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UBS Private Banking

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The new bank that was created by the 1998 merger of Swiss Bank Corporation (SBC) and the Union Bank of Switzerland (UBS) was, at the time, the largest in the world in terms of assets – although by November 1999 it had slipped to third place due to the acquisition of Bankers Trust by Deutsche Bank and Paribas by Banque Nationale de Paris, and to fifth place if two announced Japanese mergers were included. By comparison, neither SBC nor UBS had made the list of the world's 10 largest banks a decade earlier (see Exhibit 1). The logical name for the new bank, United Bank of Switzerland, had been preempted and was unavailable. So the three letters of the old UBS and the "three-keys" logo of the old SBC were chosen to define the new franchise.

The merger was generally well received by analysts. Indeed, a Goldman Sachs report dated March 24, 1998 concluded that the three letters stood for ***U**ndervalued **B**y Any **S**tandard*. This bullish outlook was based on the powerful potential role of the new UBS in the ongoing restructuring of European banking, improved deployment of capital, and a strong growth outlook for the money management business. Particular emphasis was placed by analysts on the bank's prospects in private banking as the basis for projected annual earnings growth rates of 17%, plus some 5% in near-term earnings contribution from merger-related cost synergies. Goldman Sachs forecast a price appreciation from Swiss Francs (CHF) 657 per share right after the merger to CHF 2,905 per share by year-end 1999. That proved to be something of an overestimate – on December 16, 1999 the shares closed in Zurich at CHF 411.

UBS shares had been hit by a number of downdrafts, the most notable of which related to the 1998 financial crises in Asia and Russia, as well as a legacy investment of the old Union Bank of Switzerland in Long-Term Capital Management (LTCM), the U.S. hedge fund, which led to about CHF 1 billion in losses and resulted in the replacement of five of the bank's most senior executives, including the Chairman. The events of August and September 1998 knocked over 50% off the UBS share price (Exhibit 2).

Despite the setbacks, the integration of the two banks had been forced-through quickly and efficiently, given the cultural differences, the time-consuming nature of the process, and the rigidities that confronted rationalization especially in the Swiss domestic market. Integration efforts were throughout, focused on the technology infrastructure, retention and leveraging of client relationships, rationalization of staff, and exploitation of available synergies focusing on cross-divisional revenues. In total, 2.5 million master accounts had been transferred, 130 branch locations merged, 23,000 staff retrained, as well as thousands of workstations reconfigured and infrastructure moves carried out by mid-1999.

In 1999 UBS remained one of the principal financial services franchises in the world in terms of market capitalization – see Exhibit 3. It was well capitalized at US$ 23.5 billion, representing a BIS Tier I ratio of 9.6% and a combined Tier 1 and 2 ratios of 14%. Its ratings were Aa1 from Moody's and AA+ from Standard & Poor's, both predecessor banks having been downrated from AAA in the period before the merger. Annualized return on equity was reported by management in July 1999 to be 21.2%. Revenue composition was running at about 20% net interest income, 40% fees and commissions, 25% net trading gains and 15% miscellaneous and one-time gains such as real estate disposals.

However, market valuations seemed unsatisfactory. The bank's estimated P/E for the year was only 13 times earnings and its market-to-book ratio was only about 2.5, well below many

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of its peers.[1] UBS share price performance had lagged behind archrival Crédit Suisse Group – see Exhibit 4. At the time of the merger, UBS had indicated a profit target of about US$7 billion for 2002. This seemed unlikely to be met – for 1999 profits were estimated to be roughly US$4.4 billion. So in December 1999 management replaced the earnings goal with an ROE target averaging 15–20% – depending on market conditions – and "double-digit" annual earnings growth. All of this meant that pressure was clearly on management to substantially improve the bank's overall performance and to convince the market that this was not only achievable, but also sustainable.

UBS Structure and Strategy

In late-1999 UBS was operating in some 50 countries with slightly over 48,000 staff. The bank was organized into five principal businesses, as indicated in Exhibit 5.

- *UBS Private Banking*, headquartered in Zurich and headed by Rudi Bogni, a former senior investment banker. It targeted high net worth clients in Switzerland and in various national markets around the world. It also provided offshore financial services for wealthy individuals outside their countries of residence.

- *UBS Asset Management*, headquartered in Chicago, dealt with institutional investor clients such as pension funds, and was led by Peter Wuffli, a former management consultant who had previously served as chief financial officer of the bank.

- *UBS Private and Corporate Clients* covered the Swiss domestic business ranging from retail banking to Swiss corporates' commercial banking requirements. It was headed by Stephan Haeringer, a veteran Union Bank of Switzerland executive.

- *UBS Warburg*, based in London, was the investment banking operation of UBS, whose roots could be traced back to the old Swiss Bank Corporation's investment banking strategy of the late 1980s and 1990s, which grew both organically and by successive acquisitions – first of the O'Connor partnership in Chicago (a highly regarded derivatives boutique), then S.G. Warburg in London (arguably the premier British merchant bank, which had run into difficulties) and finally Dillon Read & Co. in New York (a fine but declining U.S. corporate finance specialist). This was combined with the rump of the former Union Bank of Switzerland investment banking operations, which provided complementary resources in several areas of the business. UBS Warburg was headed by Markus Granziol, a former academic and SBC investment banker.

- *UBS Private Equity* focused on equity participations and related business around the world, and was headed by Pierre de Weck a management board member of the old Union Bank of Switzerland.

[1] Goldman Sachs & Co., 15 October 1999.

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The UBS Chief Executive Officer was Marcel Ospel, who had come up through the investment banking side of Swiss Bank Corporation and had spent part of his career at Merrill Lynch. The Chairman of the Board or Directors was Alex Krauer, a highly respected non-banker who had previously been Chairman of the Board of Novaris AG in the pharmaceuticals industry and a director of Bâloise Holding in the insurance sector.

A Goldman Sachs report released early in 1999 estimated that UBS earnings for the year would be US$5,752 million, of which 65% would come from UBS Private Banking and 20% from UBS Warburg. This reflected general analyst commentary that private banking was by far the bank's most valuable franchise because of its market penetration, the inherent profitability of private banking, the absence of high capital-intensity, and the stability of earnings.

Investment banking, on the other hand, was generally considered to be a highly unstable and capital-intensive business. UBS Warburg had established itself as perhaps the premier European investment-banking house, but was active in a tough, competitive business dominated by a few American investment banks. In 1998 it had captured composite global investment banking market share of under 4% – see Exhibit 6. A lot of work remained to be done in order to achieve an adequate footprint in the United States, the world's largest capital market. And even in Europe, the major American firms were thought to be capturing up to 70% of investment banking fees. Like most other investment banks, WDR had turned in very poor results for 1998, although 1999 showed a dramatic rebound in operating earnings.

The bank's domestic business, as the largest bank in Switzerland, remained in the final stages of restructuring following the SBC-UBS merger in an effort to drive down costs and improve efficiency – a slow business in most European countries. The bank had, on the other hand, moved quickly in e banking both at the institutional level (Internet-based research distribution, a commercial paper Website, on-line trading and automated execution) and at the retail level in Switzerland (a 44% market share in telebanking contracts and a 54% market share in e-payment transactions), attracting some 2,000 new clients weekly. Still, there was the unavoidable fact that Switzerland would remain a relatively stagnant, albeit affluent home market characterized by two mega-competitors and a large number of cantonal and regional banks.

And finally, UBS Private Equity seemed to be off to a very good start in its proprietary investment business. But the small size of the unit was such that even continued strong performance was unlikely to drive the group's future earnings growth anytime soon.

The relative prospects for the five different UBS businesses, as seen by analysts, seemed to be broadly in line with other studies that had tried to dissect universal banking firms. A 1999 report on sustainable returns and capital allocation of German universal banks undertaken by Schroders in London, for example, suggested that there were enormous differences in both profitability and capital-intensity among the various activities conducted by such organizations – see Exhibit 7.

In general, UBS management appeared to be well aware of the valuations assigned by the market to the group's different businesses and the need to link them together by maximizing cross-divisional revenues and optimizing cross divisional cost sharing. Management appeared to be strongly focused on shareholder value considerations, certainly by traditional European

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standards. For example, the bank had been a pioneer in moving loans off the balance sheet in order to use capital more efficiently and "right-size" the loan book to support its asset management and investment banking businesses. Some analysts also attributed to UBS management perceptions of shareholder-value the bank's reluctance to adopt the full financial conglomerate route by merging with a major insurance company, as Citigroup or Crédit Suisse had done – as well as continued rumors (vigorously denied by management) that UBS Warburg might eventually be spun off,

Management's strategic vision in late 1999 was that: "UBS is a global, integrated investment services firm, and the leading bank in Switzerland." The message appeared to be focused on a strong, stable domestic operating platform in Switzerland as the foundation for a highly profitable Europe-based global wholesale banking and asset management franchise. This implied continued internal growth complemented by selected strategic acquisitions, particularly on the asset management side.

For example, in September 1999 the bank had agreed to acquire Global Asset Management (GAM) – a diversified fund management group with assets under management of US$13.9 billion as of 30 June 1999 – for between US$575 and US$675 million. GAM's assets comprised mainly of portfolios and mutual funds of private clients as well as institutional mandates. GAM became part of the Private Banking Division, not the UBS Asset Management, side of the business. GAM and UBS Private Banking clients were slated to gain from an expanded range of tailor-made products and services. Through GAM's well-developed multi-manager selection, UBS Private Banking Division would also be in a position to offer third-party funds that met the bank's standards in terms of choice of funds and client advice.

Supporting its strategy, UBS had also launched a major branding offensive: to quote the 1999 press release:

> "The new UBS brand has set its sights on being the preferred choice of all of its target groups. The brand stands for service excellence, performance and responsibility, competence, innovation and energy... It aims at communicating to target groups in an emotional and unmistakable way, the values and visions of the new bank. Innovative, surprising, optimistic. The campaign, focusing on the notion of going forward with optimism, shows that frontiers can be pushed back, goals can be reached. UBS will make the optimistic nature of these visions its own, helping to turn this forward-looking attitude into reality."

In December 1999, UBS announced that it would register its shares with the U.S. Securities and Exchange Commission and seek a listing on the New York Stock Exchange in order to gain strategic flexibility and the use of its equity in share-for-share acquisitions, in addition to a streamlined stock buyback program. It also announced an aggressive strategy for an integrated pan-European e-banking platform as well as a Group-wide re-branding initiative.

Within the overall UBS strategic framework, it seemed to many observers that much of the burden of achieving management's shareholder value-driven objectives would inevitably have to be carried by the Private Banking Division. If investment banking was in fact as volatile, competitive and capital-intensive as generally thought, if domestic Swiss retail banking was too small and lacking in growth opportunities in the pan-European and global scheme of

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things, if institutional fund management was too contestable to throw-off large sustainable excess returns, and if principal investing was too unpredictable and opportunistic to make large sustained contributions to a bottom line as massive as UBS's, then building on the bank's premier position as the world's leading private bank seemed to be where management and its shareholders would have to pin most of their hopes.

The Global Private Banking Market

Individual wealth can take a variety of forms encompassing financial assets (currency, bank balances, stocks, bonds, etc.) and real assets – commodities, precious stones, objets d'art, real estate and other assets that have some sort of actual or potential market value. They range across the entire liquidity, risk and return spectrum from currency to participations in private equity deals. The ability to measure wealth at any point in time depends on the existence of a market for each asset (hence the importance of liquidity) and the ability to "mark to market."

Like other investors, wealthy individuals base asset-allocation choices on their relative preferences for risk and return. The market value of a portfolio of assets is driven by the risk-return attributes of the various assets contained in the portfolio – the risk associated with an individual asset based on the variance of its expected future returns. The risk embedded in an entire asset portfolio, in turn, is a product of correlations among the returns of all the assets contained in it – hence the value of diversification across individual assets, asset classes, political-economic environments and other "buckets" that are believed to be less than perfectly correlated. The lower the correlations across asset buckets, the greater the power of diversification. Like everyone else, wealthy people are explicitly or implicitly looking for "efficient" portfolios that minimize risk for a given target rate of return or maximize total returns for a given level of portfolio risk. They are different from ordinary people in that they have a lot to preserve, so that they often tend toward relatively conservative asset allocation approaches. They are also sensitive to confidentiality, trust and service quality – wealthy people usually don't have to deal with people they dislike or distrust, and usually they don't.

Defined in such general terms, wealth is a purely economic measure. It does not necessarily equate to an individual's own assessment of his or her personal worth in a broader context, which is affected by many of the other factors. People differ in the satisfaction they gain from higher levels of wealth, and how this may affect family members and other eventual beneficiaries. They are influenced by prevailing social, political, religious and philosophical attitudes toward wealth. And they differ in the time they want to spend on wealth management. This complex of issues tends to color their vision of the true "value" of what they have, and needs to be intuitively understood by the private banker. Achieving this understanding is not easy and usually is very personal in nature. Successful private bankers thus require a unique combination of skills in applying a broad "value chain" of services and advice.

