



cutting through complexity

FINANCIAL SERVICES

Success through innovation

Achieving sustainability
and client-centricity in
Swiss private banking

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Institute of Management



University of St. Gallen

Contents

3	Introduction
4	Executive summary
8	Methodology
9	Glossary
10	Innovation
18	Markets
26	Clients
32	Collaboration between IAMs and private banks
40	Products and services
48	Pricing
52	Operations
60	Governance and control

Success through innovation

Achieving sustainability and client-centricity
in Swiss private banking

A study by KPMG AG Switzerland in cooperation with the
Institute of Management at the University of St. Gallen.

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Introduction

The transformation of private banking continues. Changing client demands, not least the emergence of new generations of clients with distinct technological preferences, and ongoing regulatory upheaval, are just a couple of the huge challenges facing banks' management teams. These challenges are already upon private banks and will continue to evolve over the coming decade.

Yet these challenges give rise to enormous opportunities. They can drive success by forcing a radical rethink of business models, as in the Swiss watch industry. The options for dealing with the challenges and seizing the opportunities are many and varied, but they share a common theme: finding a sustainable position for the bank in a consolidating industry, based on a much deeper understanding of its client segments, and an overwhelming need for operations and offerings to be more client-centric. On this last point alone, substantial effort is required to ensure that clients' needs feed the development of products and services. All too often the reverse is true – that existing products and operational set-ups determine a bank's view of what clients should be offered and how they should be serviced.

In the coming era, scale will be increasingly important for many banks. Niche strategies will be an option only for a small number of banks. New, innovative collaborations at an industry level and between private banks and Independent Asset Managers (IAMs) will be necessary to expand client bases, reduce costs, leverage complementary skills and market positions, and ultimately provide for mutual success.

The time for innovation has come. The agenda is long and intensely challenging, but the banks that emerge from this period of transformation as successful, sustainable businesses will be those that invest time and resource now to develop a clear forward-looking market strategy, rebuild their business model and differentiate and adjust their offerings to more accurately reflect their existing and prospective clients' needs.

This is an ongoing dialogue in which new ideas continue to emerge. We firmly believe that insights can be shared, built and acted upon between industry participants, advisors and observers.

We hope you will engage with us in this debate.



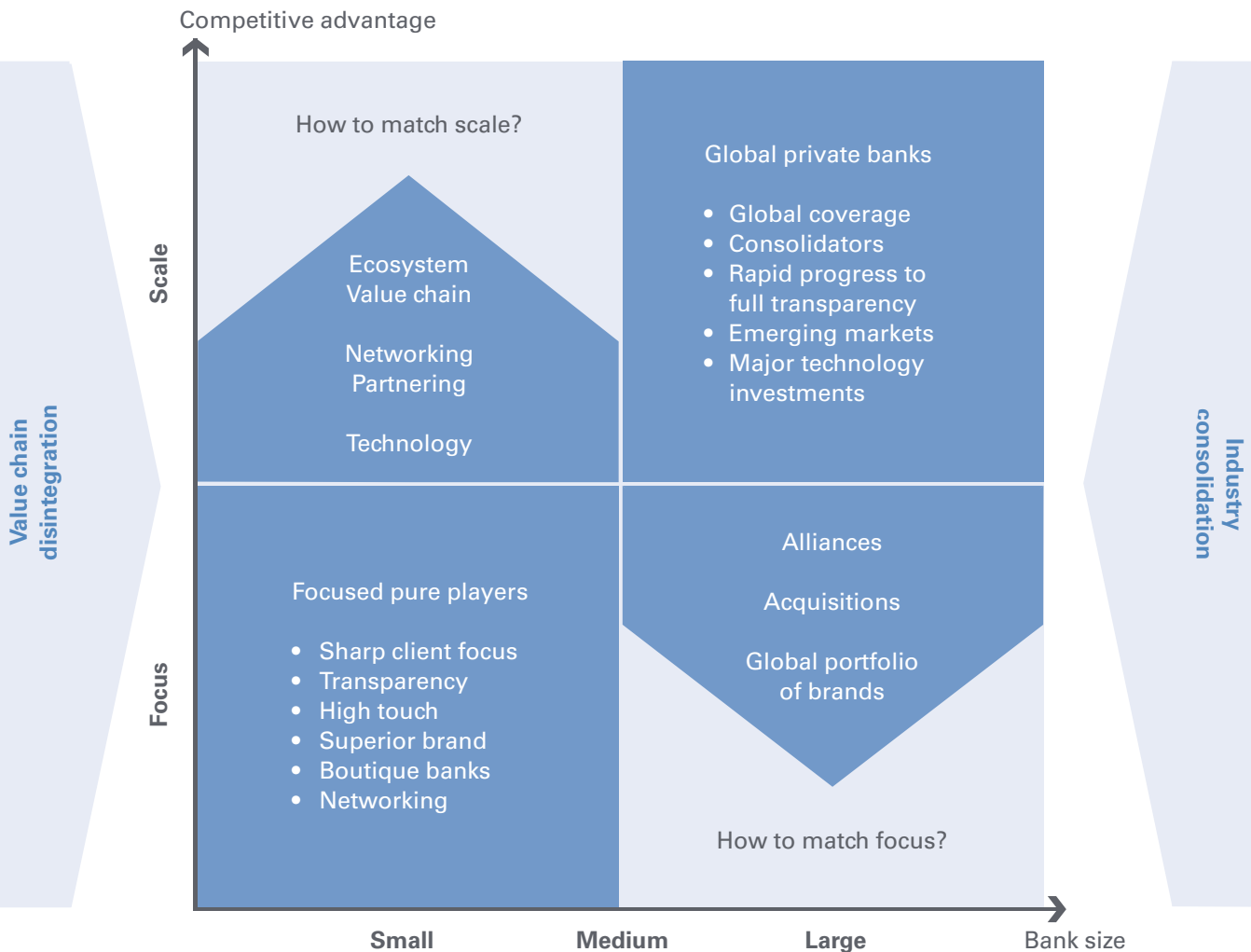
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November 2013

Executive summary



We expect that the Swiss private banking industry will experience transformation along two broad lines by 2022:

- Industry consolidation will accelerate due to ongoing profitability issues and increasing benefits of scale that arise from expanding investments in international expansion and technology.
- Technology-enabled collaboration opportunities at the industry-level will create novel positioning options.

Smaller banks have historically enjoyed the benefits of superior client-focus while larger banks benefited from scale effects. Changes in regulation, the increasing pressure to go international and new ways of interacting with clients cause the largest to become even larger and, in order to survive, pure players to further sharpen their focus. In this process, larger banks risk losing their ability to maintain a sharp focus in some client segments. In order to better target individual client groups, large incumbents may acquire a boutique bank or Independent Asset Manager (IAM) with a superior focus and achieve scale effects in back-office processes. Meanwhile, smaller banks must compensate for a lack of scale by developing a clear positioning strategy. Partnerships with larger retail banks, technology platform providers, and different international constituencies may alleviate this pressure.

Banks need to rethink their strategies to achieve both scale and focus. The study's respondents on average expect the minimum efficient size of a bank to double over the coming years. At the same time, client needs are becoming more complex, requiring banks to better tailor their offerings for distinct client segments that best match the bank's existing capability profile. Going forward, two core private bank types may be best positioned to seize strategic opportunities:

1. Small, focused pure players that can capitalize on their superior brands and client-centric advisory skills while keeping their costs capped through networking, partnering and enhanced use of technology.
2. Large, global and diversified players can actively use alliances and acquisitions to develop a global brand portfolio.

Success in the imminent transformation period is not a given. The dual mission of handling cost pressures while renewing core business activities requires a strategic vision and determined decision-making based on an industry scenario characterized by value chain disintegration and consolidation. This study spotlights the business model areas that should be of central concern. In particular, it discusses innovation, markets, IAMs, clients, products and services, pricing, operations, governance and control to derive priority agendas for action for private banks.

Markets

As foreign regulatory and political pressures continue to complicate how private banks conduct their international and offshore businesses, the support of the Swiss Government is key if Switzerland is to remain a major player in the offshore market. Further, many believe that Automated Exchange of Information (AEI) will be introduced within three years.

Priority agenda for action

- Ensure the bank's geographic strategy is viable given regulatory and cost constraints.
- Apply "Enterprise Risk Management" principles to the risks of entering a new market and measures to ensure a sustainable and profitable business.
- Plan to implement an AEI program in major countries.

Clients

Client segment focuses are set to change by 2022, with competition intensifying for clients with assets of between CHF1 million and CHF5 million and clients becoming more demanding. Greater effort is required to track client behaviors in order to achieve true client-centricity, which is critical to a sustainable private banking relationship.

Priority agenda for action

- Develop clear steps to reinforce the bank's client-centricity strategy, strengthening the differentiators in client service with particular regard to new client segments.
- Collect more comprehensive and detailed data on clients for the purpose of a dynamic segmentation. Identify clients' touch points.
- Make use of behavioral analytics for bundling service/product offers.

Products and services

As target client segments change, improvements to data collection and analysis are needed to further tailor products and services and become advisory leaders. Banks must prepare for the fusion of products and services with technology-enhanced solutions and new communication channels.

Priority agenda for action

- Adjust product and service focus in line with the bank's strategy to become an advisory, technology, production or hybrid leader.
- Advisory leaders should better capture clients' needs in order to choose from open architecture the most suitable products and develop tailored services. Universal banks should further leverage retail or investment banking products to provide a holistic offering.
- Keep abreast of attitudes to online solutions and communications.

Collaboration between Independent Asset Managers (IAMs)

Most banks view growth via IAMs as a strategic agenda point for the next decade. IAMs can give banks access to scale, while private banks can deliver benefits to IAMs through infrastructure, operations and service range. Rigorous due diligence is required by both sides to ensure best fit and mitigation of risks.

Priority agenda for action

For private banks

- Benchmark attractiveness as custodian bank and/or provider of additional services against that of other banks, ensuring articulation of benefits changes in line with the IAM market.
- Apply extensive due diligence to mitigate onboarding risks and identify upside potential. Ensure governance processes for existing relationships are robust.

Innovation

Respondents expect to experience fundamental changes over the next ten years. Many Swiss private banks need to re-invent their service offerings, operations and market footprints. More broadly, the industry must change through consolidation and reconfiguration as well as an update of the industry's global brand messaging to ensure "Swissness" remains a key selling point over the coming decade.

Priority agenda for action

- Acknowledge that the "old normal" is gone and embrace the imminent transformation period as an opportunity.
- Ensure value proposition meets future demands, is truly client-centric, benefits from scale effects, and offers best-in-class products and services.
- Take initiative at industry-level, reviving Swiss private banking's brand by strengthening the values its global clients demand including stability and service quality.

Pricing

Retrocession is over and flat fees will begin to dominate. Pricing models must more closely reflect clients' needs and profiles and be better aligned with specific product and service mixes.

Priority agenda for action

- Identify pricing models that best suit clients' profiles and needs by strengthening data collection and analysis.
- Introduce compliance risk and behavioral data analysis into pricing models.
- Develop clear pricing communications to ensure clients understand and accept new pricing models.

Operations

The minimum efficient scale of private banking operation is expected to increase. Operations managers are on a dual mission to cut costs and implement new business models. To proceed further they must reap industry-level synergies, automate operating processes, and eventually tackle job profiles and compensation levels.

Priority agenda for action

- Eradicate unnecessary operations. Outsource processes that are non-core to the bank's value proposition. Automate remaining processes where applicable.
- Seek industry-level collaboration to create scale and reduce excess capacities and industry-level redundancies (e.g. through shared services).
- Support client-centricity and productivity enhancements by revising job descriptions, wage levels and structures accordingly.

Governance and control

Substantial efforts are still necessary to ensure internal controls are aligned with regulatory requirements. Some banks think regulation should take into account size and business model. Implementation challenges are significant and staff may need support through the period of change.

