Resilience in the storm

Private banks brave tough conditions to post record results

After an outstanding 2021 with record profits, many private banks were once again able to achieve good results in 2022 despite the unfavorable environment. A strong increase in profit from the interest margin business compensated for the decline in both assets under management and the commission business in many cases. In a panel discussion, **Philipp Rickert**, Head of Financial Services, Member of the Executive Committee of KPMG, together with **Christian Hintermann**, Partner, Financial Services at KPMG, grilled three representatives of Swiss private banks to understand the current market situation. We welcomed industry representatives **Philipp Rickenbacher**, CEO Julius Baer, speaking for one of the large banks; **Eric Syz**, Founder and CEO Syz Group, representing the medium-sized private banks; and **Daniel Wittmer**, Chairman of the Executive Board of Private Bank Bellerive, acting as a voice for the smaller private banks in Switzerland. Together, we discussed the challenges facing the industry.

Photos of the CEO Business Talk by Jan van Beusekom

[From left to right]

Philipp Rickert, Head of Financial Services, Member of the Executive Committee, KPMG

Philipp Rickenbacher, CEO Julius Baer, as representative of the "Big 8" banks

Eric Syz, Founder and CEO Syz Group, as representative of the medium-sized banks (AuM CHF 10–100 billion)

Daniel Wittmer, Chairman of the Executive Committee of Private Bank Bellerive, as representative of the small banks (AuM < CHF 10 billion)

Christian Hintermann, Partner, Financial Services, KPMG

KPMG Would you agree with us that the high profits posted by private banks in Switzerland in 2022 are mainly thanks to very strong interest income – and so, in fact, beyond the scope of their core business?

Philipp Rickenbacher This is true – and for us, interest income is part of our core business. The year 2022 was a very good one for the entire industry and for Julius Baer the second best in our history. Fortunately, we have seen a return to high interest income after some long years without any significant profit contribution from this area. I consider the interest margin business to be a core banking business and therefore also part of private banks' core business. The resilience of our business model, however, is based on our ability and possibility to balance and compensate income streams over individual cycles and phases of economic development. Interest income growth in the current year will not match last year's level but we welcome the return to positive interest rates.

Private banks are very dependent on financial market developments for their earnings, while organic factors such as net new money, cost savings or pricing often seem to be less significant. Reducing this dependency has only succeeded to a limited extent. Would you say it is even possible at all?

Eric Syz This is the case. A large portion of our income from the commission business depends on exogenous factors such as financial market performance and our clients' behavior. On top of that, you have current developments such as automation in banking or new entrants from the fintech sector, which exert a certain degree of pressure on our margins. So, it is all the more important that we, as private banks, can offer a range of products and services at a price that is appropriate and acceptable to our clients.

Philipp Rickenbacher From the perspective of a large financial institution, I would add that we have become less dependent on individual earnings pillars and that we will continue to see a stronger focus in future on activities that generate recurring revenue. This will make the revenue mix more predictable and resilient.

This brings us to the question: to what extent do you feel the pressure from new, digital competitors? Are these "neo-banks" a noticeable force in the high-end segment, or are they carving out a niche for themselves in the affluent segment?

Daniel Wittmer If I reflect on the last forty years, classic or traditional banks like ours have always evolved, increased our efficiency, modernized processes and invested heavily in IT and data security. And this development just keeps on going. In the recent past, technological advances have certainly given us a little boost, but in our segment, clients value personal contact with their relationship manager. In the affluent segment, competition is set to intensify, and new tech-driven sales channels are bound to appeal to a new, younger target group.

Philipp Rickenbacher Even at large financial institutions, the relationship between the advisor and the client is central and a unique selling point. We have to perfect the triple jump between personalized client relationship, scalable sales channels and the highly scalable back-end. I am not afraid of what is happening on our doorstep. Competition energizes the business and many of the digital offerings are highly interesting. Ultimately, everyone faces the same challenges when it comes to acquiring clients, building trust and reaffirming that trust. I also strongly believe that the old world and the new world will increasingly converge.

