

FINANCIAL SERVICES

# Private Banking in Switzerland

Quo vadis?



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A study by KPMG Switzerland in co-operation with the Institute of Management  
at the University of St. Gallen

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# Foreword

The Swiss private banking industry may be forgiven for feeling that it has spent much of the past year under attack. First the deepening economic crisis. Then the culmination of measures (long sought by many governments, but hastened by the financial crisis) to curtail “off-shore banking”. The question is – is the worst now over?

The vocabulary has changed over recent years... Senior executives are now likely to be using phrases such as transparency, cost control, rationalization, re-positioning, survival, simpler products, suitability, more demanding clients, and more stringent regulation.

The one phrase that all executives in the sector should be using more frequently is “the need for change”. The market is transforming around them, and those service providers that do not adapt will become out-dated, out-competed and thoroughly out-performed. Fortunately, the opportunities as well as the challenges are diverse and far-ranging for those that get it right.

For too long the term “private banking” has implied a homogeneous unit – a single mass of banks with similar behaviors and approaches. This does not reflect the truth. In order to uncover its diversity, we have assessed the Swiss private banking sector in terms of segments and sizes. We segmented the various business models into three broad groups: the so-called “pure player” private banking firms; the universal and cantonal banks with private banking businesses; and the predominantly global “integrated hybrids” with stronger cross-fertilization of clients, products and services.

While there have been a number of studies examining some of the global challenges for the financial services industry, none has examined the Swiss private banking market recently, with its unique characteristics and traits. Many parties cite banking secrecy as a key factor behind the Swiss industry’s success; but is this really the case and what does it mean going forward in the new, transparent environment?

KPMG in Switzerland and University of St. Gallen (HSG) have undertaken research that identifies the underlying business drivers, opinions and some options that are being contemplated. The survey sample represents the majority of private banking and wealth management firms in Switzerland and Liechtenstein in terms of assets (excluding UBS and Credit Suisse which between the two, constitute about half the market). It is clear to us that those organizations that recognize, but above all act on, a need to transform and fine-tune their business and operating models fast enough to respond to market developments are the ones that are most likely to secure sustainable revenue streams.

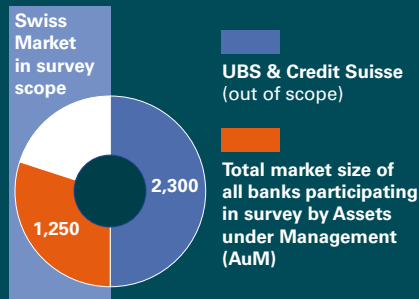
How the Swiss private banking industry faces up to the many challenges and its position as a leader in wealth management remains to be seen, but it will be critical in terms of future success.

KPMG and HSG would like to thank all respondents for their participation in the survey.

# Survey Highlights

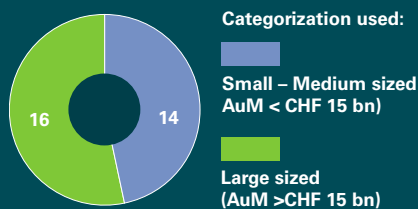
KPMG and HSG survey of 30 private banking and wealth management firms\* in Switzerland and Liechtenstein

**55% of the non-UBS & Credit Suisse market captured in survey: CHF 1,250 bn**  
Survey participants relative to Swiss\* market size (CHF billions)



\*Plus Liechtenstein banks: CHF 160 bn

**30 banks participating in survey**



- Survey research method: dual approach
- Qualitative face-to-face interviews with C-levels followed by:
- Quantitative questionnaire

## Industry landscape

1. Confronted with fundamental change, private banking is currently in an assessment phase. There is much to do in terms of overcoming the challenges as well as determining how to address the increasingly restrictive regulatory and legal environment. The risks of cross-border business activities have increased.
2. The growth in private banking will occur primarily outside Switzerland. The traditional strengths of the Swiss financial center (e.g. client banking secrecy, lower tax burden and other advantages such as stability) and strengths of a Swiss private bank cannot readily be exported. To which degree the private banking industry in Switzerland is able to capture future growth is open to debate. Almost all private banks still plan to hire Client Relationship Managers (CRMs), however only one quarter are satisfied with stated asset transfer objectives. Banks which do not currently have access to foreign markets might struggle more in the face of intensified competition in a contracted Swiss market.
3. In Switzerland, consolidation in the industry is accelerating and likely to take place mainly among the small to medium sized banks (less than CHF15 billion AuM). Currently, larger banks (more than CHF15 billion AuM) see good M&A opportunities, providing the strategic fit makes sense. Potential buyers remain cautious though and are being prudent in making moves. The private banking industry in Switzerland will see an increased intensity of competition and a trend towards larger critical size in the future.
4. Opinions regarding market size and Net New Money (NNM) growth or decline in the Swiss private banking sector over the next few years vary greatly. Smaller “pure player” banks are more pessimistic in their outlook. Overall, when weighted amongst the large and smaller banks – the industry as a whole could see “zero” growth. Realistically, the sector should be prepared for a decline over the next three years, unevenly felt. Much will depend upon the industry’s response to, and the global ramifications of, changing tax rules.

71%

Believe that the Swiss private banking industry must transform to overcome the challenges faced

79%

Believe current challenges will lead to industry consolidation

57%

Believe that the private banking industry will grow outside Switzerland over the next three years

67%

Believe that the traditional off-shore banking business will decrease over the next three years.

68%

Believe that good M&A opportunities exist and valuations are attractive

29%

Believe that the private banking industry will grow inside Switzerland over the next three years

5. The promise of emerging client segments such as from Asia holds promise for those banks that are well positioned, offer the right value proposition and have the right cultural fit and segment knowledge. Larger banks have an advantage here versus small-medium sized banks. This is no panacea and no quick win for the industry as a whole.
7. Regulatory changes (bank secrecy, application of OECD Standard 26 etc.) have a potentially massive impact upon the future business model and may lead to a decline in off-shore business. The increasing tendency to prosecute or criminalize CRM activities in various countries increases liability and reputational risks.
9. The pure players, which focus their core business on private banking are expected to increase their market share. In particular, they will be successful if their size and business and operating model can be successfully adjusted by focusing on their USP (possibly updated). Independent Asset Managers are favorably regarded in attracting niche market share. Overall, large pure players and integrated hybrid banks are the most optimistic about growth prospects.

### Catalysts for change

6. There is a noticeable downward pressure on gross revenue margins. Smaller banks may be hit harder. In this regard, the larger private banking firms that possess a greater array of options in adjusting their business models and scale have a considerable advantage. Systematic cost optimization excellence is only practiced by a small minority – the focus thus far has essentially been more shorter term tactical cost reduction measures (i.e. less than 10 percent).

### Business & operating models

8. Regarding future business models: differentiation, open architecture, client centricity, lower risk and understandable products, improved client reporting and comprehensive client advisory, integrated risk management culture all play a central role. In general, there will be less “product pushing” and greater individual client focus. Differentiation includes how the bank demonstrates “outperformance” in their asset management offering. Differentiation will also focus on the client interaction. Who produces the financial product is no longer important – much more important is that it is the right product for the client. Demonstrating competency is key.
10. Private banking will above all need to differentiate itself by so-called “value drivers”. Specifically, the core value proposition is based upon client servicing as well as being specialized in at least one area of Research, Portfolio and Asset Management. Less client facing activities such as Fund Administration and Custody Services as well as IT and Infrastructure are often outsourced.

\* The terms “private banking” and “wealth management” are used interchangeably for the purposes of this publication.

# 14%

Believe that profitability / gross revenue margins are sustainable

# 96%

See clients are demanding increased transparency from their bank and simpler to understand products

# 93%

Plan to hire Client Relationship Managers (CRMs) over the next three years

# 88%

Believe that the intensity of competition within the private banking industry will increase

# 64%

Plan to expand open architecture offerings

# 40%

Believe that private banking has become more of a commoditized business

# Section 1:

## Industry Landscape: market size, M&A and consolidation

### Market size of the Swiss private banking sector

Determining the precise size of the Swiss private banking market is difficult, but KPMG's private banking database of 112 private banks in Switzerland estimated it to be around CHF4.7 trillion in 2008.<sup>1</sup>

The private banking sector is highly fragmented, though the top end of the market is concentrated, with the top two players (UBS and Credit Suisse) and 11 larger sized private banks (AuM greater than CHF50 billion) together managing 77 percent

of the market. UBS and Credit Suisse manage half of the total assets. The part of the market that is most fragmented, and where we expect to see the greatest change and most opportunities for consolidation, is among the smaller banks. There are 26 banks (AuM greater than CHF15 billion and less than CHF50 billion) managing approximately 16 percent of the Swiss market and a further 73 banks with AuM less than CHF15 billion representing seven percent.

According to the SNB, approximately CHF2.2 trillion<sup>2</sup> or 56 percent of the

total securities holdings in Switzerland relates to non-residents (offshore clients), however we note that this does not include the cash holdings of HNWI's. Between 2004 and 2007 non-resident securities grew by a CAGR of 16 percent.