Priority agenda for action

- Develop "Road to Compliance" concept to cover upcoming regulatory requirements, mitigate compliance risks and ensure systematic, cost-efficient introduction of compliance measures, exploiting synergies by leveraging existing processes.
- Support people in making the change. Motivate by leading by example. Announce major changes in strategy, communicating openly regarding impacts.

and private banks

For IAMs

- Consider choice of bank based on a combination of client profiles and preferences, bank brand, services, costs, IT platform and international connectivity, inter alia.
- Monitor existing bank relationships and analyze potential new ones to ensure ongoing strategic and operational fit.

Methodology

This study is based on a combination of qualitative interviews and a quantitative online survey. A total of 39 banks were included in our study through this combination. We also interviewed 10 Independent Asset Managers (IAMs) to complete the view of the private banking playing field. We thank all respondents for their participation in these interviews and online surveys.

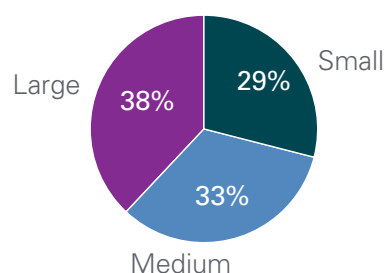
Interviews

Interviews were conducted with 25 C-level executives at 25 private banks or private banking operations of universal banks, in Switzerland.

The 25 banks interviewed are classified as:

- Seven small (AuM of CHF5 billion or less)
- Eight medium (AuM of more than CHF5 billion but no greater than CHF25 billion)
- Ten large (AuM of more than CHF25 billion)

Interviewees by bank size



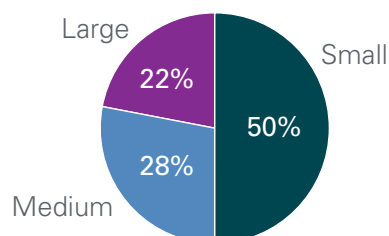
Online survey

32 private banking executives completed our online questionnaire.

These respondent banks are classified as:

- Sixteen small (AuM of CHF5 billion or less)
- Nine medium (AuM of more than CHF5 billion but no greater than CHF25 billion)
- Seven large (AuM of more than CHF25 billion)

Online survey respondents by bank size



Glossary

AEI	Automatic Exchange of Information
AuM	Assets under Management
BRICS	Brazil, Russia, India, China, South Africa
CHF	Swiss francs
CRM	Client Relationship Manager or Client Relationship Management
EU	European Union
HNWI	High Net Worth Individual
IAM	Independent Asset Manager
IT	Information Technology
KPI	Key Performance Indicator
KYC	Know Your Client
M&A	Mergers & Acquisitions
MiFID	Markets in Financial Instruments Directive
N/A	Not applicable or not available
OECD	Organisation for Economic Co-operation and Development
S.A.R. Hong Kong	Special Administrative Region of Hong Kong
UHNWI	Ultra High Net Worth Individual
US	United States of America
USD	US dollars
USP	Unique Selling Proposition

Definitions and notes:

Private bank – definitions

- The terms “banks”, “banking”, “wealth management”, “private banking” and “private banks” are used interchangeably for the purpose of this publication. All refer to private banking unless specifically stated otherwise.
- “Private banks” refers to both pure private banking organizations and the private banking operations of other banks.

Key findings and our insights

- Throughout this publication, the “Key findings” sections are based on the results of the interviews and survey as described in the Methodology section of this publication. They are not necessarily to be considered the views or positions of KPMG and the University of St. Gallen, whose views may be found in the “Our insights” sections of this publication.

Chart sources

- All charts and graphics are sourced from KPMG analysis based on the results of the interviews and survey as described in the Methodology section, unless specifically stated otherwise.



Innovation

Following several years of depressed profitability, many private banks face a moment of truth. Business model innovation is needed if they are to remain in the market.

This is a significant challenge given the present business environment. Domestic and international regulations are in a state of flux, technology is altering the industry's value chain, and a large population of competitors is poised to seize any attractive opportunities that arise.

Priority agenda for action

- Acknowledge that the “old normal” is gone and consider the imminent transformation period as an opportunity to reposition.
- Ensure value proposition meets future demands, is truly client-centric, benefits from scale effects, and offers best-in-class products and services.
- Take initiative at the industry-level and review Swiss private banking's brand by strengthening the values its global clients demand, such as stability and service quality. Put performance and stability first and substantiate these values with unique Swiss standards and resources.

“ Compared to other industries the banking industry is flexible enough to implement new rules and regulations. Yet, it needs more innovation through client-centric products and services.”

Interviewee from large bank

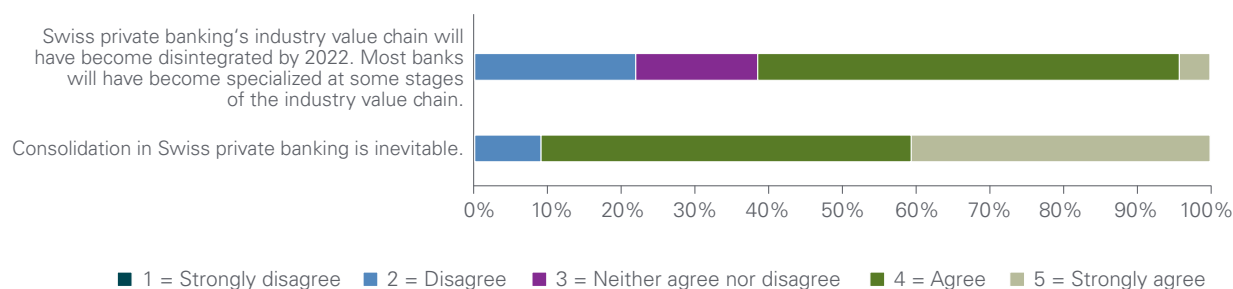
For many banks, the time for piecemeal action is past. To survive, they must fundamentally revise their business models.

Recent series of regulatory changes have given rise to a major transformation period in Swiss private banking. With depressed profitability at many banks and upcoming challenges such as digitization and new generations of clients, banks need to undertake a holistic review and revision of their business models. No area is exempt: products and services, pricing, markets and operations.

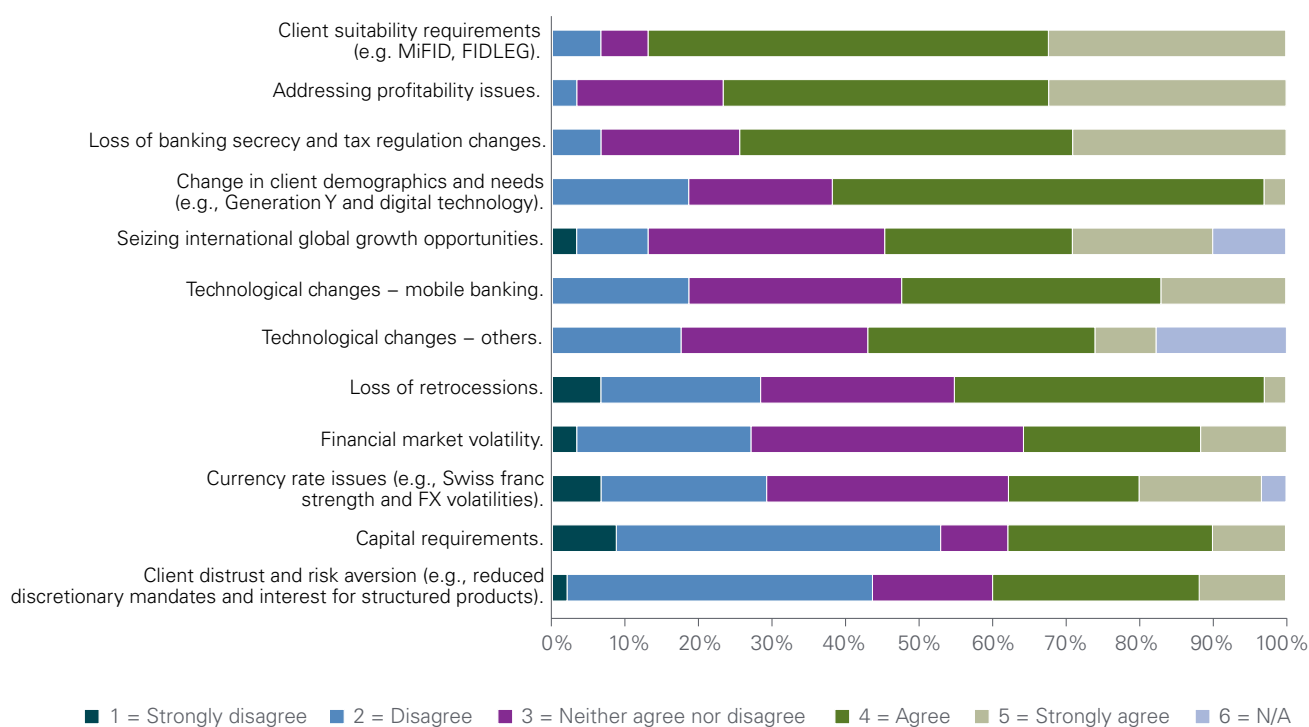
Key findings

- Respondents expect to experience fundamental change. Almost all foresee major consolidation to be imminent. More than half of respondents expect the industry value chain to disintegrate.
- Many respondents are adjusting their client segment focuses and market approaches. Broad trends are observed towards holistic financial services, higher wealth brackets and institutional clients.
- Most changes arise from the perceived need to better tailor products and services to client needs. Rather than products driving client segmentation and strategies, the reverse should be the case.
- A lack of understanding of future generations and the broad range of technological scenarios are seen by many respondents as major obstacles to change. With regard to technology, expectations range from a moderate adoption of mobile services to a full disruption of the industry.
- IT is considered a source of innovation. Respondents have substantially increased IT expenditure and plan to continue doing so in the near future.

Swiss private banking faces strong consolidation pressures and forces towards specialization and value chain disintegration



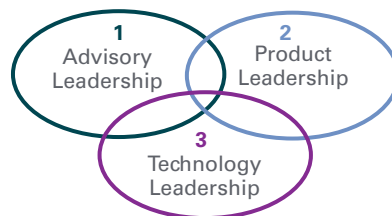
Major drivers of business model change: Beyond regulatory issues, client demographic and digitization rank high on banks' agendas



Our insights

- Two factors should guide banks' innovation efforts: the specifics of future client generations and the opportunities arising from digitization.
- Current trends such as the influx of technology, industry consolidation and open architecture will cause the industry value chain to break up. We foresee this yielding a number of positioning options: (1) advisory leadership, (2) product leadership, (3) technology leadership, or hybrid positions. Only a very few (large) banks will be able to excel in all three roles (hybrid).

Generic positioning options within private banking



- If a more open private wealth ecosystem develops, seizing a specialized role within this system could enhance scale and profitability for banks of any size.
- Serving distinct technology-related roles more cheaply may appeal to industry entrants from the Information, Communications and Technology domain, further raising the importance of scale to these roles. As an alternative to scale, increased income from superior niche strategies seems possible in certain market niches, though these will be too few to host the large population of banks presently pursuing such a strategy.

Agenda for action

- Focus on developing differentiators the bank can sustain and rivals will struggle to imitate. Keep target clients at the heart of such efforts.
- Take a holistic view to determine innovation efforts. Learn from industries that have undergone digital transformations.
- Smaller advisory-focused banks should engage in client-oriented innovations, forming alliances with like-minded parties to pool innovation capacities (e.g. mobile technologies). Seek scale effects and ally with specialized providers.
- Larger banks or banks specializing in technology-related functions should focus on scale-oriented innovations, driving consolidation and considering options to further internationalize. Aggregate across client niches by acquiring and maintaining boutique banking brands under a shared operations scheme such as that seen in Swatch's aggregation strategy.