Sources of Personal Wealth

Wealth is usually the product of past or present returns in the provision of goods or services, together with capital income (interest, dividends, capital gains) earned on the accumulated

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assets through time. As such, it can usually be considered evidence of significant economic contributions in a market-oriented system. On the other hand, wealth can also be amassed *at the expense* of the rest of society through the unchecked exercise of monopoly power, extortion, racketeering, corruption, insider trading, drug trafficking and the like. Nobody likes to talk about such things, but they nevertheless exist. Wealth is wealth. Classifying wealth in terms of its origins can provide a useful basis for the assessment of client attitudes, market segmentation and private banking requirements.

- *Family (inherited) wealth* – involves the transfer of assets from one generation to another. This form of wealth tends to be sensitive to redistribution-oriented national fiscal and economic policies especially taxation. It can arise from any of the other sources of wealth specified below. Heavy concentrations of family wealth are found in Western Europe, the home of "classic" private banking, in North America and in parts of Asia.

- *Corporate wealth* – is typically generated through service as a management employee of a corporation in the form of salaries, bonuses, stock options, severance payments. The greatest concentration of this form of wealth is found in the United States due to exceedingly high levels of executive compensation (usually though stock option grants) compared to anywhere else in the world.

- *Entrepreneurial wealth* – tends to be accumulated over an individual's lifetime either as sole- or co-owner of a business enterprise. The key word is "owner", not "employee". Entrepreneurial wealth may remain "paper" wealth for extended periods of time, and is realized only when the enterprise is sold or goes public. Traditional concentrations of such wealth are found in Europe and Asia (often in family-owned and controlled businesses) but is found more widely in the United States, with massive new wealth concentrations resulting from start-ups in the technology, bio-med and other leading-edge sectors.

- *Political wealth* – may represent "gifts" from constituents or the proceeds of corruption in political office at varying levels within national or regional governing administrations, and private businesses benefiting from official corruption. Sources include misappropriation of public funds, bribery, extortion, political contributions, kickbacks, and financial holdings linked to government contracts. Public servants are rarely highly compensated, but there are some very wealthy ex-public servants who did not start out that way. The incentives underlying ill-gotten gains are ubiquitous. They are typically leveraged into serious wealth in environments where there are poorly developed markets and a lack of transparent, rule-based democratic politics, legal systems and administrative infrastructures. As such, political wealth today tends to arise disproportionately in some of the emerging-market and transition economies of Africa, Asia and Eastern Europe.

- *Criminal wealth* – comprises assets traced to organized crime, extortion, theft of public and private property, financial fraud, arms trafficking, the drug trade and other illegal activities, usually laundered into standard asset classes and invested in various ways. Criminal activities exist in all parts of the world, but it is likely that they give rise to more wealth where there are less open and transparent markets, combined with poor law enforcement.

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Private banking obviously targets the first three sources of wealth – which may represent some 85-90% of the total asset under management. Dealing with the last two categories of wealth presents some unique problems. Contamination of a private banking franchise as a result of a major corruption or criminal investigation can seriously injure a bank's reputation or, at the very least, require a great deal of explaining to clients. Nobody who values reputation and privacy enjoys being a client of a bank undergoing extreme scrutiny and criminal investigation. In this trust- and service-based business, knowing what clients to avoid can be just as important as what clients to attract.

The Facts: Global Distribution of Wealth

What determines where wealth is distributed by source-region (held both onshore and offshore) around the world? Exhibit 8 provides estimates of the geographic wealth patterns for 1999 – a pattern that tends to change relatively slowly based on a number of fundamentals.

- *Per capita income*. Wealth is a "stock" measure and income is a "flow" measure. Macroeconomic policies can have a great impact on wealth levels, as evidenced by a decade of economic growth in the U.S. versus a comparable period of stagnation in Japan, or by the periodic booms and busts seen in some of the emerging market countries. Higher-income countries and regions naturally tend to harbor greater wealth concentrations than lower-income ones.

- *Market distribution mechanisms*. The distribution of capital ownership and property rights as well as education levels and other sources of earning- power differ significantly among countries and regions. Market processes may generate wide differences in the distribution of wealth among countries around the world, even when economic size and per capita income are comparable.

- *Government policies*. How governments treat the accumulation of wealth tends to result from a confluence of historical, cultural and sociological factors that generate a political concept of a "fair" distribution. There have always been societies where wealth is regarded as evidence of exploitation and economic parasitism. This political overlay drives national policy with respect to taxation, expropriation, and other policy measures affecting the wealthy. Policy changes related to wealth can be gradual or abrupt, and those who have assets to conserve tend to be highly sensitive to them.

When taken together, these three factors probably explain much of the geographic global distribution of wealth – not only where it can be found, but also where it is individually held rather than institutionalized. There are plenty of "rich" societies where seriously wealthy individuals are few and far between, while others have them in abundance. If wealth accumulation is heavily taxed or heavily institutionalized (for example in the form of pension funds or assets controlled by the state, labor unions or cooperatives), there is little of interest for private banking. It is where markets have been allowed to determine individual income and wealth levels that wealthy individuals and families tend to emerge and where private banking services are of greatest interest.

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Private Banking Client Objectives

The objectives of private clients tend to be more idiosyncratic than many other financial services client segments, such as mass-market retail and business customers. They reflect an amalgam of needs, among which time constraints, yield, security, confidentiality, and service level are critical.

- *Capital preservation versus total return*. The traditional private banking client tends to be focused on wealth preservation in the face of uncertain political and economic conditions, changeable government policies, and fickle markets. They demand the utmost in discretion from private bankers, with whom they often maintain lifelong relationships initiated by personal contacts. Such clients continue to be important, but have gradually yielded to a more active and sophisticated group – clients who are increasingly aware of opportunity costs associated with poor investment performance and often focus on total returns calibrated against benchmarks. They may prefer gains to accrue in capital appreciation rather than interest or dividend income, and often demand a much more active investment approach in which they themselves want to be involved.

- *Security*. The world today is arguably a more stable place than it has ever been. The probability of revolution, war and gross confiscatory taxation has declined just about everywhere. Still, many wealthy clients remain highly security-conscious and may be prepared to trade-off yield for stability and safety.

- *Tax efficiency.* Many private clients are exposed to high average and/or marginal tax rates. Nobody likes to pay taxes, but the wealthy are under more pressure than anyone else – estimates for the United States, for example, are that the highest-income 5% of taxpayers generate over half of the country's income tax revenue. Where fiscal burdens can be *avoided* using the tax code, this is a valuable service. And in some environments the same is true of tax *evasion*, which occurs in violation of the applicable tax code.

- *Discretion*. Confidentiality is a key attribute of private banking. It means keeping sensitive information away from others in the knowledge that disclosure causes damage – in whatever form – to the individual concerned. One would expect the rich to have more reasons to keep secrets than the not so rich. So the watchword of the private banking profession is "discretion, discretion, discretion."

- *Service level*. Personal services provided to private banking clients can be exceptional, and are considered critical in cementing relationships and client loyalty to a particular financial institution. Extraordinary personal services may save time, reduce anxiety, increase efficiency, and make the whole wealth management process more convenient and pleasant. They allow banks in very individual ways to show their commitment to, and understanding of, clients who are accustomed to high levels of personal services in their daily lives.

Perhaps more than other parts of the financial services industry, the essence of private banking is to accurately identify each client's unique characteristics and objectives, and bring to bear the flexibility and expertise to satisfy them in a highly competitive marketplace.

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In the 1990s, eroding lending margins and regulatory tightening of capital adequacy standards forced banks to carefully review their on-balance sheet activity, with many deciding to emphasize fee-generating services. Simultaneously, there was a general effort to reduce dependence on commodity-like financial activities. In this context the private banking client base offered a number of attractions. In terms of competitive analysis, it appeared under-served, notably in view of the increasing demographic importance of the wealthy in the main industrialized countries. The baby boomers of the 1960s were well into the prime-saving 40-60 age group – a time when their income level and wealth-base tends to increase significantly. Notwithstanding the rapid rise in the number of banks targeting this segment of the market, it was generally considered to have continued attractive business potential. "Asset gathering" became the watchword, and private banking became a key part of the strategy.

The range of private banking services was quite broad – the essential factor being to offer a truly personal service focusing on the asset and sometimes the liability side of the client's balance sheet. Moreover, due to the highly personal nature of private banking, clients generally preferred to "stay with" a particular bank, if possible, resulting in a lower price and performance sensitivity, facilitating product cross-selling and enabling institutions to compete on qualitative variables instead of pricing alone. The business seemed to be characterized by favorable cost-to-income ratios, and capable of realizing significant economies of scale in transactions processing and portfolio management activities.

Onshore Private Banking

Onshore, or domestic private banking consists of a value-chain of financial and advisory services provided within the country of residence of wealthy clients. It can be viewed as an extension of the concept of "personal banking" or a broadening of the concept of "trust banking." A key difference among competing financial institutions is the wealth cut-off point for private banking clients. One bank may require a minimum US$5 million placed in investment management accounts. Another may be more flexible – a minimum requirement of US$1 million in assets under management for example, a lower limit that may be dropped if a client appears to have significant future potential. Or there may be a US$5 million individual net worth rule, but exceptions may be made for the "right" client. Alternatively, a bank may require that each private banking client generate a certain amount of annual fees.

By 1999, some financial institutions had positioned themselves at the lower end of the wealth spectrum, especially regional banks, broker-dealers and independent asset managers such as Fidelity Group or Vanguard. Given the performance of the stock markets in many of the major industrial countries, even relatively modest equity holdings at the beginning of the 1990s put many "retail" clients into the high net worth class by the end of the decade, especially when the value of defined-contribution pension investments were included. The principal private banking client segments encompass the following:

- Traditional high net worth individuals and families, with substantial inherited wealth, requiring comprehensive advice on portfolio structures, proper inheritance planning and long-term investment strategies, in addition to having possible interest in global investing and trading opportunities.

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- Entrepreneurs / *Mittelstand*. Owners and partners of small and medium-sized businesses, as well as family-controlled industrial groups, a sector representing the driver of wealth creation in most countries and offering an opportunity for integrated advice on both business finance and personal finance.

- Professionals and executives, comprising self-employed individuals, partners in professional firms, financiers, traders and highly-paid executives, notably those with stock options and share plans. Such clients usually have complex and tax-driven compensation and asset-holding patterns, sometimes including multi-country requirements. The traditional private banking focus in this segment has been on personal assets, although it can be argued that an integrated focus on both employment-related income generation and wealth accumulation is more productive.

- Entertainers and artists, often highly paid, who are accustomed to agents in their professional activities but whose level of financial sophistication is often limited – yet with ample scope for innovation including royalty and endorsement income management, value-extraction from intellectual property and residuals securitization.

- Sports professionals, an industry that has increasingly produced seriously wealthy individuals but with a highly uneven track record for wealth preservation and asset management.

- Family offices, maintained by the very wealthy and staffed by professionals capable of handling most matters related to wealth management and dealing with lawyers, accountants and bankers to achieve family goals. Sometimes they will also take on wealth management assignments of close friends of the family.

- Intermediaries and external asset managers – a substantial and growing acquisition channel for clients that cannot be attracted directly (small private banks, independent financial advisers, accounting and legal firms, etc.). These specialists market their services as being based on independent, objective advice in combination with outsourcing a good deal of the private banking value-chain.

Key Domestic Private Banking Services

By the late 1990s many banks had made efforts to become one-stop financial supermarkets for the wealthy, offering a broad range of financial services.

- *Cash management services*. A proliferation of deposit and payments services are available to wealthy individuals – checking accounts, cash management accounts, money market accounts, savings accounts, CDs, commercial paper, bankers acceptances, Treasury bills and a variety of taxable and non-taxable mutual funds. Most are generic services available to retail clients as well, but provided to private clients as well with a "platinum" level of service.

- *Brokerage and trust services.* Traditional private client services include custodian accounts and advice on the establishment of estates, trusts, and corporations, as well as conventional stockbrokerage services – albeit with a high level of service quality. Tax

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advice is another key private banking function, since changes in tax structures, as well as changed client circumstances, may mean that the appropriate structure of an individual's balance sheet may have to change as well.

- *Investment management*. Services provided for private clients vary between and within institutions, depending on the type of client served and the assets size of funds available for investment. Smaller accounts are normally pooled, with many banks offering a variety of funds across a broad range of investments. Larger accounts may be managed either on a discretionary basis or on an active advisory basis with clients involved in each transaction. The scope of investments may include real estate, limited partnerships investing in start-up businesses, precious metals, currencies, emerging market equities, commodities, and works of art, in addition to conventional asset selections.

  In terms of the asset management function, private clients run the gamut from passive to active. Passive investors tend to risk-averse individuals whose predominant use of financial resources may be for lifestyle maintenance and inter-generational wealth transfer. Active investors tend to be more risk-oriented, and financially sophisticated and generally use their financial assets to try to increase wealth. Banks compete aggressively for both markets, and tend to be particularly attracted to active investors, where they perceive greater scope for value-added. They like to focus on individuals in the wealth-building phase of their live. By helping them in the early stages of wealth-accumulation, the argument goes, a bank may keep them later on.

