

JULIUS BAER GROUP
BUSINESS MODEL SIMPLICITY IN TURBULENT TIMES

Case Study

Authors

M.Sc. Lyndon J. Oh

Institute of Management

University of St. Gallen

&

Prof. Dr. Christoph Lechner

Institute of Management

University of St. Gallen

© 2010 by Lyndon J. Oh & Christoph Lechner, University of St.Gallen. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means – electronic, mechanical, photocopying, recording, or otherwise – without the permission of the copyright owner.

INTRODUCTION

"the world as we know it was on the brink of collapse"

-Raymond Baer, Chairman and President

Raymond Baer, Chairman and President of Julius Baer, described the atmosphere of the financial crisis and assault on Swiss banking secrecy as one similar to that of "times of war." An atmosphere of pure fear prevailed among investors. It was a time when many Swiss bank account-holders took their money out of accounts at UBS and brought it over in plastic bags to Julius Baer to open new accounts. As a consequence, many private and cantonal banks had profited. Julius Baer's executive meetings at the time dealt primarily with evaluating the counterparty risk, reflecting on "which bank could go under and which country was in trouble, and just guessing who the next victim would be while trying to avoid being the next." Adding fuel to the fire, Julius Baer, the third largest private bank in Switzerland with over 3000 employees and CHF 153 billion assets under management (AuM), joined the ranks of other Swiss banks as the entire industry faced criticism over the question of banking secrecy's role in tax evasion.

From his office across from rivals UBS and Credit Suisse, Raymond Baer pondered his bank's future amidst revolutionary change. Had Julius Baer evolved sufficiently from its platform as a European and North-American-centered bank to meet the ballooning demands for wealth management from the emerging world? How would his bank fare in view of dramatic changes to the banking industry, and to the Swiss banking industry in particular? Is his bank's "pure player" Swiss banking business model poised to withstand the gradual peeling away of layers guarding client privacy and secrecy within his bank?

INDUSTRY LANDSCAPE

For decades, Swiss private banks have profited from a unique and insulated position in global banking. Leveraging historic political neutrality that enabled Switzerland to evade two world wars in the 20th century, and offering a national value proposition defined by both banking confidentiality laws and a political system and currency viewed as synonymous with stability and independence, Swiss banks have functioned as a veritable global vault for the safe-keeping of assets. Family offices administering the wealth of single families, high net worth individuals (HNWIs), and institutional investors count among Swiss Banks' diverse international client base. Along with their much vaunted stability and conservative values, Swiss banks have profited considerably from Switzerland's privacy laws, which have historically offered individuals refuge from public inquiries into personal wealth as well as high tax rates in home domiciles. This value proposition to clients is known as "offshore banking," allowing the placement of assets "offshore" away from banking centers lacking the privilege of privacy and confidentiality. This rare position in the global financial world has functioned as a cornerstone of asset inflows for Swiss banks.

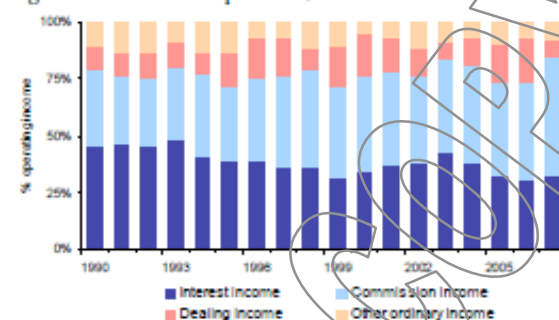
Private banking focuses on individuals with large bankable assets. Institutional wealth management, on the other hand, focuses on investor pools with professionally-managed assets, including those of pension funds, collective investment vehicles, foundations, and corporates.¹ Historically, Swiss Private Banks have offered a haven for global private wealth. An estimated USD 2 trillion of offshore wealth is held in Switzerland.² Fees can be charged against any number of transactions conducted on behalf of the client, including custody services, transaction banking, prime brokerage, and product sales. Gross revenue margins on all assets under management (AuM) in the next few years are projected to be at 75-90 bps while a few years ago gross margins were above 100

¹ Swiss Bankers Association „Wealth Management in Switzerland,“ 2009

² Ibid.

bps³. Owing to lower costs of administration, profit margins on offshore accounts tend to be higher than on onshore accounts.

Figure 8: Income composition, 1990-2007



Source: SNB; SBA research.

Exhibit 1: Distribution of private banking revenue streams

(Source: Swiss National Bank; Swiss Bankers Association, 2009)

The entire Swiss private banking market was estimated to be around CHF 4.7 trillion in 2008⁴. Its landscape exhibits remarkable fragmentation and heavy concentration among the two giants UBS and Credit Suisse. Both together are estimated to manage half of the markets AuM. The next 11 largest private banks in Switzerland divide another 27% of the market, with AuM above CHF 50 billion per bank. The rest of the market is estimated to consist of 26 banks with AuM between CHF 15-50 billion and over 70 banks with AuM less than 15 billion per bank (refer to *Exhibit 1* for illustration of the market structure). Ranked by AuM, the top 5 Swiss private banks outside of UBS and Credit Suisse include HSBC Private Bank, Clariden Leu (subsidiary of Credit Suisse), Julius Baer, Pictet, and Zürcher Kantonalbank.⁵ The industry knows three distinctive types of business models. First, the so-called "pure-play" model refers to private banks that entirely focus on private banking operations and include limited product engineering. Such banks' processes mainly involve market research, client advisory, asset allocation, and often strong brand management. Second, integrated business models encompass not only traditional private banking activities, but also other banking activities found elsewhere in the global banking system, such as investment banking or asset management. Third, retail banks (also universal business model) are banks with a dense branch distribution and offer besides traditional savings and mortgage activities for the mass market only limited private banking for affluent and high net worth individuals.

