CHALLENGES IN THE PRIVATE BANKING INDUSTRY – UNCERTAINTY, WORSE THAN TOUGH FINANCIAL RULES

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Abstract:
Our paper "Challenges in the Private Banking Industry – Uncertainty, Worse than Tough Financial Rules" describes the ascension of the Private Banking Industry in developed countries during the last years, previous to the beginning of the world economic crisis and then the challenges that came on the way, as the world economic crisis began.
It is generally known that specialist in the financial and banking business believe that the Private Banking business is poised to capture the attractive growth opportunities that exist in the market but it is also very sensitive to any uncertainty factor.
In our research we have started our presentation with the importance of the existence of the private banking sector in each country, no matter of how developed that country is, than we have outlined some of the big investment themes for individuals in 2011, an year when people should be prepared for market conditions that are volatile but, on balance, reasonably favorable and where interest rates are very likely to remain low in the advanced economies through most, if not all, of 2011, which is supportive for stocks and for commodities, and in the end of our presentation we have emphasized the main risks that the year 2011 is bringing with it, which include the still not fully resolved issue of sovereign debt in a number of European countries, the US deficit and the risk of inflation in emerging markets.

Key words: *Banking industry, uncertainty, Financial Rules, attractive growth opportunities, emerging markets, world economic crisis*

JEL classification: *M16*

INTRODUCTION

Our research entitled "Challenges in the Private Banking Industry – Uncertainty, Worse than Tough Financial Rules" describes the ascension of the Private Banking Industry in developed countries during the last years, previous to the beginning of the world economic crisis and then the challenges that came on the way, as the world economic crisis began.

It is generally known that specialist in the financial and banking business believe that the Private Banking business is poised to capture the attractive growth opportunities that exist in the market but it is also very sensitive to any uncertainty factor.
Our study has the aim to cover several important matters related to the banking industry, with a particular approach on the evolution of this sector in the context of nowadays economic and financial crisis.

In our paper we have started our presentation with the importance of the existence of the private banking sector in each country, no matter of how developed that country is. After that, our next goal was to outline some of the big investment themes for individuals in 2011, an year when people should be prepared for market conditions that are volatile but, on balance, reasonably favorable and where interest rates are very likely to remain low in the advanced economies through most, if not all, of 2011, which is supportive for stocks and for commodities. In the end of our presentation we have emphasized the main risks that the year 2011 is bringing with it, which include the still not fully resolved issue of sovereign debt in a number of European countries, the US deficit and the risk of inflation in emerging markets.

The studied matters are extremely important today, because even if there has been progress in financial reform, it's not clear whether the responses are sufficient to address a future crisis. That is the reason why, we strongly believe that the uncertainty linked to the ongoing financial reforms is more damaging than tough rules, and once set institutions will adjust to these new rules.

Our intention is to answer to these matters in our research, by trying to stress upon the importance of ignoring uncertainty, simply because it is more destructive than anything else possible, and by focusing, as a change on the attempt to create and then to balance new financial regulations, in order to generate future economic growth. Of course, the matters that we have decided to approach here have been approached and furthermore developed by other specialists and authors, in equal manner, which is the reason why our study will also emphasize the existing relation between the paper and the already existent specialized literature.

1. THE PRIVATE BANKING SECTOR – ITS IMPORTANCE IN EVERY COUNTRY

The first part that our paper covers is the importance of the existence of the private banking sector in each country, no matter of how developed that country is. In this particular matter, it is clear that the best solution that can be adopted is to find a balance concerning the new financial regulations with prospects for economic growth. The ongoing financial reform that have already implemented before the economic and financial crisis have to be improved today with new and innovative ideas on how to address risk in the aftermath of the financial crisis.

Specialists have shown that in most of the cases, uncertainty can prove to be more destructive than anything else in the world, and that is the reason why our belief is that the current uncertainty is for sure a big problem for each country and for all the people living there. Uncertainty can prove to be a "fatal" factor that can have a negative impact upon human believes and upon their philological sanity.