- *Credit extension and personal lending*. The need to borrow is particularly prevalent among entrepreneurial wealthy individuals. Such clients tend to be in the wealth-creating phase, and tend to be illiquid. They may rely on the private banker to find a way to structure a deal around an existing personal asset base, for example. Other lending may involve real estate purchases or temporary (bridge) credits pending sale of assets.

- *Business finance*. The overlap between the personal and business needs of wealthy clients is particularly interesting for some of the larger banks with strong private banking units. It allows them to penetrate more deeply into the individual's finances and provide a range of corporate banking activities in addition to personal financial services. These include bankers acceptances, letters of credit, revolving lines of credit and term loans on the commercial banking side, and initial and secondary public offerings, merger and acquisitions services, and corporate finance advisory services on the investment banking side. IPOs have made many people rich, and that wealth needs to be managed. Wealthy individuals are often interested in private equity participations and other "alternative" asset classes. Due to the links between the corporate and personal finance, familiarity with the individual's attitudes to risk, currency, maturity and liquidity requirements gives a significant advantage to an institution already servicing clients' commercial or investment banking needs.

- *Personal services*. In a business where quality of service is of paramount importance and where the fiduciary nature of the relationship is critical, private bankers provide personal services atypical to mainstream banking. These can include personal

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introductions to the great and the good, admission to exclusive schools for children or grandchildren, invitations to sports and entertainment events, and many others, provided with a good deal of style and discretion.

Private banks in many cases try to supply so-called "360E" private banking services comprising active client solicitation and retention based on a high level of intimacy and trust as a deterrent to opportunism and maximum "share of wallet." The components are asset allocation services (passive, discretionary and active), brokerage (including Internet access options), real estate, art banking (authenticity, pricing, financing), access to IPOs and private equity participations, M&A services where appropriate, research, credit, structured products such as hedge funds and funds of funds, tax advice, estates and trusts, and a supporting range of personal services.

It is in the nature of private banking that clients tend to be relatively loyal compared to other financial services sectors. Given the high switching costs that private clients feel they face, clients tend to be lost mainly as a result of consistently poor investment performance, personal disagreements or serious administrative snafus. Conversely, they are difficult to poach. Client-acquisition in private banking thus depends on distinctive value-propositions that can be put forward in a credible way, hopefully attracting a part of the individual's business that can later be expanded based on satisfactory service and portfolio performance. In larger institutions it also depends on the ability to identify future wealthy clients early in the asset-accumulation process in order to retain the relationship later on. There are perhaps two alternative approaches to delivering the private banking value-chain to clients.

The first approach involves client segmentation based on product requirements, with maximum delivery of proprietary services. The argument is that this approach can leverage across the private banking multiple in-house capabilities, sharpens application of specific expertise, helps capitalize on global capabilities, and improves operating economics.

The second approach focuses on the private client as a single continuous "advisory project" using targeted teams that emphasize best-in-class products or services, whether in-house or external, to facilitate client intimacy, maximize objectivity in fulfilling client needs, and broaden the product range. The argument is that clients need to be made aware of best products, regardless of source, on an objective basis (as against favoring proprietary services), and that this will maximize returns over the long term. It presupposes a much more fluid, capable, demanding and diverse client base in the future, with much greater transparency in both performance and costs – and a decisive shift from product-linked fees (with advice provided virtually free) to advisory fees (with some products provided virtually free). The approach is to offer private clients what they want, drawn from an open array of benchmarked vendors through a highly capable client officer.

Many private banks attempt to focus on so-called "event windows" in the life of clients, which coincide with both opportunities for client acquisition and vulnerability client erosion. For affluent individuals or families, event windows include receipt of a major inheritance, opening the way for proposing asset-holding structures in light of family and life-style preferences as well as the entire private banking value-chain. For entrepreneurs, an event window might be flotation of sale of business, creating the need for investment banking advice and IPO origination, tax issues, ownership and control questions, dealing with non-compete constraints, as well as a comprehensive and well thought-out wealth management

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strategy. Executive event windows might include compensation plan implementation or large-scale vesting, requiring ESOP life-cycle management and integration with other sources of wealth. And for athletes and entertainers there might be a major career breakthrough or contract renewal with higher compensation or change in location, triggering the need for advice on contract structure, endorsements, sponsorships, and a proper lifetime investment strategy given a short career. Implementing an event-window approach requires identification of a compelling value-proposition for each client segment – drawing on expertise of each private banking function, assessment of local market potential, definition of event-windows, and identification of generic private banking service-profile, including life-cycle dimensions.

Bundling of private banking services makes it difficult to evaluate the value/cost relationship of each component, potentially allowing the bank to extract higher fees. It is also likely that the client is more price-inelastic with respect to the purchase of bundled services than with respect to each of the services separately. While other parts of banking have been subject to a general unbundling of services as a result of a proliferation of new financial products and techniques, private banking remains an area where bundling may retain value for some time to come. And due to the existence of economies of scope, a bank can often provide several services more economically than providing a single service. This represents an important rationale for cross selling of banking products. Since the fiduciary nature of the private banking relationship gives the bank access to a rich vein of client-specific information, it may retain a competitive advantage in servicing the private client that competitors find difficult to penetrate.

Critical factors in executing an effective onshore private banking strategy include: achieving inter-generational lock-in of clients using financial and succession planning and wealth management, legal and tax-effective structures; discretionary asset management and custody, hopefully creating barriers to exit and financial promiscuity; retaining assets during life-cycle changes and achieving client retention over several generations. There are also high-quality specialist services such as art banking and real estate advisory services. No less important is excellence in commodity services such as current accounts, time deposits, fiduciary deposits, brokerage, and financial reporting. Substandard service in any of these areas can easily contaminate a private banking.

Offshore Private Banking

According to a 1999 study,[2] an estimated US$4.8 trillion in financial assets are owned by individuals and held outside their country of residence – see Exhibit 9. These assets are normally managed on behalf of non-residents in the major functional financial centers – such as London, Luxembourg, New York, Hong Kong, Switzerland and Singapore – as well as "havens" such as Antigua and Barbuda, Anguilla, Barbados, British Virgin Islands, Cayman Islands, Dominica, Granada, Guernsey, Isle of Man, Jersey, Montserrat, Liechtenstein, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Turks and Caicos Islands, and Vanuatu, among others.

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[2] Merrill Lynch, *World Wealth Report - 1999* (New York: Merrill Lynch, 1999). Prepared in cooperation with Gemini Consulting.

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People want assets held outside the country of residence for various reasons, which include: portfolio diversification; risks pervading the home environment; tax evasion and avoidance, escape from domestic legal and enforcement actions, and confidentiality. The core client-base for offshore private banking therefore comprises security- and confidentiality-seeking wealthy individuals and families who wish to hold funds in a tax-friendly environment offshore and in a form that will maintain its value, but which is protected from exposure and disclosure – in addition to standard portfolio diversification and lifestyle requirements.

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Confidentiality

Financial confidentiality, involving non-disclosure of financial information concerning individuals, firms, financial institutions and governments represents an integral part of the market for all banking and financial services, fiduciary relationships, and regulatory structures. It also constitutes a "product" that has intrinsic value, and that can be bought and sold separately or in conjunction with other financial services.

The Demand for Financial Confidentiality. The demand for financial confidentiality can be defined as assured non-disclosure of financial information that people are willing to pay for.

- *Personal financial confidentiality* usually remains in substantial compliance with applicable laws and regulations, and in many countries has been well served by long-standing traditions of banking confidentiality. Indeed, it is often regarded as a cornerstone of individual liberty.

- *Business financial confidentiality* involves withholding financial information from competitors, suppliers, employees, creditors and customers. Release of such information is undertaken only in a tightly controlled manner and, where possible, in a way that benefits the enterprise. Financial information is proprietary. It is capitalized in the value of a business to its shareholders.

- *Tax evasion* (as distinct from *tax avoidance*) is a classic source of demand for financial confidentiality. Some people are exposed to high levels of income taxation. Others are hit by confiscatory wealth taxes or death taxes. Still others feel forced by high indirect taxes or quasi-taxes to escape into the underground economy – see Exhibit 10. And there are those for whom the only, "fair" tax is zero. Tax evasion requires varying degrees of financial confidentiality to work.

- *Capital flight*, normally refers to an unfavorable change in the risk/return profile associated with a portfolio of assets held in a particular country – as compared with a portfolio held in other national jurisdictions – sufficient to warrant active redeployment of assets. It usually involves significant conflict between the objectives of asset-holders and their governments. It may or may not violate the law. It is always considered by the authorities to be dysfunctional.

- *Criminals*, such as drug traffickers, not only accumulate large amounts of cash, but regularly deal in a variety of financial instruments and foreign currencies. All require ways to launder funds and eliminate paper trails that can be taken as evidence of

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criminal activity – money needs to disappear and stay that way. Bribery and corruption require financial confidentiality no less.

No matter what the motivation, the value of confidentiality depends on what may happen if disclosure occurs and the probability of that happening. Damage can range from familial conflict and social ostracism to confiscation of assets, fines, incremental taxes, fines, imprisonment, and worse. Avoidance of damage is what the confidentiality-seeker is after. Since damage is usually a matter of probabilities, the individual's attitude towards the risk of exposure is a critical factor in how this benefit is valued.

The Supply of Financial Confidentiality. As with the demand for confidentiality, the supply of confidentiality-oriented financial services encompasses a complex patchwork of intermediaries, conduits, and assets that provide varying degrees of safety from unwanted disclosure. Supply dimensions can be classified into onshore financial assets, offshore financial assets, and physical assets held either onshore or offshore.

Traditional banking practice in most countries provides for adequate confidentiality with respect to unauthorized inquiries, which gives reasonable shielding for "personal" and "business" needs for protection from disclosure. Once the law gets involved, however, either in civil, tax or criminal matters, much of this protection is lost. Under applicable legal procedures, the state can also force disclosure in the event of divorce proceedings, creditor suits, inheritance matters and tax cases, not to mention criminal actions. Assets held abroad may offer a good deal more confidentiality since national sovereignty halts at the border, and extraterritorial investigation normally requires disclosure terms carefully and often reciprocally negotiated between governments. Bank deposits or assets in fiduciary accounts may be held abroad in jurisdictions (which often are also tax-friendly for non-residents) that safeguard confidentiality through credible non-disclosure laws and blocking statutes. Bearer certificates, beneficial ownership structures and shell companies may provide added protection, and increase the complexity of any future paper chase. All suppliers of financial confidentiality – whether individuals, financial institutions or countries – have an important stake in doing their best to limit disclosure as far as possible in order to avoid damaging the value of what they have to sell.

A broad array of offshore confidentiality-oriented services and vendors thus exists, competing with one another. A few offer confidentiality-oriented services with no good substitutes, so that prices may be quite high. Some traditional sources of confidentiality are easily available in some places but less so elsewhere. Others have been built up over the generations as secure repositories, and can command high premiums. Arguably, higher levels of confidentiality involve successively greater degrees of monopoly power in the competitive structure and organization of the market for financial confidentiality.

Market Dynamics. Together with conventional motivations related to risk and return, investor behavior thus may also be driven by confidentiality regarding the nature, location, and composition of financial or other assets that comprise a portfolio. If confidentiality is not a free good, it must be "purchased" by putting together a portfolio of assets (or a single asset class) that yields the desired level of non-disclosure. One "cost" of confidentiality to the asset-holder requiring confidentiality is thus the difference between the expected yield on a confidentiality-oriented portfolio and the yield on a "benchmark portfolio" put together for the same individual when confidentiality is not a consideration.

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Part of the total return differential attributable to the need for confidentiality simply reflects charges levied by financial intermediaries. Banking fees may be higher for asset-holders driven by the need for confidentiality. Transactions may have to be routed in clandestine ways, through narrow markets with wide spreads, via inefficient conduits – adding to transactions costs in the process. Foreign exchange transactions, perhaps repeated several times or involving parallel (black) markets, may add further costs. Third parties, beneficial owners, lawyers and shell companies may have to be used to enhance confidentiality, all of which involve costs. And in some cases people may have to be bribed. Since many of the intermediaries know the name of the game well, they may not be shy about pricing their services.

Besides the confidentiality-related differential in the expected total return on assets, there is also the matter of differential risk. It seems likely that portfolios of assets containing greater degrees of financial confidentiality can be more risky. For example, assets may have to be held directly or indirectly in offshore jurisdictions, resulting in increased foreign exchange risk and/or country risk. Or the portfolio may be forced into a configuration that is susceptible to increased interest-rate risk, and various ways of diversifying or hedging risk may not be available to portfolios incorporating a high degree of confidentiality.

The Agency Problem. There can also be so-called "agency problems" that confront those with substantial needs for confidentiality. An "agency" relationship exists whenever an asset-holder delegates decision-making authority to the manager of a portfolio. Interpretation of investor objectives is often not easy under the best of circumstances. Investor objectives may change, with the fiduciary being uninformed or poorly advised. Or the investor may psychologically reposition his or her objectives after the fact if the portfolio has under performed in some way, with undeserved blame assigned to the asset manager. In addition, serious agency problems arise if, for example, the asset manager abuses his or her mandate by "churning" the portfolio to bolster commission income, or by "stuffing" the portfolio with questionable securities or other assets. Usually, well-defined contracts between principals and agents, together with redress incorporated in banking and securities laws, provide adequate incentives for agents to make decisions that are in the interests of asset-holders.

