

Is privacy a luxury?



Daniel Senn

Private banking is changing...

With curbs on offshore banking, growing demands for transparency and greater pressure on margins, many private banks find they are having to rethink their business models. The growing importance of scale should lead to consolidation, while the rise of the East is shifting attention away from traditional territories. As **Daniel Senn** explains, to successfully compete in this new environment, banks need to excel in the age-old skills of managing assets and servicing clients.

Pprivate banking is a sector under siege. National governments, reeling from excessive debt, are desperate to recover tax from the undeclared overseas assets of their citizens. This has accelerated the development of tough tax reporting standards, with many regulators threatening to blacklist any bank that allegedly aids individuals in tax evasion. There are also calls for disclosure of personal details – a significant threat to an industry that prides itself on secrecy and discretion.

Banks now run the risk of having offshore assets repatriated, and in many cases are effectively barred from accepting further undeclared money. Such changes are inevitably affecting their business models. In a 2009 KPMG survey of leading Swiss private banks, two-thirds of respondents feel that traditional offshore banking will decline over the next three years.¹

Competition has also intensified, with more banks chasing fewer assets. At the same time, the fear of

regulatory punishment and damage to reputation is pushing up the cost of compliance and risk management. It's no surprise then that in the same survey almost six out of ten banks expect to spend more on risk management.

In the face of such challenges, some of the smaller banks may struggle to survive. And with slower growth and greater competition in European markets, larger banks may be attracted by the burgeoning wealth in Asia.

The four main types of a private bank

Cross-border: these big or mid-sized institutes rely heavily on cross-border activities, including on-shore activities in the key markets.

Pure players: by focusing purely on private banking with off-shore clients, with no retail or investment banking arms, these organizations major on their independence and specialism, in the sector or a particular region.

Private banking operations of national or regional banks: with a far more local presence, these banks can claim to offer a more intimate service through their proximity to clients.

AuM² below CHF 10 billion: these banks, often traditional, small private banks or Swiss subsidiaries of foreign banks, run the risk of take-over or disappearing from the market.

Consolidation and expansion

What has historically been a highly fragmented industry is likely to become more concentrated, which should mean some good merger and acquisition opportunities at attractive prices. In a bid to recoup much needed capital, some governments (notably the Netherlands and Germany) are selling the private banking arms of banks that they rescued during the credit crisis, which puts some single tempting targets up for grabs.

Meanwhile small-to-medium-sized private banks are suffering from a more competitive market and rising costs, making a fair number of them ripe for takeover.

Consequently four out of five respondents to the Swiss survey believe there will be more consolidation in the industry. Such change could usher in a new era of cross-border banking, making the specific location of a bank less important, leading to a more globalized market, with scale becoming ever more critical.

Larger banks from Europe, the Caribbean and the Middle East may choose to expand into the high growth markets in Asia and the Middle East, setting up operations in Hong Kong and Singapore. However, establishing such a presence requires a significant investment, local knowledge and a long-term viewpoint – and is not without risks.

Anyone considering such a move should be aware that the traditional advantages of lower tax, banking secrecy and a favorable regulatory environment may no longer apply, with competition based more upon a strong brand and genuine expert knowledge.

Building new business models

The shake-up in the industry offers a number of possible directions for private banks, as they attempt to attract new clients and retain existing ones. Those engaged in cross-border banking will be keen to ensure that there is tax compliance with clients' home countries, which may require self declaration to avoid accusations of tax fraud.

Of the Swiss private banks questioned in our survey, 60 percent believe the 'pure player' model (a focus simply on private banking) will be the most successful in gaining market share over the next three years. These organizations look to differentiate their service through expertise in research, asset management and portfolio management.

And with customers demanding lower fees – and greater transparency over these fees – there is likely to be a greater focus on client service. The survey supported such a trend, with respondents rating a client-oriented approach as the most important proposition, followed by brand reputation and service quality. Virtually all those taking part in the research say they expect to hire additional client relationship managers in the next three years.

Clients also place a high value on comprehensive, analytical, frequent and error-free reporting.

Another area where private banks may be able to distinguish their service is through 'open architecture': offering a range of products from other providers.

Such an approach is again indicative of a more client-centric attitude, whereas in the past, many organizations were happy merely to push their own products.

Of course, there is still a future for the more localized players. One consequence of the demise of offshore banking is an exodus of customers to lower tax environments. For example, many thousands annually are emigrating from Germany to Switzerland. And companies are taking similar decisions by moving headquarters to Switzerland, Hong Kong and Singapore, enabling both the corporation and its executives to benefit from more favorable tax regimes. This should ensure a continued demand for those banks with very particular knowledge of local laws and taxes.

Towards globalization

One interesting phenomenon is the emergence of independent asset management firms, typically consisting of just a handful of individuals. The main attraction of these organizations is the impartial advice they give, having no products of their own to support. However, they will probably remain a small niche, and in addition are quite vulnerable to stringent regulation and potential license requirements.

Overall, the future seems to favor private banks with both the size and the geographic reach to follow wealth wherever it goes. As economies develop in different parts of the world, high net worth individuals should hopefully continue to seek ways of managing their assets effectively and safely, thus maintaining demand.

The traditional offshore tax haven may be on the decline, but in the new global marketplace, those firms able to combine the brand, the competence and the reach are the most likely to win the trust – and the business – of clients.

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1. *Private Banking in Switzerland: Quo vadis?* KPMG Switzerland/ University of St Gallen, Institute of Management, 2009.
2. Assets under management.