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NEWSLETTER

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Banks in transition – hidden costs

Dear Ladies and Gentlemen,

This guest contribution informs you about current topics in the banking industry and about the challenges an independent financial advisor is facing.

The finance and banking industry is undergoing a major transition. Since the demise of investment bank Lehmann Brothers in autumn 2008 the world of banking has constantly been facing new challenges. Pressure from abroad has increased, and banks have also to deal with national and international regulations (MiFID, anti-cyclical capital buffers, FATCA, AIA, etc.). Legal and compliance expenses are going up, and commissions have collapsed, not least because of the strategy for "legitimate" money pursued by both the Federal Council and the Swiss Bankers Association. The Midas sources of revenue from once highly desired structured products like derivatives etc. have dried up. In the near future many banks will be forced to reconsider and readjust their strategies. As a consequence, they will try to offload additional recurring costs and their eroding margins in wealth management onto their existing customers. Various market participants believe that around 50 banks in Switzerland may have to be wound up within the next few years.

Who pays the bill?
The bank customer will be footing the bill, by having to pay increasing banking fees and charges. There is no more a discernible significant advantage for customers with an asset management mandate: they will be supplied with expensive products, preferably the bank's own.

Hidden costs
The cost of financial products can be bizarre. Some fund management companies earn commissions even while the investor's fund is making losses. Beating the whole market is what matters to the funds manager. If the fund's loss is lower than the market's average loss, the customer pays a commission. The customer will be billed a management fee within the Net Asset Value (NAV), i.e., each year the customer pays a fee that does not appear on the account statement, but which can only be seen in the prospectus. Certain funds, on the other hand, invest their money in other bank-owned funds – a profitable business.
The funds' costs include more than just the few expenses on the statement. Besides TER (total expense ratio) and transaction fees, hidden expenses will be added, such as the difference between buying and selling rate and foreign currency spreads. However, the longer an investment fund is held, the less these cost factors matter.

This lack of comparability has considerably contributed to the reputation of certificates as non-transparent investments. So far no independent platforms exist that would give investors the opportunity to simultaneously ask for second opinions from different banks about a desired product. Even in secondary trading with structured products the issuers set the prices, and it is difficult to compare the terms of the listed products.

The bank is not independent and still subject to internal regulations, and budget and product targets. Conflicts of interest (like retrocessions, kick-backs, bonus relevance) render independent advice a difficult task.

How should an investor proceed?
First of all, a customer should try to ascertain the overall costs of his investments (TER). This will directly serve as a basis to allow the customer, if need be, to optimise the costs of his portfolio, together with his advisor at the bank, and make informed comparisons.

Independent
The term "asset lawyer" still seems to be relatively unknown. A respectable financial advisor considers himself first of all as a risk-manager, the ultimate goal being asset conservation. He will support and represent the client's interest, survey the transactions and negotiate with the deposit banks about the best possible terms. All costs, fees and charges are disclosed, to ensure maximum transparency. Thus, independent financial advisors are able to wrap up the best possible and most lucrative packages, are exclusively liable to the customer and completely forego any kind of reimbursement by the banks.

Despite setbacks in the last few years, Switzerland is still a burgeoning financial centre with great prospects. The trend of customers increasingly taking over direct responsibility for their portfolios will gain in strength. There is a need for action regarding independent and neutral support for all financial matters.

About the author
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Kind regards
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