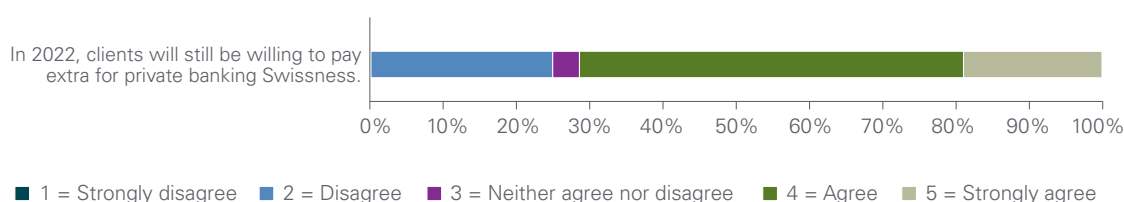
Benefits would be gained from revising Swiss private banking's global brand messaging and greater industry-level collaboration.

Switzerland has lost a competitive advantage with the erosion of its banking secrecy, yet the country remains synonymous with stability: a valued attribute in a politically and economically turbulent world. This stability, together with client confidentiality and high service quality, meanwhile, are Swiss values that will remain valid. As consolidation and reconfiguration progress, Swiss market incumbents and governing institutions need to invest effort in revising the brand messaging.

Key findings

- Respondents retain confidence in the value of private banking “Swissness”: Many believe it will still command a premium in 2022.
- Respondents agree the Swiss private banking brand needs updating. Stability and performance should move to the fore while secrecy and tax topics decline in clients’ thinking.
- To improve Swiss private banking’s global competitive position, more effective collaboration is necessary between banks and institutions constituting the Swiss financial center.

The value of “Swissness”



Private banking "Swissness" 2013 vs. 2022

The size of the word reflects its perceived importance - the larger the word, the more mentions it received from respondents.

2013



2022



Our insights

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- Switzerland will remain an attractive location for private banks, with its unique tradition of stability and its enviable reputation among global clients for performance and service quality. Despite increasingly fierce competition between financial hubs, Switzerland has the chance to leverage its strengths to lead the competitive field.
 - More effective collaboration between banks and formal institutions is needed to promote the competitiveness of the Swiss financial center, such as re-defining private banking “Swissness”. This may imply developing superior Swiss standards or the establishment of high-quality shared service functions that support the quality perception of the Swiss brand image.
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Agenda for action

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- Actively engage in industry-level efforts to further develop the Swiss financial center’s competitiveness.
 - Help to re-define the Swiss private banking brand and determine with which values Swiss private banking should be associated going forward.
 - Consider initiating a task force on industry-level initiatives (e.g. standards or shared resources) that underpin the client value proposition.
 - Lobby more strongly for the industry’s interests – especially small to mid-sized banks that feel they lack a voice in Berne.
-



Markets

The offshore private banking market is expected to change dramatically by 2022. Nonetheless, most respondents remain positive about prospects despite foreign regulatory and political pressures, expressing confidence that Switzerland will continue to play a leading role in international private banking.

Determining which markets to service is an increasingly complicated affair, however. Growing regulatory complexity and cost pressures heavily influence market footprints, as do politics and the policies and activities of financial market authorities.

Priority agenda for action

- Determining geographic strategy should be premised on which countries the bank is realistically able to serve. Regulatory and cost impacts may contrast with existing strategy.
- Plan to implement an AEI program in major countries. Analyze client data systems and physical files to ensure compliance with expected future requirements.
- All risks relating to a future business model (on- and offshore) should be assessed. Apply “Enterprise Risk Management” principles to the risks of entering a new market and measures to ensure a sustainable and profitable business.

“ Our opportunities and goals by entering into new markets are clearly the growth of our business – however it is a challenge to do it in a profitable way with a business model that is tailored and makes the new market a success! ”

Interviewee from large bank

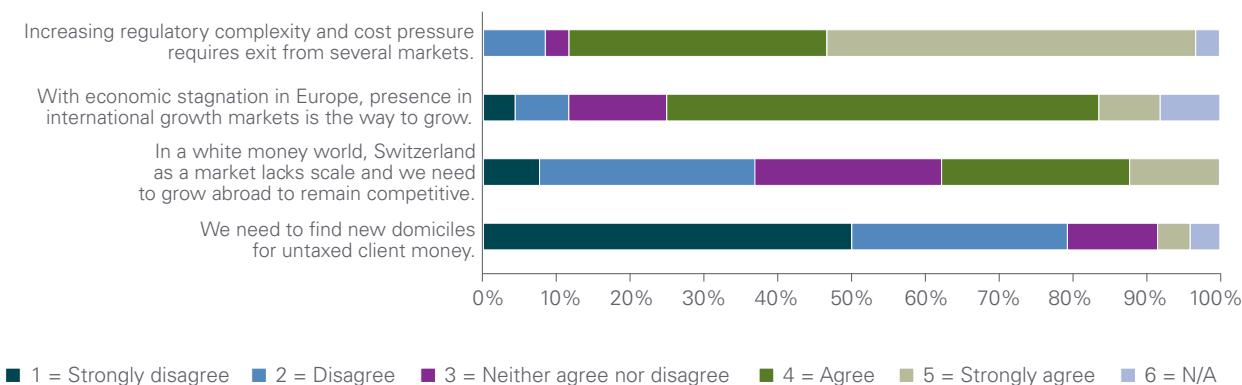
Foreign regulatory and political pressures will continue to influence private banks' international /offshore business.

Regulatory developments have exacerbated the risks of maintaining an onshore presence, with the result that deciding which markets to service is now an even greater factor in whether a Swiss private bank will survive or fail. Much time and resource is swallowed across the industry by organizational changes driven by compliance with cross-border rules and other regulations. In this environment, banks should focus on a manageable number of core markets.

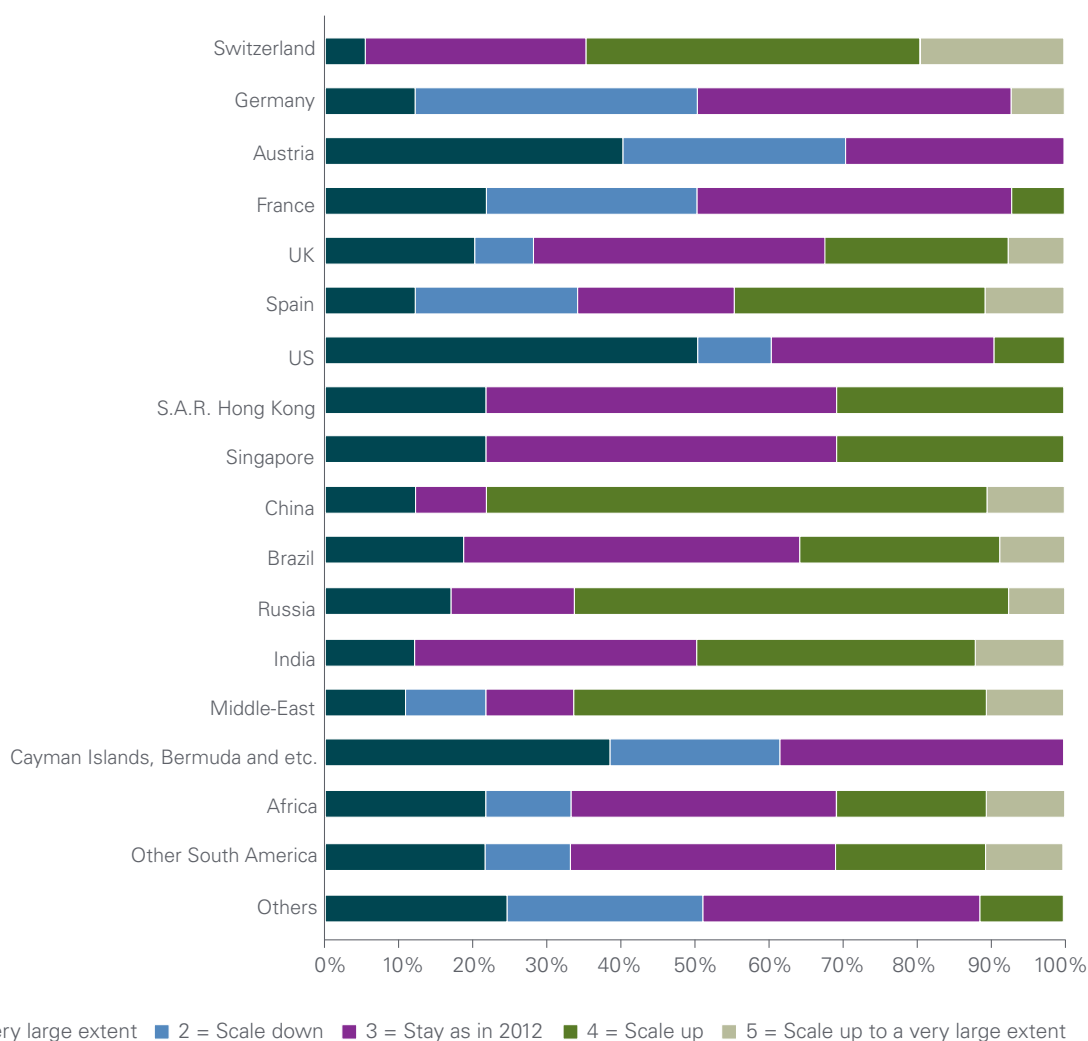
Key findings

- Around 60% of respondents plan to expand their Swiss market share by 2022.
- Almost all respondents view an onshore presence in international growth markets to be important given Western Europe's relative economic stagnation. Most see the growth markets to be BRIC, the Middle East, Singapore and S.A.R. Hong Kong. A scaling down of business is observed in Europe (notably France, Germany and Austria), the US, Bermuda and the Cayman Islands.
- Entering foreign markets is seen as especially important to stay competitive in a declared money world, as the Swiss market lacks scale. Maintaining a cross-border model focused on a manageable number of core markets can deliver opportunities. A major challenge, however, is ensuring appropriate regulatory knowledge and profitable growth in a new market.
- Approximately 80% of respondents believe growing complexity of regulatory requirements and cost pressures will drive future geographic footprints.

Regulation driving international business strategy by 2022



Analysis of onshore market footprint by 2022



Our insights

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- Swiss private banking is in a reconfiguration phase. This could result in a rise in a number of client portfolio deals between banks due to changes in strategy.
 - Onshore banking is the favorite model for international private banking. Our experience shows this model to be investment and cost-intensive compared to an offshore strategy. Given the huge regulatory hurdles, banks should consider how to profitably serve onshore clients while meeting clients' evolving needs.
 - We observe no clear interest in Africa over the coming decade despite the continent being a source of opportunities in many industries.
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Agenda for action

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- Define a strategy that takes into account the cost of compliance and potential revenue generation when determining onshore and offshore opportunities.
 - Identify and prepare exit strategies for client portfolios the bank will not be able to serve in the future due to change of focus countries.
 - Apply "Enterprise Risk Management" principles to the consideration of future business model risks (know your market, cross-border issues, adequacy of systems, processes and staff, appropriate sustainable financing etc.) and mitigation.
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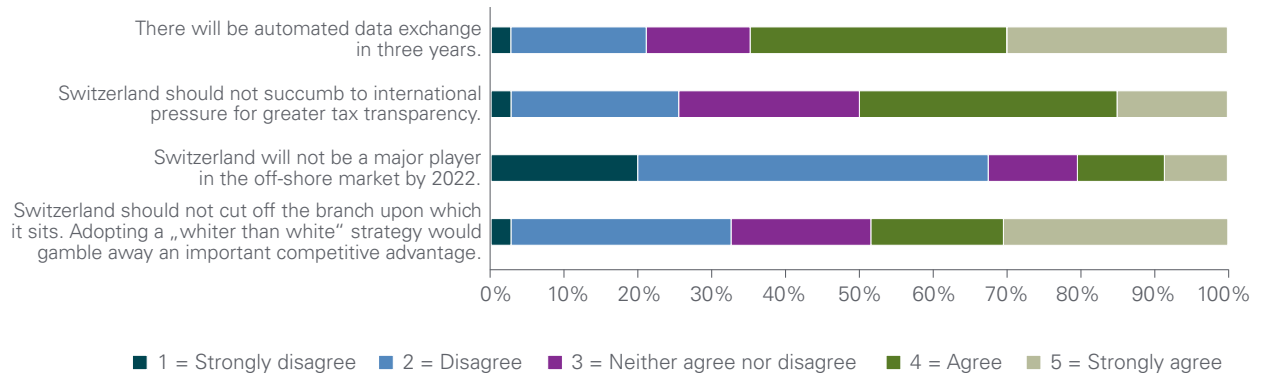
Switzerland will remain a major player in the offshore market by 2022, though sustaining banking requires the support of the Swiss Government.