Financial confidentiality raises some unique agency issues. If confidentiality is added to the fiduciary's mandate, the job becomes much more complex. Violation of the fiduciary's role, at least in the eyes of the client, includes violation of the confidentiality mandate – even if this is itself in violation of applicable laws or regulations. Ordinarily, agency-related disputes can be taken into court in civil suits or other means of dispute resolution But, how can the asset-holder take the agent to court when a foreign legal jurisdiction is involved, when that jurisdiction is unclear, or when any such action would itself compromise the confidentiality that is being sought? So the agent acquires a certain immunity from the kind of redress usually available to asset-holders confronted by agent misconduct.

The question is whether such quasi-immunity influences the behavior of the fiduciary to the detriment of the asset-holder. Perhaps those seeking high levels of confidentiality are prepared to pay some agency costs, as long as there are no large unaccountable losses. Perhaps competition in the asset management business, as well as traditions of prudence and competence, tend to impose constraints on abusive behavior. Still, this problem puts a real premium on selection of the offshore private banker, who must be depended upon to carry out

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fiduciary responsibilities with great care and sensitivity to client desires without succumbing to the temptations that derive from his potential leverage as a "secret agent".

Supply and demand thus interact in the (predominantly offshore) market for financial confidentiality, just as they do in any other market. A hierarchy of differentiated products exists, each with its own characteristics. The greater the demand, the higher the price. The more intense the competition among vendors, and the easier the substitutability of confidentiality products, the lower the price. The rational offshore client will presumably shop around, insofar as his or her position is not jeopardized thereby, to acquire an optimum mix of products at a cost (including agency costs) that makes the whole exercise worthwhile. The acquisition of offshore assets in the presence of confidentiality can thus be thought of as a rational process – one that balances a number of costs against benefits and in which the confidentiality factor is likely to alter behavior in rather predictable ways. If confidentiality-seeking asset-holders are risk-averse, they may prefer rather conservative portfolios, since they are seriously exposed to risk in other ways.

Regulatory Pressures on Offshore Private Banking

There are indications that the value of confidentiality may be on a gradual decline as a competitive driver in global private banking. This is based on changing attitudes towards financial secrecy and the kinds of pressure that national tax and criminal authorities can bring to bear on foreign jurisdictions.

National authorities seem to be determined to use their influence to combat criminal uses of secrecy as well as tax evasion – and more willing to share information – so it may be increasingly difficult to guarantee customary levels of secrecy in some cases. A driving force is governments' appreciation that financial secrecy facilitates criminal activities and that one of the best ways to attack these is to increase the cost and reduce the opportunities to launder money. At the same time, fiscal constraints such as the Maestricht criteria in the Euro-zone, budgetary compacts in the U.S. and IMF- imposed fiscal austerity in many emerging market countries tends to reinforce government determination to collect taxes that are due.

According to one 1999 OECD report, secrecy laws and other factors made the use of Swiss bank accounts in particular "attractive to non-residents" seeking to evade taxes and avoid detection in their home country:[3]

> Switzerland is the world's biggest offshore banking sector for wealthy individuals, with about a third of the global market. It has always been suspected Switzerland's dominant market share in private banking was partly dependent on its long tradition of banking secrecy, which protected customers who wanted to evade tax in their own country. But until now the OECD's annual country reports on Switzerland have not dealt with the subject. Switzerland and the OECD have, however, clashed once before on the question of tax evasion and bank secrecy. In April 1998 Switzerland, along with Luxembourg, refused to endorse the OECD's guidelines on harmful tax competition. The move was part of an attempt by the

[3] William Hall, "OECD Warns Swiss Over Tax Evaders", *Financial Times*, 7 August 1999.

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> OECD to combat unfair fiscal practices. Swiss banks argued that their big market share is primarily due to Switzerland's long tradition of neutrality, political stability, a strong currency and professional banking services. Switzerland has long provided a home for extremely wealthy foreign individuals who want to minimize their tax bills.... the vast bulk of Swiss bank customers rarely step inside the country and rely on banks there to handle their affairs. The OECD said access to information was essential for effective tax enforcement and that, as globalization and technology continue to advance, it would become increasingly important.

In November 1999, Congressional hearings on private banking in the U.S. were held in response to allegations of massive diversion of foreign aid funds, official corruption, organized crime, the drug trade and related sources of money laundering, and several high-profile cases once again trained the spotlight on the role of offshore private banking and the quality of due diligence and appropriate conduct on the part of private banking organizations and their employees.

In general, there seems to be a growing disparity between the degree of financial secrecy offered in the high-quality offshore banking centers like Switzerland and those of lesser standing. This is probably because the high-quality financial centers have more to lose from being "tainted", and are at the same time more vulnerable to outside pressure due to their own banks' large presence in global markets.

Those concerned with the future of offshore private banking usually focus on (1) tax coordination, cooperation and alignment among countries of residence of offshore clients, (2) tighter notification and reporting requirements imposed on banks dealing with suspect or under regulated banks and countries, (3) international agreements to expand account investigation related to money laundering, including a more intense focus on accountants and lawyers, and (4) the use of "cordons sanitaires" in the case of non-cooperating institutions and countries. These things don't change overnight, but the pressures are sufficiently visible to raise concerns about offshore private banking as a major source of future earnings growth for financial services firms engaged in private banking.

Economics and Competitive Structure

Private banking is an unusually attractive business within the financial services industry in general. The value-chain is estimated to be capable of supporting annual custody fees of roughly 20-25 bp, broker-dealer fees of perhaps 40-45 bp, and fees related to trust services of perhaps 25-40 bp, for total value-added on the order of 80-125 bp on total assets under management. As noted, private banking services are not particularly capital-intensive in comparison to commercial or investment banking activities. And they can be generally carried

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out at cost-to-income ratios on the order of 45-60%. The revenues are relatively stable as well, including resistance to major losses attributable to market risks and credit risks.[4]

Within the private banking domain, offshore private banking is evidently more profitable than onshore private banking, given the offshore client's need for confidentiality and consequently his or her willingness to pay higher fees and/or tolerate a lower level of portfolio performance. In addition, the competitive pressure on pricing may be considerably less intense in offshore than in onshore private banking.

The size, growth prospects and profitability of the private banking market in general has resulted in fierce competition. Virtually every strategic group in the financial services sector has targeted private banking as a key area for development. This includes the classic specialists such as Lombard Odder, Pictet, Julius Bar, Coutts & Co. and U.S. Trust Company, as well is mega banks like Citigroup, Deutsche Bank AG and Crédit Suisse Group. Insurance companies like Groupe AXA and Zurich Group have targeted insurance and asset-gathering units catering to wealthy clients as well. American Express focuses on "Platinum" and "Black" travel and entertainment cardholders in efforts to cross-sell private banking services. Broker-dealers like Merrill Lynch and Goldman Sachs have initiated major efforts to become important players in private banking. So have merchant banks like Schroders, Flemings and Rothschilds in the U.K. and MeesPierson in the Benelux countries. In addition fund management companies like Fidelity Group and Vanguard have intensive efforts underway to target affluent clients as well. Everyone is in on the act, each coming from a different strategic direction and competing in ways that can be traced to their origins, ranging from retail-like approaches such as advertising campaigns and toll-free numbers to sophisticated personal marketing and efforts to enlist intermediaries such as attorneys, accountants, and independent financial advisers. For some of the larger and broader firms, referrals from other units within the organization can be valuable. Whatever the "surface" tactics for attracting clients, the key to profitable private banking is the relationship with a client.

In order to perform effectively, especially the large institutions in private banking markets have to engage in considerable market segmentation – based on sophisticated analysis that incorporates a range of characteristics, needs and financial sourcing habits of specific client groups. This can help a large banking organization focus its resources more accurately in order to target its product line, its distribution system and its promotional efforts to particular market segments. Smaller, specialized private banking institutions, on the other hand, can rely on a broad, generalist approach. In either case, sophisticated marketing is vital in order to attract clients who have become newly wealthy or have been clients of competitors, and to persuade customers to remain even when wealth levels and portfolio requirements change.

The most important component of any private banking effort remains the quality of the bankers. It is not easy for a private client to share confidences with his or her banker, so that a low turnover in staff is particularly important. At the same time, the changing nature of wealth and the demands of the wealthy suggests that tomorrow's private banking will have to be quite different from the past, with classic private banking qualities combined with a strong

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[4] In combination, these characteristics have prompted some banking analysts to assign a value to private banking activities on the order of 15-25 x earnings, depending on perceptions of sustainability, quality of earnings, and growth potential. This is a good deal higher than both commercial banking and investment banking valuations.

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understanding of modern financial markets and instruments and how they can be used to the client's advantage – as well as personal acquaintance with individuals in the organization who are the relevant specialists and can be brought to bear on the client at the right place and the right time. Good ideas, combined with good execution and a strong relationship, is what tends to determine competitive performance in private banking.

UBS Private Banking Division

At the end of 1998 UBS was the largest fund manager in the world[5] with AUM of US$1,145 billion (see Exhibit 11), of which about US$ 415 billion represented private client assets, roughly 81% offshore and 19% onshore including Switzerland (about half of which also represented non-residents). Private client assets under management in 1999 were growing at a rate of about 6.5% annually and supporting pre-tax profit growth of roughly 4% per annum. For 1998 operating income of the Private Banking Division was slightly over US$5 billion, or 0.41% of total assets under management after tax. Private banking net income at UBS in 1998 contributed about 65% of global net income. Private Banking Division headcount was slightly over 7,500, of whom about 1,800 were professional private bankers.

In general, global private client advisory services in 1999 represented the bank's flagship business. This strategy took a comprehensive approach that focused on the specific situation of each client while encompassing all aspects of the legal and regulatory environment in which the client operated. Accordingly, the UBS Private Banking Division offered the full range of private banking services for both onshore and offshore clients. An up-to-date description of both onshore and offshore UBS private client services is available on the UBS Website at http://www.ubs.com. These services are summarized in the Annex to this case.

UBS private banking activities were conducted from the bank's branches in Switzerland and around the world, including the principal offshore private banking centers. In addition, UBS had a number of subsidiaries specializing in private banking: Bank Cantrade, Ferrier Lullin and Banco di Lugano in Switzerland, and Schröder Münchmeyer Hengst in Germany (acquired in 1998), Potter Warburg PTY Ltd. Australia (also acquired in 1998), and GAM (Bermuda), an active fund management and multi-manager selection firm with US$13.9 billion in assets under management acquired in 1999. Onshore private banking operations included UBS Italia S.p.A. (1998), UBS Private Banking Division U.K. (1998), UBS Trust and Banking Ltd. Japan (1998), UBS Sucursal España (1999), and UBS (France) S.A. (1999). In addition to geographic private banking, sector initiatives included the 1999 creation of the Global Executives Segment and the Corporate Advisory Group.

An example of the bank's onshore expansion was the opening of UBS (France) S.A. in June 1999, with a staff of 75 (including a number of portfolio managers and investment advisors). Management noted that the bank planned to set up asset management activities in other French cities as well, with the aim of becoming one of the major players in wealth management in France. UBS (France) S.A. offered clients various services: discretionary

[5] With the exception of Kampo, the pension fund of Japanese postal employees.

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asset management, investment advisory services and investment funds. According to Jean-Louis de Montesquiou, President of the Executive Board of UBS (France) S.A.:

> "By benefiting from the experience, know-how and substantial resources provided by the UBS Group as a whole, we are in a position to offer French investors very high-quality advisory services in all areas of asset management, both within France and internationally. These include securities, real estate, precious metals, objets d' art and other assets. Our aim is to offer our clients a range of innovative products and services with exceptional quality and to become one of the major players in private asset management in France in the years ahead."

The organization of UBS Private Banking is presented in Exhibit 12 – divided into domestic Swiss clients, international (offshore) clients, domestic (onshore non-Swiss) clients, and private banks (financial intermediaries serving their own clients and outsourcing services to UBS), in addition to a products, services and logistics group. Each of the unit heads except George Feiger grew up in the private banking business. Feiger had been an academic and management consultant who joined the previous Swiss Bank Corporation investment banking business, where he held a number of senior positions. Links to UBS Warburg, UBS Private Equity and UBS Asset Management (see for example Exhibit 13) promised substantial synergies, and required that the Private Banking Division's management be well integrated into the rest of the organization.

A UBS Private Banking advertisement summed-up the bank's marketing approach in late 1999 as follows:

> "Wealth does not just accumulate overnight. It takes time. Nurturing. Care. And perhaps most importantly, dedicated effort. At UBS, adding value to your portfolio means more than increasing assets. It means providing the right people, technology and insights that are of significant value to our clients. UBS has been formed by the merger of two large Swiss banks, each a leader in Private Banking worldwide. We are now one of the largest banks in the world. Which means, you can be confident your wealth is secure with us."

