



Clarity on Performance of Swiss Private Banks

Further and faster: Radical change needed



University of St. Gallen





New realities for Swiss Private Banks

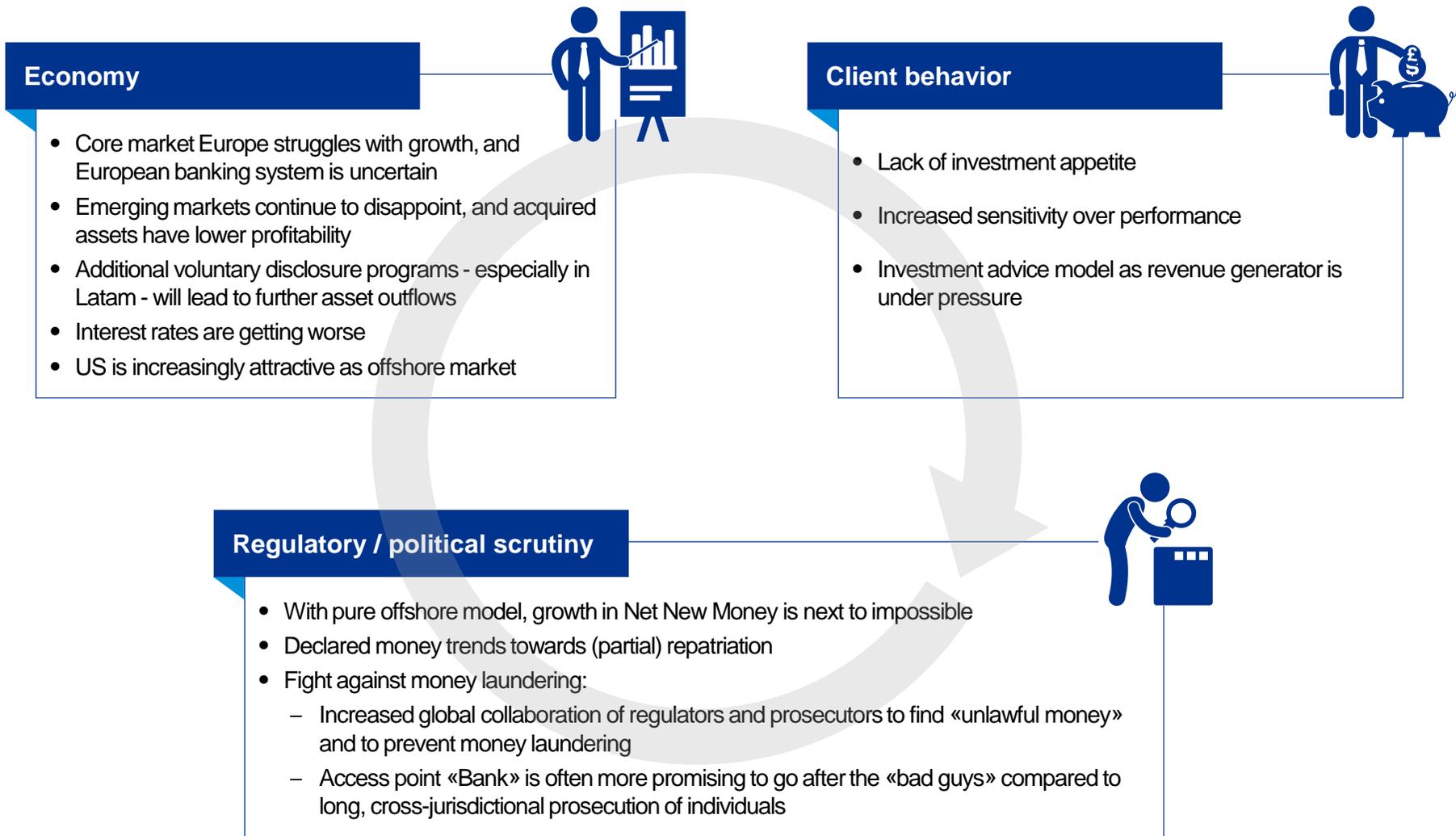
Philipp Rickert

Head of Financial Services and
Member of the Executive Committee

Macro environment did not improve...