³ KPMG-HSG, Private Banking in Switzerland - Quo vadis? 2009; Deloitte, Winning in Wealth Management. 2009

⁴ KPMG-HSG, Private Banking in Switzerland - Quo vadis? 2009

⁵ Helvea, "Swiss banking secrecy and taxation" 2009

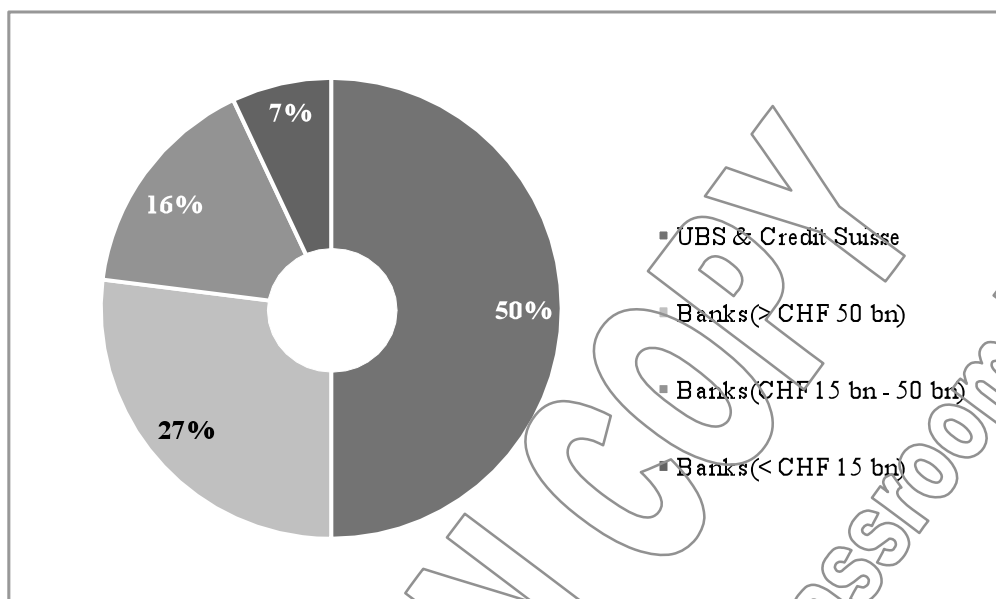


Exhibit 2: Swiss private banking market structure

(Source: KPMG-HSG, Private Banking in Switzerland - Quo vadis? 2009)

In 2009, Swiss private banking sat in the eye of a regulatory storm. France, Great Britain, the United States, and Germany have launched an international regulatory effort coordinated through the Organization for Economic Cooperation and Development (OECD) to contain the use of offshore banks as tax shelters and repatriate funds as tax revenues. Both banks and its clients acknowledge that banking secrecy as a shield for tax evaders is coming to an end, as noted in an official OECD statement.⁶ The US Internal Revenue Service launched a law suit against UBS pressing for the names of 19,000 US clients with an estimated \$US 17.9 billion in undeclared accounts. At UBS's Wealth Management division alone, net money outflows were a net CHF 107.1 billion in 2008 and CHF 89.8 billion in 2009, reflecting the general loss of confidence.⁷ With the onslaught of government-led action against Switzerland's prized banking sector, the uncertainty surrounding Swiss banking continues. Many questions loom large over the future of the industry's profitability and sustainability of its business model in view of damaged secrecy: To what extent do Swiss banks depend on secrecy to attract new money inflows? How does the new geography of regulation affect Swiss banks' growth targets? Where are the new sources of net new money when the doors have closed on other sources? What kind of business model is best poised to survive when one cornerstone of its value proposition is swept away?

Corporate History

Julius Baer's evolution in many respects is a mirror reflection of the evolution of the Swiss private banking industry, moving from a small base in central Europe to a global network of multi-service offices dedicated to the management of private wealth. Julius Baer was born Isaac Baer in Heidelberg, Germany in 1857. Baer first trained in the Bavarian city of Augsburg in the banking business of his father's friend, August Gerstle. Zürich would become the Baer family's ultimate home as he formed a partnership with Zürich-based financiers Theodor Grob, Ludwig Hirschhorn, and Joseph Michael Uhl in 1896.

The Baer family responded to the rise of Nazism in the 1940s by leaving Switzerland and establishing an office in New York City in the 1940s, with future Chairman Hans J. Baer pursuing his education in

⁶ BusinessWeek, 10 September 2009

⁷ 2009 UBS Business Divisions Report

the United States before returning to Switzerland in the 1940s to join the private banking firm. Julius Baer expanded its businesses into securities trading in the 1960s, which served as a platform for its international expansion. By the 1980's Julius Baer was trading as a publicly-listed company on the Swiss stock exchange, with a representative office in Hong Kong, a branch office in London, and securities trading in New York, where it also focused on offering international pension fund products to the U.S. market. The 1990s saw a wave of consolidation in the Swiss private banking industry. Baer was no exception, taking over the family-owned Bank Falck & Co., and converting it into a branch of Bank Julius Baer. With an enlarged asset base, the company focused its value proposition on wealth management, targeting HNWIs in North America. The bank set up offices in Los Angeles, in 1989 and in Palm Beach, Florida in 1991, and then launched a joint venture, BJB Global Investment Management, which aimed at entering the Canadian market in 1993.