Eric Syz Digitalization in the banking business is not just about automating the bank's back office – it is also a great support for employees. A purely tech-based approach to clients will only work to a certain level. At some point, clients want to talk to someone and get individual answers to their questions. This is true even of highly tech-savvy clients, as I recently experienced myself in the case of a wealthy venture capitalist.

Philipp Rickenbacher As we approach the top end of economies of scale at the largest banks in the industry, the question is whether there is a limit. And whether from this point onwards, wealth management no longer works and industrialization models might cease to produce efficiency – let alone quality – gains.

A considerable rise in interest income compensated for the sharp decline in AuM and the commission business in many cases, leading to good results for many private banks despite the unfavorable conditions.

Christian Hintermann
Partner, Financial Services, KPMG

Size and growth are not a goal per se for a private bank, but our comprehensive data shows that these are key factors in enabling a private bank's ongoing development in an increasingly complex and regulated environment. This is demonstrated not least by the high market concentration in Switzerland, where 80 percent of assets under management are held by the "Big 8" banks (excluding UBS and CS), and the fact that more than half of the banks with less than CHF 10 billion have disappeared in the last decade. How important is growth in your size segment?

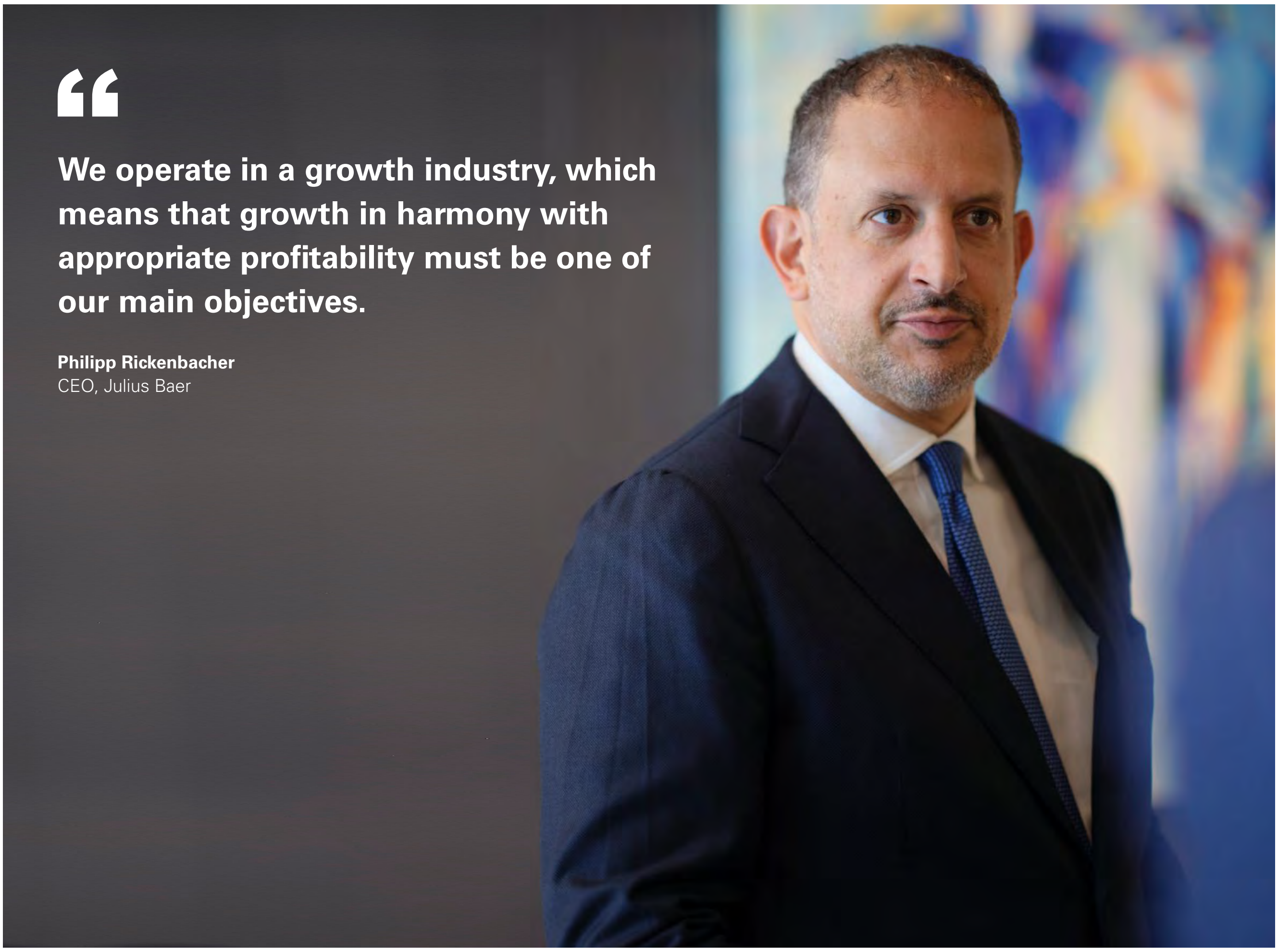
Daniel Wittmer Of course, we would very much like to grow. But in our very special segment, with a small number of large portfolios under the Bellerive Bank umbrella, growth is more difficult and not our main goal. For us, new clients also have to be compatible with the existing ones. After all, everyone comes face to face at the annual general meeting. We also try to reduce complexity and limit risks through our focused business model. Although there are international rules, legal certainty in cross-border service transactions has decreased significantly in practice. That is why we only operate out of Switzerland and, in doing so, consciously forego growth.