Declared money strategies and related issues are widely covered in politics and the media. There is a question whether future regulation should be in line with OECD regulations, seen as the applicable standard for all countries.

Key findings

- Respondents are concerned that the Swiss Government may initiate measures for a declared money strategy without foreign financial centers doing likewise.
- Respondents believe Switzerland should not succumb to international pressures for greater tax transparency. Nevertheless, they believe undeclared money has no place in their books.
- Despite foreign pressures, most respondents are convinced that Switzerland's private banking business will continue to play a leading role globally, due to excellent service quality, knowhow and stability.
- More than 60% of respondents believe AEI will be introduced within three years.

Status and positioning of Swiss private banking by 2022



Our insights

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- It is as yet undecided whether Switzerland should reach an agreement with the EU on a stand-alone basis or wait until OECD requirements might become the mandatory standard for all countries.
 - In our opinion the “whiter than white” strategy of the Swiss Government and parliament may be obsolete, as a majority of respondents believe AEI could be in force within three years.
 - It should be kept in mind that not all clients heading for the political stability of Switzerland are tax evaders. Switzerland continues to be a fortress for money of persons in politically distressed countries. Distinction should be made between tax evasion data and client privacy data, to result in continued protection of client privacy.
 - We believe some foreign-owned banks in Switzerland have an advantage over Swiss banks by being more prepared for the changing regulatory environment, such as by being ahead in implementing MiFID rules due to their parent companies.
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Agenda for action

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- Plan to implement an AEI program in major countries. Analyze client data systems and physical files to ensure compliance with expected future requirements.
 - Banks of all sizes and business models should join to approach the regulator with one voice in order not to be disadvantaged globally.
-

Clients



The present focus of private banks is set to shift by 2022 from being generally on all segments to being on all segments except clients with assets of less than CHF1 million. Severe competition is expected over clients with assets of CHF1 million to CHF5 million.

Clients' needs will continue to evolve in this time. They will increasingly demand more autonomy and prefer greater involvement in investment decisions. They will utilize social media for banking and make growing use of digital channels to monitor and manage their portfolios.

Priority agenda for action

- Develop clear steps to reinforce the bank's client centricity strategy, strengthening the differentiators in client service with particular regard to new client segments such as generation Y.
- Develop acquisition and retention strategies for clients in order to achieve a differentiating brand and a superior client service experience.
- Collect more comprehensive and detailed data on clients for the purpose of a dynamic segmentation. Identify clients' touch points. Make use of behavioral analytics for bundling service/product offers.

“ A client in 2022 wants even more transparency, is more sceptical about products, and possibly more risk averse than he was some years ago. ”

Interviewee from small bank

Greater effort is required to understand client behaviors in order to achieve true client centricity, which is critical to a sustainable private banking relationship.

Banks' focuses are moving to clients with assets in excess of CHF1 million. This may require banks to review their unique selling propositions (USPs) and client management processes. Banks are tending towards becoming holistic financial service providers in order to meet clients' growing requirements for their present lives and their aspirations in terms of independence, transparency and services.

Key findings

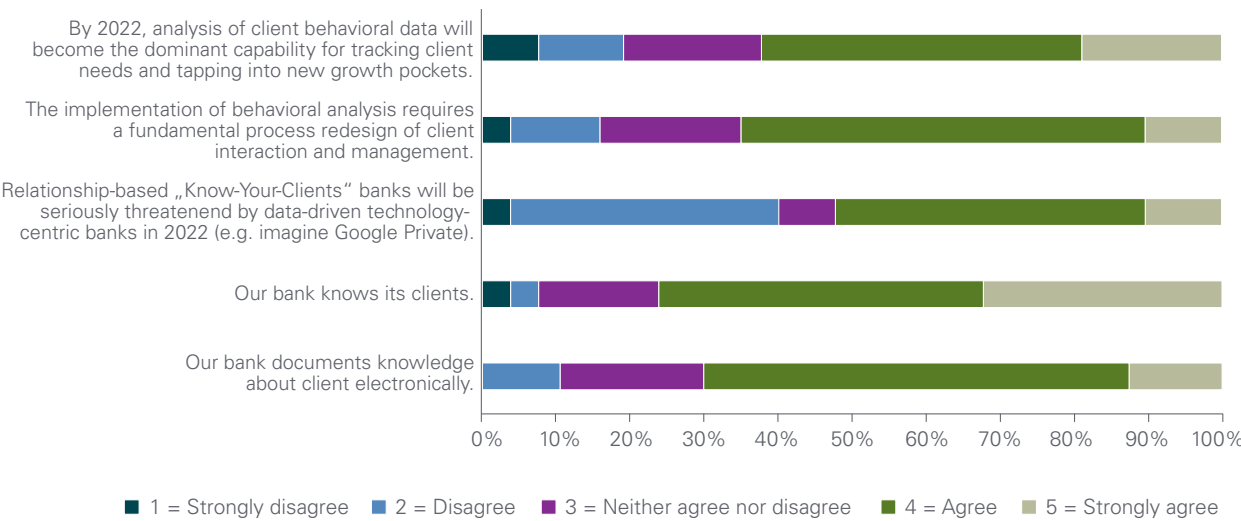
- Respondents' emphases on clients with assets of less than CHF1 million is decreasing. This space is increasingly serviced by retail banks and others. Instead, the focus of respondents is moving to other segments, especially to clients with assets of between CHF1 million and CHF5 million. Competition for such segments is therefore becoming much more severe.
- Clients have become much more risk averse and attuned to the broader financial and investment environment since the start of the financial crisis. Respondents believe greater transparency and sophisticated holistic services such as lifecycle financial planning are required.
- Some respondents believe existing client behaviors will remain unchanged over the next decade. However, those that do anticipate change are of the opinion that clients will become more autonomous and prefer more involvement in investment decisions. The role of relationship managers for such clients will expand to helping the client navigate the broader asset universe in addition to connecting clients with the right experts and centers of excellence within the bank.
- Most respondents feel they understand clients well. Many describe their typical clients as "entrepreneurial", with whom they enjoy a personal, long-term relationship in which open communications are more important than performance. At the same time, banks agree that to know their clients better, analysis of client behavioral data is increasingly important, though doing so properly requires fundamental process redesign.



Client mix as a percentage of AuM, 2022



Know your client data analysis



Our insights

- The majority of banks will pursue advisory leadership positions over the coming decade. Many will look to develop their USPs in tailored offerings along the client's lifecycle, advice and service excellence as well as alternative investment opportunities, specialized niches (e.g. corporate advice, art, luxury, philanthropy investment, yacht financing, etc.). Success will require long-term effort and investment in process redesign, especially in light of the very strong competition.
- Clients' commitment to compliance matters is high. They are more open to providing personal or financial data given the declared money environment and new generation's mindset (tax compliance).
- Many banks have a high level picture of their clients, but the data they hold on client behaviors is generally too limited for reasonable clustering or segmentation analysis. Greater effort is needed to capture, improve and maintain knowledge about clients. Sophisticated CRM systems can deliver the greatest benefits.
- In our opinion, the emphasis in acquiring and retaining clients should be on share of wallet rather than increase in market share.

Agenda for action

- Ensure CRMs are equipped with the knowledge, tools and training to be truly client-centric and to understand clients' evolving needs and the channels through which these needs can best be served.
- Collect more comprehensive, detailed data on clients. Identify touch points and use appropriate information for more sophisticated client segmentation. Periodically review client data to re-allocate clients between segments (dynamic segmentation) where necessary.
- Make use of behavioral analytics for bundling product and service offers.
- Develop a new acquisition and retention strategy for clients in order to differentiate the bank's brand and provide the best client experience.

Collaboration between IAMs and private banks



Substantial, strategic opportunities exist for private banks and IAMs to leverage each other's strengths to their mutual benefit. A major challenge for both parties is conducting appropriate due diligence on each other to mitigate risks and support potential upsides.

Benefits private banks can gain from IAMs include:

- scalability through reaching more end-clients
- leveraging closer IAM/end-client relationships
- accessing key competencies in certain asset classes
- ultimately acquiring end-clients as part of IAM's succession plans

Benefits IAMs can gain from private banks include cost-effective access to:

- the core banking system (direct access)
- specialized operating platforms designed for IAMs
- tax and regulatory expertise
- geographic locations and knowledge
- broader, tailor-made service offerings
- brand and reputation

Priority agenda for action

For private banks

- Benchmark attractiveness as a custodian bank and/or provider of additional services against that of other banks, ensuring articulation of benefits changes in line with the IAM market. Ensure the bank understands end-clients' behaviors and needs.
- Apply rigorous due diligence to mitigate onboarding risks and identify upside potential. Ensure governance processes for existing relationships are robust and provide notice of matters that might jeopardize the IAM's sustainability.

For IAMs

- Carefully consider choice of bank based on a combination of client profiles and preferences, bank brand, services, costs, IT platform and international connectivity, inter alia.
- Monitor existing bank relationships and analyze potential new ones to ensure ongoing strategic and operational fit.

“ In Switzerland, with no prudential supervision for IAMs it is even more important that the roles and responsibilities between end-client, IAM and bank are clearly defined and known by the involved parties. ”

Interviewee from large bank

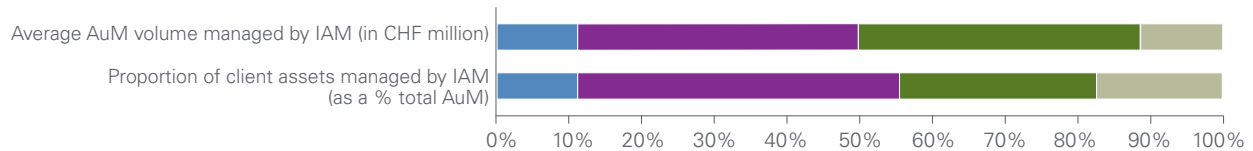
Private banks can use IAMs to support scale but must apply rigorous due diligence to new and existing relationships.

IAMs manage more than one tenth of Swiss-based AuM (around CHF5,300 billion in 2011), representing a route for private banks to build scale by expanding their universe of end-clients. Relationships should be neither formed nor maintained without continuous reassessment, however, to ensure timely identification of potential risks. Also to ensure banks' USPs to the IAM are in line with the evolving IAM marketplace, and that IAMs' clients fit the bank's strategy and offerings.

Key findings

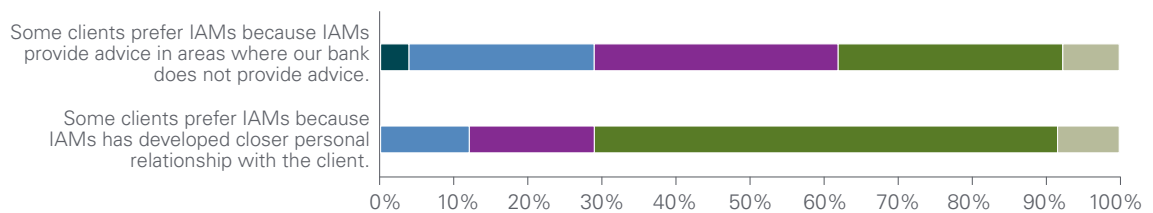
- Two-thirds of interviewees view growth via IAMs as a strategic agenda point for the next decade.
- IAMs often develop closer relationships with end-clients. They are viewed as independent with no conflicts of interests, not pushing own products or depending on a single counterparty. IAMs' end-clients can benefit from fee arrangements such as custody flat fees, lower transaction fees, pooling or special conditions. 90% of online survey respondents believe that, going forward, IAMs' average AuM will scale up or at least stay as it is.
- While IAMs' AuM levels are a factor in potential collaborations, half of respondent banks say IAMs' skill-sets and client satisfaction levels are more important.
- Challenges in maintaining bank/IAM relationships include avoiding clients from countries not served by the bank in future, protection against IAMs' acquisition of the bank's own clients, and a dynamic governance process.