By the early 2000s the bank was growing fast and eager to catch the wave of the booming global equities market, where growth in brokerage services had ridden the wave of the tech bubble of the 1990s. In 2001 the bank established a brokerage division, which it quickly closed after the collapse of markets at the end of 2001 to refocus its core business. In 2002, the bank also revised its customer profile, setting a preferred minimum investment target of \$2 million from clients. In the same year, Raymond Baer, son of Hans Baer and great-grandson of Julius Baer, was installed as Chairman to steer the bank on its refocusing effort.⁸

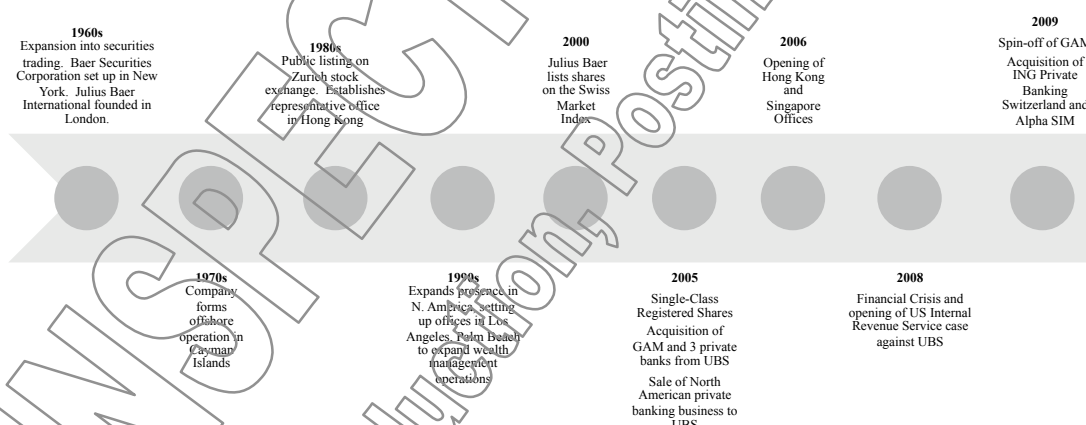


Exhibit 3: Julius Baer Corporate History

(Source: "Julius Baer," www.fundinguniverse.com)

Year of Change

In 2005, Julius Baer took the private banking world by surprise by announcing that it not only held off takeover by rival UBS but that it would actually acquire its asset management business, Global Asset Management (GAM), in exchange for roughly 21% holding in Julius Baer. It further acquired from UBS private banks Ferrier Lullin & Cie SA in Geneva, Banco di Lugano (Lugano), and Ehinger & Armand von Ernst, headquartered in Zurich. The CHF 5.6 billion⁹ transaction brought the integration of four private banking operations, including the existing private banking operation at

⁸ www.fundinguniverse.com

⁹ "Julius Baer to Buy 3 UBS Private Banks, GAM Unit for SF5.6 Bln,"

<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aDHoxnK.LHzk&refer=europe>

Julius Baer, and the acquisition of a hedge fund unit at a time when investor demand for alternative assets was nearly insatiable. The transaction was what Mr. Baer called one “bouquet of flowers,” where the acquisition of three smaller private banks was attached to the pickup of GAM as indispensably part of the transaction. The logic of the transaction was twofold in that it sought to expand its share of the Swiss private banking market in a pan-Swiss geographic strategy that would cover the French, German, and Italian-speaking regions of the country, and introducing the specialized knowledge capital of dedicated global asset management at a time when investor demand for alternative asset classes soared. GAM would provide extensive hedge fund experience, having the longest track record in the industry, and would fold nicely into private banking operations given the fact that HNWIs were the largest investors in hedge fund vehicles. The resultant scale, doubled capital base, and instantaneous asset management proposition allowed Julius Baer to begin its expansion to Asia, where it currently holds presence in Hong Kong, Singapore, and Jakarta, and will soon follow with a Shanghai office by the end of 2010.

Quick Turnaround: Countering crisis with speed

The changes to the business model would not last. Julius Baer believes one of its core strengths is its operational speed, as evidenced by its quick turnaround in the face of adverse market circumstances. As ripple effects from the financial crisis swept across Switzerland's asset management world, Julius Baer's own Asset Management group lost AuM CHF 96 billion at the end of 2008, resulting from adverse market performance CHF 50 billion and net outflows of CHF 27 billion.¹⁰ The losses prompted Julius Baer to spin off its GAM-asset management business, completed in 2009. Of the change, Raymond Baer noted, “It’s amazing how quickly people and processes adjusted to new realities.” The move aimed to refocus its value proposition as a pure player Swiss bank and separate a business, steeped in the high risk-taking and product sales-oriented culture of investment banking viewed as increasingly incompatible with the demands of a private bank. The same year, Julius Baer acquired the private banking operations of the Dutch bank ING at a price tag of CHF 520 million in cash, which gave the bank access to an additional CHF 15 billion AuM and doubled its presence in Geneva. ING’s staff of 310 were integrated into Julius Baer. The bank’s acquisition of Alpha SIM, an Italian wealth manager with AuM of approximately 400 million EUR, aimed at expanding onshore activities in Italy in view of shrinking opportunities from offshore banking. Mr. Baer believes his bank’s operational speed and adaptive ability distinguishes it from other Swiss banks and puts into a comfortable position for the 21st century. This capability, according to Mr. Baer, should counter any claims about the inherent inflexibility of the Swiss banking model. He remarked, “I think we manage more change at Julius Baer on the Swiss platform than I’ve ever seen in the Anglo-Saxon environment...What the people here did, transforming the old brand and catapulting it into the new world, going through multiple mergers, demergers, and management changes...I think it made this organization proper for the future.”¹¹