	External developments	Response capabilities	
	Such as...	Large private banks	Small private banks
+ ↑	Accelerated wealth creation Asia, US, etc.	<ul style="list-style-type: none"> Build onshore presence Tailor service offerings 	<ul style="list-style-type: none"> Dependent on market access, limited growth prospects
	Equity boom, chase for yield	<ul style="list-style-type: none"> Lombard lending Mortgage products 	<ul style="list-style-type: none"> No lending capabilities
	FX volatility & new currency pair	<ul style="list-style-type: none"> Structured products Trading capabilities 	<ul style="list-style-type: none"> No product and trading capabilities
	Innovation in technology	<ul style="list-style-type: none"> Global reach for talent 	<ul style="list-style-type: none"> Disconnected from innovation
- ↓	Regulatory changes	<ul style="list-style-type: none"> Knowledge and financial resources for rapid adoption & compliance 	<ul style="list-style-type: none"> Risk of failure is threat to capital
	CHF strength	<ul style="list-style-type: none"> Offshore capabilities / presence FX balance revenues and costs 	<ul style="list-style-type: none"> Cost in CHF, revenues in EUR
	Digitalization	<ul style="list-style-type: none"> Significant investments in digital transformation 	<ul style="list-style-type: none"> Lack of financial resources Legacy operating platforms
	Tax transparency	<ul style="list-style-type: none"> Ability to attract tax-compliant money off and onshore, investment capabilities 	<ul style="list-style-type: none"> Unclear whether declared assets return

... on the contrary!





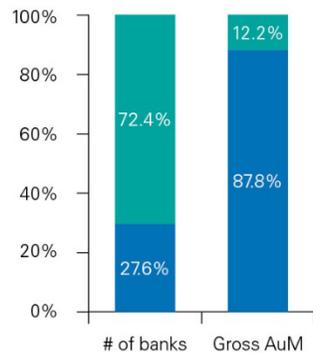
Performance of Swiss Private Banks

Christian Hintermann

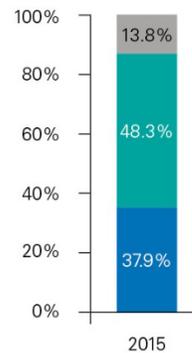
Head of Advisory Financial Services

Methodology and basis

The dataset – Sample Composition



■ Large (AuM > CHF10 billion)
■ Small (AuM < CHF10 billion)



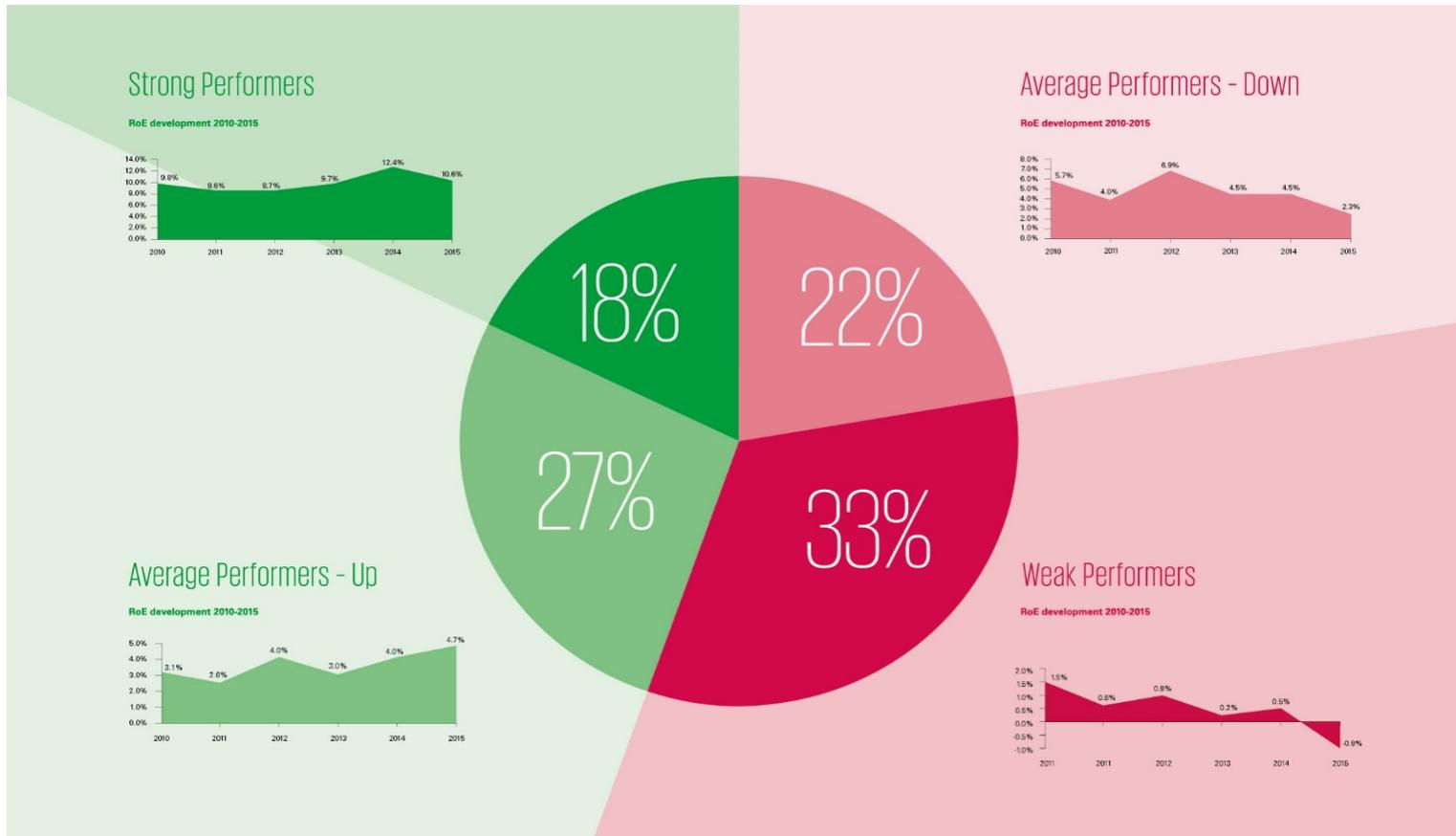
■ Italian-speaking Switzerland
■ German-speaking Switzerland
■ French-speaking Switzerland