<sup>1</sup> AuM according to KPMG's database (total of 112 banks) includes all securities net of double counting of own bank fund investments according to their statutory reporting  
<sup>2</sup> SNB statistics 2008: SNB statistics are based on the securities holdings in bank custody accounts which excludes balance sheet assets (cash and cash equivalents)

Chart 1 – Swiss private banking market by bank size (AuM)

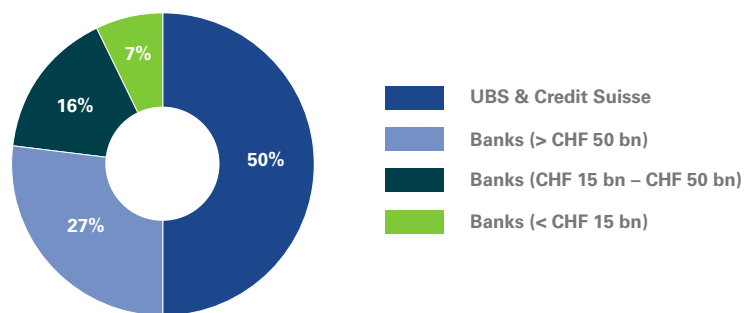
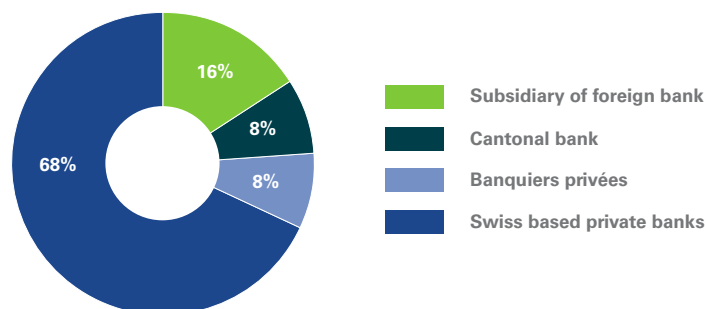


Chart 2 – Swiss private banking market by bank type



**European Union (EU) citizens' undeclared assets – the threat**

The current pressure on perceived tax haven countries such as Switzerland represents a potential risk to offshore assets booked in Switzerland should the undeclared assets of private banking clients be repatriated to their respective home country. In the absence of statistics on the precise size of this market, we provide an estimate below derived from the SNB data for 2008 and statistics from the Swiss Federal Department of Finance on EU withholding tax. This estimate of the "at risk" assets is considered as part of our assessment of the Swiss private banking market growth expectations.

**Growth expectations for the Swiss private banking sector – a cause for optimism?**

More than half (57 percent) of respondents expect the industry to grow outside Switzerland, whereas

29%

Believe that the industry will grow inside Switzerland over the next three years

less than one third (29 percent) see the industry growing within Switzerland over the next three years.

There are polar views between large and small-medium banks. Three quarters of larger banks tend to see growth prospects outside of Switzerland with intentions to expand their onshore businesses which would limit the risk of European asset repatriation of undeclared assets. Smaller banks think there is too high a price to pay and plan to develop their client relationship manager (CRM) teams and services to reach out and fulfil the needs of their offshore HNWIs. We would question if enough Swiss banks in their current form are well positioned to take best advantage of this trend. Are their business models conducive to retaining or capturing business outside of Switzerland? Are they positioned in a way which will

57%

Believe that the Private Banking Industry will grow outside Switzerland over the next three years

enable them to service foreign clients on a "compliant" cross-border basis out of Switzerland? Can they compete against home-grown players in the clients' respective domiciles?

Fifty percent of participants believe there will be growth of between zero percent and 25 percent, while 36 percent believe that there will be a decline of between zero and greater than 25 percent in the Swiss private banking market over the next three years. Larger banks are about twice as optimistic as the small-medium sized banks. These conflicting findings reflect the continued source of new emerging wealth from markets such as the Middle East, which is an opportunity for some banks, while losses are highly dependent on the speed of asset repatriation and pressure from EU governments.

Chart 3 – Resident / Non-resident development

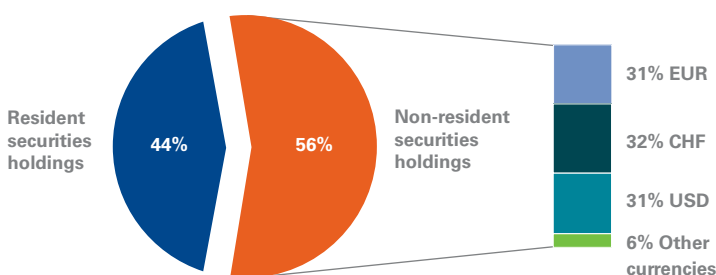
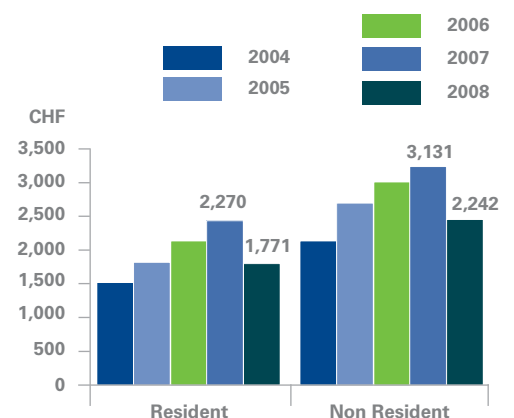


Chart 4 – Resident / Non-resident development



When we assess the long term growth expectations for the Swiss private banking industry we see on the negative side the potential outflow of European client assets booked in Switzerland and on the positive side growth in worldwide wealth along with improved performance returns as the financial markets recover.

**Loss of European undeclared assets**

Using the SNB statistics for non-resident securities and holdings and the findings of the Swiss Federal Department of Finance, we assume approximately half of the non-resident securities holdings are EU clients, of which 80 percent are undeclared in Switzerland, resulting in 40 percent of

the non-resident securities holdings from EU clients being “at risk” (approximately 20 percent – 25 percent of the total Swiss private banking market).

We assume the risk of the Swiss private banking industry losing the 20 percent – 25 percent stated above to be the worst case. More likely it may be approximately 10 percent – 15 percent.

**Positive growth of worldwide assets**

Growth expectations for worldwide assets is 8.1 percent<sup>3</sup> per annum to 2013. Switzerland has long been

<sup>3</sup> “World Wealth Report 2009” Cap-Gemini and Merrill Lynch

the center of wealth management expertise and continues to attract NNM from emerging wealth regions such as the Middle East, Asia and more recently Russia and Central and Eastern Europe.

**Return of asset values**

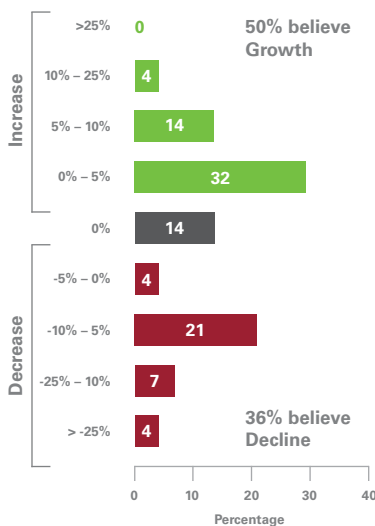
In the seven months to July 2009, the securities holdings of the Swiss private banking industry grew by approximately eight percent according to the SNB. This was driven largely by the rally of equity values across Europe’s major exchanges.

**The implications...**

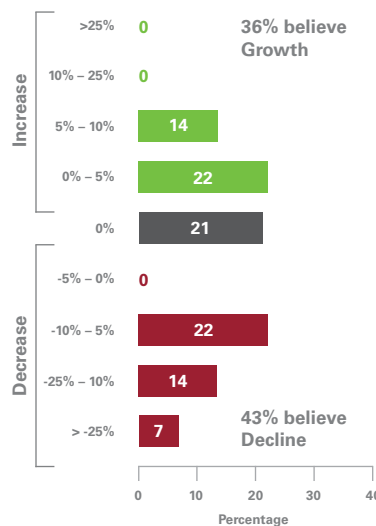
We expect that the potential repatriation of European citizen assets

Chart 5 – What will be the percentage growth or decline in the Swiss Private Banking industry in the next three years?

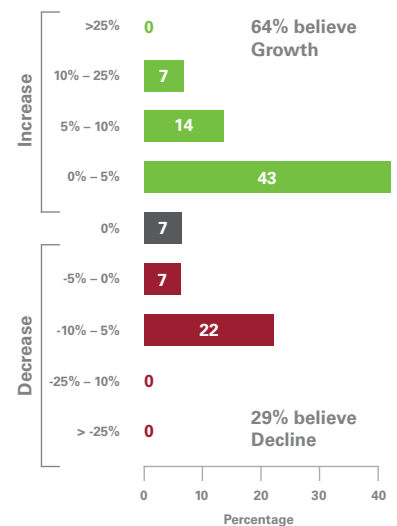
**All respondents**



**Small-Medium banks (AuM <CHF 15 bn)**



**Large banks (AuM >CHF 15 bn)**



to onshore banks is likely to result in Switzerland losing market share in the short term on the world stage. Overall, AuM may fall by between zero percent and ten percent, a substantial decline compared with historical growth rates of 15 percent between 2004 and 2007. There are many variables which could influence the precise figures, which includes the extent to which the Swiss private banking industry can address

the challenges. This is not expected to have a long term material impact on Switzerland’s position as a wealth management center if Swiss private banks adjust their operating models to the new world order.

