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# Risk management strategies for high-net- worth individuals

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WS Global CIO Office



When it comes to managing portfolios of high-net-worth individuals (HNWIs), there is a lot of focus on potential returns but not nearly enough on protecting against risks.

HNWIs often possess diverse and complex financial portfolios. They are vulnerable to a wide range of risks, including geopolitical shifts, exchange rate fluctuations and global market volatility. A wide geographical spread of assets means adherence to cross-border regimes, which can be time consuming and challenging. The lack of standardised measures to assess investments from a sustainability perspective remains an unsolved paradox. Preservation and seamless transfer of accumulated wealth continue to be a key priority for HNWIs. In this digital age, it is also important to keep up with technological advancements to leverage deep insights for better due diligence and risk management.

We argue that besides focusing on potential investment return strategies, adopting a dynamic, customised and robust risk management strategy is key to ensuring sustained preservation of wealth.

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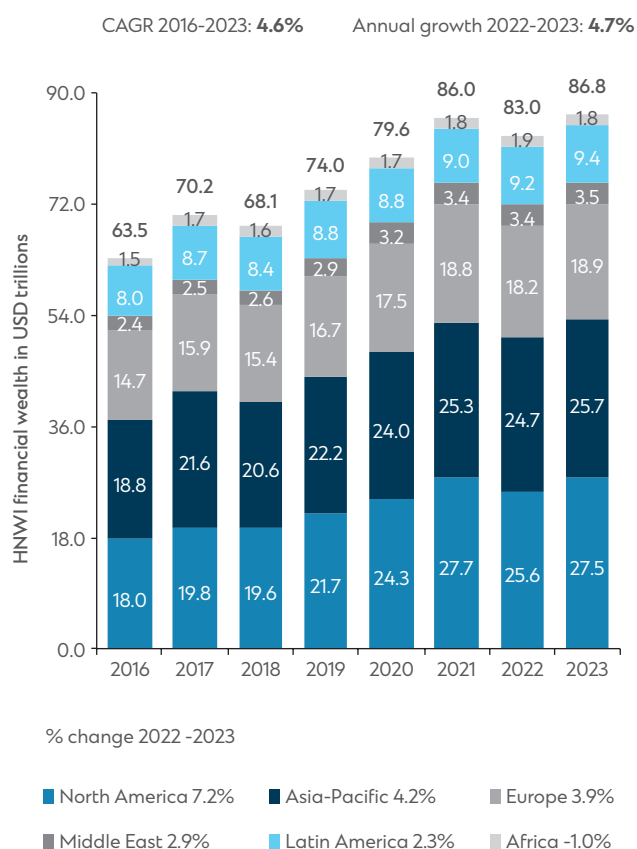
# Understanding the world of HNWIs

As per the Capgemini's 2024 world wealth report, HNWI's accounted for 0.28% of the world's population in 2023. Despite their relatively small size, their economic representation is, unsurprisingly, quite significant. The report also noted that the rebound in asset markets boosted global HNWI wealth and population by 4.7% and 5.1%, respectively, in 2023. This comes as a relief after a grim investment environment in 2022 that resulted in HNWI portfolios losing over USD 10trn.