Thinking about the Future

Private Banking in late 1999 was clearly UBS's dominant business in terms of generating shareholder value. At the same time, the bank was in the enviable position of being the largest asset management firm worldwide. Still, as they say, "if you're number one, there's only one way to go." And so UBS management was keenly aware of the need to preserve and build on this valuable franchise. But more than its dominance as the principal income-generator of UBS, management had targeted the Private Banking Division as the key source future growth and profitability – with an indicative goal of US$900-950 billion under management globally by 2002 and after-tax income well in excess of US$3 billion. Given the numbers for 1998 and 1999, impressive as they were, seemed an ambitious goal indeed. So the pressure was on.

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Issues Facing UBS Private Banking

The following questions seemed compelling in defining future strategic imperatives for the UBS Private Banking Division:

1. What is the likely future course of classic *offshore* private banking as a source of competitive performance, growth and value for shareholders of UBS?

2. How is the competitive structure of *onshore* private banking likely to evolve in the next five or ten years, in terms of the types of firms battling for market share and, in turn, the impact on competitive structure in the industry?

3. What are possible changes in private client behavior that may influence the competitive dynamics of the industry – especially onshore – and how should UBS react to them?

4. In expanding its onshore business in various parts of the world, what value-propositions can UBS put forward against what, in many cases, will be tough and entrenched domestic competition?

5. What are some of the key challenges UBS faces in leveraging its premier private banking franchise to get the most out of the rest of the bank, and what are some of the important implementation issues that must be resolved?

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Annex 1

UBS Private Banking Services

The principal services as UBS presented them in client materials in late 1999 were the following:[6]

Wealth Planning. The bank offers tailor-made financial planning and wealth management solutions for each client, in consideration of his or her specific needs. "Regardless of where your assets, real estates, companies, family members or business interests may be located throughout the world, we provide you with best strategies and structures professionally designed to meet your financial needs." Financial Planners work together with specialists from Investment Banking (UBS Warburg), Mergers & Acquisition, Institutional Asset Management (UBS asset Management) and Private Equity (UBS Private Equity), Portfolio Management, Active Advisory Team and Investment Funds – see Exhibit 13.

You as a customer profit from this global strength that enables us to situation. The result of it is an optimization and adding value for your overall financial assets. First there is a special financial analysis needed. An in-depth analysis of your overall personal financial situation is fundamental to effective financial planning. By establishing the status quo we can identify trends and problems that may require attention. The next step will be to identify your personal needs and objectives. By comparing the status with your personal objectives we can identify gaps, problems, that will need to be solved.

We aim to provide you with constructive solutions that will preserve and enhance the value of your wealth and that will ensure that your personal objectives can, as far as possible, be realized. This process of analysis and evaluation will culminate in the development of your personal wealth plan, a tailor-made document which will encompass all restructuring aspects.

With the benefit of your personal wealth plan you can determine the extent to which, and the manner in which, you wish to implement our recommendations. We can assist in this process and will agree to undertake periodic reviews, either annually or whenever significant changes occur in your personal or family circumstances, at which time we will advise on the impact of any changes.

Portfolio Management. With a portfolio management mandate the client can delegate asset allocation within the investment portfolio to the professional asset managers of the bank. Together with the investment adviser, the client defines his or her specific investment needs and goals. These allow the professional portfolio managers to develop an optimally diversified long-term asset allocation which is best suited to the client's needs. The strategy is subsequently adjusted to reflect the bank's investment outlook. The UBS investment policy is reviewed at monthly intervals based on extensive financial market and company research efforts.

The Active Advisory Team. The Active Advisory Team provides the client as the active decision-maker with everything he or she needs to know from a single source, enabling the client to take advantage of the individuality of Private Banking while benefiting from the facilities of a global financial services firm.

The AAT Investment Advisory staff keeps the client's portfolio under constant scrutiny and contacts him or her as soon as some action has to be taken. This means that the client is kept regularly in touch with the fundamentals of the portfolio, and can combine his or her own knowledge and experience with UBS competence in the area of modern Private Banking. The objective of both the client's Private Banking Advisor and the UBS

[6] Based on descriptions contained on the UBS Private Banking Website, October 1999.

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Investment Advisory service is to support the client in making his or her own investment decisions – the client decides how much is needed in any given case.

The Active Advisory Team also issues up-to-date bulletins with strategies, investment ideas and recommendations. Experienced analysts and product specialists, working together with UBS Warburg and UBS Asset Management, filter a mass of information and present the informational content in such a way that the client can use it effectively. The AAT also provides sales brokerage, enabling the client to drive the decision-making process in an active and product-oriented way. "You have experience of financial market products of all kinds and can use your investment knowledge to actively manage your portfolio. The Sales Brokerage staff, who will supply you with ideas for the short and medium term, will support you in this. And last but not least, you will receive practical support from the Syndicate Desk, your information center for new product subscriptions and syndicated issues in Private Banking. In order to be able to present you with new tailor-made proposals, we will be involving you in the development of financial instruments before they reach the market."

Inheritance Planning. This classic dimension of private banking facilitates orderly and confidential transfer of wealth from one generation to another while avoiding issues related to espousal rights, decedent's estate administration, family disputes and estate duty. Related planning objectives include a safe and reliable transfer of maximum wealth to surviving heirs, avoidance of delays in transferring wealth, avoidance of public proceedings in court, enhanced confidentiality and implementation of specific distribution plans which may span several generations.

Tax Planning. Wealthy individuals who have a substantial estate consisting of large movable and immovable assets such as land, buildings, art or substantial holdings in companies are well advised to diversify their portfolios and optimize their taxes. One of the most important goals of Financial Planning & Wealth Management is therefore performance after tax. Related planning objectives consist of proper and careful investigation of the current personal and financial situation of individuals and, where permitted by law, in developing tailor-made increased accumulated wealth through tax savings and tax deferrals.

Trusts are established by individuals for a great variety of reasons, but often to benefit their families and friends. Among the most common drivers are tax planning and estate planning. Trusts can also be set up, for example, to distribute benefits to employees and for charitable purposes. A trust is a legal obligation which binds a trustee to deal with property or income in a particular way, usually for the benefit of another person or class of persons (the beneficiaries). A trust is created when a client, known as the settlor, transfers property to trustees to be administered by the trustees in accordance with the terms of the trust agreement, known as a Deed of Trust. This document sets out the entitlement of the beneficiaries to benefit from the assets of the trust (the trust fund) and the duties and obligations of the trustees in administering those assets. The assets may consist, for example of cash, securities (quoted or unquoted), real estate, jewelry and works of art. The assets may be held directly by the trustee or indirectly through an underlying company.

Foundations may be established for the endowment of certain funds for any specific purpose whereby these funds, being placed under an organizational statute, obtain legal independence as a legal entity. The form of Liechtenstein (FL) Foundation mainly used is the Family Foundation. It is particularly suitable for ensuring the succession of the founder with regard to specific assets legally separated from his/her estate. The Family Foundation offers the possibility of settling the succession in favor of family members or third parties according to the wishes of the founder and allows him/her to be the sole beneficiary during his/her lifetime. The wishes of the founder are formalized in Regulations which can be changed at any time if required by the founder. They will be executed at the appropriate time by a reliable Board of Foundation. "UBS, within the terms of its

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business policy, advises and assists private clients in setting up FL-Foundations and in implementing any changes that may be requested at a later stage. After incorporation, UBS will supervise the execution of the client's wishes as laid down in the Foundation's Regulations. This service is carried out in conjunction with the Foundation's obligatory governing bodies in Liechtenstein."

Insurance. A bank investment is expected to achieve the highest possible return while corresponding to the client's personal investment profile. A life insurance cannot only complement tax planning but also secure the financial future of families. As a part of the concept unit-linked life insurance an extremely attractive product was developed in the field of private retirement planning in collaboration with Lombard International Assurance SA, Luxembourg. This product combines advantages of private banking and life insurance.

Art Banking. Art Banking builds on tradition in the collection of beautiful objects by wealthy individuals and the discreet management of their wealth. "UBS realizes and appreciates the significance and pleasure of investing in art of high value: whether it be paintings, antiques, jewelry, precious metals or numismatics. We are aware that our Private Banking clients need a comprehensive service, tailor-made to their specific requirements. In recognition of this, we established Art Advisory to complement our clients' appreciation and love of art with the reliability and discretion of Private Banking. The UBS Numismatics Service has over 20 years' experience in auctioning and dealing and is acknowledged internationally for its expert advice concerning coins, medals and precious metals.'

Reporting. Reporting services are critical in asset management and private banking, but must be accomplished with great discretion. They must keep control and be documented so as enable the client to decide in good time when necessary steps should be taken. "Our products are adapted to your individual needs and show you in a clear way what contributed to your actual situation. If you wish to receive detailed information on the development of your assets, we will establish a performance report for you. We register all the transactions within a period specified by you. You receive clear documentation and have an overview of all account movements. If you don't require a full performance report, but nevertheless need to have clarity regarding your assets and their development, we offer you a clear report which reflects only the business transactions which you need to see at a glance."

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Exhibit 1
The World's Largest Banks
(assets in billions of U.S. dollars)

March 1989		August 1999	
1. Dai-Ichi Kangyo	$271	1. DKB-Fuji-IBJ[7]	$1,321
2. Sumitomo Bank	251	2. Sakura-Sumitomo[8]	925
3. Fuji Bank	244	3. Deutsche Bank AG	866
4. Mitsubishi Bank	228	4. Banque Nationale de Paris[9]	755
5. Sanwa Bank	218	5. UBS AG	687
6. Industrial Bank of Japan	216	6. Citigroup	669
7. Crédit Agricole	214	7. Bank of America	618
8. Citicorp	198	8. Bank of Tokyo – Mitsubishi	580
9. Norinchukin Bank	187	9. HSBC Holdings	554
10 Banque Nationale de Paris	183	10. HypoVereinsbank	541

[7] Pending. Scheduled for completion in 2001.

[8] Announced 14 October 1999.

[9] Including Paribas, acquired in August 1999. Control of Société Generale pending. Source: Bloomberg, *American Banker*, *The Banker*, August 1999.

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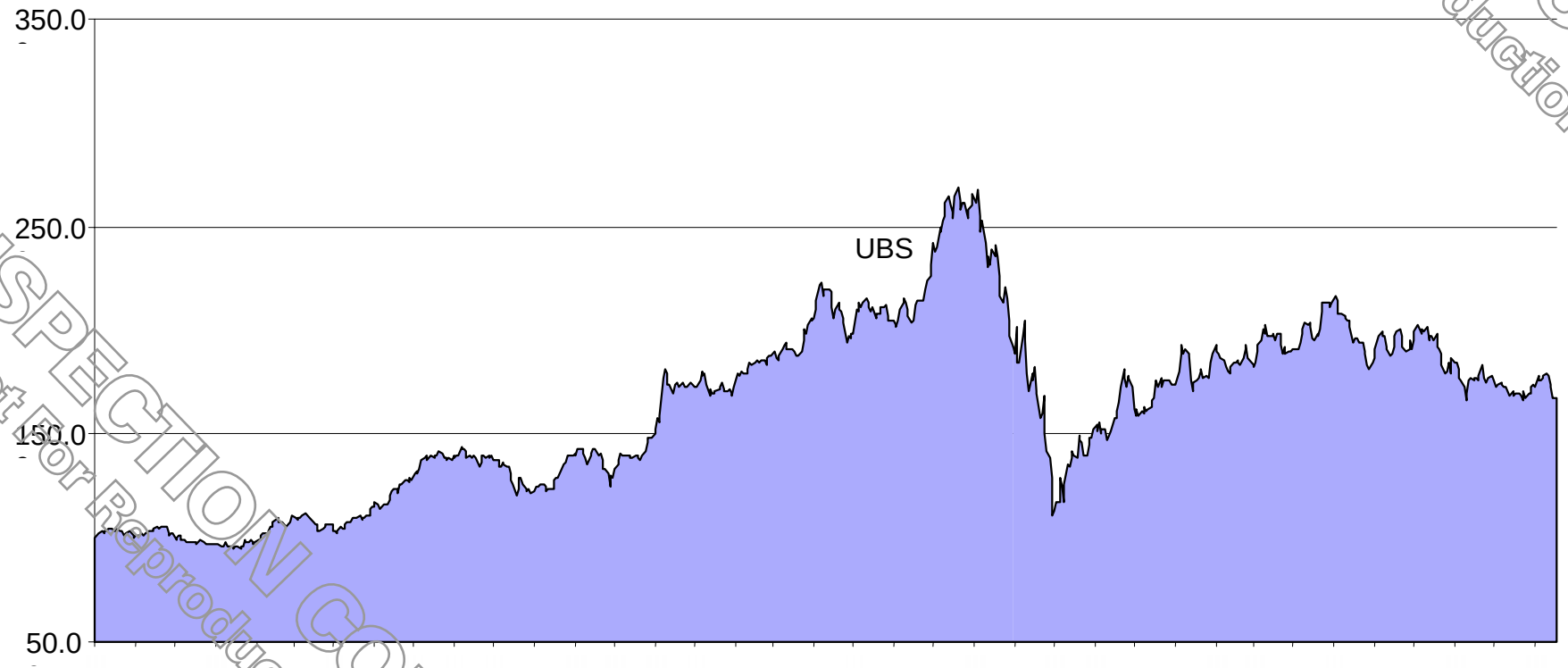
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Exhibit 2

UBS Share Price Development, 1996-1999

(10/1/96 = 100)



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Exhibit 3

The World's Most Valuable Financial Services Firms
(market capitalization at July 1999, billions of US $)

North America		**Europe**	
Citigroup	150.9	HSBC Holdings	93.7
AIG	141.6	LloydsTSB Group	72.0
GECS[10]	139.9	Allianz	66.1
Bank of America	112.9	UBS AG	63.4
Berkshire Hathaway	109.4	ING Groep	50.8
Banc One	66.8	Zurich Fin. Serv.	49.1
Wells Fargo	66.4	Crédit Suisse Grp.	48.1
Chase Manhattan	61.1	Aegon	47.9
Morgan Stanley DW	55.1	Barclays Bank	45.8
American Express	54.5	Groupe AXA	41.4
First Union	44.7	NatWest	38.8
Charles Schwab	42.9	Generali	36.6
Goldman Sachs Group	32.3	Deutsche Bank AG	32.2
Merrill Lynch	30.2	Halifax	31.4
Allstate	29.5	BBV	30.1
Associates First Capital	28.5	Münchener Rück.	29.8
Bank of New York	27.2	Abbey National	29.3
J.P. Morgan	24.5	Swiss Re	27.6
U.S. Bancorp	23.6	Prudential Corp.	25.7
Washington Mutual	22.7	Unicredito Italiano	23.3
Total top-20	1189.8	Total top 20	864.4

Note: Top Asia market capitalization rankings are DKB-Fuji-IBJ 86.1, Bank of Tokyo-Mitsubishi 61.8, Sumitomo Bank 36.6, Sanwa Bank 28.3.