Of course, each country has to have a private banking sector based on a regulatory framework that needs to be firstly and most important clear, secondly certain and third predictable, in order to attract investors, for example. The major challenge right now is to find a balance in the private banking sector, and to carefully address pending issues and carry these out at a proper speed. We also believe that uncertainty against incomplete regulatory process is actually more damaging to the economy than if rules are tough, and that is the reason why once the rules are clear, banks will adjust to them even if they're tough.

In this particular matter, specialists have stressed there are three main issues left to be taken into consideration, respectively: first, with regard to liquidity, there is a lot of hard work left to do, because the new liquidity regime must be first tested during a special period of time before being put into a firm set of rules; second, from the banks' perspective, this liquidity regime is at least as important as the capital requirements, if not more important; and third, the shadow banking system and the "too big to fail" debate is another big issue that must be further more taken into account especially in the near future.

Due to all these recent events, the private banking sector feels more and more the need for a global regime. That is the reason why, the newly set up Financial Stability Board (FSB) strives to ensure maximal consistency across the marketplace with regard to financial regulations, but individual countries have tended to address specific issues. This is clearly seen in the national implementations of different financial frameworks, because each framework has a different emphasis. For example, Switzerland focuses on capital, the UK on compensation and the US on the Volker rules and proprietary trading. The challenge is to make sure that the FSB delivers some consistency.

After analyzing all the new problems that have occurred, there is also good news to add, and that is the fact that the FSB has turned into a G-30 meeting with all major jurisdictions represented and being part of the discussion. One of the FSB's highest priorities is to come up with a global resolution regime should a global financial institution fail. Specialists have pointed out at the meeting that there are some good national resolution regimes, but there is no way of doing resolution for a globally active financial institution. Of course, they have also stated that all the countries are many years away from a global regime, due to the legal challenges, which are vast, but they wanted to make sure that in the next future all the countries are aware that they would need a mandate from the heads of state to resolve this matter.

2. GOVERNMENT INTERVENTIONS – A WAY TO WORSEN OR TO QUIRE A CRISIS SOMETIMES

After presenting the importance of the private banking sector and the need to create a global financial institution based upon a clear global financial regime, our next goal is to outline some of the big investment themes for individuals in 2011, an year when people should be prepared for market conditions that are volatile but, on balance, reasonably favorable and where interest rates are very likely to remain low in the advanced economies through most, if not all, of 2011, which is supportive for stocks and for commodities.

That is why a good place to begin to analyze the central paradox of the financial crisis is precisely from a macroeconomic point of view. Specialists worldwide came to believe today that the financial crisis was caused by excessive confidence, excessive borrowing, excessive lending and excessive asset prices. Of course, the financial crisis is now being resolved by more confidence, more borrowing and more lending.

Some researchers emphasized in numerous time that this particular way of acting is exactly the wrong response to the crisis and actually makes it worse. From a financial regulatory policy point of view, it is very important to be focused on what apparatus will be available to avoid a repetition of the errors of the past. In fact, that is exactly the paradox of financial regulation.

Firstly, in order to analyze the traditional paradox of financial regulation, we have to say that it is built around a phenomenon that essentially never happens, in order to protect individual institutions from taking excessive risk, in a way that causes them to fail under normal circumstances. Even so, some failures do nevertheless happen because there is a rogue trader, a major control failure or fraud. But most failures happen because the whole system goes down and asset prices collapse.

Secondly, in order to analyze the new paradox that can be seen today, the macroeconomic approach is needed. Specialists' belief is that financial regulations need to become a macroeconomic exercise, rather than a microeconomic exercise. Combating the pro-cyclical impacts of regulations is at the center of the problem, and being widely propounded by academics and repeated by the official sector. Of course, if regulatory capital levels are set at a level not far off from levels that financial institutions would choose on their own, they are not very burdensome, but if there is an aspiration to set capital levels far above the level that financial institutions would choose on their own, there is a "Maginot line risk": these levels are defended as impregnable, but not difficult to circumvent and this ultimately creates risk.

As an answer to all the matters stated until now, specialists recommendation, to which, of course we subscribe as well, is the need of having an excessive risk aversion right now. We are currently in a period of excessive risk aversion, where we are unlikely to recreate the crisis in the near term. The measures agreed domestically and internationally seem to be constructive in reducing leverage, increasing capital levels and moving forward on liquidity requirements, but, even so, there is still the concern that when the world becomes optimistic again, we are taking an excessive microeconomic view, focusing too much on the health of the individual institutions and sectors rather than on a macroeconomic approach.