Bank's expectations of AuM developments involving IAMs by 2022



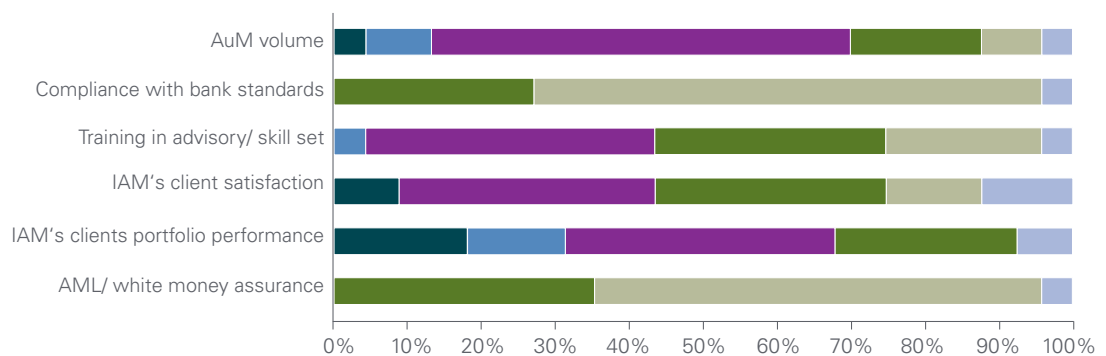
1 = Scale down to a very large extent 2 = Scale down 3 = Stay as in 2012 4 = Scale up 5 = Scale up to a very large extent

Banks' views on why clients may prefer IAMs



1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree

Banks' considerations prior to collaborating with an IAM



1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree 6 = N/A

Our insights

-
- IAMs can help banks achieve scale through access to new client bases. Dramatic changes to the IAM market, however, require caution. IAMs must comply fully with banks' standards, but some banks lack a clear due diligence process. Rigorous processes to ensure compliance are critical for banks, but can be tricky in the midst of evolving regulations.
 - Most banks understand with which IAM and end-client types they wish to collaborate but struggle to articulate it to the market.
 - Private banks should clearly state the benefits to IAMs of utilizing the bank as a custodian bank and/or provider of additional services.
 - Banks invest heavily in IT solutions and e-services, which help them serve IAMs and differentiate themselves from other banks.
-

Agenda for action

-
- Use IAMs to increase market share in the bank's specific client environment. Consider feasibility of acquiring an IAM or integrating its clients into the bank as part of the IAM owner's succession planning.
 - Continuously assess and articulate attractiveness not only as a custodian bank but also as a provider of additional services to IAMs compared to other private banks, in line with changes to the IAM marketplace. Also to ensure the bank fully understands the end-clients' behaviors and needs.
 - Exercise caution in selecting and maintaining IAM relationships given the rapid evolution of the IAM market. Apply rigorous due diligence to ensure cultural fit and mitigate onboarding risks such as client suitability. Ensure ongoing governance with regular assessment points.
 - Consider the extent to which the IAM can offer access to clients who might otherwise not use the bank and to what extent the IAM utilizes the bank's services but also provides independent client advice. Ensure any collaboration represents genuine win-win-win for the bank, IAM and end-client.
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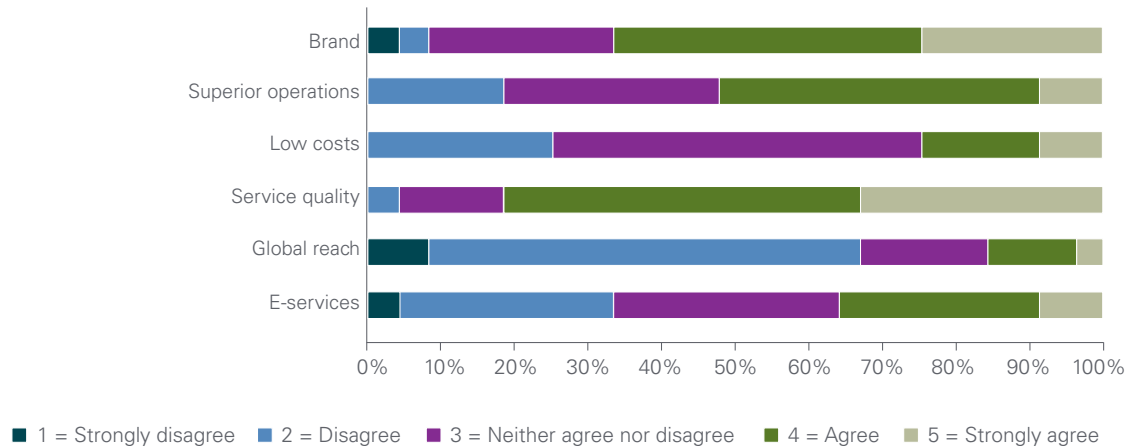
IAMs can leverage banks' operations and services, gaining access to banking markets that may be otherwise unattainable.

Banks' heavy investments in operational systems, processes and service offerings can be hugely attractive differentiators to IAMs. However, IAMs must ensure that their choice of bank suits the IAM's end-clients and that the bank demonstrates a long-term commitment to the collaboration.

Key findings

- In the view of private banks, IAMs may seek relationships with banks to acquire access to brand, superior operations, service quality and e-services. Cost is not a primary consideration.
- Banks' USPs to IAMs vary by segment: government guarantee, geographic location (e.g. Liechtenstein), dedicated IAM desk, IT platforms, cross-border know-how and regulatory training, tailor-made offerings, international connectivity and reputation, among others.
- State of the art execution, robust IT systems with reporting and analysis functionality and direct access are among the most stated operational needs of IAMs. In limited instances, research information, regulatory and technical support are of greatest importance.
- Some IAMs are actively considering M&A to build scale and achieve growth.

Reasons for IAMs to collaborate with private banks (in the view of bank respondents)



Our insights

- IAMs choose banks for a wide variety of reasons, but notably robustness of IT systems, reporting and analysis functionality, direct access and state of the art execution.
- IAMs require of banks operational excellence such as proactive corporate action information and asset allocation matters, enabling the IAM to act in a timely manner.
- Networking and shared service functions are of lesser importance.
- A high number of IAM employees have an entrepreneurial mindset and are seen as more client-focused than banks' relationship managers.

Agenda for action

- Carefully consider with which bank to collaborate, based on a combination of client profiles and preferences, costs, bank brand, breadth of services, IT platform, international connectivity, and other factors.
- Monitor existing bank relationships and analyze potential new ones to ensure ongoing strategic and operational fit.



Products and services

Product and service offerings are undergoing substantial changes as open architecture continues to be adopted throughout private banking. 84% of interviewees will seek to enhance their independent advice and services by 2022, while a few banks will focus on production, looking to become the industrial supplier. Those banks pursuing advisory leadership positions will specialize further in the value chain.

Innovation is central to keeping pace with behavioural and demographic changes. Recent years have seen banks become more open to mobile and internet-based solutions. Dynamic client segmentation will play an increasingly important role in product and service development.

Priority agenda for action

- Re-assess current product and service offerings, adjusting focus in line with the bank's strategy to become an advisory, technology, production or hybrid leader (see page 14).
- Banks wishing to specialize as advisory leaders (especially pure players) should keep to open architecture to ensure independence, strengthen client data collection and analytical processes, pick best-in-class products and develop services based on dynamic client segmentation.
- Universal banks should further leverage retail or investment banking products to provide a holistic offering.
- Particular attention should be paid to whether a bank's service offering meets clients' needs in terms of digital channels. Keep abreast of attitudes towards mobile banking, internet-based solutions and online communication preferences in particular.

“ Client needs drive segmentation + segmentation drives products offering = tailor-made products and service to clients. ”

Interviewee from small bank

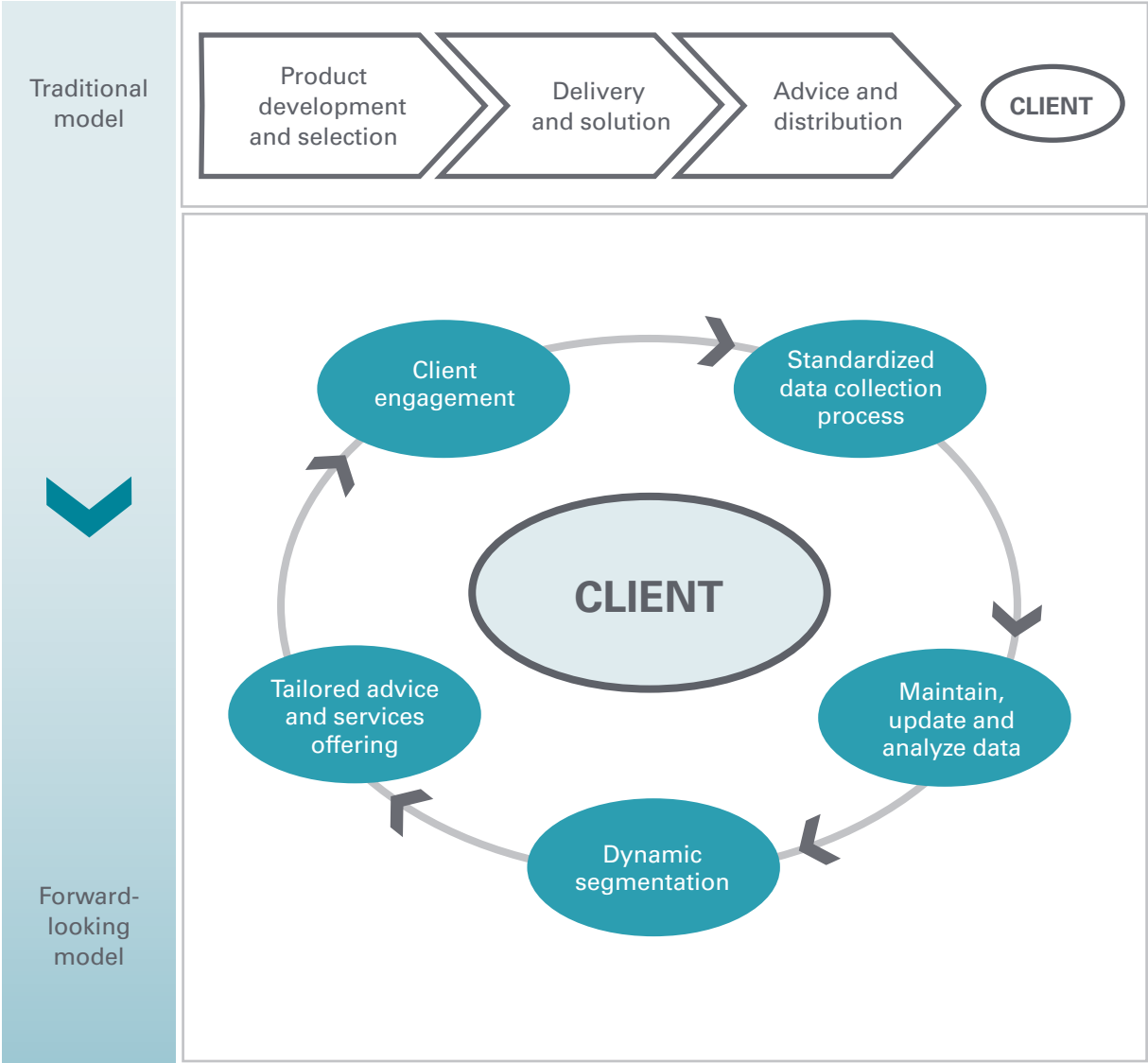
Continuous improvements to how and what client data are captured are vital to become an advisory leader that provides truly tailored products and services.