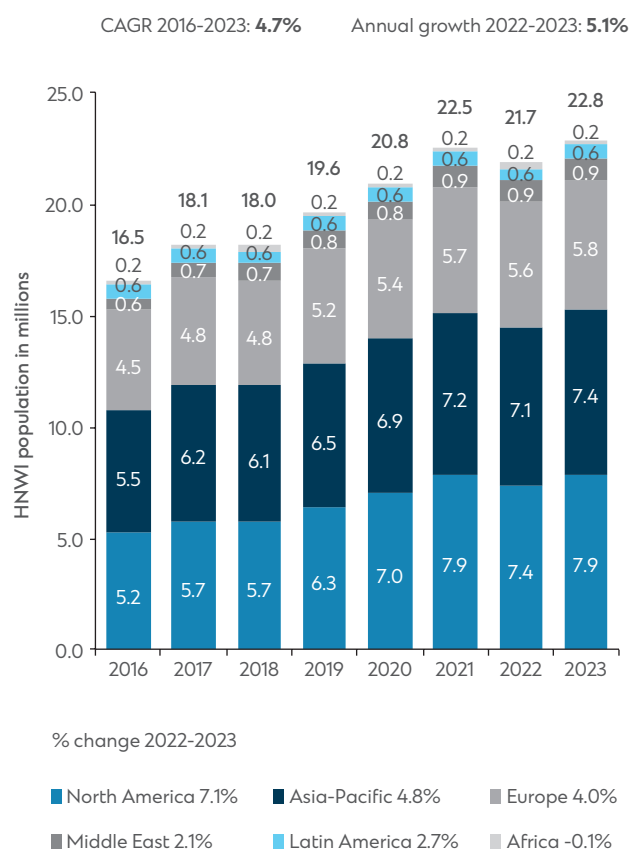
Fig. 1

## HNWI wealth and population recovers from 2022 dip

### HNWI wealth recovers from 2022 losses



### 2023 Global HNWI population surpasses 2021 highs



Source: Standard Chartered, Capgemini Research Institute for Financial Services Analysis, World Wealth Report, 2024  
Chart numbers and quoted percentages may not total 100% due to rounding

According to Cerulli Associates, an estimated USD 84.4trn multi-generational wealth transfer is expected to play out over the next two decades. Against this backdrop, there is growing evidence of changing purchase behaviour and a renewed focus on risk management and asset protection.



# A customised set of solutions

HNWIs' financial needs and objectives differ from standardised solutions. Hence, they often work with an expert to continue to preserve and grow their wealth.

## **The need for personalised solutions**

HNWIs require tailor-made solutions to align with their service requirements. Examples of this include insurance planning, estate management and risk management. To chalk out customised solutions to their unique and specific needs, expert intervention is often necessary.

## **Wealth preservation is a priority**

Recent studies by Wealth-X and Fidelity Investments found that over 75% of HNWIs are self-made – they have accumulated their wealth with significant effort over a period of time. Given this context, HNWIs often prioritise wealth protection and preservation, and intend to take necessary measures to protect themselves from potential risks and threats, including macroeconomic factors, geopolitical events, market volatility and cyber attacks.

## **Long-standing relationships with experts**

HNWIs deal with complex financial situations that often require expert advice. They also value expertise and exclusivity and are willing to pay for dedicated services and access to exclusive investment strategies. This points to the need for a deep and long-standing relationship with experts to help meet these unique requirements.



# A unique set of risks

HNWIs are exposed to a unique set of risks that can hinder their financial success, requiring them to take additional steps to protect their wealth. In addition to generic risk factors, such as macroeconomic, market-oriented and environmental, below are several examples of unique risks to which they are exposed:



## Potential lawsuits

HNWIs engaged in businesses and high-risk professions, such as medicine, entertainment and law, are susceptible to lawsuits. A lawsuit can not only cause reputational damage but can also threaten one's financial stability. For example, the average medical malpractice settlement in the US is approximately USD 330,000, as per the Journal of American Medical Association, and those that go to trial could average around USD 1mn. Protection against lawsuits is a critical aspect of estate planning. By leveraging asset protection trusts and umbrella insurance, HNWIs can build some protection against certain types of lawsuits.



## Cyber-attacks

Due to their quantum of wealth, HNWIs are often targeted by cybercriminals. As per a Campden Research study, over 25% of HNWIs and family offices with average wealth over USD 1.1bn are exposed to cyberattacks. While it is important to detect, monitor and safeguard against cyber threats, it is also important to respond through an appropriate incident response plan. Elite cybersecurity services can help by significantly reducing their vulnerability.



## Passion investment and collectibles risks

Passion investments and valuable collectibles (e.g., fine art, vintage cars, luxe watches, rare wine and antiques) are subject to risks such as fraud, forgery and theft. The primary methods to reduce exposure to these is via thorough due diligence and insurance. Depending on the type of investment, curated risk management strategies may need to be adopted.



## Geographic risks

A survey by Connection Capital in 2021 found that around 75% of global HNWIs have exposure of more than 10% of their portfolio to alternative assets that includes international investments. This makes HNWI portfolios vulnerable to geopolitical risks. The experience of extreme risk events shows that a simple diversification approach cannot completely insulate a portfolio against downside risk. Therefore, more sophisticated risk mitigation strategies may be required.



## Regulatory risks

Wealth management is subject to stringent and evolving regulations, with non-compliance potentially leading to reputational damage, significant fines and/or criminal charges. This means HNWIs need to work with wealth managers to stay abreast of the evolving regulatory requirements and to ensure compliance at all levels.