3. MANAGERIAL ACCOUNTABILITY OR HOW TO RESOLVE THE ISSUE OF DEBT IN THE WORLD

In the end of our presentation we have emphasized the main risks that the year 2011 is bringing with it, which include the still not fully resolved issue of sovereign debt in a number of European countries, the US deficit and the risk of inflation in emerging markets.

As always happens, there also needs to be consequences for failures. What countries need today is to put much more effort to make individuals and institutions accountable for the messes created, many more consequences for CEOs whose risk management systems failed. The response to an increasingly complex world is first, accountability rather than oversimplifying regulations, or pretending that the financial industry is not self interested and second, increased cross-border coordination.

Today, endorsed by the G-20 in November, the Basel III rules are now in the implementation phase and making the financial system much safer and one of the first elements in the Basel discussion is to seriously think about the capital levels needed. The resolution is that additional capital will substantially help reduce the probability of this type of crisis again. The average capital level of the 19 largest banks was 5.7 percent at the end of 2009, up from 1 percent at the beginning of the crisis. So, a lot has already been done, but some additional efforts are still needed. As the Basel III rules are minimal requirements, countries can adapt them according to their needs. Each country needs, however, to increase the consistency here, and have to balance between national and international implementation. There is a strong commitment at G-20 level to improve this consistency.

For the near future consistent execution of new implemented strategies must prove to be successful.

4. CREDIT SUISSE – A STUDY CASE ON SUCCESSFUL PRIVATE BANKING

At the end of our research, as a study case, we have chosen to present a very powerful bank that exists today, respectively the private bank Credit Suisse which also has a global private banking franchise and which was also named the best private bank globally for the second consecutive year based on the results of the magazine's Private Banking Survey 2011.

Firstly, in order to have a clear image of this bank's evolution, we are going to present, at the beginning of our study case the challenges brought by the year 2010 in the private banking industry. In this matter, the bank's officials have stated that their client activity was more subdued than in 2009 and this impacted revenues in the private banking industry, especially given the low interest rate environment; regulatory developments also presented challenges, and continue to do so; despite the difficult environment, the bank has focused on executing our strategy consistently and on meeting the needs of their clients; the bank also continued to invest in people, in the global platform and in the product and service offering. All in all, the bank entered 2011 on a firmer footing than a year ago.

Secondly, we are also going to emphasize upon the main developments that are expected to be seen in 2011. That is the reason why, regulatory developments will remain a key focus for the industry this year and besides that, two of the bank's biggest challenges will be to create even greater value for the existing clients and to deliver an optimal investment performance, particularly relative to the peers. The bank's officials also believe that Private Banking business is poised to capture the attractive growth opportunities that exist in the market.

Thirdly, we are going to present the drivers of revenue growth in 2011 for Credit Suisse. For the bank, the ultra – high – net – worth segment and wealth from the emerging markets will remain important drivers of revenue growth, and in the current environment, optimizing risks and returns presents a significant revenue opportunity. There are a lot of big investment themes for high – net – worth individuals over the coming 12 months that can be outline, such as: in 2011 the bank should be prepared for market conditions that are volatile but, on balance, reasonably favorable; also, with economic growth picking up further, especially in the US, and corporate profits quite strong, equities should produce good returns; in this matter, interest rates are very likely to remain low in the advanced economies through most, if not all, of 2011, which is supportive for stocks and for commodities.