Philipp Rickenbacher We operate in a growth industry, which means that growth in harmony with appropriate profitability must be one of our main objectives. We have shown internally that we can, in principle, reach 1,000 billion Swiss francs of assets under management without deviating from our core business and our strategy. You need to set ambitious goals, and from a purely technical point of view, it is possible. Economies of scale – everywhere we operate – are an important element of this. We need to achieve critical mass, keep our costs under control and manage risk with iron discipline in every market we operate in.

Eric Syz We have our central cost structure with high wages in Switzerland, but generate the majority of our revenue in euros or dollars. From a purely business perspective, we should outsource as many management and back-office tasks as possible to bring the cost structure more in line with our income streams. But in a medium-sized private bank, you can only do that to a very limited extent. I also firmly believe that it is precisely our foreign clients who look for and value this Swiss identity in us. That's why we don't think there will come a point when the Swiss USP loses so much importance that it no longer justifies the higher cost prices in Switzerland. It also takes time to build a trusting client relationship. This means that while our growth is not fast, it is sustainable.

Despite advances in digitalization and automation, the effect on profitability remains modest. Is this due to the high personnel costs, which remain at around 70 percent and may even increase?

Philipp Rickenbacher Despite all the automation, our business is very people-intensive. This also applies to our booking center hubs abroad, where efficiency gains are curbed by high regulatory requirements and regional or country-specific peculiarities.