# Advanced risk mitigation strategies for HNWIs

There is a need to develop a comprehensive risk strategy that aligns with long-term objectives to facilitate preservation and sustained growth of wealth. Risk management strategies should enable assessment, identification and mitigation of the risks.

In addition to thorough due diligence and diversification, which is commonly employed as a risk mitigation strategy, sophisticated strategies should be employed to manage risks faced by HNWIs.

## **Alternative investments**

In a survey, Connection Capital, a London-based alternative investments platform, found that investors were adopting a radical shift away from the traditional 60% equities/40% bonds mix with the intent of achieving better diversification and risk-adjusted returns. Around 40% of the respondents had over 20% exposure towards alternative assets in their portfolios.

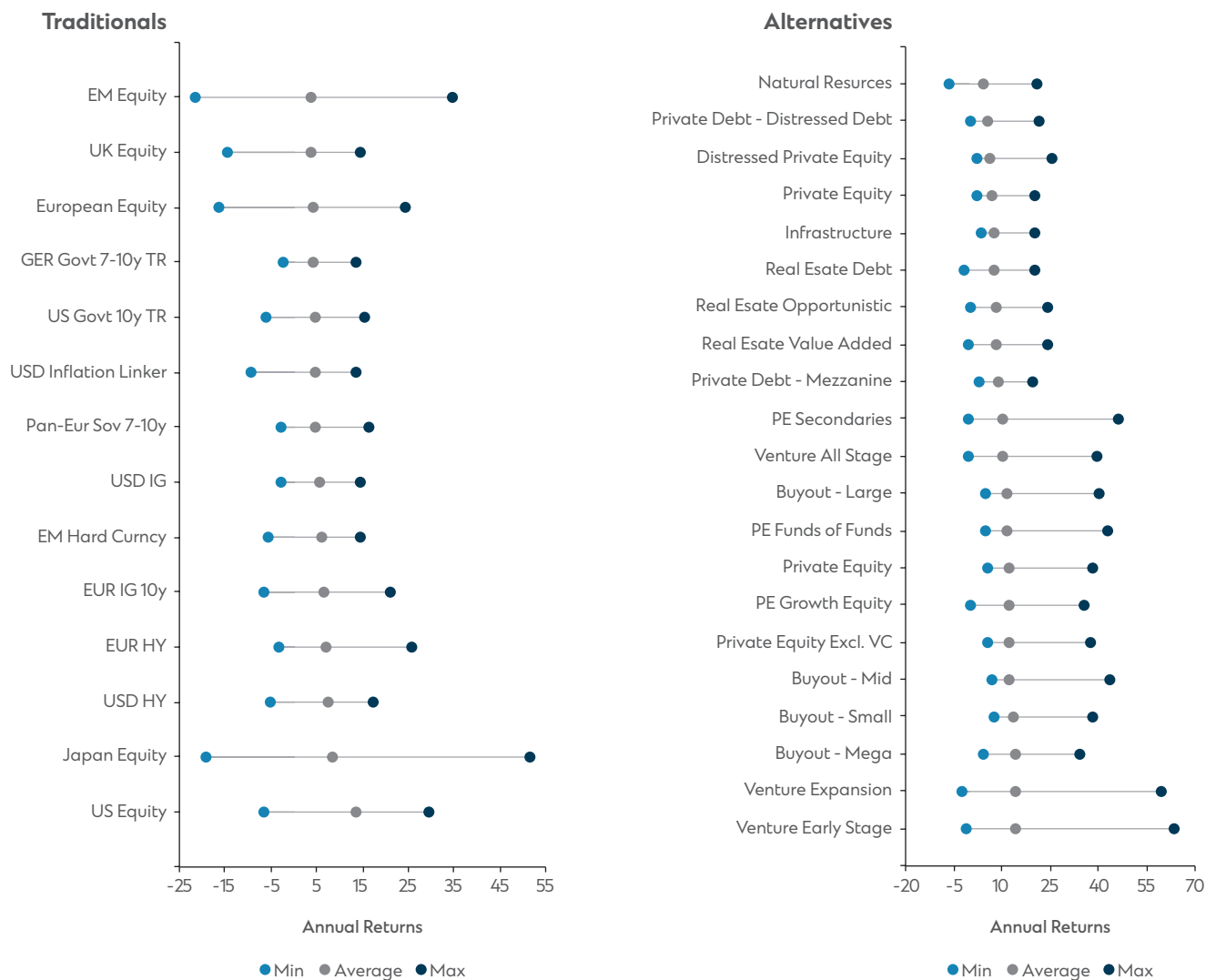
Another study by Cerulli Associates concurs with this observation; they noted HNWIs wanted to pursue alternative investments to either diversify and reduce volatility or capitalise on new growth opportunities. They noted the average exposure towards this asset class in 2022 was 9.1%, and this average is likely expected to hover around 9.6% by the end of 2024.

