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The Swiss Private Banking Sector
Back to the fast track

An assessment by Jürg Frick

Audit. Tax. Consulting. Corporate Finance.

Jürg Frick is a Senior Partner, Leader of the Banking Industry and Vice Chairman at Deloitte, and has been a banker and consultant for over 40 years. He was one of the founders and a Senior Executive Partner of a consulting firm, which was acquired by Deloitte in 2010.

Jürg Frick looks back on 40 years of experience in the financial services sector, including positions as the country representative of a US-bank, as Director and Leader for the Middle East and parts of the far east, as well as the Leader Asset Management at a large Swiss bank and CEO of an insurance company.

As a result of his experience building his own consulting firm with 150 employees and its successful sale, Jürg Frick has a vast treasure trove of experience and a broad network in the financial services sector and other industries.

The past: A personal retrospective

I like to remember the times when the profession of the Swiss banker was well perceived and bankers took pride in themselves and their organisations. Loyalty, modesty, trust, training and perspective were the basis for one goal: serving the client, either to protect and grow their earned, inherited or acquired assets over generations, or to support and finance entrepreneurship cautiously and with sound judgement.

These principles together with competence, trust, continuity, stability and foresight and coupled with an independent, strong currency and a politically balanced environment were the basis for a banking sector that brought us recognition and prosperity.

Clients have valued our environment for decades, because they could not find these circumstances anywhere else in the world. The higher the political uncertainties in other countries, the more assets were given to us.

The larger the asset base and the more influential and wealthy families became all over the world, the more money came to Switzerland for diversification reasons. The primary goal was rarely tax optimisation; much rather it was the integral, integrated and professional customer service and advice from Swiss bankers, who had served in this role with the same families and clients over decades.

This led to longstanding friendships. The primary goal was not the optimisation of profits for the bank, but rather the optimisation of gains and the preservation of wealth for clients. The fact that this also resulted in profits for the banks was nothing but a logical consequence.

Our competence, the economic stability and the strong currency of Switzerland as well as the financial strength of our financial services industry made us a role model for the entire world.

For a long time the Swiss people were innovators in financial services, always motivated by our own expectations for high quality services, better products, the best service offerings and the goal to meet all our clients’ needs from under one roof. We were the treasurers of this world. Our competence, our economic stability and Switzerland’s strong currency as well as the strength of our financial services companies made us the world’s role model.
We were thinking of and for our clients, launched product innovations with a strong client focus and paid attention to quality on a long-term perspective. We were the ones who challenged the banking world globally; even though we were smaller than Anglo-Saxon competitors, we moved faster and were more successful. Our firm culture was characterised by a pioneer spirit, a “can do” mentality and self-confidence coupled with the typical Swiss attributes of modesty and understatement.

Analysing the problem: What went wrong?

The strategic focus on clients and their long-term success has increasingly been lost over the last 20 years. Unfortunately, exactly during a time when, internal and external pressures on the banking sector in Switzerland increased significantly.

Internal pressure: How we lost our strategic focus

Previously, we earned good money at a margin of 60 basis points per client, with a credit policy based on sound judgment and an investment banking which focused mostly on product development for private banking.

At the same time as the "Trusted Asset Advisory" – concept, which describes Swiss client focus pretty well, gained popularity in the Anglo-Saxon world, Swiss banks took over the rather Anglo-Saxon focus on short-term profit maximisation. Larger, more profitable, faster – became the credo.

Short-term profit orientation masked the view of what was essential and the long-term development. Rather than the client's well-being, rapid growth of their own money became the focus. The actual goal of a bank to make money from the interest margin, commissions and trading business gave way to excessive speculation, which almost brought down large banks, as their balance sheet resembled the one of a hedge fund rather than the one of a reputable bank.