Private banks will specialize in individual production selection and restore margins by providing more specialized expert advice. Understanding clients' needs and behaviors is a fundamental basis for offering the most suitable products and services. Behavioral and demographic analysis of client data will therefore help banks tap into sources of growth. Dynamic categorization of clients will facilitate more tailored products and services based on thorough data collection and analysis.

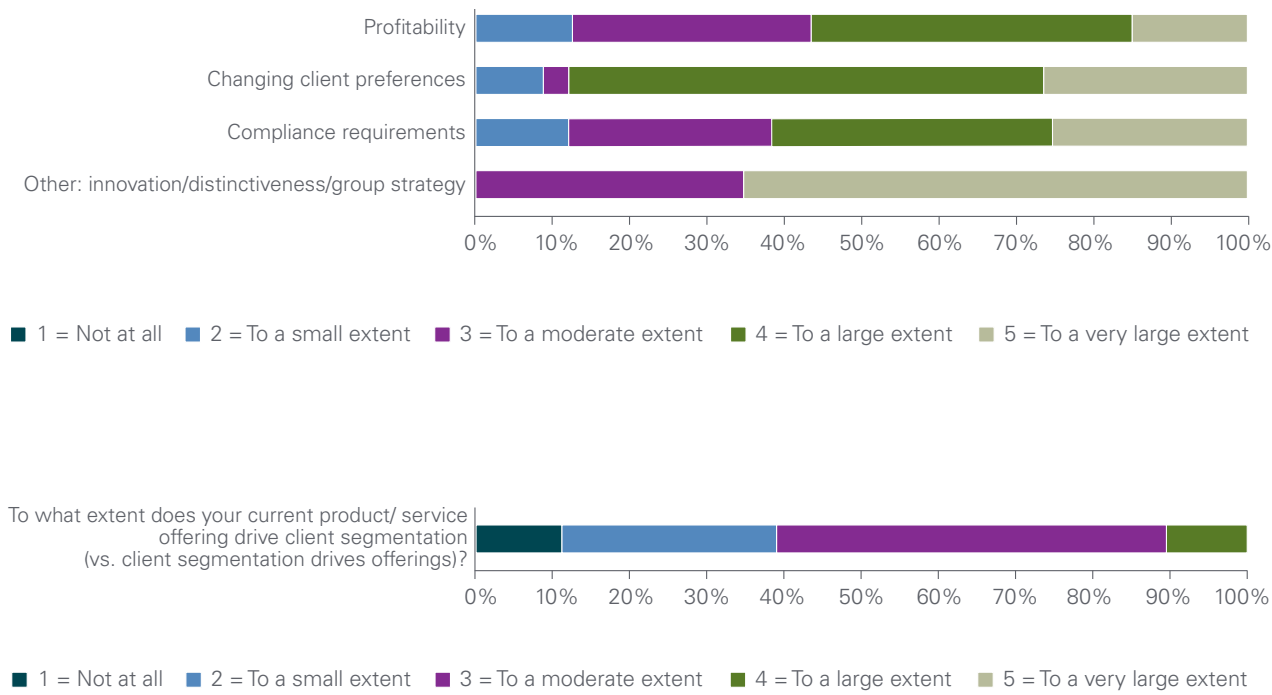
Key findings

- To further improve performance and independence, most respondents believe they must continue to adopt open architecture and specialize in different stages of the value chain. Some will focus on production while many will develop into advisory leaders that provide best-in-class products and services.
- More than 80% of respondents believe evolving client preferences substantially drive product offering. Regulatory compliance and profitability considerations are important, but secondary, influencers.
- Client segmentation is presently based on traditional data, demographic characteristics, AuM, profession, and legal status. While respondents recognize client segmentation should drive product and service provision, some accept this is not the case in their organizations. 40% believe existing offerings determine their bank's client segmentation.

Evolution of products and service offerings – moving to a more client-centric view



Drivers of products and service development



Our insights

-
- Client segmentation presently plays a limited role in product development, severely hindering client centricity. Even banks that use segmentation to drive service provision tend to still focus too much on wealth level.
 - By 2022, client behaviors and investment needs and their potential to improve share of wallet or accumulate future wealth should be common to segmentation efforts, facilitating the development of products and services that truly reflect the market's needs.
 - Banks must change their approaches if they are to specialize and become more client-centric. Dynamic segmentation should be used to cluster clients according to needs and preference along life cycles.
 - Going forward, banks should select the most suitable products and services from the open architecture according to dynamic client segmentation based on clients' needs. Ideally, like Amazon, every client should be viewed differently and segmentation replaced by comprehensive client data processing, with truly tailored products and services being based on continuous, high quality behavioral analysis.
-

Agenda for action

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- Re-assess current product and service offerings, adjusting focus in line with the bank's strategy to become an advisory, technology, production or hybrid leader.
 - Banks wishing to specialize as advisory leaders (especially pure players) should keep to open architecture to ensure independence, strengthen client data collection and analytical processes, pick best-in-class products and develop services based on dynamic client segmentation. A third party product selection process should be considered an add-on to reinforce independence.
 - Universal banks should further leverage retail or investment banking products to provide a one shop stop experience, especially for (U)HNWI and entrepreneurs.
-

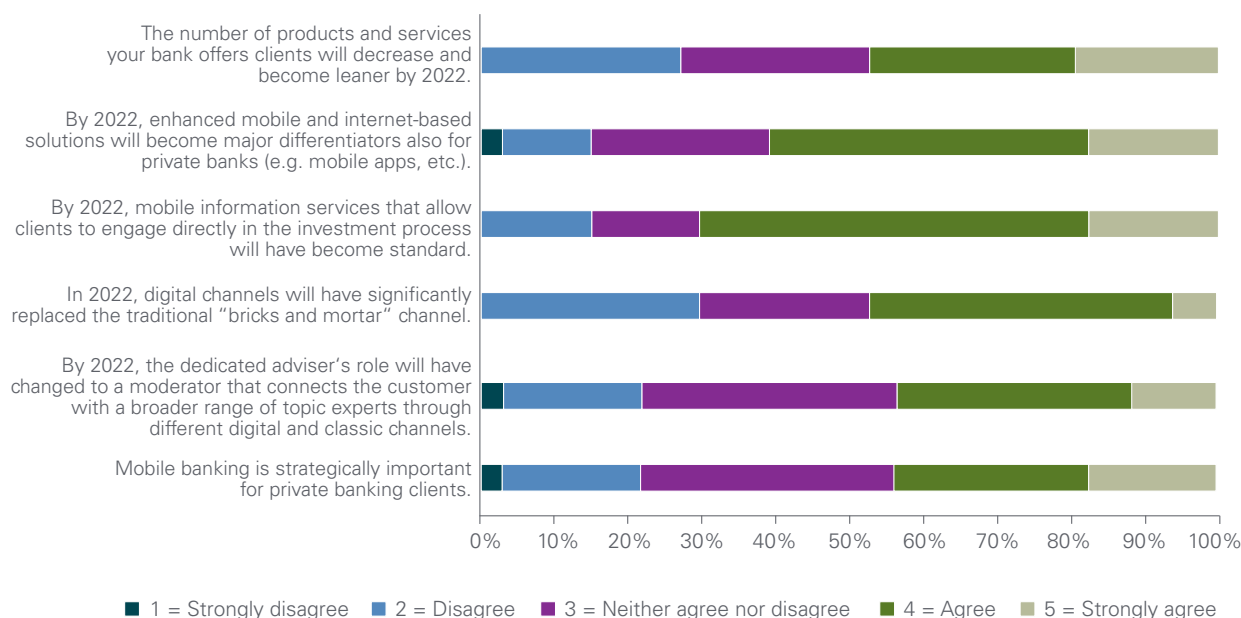
Technology-enhanced solutions and new communication channels will be part of integrated products and services.

Clients are becoming increasingly open to digital channels. Younger generations in particular are used to a huge variety of digital channels and technology-enhanced solutions, and indeed expect these to be available to them. To fulfil clients' evolving needs, banks must further innovate and develop relevant propositions.

Key findings

- Most respondents believe enhanced mobile and internet-based solutions will be a differentiator by 2022.
- There is strong agreement that mobile services and apps allowing clients to engage directly in the investment process will become standard. Digital channels can facilitate communication with a range of topic experts, through which the client will receive solutions, proposals and professional research.
- Conservative opinions remain, however, that face-to-face contact continues to be important for complex services such as strategic asset allocation or financial planning. Respondents broadly accept the provision of other services through digital channels.

Expectations regarding digital channel development



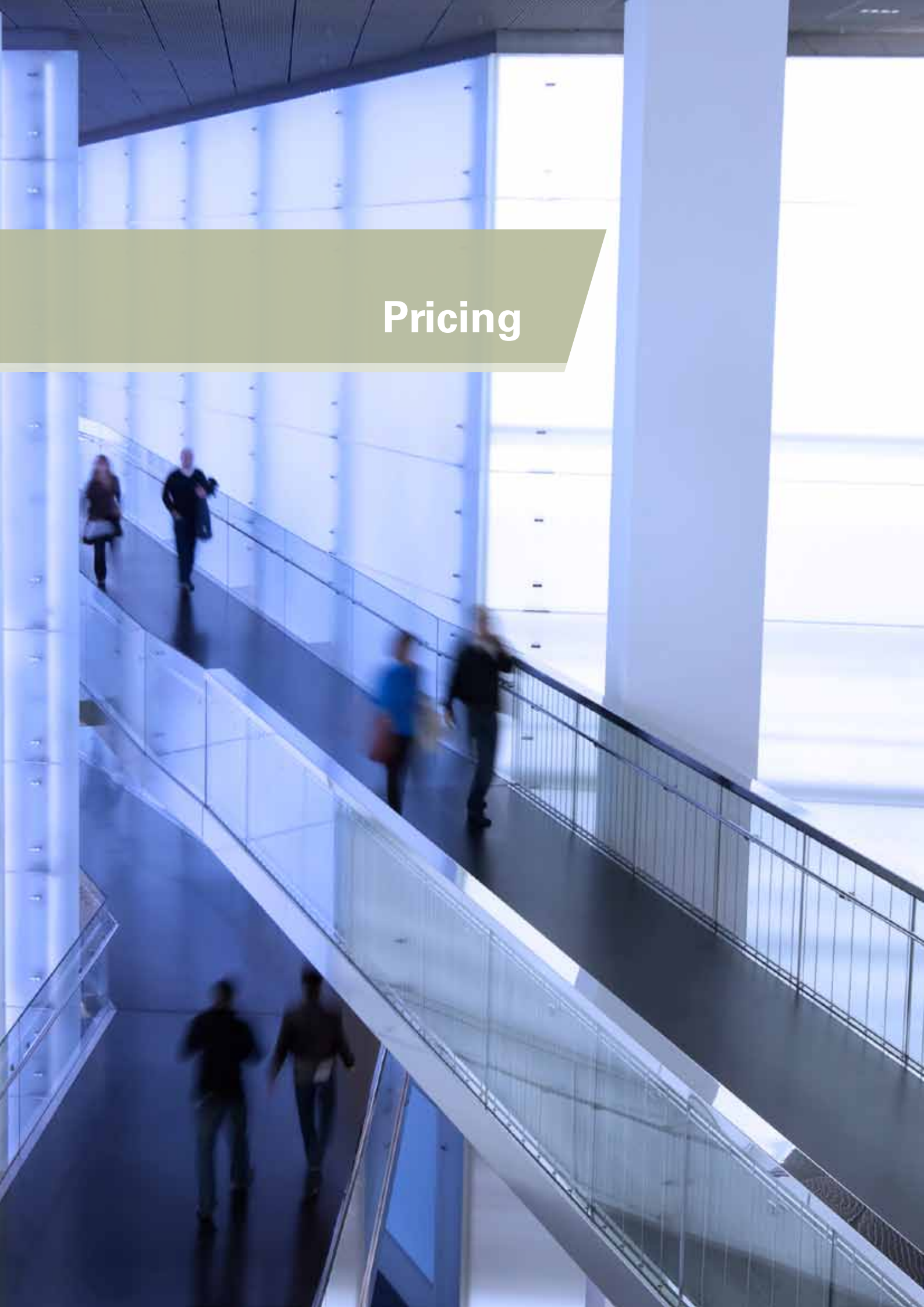
Our insights

- How to succeed in service provision utilizing digital channels will be a hot topic for some time. Banks should consider not only clients' preferences, but also experiences of other industries such as digital retailers.
- To succeed as an advisory leader and fulfil the needs of future clients, banks should start now to seek ways to differentiate themselves by such means.