**Consolidation – is it ever going to happen?**

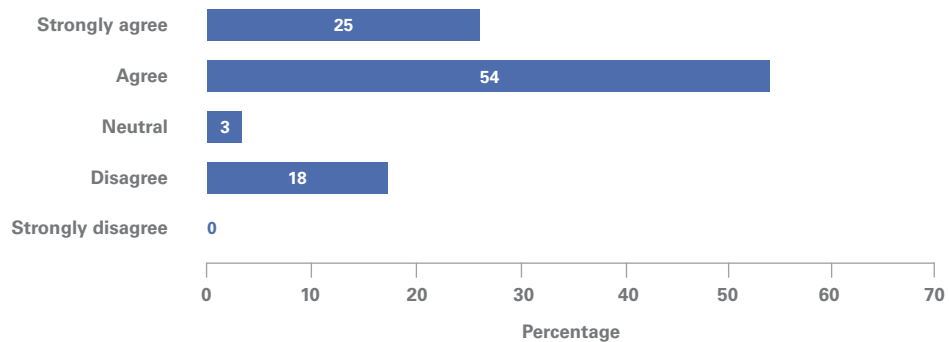
Consolidation within the private banking industry has long been talked

about. In the previous three KPMG global private banking surveys “Hungry for more”,<sup>4</sup> respondents believed that deal activity will increase with fewer players having greater market share.

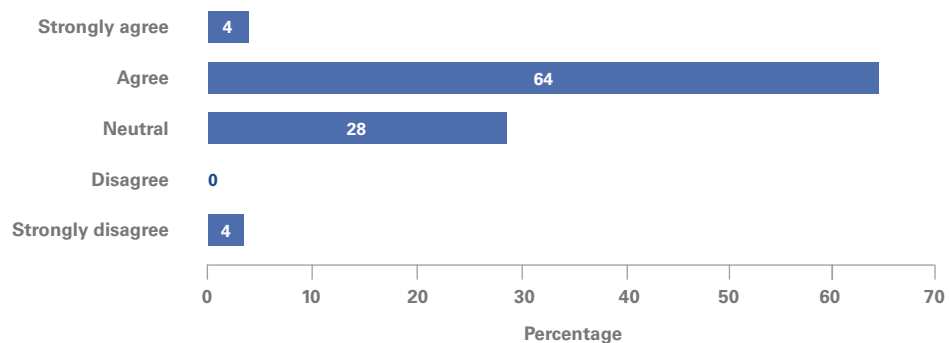
This has not happened in Switzerland, due largely to limited opportunities and high prices (very often in the range of

<sup>4</sup> KPMGs “Hungry for More?” 2006, 2007 and 2009

**Chart 6 – Current challenges in our industry will lead to industry consolidation. Fewer players will have a higher market share**



**Chart 7 – Currently, good M&A opportunities exist and valuations are very attractive**



We believe the consolidation of the Swiss private banking sector will accelerate – the challenges that exist for private bankers in Switzerland mean that M&A is more likely now than it has been recently:

- Increasing competition: 88 percent of respondents are convinced that competition will increase over the next three years
- The erosion of banking secrecy and the perceived benefits taxation benefits
- Repatriation of European offshore banking assets due to tax amnesties such as in Germany, Italy and the U.K.
- Sale of foreign owned subsidiary private banks in Switzerland due to the need for capital and the restructuring requirements of the EU on foreign banks that receive government support
- Increasing regulation: particularly impacting smaller banks where the increasing compliance costs may lead to continued poor returns
- The trend points to larger sized banks and depending upon the amount of markets served, degree of product and service, and business complexity - size is increasing across the industry.

equity plus 3.0 percent to 4.5 percent of AuM). The price expectations of buyers and sellers were historically wide – we have seen fewer than ten completed transactions with private banks in Switzerland greater than CHF5 billion AuM in the last two years. So why should it happen now?

Seventy nine percent of respondents believe that industry challenges will lead to consolidation. In addition, 68 percent of respondents believe that there are good M&A opportunities in the market and that valuations are attractive. This view is very different to the previous three “Hungry for more” surveys, where participants named higher prices and the lack of opportunities as the key reasons why transactions did not happen.

Recent transactions in Switzerland support the consolidation trend, with prices being in the range of 0.5 percent to 1.5 percent of AuM. Recent examples include the Swiss private banking operations of AIG, Dresdner, Commerzbank and ING.

Despite opportunities existing for Swiss banks, more than 85 percent of participants believe that growth through M&A is risky and have recently focused on acquiring smaller, bolt-on CRM teams. Ninety three percent of all respondents intend to increase the number of CRMs over the next three years despite the fact that only 25 percent are satisfied that

CRMs actually achieve their stated asset transfer objectives. Strikingly, about 43 percent across all banks were not convinced either way. Pure player CRMs enjoyed slightly more success with asset transfers. Hiring CRMs is above all the most favored approach to private banking growth with perceived medium risk and, generally speaking, representing a good source of new client AuM.

Given the current challenges for private banking in Switzerland it is likely that consolidation in the sector will gather pace in 2010, particularly for the foreign owned subsidiary banks and small to medium sized private banks. This is the sector of the market that is highly fragmented, is under the regulators microscope, is suffering from relatively poor performance and is ultimately where the competition battle may be won or lost.

# Section 2: Catalysts for change – the impending transformation

### Margin pressure as a catalyst for change?

Margins will be squeezed still further, in our view, as lower asset yields and fewer structured products lead to lower margins in the potential new era of “declared assets” together with the additional costs associated with increased compliance. Products and services aside, the greatest driver will ultimately be sustaining margins.

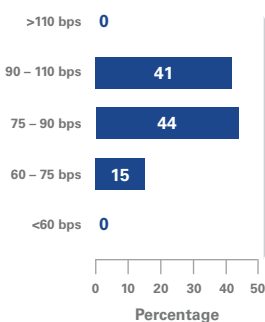
Many clients may of course continue to pay a premium for perceived value, quality, brand and stability. However, many of the younger generations of HNWI’s (i.e. new and inherited) are prone to be less stable in their choice of private banker and may go for best value rather than base their choice of service provider on loyalty or past relationships.

### Size more important than business model, but model may still be the key

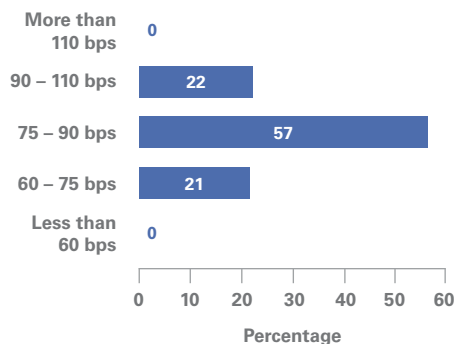
A difference in margins between the various business models was identified mainly in the mid-range. Integrated hybrids’ believed that the 75-90bps margin range was realistic, which was the highest of the respondents in that range. Interestingly, almost half of all respondents are unsure when asked about the future sustainability of gross margins.

Chart 8 – What is your gross revenue margin target (in basis points) on your AuM which you will be realistically able to achieve given the current situation in the next three years?

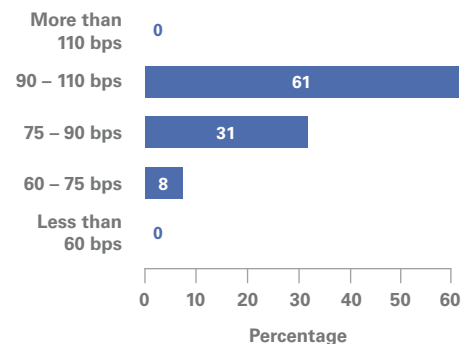
#### All respondents



#### Small-Medium banks (AuM <CHF 15 bn)



#### Large banks (AuM >CHF 15 bn)



14%

Believe that profitability / gross revenue margins are sustainable

Size, on the other hand, did make a difference. Sixty one percent of the larger banks surveyed see gross margins in the 90-110bps range compared with 21 percent of small and medium-sized banks. Conversely the 75-90bps range represented only 31 percent of the larger banks yet 57 percent of the small and medium-sized.

The majority of respondents were not convinced they would be able to continue to sustain margins at current or past levels. Despite being relatively close, most still see gross margins falling to 75-90 bps, though 21 percent (the small-medium sized) expect the range to be 60-75bps when drawing comparisons to “on-shore” peers.

Questions arise as to how banks can stem this pressure. What impact on margins will brand and reputation play? To which aspects will clients attach

**67%**  
Believe that the traditional off-shore banking business will decrease over the next three years

most value? Might some banks choose to focus on higher-end products and drop some lower earning services? The answer may be in refocusing the business and operating model.

Rationalization, alignment of client segments with the service and product portfolio, and better strategic cost optimization may be the name of the game given the complexity and compliance requirements of some services. Therefore, their business and operating model may undergo a transformation which will include “right-sizing” priorities.

Despite accepting that margins might not be sustainable at current levels, it was striking that respondents generally did not consider margins to be dramatically under threat. Of those that expressed concerns, it was the smaller

players who were most pessimistic. Pure players seemed to pin their hopes on improving client service quality and orientation as a means of being able to realise higher margins. This will further put the squeeze on small-medium sized banks in terms of sustaining their income.