Supported by hubris and arrogance, the benchmark for the success of a bank was constantly raised and expectations increased immeasurably. Higher risk became acceptable and employees were incentivised mainly through above average monetary compensation rather than intrinsic motivation. Banks lost the connection between performance and reward, risk and return – and at the same time, also basic entrepreneurial values. Many banks also increased their internal departments excessively and carelessly so that profitability could not be sustained in an environment of lower margins, rising risks and a probably even lower long-term interest level. Additionally, above-average compensation was awarded mainly to those employees who generated good numbers in the short-term without ever measuring the underlying risks and consequences in a transparent manner. As long as the industry can afford staff units with no direct link to client activity, fails to manage the risks of the business and supports expensive outdated information technology, our banking sector will not recover.

The financial sector is standing in its own way with current disputes and has lost its reputation with its own people.

External pressures: Politics with a weak backbone

The Swiss banking sector has also increasingly come under pressure from abroad. Our success has resulted in attention and recognition, but also in envy. Global competition is tough – and not always fair. It becomes even easier if the Swiss financial sector is accused of breaking laws, which have a different legal meaning in their own country, thereby attempting to bring it to a downfall with geopolitical sanctions. An early example was the introduction of the anti-money-laundering legislation, which at first only made Switzerland suspicious, even though money laundering was a far bigger problem in other countries. Switzerland then implemented the law exemplary, and contrary to many other countries, is considered a pioneer in this area.

Nowadays it is the issue of untaxed assets of American clients for which we are apparently willing to pay questionable withholding taxes. If we do pay these in a mindset of surrender as demanded by a large number of our politicians, the banking sector will continue to change to its own disadvantage. One can suspect that additional claims will be raised, which can not be foreseen at this point in time. We can prevent additional claims and damage to our financial sector only with the necessary self-confidence and backbone.

Current problems: What are we facing today?

The current situation is not optimistic: We have turned into defendants against often enough unfair and politically motivated opponents. We are not united ourselves, we have lost our self-confidence, we need to adjust structures and processes, we lack innovation, we have legacy liabilities, we are being counted down like the boxer in the ring and at times are lead by people, who have lost the connection between performance and compensation.

In particular, we are currently confronted with the following situation:

- Existing legacy liabilities with regards to the tax issues of our clients (USA, Germany, etc.). It can be assumed that additional countries will follow.

- Excessive overregulation, which is barely manageable from an organisational, process and technology standpoint, which will lead to banks employing more Compliance and Risk Officers than Relationship Managers.

- Capital requirements, which exceed the levels imposed on foreign competitors.

- “Too big to fail“ topic, which is less significant in other countries, but has a highly economic relevance in our country.

- Difficult market access to other countries, which was intensified with the introduction of MIFID II.

Unresolved fundamental questions about investment banking: Should its role be the one of the product developer for private banking as in the old days or should it have a life of its own?

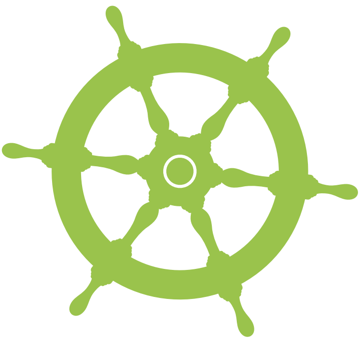
Can the volatility of the results and the related risks be managed in a meaningful way?

- Lack of professionalism in asset management.
- Inefficient structures, excessive staff functions, cost-income-ratios too high.
- Below average and outdated technological infrastructure, which cannot be adjusted in the short-term in a meaningful way.
- Trend for questionable outsourcing.
- Lack of motivation as well as cultures and subcultures, which have never entirely merged, furthermore high compensation coupled with below average performance.
- Excessive incentives for short-term profit maximisation, among others due to quarterly financial accounting and short-term reporting, which runs counter to a sustainable strategy. In this context size is – counter to the frequent notion – by no means the silver bullet.

Success is less dependent on the size of the assets and the balance sheet, but rather on the business model, client segmentation, the origin of clients and the focus on essential client services by employing efficient processes. Holding on to earlier successes is no longer sufficient. A reorientation is needed.