In the toughest months of the crisis, Julius Baer found itself in the unique position of being on the receiving end of new net money inflows, owing to the fact that private clients believed the bank could handle the crisis better than others. Julius Baer managers believe that this illustrates one of its core value propositions is its “stickiness”—the capability of acting as a reliable safety deposit box when markets experience turmoil. Creating distance between other players in the global banking industry only consolidates this core offer. Julius Baer’s separation of GAM was part of a broader strategy to manage risks at a time when few in the industry could accurately value instruments on their balance sheet. By stepping out of the high-risk world of investing on behalf of institutional investors in search of alternative asset “alpha” performance, the bank was able to limit its exposure to unwanted market volatility and credit risk—balance sheet risk tied to the ability of the counterparty to pay what

¹⁰ Julius Baer Group, 2008 Business Review.

¹¹ Interview, Raymond Baer, 5 May 2010, Zürich, Switzerland

it owes on its side of a transaction. Nevertheless, Julius Baer is able to keep its arms-length relationship with this class of investment vehicle on behalf of its clients, while shoring up its offer as a pure player with open architecture. Mr. Baer believes the spinoff of GAM enabled Julius Baer to claim the most credible position as a pure player private bank dedicated to an “open architecture,” where clients can choose best-in-class services and product classes from both within and outside of its banks. Clients and investors met the transaction with near unanimous approval, endorsing the logic of Julius Baer’s refocused value proposition. Despite the fact that demand for alternative asset classes like private equity and hedge fund investments on part of HNWI’s has fallen considerably in the aftermath of the 2008 financial crisis, Julius Baer maintains a preferred arms-length partner relationship with GAM, where it is able to provide its private clients with the dedicated asset management services of GAM, particularly in fund of hedge fund products.

The separation of GAM has come at a price of testing Julius Baer’s ability to handle the blows that come with deep structure change. Mr. Baer equates the process of de-merger of businesses to that of “unscrambling eggs and trying to put them back in the eggshells.” The people, workflows, and operational processes had become deeply woven into one another so that the de-merger process required a high degree of resolve on part of employees in a banking system who many outsiders view as resistant to change and spontaneity. Mr. Baer, however, is emboldened by the success and speed of the bank’s demerger process and views the project as counterevidence to those critics from the Anglo-Saxon system who view the Continental system as rigid and unsuited to radical change.

“The financial industry has been too creative, too in-transparent, too many conflicts of interest in business models, and too engineered, and in fact culturally it was difficult to run an investment banking culture within a private banking culture – those are two different cultures that are at the end of the day incompatible.”

--Raymond Baer

Growing the core through timely acquisition

Decisions in 2009 largely reflect a broader strategy of concentrating its growth at the core—pure player private banking. In that year its client assets reached CHF 299 billion, up 9% from CHF 275 billion since the end of 2008 on positive market performance. The year was also characterized by aggressive growth through acquisition. This strategy has been twofold in enlarging its asset base in both onshore and offshore markets. For the former target area, its acquisition of Italian private wealth manager Alpha SIM, adding approximately CHF 400m to its AuM base, was aimed primarily at making its “onshore” banking proposition more robust, while simultaneously handling tax amnesties on behalf of Italian clients facing new tax evasion regulations (of total assets declared by Italian clients taking advantage of the Italian tax amnesty, 60% remained with Julius Baer¹²). Similarly, the bank’s 2009 opening of a Munich office reflected its continuing ambition to be a major private banking player in the German market, representing together with the United States and Japan approximately 54% of global HNWI’s in 2008.¹³ Targeting a growth market of entrepreneurs and new HNWI’s in the Lake Constance region of Switzerland, Julius Baer opened an office in Kreuzlingen, Switzerland in summer 2010 to spearhead its growth goals in its home market of Switzerland. Offsetting expected net asset outflows as a result of the collapse of banking secrecy, Julius Baer opened a new office in Munich to focus on growth in the Germany market.

Julius Baer’s global growth strategy is twofold: a revised onshore proposition following new rules on secrecy, and expand its offshore proposition in the Middle East, Latin America, and Asia. Julius Baer management believes its value proposition as an offshore entity is sustainable, and that the discretion / privacy component of its business model remains attractive to those wealth clients who are comfortable making tax-compliant bookings that take advantage of the privacy privileges afforded by

¹² Julius Baer Group, 2009 Business Review

¹³ CapGemini & Merrill Lynch Wealth Management, Global Wealth Report 2009

its offshore location. For its onshore business, Julius Baer is active in performing tax amnesties for clients who are moving from undeclared to declared accounts. Critical to growth, its "passporting" approach enables it to use established positions in onshore European Union branches to establish other locations within the EU. Its country targeting strategy largely hinges on the extent to which it believes the political system in the country will grant it.