- Quantitative analyses based on Private Banking database of KPMG.
- Collaboration with the Institute of Business Administration from the University of St. Gallen (IfB-HSG).



- The study assessed the annual reports of 87 private banks (2015: 91) with AuM totaling CHF1,449 billion and with 24,949 full time employees (UBS and CS not included).
- 72.4% of the 87 banks managed less than CHF10 billion in AuM in 2015. Conversely, a mere 27.6% of banks managed 87.8% of AuM.

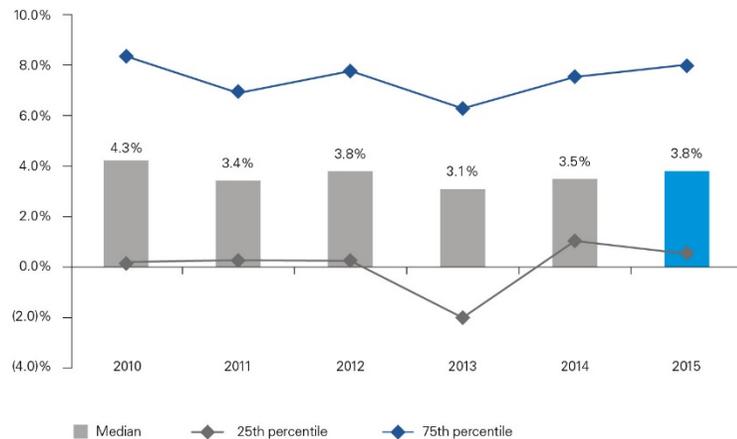
The weak are getting weaker



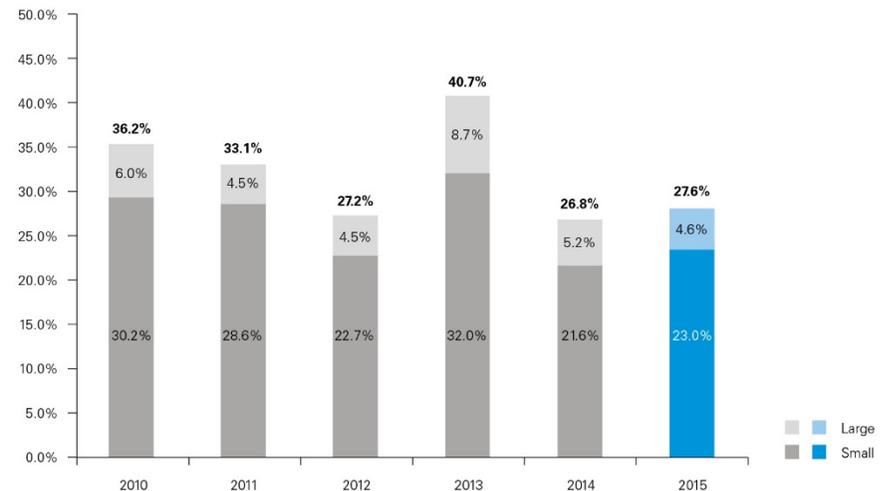
- Banks were clustered into 4 groups (Strong Performers, Average Performers – Up, Average Performers – Down, Weak Performers) based on their performance patterns since 2010 (RoE development, statistical analysis, etc.).
- Despite seven of the weakest performers being sold / liquidate in 2015, the group of the Weak Performers didn't get smaller and their performance got even much weaker.