A leading investment management company in Europe, Klarphos, studied annual returns and the ranges (worst-to-best returns) between traditional and alternative funds from 2010 to 2021. According to their findings, core traditional asset classes such as bonds had an average annual return ranging from 3% to 8%.

In contrast, alternative assets posted relatively higher average returns over the past 10 years. Of the 21 strategies included, 17 of them provided double-digit returns, and the ranges for most assets were narrower than that of traditional assets.

Fig. 2

## Mean and median dispersions – traditional vs alternative



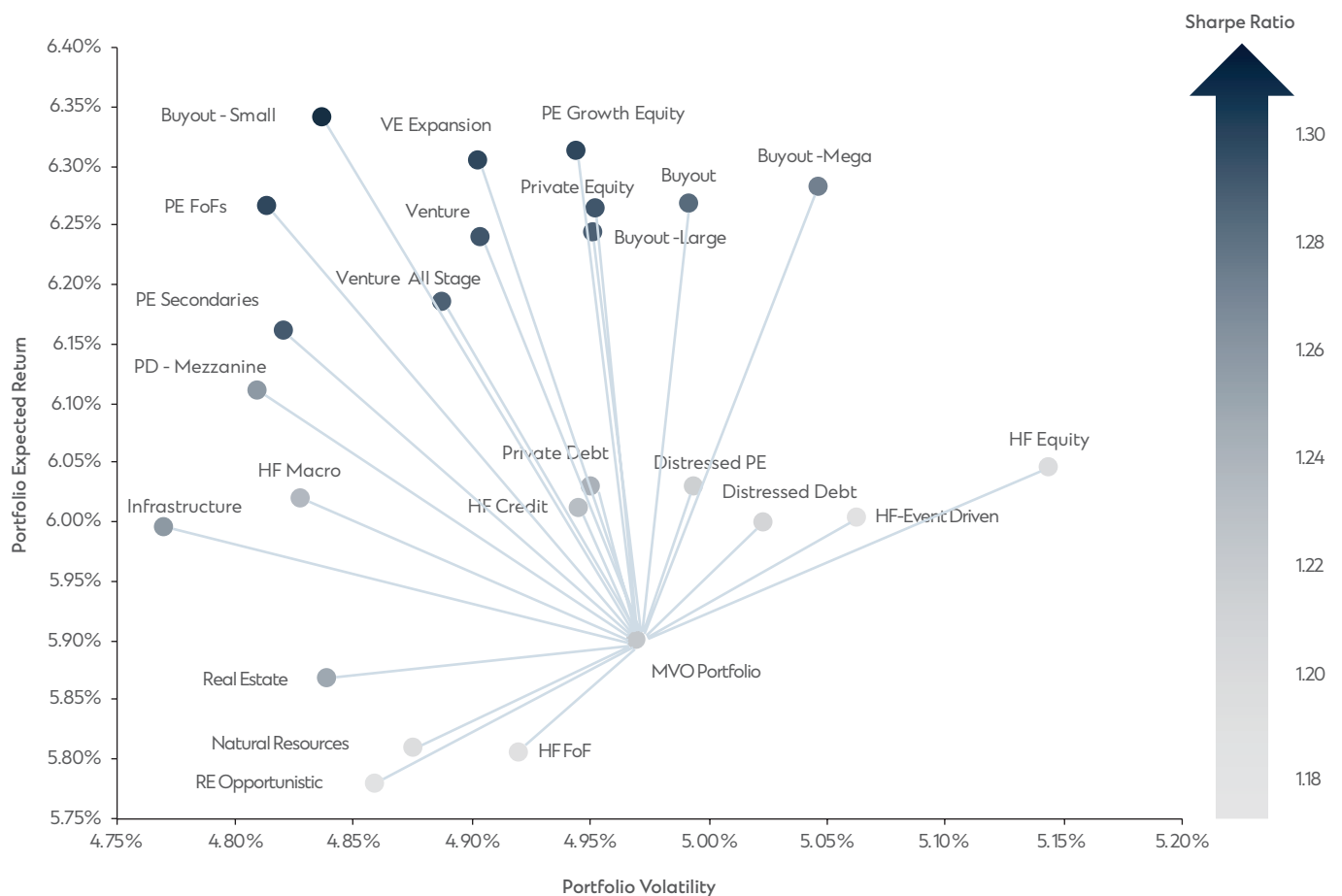
Source: Standard Chartered, Klarphos, Bloomberg, Preqin, 2022; data as of December 2022