Open Architecture: Preventing substitution with flexibility

Without a "sell-side" business, where products are created in-house from investment banking operations and sold through private banking channels, Julius Baer can offer an "open architecture" to its clients, which seeks asset and product composition from outside of its own profit channels and does not necessarily return fees to Julius Baer itself. Contrary to larger banks with large proprietary businesses and trading volumes in search of high transaction fees, Julius Baer's 250 traders focus on executing trades exclusively on behalf of their private clients. The bank has no syndicated loans business, no capital markets transactions, and no sell-side brokerage. It ended its research sales in 2003 and currently maintains the unit purely as a cost center to support its private banking clients. Similarly, research remains a cost center function and allows RM's to better advise their clients on investment strategies. This enables the banks to offer something different from other private banks with ties to investment banking operations. Gian Rossi, head of private banking for German-speaking and Northern Europe, remarked on this distinction, "[M]y client says to me, I don't want a Goldman Sachs or UBS strategy sold to me. They want first-hand, independent research. There's no reason for us to write a good report about Nestle because they're not giving us any capital market transaction or cash pooling."¹⁴

The bank's open architecture feature enables lock-in effects. In the event that customers are unable to find what they are looking for directly through Julius Baer's own fund universe, it offers the feature of choosing external assets or fund managers while maintaining a principal banking relationship with Julius Baer. In addition to its preferred partner relationship with GAM, it also maintains select relationships with other asset managers to provide access to other funds for their clients. Open architecture in effect offers "mix and match" through Julius Baer, which has the competitive effect of curbing substitution effects from rivals. Furthermore, Raymond Baer suggests that of all Swiss private banks, Julius Baer offers the most "credible case for open architecture."¹⁵ Competitors differ in that they have in-house incentives to cross-sell investment products created in the investment banking division through its private banking distribution channels.

"Edelweiss" and in-house expertise

The bank's investment mandates are aimed at complementing its open architecture with strong inhouse expertise. Like a good tailor who knows his client's measurements and tastes, the bank is able to provide highly-specialized solutions. While Julius Baer's typical client has basic liquidity demands—holding typically around 30% of cash or cash-equivalent instruments¹⁶—others may seek asset allocation across a particular class of equity holdings. For example, Julius Baer's Bern office offers an "Edelweiss" mandate, which entrusts relationship managers with a mandate to purchase only those shares quoted on the Swiss stock exchange, a "plain vanilla" Swiss investment focus. Many investment allocation choices such as these often defy what is recommended by conventional theories in finance. However, according to one Relationship Manager in the Berne office, Julius Baer recognizes the behavioral and "non-rational" drivers of investment behavior, and works to provide solutions accordingly.

¹⁴ Interview, Gian Rossi, 4 December 2009, Zurich, Switzerland

¹⁵ Interview, Raymond Baer, 5 May 2010, Zürich, Switzerland

¹⁶ Interview, Raymond Baer, 5 May 2010, Zürich, Switzerland

The Relationship Manager-to-Client ratio, an indication of a private bank's resource distribution per client, varies from branch to branch, but is roughly at 150 clients per relationship manager. A typical Julius Baer client may be a retiree with a pension, plus income from a portfolio, along with property either inherited or acquired, and some rental income. Such a client would represent in Baer's view a conservative investor, who doesn't seek entry into new products, and is content to maintain a bond-weighted portfolio with 2.5% interest. On the other hand, Julius Baer may also serve young entrepreneurs who have sold their companies, have earned money from the sale, and would like to see the money perform. Often these assets might go across several managers: a family office, self-management, or split holdings across different banks. Such a client is less stable for Julius Baer as he / she tends to be a savvy investor and consumer of market information, demanding much based on information the client has sought out from personal information sources. This client profile is the least likely to stay long-term with Julius Baer, as the investor might find an interesting investment opportunity.

Julius Baer's independence, however, does not necessarily mean a compromise in its ability to deliver services available at large investment banks. For example, it maintains an in-house structured product team. This team is comprised of a staff of financial engineers capable of structuring an investment portfolio designed to meet complex risk/return demands of a client. Those financial engineers often participate in client meetings to discuss potential strategies for hedging risk, diversification, and yield-enhancement. In April 2010, Julius Baer won first prize in the category "Leveraged Products" at the 2010 Swiss Derivatives Awards, underscoring the bank's growing capability in providing complex investment structures for its clients. The bank has also actively recruited relationship managers, who have experience at banks with investment banking and proprietary trading operations and risk-taking cultures to boot. With new recruits from Citigroup, Goldman Sachs, and other rivals from the "Anglo-Saxon" banking world, Julius Baer aims to offer the best of both the risk-savvy, innovation-driven Anglo-Saxon banking system and the balance sheet-oriented, conservative banking values offered by "Continental" counterparts. It is able to draw recruits from these counterparts, Mr. Baer claims, precisely because of its independence: "They've had it with product push. They want to cater to their clients' needs. They like the fact that we were not too big with a headquarters interfering and micromanaging, etc.¹⁷" Nevertheless, Mr. Baer warns of the power of financial innovation, agreeing with Warren Buffett's statement that derivatives can be likened to "financial weapons of mass destruction."¹⁸

"I would never for a second underestimate the innovation power of financial markets."

