example 13 Curriculum, Reading 21.



**Practice:** End of Chapter Questions + FinQuiz Questions & Item-sets