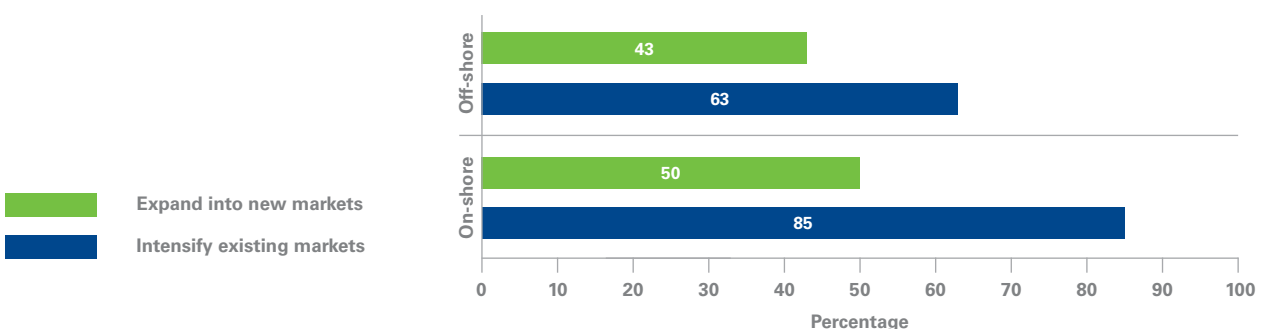
**Off-shore business under pressure**

Off-shore banking has come under increasing pressure. This has encouraged private banks to look beyond and favor a strategy paying due attention to on-shore business.

The precise meaning of “on-shore banking” depends upon the perspective of the bank. It is generally interpreted as being the provision of banking services to a client through operations based, and assets booked, in the client’s country of domicile. For the Swiss private banking industry this means either the bank focuses

Chart 9 – Business and Operating Models: On-shore / Off-shore strategies

**All respondents**



on-shore within Switzerland and / or in addition operates on-shore in the client's country of domicile. "Off-shore" is commonly meant to imply the opposite of an "on-shore" client, i.e. non-Swiss domiciled clients booked in Switzerland.

A move towards on-shore banking could be hugely significant for Swiss banks. As 88 percent of all respondents judged that competition within the industry will intensify, along with opinions that the Swiss market could possibly contract, the question is whether there will be too many banks chasing too few client assets for on-shore domestic private banking in Switzerland. Attention has therefore turned to considering the potential of on-shore banking within the client's country of domicile. The risks are high from an operational as well as a regulatory viewpoint.

# 54%

Believe it important to expand into new markets abroad

With mixed results, the past five years or so have seen a surge of Swiss private banks, including cantonal banks, establishing branches and subsidiaries around Europe. Not only has this strategy been costly and the benefits to be realized in the long-term, many banks have been caught by surprise by the regulatory burden, funding costs and

adaptation required, which can affect their cross-border operating model. Further hurdles can be around choice of local distribution network and partners, and cultural aspects, among others.

Perhaps it is time to consider less explored routes to markets. Could banks adapt to the new regulatory and tax environment by passporting existing EU subsidiaries under MiFID (Markets in Financial Instruments Directive)? Or seek new ways to offer their services in-country based from Switzerland via specific country exemptions of local banking licence requirements in Europe? We are aware of such opportunities which do in fact provide a certain degree of flexible off-shore strategy in a compliant manner. No matter what, a review of cross-border business models would be desirable, or even necessary. Getting smart about dealing with regulation to your advantage in the future is essential to ensuring that your business can function and opportunities can be captured. Regulation per se need not always be a negative thing.

# 61%

See growth opportunities in addressing new client segments and types

### **Burgeoning client segments: Look East! But no panacea**

Private banks may decide to focus on the high growth markets in Asia and the Middle East. Fifty four percent of all respondents attributed a high importance to expansion into new markets abroad. This strategy however is interpreted as highly risky by 68 percent of all banks. The issue here is how portable the Swiss banking model is. Some of the traditionally strong selling points such as discretionary, managed mandates, tax advantages and particular service standards do not necessarily translate into advantages in the Asian market for instance, where there is typically a preference for non-advised type models. Some of the respondents mentioned Asian client investment behavior and their reasons for selecting a private banking relationship are different from that of a European or Swiss client. This is a segment where clients tend to take much more active control over their assets. Establishing a new local presence in Asia may be highly desirable but is also an expensive, riskier proposition with long lead times. The cultural fit is important according to many respondents.

### **Greater information and transparency**

Four out of five integrated hybrids recognised that clients want simpler to understand, less risky products. Perhaps this is due to the experience of these banks in foreign

markets, that they can bring to bear in Switzerland. Interestingly, it was largely the integrated hybrids that were instrumental in creating some of the more complex financial products in the past. In our opinion, a combination of regulation and market pressure has led them, and others, to be more realistic about current client expectations.

An overwhelming 88 percent of respondents across all segments agreed that clients increasingly value reporting that is analytical, frequent, clear and comprehensive. Meeting these expectations will for many banks require investment in processes and systems. Above all, it is a case of the bank obtaining the information it needs, rather than simply a matter of technology. The current economic crisis and the consequent regulatory and other pressures make the quest for information ever more critical.

To date, the Swiss private banking sector has typically done a good job at satisfying its clients' needs. However, further improvement is necessary if the sector is to retain its lead over competitors. As liability claims are on the increase, there is more regulation, and greater client demands for regular and transparent reporting, action is required. It seems that aside from regulation, it is also the clients themselves who are demanding such. This runs contrary to the views of many smaller banks. Perhaps they have not yet been confronted with real challenges in this regard, or they perceive themselves as already offered the required comprehensiveness.

**The industry's viewpoint on fees and transparency:**

When it comes to fees and transparency there are some stark differences amongst segments

96%

See clients are demanding increased transparency from their bank and simpler to understand products

and sizes. Fifty seven percent of respondents agreed that clients are demanding greater fee transparency. Fifty percent of clients are also increasingly challenging the traditional "all-in" fees and bundled services. However, "all-in" fees can have advantages in the context of discretionary mandates and it is interesting to note that pure players saw this threatened by clients.

We explored one of the well-known themes that private banking clients are not overly concerned with price if quality, service and satisfaction criteria are met. Of all banks surveyed, only 18 percent disagreed with the notion that clients are increasingly demanding fee reductions. Therefore, clients are challenging the private banks on the value they receive relative to fees.

Chart 10 – Business and Operating Models: Client issues

**All respondents**



Interestingly, when we examined the pure players we saw similar responses that clients were in fact demanding fee reductions. The integrated hybrids are essentially in their own class as they see clients asking for less than half the fee reductions. However, they also admitted that clients are demanding increasing transparency about their fees. The differences between the large and small-medium bank paints a similar picture. Large banks see that only 21 percent agree that clients are

increasingly demanding fee reductions versus the small-medium banks that experience this more by almost threefold. However, on attitudes towards greater fee transparency there is no real difference across the banks and they agree that this is one of the catalysts for change.

*“The client and bank can have a very different perception of value in a private banking relationship. For example, banks proudly state that their value lies in stability, brand etc. However, clients tend to place a higher value on the more tangible items such as excellent and error free reporting as one way in concretely measuring what’s being done with their assets. This value should not be under-estimated.”*

*CEO of a large Integrated Hybrid*

88%

Believe that clients value reporting which is comprehensive, analytical and frequent

89%

Believe clients are expecting comprehensive advice regarding their investment objectives & transparent information on risk

57%

See an increasing trend that clients are demanding greater fee transparency

40%

See an increasing trend that clients are demanding fee reductions

# Section 3:

## Private banking business models and their propositions

### Value propositions: in terms of size (AuM) of bank

Secrecy and discretion:

- Small-medium: 50 percent include in their value proposition
- Large: 79 percent do not include it in their value proposition

Brand reputation:

- Small-medium: not the deciding factor (50 percent)
- Large: attach the same importance (50 percent)

Client centricity:

- Small-medium: also important (57 percent)
- Large: attach greater importance (86 percent)

Quality of service:

- Small-medium: only slightly more than for one third (36 percent)
- Large: important for more less than half (43 percent)

### Business model differences: value proposition characteristics

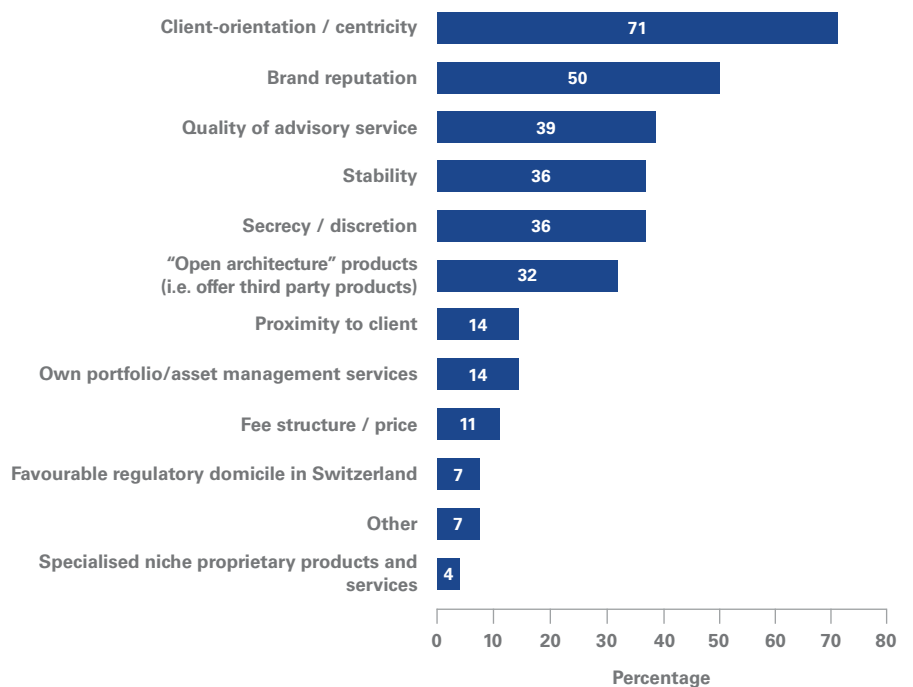
In order to illustrate the diversity of the Swiss private banking sector, we have analyzed the survey participants' responses based on value propositions and have segmented the various business models into three broad groups:

**Integrated/hybrids** (primarily global players): rely on their brand reputation and attach relatively high importance to client orientation and centricity. They further distinguish themselves from other types as they do not focus their value proposition on secrecy.

