Swiss private banking: The green shoots of a recovery?

When one of Switzerland’s most venerable names in private banking Vontobel had to sack its chairman, deputy chief executive, and financial officer for losing the bank millions in a series of botched initiatives, shockwaves were sent through the highly secretive and conservative world of Swiss private banking. Hardly recovering from this debacle, the country’s beleaguered bankers were treated with the news that Bank Sarasin, another of the great and good of country’s banks, needed help from a Dutch firm called Rabobank, to keep it afloat.

These banking catastrophes and a host of others, coupled with plummeting profits began to hint of systematic difficulties in the Swiss private banking model—one that for more than a century had ensured the Alpine nation one of the most successful financial sectors on the globe. Observers began to ask, were some of the grandest names in Swiss banking heading down the same path of the country’s national airline, namely into bankruptcy? Two and bit years on from the Vontobel fiasco, the answer would appear to be a qualified—thankfully for the industry—no.

The sector as a whole appears to have turned the corner, with the first signs of returning profits and client assets. “The last few months has witnessed a noticeable change in sentiment, which has been led by the private banking results of the big two (UBS and Credit Suisse),” believes Thomas Wolfensberger, chief executive of the consultancy Swiss Risk in Zurich.

Credit Suisse’s private banking results were particularly encouraging given the bank’s difficulties during the last two years. The Zürich bank saw a net inflow of SFr3.5bn of assets in the first half of the year. Down the road at UBS pre-tax profits came at SFr656m in the second quarter—a 23 percent rise on the first quarter. The first half saw more than SFr4bn of net new money flow into its vaults below Zürich’s Bahnhofstrasse.

An improvement in profits at the two big names of private banking in Switzerland was, say analysts, to be expected. “Both had benefited from a ‘flight to quality’ of assets to the big financial houses in the downturn. Their size also gives them the economies of scale to ride out a downturn more than their smaller competition,” said Mr. Wolfensberger.

Profits improve for the mid-sized banks

More indicative of improving times were the results of the mid-sized private banks such as Vontobel, Sarasin, Julius Baer, and unlisted Union Bancaire Privee and Pictet. Their first half results began to trundle with considerable trepidation in during July and August.
Sarasin—possibly the biggest turn around story in the sector—reported a net profit of SFr31m in the first half, compared with last year’s record loss of SFr316m. Geneva-based UBP reported an eight percent rise in client assets during the first half of the year to SFr79bn. And reported net profit rose 19 percent to SFr183m, compared with the same period in 2002. Performance numbers also looked better at Vontobel and Julius Baer.

The highly secretive Pictet very rarely gives the wider world a glimpse of its results, but anecdotal evidence suggest a warm breeze of greater profitability is flowing through its headquarters in Geneva.

The results of the plethora of smaller private banks have been patchy. Many are still reporting results for 2002, which show just how badly they have been affected by the downturn. First half results are too few and far between to give an idea of how well they have performed anecdotal evidence is the best guide. “Things are improving definitely for the smaller private banks—most of them have had to cut costs to improve profitability, but that's to be expected against the background of weak financial markets,” said Michel Dérobert secretary general of the Swiss Private Bankers Association in Geneva.

Cost/income ratios have been sliced as banks have implemented the hatchet road to recovery. Most of these cuts have been on the personnel front. “Private banks have cut costs. They started to do so later than the big two (UBS and Credit Suisse)...The largest cost factor is personnel and since the end of June 2002, the number of employees has been cut by most private banks (Julius Baer by seven percent; Vontobel, nine percent; Sarasin, 12 percent),” said Mr. Dérobert.

Some analysts say these are still early days and further restructuring and consolidation is needed before real improvements are obvious. “The massive cost cutting has been the first phase of the recovery process. The next stage is consolidation through mergers and acquisitions. This will probably be at least a two-year-long period. After that, the final stage of recovery will be reached: a return to higher revenues and organic growth,” said the wealth management acquisition specialist Ray Soudah of Millenium Associates.

Mr. Soudah believes the current conditions are ripe for acquisitions. “The market has reached an equilibrium, whereby the seller and buyer are seeing eye-to-eye on price.”

A number of banks such as Banca del Gottardo in Lugano have been up for sale for at least a year now, but potential buyers up until now were unwilling to pay the prices asked. Analysts say there are at least six banks conspicuously up for sale and another 10 or more beginning to sniff around for buyers.

“Buyers are out there too,” points out Mr. Wolfensberger. “Many see the only way of growing the business is through acquisition, given that organic growth is very difficult in the current circumstances and buying teams of individuals doesn’t necessary guarantee they retain their clients.”

And consolidation is beginning to be a reality. UBS plans to merge three of
its wholly-owned private banks, Armand von Ernst & Cie, Bank Ehinger & Cie and Cantrade to form a bank called Ehinger & Armand von Ernst.

**2004: the year of sustained recovery**

Most bankers are hoping that as early as next year will herald in a much better one for profitability and growth. Ivan Pictet, one of the patriarchs of the Geneva private banking world and managing partner of Pictet, said recently that he expected a “**strong recovery**” in 2004.

His sentiment is shared by Mr. Dérobert. “The improving markets allow for a much more optimistic view of the future. On the whole, this year should be somewhat better than 2002, but the real improvement is only expected in 2004.”

But isn’t there another time bomb ticking away in the background for Switzerland’s private banks? That being the European Union’s withholding tax on savings. Earlier this year EU members states with offshore centres such as Luxembourg, Austria and Belgium agreed to introduce a withholdings tax by 2009 on a compromise deal on banking secrecy. As part of the deal Switzerland has said that it would introduce a similar timetable for the introduction of such a tax.

Some analysts are unperturbed by the withholding tax/banking secrecy issue on the health of Swiss private banking. "I am not so sure the global market understands that there is much more to Swiss based private banking than bank secrecy," said Philip Marcovici, partner in the Zurich office of Baker & McKenzie at a recent forum hosted by 21i.net Private Wealth Partners.

Whatever the eventual outcome of the withholdings tax issue along with greater regulatory pressures, Swiss private bankers are for the most part more content then they were this time last year. “I’m actually beginning to feel I can come out of the bunker into the fresh light of day and breath a sigh of relief,” said a senior Zurich-based banker.