-Raymond Baer

Large capital base: the engine of opportunity

A key policy of the bank—which strengthens its proposition as a pure wealth manager—is its conservative use of capital. The bank maintains a Tier 1 capital ratio of 20.3%, far exceeding the target ratio of 12%. Julius Baer recorded a maximum Value-at-Risk (VaR) in 2009 at CHF 3.00 million. These liquidity levels support its growth strategy as a pure player, enabling it to quickly snap up fleeting opportunities when availed, as evidenced by its quick acquisitions of ING Private Bank and Alpha SIM in 2009. The policy also allows for creative private banking solutions where other banks with lower liquidity cannot compete. For example, for the growing market of China, the bank implements a "broker / private banking" model that allows it to meet the complex, risk-seeking needs of its clients in the region. In a typical case, the bank can provide a wealthy individual from the People's Republic of China a 20-30% advance on a certificate of stock on his publicly-listed company in order to construct a portfolio of diversified securities, and then also obtain cash against the deposit to purchase real estate or a major luxury item such as a yacht or private jet. Mr. Baer contends that

¹⁷ Interview, Raymond Baer, 5 May 2010, Zurich, Switzerland

¹⁸ Quoted *BBC News*, 3 March 2003

this is a unique competitive strength of the bank, whereas “private Banks in Geneva could never do this because they don’t use the balance sheet in the same way”

Consolidated balance sheet

	31.12.09 CHF m	31.12.08 CHF m	Change %
Assets			
Due from banks	6 598.2	8 626.4	-23.5
Loans to customers ¹	10 431.2	9 876.8	5.6
Trading assets	2 735.1	1 289.1	115.5
Financial investments available-for-sale	15 011.5	12 171.3	23.3
Goodwill and other intangible assets	1 705.9	1 748.6	-2.5
Other assets	6 247.7	8 984.0	-30.5
Total assets	42 729.0	42 676.4	0.1
Liabilities and equity			
Due to banks	3 962.4	3 605.4	9.6
Deposits from customers	27 284.7	25 564.6	6.7
Financial liabilities designated at fair value	3 942.7	2 540.0	57.1
Other liabilities	3 347.4	7 512	-55.4
Total liabilities	38 537.2	39 191.9	-1.7
Equity attributable to shareholders of Julius Baer Group Ltd.	4 190.1	3 483.1	20.3
Non-controlling interests	7	1.4	22.9
Total equity	4 191.8	3 484.6	20.3
Total liabilities and equity	42 729.0	42 676.4	0.1
Key performance ratios			
Loan-to-deposit ratio	0.38	0.39	-
Leverage ratio ²	17.2	24.6	-
Book value per registered share outstanding (CHF)	20.5	-	-
Return on equity (ROE) ⁴	17.4%	19.6%	-
BIS statistics			
Risk-weighted assets	10 970.4	13 250.5	-17.2
Eligible tier 1 capital	2 656.4	1 963.0	35.3
Tier 1 ratio (%)	24.2%	14.8%	-

¹Mostly lombard lending and mortgages to clients

²Total assets/tangible equity

³Based on total equity

⁴Net profit/average equity, plus goodwill

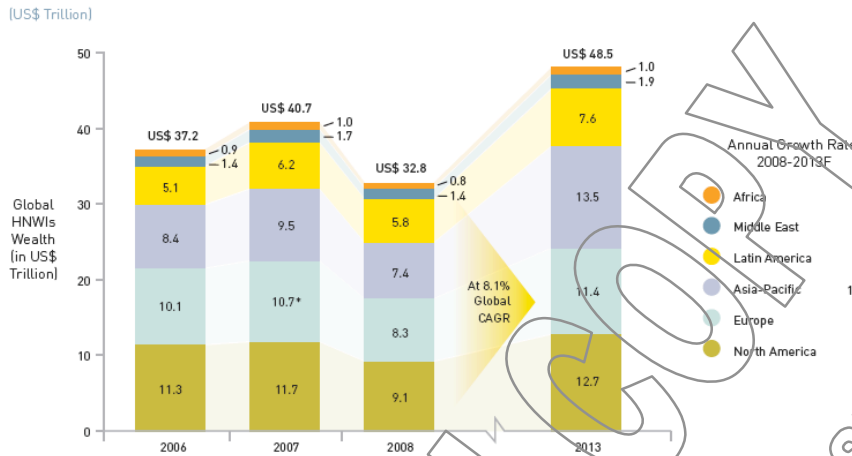
Exhibit 5: Consolidated Balance Sheet

(Source: Julius Baer 2009 Business Review)

Positioning: Banking on luxury

Julius Baer positions itself as luxury brand, offering premium products and services to select customers. Indeed, one senior manager equates the Julius Baer line of products to that of Patek Philippe, the premium watch manufacturer headquartered in Geneva. Patek Philippe products range from reasonably affordable watches aimed at up-market consumers to exquisite, one-of-a-kind timepieces available only to exceptionally high net worth individuals. For example, in the local Swiss market Julius Baer offers credits and loans to customers looking to make personal real estate market purchases as well as a retail solution for Swiss citizens looking to reduce their tax liabilities. On the other hand, the bank targets Ultra-High-Net-Worth Individuals (UHNWIs) such as young and successful entrepreneurs as well as those individuals featured in *Manager* magazine as the 300 wealthiest Germans, representing a major target area for its onshore growth in Europe.