The future: Proper reorientation as a chance

The future environment of the financial sector can be foreseen easily based on the current developments. The number of banks in the financial sector will decrease significantly and foreign banks will leave the private banking business. Smaller banks will increasingly return their banking licence, they will try to sell themselves or their client database or leave the marketplace altogether, because of the burden of the expected withholding taxes. The huge number of asset managers will decline significantly and be concentrated at professional organisations and niche suppliers. The profitability of banks will disappear and the compensation for bankers will come down. The business as a whole will continue to grow, but it will be concentrated on fewer market participants, due to increased efficiency, continue to generate the necessary contribution to the financial sector.



The resulting transition period, which will probably span the next 5 to 7 years, will force many banks to go "back to the roots". As a result the client may move back into the centre of attention. Furthermore, the focus will be on the motivated, loyal and well-trained relationship managers, the product portfolio will be tailored to the client needs and the infrastructure will be completely overhauled.
To accomplish this, it is not sufficient to make small corrections; what is necessary are innovative structures. The entire value chain of a bank must be challenged, the client strategy and cross border banking must be adjusted to the new requirements and regulations such as MIFID II and every internal service function must be reassessed. Do we need an expensive army of compliance employees, risk controllers and numerous internal staff functions as well as expensive internal back office centres? How can we reorganise our organisation so that we can focus on those activities that are absolutely necessary and generate value?

Where can we buy processes that are available for less money, more professional, more focused and more quickly adaptable? I am decidedly not speaking about past, many a time unsuccessful attempts to outsource non-compatible activities into foreign countries. This is meant to happen in our own environment, in Switzerland, with our own quality standards and our own common understanding.
With such a reallocation of jobs within Switzerland it will also be possible to obtain the necessary support from politicians and create a better image of the banking sector. These steps result in leaving behind today's integrated value chain and move to a so-called value network (value creation network) of specialised firms, which can offer the mentioned services more effectively and more efficiently. In the future the Swiss financial sector should merge more, work together rather than against each other and thereby return to old successes. Switzerland must be seen again as a country of banks and a safe haven and the focus on individual banks should disappear. This would also lead to a more cooperative collaboration between banks,regulators, oversight and interest groups without bringing a healthy competition among banks to a stillstand.

How can an individual bank approach this? Courage to change

Actually, it is the trivial questions that banks have to evaluate as quickly as possible:

- Are we willing to benefit from the dynamics of the transition period and transform it into immediate use?
- Are we prepared to give up tried and trusted methods and go new ways?
- Are we in a position to implement new business models to support these changes? What could these business models look like, given the extent of expected regulations?
- Do we have the right people in the right positions, to support us?
- Are we properly executing the fundamental factors in management, i.e. sales, cost control, processes and IT?
- Where are costs generated, how much can we afford? How do we reduce our cost/income ratio to below 60?
- Do we have the right clients? And how can they be served in a professional manner with a reasonable effort? Do we even understand our clients' needs?

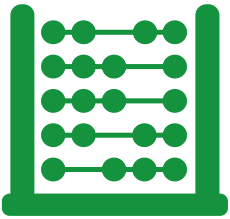
- Do we have the right products and service offerings? Often we are convinced of our own product, not knowing if the market even wants or needs it. If a product is more useful to us than to our clients, should we really launch it into the market?

- Is transaction-focused banking still the right way to go or is it necessary to move towards a consulting-focused banking?

- How can we manage private banking together with a retail banking business knowing that the product portfolio, the execution and the relevant regulations should not only be looked at differently, but are also based on different needs?

- Do we understand the dynamic and strategies of our competitors?

- Which instruments do we really need to actively support our business? Which service offerings and products do we need to let go?



- Are we prepared to focus on the integration and use of external information and competencies? What do we need internally and what can be done externally?

- How can we cooperate with other market participants in a meaningful way?

- Are we technologically in a position to launch new ideas, products and service offerings into the market efficiently and effectively and what would impede this process?

Do we make use of and benefit from the new resources “digital”, “cyber” and “cloud” to an appropriate extent?

