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## Cautious optimism and a lot of work left to do in the private banking sector

**According to the study entitled “Defining the Future of Swiss Private Banking” conducted by KPMG and the University of St. Gallen, private banks in Switzerland are once again cautiously optimistic with regards to their growth potential. Their clients, however, have become much more demanding when it comes to returns on investment, product and performance transparency as well as the quality of advisory services provided. So far, only a third of the private banks have begun modifying their business models in order to accommodate new regulatory requirements and client needs. Additionally, the topic of data security has taken on strategic importance.**

Swiss private banks must satisfy an increasingly complex catalog of regulatory requirements. At the same time, clients and investors are demanding greater returns on investment, increased transparency of products and performance as well as improved quality in the advisory services provided. The increase in costs that this is triggering combined with the still unstable international market environment are making these challenges particularly difficult to manage. The study entitled “Defining the Future of Swiss Private Banking” conducted by KPMG and the University of St. Gallen (HSG) has identified some central findings which can be broken down into four main categories:

### **Growth is making a comeback – the only questions remaining: when and where?**

The stability of the Swiss financial system continues to lend a significant advantage to the private banking sector in the country. The Euro crisis also appears to have helped Swiss banks win new business. Cautious optimism over future growth prospects prevails, both in terms of expected NNM developments and the broader environment in which Swiss private banks operate. Conditions remain challenging, however, and some banks might need to adapt their expectations to the new reality of intensive competition and the disappearance of “guaranteed” double-digit annual growth rates. The majority of any consolidation in the sector is expected to be driven by regulatory developments and critical size considerations. The rising costs of regulatory compliance and an erosion of revenues has put pressure on profit margins. Demand to acquire Swiss private banks actively exists, although individually banks are being careful about pursuing an M&A strategy in the current environment. Until certain barriers to M&A activity are overcome, the long awaited consolidation in the sector may prove elusive. Main barriers include: strategic and cultural fit, lack of attractive targets and the level of “undeclared” client assets.

**Key facts:**

- 75% believe that Swiss private banking will grow – however, below 10% in total over the next three years
- 78% expect a greater consolidation in the Swiss market – driven by lack of critical size, regulatory developments and a decline in profitability
- 71% expect goodwill premiums in the range of 0.5% to 1.5% of Assets under Management (AuM)

**Need for services that is more proactive, personal and value add**

Many may draw comfort from the fact that Switzerland can still boast one of the most financially and politically secure financial centers for private banking anywhere in the world. However, this may not be enough to sustain the industry's future without action from the banks themselves.

Attention should be focused on maintaining closer client relationships, being much more proactive in approaching clients and facilitating dialog. There is a clear need for banks to further develop their ability to provide insightful investment ideas in a rigorously transparent manner. Some believe the implication is a move away from traditional long equity financial product ranges. After the banks' financial stability, a demonstrable investment performance track record tops clients' lists of priorities – this is proving much more difficult during present and foreseeable market conditions. These ever more pressing client demands require a transformation of business models and client service delivery approach.

The extent of the challenges should not be understated as they affect almost every aspect of a bank's service delivery and are likely to require thorough strategic overhauls. Many Swiss banks are taking steps to master these challenges by looking at ways to enhance client service delivery and to improve in-house capabilities. Isolated tactical improvements will not suffice. While individual solutions and services offered will be a function of the market context and the client's own sophistication level and risk appetite, the trend must nevertheless be towards a holistic client-centric approach if the goal is to achieve higher margin services.

**Key facts:**

- Only 23% of banks consider the current Swiss market to be favourable in terms of being able to hire the right quality CRMs
- 83% believe in the importance of having sophisticated documented risk profiling to determine the right investment strategy
- 78% are presently reviewing the effectiveness of IT in the client advisory process

**Integration of compliance requirements into banks' business models**

Rather than foreseeing a painful task to assess and achieve transformation in light of recent and expected regulation, many banks see a unique chance to explore new opportunities and to modify their business model in the interest of greater sustainability. Ultimately, redefinition and / or adaptation should aim to meet significant compliance obligations from non-Swiss authorities. The Swiss FINMA has recently published guidance on cross-border risks which obliges banks to establish what it considers to be principal compliance measures in managing cross-border banking. Surviving in the new regulatory world means facing up to growing demands by clients over security, investment transparency and performance which, coupled with increased competition, is placing banks under even greater pressure. Many banks remain concerned that tax compliance may lead to outflows of AuM, though this need not be the case.

Some are ahead of the pack in proactively tackling the regulatory agenda challenges and implementing more robust measures. These banks have tended to review their key differentiators, operating models and client advisory processes as well as introducing some of the main MiFID principles such as “suitability”. Seizing the chance to enhance their competitive advantage, they are improving and leveraging their positioning to serve client markets by moving towards full compliance with foreign rules for cross-border business.

**Key facts:**

- 86% recognize the need to further enhance compliance with foreign rules
- 81% see a fully compliant off-shore banking model as a primary strategic focus
- 82% expect the convergence of Swiss rules with EU/EEA investor protection regulation
- Only 36% have begun or completed implementing cross-border compliance measures

**Data security as a strategic topic**

There is widespread recognition of the growing strategic value and inherent difficulties in managing potential breaches in an area that is close to clients’ hearts: data confidentiality. The potential for reputational damage and client loss is clear, and indeed in some areas, such as parts of South America, data confidentiality is key for the physical safety of HNWIs. Appreciating the importance of client data confidentiality, the agenda is now being lead at the highest levels by the CEO and COO, with significant participation from the heads of IT security and compliance. Risks from internal sources are perceived to be rising, partly driven by external factors such as increasing pressure from foreign tax authorities and regulators. The IT, back-office and front-office functions represent risks also for accidental data loss.

Consensus over the need to reassess and further tighten security and protection levels is underpinned by proactive activity at the vast majority of banks. Four out of five have initiated specific projects to review strategy and safeguard effectiveness. Most expect to increase expenditure over the next two years on both current and new measures.

**Key facts:**

- 83% are looking to revise client data protection strategies
- 60% anticipate increasing their spend on enhancing current measures while around the same number expect to do so on introducing new measures
- 30% of smaller banks need to improve data protection technology

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