Two thirds of banks see worsening returns and number of loss-making banks remains high

RoE development 2010 to 2015



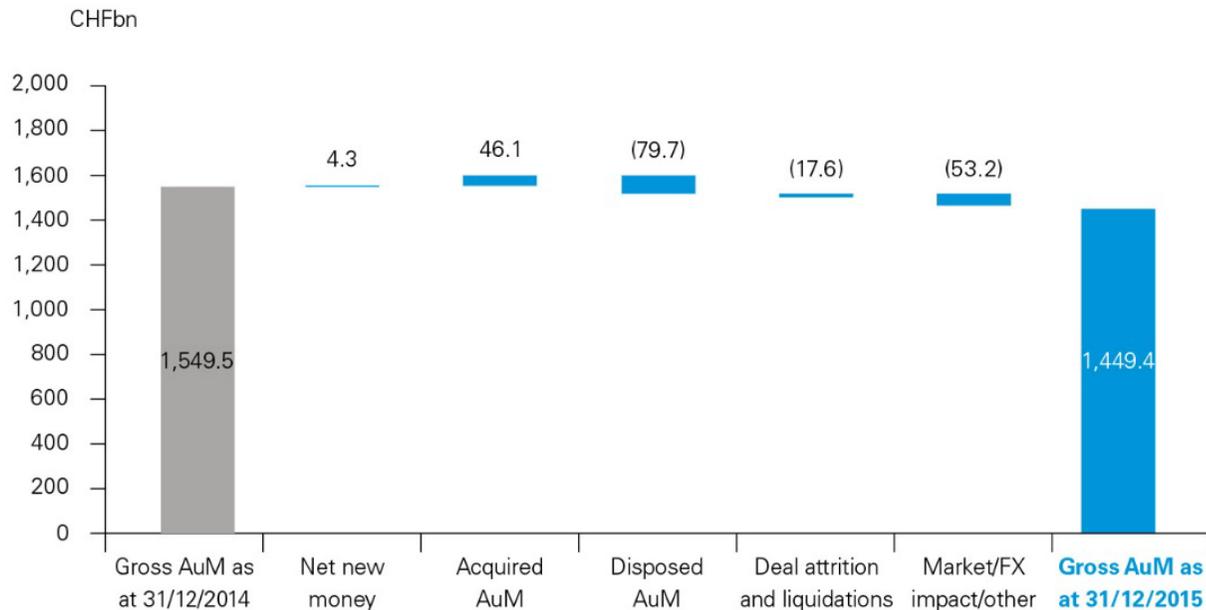
Percentage of loss-making banks 2010 to 2015 (before extraordinary items)



- A slight increase in reported RoE from 3.5% in 2014 to 3.8% in 2015 is largely due to the exclusion of 10 banks that were sold / liquidated in 2015. The median RoE of these 10 banks in 2014 was negative 16.6%.
- RoE in 2015 fell at two-thirds of banks. The one-third that saw an improvement were mostly Average Performers – Up.
- Banks were impacted by the strong Swiss franc, negative interest rates, various voluntary disclosure programs and clients regularizing their fiscal situation ahead of the introduction of the Automatic Exchange of Information.
- Number of loss-making banks remains high: twenty-four banks reported a loss before extraordinary items in 2015.