Figure 5. HNWI Financial Wealth Forecast, 2006 – 2013F (by Region)



*The 2007 number for Europe was revised from 10.6 to 10.7
Source: Capgemini Lorenz curve analysis, 2009

Exhibit 6: Global Wealth growth forecasts by region

(Merrill Lynch Cap Gemini World Wealth Report, 2009)

Up to CHF 250-500,000	CHF 250-500,000 to 1-2 million	CHF 1-2 million to 50 million	CHF 50 million and above
Mass Affluent	Core Affluent	High Net Worth	Ultra High Net Worth

Exhibit 7: Typical Private Banking Client Segmentation

(Source: Swiss Bankers Association Research, 2008)

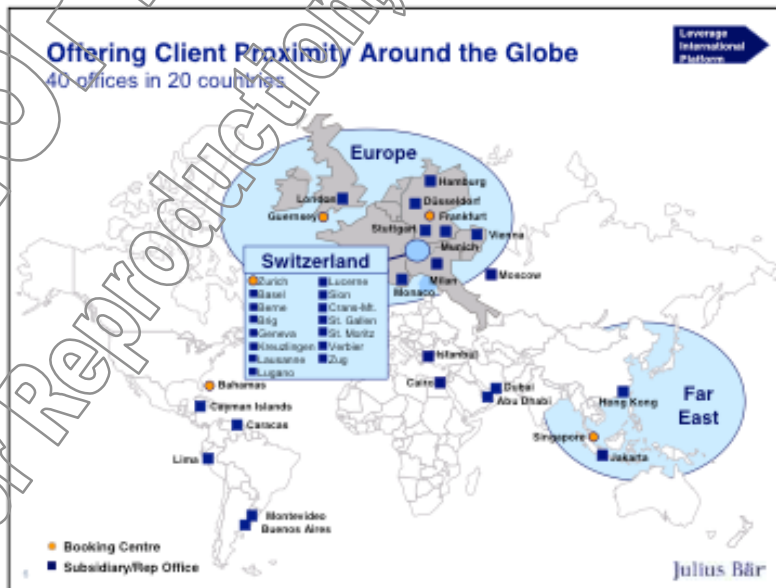


Exhibit 8: Julius Baer worldwide locations

Looking Ahead: Preserving the Past

Raymond Baer believes the company's core principles are exactly the right ingredients for a successful private banking business model for the 21st century. Individuals then and now are attracted to Switzerland's rock-solid stability and Swiss banks' ability to provide privacy and discretion. Net money continues to flow in from low-tax countries such as Russia and the United Arab Emirates, where clients are not concerned about avoiding taxes at home, but stability of their currencies and political regimes. Other clients of Swiss banks fear that if others in their home countries were to know of their wealth, they could become targets of kidnapping or other crimes.¹⁹ Taxes in these countries, Mr. Baer claims, "*are not an issue, and indeed remains very much a European and American topic.*"²⁰ This continued offshore proposition is reinforced by its strong balance sheet and sheer size, which enables it to expand this model into key growth areas. Julius Baer's goal of making Asia its "second home" is tied closely to expected growth rates in its target market of HNWIs, currently at 7.9% annually in the Asia-Pacific region, with approximately 75% of private assets unmanaged.²¹ Raymond Baer believes this new target base differs from its traditional clients, showing greater capacity for risk-taking, stronger equity-orientation, propensity toward leverage, and highly concentrated, as opposed to dispersed, asset bases. Furthermore, according to Mr. Baer, in emerging markets, "*brand is everything, and in the private banking business, you can't copy history.*"²² Julius Baer's strong historical brand equity, and its early presence in Hong Kong in the 1980s, puts it in strong position to fend off imitation or potential entrants.

Julius Baer remains one of the few banks of its size with singular focus and commitment to simplicity in its business model. While it continues to rival other banks in offer of financial engineering knowledge and sophistication of products and services, it sets itself apart by emphasizing its conservatism over innovation, safeguarding over risk-taking, and transparency over complexity. However, Mr. Baer acknowledges the inherent risk in such a singular focus: "*We have the issue of putting all our eggs in one basket. That's good news and bad news. I think investors like it because of our risk profile. If they like it, it's the purest form of being exposed to private banking. On the other hand, it makes it more volatile because you go with the cycles of private banking. On good days it's great, on bad days it's horrible. But you can't have it both ways.*"²³

¹⁹ Craig, Elise. "Is Swiss Banking Dead?" *Business Week* 1 July 2009, Accessed at http://www.businessweek.com/blogs/money_politics/archives/2009/07/is_swiss_bankin.html

²⁰ Interview, Raymond Baer, Zürich, 5 May 2010

²¹ Helvea, "Swiss banking secrecy and taxation: Paradise Lost?" 2009

²² Interview, Raymond Baer, Zürich, 5 May 2010

²³ Interview, Raymond Baer, Zürich, 5 May 2010

This case was made possible through the generous co-operation of Julius Baer Group AG. The case is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of management situations. © Lyndon J. Oh & Christoph Lechner, University of St. Gallen

GLOSSARY

Asset Management: Also called surplus management, the task of managing the funds of a financial institution to accomplish the two goals of a financial institution: (1) to earn an adequate return on funds invested and (2) to maintain a comfortable surplus of assets beyond liabilities.

(<http://www.forbes.com/tools/glossary/glossary.jhtml?letter=a>)

Basis Point: A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

(<http://www.investopedia.com/terms/b/basispoint.asp>)

Bond: A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate. Bonds are used by companies, municipalities, states and U.S. and foreign governments to finance a variety of projects and activities. Bonds are commonly referred to as fixed-income securities and are one of the three main asset classes, along with stocks and cash equivalents.

<http://www.investopedia.com/terms/b/bond.asp>

Brokerage/Broker: An individual who is paid a commission for executing customer orders. Either a floor broker who executes orders on the floor of the exchange, or an upstairs broker who handles retail customers and their orders. Person who acts as an intermediary between a buyer and seller, usually charging a commission. A broker who specializes in stocks, bonds, commodities, or options acts as agent and must be registered with the exchange where the securities are traded.

