The past year once again featured major challenges and changes in our industry. The regulatory framework in particular is becoming increasingly complex. We are going to be hit by a flood of regulations and laws in the coming years. This issue of regulation is our first topic. Unfortunately, the main task of a private bank often gets pushed to the background: the task of providing good advice that implements the best solution for clients independently of the bank’s own interests. You will find our thoughts on this issue in the second topic «On the art of advising – a declaration of independence.».

Rahn & Bodmer Co. had a good year in 2015. As at the end of October 2015, 190 employees managed client assets totalling 10.8 billion francs. Your bank has a solid capital base, with equity capital of more than 200 million francs. The Tier 1 ratio of 21.2%, which is well above the legal requirement of 9% for comparable banks, is a testament to the bank’s capital strength. As traditional private bankers, we are liable with our own personal assets. We are therefore aware of how important it is to be prudent and conservative with assets. And we do not plan on changing this approach in the future.

We will remain what we are: Rahn & Bodmer Co. – Private bankers since 1750.

We wish to thank you for your loyalty and also for giving us the opportunity to serve you once again in the 266th year of our bank’s existence.
Risk and assuming responsibility

Our daily life is subject to a lot of regulation, whether you are working in your garden or driving your car. If you mow the lawn over lunchtime, your neighbour will give you a dirty look, or you might even be fined. Driving without the seat belt fastened will also draw a fine. The correct behaviour at official events in Switzerland is laid out in 80 pages of regulation. A recent article in the press told the story of a hobby angler who caught a huge pike in the Greifensee, but was threatened with two fines because he released the fish back into the lake, which contravened a regulation on the protection of animals. Not only that, but at the time he released the fish, he was near a reed bed and his boat had therefore illegally entered a lake protection zone.

The list of examples such as this is long. It is quite obvious that there is no shortage of laws and regulations in Switzerland. And if there happens to be some gap in legislation, there is always a legislator who is quick and happy to fill it. Often all it takes is a misstep by a few members of the community or a single person, and soon all citizens are brought back to the path of virtue via new regulations. If a child somewhere is bitten by a terrier, then many lawmakers believe it makes good sense to propose a law that makes it mandatory for dogs to be muzzled. Even the Swiss Federal Council has not shied away from new regulations. A few years ago, the justice minister at the time proposed in all seriousness that grandparents and godparents who babysit their grandchildren or godchildren should take a mandatory course in child-minding.

These examples are to be seen as small anecdotes about bureaucratic excesses that can take place in any country. But the examples are also an indication of the general trend toward more regulations and laws that the world has seen for many years. The regulatory framework is expanding, security measures are tightening and liability exemptions becoming the norm. These are the final expression of the increasing aversion to risk in our society. It feels as though legislators are striving to implement a kind of full-coverage insurance for everyone. Instead of common sense, all our situations in daily life, and in various activities and industries, are governed by new laws. Often, the result is that even in new regulations there is a search for gaps. Once gaps are found, clever people are quite capable of systematically and pleasurably exploiting these gaps.

The financial industry has not been able to escape this trend. To open an account, a customer has to pore over many pages of fine print and sign a number of agreements. This encroachment of a regulatory framework is affecting not only the balance sheet structure of a bank, but also the design and advertising of products and the contact with clients and the handling of their data. There has been a steady drumbeat to draft, revise and then put into effect laws, regulations and agreements. By now, we have become used to terms such as MiFID I and II, revised Banking Ordinance, FATCA, NBG (National Bank Act), FINMAG (Financial Market Supervision Act), FIDLEG (new Federal Financial Services Act), FinfraG (Financial Market Infrastructure Act) and FINIG (Financial Institution Act). From a regulatory viewpoint, no stone has been left untumed in the financial services industry.

In principle, we have nothing against new regulations, provided that they protect clients from harm over which they have no control, and that they make complete legal sense and are therefore beyond dispute.
Unfortunately, often just the opposite is true. We laughed in disbelief about a well-known US court ruling in favour of a dog owner who inadvertantly roasted her dog to death in a microwave oven because the instructions for use did not indicate that the microwave is not suitable for drying her poodle. But in Switzerland, too, common sense and personal responsibility are giving way to an ever greater regulatory framework. The German writer Erich Limpach has written: «The fear of responsibility is enabling the flight to dependence.» One could also say: the tutelage coming from laws and regulations is leading to the same result.

Responsibility cannot be delegated

It makes perfect sense to prevent or penalise wrong behaviour through legislation. But it must always be asked whether common sense is a better guide than simply piling on more voluminous legislation. At stake are two disturbing factors. First, it is assumed that clients themselves are not intelligent enough to assess certain risks and to make a decision. It is also implicitly assumed a priori that the client’s bank or wealth manager is not doing a very good job for the client. But just the opposite is true. The financial services industry, like any other, may have a few bad apples and poorly informed clients; however, I would maintain that most banks and their clients know that risk and return are closely linked when it comes to investing. There is no disputing that one of the main duties of a client advisor is to inform his or her clients about the risks involved in a specific investment strategy. But the final decision about what to do with the client’s assets has to be made by the client. No regulation in this world can tell investors how much risk they should assume and what the return should be. Common sense and an awareness of responsibility are needed on both sides.