These are only a few of the most basic questions every management should ask itself prior to a larger strategy exercise. It will be of little value to make small corrections here and there and to believe it is all that is needed to be prepared for the future. It is also of little value to assume that our own organisation is not impacted by the current environment. It will become essential that responsible board members become active and whether or not they lead their organisation onto the strategically appropriate path.

How can the Swiss banking sector approach this? Development of a value network

Up to now, banks have been convinced that it is advantageous to execute the entire value chain in-house. Erroneously one assumed that an executing IT is a Unique Selling Point and has advantages for clients. Often there was no awareness of the development and maintenance cost of IT-systems. The speed with which changes occur and the constant stream of technological innovations as well as the increasing number of internal and external reporting requirements have become a major challenge for every IT-department – regardless of the size of the bank. Would it not be more efficient to team-up with others, to secure a competitive advantage through lower costs caused by economies of scale, adjustments of the business model and common products rather than trying to do it all on one's own?

The same is true for the HR-department. Banks do not need expensive systems to account for the salaries of their employees as long as there are more competent and cheaper service providers.

Another example is the compliance-department. How can a bank meet the regulatory requirements in the cross-border business, if they need to develop and maintain up to 1'500 manuals for clients in 50 countries?

How do relationship managers feel if they have to spend 60% of their time dealing with administrative and regulatory requirements prior to any client service? These needs can be met in a better way by specialised firms. I personally am a big supporter of outsourcing commodity-type processes to specialised suppliers. These firms will grow above average in the next few years and will also take over a large part of the personnel currently employed by the banks. This way necessary personnel adjustments at those banks can be elegantly absorbed. All participants will benefit from this development, the banks primarily through significantly lower costs by an estimated 30%. These so-called value networks will positively change the banking sector in Switzerland. Qualitatively questionable off- or nearshore activities are no longer necessary. A large portion of the value creation could remain in Switzerland. Establishing these networks will strengthen the financial community and the industries that are dependent on it.

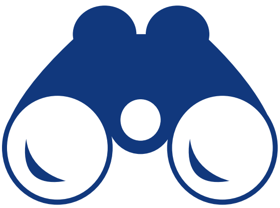
How can Swiss regulators approach this? Exercise restraint

One should critically question whether it makes sense to apply all kinds of regulations to all organisations in the same manner. The administrative burden put on these organisations is rising exponentially and is not connected to the individual business model and the risks related to it. We should have the courage to take a nuanced view. I am convinced that the cooperation among banks, with the politicians, the oversight and the SNB must be promoted. This requires a clear definition of which tasks are taken on by which stakeholders towards third parties. The requirements we are confronted with whether they are financially or politically motivated can only be met with a common language and action plan in the interest of the financial sector. Disagreement will only support our adversaries in attacking us even more.

A future as successful as our past: What will be the focus tomorrow?

We will have to continue to cross the "valley of tears" for a little while longer. Additionally, we have to face the challenge to make decisions that hurt, that will not be easy and that are moving us away from the last 20 years. We are at a point where IBM, Apple and the watch industry (to mention just a few) were also stagnant at some point in time and they have managed to put themselves back on a successful track by having the courage to change. These examples show that we can be in a much better position in 5 to 7 years, much better than ever before, if we start handling things the right way. We should put more focus on being less vulnerable and open to political blackmail and distinguish ourselves through competence and client service. On this basis topics like "too big to fail", "leverage ratio" etc. will become less important because a new interpretation of our classic, client-oriented business model will reduce risks and thereby give us more room for action – also internationally.

This will bring back what we are missing today: self-confidence, motivation, loyalty, closeness to clients, profitability, competence and an image that will help us grow globally. Our clients will be thankful and demand more professional services than ever before. The opportunities this will create for our financial sector are immense. A few organisations have already come to realise that it is beneficial to go down this path. It will be important however to go on this journey optimistically, systematically and without compromise. I am convinced that in 5 to 7 years we will not only be stronger and more profitable, but also that our motivation and pride in our financial sector and our organisations can reach those same levels that have been lost over the course of time. I am also convinced that our financial sector will be even larger, more valuable and more successful than it is today.



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