To understand the impact of inclusion of alternative investments in an existing traditional portfolio, the chart in figure 3 illustrates how the risk and return of an optimised (mean-variance) portfolio changes if a 5% allocation is added to each specific alternative asset class.

Fig. 3

### Benefits of adding alternatives in a traditional portfolio



Source: Standard Chartered, Klarphos, Bloomberg, Preqin; data as of December 2022

This figure shows that a significant majority of alternative assets improve a portfolio's return per unit of risk, or the Sharpe ratio. The addition of options such as equity hedge funds and real estate results in incremental expected returns and a corresponding linear increase in risks, while investments like private equity and venture capital result in a sharp rise in returns but with only a marginal impact on risk. In contrast, options like infrastructure and private debt largely reduce the portfolio risk with only a minor impact on returns.



## Hedging

Hedging is a time-tested strategy to manage risk, commonly used to offset potential losses and protect one's wealth. It is often executed by taking an equal but opposite position in the same or related investment. For example, if you have significant exposure to currency fluctuations in the spot markets, you can hedge the risk by taking opposite positions in the derivatives market. Strategies like sector rotation (increase/decrease exposure to cyclical sectors) are another example of this.

A HNWI's portfolio is likely to have exposure to a wide range of asset classes. Hence, it is usually necessary to curate hedging strategies tailored to the specific situation of each portfolio.

# Types of hedging strategies

## Portfolio Hedging

Mitigates overall risk of an investment portfolio using various strategies and financial instruments

**Examples:** Risk Assessment, Diversification, Use of Derivatives for Risk Mitigation

## Interest Rate Hedging

Manages the risk of changes in interest rates

**Examples:** Interest Rate Swaps, Bond Laddering

## Currency Hedging

Manages the risk of fluctuations in foreign exchange rates

**Examples:** Forward Contracts, Currency Options

## Commodity Hedging

Manages the risk of price fluctuations in commodities

**Examples:** Commodity Futures, Exchange-Traded Funds (ETFs)

Source: Standard Chartered, Finance Strategists

Implementing an effective hedging strategy requires a deep understanding of market dynamics, consistent monitoring and realignment of strategies in evolving market conditions. This is why HNWIs are likely to be best served by an expert to tailor their strategy such that it aligns with their long-term objectives.

## Sustainable investing

There is growing awareness of sustainable investing and the long-term benefits of such strategies.