AuM dropped by CHF100 billion in 2015

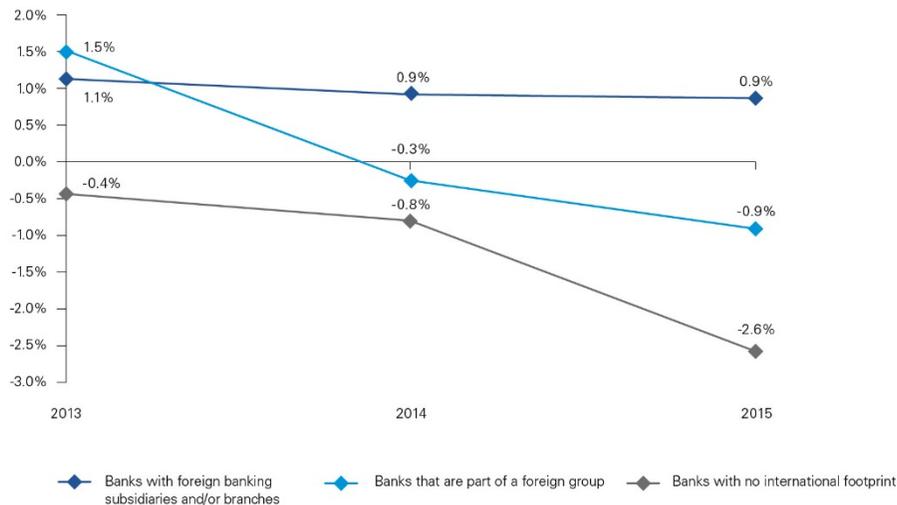
Development of gross AuM, 2014 to 2015



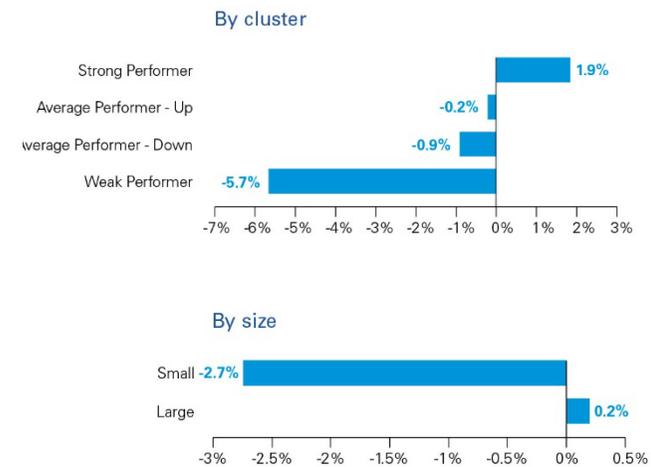
- At CHF4.3 billion (or 0.3% of AuM), 2015 saw the lowest level of NNM generated since 2009.
- Eleven M&A deals representing total AuM of CHF46.1 billion were closed by ten banks in our sample – the effect was to redistribute AuM among our sample rather than introduce fresh AuM.
- While performance helped banks to increase AuM by CHF98.9 billion in 2014, financial markets did not contribute positively to AuM in 2015 for the first time since 2011. AuM decreased by CHF53.2 billion due to negative performance.
- The negative median performance contribution of 3.6% in 2015 was driven by the appreciation of the Swiss franc against the Euro and Pound Sterling and less positive (or even negative) returns in certain asset classes.

N(o) N(ew) M(oney)

NNM contribution to AuM by bank's international footprint

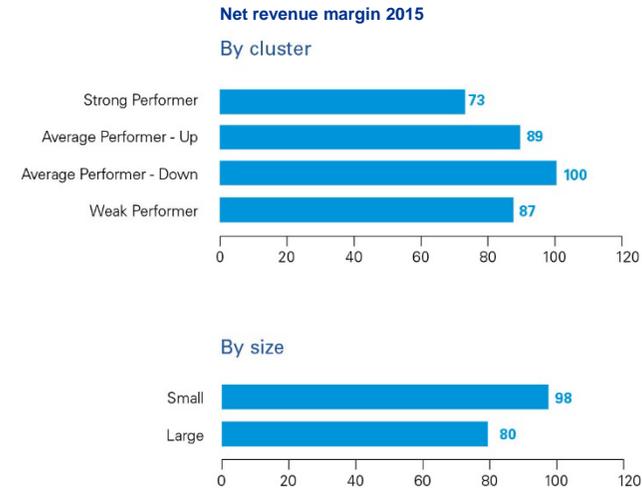
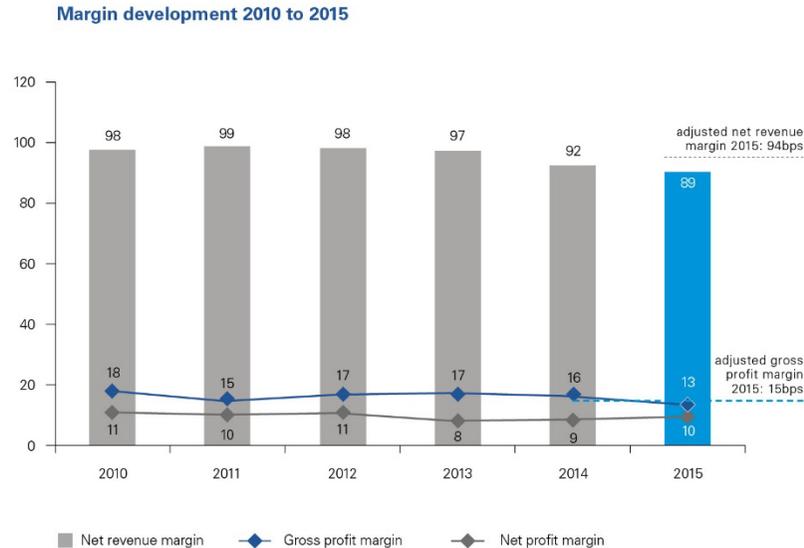


