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"Private Banks –The survival of the smartest"

Ray Soudah, Founder of MilleniumAssociates (the Swiss-based independent M&A adviser to the global wealth management industry) looks at the future of Swiss Private Banking.

Swiss Private Banking has enjoyed a decade of sustained growth. Profits rose almost without pause, clients seemed happy, staff were content and expanding in numbers, and most importantly, assets under management were growing unabated. It could even be said confidence was so high that many private banks felt unthreatened by their larger rivals as many attracted clients defecting from mega mergers and perceived bureaucratic processes. Global markets were rising almost continuously and clients were enjoying regular rewards. Private banks assumed they had some superior asset management skills and thus allowed private banking salaries to rise substantially in the period in question as they attempted to retain and grow client-facing personnel.

The crash of the NASDAQ and of global equity markets that we have seen in the past twelve months have abruptly halted and even reversed the seemingly unstoppable rise in profitability and assets under management of almost every Swiss private bank. What went wrong and who will survive? Since a quick substantial recovery in the global stock market is unlikely, which is usually accompanied by greater commission generating trading turnover by private clients, private banks will need to undertake some intelligent and fundamental adjustments rather than the easy to achieve one-off cost cutting measures, traditionalist managers pursue when faced with declining revenues.

The biggest error made by many private banks, not only by the Swiss in Switzerland but also by the many foreign presences, is the assumption that their business model was sustainable. The majority derived their revenues from fees based on a combination of brokerage and trading commissions as well as fees based on the value of client assets under management. So long as assets under management were stable or grew (often only due to market revaluations although also by net new client acquisitions) revenues grew at the same speed or even greater than expenses. This encouraged the private banks to increase their staff levels as well as the compensation levels, which grew substantially as competition for clients grew. In fact the private bankers believed they had a permanent one-way profit stream. The fundamental error was the fact that their costs were broadly fixed but the revenues broadly floating and when the latter dropped off dramatically as a result of falling asset prices their profits were squeezed to an extent never imagined. This rise in the cost income ratio of most private banks was further made worse by many private banks undertaking unprofitable activities where they did not possess economic

efficiencies (lack of scale of scope) such as research, custody and certain operational activities. Further many assumed that undertaking wholesale asset management activities especially for less profitable institutional rather than private clients would ensure their ability to leverage what have become commodities. Some even undertook expensive technology projects. All these factors as well as the slow introduction of third party and alternative products and services caused an imbalance between the more fixed and even more floating

/declining revenue structures which have now collapsed resulting in declining profits on a shocking scale. Listed stock prices of private banks as defined by their various multiples are still considered optimistic because investors are assuming the future risks in private clients' banking business fundamentally sound but only the smart will survive in the long term when they undertake drastic business model restructuring not just cost cutting - which changes nothing in the underlying structural cost income relationships.

So what actions are needed to remodel the Swiss private bank? I am sure that size is not an absolute critical factor but rather the balanced business model is key. The small to medium sized banks can survive when they adopt smart policies such as:

- Acquire as much as possible from third parties, in order to increase efficiency and optimise costs: research, custody, brokerage execution, mutual funds etc as well as IT solutions.
- Abandon institutional asset management business for pension funds and large corporate clients to liberate significant costs for what are very unprofitable activities on a relative basis (due to lack of scale or scope in private banks).
- Keep the key private banking personnel rewarded highly on the basis of new client acquisition and client retention in a balanced way.
- Whilst adjusting cost bases more to a less fixed and lower level the revenues which today are mainly floating based on asset values, must be adjusted to a fixed and floored level as much as possible. Private bankers should ask their clients to agree to a much greater fixed fee irrespective of the fluctuating values of their assets under management.

In this way when asset values fall, private banks can hedge a certain degree of their revenues and when assets rise, they will earn less but they wont be simultaneously faced with rising operating costs or at least they wont be tempted to incessantly increase their costs as before.

By focussing on their strengths - which is to take care of their clients - rather than carry out activities in which they are economically inefficient – private banks acting smartly can survive to satisfy their clients who really don't mind paying for their services when they see that the banks undertake to focus on their strengths rather than to duplicate activities best carried out by third parties who posses better economic efficiencies. Those who operate an increasingly open architecture and better balanced cost income business model will be able to survive and even increase their profitability and should not be afraid of competing with the larger banks or those who undertake most activities in house. Taking care of the client will be smart - and will ensure survival.

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Note to Editors

MilleniumAssociates AG is headquartered in Switzerland, the heart of the Wealth Management Industry. The firm specialises in advising on Merger and Acquisitions and strategy consulting with emphasis on private banking, family offices, asset/fund management and other Wealth Management businesses including life insurance. As a Swiss-based corporation, MilleniumAssociates AG is not part of an integrated investment house and the firm is therefore uniquely positioned to offer independent pure advice in order to maximise shareholder value for its clients.

The company currently has numerous well-experienced specialists who have managed, amongst other important deals, the acquisition of **Global Asset Management**, with about CHF 20 billion assets under management, by **UBS AG,** and the acquisitions of **J O Hambro Investment Management** and **Frye-Louis Capital Management** by **Credit Suisse**. The team has experienced participating in numerous transactions in the past few years covering key aspects including origination, valuation, due diligence and contract negotiations.

MilleniumAssociates' fully dedicated team of specialists are involved in numerous active Wealth Management advisory projects with assignments supporting clients with expanding global strategies as well as those seeking to determine their ideal strategic options including partnerships and alliances. The firm recently stated that it intended to donate at least one percent of annual gross profits to charity.

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