Does this mean that a bank should turn away from all responsibility, in the assumption that it is only dealing with well-informed clients who always make the right decision?

No, of course not. The bank also has a responsibility, just like its clients. The bank should serve as a professional advisor and show clients what their options are. As traditional private bankers, we are liable with our own personal assets. So we know what it means to act responsibly. We do this gladly in the conviction that cooperation is only successful if the two partners work as equals, with both taking on their share of responsibility.

Our aim is to use our professionalism and dedication to create the best conditions for making the right investment decisions for our clients and to do this on a mutual basis and with a sense of responsibility. The basis for working closely together with clients cannot be laws and regulations; rather, it has to be the mutual trust that is built up over the years.

The trust that you have placed in us is confirmation of the work we do. In addition, it is also a reminder and an inspiration to handle all mandates responsibly in the future as well.
On the art of advising – a declaration of independence

The financial services industry has for a number of years been going through an intensive period of change. The increase in regulations we mentioned at the outset and the rapid advances made in technology are changing the environment dramatically. Heightened compliance requirements and modern information technology are creating more transparency, but also greater work and expense for financial institutions. But since income often does not keep pace, the danger of shrinking margins is great. To counteract this trend, banks are attempting to generate more income in their core business of investment advisory. The drive to generate more income is understandable and reasonable for every business. A good product has its price and should also be rewarded through pricing. But how can good quality be measured? The answer is simple in the consumer goods industry. Standardised products have specific recurring features that can be measured accurately. If a consumer wants to have clean, fresh-smelling laundry, there is a selection of detergent to buy. If the clothes become clean and fresh-smelling, the product is judged to be good quality.

A wide variety of values and needs

But how can a good performance be recognised in financial advising? Every client has his or her own ideas, wishes and goals. Some people want to save to buy a house, while others want financial security for their retirement years. Some investors are looking for as large a return as possible, while others are content with having investments that pay over the long run. The client advisor must be able to understand the ideas and financial goals of each client and propose a solution that is tailored to the client's individual needs. The client advisor is like a fitness coach who gives specific advice about nutrition and training. The task of the client advisor of a bank is to develop the right investment strategy for each client and to help them implement this strategy. What is more, this strategy has to be independent of the advisor and the bank's own interests.

Permanent conflict of goals

When the strategy is actually put into practice, however, conflicts can arise. The client advisor's actions can be influenced not only by the client's interests, but also by the goals of the advisor's company. This is true in particular if the bank not only provides investment advice, but it also develops and markets its own products such as investment funds, ETFs or structured vehicles. Logic dictates that it is not possible for every single one of these products to outperform the competition. Performance by definition means that a product is sometimes better than the competition, and at other times worse.

A client advisor whose salary depends on selling investment products therefore constantly operates in a grey zone between the client's interest and the advisor's interest. Should the advisor recommend the investment fund with the best performance, or the one offered by his own company? In actual practice, it has been shown that clients of banks with their own products have disproportionately more investment funds and derivatives from their bank in their portfolios.

Against this backdrop it is worth taking a look at the product offering of a bank and the incentive structure for the advisor. Is the advisor paid on the basis of sales? Is the advisor’s bank obliged to present quarterly financial statements, or does it operate on a longer time...
horizon? In our view, it is dangerous to succumb to the attraction of fast money when the long-term goals of the client are at stake. It is our firm conviction that success can come only from a financial strategy that is set up for the long run over several years. The interests of the bank must take a back seat to the client’s interests at all times.

Independence is paramount

This is the reason that Rahn & Bodmer Co. does not have any products of its own. We can serve our clients better if we use our expertise for determining the right investment strategy and the selection of the right investment vehicles, rather than for selling our own financial instruments.

Our client advisors make their recommendations independently. They therefore do not participate in the revenue that they generate with their clients. Independence is best guaranteed if the advisor has plenty of freedom for making decisions. We have always placed a priority on building long-term relationships with our clients based on trust and to help them achieve their long-term goals.

Independent, long-term thinking also requires continuity in advising. We are proud that our employees on average stay with our bank longer than employees do at other banks. We are often asked why this is the case. The answer is simple. In a securities portfolio, it is wrong to be constantly changing your positions. In the same way, it would be wrong to have a hire-and-fire mentality at our bank. It is our firm conviction that, when it comes to investing, it is crucial to have a long-term relationship based on trust between clients and their advisors.

Many of our client relationships go back several generations. The priority is always on the close relationship of the partners and the client advisor with clients, a thorough understanding of the arc of their lives, their needs and their objectives – and not on the profits of the bank. As an independent private bank based in Zurich, run by five independent partners, we are aware that for sustainable wealth management only a well-conceived, long-term plan of action can be successful.

The partners of Rahn & Bodmer Co.

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