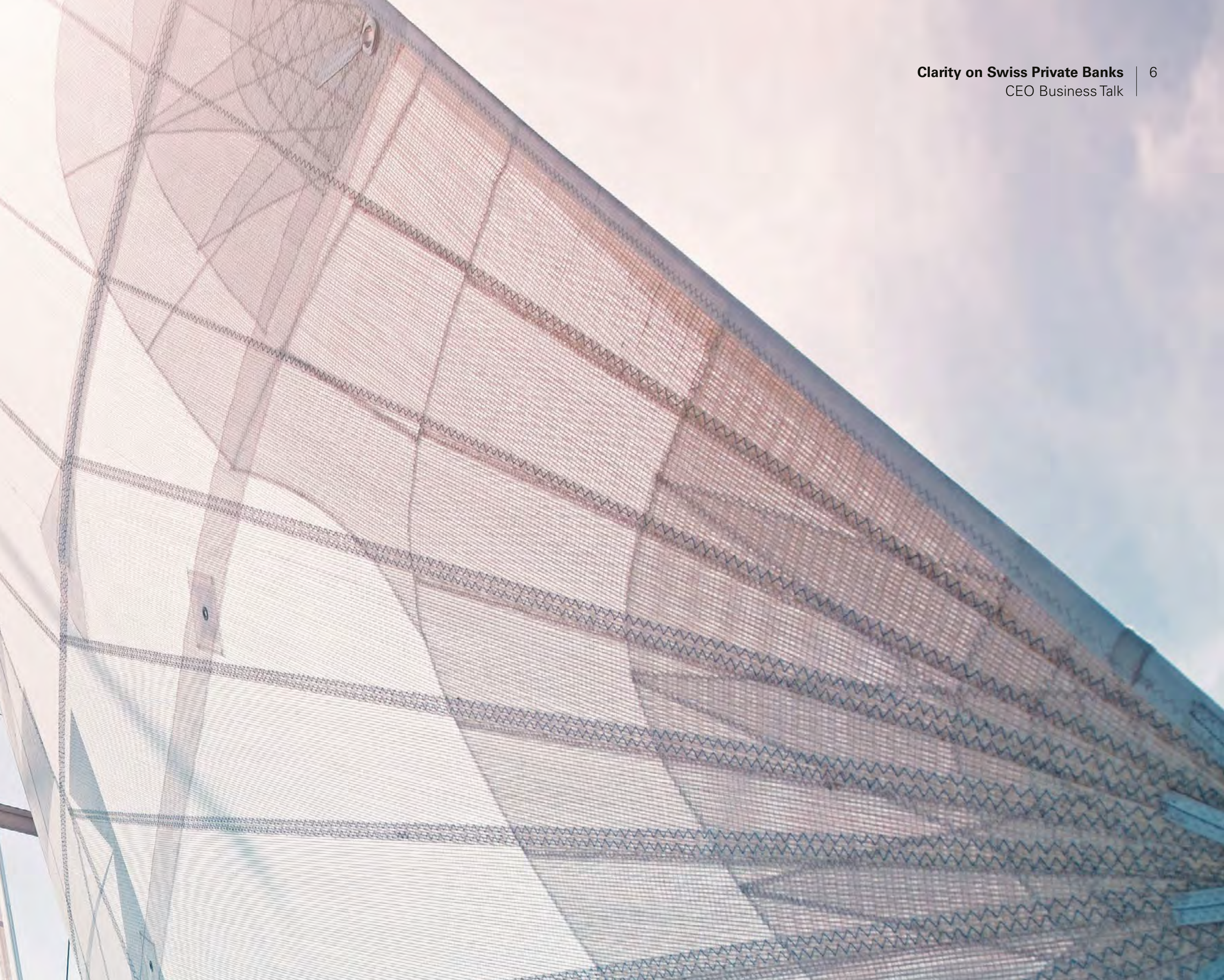


Global wealth is growing every day. Private banking should really be a growth business. What are the limiting factors?

Eric Syz It is important to distinguish between the sources of increasing wealth. There are in fact earned assets that grow far less quickly than the accounting gains arising from asset movements of wealthy individuals. Moreover, growth should not be an end in itself. At the end of the day, we have to operate profitably and also make money. Increasing regulation is certainly not helpful in this regard and places a lot of demand on us. A banker friend from Geneva recently told me, "if you want to progress in your career with us, you should head to the compliance department, they are growing the strongest and the fastest." Another limiting factor is certainly the availability of qualified relationship managers, who understand the importance of building trusting relations with clients.