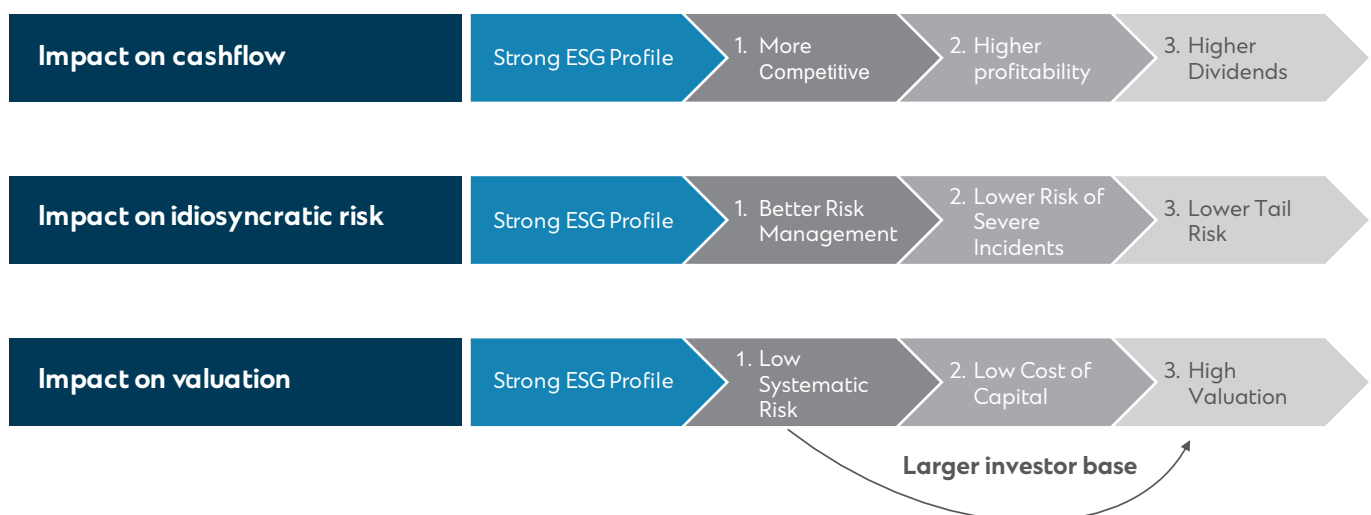
A study by Abiodun Moses Adetokunbo and Afe Success Mevhare, Professors at Augustine University in Nigeria, recommends exposure to green investing. There is evidence that investing in impact sectors such as renewable energy, affordable housing and sustainable agriculture can provide meaningful diversification due to inverse or low correlation with traditional assets.

Another study by MSCI focused on understanding the relationship between ESG scores and the risk-return profile of stocks. They found that strong ESG scores helped support better valuations and investment performance. This was achieved through lower cost of capital and correspondingly higher valuation.

Including ESG metrics for actively ascertaining risks due to climate, supply chain or governance ensures that portfolio risk evaluation extends beyond a traditional framework. This can help result in more resilient and future-proof portfolios.

Fig. 4

### Impact of strong ESG scores on the risk-return profile of an investment



Source: Standard Chartered, adapted from MSCI, The Journal of Portfolio Management, 2019

## Insurance

Insurance can help mitigate different types of risks faced by HNWLs.

Insurance can enable beneficiaries to pay estate taxes and, in many jurisdictions, can be a way to mitigate inheritance tax obligations. There is a growing trend of HNWLs availing universal life insurance to protect ones' legacy and wealth. This ensures that the estate is not liquidated to meet tax obligations.

Many HNWLs have accumulated their wealth, and not inherited it. While their passive income continues to accelerate growth of their wealth, their active profession has helped them create the corpus. If there is an unforeseen illness or disability, it can not only disrupt the income flow, but also possibly deplete the corpus. Thus, most HNWLs hedge against such possibilities through critical illness and disability insurance.

Finally, HNWLs may benefit from insuring their valuable collectibles and homes. A specially curated insurance coverage strategy needs to be chalked to meet their unique needs.

## Estate planning

A wealth transfer plan fosters efficient and intentional distribution of wealth. The plan should ensure financial safety of beneficiaries, protect assets from claims/creditors and navigate complex regulations. Some of the prominent reasons for considering a wealth transfer plan are:

**Optimising taxes:** Reduction of estate taxes is one of the main benefits of an effective estate plan. For example, by using techniques and structures such as gifts, life insurance and trusts, one can preserve and transfer estate value. Without an estate plan, beneficiaries may face high taxes and probate that can lead to reduced estate value and delayed transfers.

**Preserving wealth:** Studies suggest that wealth does not sustain beyond three generations; this phenomenon is called the 'third-generational curse'. About 70% of wealthy families lose their wealth by the second generation and 90% lose it by the third generation. One of the prudent ways to sustain and grow wealth across generations is by creating trusts, wills and other vehicles.

**Averting potential family conflicts:** Prominent families such as the Murdochs, the Osbournes and the Jacksons have one thing in common – family conflicts over estate. Family dynamics is the most crucial aspect to handle during a wealth transfer. An estate plan that clearly outlines intentions, expectations, roles and responsibilities can reduce misunderstandings and foster harmony among heirs. It is also important to communicate to heirs about their inheritance to ensure financial preparedness.

**Bypassing probate and preventing claims:** An estate plan that leverages trusts, insurance, joint ownerships and family limited partnerships (FLPs) can bypass probate and protect assets from claims.