Agenda for action

- Invest strategically in digital channel development (including internet-based solutions, mobile services and digital communication tools) to fulfil the needs of emerging generations as well as some more mature clients.
- Continuously enhance data collection processes to understand and capture demand for these developments.

Pricing



Private banks are looking to adopt new pricing strategies. Considerable scope remains to further improve and integrate pricing models based on sound client risk and behavioral data analysis.

While the appropriateness of advisory fees has been subjected to much debate in recent years, evidence suggests they are now acceptable. Embedding client data into the pricing model can help banks explain fees, improving transparency and promoting client acceptance.

Banks may include in their pricing model client relationship history data and client retention rules. This would deliver higher, more sustainable margins as a result of reallocating financial costs.

Priority agenda for action

- Identify pricing models that best suit clients' profiles and needs by strengthening data collection and analysis. Introduce compliance risk and behavioral data analysis into pricing models.
- Develop clear pricing communications to ensure clients understand and accept new pricing models.

“ Retrocession will be neutralized by flat fees. ”

Interviewee from large bank

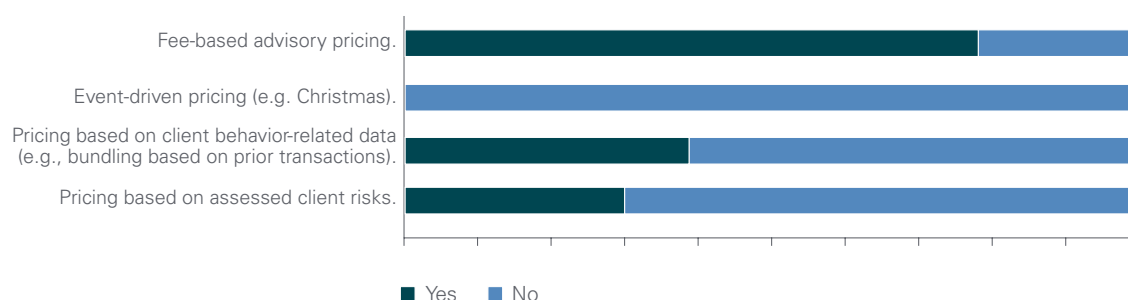
Pricing models should more closely reflect clients' needs and be better aligned with specific product and service mixes.

Razor thin margins and the incorporation into services of expensive new cutting edge features mean current combined fees are unsustainable. Banks must establish new pricing models that better suit their clients' needs and improve return on assets (ROA).

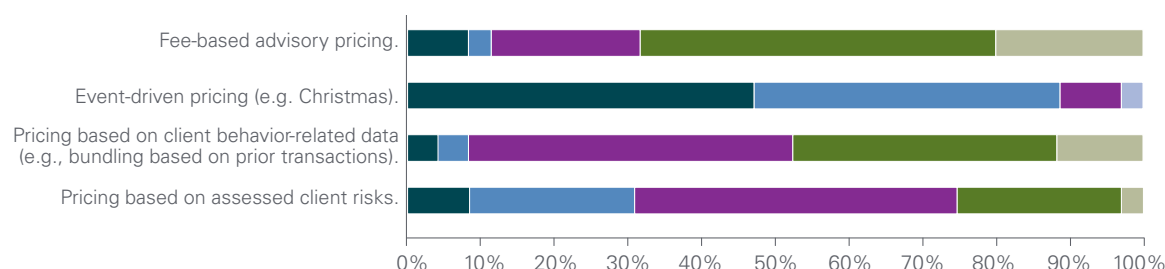
Key findings

- Retrocession is no longer a major issue, according to respondents, who also believe pricing models must change and younger generations will be more open to new pricing approaches such as flat fee models.
- Advisory fees will continue to become increasingly important. Only a few years ago, respondents viewed such fees as unrealistic.
- Many respondents believe future pricing models will incorporate more risk elements and client behavioral data.

Pricing models: 2013



Pricing models: 2022



1 = Not at all 2 = To a small extent 3 = To a moderate extent 4 = To a large extent 5 = To a very large extent 6 = N/A

Our insights

- Flat fees for pre-defined services/service packages are increasingly acceptable despite being more opaque. They give clients a simpler understanding of the cost of their banking relationship.
- Client behavioral data analysis will be important to new pricing models. Benefits of embedding client data include:
 1. Greater transparency and banks earn more based on clients' varying situations.
 2. Communicating flat fees will be easier due to clarity in pricing models.
 3. Financial costs can be reallocated according to client profile, while banks can ultimately improve efficiency and achieve reasonable, sustainable compensation.
- With the shift in attitude to advisory fees, bankers should be more open to further developing pricing models. Event-driven pricing is not yet accepted, but the next decade will see new creative pricing models emerge that are better tailored to clients, segments and services.

Agenda for action

- Strengthen client data collection to identify pricing models that best suit clients' profiles and needs. Build compliance risk and behavioral data analysis into pricing models.
- Develop clear pricing communications to ensure clients understand and accept new pricing models.
- Consider implementing strategies for advisory fees and modular pricing based on service packages.

Operations



The revision of organizational processes has gone from being a cost-cutting exercise to becoming a strategic means of business model implementation. This is especially true in the banking industry, where a tremendous need for change has accrued over recent decades, culminating in the rise of new business models.

Many operations managers are on a dual mission. First, and most pressingly, they must resolve a fierce profitability crisis. Second, they need to gradually move their banks into new viable market positions within an evolving and not yet fully predictable future industry structure.

Priority agenda for action

- Eradicate unnecessary operations. Outsource processes that are non-core to the bank's client value proposition. Automate remaining processes and aim for straight-through processing where applicable.
- Seek industry-level collaboration to create scale and reduce excess capacities and industry-level redundancies (e.g. through shared services).
- Support client-centricity and productivity enhancements by revising job descriptions, structures and wage levels accordingly.

“ Never say never. Everything is possible, especially in the digital industry. A bank always has to be up to date regarding digital changes and possibilities. ”

Interviewee from small bank

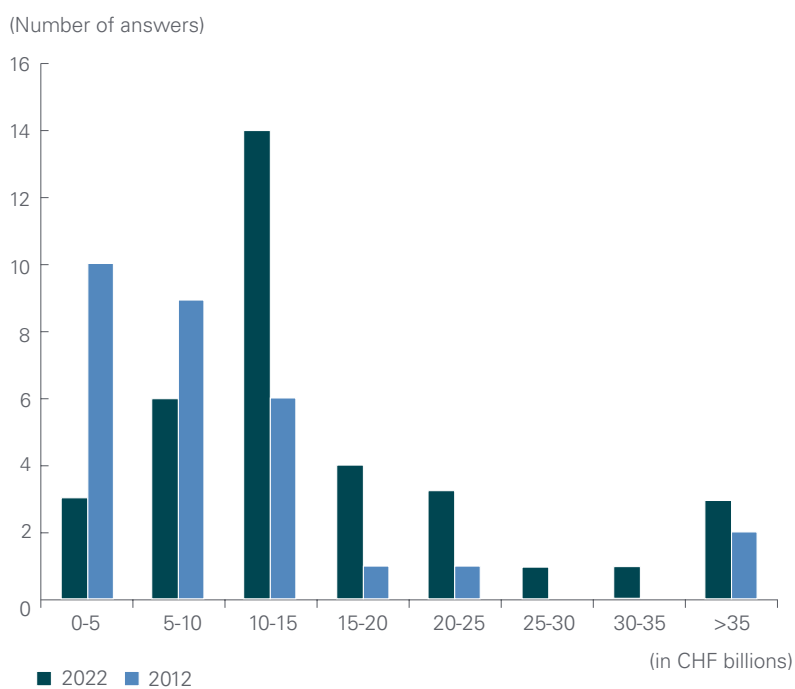
Operation managers must succeed in both cutting costs and implementing new business models.

Despite efforts already undertaken, many Swiss private banks still do not earn their cost of capital. Operations managers at many banks therefore need to manage down costs while revising operating processes to fit the future business model envisioned for the bank.

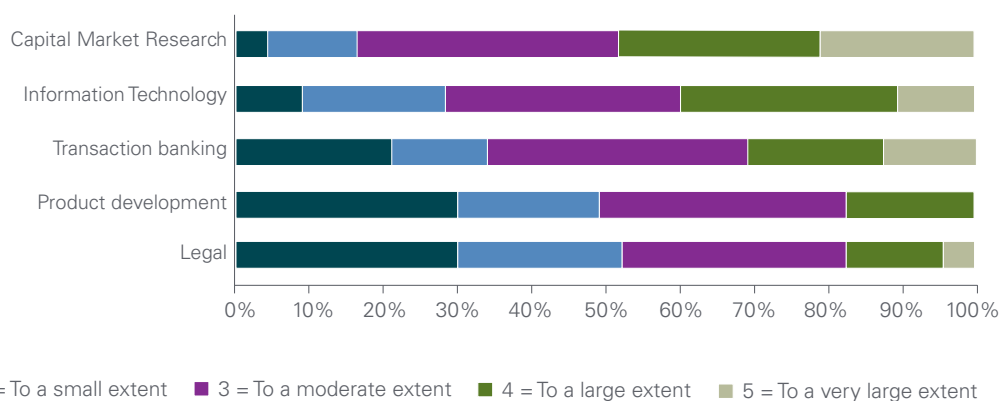
Key findings

- Spreading costs over a larger asset and client base is seen as a major lever to restore profitability. The minimum efficient scale of private banking operations is expected to increase from CHF5 billion AuM in 2013 to at least CHF10 billion by 2022.
- The nature of cost saving initiatives is changing. Classic cost-cutting measures are being replaced by structural approaches such as digitization initiatives or reconfiguring footprints.
- The focus is on improving back-office efficiency through process redesign to achieve straight-through processing.
- Potential exists to outsource non-core activities such as IT, capital market research, transaction banking, product development and some aspects of legal.