NNM contribution to AuM 2015



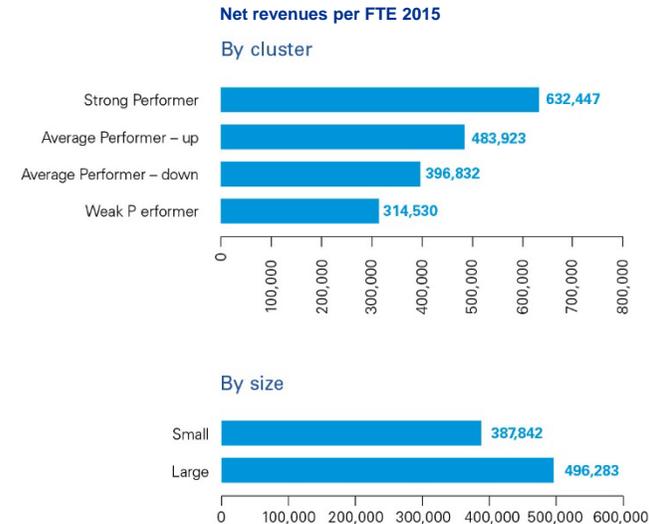
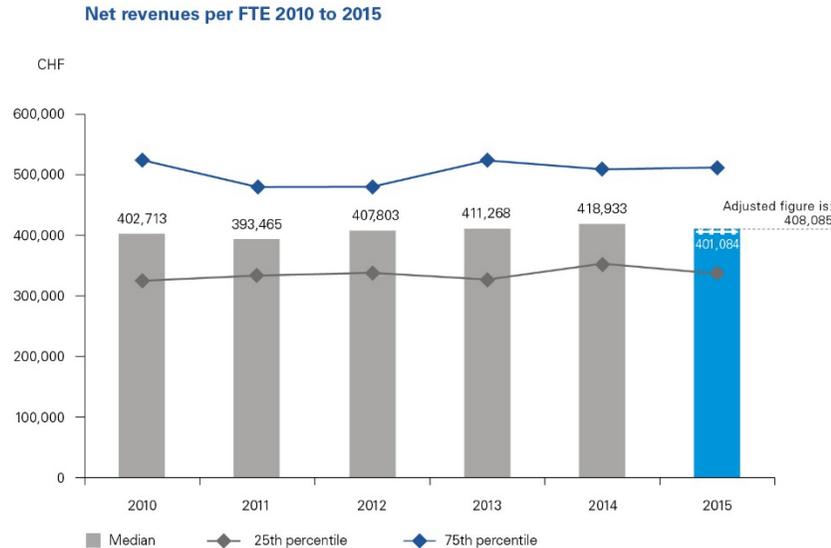
- 2015 generated the lowest NNM in recent years – 54% of banks reported net outflows.
- Banks with one or more banking subsidiaries abroad find it easier to gain new clients.
- Banks with no international presence are losing clients.
- Banks that are part of a foreign group but that have no subsidiary or branch abroad seem to benefit only to a very limited level from intragroup referrals of clients.
- The difference in NNM between Strong Performers and Weak Performers was almost 8 percentage points, at positive 1.9% and negative 5.7% respectively.
- The capability to attract new customers is a key strength that distinguishes Strong Performers.

Stable median net revenue margin masks a fall at 68% of banks



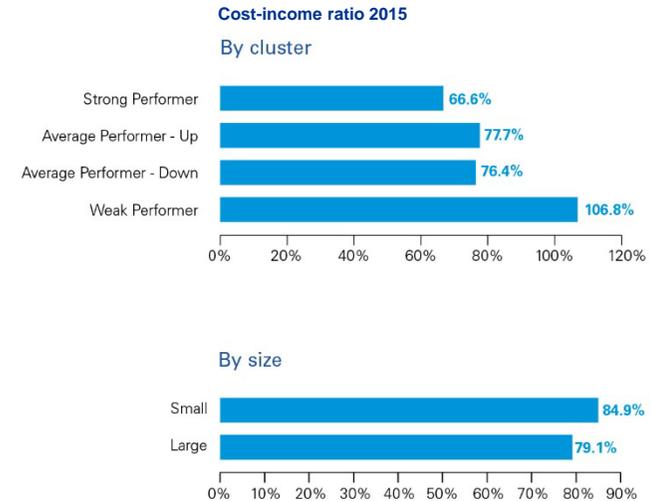
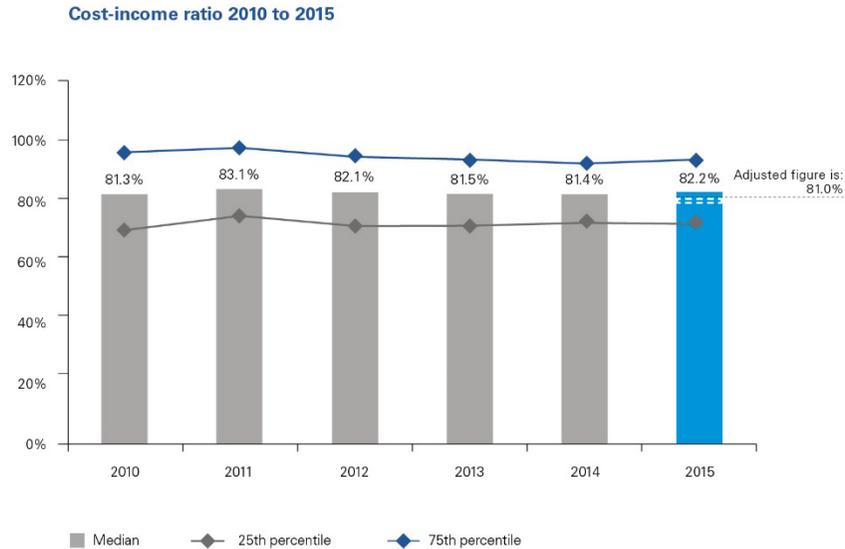
- Sixty-eight percent of banks saw net revenue margins decline, by more than 10 bps at almost one-quarter of banks, mainly due to ongoing pressures on commission margins and the introduction of negative interest rates.
- Banks of our sample paid a total of CHF247 million in negative interest.
- Strong Performers suffered the largest fall in net revenue margins (-22bps since 2010) and generated lower margins than other clusters.

