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The future of private banking:

Interview with Michel Dérobert, Secretary General, Swiss Private Bankers Association

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Does private banking have a future? This question is increasingly asked given the US government's attack on Switzerland's oldest private bank and the mounting pressure traditional Swiss private banks have come under from tax-greedy politicians in many countries and international financial regulators, as well as the increasing complexity of the banking business.

Richard: The Swiss private banks have had a well-deserved reputation for protecting the assets of wealthy individuals and institutions from around the world for the last couple of centuries. How do the Swiss define a "private bank"?

Michel: There is no official Swiss definition for the term "private bank". But most people understand that these banks are active in the field of private banking, ie they help wealthy individuals manage their financial assets. The majority of the 340 banks or so registered in Switzerland offer this kind of service, but not all of them would call themselves "private banks".

There is sometimes confusion between the terms "private banks" and "private bankers". In Switzerland, the latter does not refer to a bank officer whose job it is to serve private clients. It refers to a specific definition in the Banking Law and applies to banks whose legal status is justified by the presence of at least one partner with unlimited liability for the bank's commitments.

As such, "private bankers" have been around for a long time in Switzerland, and they are sometimes considered as the typical Swiss "private banks".

Richard: Some of the Swiss private bankers have been around for a couple of hundred years. Please give us a quick history of the development of the private bankers.

Michel: The private bankers represent the oldest form of a Swiss banking establishment. Originally, wholesalers, brokers or forwarding agents, they specialised in credit business and bills of exchange related to goods trading. Throughout history, names of illustrious people and families appear as precursors of today's private bankers. One of these forebears was Cosimo de' Medici who, during the Council of Basle in the 15th century, set up one of the very first banking houses in that city.

The Reformation in the 16th century and the emergence of Calvinism, caused persecuted Protestants from all over Europe – but mainly from France and Italy – to flock to Geneva, where they found refuge. Today, there are still many private bankers' families who can retrace their origins to these ancient times. The oldest banking houses were founded during the 18th century. They originally operated as universal banks fulfilling their customers' borrowing needs.

However, with the development of industry in the second half of the 19th century, it was no longer possible for these banks to satisfy the increasing demand for loans while retaining their legal form characterised by the partners' unlimited liability. It was from this situation that the first limited liability credit banks emerged, often on the initiative of private bankers. As these banks developed, the number of private bankers decreased. In contrast to their numerical decline, the size of some the individual private banking houses has grown significantly.

The second half of the 20th century as well as the first decade of the 21st century represents a period of rapid growth for the Swiss private bankers' business and in the total assets that they hold under management. Today, many of them are present in the major financial centres.

Richard: Why do you think the Swiss private bankers have been so durable for such a long period of time?

Michel: The answer lies undoubtedly in their prudence and focus on the long term. Owned and managed by partners with unlimited liability, these banks avoid taking wild risks for their clients and for themselves. The traditional Swiss private banks in Geneva, Basel and Zürich have sailed through many financial crises, and the sense of history that the owners' families have developed over the centuries has served them well. Tough risk controls and high capitalisation is a recipe for a long life in the world of banking.

Richard: How has the world economy benefited from the existence of private bankers?

Michel: Swiss private bankers avoid big words and they surely would not pretend that the world economy would have developed in an entirely different way if they hadn't been around. However, they helped many families protect their assets over generations. The European continent endured two major wars during the 20th century. For some families, the existence of Swiss private banks certainly made a great difference.

Nowadays, allocating capital wisely is an important economic function and banks that regularly report a growth in their assets under management must do something right.

Richard: A couple of the largest private Swiss banks, Pictet and Lombard Odier, have decided to move away from the traditional partnership form of organisation to a more corporate form. Why do you think these banks decided to make the change in governance and structure?

Michel: The world is becoming more uniform. In many countries regulators have forgotten that successful banks can be organised in the form of partnerships. I personally find it paradoxical that, on the one hand, everybody deplores the fact that bankers around the world are not liable for the risks they take in the name of their organisations and, on the other hand, state authorities don't understand why banks should be run in any other form than that of a limited company.

The two largest Swiss private banks, Pictet and Lombard Odier, have rapidly expanded during the last decades. They have come to the conclusion that running a bank as a partnership is fine as long as the size of the operations does not reach a certain level. But when, as banking groups, they employ thousands of people in many different places, it becomes more difficult. It must be noted that these two banks want to keep their DNA, which is why their holding companies will remain in the form of partnerships limited by shares. Independence and responsibility will remain their core values.

Richard: Is it possible for the traditional private bank, whose partners have unlimited liability, to exist in the modern world, particularly with the added risk of political actions in foreign countries, like the US, which is outside the control of the bank partners?

Michel: Up to now, the answer has always been that the unlimited liability had more pros than cons. This form of organisation proves to the clients that the partners believe in what they preach. During the last decades, the fact that the traditional private banks didn't lose but, on the contrary, gained market shares despite the fact that their number actually shrank has demonstrated that this type of organisation works.

But I admit that the world is becoming riskier. As long as the banks don't exceed a certain size, things are fine. But, with added complexity, they become more problematic.

Richard: Do you see a need for the continued existence of the traditional private bank?

Michel: It is not for me to see the need for the continued existence of this particular type of bank. But I must admit that I don't understand why legislators don't actively favour it. People respond to incentives. An organisational form that puts more risks on the bankers' shoulders should be seen as generally advantageous to society.

As we have seen, instead of encouraging such banks, governments and regulators merely tolerate them, which is a pity. But then, one should at least stop complaining that bankers are not behaving in a responsible way.

Richard: Given the push, by some major governments and international organisations, such as the OECD, towards global tax harmonisation and financial transparency, do you think private banks will continue to exist in the foreseeable future?

Michel: I don't think for a minute that private banks will cease to exist. But I am certain that governments will, in order to restore their finance, do whatever is in their power to get a larger share of the savings accumulated by individuals. Transparency in tax matters will undoubtedly increase, which does not mean that client confidentiality will disappear, on the contrary. More worryingly, we will probably witness a wave of protectionism in the area of cross-border banking with a particular emphasis on private banking.

The new FATCA rules in the United States are just one example. Others will follow, especially in Europe. Keeping markets open will be a challenge during the coming years. This is why operating from just one country might prove more difficult, even if that country is the world's safest. But the need to get personalised services from independent private bankers will remain for a large number of individuals around the world.

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