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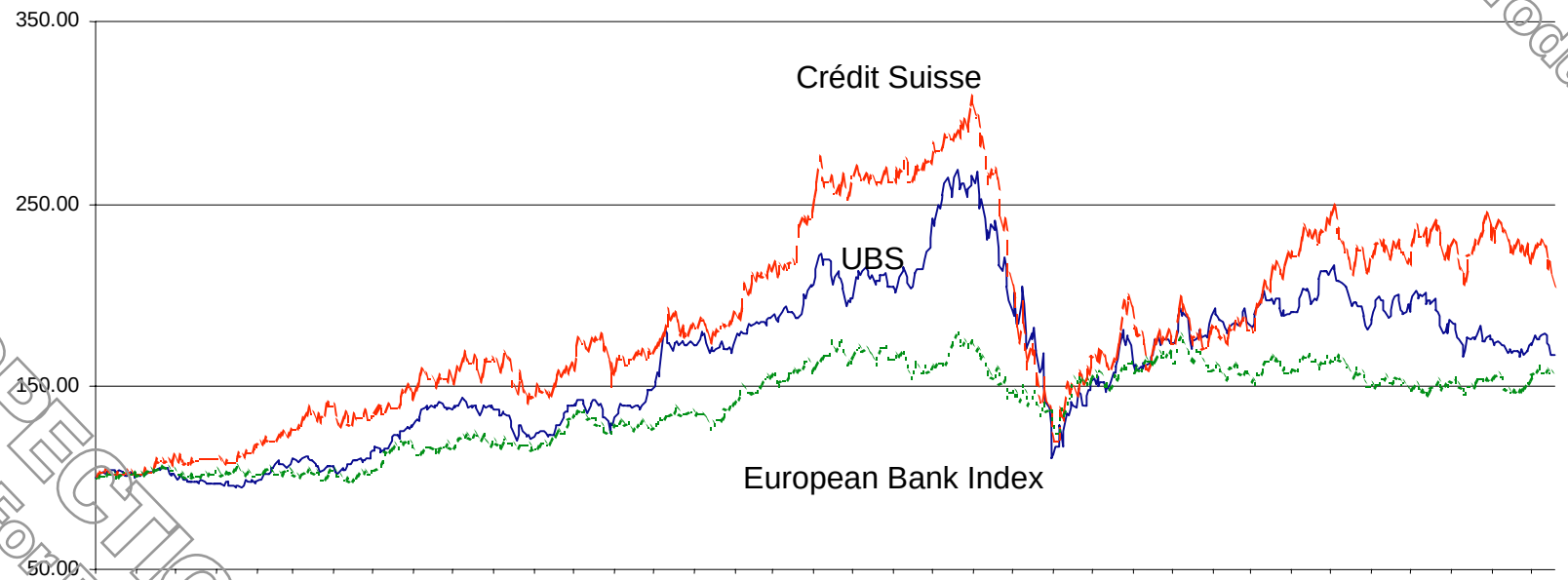
[10] Estimated. GECS net 1998 after-tax earnings contribution as a percent of General Electric Company consolidated after-tax earnings times GE's July 1999 market capitalization. Data: *Business Week*, 12 July 1999, Bloomberg Financial Markets, American Banker.

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Exhibit 4

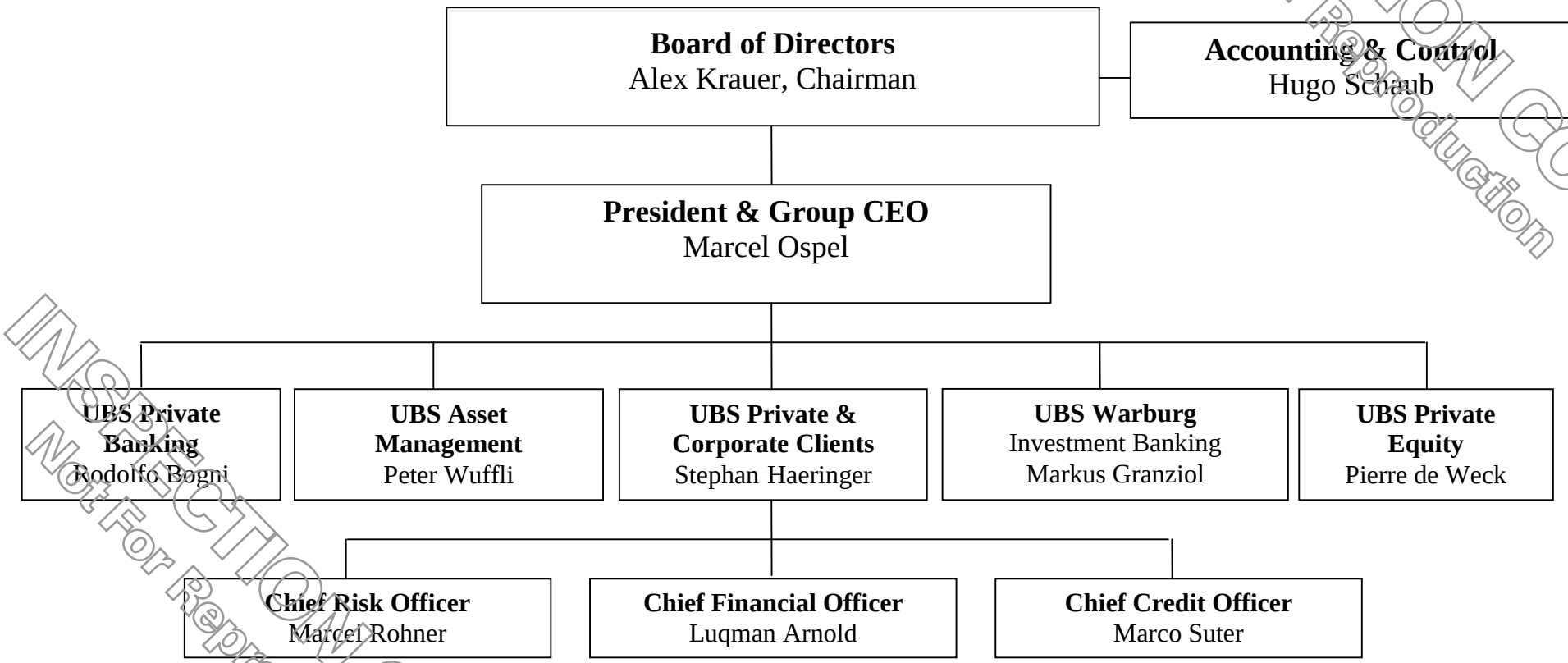
Share Prices – CS Group, UBS and European Bank Index, 1996-1999
(10/1/96 = 100)



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Exhibit 5
UBS Group Management Structure
(December 1999)



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Exhibit 6

Global Wholesale Banking and Investment Banking 1998 - Full Credit to Book Running Manager Only - ($ millions)

Firm Rank 1998 (1997 in paren.)	Global Securities Underwriting and Private Placements	Global M&A Advisory (a)	International Bank Loans Arranged	Medium Term Notes Lead Managed (b)	Total	Percent of Top 25 (c)
Goldman Sachs & Co (2)	388,765.9	1,067,258.8	16,404.5	54,419.6	1,526,848.8	13.89%
Merrill Lynch & Co (1)	549,797.3	692,920.3	10,999.7	129,629.4	1,383,346.7	12.59%
Morgan Stanley Dean Witter (4)	404,497.5	635,623.9		32,680.2	1,072,801.6	9.76%
Salomon Smith Barney /Citigroup (7/11)	366,353.8	483,761.8	107,565.7	51,412.2	1,009,093.5	9.18%
Credit Suisse First Boston (6)	290,502.0	431,756.5	19,086.9	60,166.1	801,511.5	7.29%
JP Morgan & Co. Inc. (5)	250,064.7	324,207.0	115,665.7	27,502.8	717,440.2	6.53%
Chase Manhattan Corporation (3)	122,602.9	172,858.9	307,131.0	20,448.0	623,040.8	5.67%
Lehman Brothers (8)	264,339.6	225,415.6	26,311.8	48,982.5	565,049.5	5.14%
Deutsche Bank / BT (15/16)	158,681.0	147,874.4	53,780.3	84,419.0	444,754.7	4.05%
Warburg Dillon Read / UBS (9)	201,809.6	143,743.3	17,009.9	53,780.1	416,342.9	3.79%
Bank of America Corp (14)	57,975.7	83,679.4	200,100.1	42,250.0	384,005.2	3.49%
Bear Stearns (12)	140,608.7	184,752.8		17,610.0	342,971.5	3.12%
Donaldson, Lufkin & Jenrette (13)	111,498.7	217,614.0	12,618.8		341,731.5	3.11%
ABN AMRO (17)	127,077.6	34,143.3	16,282.5	125,333.1	302,836.5	2.76%
Paribas / Societe Generale (25/41)	153,649.0	54,472.3		11,398.0	219,519.3	2.00%
Lazard Houses (18)		160,775.5			160,775.5	1.46%
Barclays Capital (19)	81,236.9		14,457.3	6,370.2	102,064.4	0.93%
Dresdner Kleinwort Benson (30)	54,611.5	37,373.2		8,273.0	100,257.7	0.91%
Rothschild Group (28)		84,291.2			84,291.2	0.77%
Nomura Securities (34)	58,998.1			14,556.0	73,554.1	0.67%
Schroder Group (22)		69,179.4			69,179.4	0.63%
BankBoston (38)		49,903.0	19,124.8		69,027.8	0.63%
First Union Corp (39)	24,972.3		21,591.7	20,000.0	66,564.0	0.61%
PaineWebber (23)	57,604.2				57,604.2	0.52%
HSBC (24)	57,260.5				57,260.5	0.52%
Top 25 Firms	3,922,907.5	5,301,604.6	958,130.7	809,230.2	10,991,873.0	
Top 10 as % of Top 25	**76.41%**	**81.59%**	**70.34%**	**69.63%**	**77.88%**	
Top 20 as % of Top 25	**96.44%**	**97.75%**	**95.75%**	**97.53%**	**97.09%**	

(a) Completed deals only. Full credit to both advisors to targets and acquirers.
(b) Equal credit to both book runners if acting jointly.
(c) To avoid overestimation, the top 25 total -- $10,991,873.0 mil was used instead of the industry total -- $8,470,261.3 mil
Data: Thompson Financial Securities Data Company.