Philipp Rickenbacher Having and retaining the right people is certainly a critical but also a limiting factor. In our larger segment, however, we no longer have relationship managers who act as lone wolves and take care of everything; instead, we build interdisciplinary teams to manage client portfolios. We also support our relationship managers with IT tools that relieve them of a lot of work, particularly in the area of compliance and legal requirements. This leaves more time for contact and interaction with clients. Despite efficient processing tools, personal exchange is always at the heart of the client relationship. We also aim to train and develop young professionals ourselves, because the battle for the best talent in the market is fierce.

Eric Syz That is a key point. In the past, the industry did little in the way of employee training and development, but today the Head of Human Resources is one of the most strategically important positions in the company.

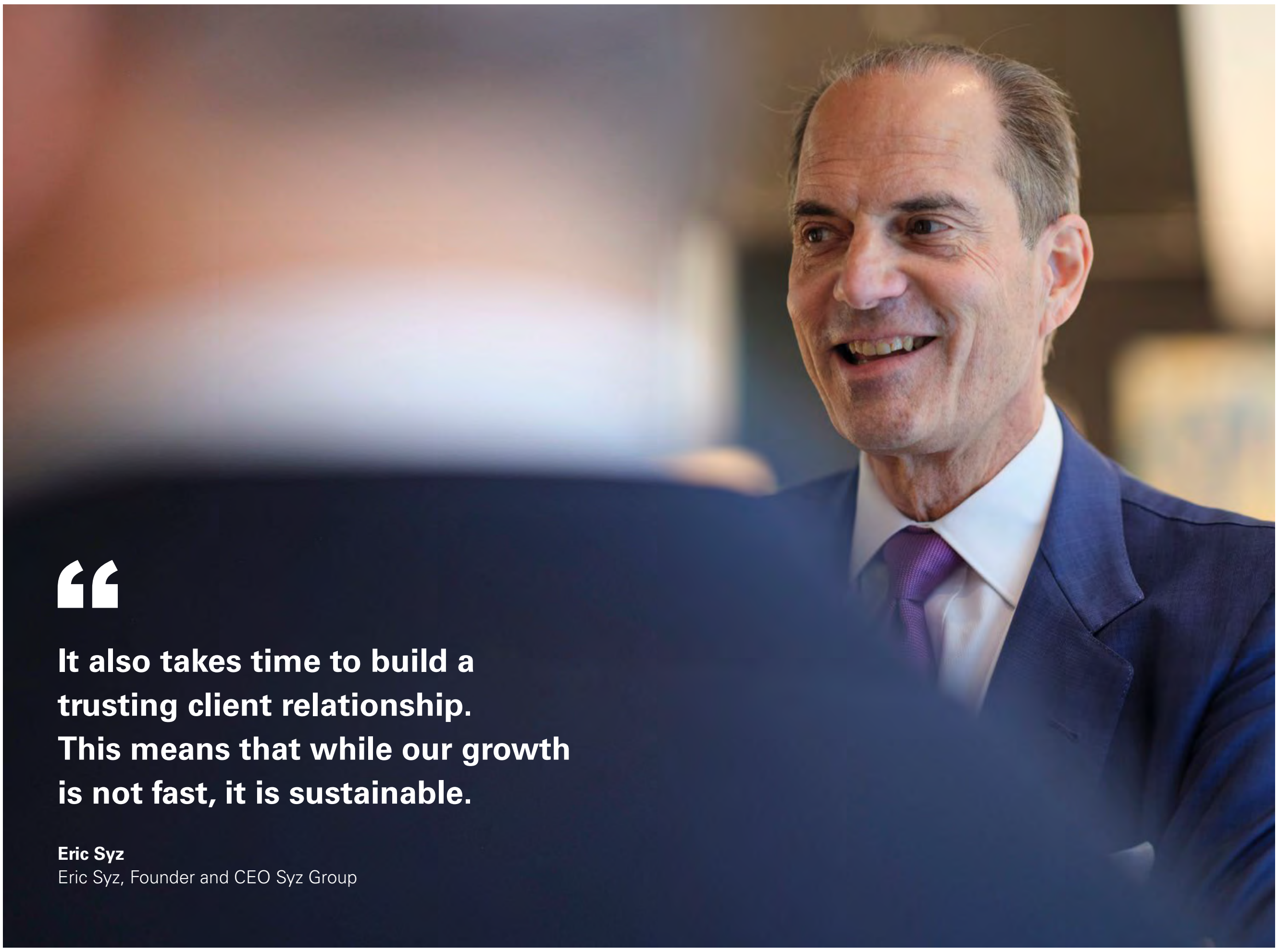


Especially in times of crisis, Switzerland as a financial center has benefited from its role as a "safe haven" and continues to enjoy a strong position. However, questions about quality and reliability are more critical at present than they have been in the past, and the Swiss financial center has slipped significantly in certain rankings. What is your assessment of the current situation?

Philipp Rickenbacher I am a great advocate of Switzerland as a financial center. We have the best prerequisites to be and remain number 1 worldwide, but we have to work hard for it. We all know the advantages of our country in terms of stability, legal security and tradition as well as banking density and expertise. But we face tough international competition. In the last few years, Switzerland's reputation as a financial center has suffered. It started with the Ukraine war and the discussions about neutrality and sanctions. The downfall of Credit Suisse, including the discussion about the write-off of AT1 bonds, was another low point and has even tarnished Switzerland's much-praised legal security.

Daniel Wittmer What concerns me is the way Switzerland's neutrality is being dealt with and discussed. In my view, the politicians are not cutting a good figure here and are showing little resistance. At that level, we have become vulnerable and have let the discussion get too far out of hand. Money likes to go where the conditions are predictable. We have to invest a lot of energy in regaining this predictability, or rather in conveying it to the outside world.