(<http://www.forbes.com/tools/glossary/glossary.jhtml?letter=b>)

Bull market: A financial market of a group of securities in which prices are rising or are expected to rise. The term "bull market" is most often used to refer to the stock market, but can be applied to anything that is traded, such as bonds, currencies and commodities.

(<http://www.investopedia.com/terms/b/bullmarket.asp>)

Corporate Finance: One of the three areas of the discipline of finance. It deals with the operation of the firm (both the investment decision and the financing decision) from that firm's point of view.

(<http://www.forbes.com/tools/glossary/glossary.jhtml?letter=c>)

Counterparty Risk: The risk to each party of a contract that the counterparty will not live up to its contractual obligations. Counterparty risk as a risk to both parties and should be considered when evaluating a contract. In most financial contracts, counterparty risk is also known as "default risk".

<http://www.investopedia.com/terms/c/counterpartyrisk.asp>

Custody/Custodian: A financial institution that has the legal responsibility for a customer's securities. This implies management as well as safekeeping.

(<http://www.investopedia.com/terms/c/custodian.asp>)

Derivative: A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage.

(<http://www.investopedia.com/terms/d/derivative.asp>)

Hedge Fund: An aggressively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark). Legally, hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid as they often require investors keep their money in the fund for at least one year.

<http://www.investopedia.com/terms/h/hedgefund.asp>

Investment Banking: A specific division of banking related to the creation of capital for other companies. Investment banks underwrite new debt and equity securities for all types of corporations. Investment banks

also provide guidance to issuers regarding the issue and placement of stock.

(<http://www.investopedia.com/terms/i/investment-banking.asp>)

Issuer: A legal entity that develops, registers and sells securities for the purpose of financing its operations. Issuers may be domestic or foreign governments, corporations or investment trusts. Issuers are legally responsible for the obligations of the issue and for reporting financial conditions, material developments and any other operational activities as required by the regulations of their jurisdictions. The most common types of securities issued are common and preferred stocks, bonds, notes, debentures, bills and derivatives.

(<http://www.investopedia.com/terms/i/issuer.asp>)

Mortgage: A debt instrument that is secured by the collateral of specified real estate property and that the borrower is obliged to pay back with a predetermined set of payments. Mortgages are used by individuals and businesses to make large purchases of real estate without paying the entire value of the purchase up front.

(<http://www.investopedia.com/terms/m/mortgage.asp>)

Passporting: European Union single market rule that allow banks in one country to operate as branches in another, with the supervision of solvency and of whole bank liquidity resting with the home country supervisor (<http://www.lexology.com/library/detail.aspx?g=e1efb89b-c395-4a7d-a416-feb6d85e7720>)

Pension Fund: A fund established by an employer to facilitate and organize the investment of employees' retirement funds contributed by the employer and employees. The pension fund is a common asset pool meant to generate stable growth over the long term, and provide pensions for employees when they reach the end of their working years and commence retirement. (<http://www.investopedia.com/terms/p/pensionfund.asp>)

Prime Brokerage: A special group of services that many brokerages give to special clients. The services provided under prime brokering are securities lending, leveraged trade executions, and cash management, among other things. Prime brokerage services are provided by most of the large brokers, such as Goldman Sachs, Paine Webber, and Morgan Stanley Dean Witter. (<http://www.investopedia.com/terms/p/primebrokerage.asp>)

Private Banking: Personalized financial and banking services that are traditionally offered to a bank's rich, high net worth individuals (HNWIs). For wealth management purposes, HNWIs have accrued far more wealth than the average person, and therefore have the means to access a larger variety of conventional and alternative investments. Private banks aim to match such individuals with the most appropriate options. (<http://www.investopedia.com/terms/p/privatebanking.asp>)

Private Equity: Equity capital that is not quoted on a public exchange. Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet. The majority of private equity consists of institutional investors and accredited investors who can commit large

sums of money for long periods of time. Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as an IPO or sale to a public company. (<http://www.investopedia.com/terms/p/privateequity.asp>)

Proprietary Trading: When a firm trades for direct gain instead of commission dollars. Essentially, the firm has decided to profit from the market rather than from commissions from processing trades. (<http://www.investopedia.com/terms/p/proprietarytrading.asp>)

Tier 1 Capital: A term used to describe the capital adequacy of a bank. Tier I capital is core capital, this includes equity capital and disclosed reserves. Established by Bank for International Settlements (BIS) rules on capital adequacy. (<http://www.investopedia.com/terms/t/tier1capital.asp>)

Transaction Banking: Global Transaction Banking (GTB) comprises commercial banking products and services for corporate clients and financial institutions, including domestic and cross-border payments, professional risk mitigation for international trade and the provision of trust, agency, depository, custody and related services. Business units include Cash Management, Trade Finance, Capital Market Sales and Trust & Securities Services. (<http://www.gtbank.com/wms/gbd/index.php?language=2>)

Securities Trading: financial activity involving transactions of property such as stocks, bonds, commodities, and currency (<http://www.encyclopedia.com/doc/1E1-securtrd.html>)

Structured Investment Product (SIP): A type of investment specifically designed to meet an investor's financial needs by customizing the product mix to adhere to the investor's risk tolerance. SIPs are generally created by varying the amount of exposure to risky investments and often include the use of various derivatives. (http://www.investopedia.com/terms/s/structured_investment_products.asp)