Fourthly, the bank has also to take into account potential risks and to be more and more prepared. In the bank's view, the main risks include the still not fully resolved issue of sovereign debt in a number of European countries, the US deficit and the risk of inflation in emerging markets. Particularly the first of these will have a significant impact on currencies. If the European debt issue is defused, we think the euro will stage a comeback against the US dollar, the Swiss franc and other currencies. But even so, the bank has continuously geographically expanded and will still continue to evolve even more. Over recent years the bank has added onshore offerings in several countries, including Russia, Japan, Australia and Mexico. Today, the bank has a strong presence in all major markets globally; therefore they will focus on strengthening the existing platforms so that they are in the best possible position to serve the clients. From a regional perspective, the bank's main focus will be on growth in Asia, the Middle East, Eastern Europe and Latin America, but the bank also sees many opportunities to bring the comprehensive offering to entrepreneurs, especially in Western Europe.
Fifthly, we have presented also the bank's approach to recruitment in 2011. The bank's ability to attract and retain people who have the skill to succeed in a highly - demanding business and regulatory environment is fundamental to its long - term success, that is the reason why the bank wants to recruit people globally in 2011 – mainly in the Middle East, Latin America and Asia. In Europe, the bank's focus will be on increasing efficiency, because the bank is committed to maintaining high standards with regards to the people its recruits. A major focus is to develop its own talent within the bank, a key driver for long - term success. Of course, there are several aspects that must be taken into account in this matter and that include, for example, the clients' changing needs that have influenced and will always influence the profile of the candidates that the bank is looking for. The bank's clients have increasingly complex financial requirements and it is therefore essential that the bank has skilled people on hand to provide them with the right investment ideas. For example, many of the bank's clients not only require

traditional private banking services but also want specialized solutions that can only be supplied using the market access and expertise of an investment bank. The bank is therefore particularly interested in investment bankers and corporate bankers who the bank can train to become skilled relationship managers; individuals who can successfully tap into the entrepreneur market are clearly in demand. Sometimes, even the process of hiring people can be a serious challenge for the bank. In today's highly competitive marketplace, retaining the best people to serve clients can sometimes be a challenge and talented relationship managers are scarce globally, particularly in Latin America and Asia. However, the bank has built an attractive global platform, which combines dedicated coverage models, state – of – the – art advisory tools, a comprehensive range of solutions, a leading brand and excellent development opportunities – giving clients a single point of contact and giving talented relationship managers the opportunity to succeed. And, in this matter, the most sophisticated clients are also looking for connectivity to the right people for business and personal interests, which only a bank with a truly global network can provide.

Sixthly, we wanted to present as well a few data concerning the lending environment in order to see if it is back to normal for high – net – worth clients or it is still in the process of getting into the right track. The lending environment has recovered substantially on the private banking side but business has not returned to pre-crisis levels. The bank is active in margin and structured lending. With a global network spanning many markets, the bank is very well positioned to find ways to raise capital for our clients and we have market - leading expertise in providing complex structured loans. Furthermore, there are products or services that clients showing an interest in all the time. The bank's officials are seeing increasing interest from clients in the holistic advisory approach, which provides comprehensive solutions tailored to individual needs based on expertise from across the integrated bank. Clients want to know that their full story is understood and that all their needs can be met. Given that the bank's clients often live and work in a number of locations and move between different worlds, they want a financial partner that can accommodate their global needs. They require access to all of the world's markets; the opportunity to diversify their assets across different geographies, currencies and investment categories; access to a broad product range and the opportunity to benefit from wealth creation in the emerging markets. The bank's most sophisticated clients are also looking for connectivity to the right people for business and personal interests, which only a bank with a truly global network can provide.

CONCLUSIONS

All in all, we want to summarize the main outcomes that our research has provided: firstly, it is a clear fact that the banking sector today is extremely vulnerable due to the economic and financial crisis, but as it is one of the most important private sectors in each country world wide it must be well taken care of threw new and improved reforms and as specialists have advised for the future a global financial system must be implemented in order to have a complex image of the banking sector and even to be able to avoid future destructions; secondly, Government interventions can prove to be sometimes a way to worsen or to quire a crisis, but even so implementing strict regulations must be now strict priority to the officials; thirdly, finding a way to make individuals and institutions accountable for the messes created, implicate many more consequences for CEOs whose risk management systems failed and also stress the necessity of increased cross - border coordination; fourthly, having a good image of banks that have succeeded even during rough times and managing franchising systems worldwide can offer an encouraging image upon the future and that is the reason why we have chosen Credit Suisse as a study case on successful private banking.

Of course, all the ideas presented here shall undertake the implications of such outcomes and as suggestions for future researches we would like to stress the necessity of trying to present more examples of successful banking ideas as integrated part of a private banking sector in order to furthermore encourage this sector to evolve and grow.

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