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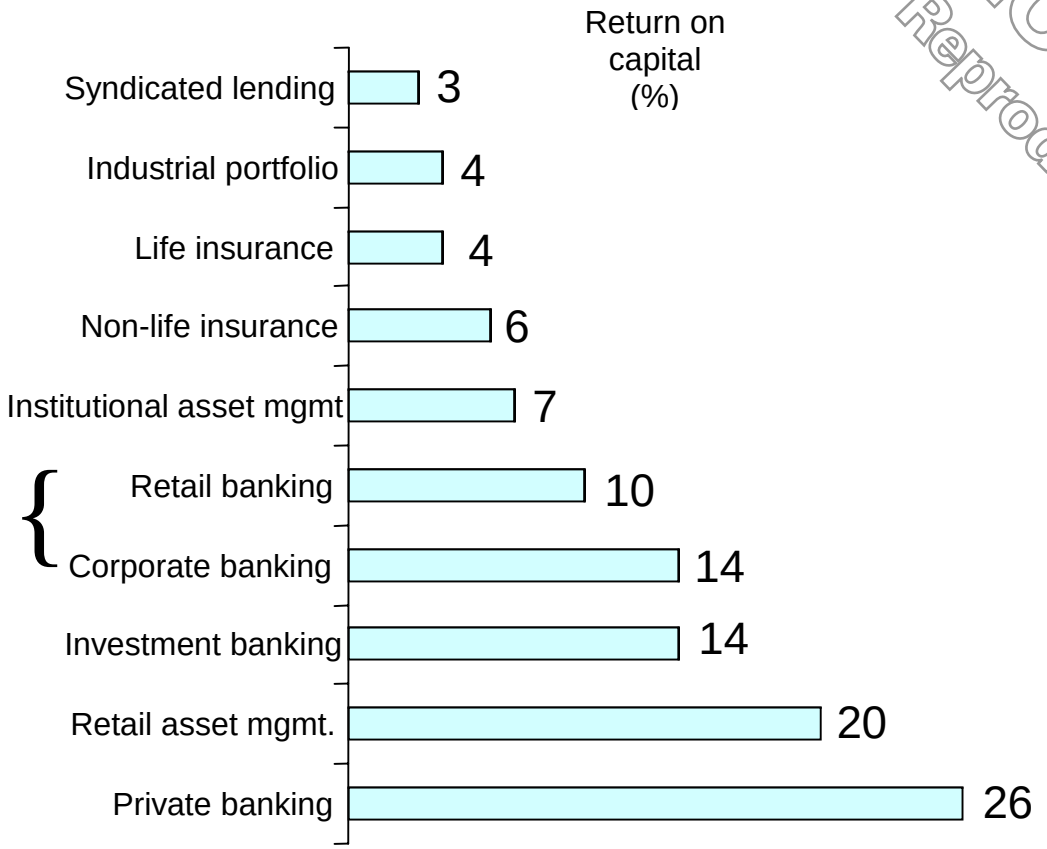
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Exhibit 7

Sustainable Returns and Capital Allocation of Universal Banks by Business Line

Estimated Capital Allocated to Each Business Line as % of NAV

Deutsche	Dresdner	Commerzbank
11	12	20
58	63	20
0	0	0
4	0	0
3	5	4
23	26	47
9	12	7
2	3	2
1	0	1

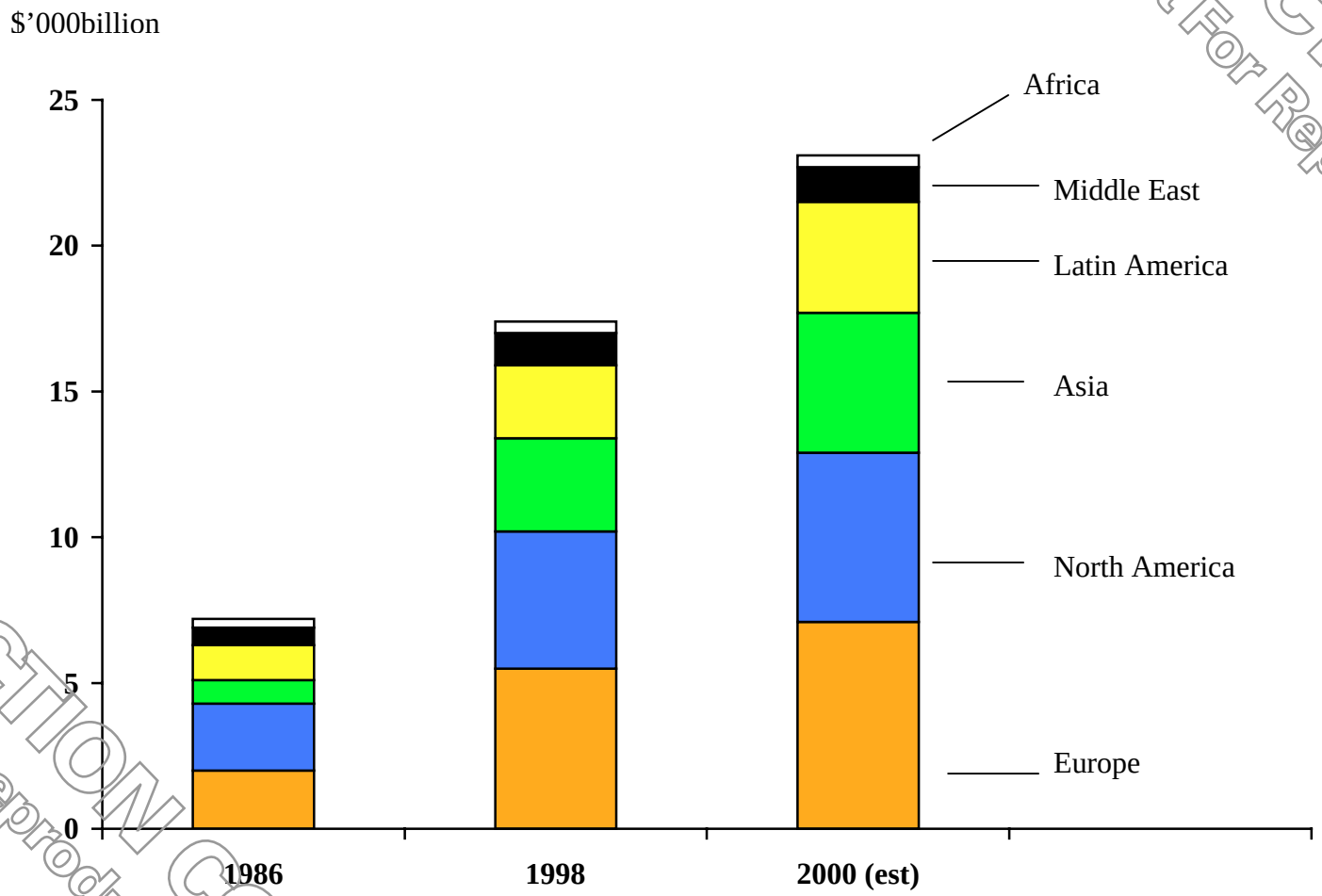


Source: Schroders Estimates (March 1999) for German universal banks.

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Exhibit 8
Global Private Client Assets by Source Region

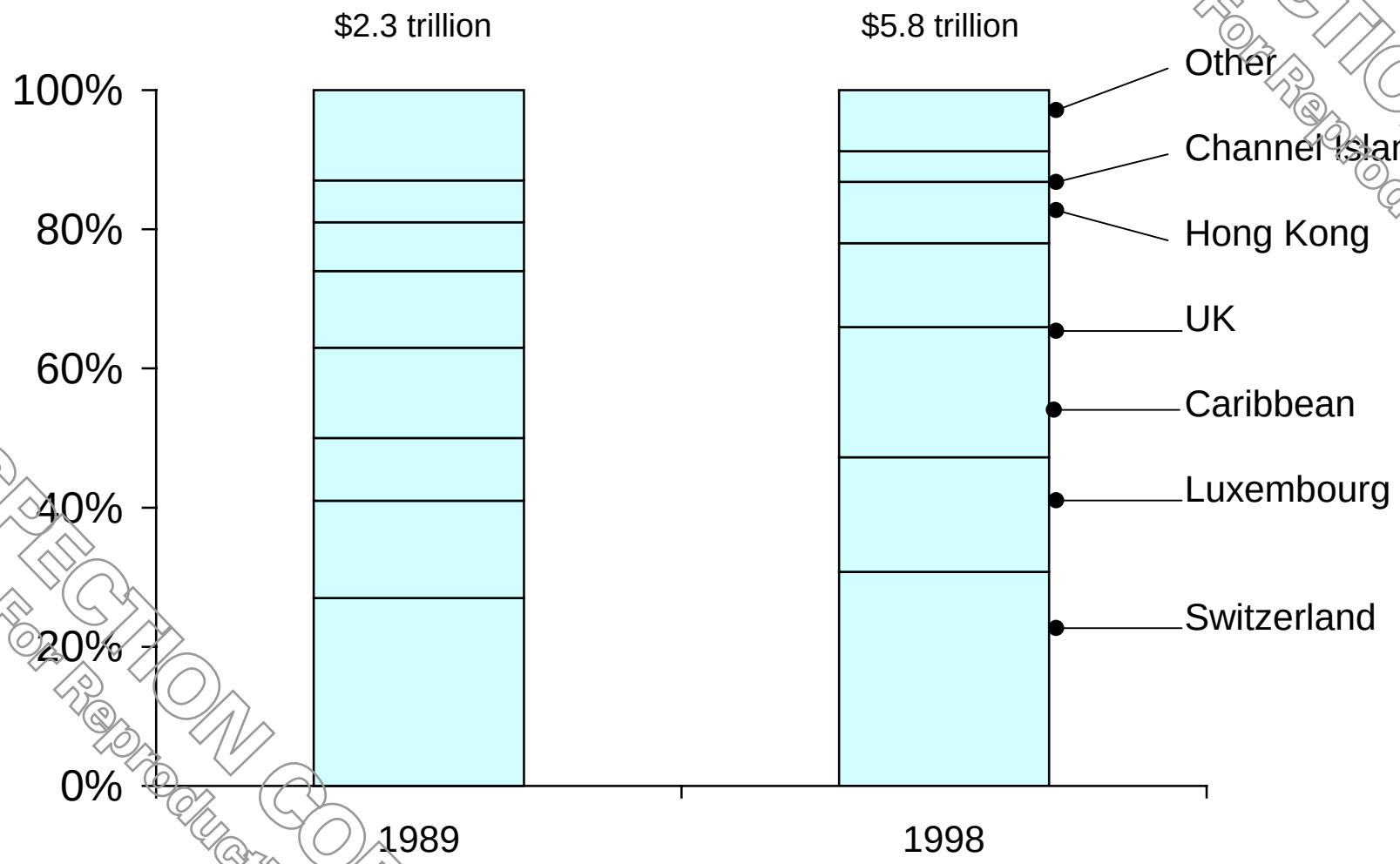


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Exhibit 9

Private Client Assets in Offshore Financial Centers



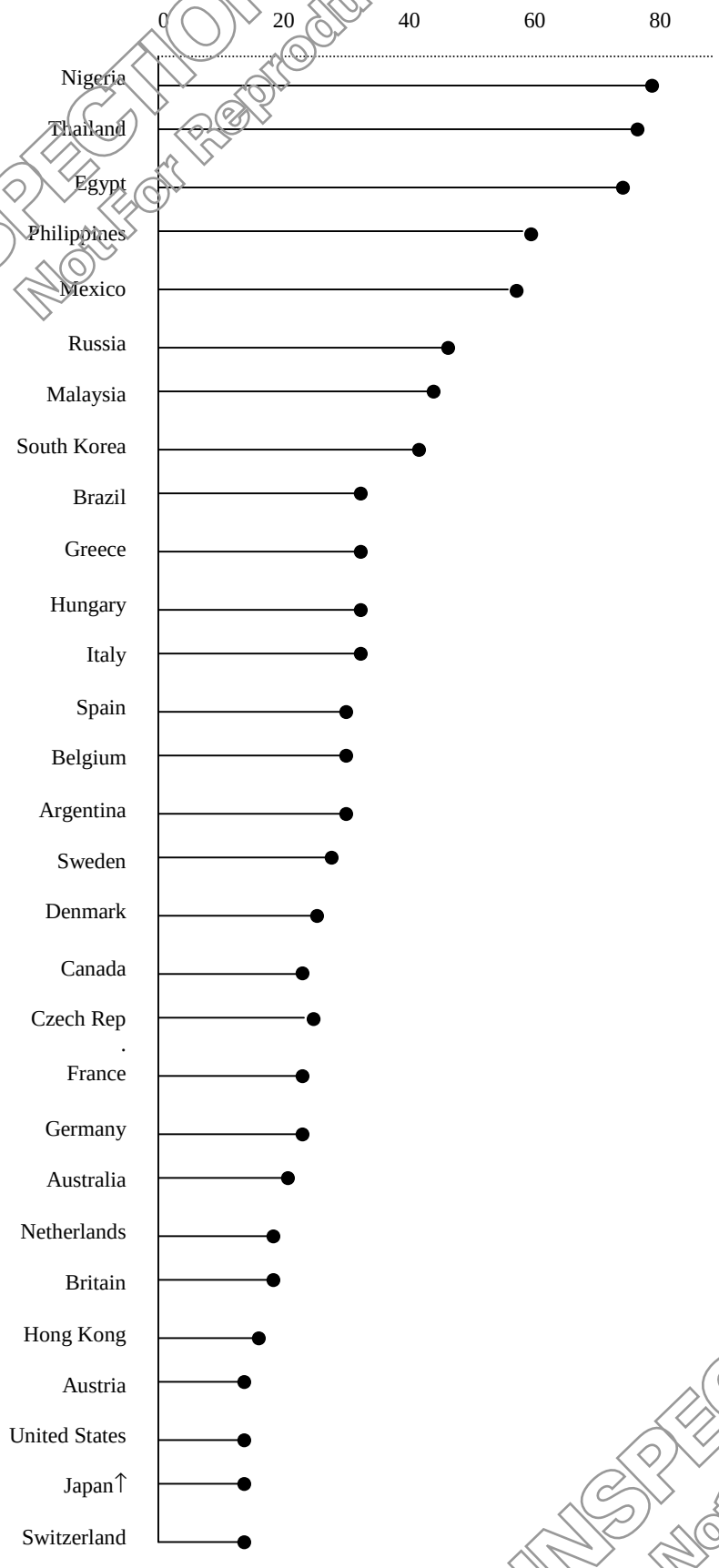
Source: Merrill Lynch, World Wealth Report (New York: Merrill Lynch, April 1999).