**Aligning values with legacy goals:** Intentionally directing wealth distribution among heirs, communities and causes can help to align legacy goals with family values. Guidelines can be established on how assets should be managed and used with the help of governance structures and councils. This can ensure that assets are used for their intended purpose even after one's passing.

Fig. 5

### Estate planning strategies that optimise on taxes and costs

Strategy	Definition	Benefits
<b>Trusts</b>	Holds assets for beneficiaries	Avoids probate, optimises taxes and offers privacy. Protects estate from creditors and litigation
<b>Wills</b>	Are legal documents that mention the distribution of assets	Ensures a written direction to how assets are to be distributed and to whom
<b>Gifting</b>	Can transfer within one's lifetime	Mitigates risk of family disputes
<b>Life insurance</b>	Are policies that provide financial support to beneficiaries	Effective way to creating liquidity to support the family
<b>Family Limited Partnership (FLP)</b>	Is a partnership among family members to manage and control assets	Provides asset protection and tax optimisation
<b>Charity</b>	Is a voluntary transfer of assets to charity of choice/those in need	Supports philanthropic endeavors after one's lifetime and optimises on taxes
<b>Private Foundations</b>	Are entities for charitable services	Offers control over business and charitable entities. E.g., Bill & Melinda Gates Foundation
<b>Family Office</b>	Is an entity for management of wealth and investments of the family	Centralised fund management. Offers optimized asset allocation and returns at risk-adjusted levels. Optimises costs and taxes. E.g., Cascade Asset Management manages Gates' wealth

Source: Standard Chartered

# Types of wealth transfers

There are many types of wealth transfer strategies, each offering different tax efficiency and control over distribution. It is important to choose the right type to preserve estate's value and avoid conflicts.



## **Direct transfers**

This involves a simple transfer of assets to beneficiaries without the hassle of probate or other court proceedings, either during or after the lifetime of the grantor (benefactor). Some of the prominent ways in which direct transfers are made are discussed here:

### **Gifts**

The benefactor voluntarily gifts investments or assets to a beneficiary without expecting any compensation in return. The assets can include cash, securities, valuables or property. It is always prudent to document such gifts to avoid conflicts in the future. For example, in the US, gifts up to USD 18,000 per individual per annum are exempt from gift taxes.

### **Bequests**

Some assets from the estate are specifically designated to be distributed among certain beneficiaries after the benefactor's passing. The assets can be cash, property or heirloom and are often outlined in a will. However, such bequests are subject to probate and legal proceedings that validate the will to ensure proper asset distribution.

### **Nominations**

This refers to naming specific beneficiaries as nominees in your investments or assets. This will allow them to directly receive the proceeds from the investment such as insurance policies and retirement accounts upon the passing of the benefactor. For instance, in some jurisdictions, mentioning a nominee in the retirement account will ensure smooth transfer of account balance. Such beneficiary designations often help bypass probate and legal proceedings.



## **Trust structures**

A trust is a legal agreement with separate rights similar to an individual or a company. They can buy, sell, hold and manage assets as per terms mentioned in the trust deed. It is an arrangement where a settlor transfers the assets into the trust and appoints a trustee to manage and distribute the underlying assets based on documented instructions. This arrangement can protect assets, bypass probate, reduce documentation and optimise estate taxes. A trust can also be established to provide for a minor beneficiary or an heir with special needs. A qualified estate attorney can help to set up a trust. There are broadly six different types of trusts, each with their unique characteristics and benefits.

### **Living or testamentary trust**

A living trust is an arrangement where the settlor transfers assets to the trust for their own benefit during their lifetime. The trustee is responsible for management and distribution of the assets during and after the lifetime of the settlor. This type of trust is also called an inter-vivos trust.

A testamentary trust is established only after the grantor passes away; it outlines the specifics of asset distribution among beneficiaries. This trust is also called a will trust.

### Revocable and irrevocable trust

A revocable trust is one where the settlor can revoke the arrangement during their lifetime. Upon the grantor's passing, these trusts bypass probate, saving time and costs for the beneficiaries.

An irrevocable trust cannot be modified or terminated by the settlor without court approval or permission from the beneficiary. Under this arrangement, the settlor transfers the assets and all associated rights. This type of trust reduces estate taxes, protects assets and provides access to any government benefits.