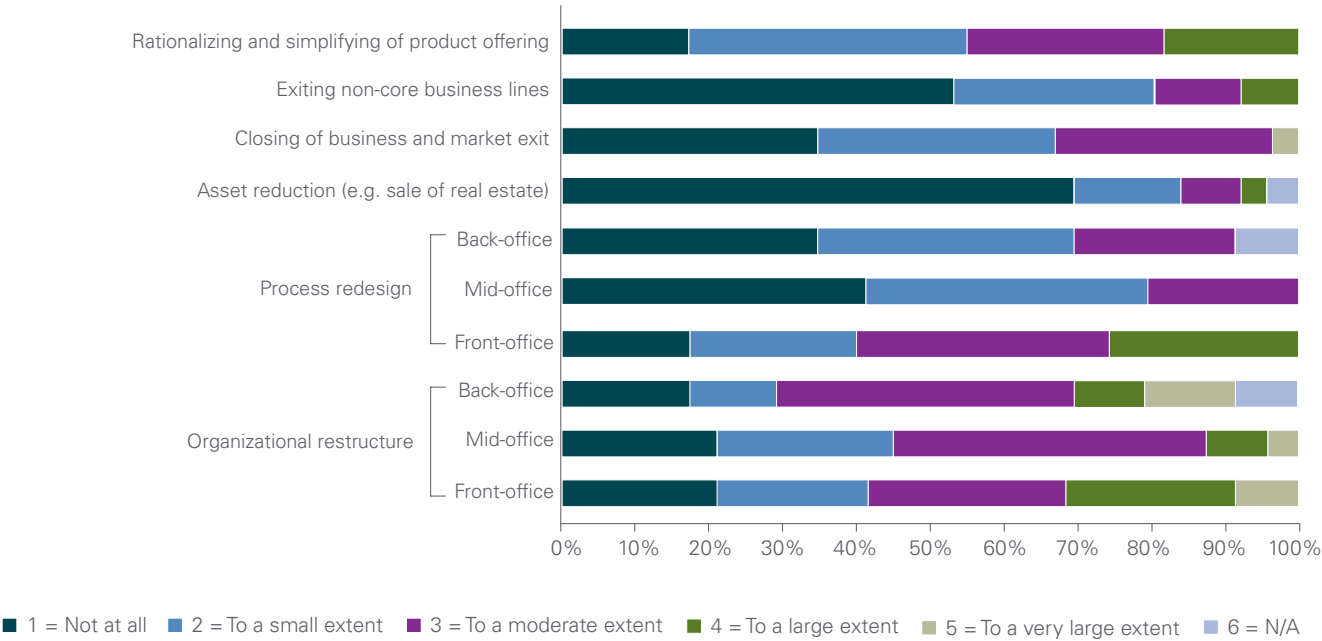
Minimum efficient scales are skyrocketing in Swiss private banking



Top five functions to be outsourced



The quest for cost savings is still on: areas of focus for outsourcing potential



Our insights

-
- Ill-planned cost cutting may jeopardize a bank's future viability. Management's focus should be on moving to a more efficient business model.
 - The industry needs to undergo a reconfiguration that captures efficiency potentials at the sector-level. Apart from M&A and consolidation, a number of collaborative instruments may provide scale effects: swapping country desks or client books, co-creation through alliances or outsourcing, and shared service centers.
 - Client-centricity of products and services can be achieved only with improved operations. Distribution channels, data and systems must be integrated to permit seamless and efficient servicing along an extended client process.
-

Agenda for action

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- Banks' operations and IT managers must take a more prominent role in strategy development.
 - Think in 'reconfiguration mode'. Reduce or outsource areas of operations that are not central to the future business model. Adjust the client book portfolio to reflect new regulatory fault-lines and growth regions.
 - Make better use of IT to help the bank really own the client relationship. Collect client information at various client touch points, using this information to more effectively service clients. Introduce moderate service automation and client process standardization such as online self-service (see page 43).
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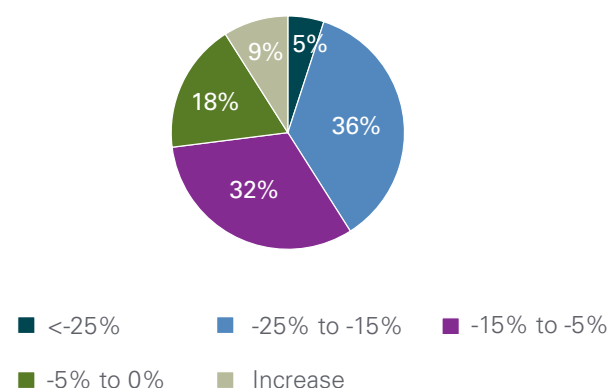
Revise wage levels and structures to better service future clients and manage down costs.

As in any service industry, operating costs comprise largely salaries. These must be reviewed as banks seek to shrink their cost bases. At the same time, talent becomes a more decisive factor in mastering major strategic challenges. Banks' critical missions to recalibrate around the client are tightly linked to compensation schemes. Consequently, several organizational goals collide and warrant HR having a top ranking on the management agenda.

Key findings

- Employee levels have remained fairly stable in most banks. In front-office functions, however, staff levels have been skimmed and compensation lowered.
- Respondents expect compensation levels to drop sharply in the future. As well as changed economics, this can be linked to banks' ambitions to establish better-documented client processes that weaken relationship managers' positions as the exclusive owner of the client relationship.
- Respondents plan to link employee compensation more directly to the client. KPIs such as client satisfaction, portfolio performance and adherence to compliance efforts are being considered for future compensation schemes.

Wage levels are presumed to decrease significantly



Our insights

-
- Banks must invest to attract the right talent and selectively enhance heterogeneity in existing salary levels.
 - The internal structure of compensation schemes needs to be adjusted. Banks must introduce new client-centric KPIs into compensation schemes if they are to truly recalibrate services around the client.
 - To allow for more tailored compensation schemes, banks need to build better empirical databases to objectively assess service quality and employer performance.
-

Agenda for action

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- Review and revise job profiles and compensation levels. Employ entrepreneurial and IT-savvy staff to seize the digital growth opportunity.
 - Derive from the bank's future selling proposition the variables required to tie compensation scheme to client value proposition. Develop appropriate data collection processes, more client touch points and advanced analytics to secure the link between strategy and compensation.
-

Governance and control



Cross-border requirements, client suitability, Basel III, Federal Financial Services Act ("FIDLEG") and tax issues are but a few major topics posing substantial implementation challenges. Some see the new regulations as seriously harmful, even fatal, to small banks in particular. Others believe they will provide Swiss banks with a competitive advantage over foreign banks. Either way, the changes require a shift in the mindset of board and management teams.

A "Road to Compliance" would systematically set out the steps to deal with the challenges and articulate how the bank will gain from synergies and efficiencies such as project organization or enhanced data quality. The approach would include measures to directly support staff's efforts and reduce compliance risks during this period of change.

Priority agenda for action

- Develop a "Road to Compliance" concept to cover upcoming regulatory requirements and mitigate compliance risks. It should ensure the systematic, cost-efficient introduction of compliance measures, exploiting synergies by leveraging knowledge and competences across existing processes.
- Identify potential to automate compliance programs through tools and strategies that ensure compliance with regulatory requirements while realizing synergies.
- Support people in making the change into the new world. Motivate them by leading by example. Announce all major changes in strategy, communicating openly and frankly regarding the impacts of the changes.

“ Some regulatory forces are necessary but it should not be approached in the same sense that one size fits all, same rules for all market places, costs are over-boarding. ”

Interviewee from large bank

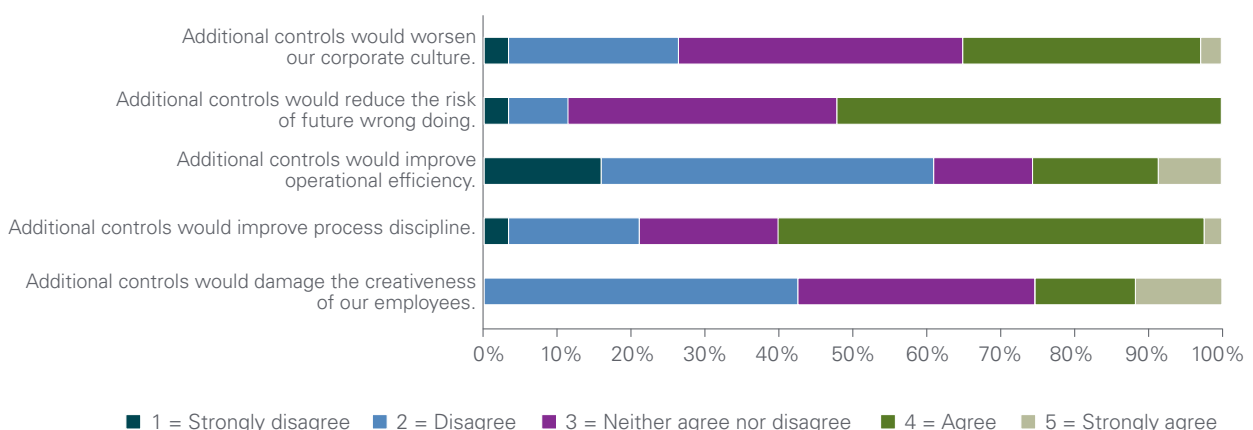
Strenuous efforts continue to be necessary to keep internal control processes in line with regulatory requirements.

Uncertainties in the regulatory environment leave many banks, especially small ones, dissatisfied and isolated. Internal controls are continuously enhanced to guarantee cost-efficient compliance, though some requirements appear to add no real value to clients.

Key findings

- Most respondents feel they are over-regulated and that some client protection requirements create substantial documentation but no real value for the client. Although in the long term a declared money strategy and AEI can advantage Swiss banks, in the short term the level of regulations is to the detriment of banks operating in an already complex and competitive environment.
- There is a feeling that the Swiss regulator is excessively enthusiastic and there is a lack of coordination with government bodies. Small banks complain that regulation should take into account size and business model.
- The majority of respondents believe there is scope for additional or strengthened controls to reduce the risk of wrongdoing and improve process discipline, though this would be at the cost of operational efficiency.

Impact of additional controls on employees and the organization



Our insights

-
- We acknowledge the view of numerous banks that future regulatory requirements and additional controls may be a burden that adds security to neither clients nor the finance environment. In our opinion, however, regulation represents a competitive advantage over foreign restrictions and is necessary to participate in international markets.
 - Additional control work is needed by compliance functions. This may require an expansion of compliance functions and number of control personnel. Consequent higher costs may be partly offset by control efficiencies and standardizing processes.
 - Successful business model transformation relies heavily on staff behavior. Banks are moving from “self-centric money production” to navigating regulation and competition by using human capital – human resource measures will thus play a much more important role going forward.
 - Many employees will require a change in mindset. Some will readily accept the challenge, but many others may need motivating. Senior management should lead by example and openly communicate changes to strategy and business models.
-

Agenda for action

-
- Develop a “Road to Compliance” concept to cover upcoming regulatory requirements and mitigate compliance risks. It should ensure the systematic, cost-efficient introduction of compliance measures, exploiting synergies by leveraging knowledge and competences across existing processes.
 - Assess regulatory requirements relating to the existing business model, i.e. implementation costs by market or customer type as well as income generated.
 - Identify IT-based solutions with standardized, automated controls and processes to enable the compliance function to cope with the additional workload and minimize human errors.
 - Define a communication concept to announce major strategic and organizational changes. Report openly and honestly on impacts on employees. Identify coaches where necessary for staff members struggling with changes to the banking landscape and what is required of them.
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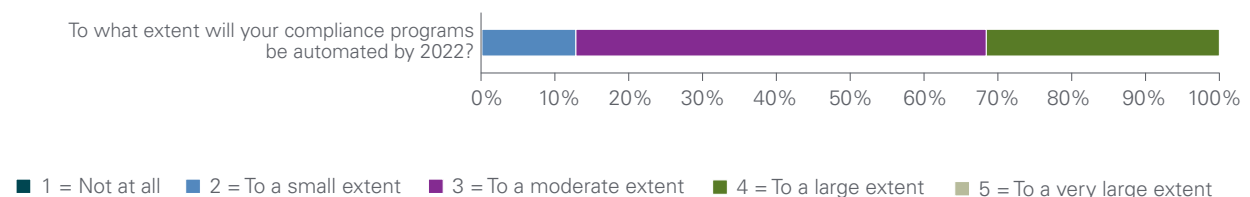
Greater automation of compliance processes is vital.

Compliance functions have gained in importance. The sheer number and complexity of new regulations, as well as additional control functions, give rise to intensified supervision and increasing costs. Banks are encouraged to move away from manual compliance processes towards automated control plans and reporting.

Key findings

- Compliance costs are a major cost and are expected to increase further. Around 10% to 15% of total income will be absorbed by the function in the future.
- Most respondents believe the number of compliance and other control personnel will increase to a large or very large extent. This may explain the anticipation that around 30% of compliance programs will be largely automated by 2022. The bulk of compliance work is presently performed manually at most respondent banks.

Compliance Automation



Our insights

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- Compliance management is the hub for implementing regulatory requirements. An adequately equipped compliance function and a compliant mindset among all employees is key to success.
 - Front-office staff levels will remain largely the same as in the back office in the long term, due to the automation of processes and controls and increasingly advisory-focused strategies.
-

Agenda for action

- Identify potential to further automate compliance programs, enabling CRMs to focus on providing added value to the client and developing the client relationship.
 - Develop strategic options based around tools and processes to ensure compliance with regulatory requirements (suitability, cross-border etc), realize synergies and mitigate compliance risks.
 - Perform a quality review of the compliance organization at least every five years.
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