Important features include client cross-selling, market access and leverage expertise across the group (such as from their investment banking and asset management businesses) for the benefit of bank and client alike.

**Pure players:** client orientation and centricity is their top priority and USP while they also rely on discretion and secrecy advantages coupled with a solid brand reputation and stability. They also believe that providing "independent" advisory to their clients is important and are prone to expand "open architecture" offerings.

Chart 11 – The most important aspects of the current private banking value proposition



### Private banking operations of universal / cantonal banks:

distinguish themselves from the other two types through their proximity to clients (i.e. within a region) and quality of service promise. Stability is a further USP, though they focus less (relatively speaking) on client orientation and centrality. They also consider secrecy and discretion to be important.

### What is being changed and by whom?

In terms of changing business models and approaches, just fewer than 60 percent of respondents intend to change their value propositions in the next three years. Large banks (64 percent) feel slightly more urgency in doing this compared to small-medium banks (50 percent). The greatest changes are expected to occur at both universal banks and integrated hybrids, of which the hybrids by and large have not changed their value proposition in the recent past. Pure players appear

## 40%

Believe that private banking has become more of a commoditized business

to have focused on this already over recent years, and about half intends to pursue changes in the next three years. The test will be whether the modified propositions of pure players will stand the test of time given the number of changes the private banking sector is undergoing.

### No “one size fits all”

The suitability and potential prospects of a bank’s business model can be determined by a number of factors, including transparency, reputation and differentiation, scale and global footprint, management of conflicts of interests, and value proposition (with the sub-elements of brand, reputation, value proposition and distribution relationships).

While 40 percent of respondents held that private banking is becoming more of a commoditized business,

## 60%

Believe that the “pure player” advisory model will gain market share over the next three years

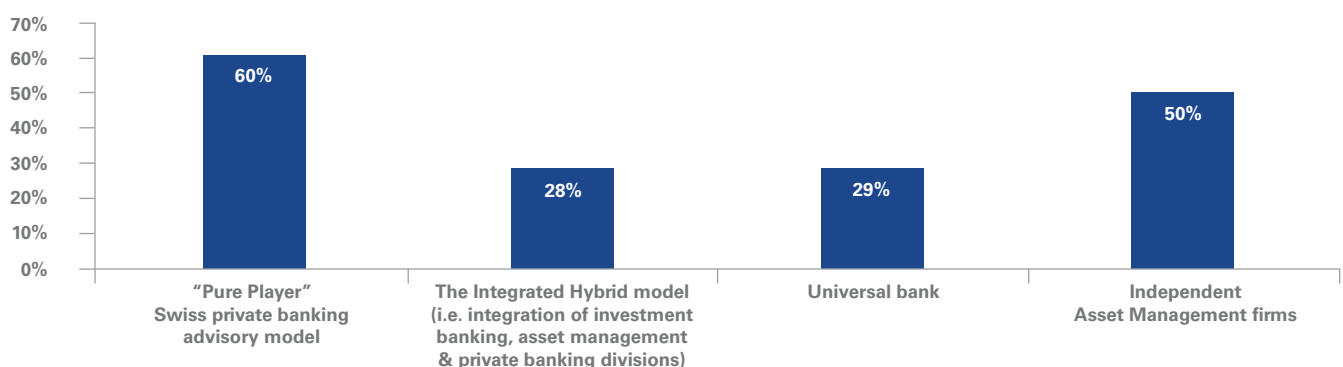
75 percent of them believed clients acknowledge the differentiation of their bank over others. The obvious question here is whether banks may falsely believe they are unique.

### Which business model will likely gain private banking market share in the next three years?

Sixty percent of respondents agreed that the **pure player model** would be the one to gain market share over the next three years. Interestingly, the pure players themselves were mixed in their response, while the integrated hybrids viewed the pure players’ market share increase with more certainty.

The life of a pure player is not without risks, however. They must ensure that they do in fact provide impartial and independent advice which clients expect. Those that lack the scale to modify USP or are found to push too

Chart 12 – Which business model will gain market share in the next three years?



many “own” products are especially vulnerable in this age of transparency unless the bank can demonstrate to a more inquisitive client base that their product is the best in terms of suitability for the client.

Pure players might be hindered by their market reach, client segment type, high fixed cost base or exposure to developments in off-shore markets which means they must specialize in order to succeed. Pure players consider their core competencies to include their research, asset and portfolio management function. As a result, more than four out of five players have these functions in-house and would be reluctant to consider outsourcing them.

Mixed reactions met the proposal of **integrated hybrid** models, with only 28 percent believing this model to be sustainable in gaining market share within the current environment of enhanced transparency and avoiding conflicts of interests. The primarily global players who adopt this model, however, believe client cross-selling, market access and presence, and access to expertise, all bring real and distinct benefits for bank and client alike.

Approximately half the respondents believe the **independent asset manager** model will grow over the next three years. These firms are typically very small one to five person firms, often ex-CRMs from larger banks. The central attraction

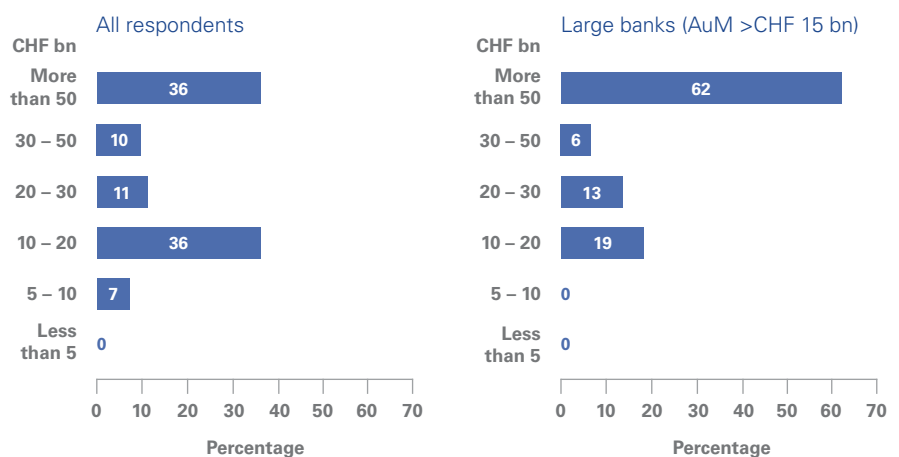
is the provision of impartial advice. Respondents also perceived an improvement in professionalism among independent asset managers and even viewed them as potential partners to their own organisations. The model does have its flaws. Key issues include: limited scale, client lifecycle and succession, a future of more stringent regulation and the potential licence requirements may all hit the industry hard.

**Critical size: the future points to larger not smaller pure players**

There are various opinions concerning the critical size required to run a “multi-shore” strategy. We researched what industry leaders believed was a sufficient critical size for a private bank to provide an adequate range of services and products supported with an adequate level of infrastructure based out of Switzerland

for international on-shore expansion. Overall, the respondents approached this in two groups. Thirty six percent believed that the minimum critical size should be greater than CHF50 billion while another grouping of CHF10 billion to CHF20 billion was as well identified by 36 percent of the sample. Not surprisingly, 62 percent of the large banks believed the critical size was greater than CHF50 billion and most of the integrated hybrids shared this opinion. The small-medium sized group also indicated that below CHF5 billion was not viable and only nine percent thought a size within the range of CHF5 billion to CHF10 billion was somewhat viable. The trend points to a larger critical size and depending upon the amount of markets served, degree of product and service offerings coupled with business complexity, size requirements are increasing across the industry.

Chart 13 – What is the minimum critical size in terms of AuM for private banks to support international on-shore expansion? (in CHF billion)



# Section 4: The use of “Open Architecture”

64%

Plan to expand open architecture offerings

Sixty four percent of all respondents said they intend to expand their service and product offering via open architecture. Thirty two percent said creating an open architecture was one of their most important cornerstones of their current value proposition. This suggests that the idea is gaining a strong appeal.

Who produces the financial product appears to be less important than whether or not it is the most suitable product for the client. This implies more flexibility over sourcing the product, and a more client centric attitude. The bank will need to demonstrate a product selection competence, especially if selecting one of its own products, in order to persuade the client of its value.