### Funded or unfunded trust

A settlor transfers assets into a funded trust during their lifetime. Under this arrangement, the settlor moves the ownership of the assets into the living trust. Even assets with beneficiary designations such as insurance and bank accounts can be moved into such trusts wherein a trust becomes the primary or secondary beneficiary.

An unfunded trust is often funded after the settlor's passing. Such trusts do not hold title to assets until the passing of the settlor. The assets held in these trusts are not protected and this set-up does not meaningfully reduce taxes. It is considered as a preparatory step towards establishing a holistic estate plan.



### Charitable giving

Global philanthropy tracker's 2023 report indicates charitable giving in the year 2020 amounted to approximately USD 70bn. The report also highlights the growing trend of giving, specifically from high-income countries. Philanthropy continues to evolve with the changing preferences and behaviour of donors. Donor-advised funds (DAFs) based grants have seen a meteoric growth of 400% in the past decade. Some of the popular vehicles used for charitable giving are mentioned below:

Fig. 6

Charitable giving vehicles

Aspect	Definition	Benefits
<b>Private foundations</b>	A non-profit organisation created with endowments from the affluent community	<ul style="list-style-type: none"><li>• Promotes multi-generational engagement</li><li>• Enhanced public profile</li><li>• Provides tax deductions</li></ul>
<b>Donor-advised funds</b>	A fund set up through a sponsor (e.g. community foundation, fidelity giving account, peace development fund)	<ul style="list-style-type: none"><li>• Immediate tax benefit</li><li>• Reduces estate and gift taxes</li><li>• Supports charity for specific term</li></ul>
<b>Charitable remainder trusts (CRTs)</b>	A trust that pays income to the donor or heir(s) for a set period and remaining goes to a charity	<ul style="list-style-type: none"><li>• Provides financial support</li><li>• Reduces estate and gift taxes</li></ul>
<b>Charitable lead trusts (CLTs)</b>	A trust that pays an income to a charity for a set period and remaining goes to heirs	<ul style="list-style-type: none"><li>• Reduces estate and gift taxes</li><li>• Supports charity for specific term</li></ul>

Source: Standard Chartered





## Business succession

Any business must undergo ownership transition. To avoid chaos and feuds, it is best to thoughtfully draw out a succession plan. With a succession plan, transitions happen as per the owner's intentions and timeline. JP Morgan's 2023 report indicates that around 76% business owners are likely to consider business succession over the next decade. However, only 35% of businesses have formalised a succession plan. Without a plan in place, owners risk hampering the ability to transfer their business, protect employees' livelihoods and sustain commitment to the local community. Notable methods of business transition include:

Fig. 7

Types of business transitions

Type	Definition	Advantages
<b>Family succession</b>	Transfers within family and involves mentorship	<ul style="list-style-type: none"><li>• Ensures family control and preserves legacy</li></ul>
<b>Management buyout (MBO)</b>	Transfers ownership to existing executives and maintains continuity and business vision. This is financed through loans or strategic investment partners	<ul style="list-style-type: none"><li>• Offers continued leadership and stability of operations</li><li>• Avoids external sale</li></ul>
<b>Third-party sale, or merger and acquisition (M&amp;A)</b>	Sale or M&A to external buyer and involves valuation and negotiation	<ul style="list-style-type: none"><li>• No successor within family</li><li>• Offers monetisation of the business</li></ul>
<b>Employee stock options (ESOPs)</b>	Transfers ownership to employees through ESOP trust. This offers tax benefits	<ul style="list-style-type: none"><li>• Ensures gradual ownership transition</li></ul>
<b>Private equity (PE) or venture capital (VC)</b>	Sale (partial or full) through PE or VC. This offers growth opportunities	<ul style="list-style-type: none"><li>• Ensures phased succession and strategic exit</li></ul>

Source: Standard Chartered

# Conclusion

In a constantly evolving financial landscape, a customised and robust risk management strategy is key for HNWIs to ensure preservation and growth of their wealth.

Technology now allows monitoring of these risks on a much more real-time basis than ever before. Examples of advanced risk management strategies employed to mitigate risks include diversification across alternative assets, hedging, sustainable investing, insurance and estate planning. It is also important to stay abreast of emerging risks and adapt to address them appropriately.

With a dynamic risk management framework, HNWIs can grow and preserve their wealth for future generations.



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