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Exhibit 10

*National Shadow Economies: Estimated Activity as a Percent of Official GDP. 1998**



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Exhibit 11

Global League Table of Leading Asset Managers
(assets under management exceeding $100 billion)[11]

Rank 1/1/99	Firm	Country	AUM ($ bil.)
1	Kampo	Japan	1,685
2	UBS AG[1]	Switzerland	1,167
3	Fidelity Investments	USA	773
4	Deutsche Bank Group[2]	Germany	698
5	Groupe AXA[3]	France	672
6	Barclays Global Investors	UK	616
7	Allianz (including PIMCO)	Germany	607
8	Merrill Lynch	USA	501
9	State Street Global Advisors	USA	493
10	Capital Group Companies	USA	424
11	Zurich Group[4]	Switzerland	407
12	Mellon Financial Services	USA	401
13	Nippon Life	Japan	383
14	Equitable Cos.	USA	359
15	Morgan Stanley Dean Witter	USA	346
16	Citigroup	USA	327
17	JP Morgan	USA	316
18	Putnam Investments	USA	294
19	Zenkyoren	Japan	279
20	Vanguard Group	USA	276
21	Dai-Ichi Mutual Life	Japan	267
22	TIAA-CREF	USA	244
23	Pimco Advisors	USA	244
24	Prudential Insurance Co.	USA	242
25	Bank of America Corp.	USA	234
26	Crédit Suisse Group	Switzerland	231
27	Northern Trust Company	USA	226
28	Mitsui Trust and Banking	Japan	225
29	Franklin Group of Funds	USA	220
30	Sumitomo Mutual Life	Japan	220

[11] Sources: *Euromoney*, August 1999 (non-US asset managers) based on InterSec Research Corp. Data. *Institutional Investor*, July 1999 (US asset managers).

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Exhibit 11 (Cont'd)

Rank 1/1/99	Firm	Country	AUM ($ bil.)
31	Fortis Group	Belgium	219
32	Amvescap	USA	217
33	National Westminster Bank[5]	UK	212
34	Wellington Mgmt Co.	USA	211
35	Generali Group[6]	Italy	198
36	Schroder Investment Man.	UK	197
37	American Express	USA	196
38	Chase Manhattan Corp.	USA	190
39	United Asset Mgmt Corp.	USA	188
40	BNP Gestions[7]	France	184
41	Goldman Sachs Asset Mgmt	USA	181
42	Commercial Union	UK	175
43	Société Generale	France	175
44	First Union Corp.	USA	169
45	ING Groep	Netherlds	169
46	Groupe Caisse des Dépôts	France	168
47	MassMutual	USA	157
48	Aegon NV	Netherlds	156
49	Metropolitan Life	USA	154
50	Dresdner Bank Group	Germany	152
51	Lloyds TSB[8]	UK	151
52	Indocar (Crédit Agricole)	France	151
53	Meiji Mutual Life	Japan	150
54	T. Rowe Price Assoc.	USA	148
55	Mitsubishi Trust & Bank	Japan	145
56	HypoVereinsbank	Germany	140
57	Prudential Corp.[9]	UK	141
58	Sumitomo Trust & Bank	Japan	137
59	Nvest Cos.	USA	135
60	BlackRock	USA	132
61	Münchner Rückversich	Germany	130
62	Asahi Mutual Life	Japan	129
63	Commerzbank Group	Germany	124
64	BancOne Inv. Advisors	USA	122
65	Standard Life	UK	122
66	Daiwa Trust & Banking	Japan	115

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Exhibit 11 (Cont'd)

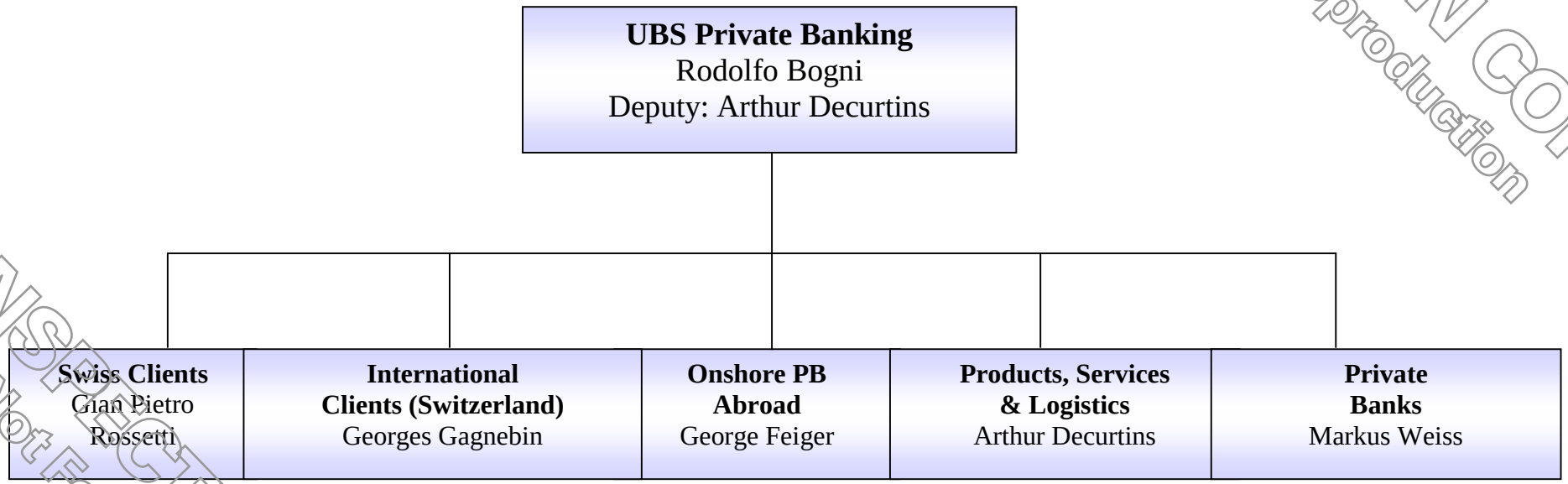
Rank 1/1/99	Firm	Country	AUM ($ bil.)
67	Yasuda Mutual Life	Japan	114
68	Desjardin-Laurentian	Canada	114
69	Toyo Trust & Banking	Japan	111
70	Janus Capital Corp.	USA	108
71	Fleming Investment Mgt	UK	108
72	Federated Investors	USA	107
73	Grupo Intesa	Italy	107
74	John Hancock	USA	105
75	Deka Bank	Germany	105
76	Sun Life of Canada	USA	105
77	Daiwa Group	Japan	103
78	Sun Life of Canada	Canada	102

1 Includes Global Asset Management.
2 Including Bankers Trust Co.
3 Includes Guardian Royal Exchange.
4 Including Scudder Kemper Investments.
5 Includes Legal & General and Gartmor.
6 Includes Achener & Münchner.
7 Includes Paribas.
8 Includes Scottish Widows.
9 Includes Mutual & General.

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Exhibit 12
UBS Private Banking: Organization

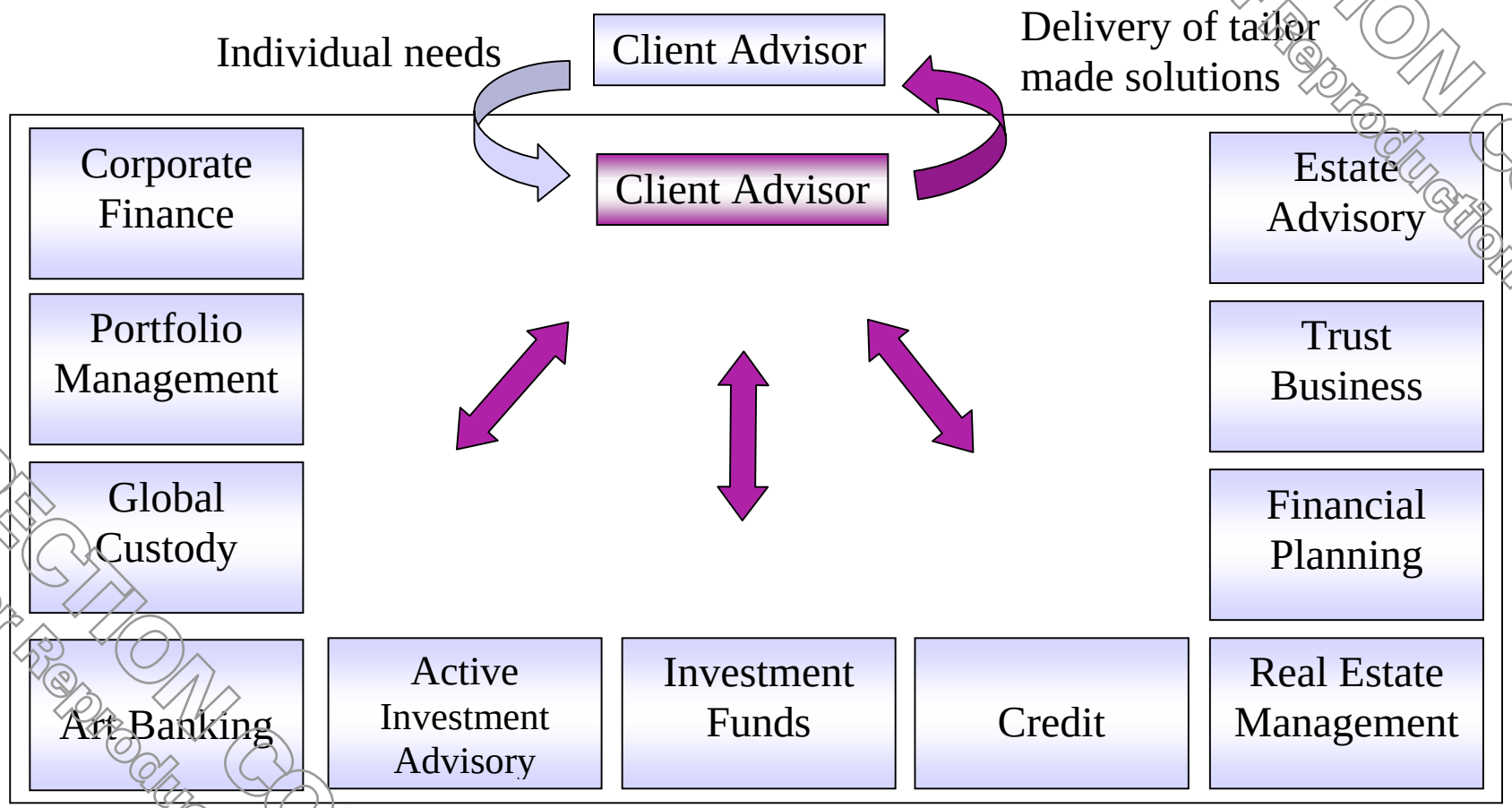


Source: UBS

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Exhibit 13
UBS Private Banking: Integrated Wealth Management



Source: UBS

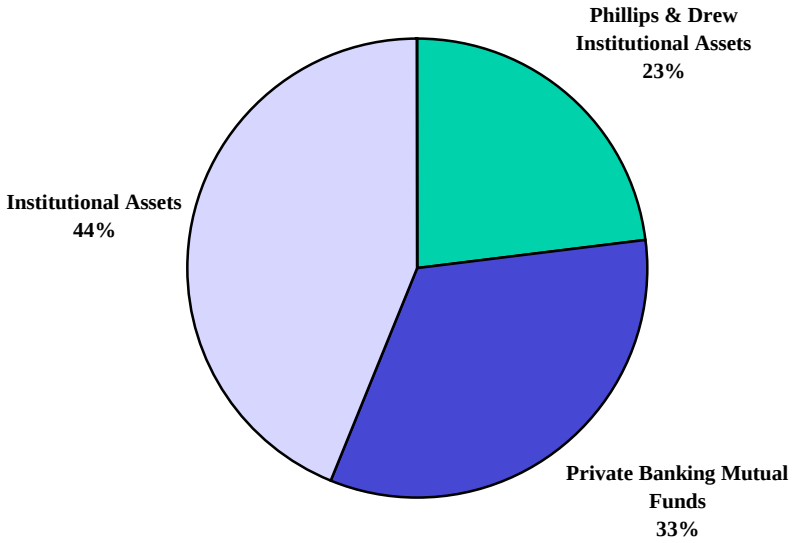
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Exhibit 14
UBS Asset Management – Funds under Management

As of June 30, 1999

Total Mutual Fund Assets – USD 120 Billion
Total Institutional Assets – USD 240 Billion
Total Assets – USD 360 Billion



Source: UBS Asset Management, November 1999.

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