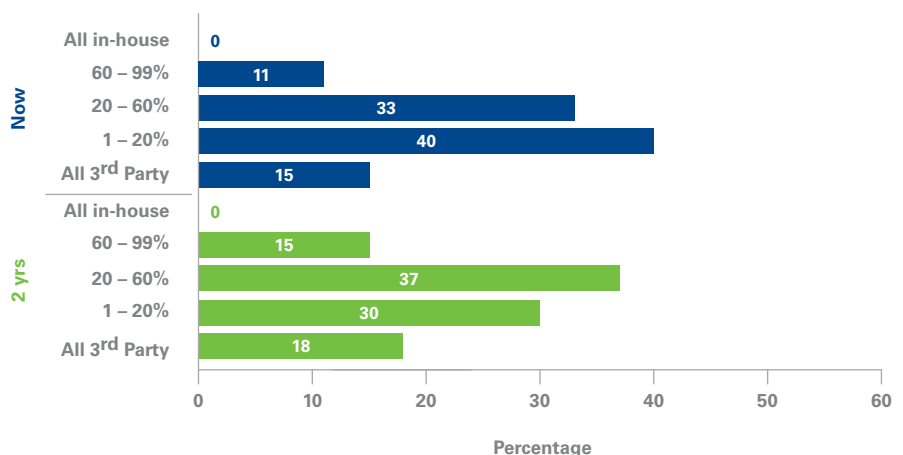
When the relationship of “own” and “third party” product offering mixes are compared, there appears to be a slight tendency to actually increase the share of own product use within the next two years. However, pure players are also showing tendencies to increase both third party and own products.

In terms of offering open architecture in their current value proposition, pure players seem to be leading slightly here, while integrated hybrids also see this as a feature.

Interestingly, those banks that have already made recent changes to their value proposition indicated open architecture as one of their top three core value propositions. This contrasts

Chart 14 – What is your percentage of products offered that are produced “in-house” (“own” products)

**All respondents**



with banks that have not changed their value proposition recently (and do not intend to do so in the future) where open architecture does not feature in their value proposition.

Discussions concerning product trends resulted in wide-ranging views on which will be the “next wave” that could match the higher margin structured products. No next “mega trend” concerning products was identified. It should also be recognised that clients may increase their risk appetite again once their confidence in the market, economic recovery and their bank reaches a higher level of comfort. There was a general consensus that the bank should not just create another product for the sake of it.

#### Some product and service trends

- Provision of transparent and independent advisory services
- Sustainable investment products
- Active management of fixed income products
- Capital protection and liquidity management
- Open architecture platforms
- Behavioral investing
- Core and satellite portfolio management
- Combining discretionary and advisory mandates
- Family office and financial planning, with tax services
- Relocation services

## Section 5: CRM growth and excellence

What's in a name? The Client Relationship Manager (CRM) or the Client Advisor? Both terms are used to describe the function that interfaces with the client, but their role and profile are undergoing dramatic changes. Across all banks, approximately 90 percent are convinced that hiring CRMs to grow AuM is vital to their organic growth strategy.

Furthermore, within excess of 90 percent of banks expressing a firm intention to hire CRMs within the next three years, the demand for these individuals will be extremely high. Where will they all come from?

Sixty one percent believe that the market in Switzerland is favorable, though only 25 percent have really been satisfied with past asset transfer levels. Strikingly, a transfer rate of only 15 percent to 25 percent was seen as realistic by about 40 percent of the sample (only 14 percent disagreed). This suggests that actual transfer rates are on average close to this. Pure players were more satisfied with their newly hired CRMs meeting stated asset transfer objectives.

During the interviews, we also determined that a few large pure players claimed to have average asset transfer rates of 40 percent. They explained that the success is based on an holistic approach of very diligent candidate selection, examining the potential asset quality and its history plus a combination of technical and

soft skills. Quite often, whole teams or sub-teams are acquired rather than the individual CRM. Overall, this process can span anywhere from one to two years by the time clients actually transfer their assets to the new bank. These same pure players also displayed relatively advanced methods, processes and tools to measure the performance of client relationship managers.

Increasingly, asset "hunting" versus "farming" skills of existing CRMs are being challenged. Sixty one percent of the respondents believed that their existing client relationship managers were better at managing existing client assets than acquiring new assets. Pure players shared the same opinion, judging that their CRMs were better at "farming" rather than "hunting" (i.e. acquiring) new client assets. Therefore a change from the stereo-type "wine and dine" CRM profile could be in store and a transformation needed. There was almost unanimous agreement that improvements are needed to CRM's financial qualification skill set, increased regulatory know-how plus a combination of soft skills in order to cope with an ever more complex future in private banking.

During the interviews, some pure players elaborated that their vision for excellence in the client advisory experience centers on distancing the actual investment decision process from the CRM, with CRMs instead focussing on selecting the

### 93%

Plan to hire Client Relationship Managers (CRMs) over the next three years

### 25%

Are satisfied with newly hired CRMs achieving stated client asset transfers

### 61%

Judge that their Client Relationship Managers (CRMs) are better at managing ("farming") than acquiring ("hunting") new client assets.

right investment strategy and risk preferences (i.e. behavioral finance) with the client. This should follow a highly structured suitability assessment of the client, truly assessing their risk appetite and realistic investment horizon. Approximately 80 percent of pure players recognised the imperative behind this, acknowledging that clients expect comprehensive advice regarding their investment objectives and to receive transparent product and market risk information. This should lead to an improved, consistent client advisory experience. Despite acknowledging the issue, only some banks have yet undertaken this change.

Asset management and optimization decisions concerning investments should be done by thoroughly trained specialists, with on-going monitoring of client portfolios independent of whether or not there is currently a mandate for such. By doing this, the private bank can demonstrate its competency and value proposition more clearly to ever more discerning clients.

# Section 6:

## Cost optimization – a business imperative

Today’s market demands a robust approach to cost optimization. A fundamental review of the operating model, embedding rigorous cost management disciplines and functional efficiencies are all required. We have found that there is generally no institutionalised cost cutting culture and little still concerning strategic cost optimization. Most measures tend to be of a shorter term tactical nature.

Supported by the findings of our survey, we believe the huge challenges to the private banking business and operating models necessitate the banks first understanding their strategic direction and value proposition before they can embark upon aggressive cost reductions. More see investment in growth as taking precedence over cost control. We question whether this will be enough.

**52%**

Expressed satisfaction that past cost optimization initiatives have brought sustainable benefits

### Sixty five percent of banks see no need to take action within the next three years

We estimate that the cost base of the Swiss private banking industry between 2003 and 2007 increased at approximately the same rate as asset growth over the same period. However, from the end of 2007 to 2009 banks saw assets fall by an average 25 percent.

It is commonly accepted that private banking is a high fixed cost industry largely due to its high labor costs. One might therefore expect cost reduction programs to be at the forefront of many banker’s minds. Only one third appeared to see the need for action within the next two years.

The results show that 42 percent of banks do not see sustaining their current cost structure as an issue. Fifty percent of the large banks took this view compared to 36 percent of their small-medium sized counterparts.

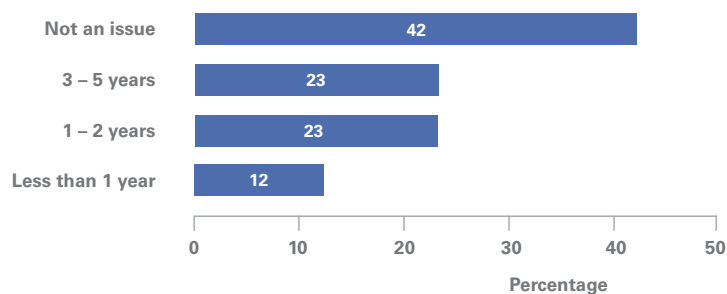
### Assuming a need for action, what is being done about it?

Aggressive cost reduction measures and strategic cost optimization do not (yet?) appear to have taken root. The results suggest that over the past year, cost reduction measures have been of a short-term, tactical nature. They also suggest that the small-medium sized banks can afford less time to take the tough strategic decisions.

As one third of the large banks indicated that they could sustain their current cost structure only for the next one to two years, and they expect their cost optimization measures to return a benefit only within two years, it is questionable whether results will be yielded in time.

Other than the larger integrated hybrid banks who displayed some of the more advanced approaches to institutionalizing cost management within their firm, the vast majority were focused on cost management

Chart 15 – Given the economic environment, how long will you be able to sustain your current cost structure (i.e. cost income ratio)?



items. Headcount reductions and hiring freezes played a factor and some banks commented that they had used the past year to review staff performance and weed out under-performers.