Net revenues per FTE: Strong Performers extend their lead



- Median revenue per FTE fell by 2.6% to CHF408,085 due to a lower CHF-denominated AuM base, a higher number of FTEs and the impact of negative interest rates.
- Median revenue was positively impacted by seven Weak Performers that were sold or liquidated in 2015.
- Strong Performers have widened their lead over Weak Performers by further growing net revenues per FTE (+CHF112,584 since 2014).
- Also, the gap between small and large banks continued to widen in 2015 (plus 3.2% versus minus 4.7%).

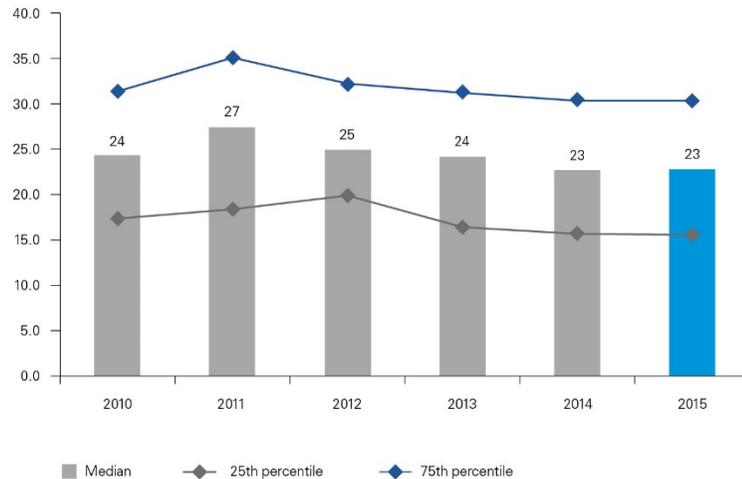
Higher cost-income ratio at two-thirds of the banks



- Declining revenues were largely responsible for the median cost-income ratio rising by 1.3 percentage points in 2015 on a constant sample basis.
- Weak Performers were the most affected, with the median cost-income ratio rising by 9.5 percentage points in 2015 due to higher total operating costs and lower revenues.
- Strong Performers have meanwhile improved their cost-income ratio over the past five years by 7.8 percentage points.
- Unless banks get a handle on employee numbers and personnel costs per head, the cost-income ratio will not improve.

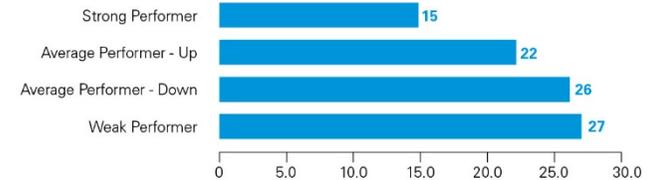
Number of FTEs to serve CHF1 billion of AuM remain stable

