THE SWISS PRIVATE BANKING INDUSTRY

FOREWORD

Due to the financial crisis and increased international pressure on the offshore business, the Swiss private banking industry has undergone a fundamental shift. In the future, all private banks in Switzerland are well-advised to make strategic adjustments to their business models in order to survive in this changed competitive environment. In recent years, there has been a clear trend towards tax-compliant business models, which has had a significant impact on developments in the private banking sector. The more stringent tax regulations have resulted in offshore business models losing their appeal as these are primarily tax-driven. In the last few years, the Swiss private banking industry suffered a significant decline in revenue, whilst the cost of regulation adjustments and improving product and service quality continued to rise.

THE TRANSITION PROCESS IN THE SWISS PRIVATE BANKING INDUSTRY

A FUNDAMENTAL CHANGE IN THE OFFSHORE PRIVATE BANKING INDUSTRY IN SWITZERLAND

According to a report from BCG (Global Wealth 2011, Shaping a New Tomorrow), Switzerland remains the world's largest financial centre for offshore private banking with a market share of around 27%, followed by the United Kingdom and the Channel Islands (24%). Of the USD 2.1 trillion total offshore private banking assets managed in Switzerland, roughly 50% are attributable to clients from other European countries, here the future growth perspectives are limited and the asset base is at risk due to anticipated asset repatriations. Due to the intensifying competition by other financial centres for offshore money and the recent political and tax developments for offshore assets, it is widely expected that the business model of Swiss private banks active in the cross-border private banking market will be impacted adversely.

The total volume of securities holdings (off-balance-sheet) deposited with banks in Switzerland peaked at CHF 5.4 trillion by the end of 2007. Since then, the volume has decreased to CHF 4.4 trillion as of 30 September 2012. The decline is primarily attributable to negative performance and foreign currency effects. Still, more than half of the volume of securities holdings in Switzerland is attributable to foreign investors, i.e. clients not domiciled in Switzerland. However, this proportion has decreased steadily over the past years.

PRIVATE BANKS LIQUIDATED OR IN THE PROCESS OF BEING LIQUIDATED

During the period 2006-2011, an increasing number of private banks in Switzerland decided or were forced to go into liquidation. In many cases, the impossibility to find an adequate buyer for the bank's assets led to the liquidation of the private bank and the surrender of its banking licence. In other cases, pressure from regulators led to the decision to liquidate the bank.
Currently, there are as many as 8 banks in liquidation proceedings according to the Swiss financial market regulator FINMA (see table below). Not unsurprisingly, all of the concerned banks are owned by foreign investors and most of them are focused on the offshore private banking industry in Switzerland. These market players are impacted the most by the increasing regulatory pressure and the diminishing base of AuM.

Besides liquidation, the possibility of surrendering the banking licence and changing the purpose of the company has been used by certain players to exit their private banking activities and focus on another business activity which does not require a banking licence.

FUTURE ENVIRONMENT FOR PRIVATE BANKING IN SWITZERLAND

This far, Switzerland has been able to defend its position as a globally leading offshore private banking centre. However, the Swiss private banking industry is currently undergoing a phase of fundamental change which exposes its players to various challenges.

STRATEGIC IMPLICATIONS FOR SWISS PRIVATE BANKS

Basically, there are three garden-variety strategic options for private banks on how to react to and cope with the challenges in the industry:

Option 1: Organic growth, i.e. continuing the present activities on a stand-alone basis, implementing measures to increase revenues and reduce operating expenses;

Many of the measures aimed at increasing revenues, such as poaching CRMs from competitors, extending the service offering by building up new competencies in-house or developing additional markets, give rise to further operating expenses in the short to medium term and their positive effects on a private bank's profitability will only show up in the long run. The potential to reduce operating expenses is limited and many cost-cutting measures will have a negative impact on the bank's ability to grow. The situation will become most difficult for medium-sized private banks as they will be trapped in a kind of a "vicious cycle": on one hand, they are too small to establish local presence in foreign markets and thus are unable to reduce their dependency on the Swiss market; and on the other, they are too big to pursue a clear niche strategy.

Option 2: External growth, i.e. joint ventures, acquiring another private bank/wealth manager or merging with a competitor in order to increase the volume of AuM and exploit economies of scale;

Size has become an important driver of a private bank's efficiency as investments in infrastructure and know-how are largely scalable. Smaller to medium-sized private banks therefore have come under pressure to increase their volume of AuM. An acquisition allows a bank to grow its AuM significantly at a single shot and to take a step forward in ensuring its long-term prosperity. Often, it takes several years for a bank to reach the equivalent business volume created by an acquisition if it grows organically. However, acquisitions do not come without risks. Firstly, it is difficult to find a suitable target as many private banks in Switzerland have legacy problems from their former cross-border activities. Secondly, if there isn't a sufficient cultural fit between target and acquirer and if integration aspects are not considered early in the transaction process, there is a high risk of CRMs leaving and client assets being withdrawn

Option 3: Exit from the Swiss wealth management market by selling the entity (or its activities) to a third party.

A partial or full exit from the Swiss private banking market in the form of a share or asset deal represents an option of last resort if a bank has no attractive growth prospects on a stand-alone basis, if there are no sufficient financial resources available to conduct an acquisition, or if no suitable acquisition target or merger/joint venture partner can be found. If the owners of a bank are considering a disposal, it is important that such a disposal be realised at a time when the bank is still attractive in terms of its profitability and client portfolio. If a company waits too long, it can be that no buyers will be found and, in the end, the only option left is liquidation.

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