Outsourcing can sometimes represent an opportunity to manage one's costs, but many respondents were reluctant to outsource more as they seem to prefer retaining direct control. This

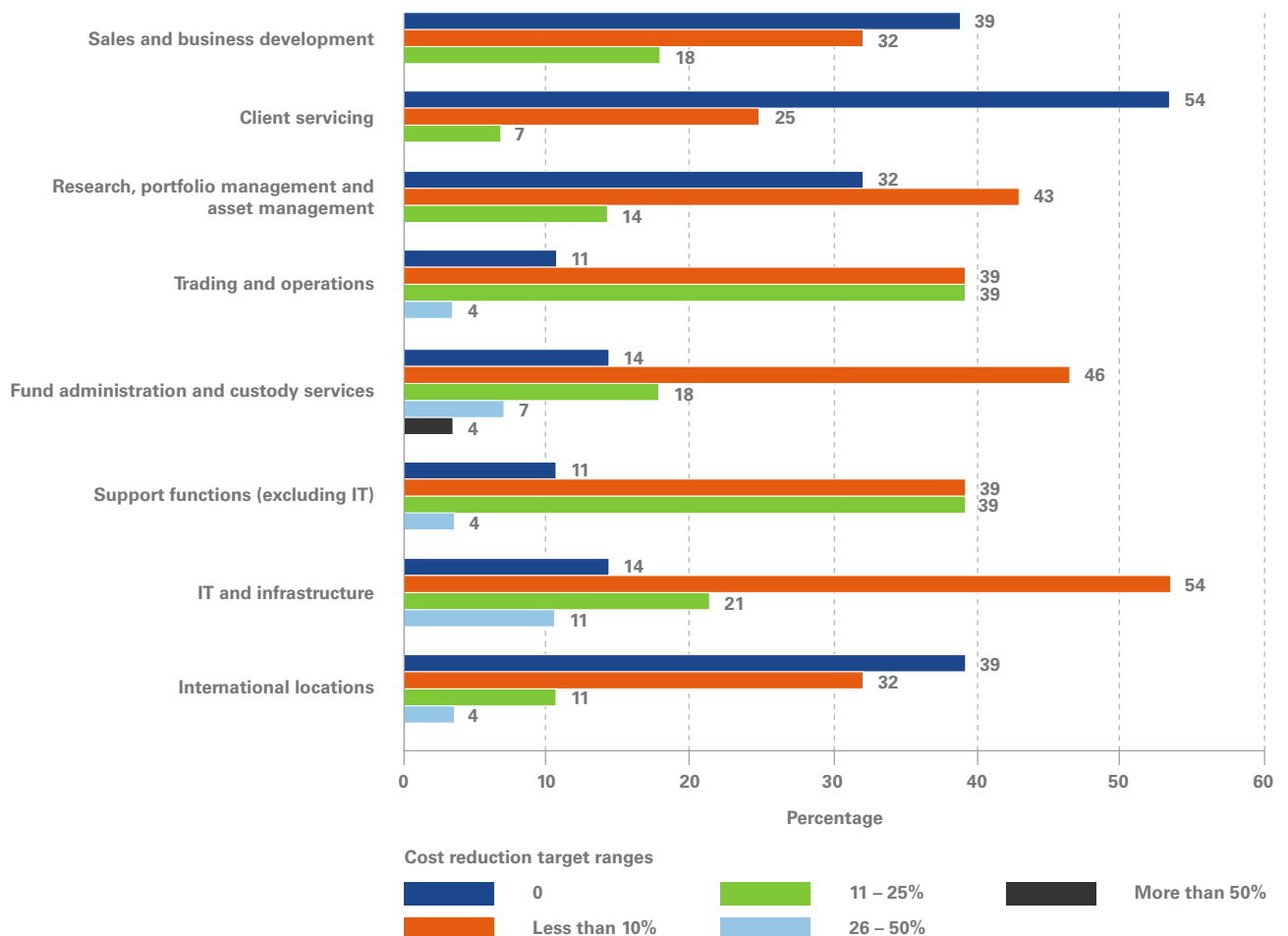
reluctance might also be an indication that the outsourcing market in Switzerland is insufficiently developed to handle the business complexities which many of the banks require.

**Cost optimization targets over 2009 / 2010 – is nothing sacred?**

More than 80 percent of the large banks intend to cut costs in their research, asset management and

portfolio management functions (78 percent of these large banks have targeted cost savings of less than 10 percent and the remainder have targeted savings of up to 25 percent). This compares to fewer than 40 percent of the small-medium sized banks. Following this trend, the larger banks were also found to be more aggressive in reducing costs in their trading and operations and

Chart 16 – Percentage of respondents identifying cost reduction target ranges across the bank



support functions. This was also noticed by their heavier application of “industrialization” (e.g. automation) approaches to operations. By contrast

small banks may see limited cost saving potential in these areas as they usually have less staff, flexibility and scale to play with.

On action taken to date, only slightly more than half expressed satisfaction over progress made with about 40 percent not convinced either way.

Chart 17 – All respondents: key challenges and risks associated with cost optimization

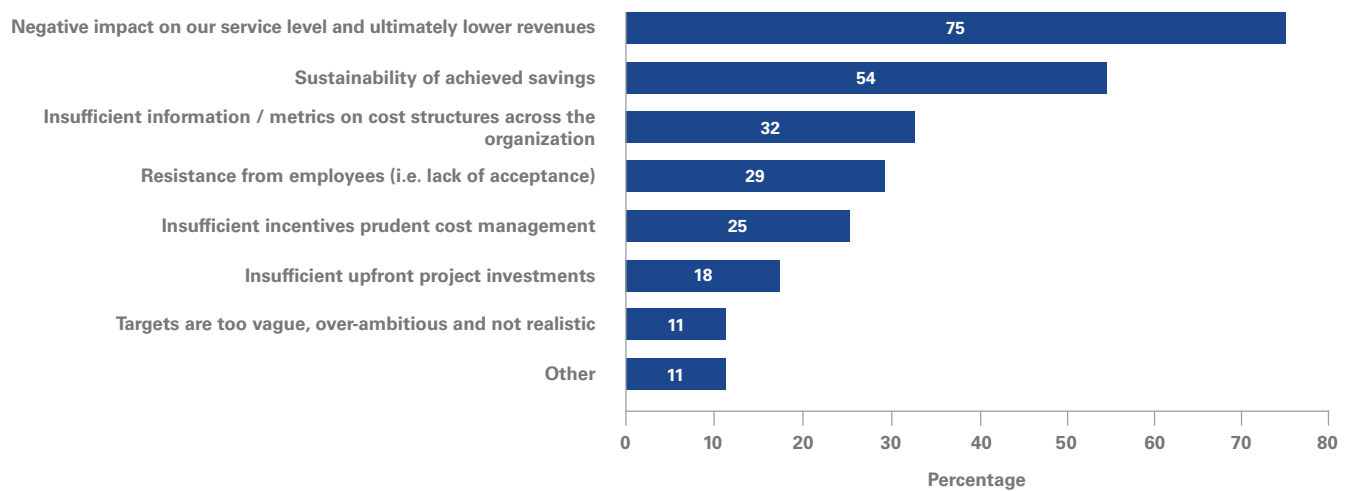
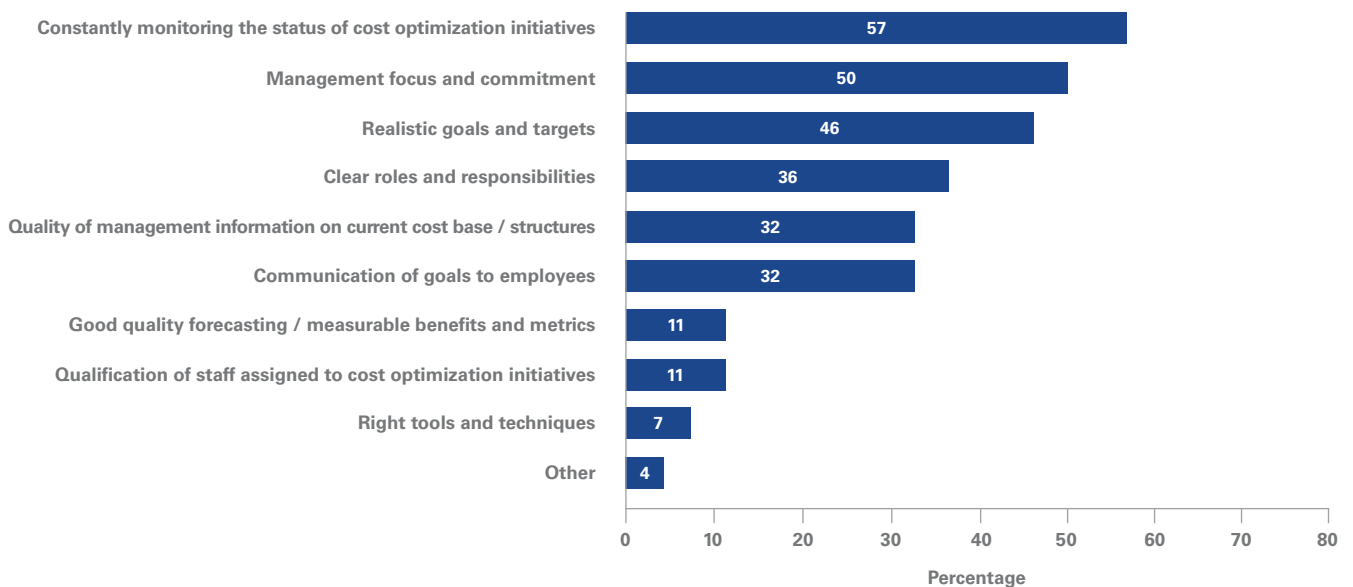


Chart 18 – All respondents: critical success factors for a cost optimization programme