Eric Syz You also need to differentiate between the internal and external view. We have a much more dramatic perception of the debate and the loss of reputation of the Swiss financial center than outsiders. If you ask people in Brazil or Hong Kong how Switzerland has changed, their perception does not match ours. The well-known advantages of banking in Switzerland are still the same. And let us not forget that many of the current negative events are also affecting the surrounding countries. But our status is not set in stone forever, and we have to work on it continuously. I believe that we banks should once again become more involved in the overall economic fabric of our society. We should actively contribute not only to the progress of the financial center, but also to that of the country as a whole.



Looking back, what have been the biggest drivers of change, and what trends will be important in the future?

Philipp Rickenbacher In the end, it is the sum of many developments and events that has led us to where we are today. Regulatory changes, the macro environment, digitalization and geopolitics are certainly noteworthy examples. However, as an industry, we have always been agile and adapted to changing conditions. Looking ahead, I see major shifts and opportunities coming our way in the areas of sustainability and artificial intelligence, which will once again be very demanding on us. It will certainly not be boring.

Daniel Wittmer A major game changer for me in recent years has been how professional our clients have become. They are better informed, have greater financial expertise and challenge us more as a result. This can be observed equally across all client segments.

Eric Syz The move away from banking secrecy in Switzerland was probably one of the most significant business-changing factors in recent years. Many people have already proclaimed the demise of the private banking industry, just as the Swiss watch industry was declared dead when Japanese digital watches came onto the market. Today, we remain the largest off-shore financial center in the world, and will continue to be so for some time to come. But we will always have to adapt to new challenges and conditions. I see new technological capabilities as a great opportunity for the future. If we manage to use artificial intelligence to make our services even more precise, even faster, and even more client-centric, that will be the next quantum leap.

Philipp Rickenbacher And the constant throughout all the changes will be people and our personal advice. This is the foundation on which we will build our future success.

This CEO Business Talk is part of KPMG's study "Clarity on Swiss Private Banks 2023".
Read more at **kpmg.ch/privatebanking**