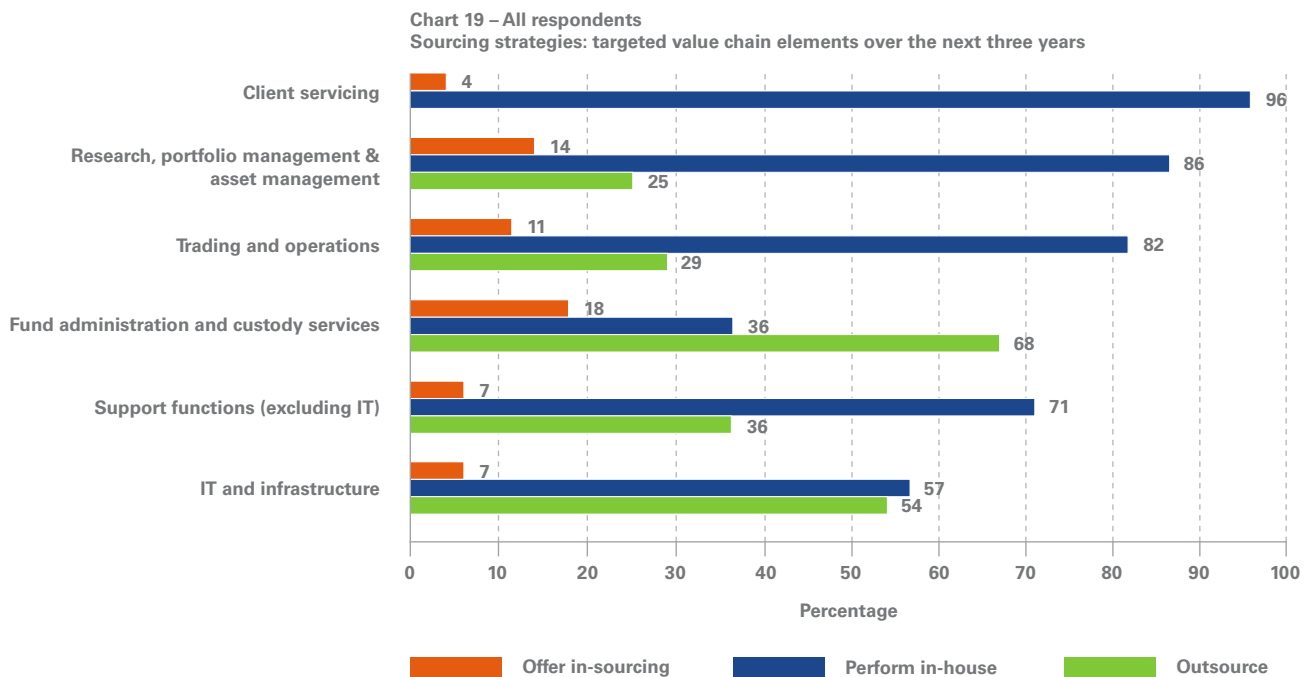
# Section 7: Sourcing strategies

We believe the two elements of the value chain (research, asset management and portfolio management; and trading and operations) will be subject to many changes over the next three years as banks re-assess and amend their business models. Key will be a decision how, and indeed whether, to keep these functions in-house and whether they form part of the USP. This is especially pertinent given how expensive the functions are to maintain, and in light of the fact that further investment is most likely needed to upgrade or enhance them.

Some banks may simply not have the critical mass to attract and support such expanded, improved functions.

Some banks are resisting greater outsourcing, partly in the belief that these are core internal functions and partly due to the relatively under-developed outsourcing market in Switzerland not providing an attractive alternative.

In terms of size, 42 percent of large banks outsource the “trading and operations” function compared to only 16 percent of small banks.



### **Sourcing outlook**

We would expect growth potential in outsourcing requirements from the small-medium sized banks as they may seek to avoid the need to employ specialist (costly) functions and the need for complex client reporting services, best execution demands, more sophisticated IT systems and the possible link up to automatic data exchange feeds.

### **The most common outsourced functions:**

- Sixty eight percent – fund administration and custody services.  
This is a sign of a mature market.
- Fifty four percent – IT and infrastructure.
- Thirty six percent – other support functions, excluding IT.
- Thirty percent - trading and operations functions.

## Section 8: Risk management – increasing importance in private banking culture

A true risk management culture is as much about awareness and behavior as it is about meeting legal and regulatory requirements.

While the majority of respondents foresee increasing their expenditure and resource on risk management, this proportion (56 percent) is not as high as one might expect given the challenges facing the industry.

There is a real need for organizations to go beyond the (increasingly complex) regulatory and legal requirements and to create a real risk management culture and awareness. We believe that even those parties not planning to increase their spending on risk management may need to re-allocate existing resource to meet new priorities.

The pure players seem to be planning the biggest changes (67 percent) though perhaps this is in part because the universals appear to have already started making the necessary investments in their risk management frameworks and infrastructures. However, part of the reason may also be that the pure players will arguably face some of the biggest challenges going forward in terms of restructuring their business models around on-shore / off-shore trends.

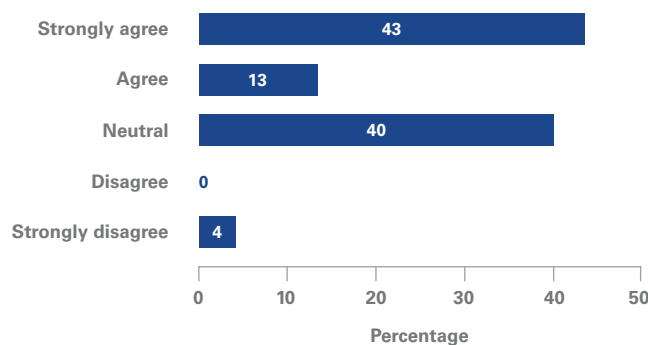
Getting the risk right and under control in the cross-border business could be a critical success factor. Going beyond compliance, revamping country manuals (which specify for CRMs the guidelines in carrying out business abroad), and assessing which

products, services and client segments represent a cross-border risk, are some of the first steps that should be taken. Those banks that manage to do this successfully may well be able to capture new off-shore business in compliance with local and international regulations. Such a move will almost certainly require closer integration of their risk management function into the business.

### Key areas of focus

Beyond the usual primary risks such as fraud, respondents agreed that the general risk landscape is changing. Actively managing reputation risk becomes more important in the current environment – for banks and regulators alike. Given that reputational risk is a consequence of failures relating

Chart 20 – All respondents: We intend to increase spending/resources in our risk management practices



to financial, business or operating risks, the most effective lies in a comprehensive risk management framework covering all these aspects and more.

The renewed focus on risk management is in part due to the increase in clients lodging liability claims, as well as public sentiment that banks have done insufficient to ensure effective internal controls.

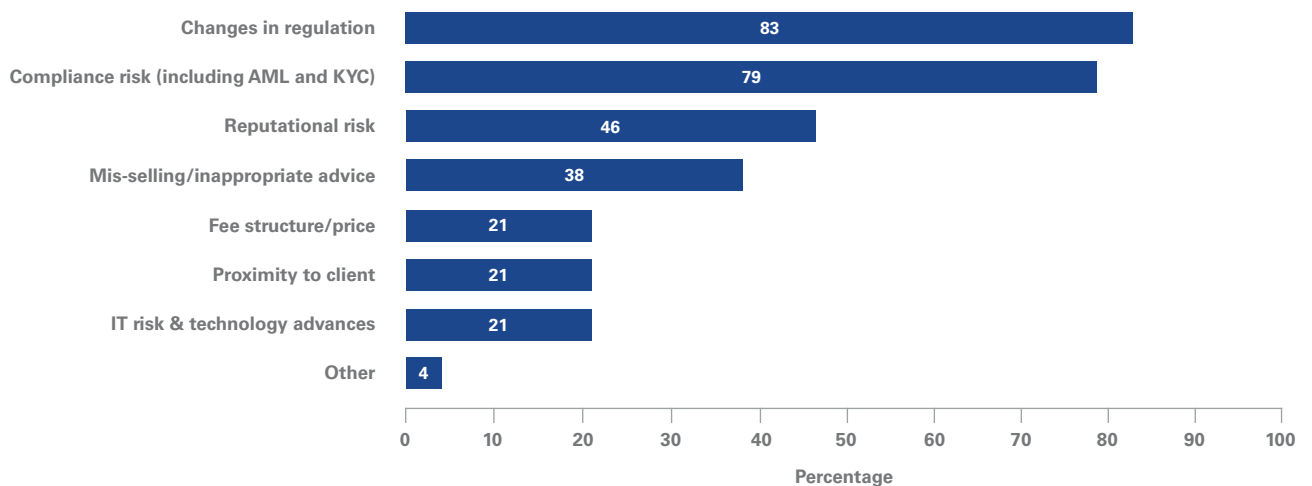
Many banks acknowledged that mis-selling (i.e. MiFID’s Suitability and Appropriateness) should now be considered an operational and liability risk. We are aware of approximately ten private banks which have been revising their client advisory processes with this in mind and more work is in store.

Other identified risks include data security, specifically the handling of client data. In addition, the Swiss

government is rapidly revising and issuing new regulations regarding retrocession, incentive systems and bonuses.

It remains to be seen whether risk and compliance departments can cope with the new focus, greater workload and pace of change, or whether there might alternatively be a trend towards outsourcing these tasks.

Chart 21 – All respondents: Which of the following key risks will be addressed by your management procedures in three years’ time? (Please pick up a maximum of three)



# Suggested process of addressing the challenges

1. Self-assessment, determine future off-shore, on-shore, cross-border strategy and scenarios.
2. Use regulation as an opportunity. Proactively approach and structure tax issues plus MiFID.
3. Derive competitive response for positioning, differentiation, target tax compliance for clients.
4. Articulate value proposition and service offering, effects of clients' needs and transparency.
5. Define the private banking business and operating model for the future.
6. Reduce high-fixed cost base – investigate sourcing options.
7. Consider opportunities and threats of M&A options.
8. Client relationship management roles, advisory, excellence, and growth perspectives.
9. Integrate regulatory issues and compliance management across the business.
10. Implement new business and operating model changes plus monitor success.

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