Number of FTEs to serve CHF1 billion in AuM 2010 to 2015

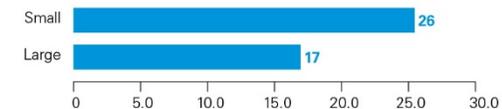


Number of FTEs to serve CHF1 billion in AuM 2015

By cluster



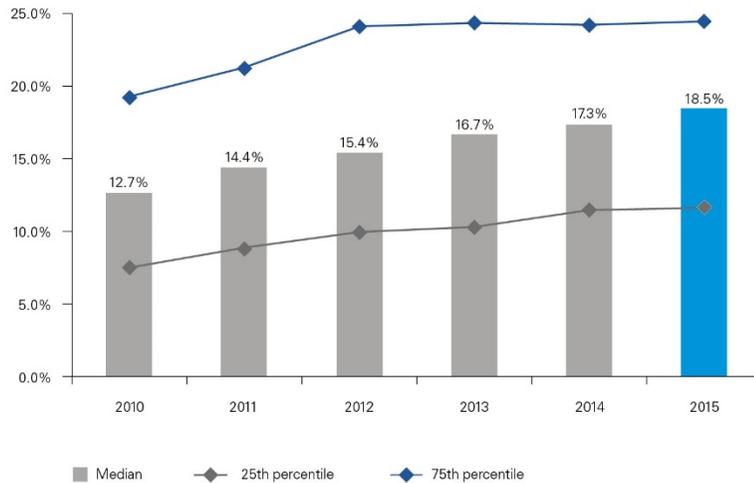
By size



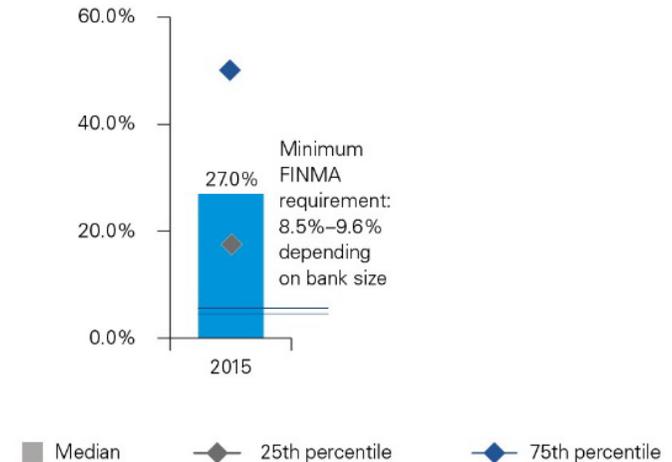
- An average of 23 FTEs is employed to serve CHF1 billion of AuM. This ranges from 15 FTEs at Strong Performers to 27 FTEs at Weak Performers.
- Strong Performers improved productivity over the past five years, as illustrated by fewer FTEs per CHF1 billion of AuM (-21%) and higher revenues per FTE (+22%).
- The median number of FTEs per bank grew slightly and average personnel expenses per stayed the same at CHF219,000.

Balance sheet: Private banking clients holding cash

Customer deposits as a percentage of net AuM 2010 to 2015



Tier 1 capital ratio

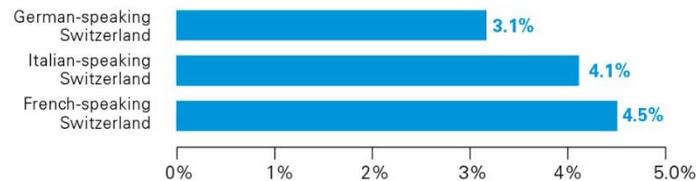


- Risk adverse clients are holding a greater proportion of their wealth in cash than at any time in the past 10 years, causing a reduction in banks' earnings potential.
- Banks have withdrawn liquidity from SNB following its introduction of negative interest rates. Liquid assets as a percentage of total balance sheet fell by three percentage points.
- Most banks have maintained comfortable regulatory ratios with regard to minimum capital requirements.

Regional perspective

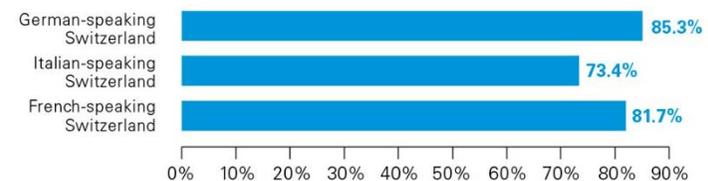
RoE 2015

By location



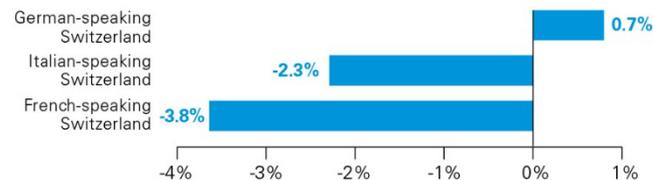
Cost-income ratio 2015

By location



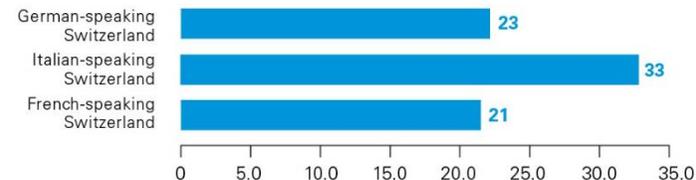
NNM contribution to AuM 2015

By location



Number of FTEs to serve CHF1 billion in AuM 2015

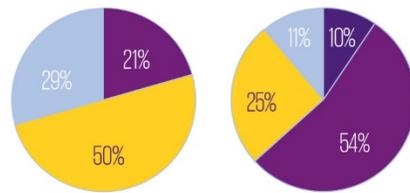
By location



- Banks based in French-speaking Switzerland reported median net outflows of 3.8% in 2015 – a full 4.5 percentage points worse than banks based in German-speaking Switzerland.
- Banks based in Italian-speaking Switzerland have much more employees however personnel costs per FTE are at CHF175,214 compared to approx. CHF230,000 in the other regions.
- Banks based in Italian-speaking Switzerland have a lower cost-income ratio mainly due to a much higher revenue margin and in many cases lower IT costs due to a high share of old generation banking platforms.

Operating model: Lack of investment to impact future success

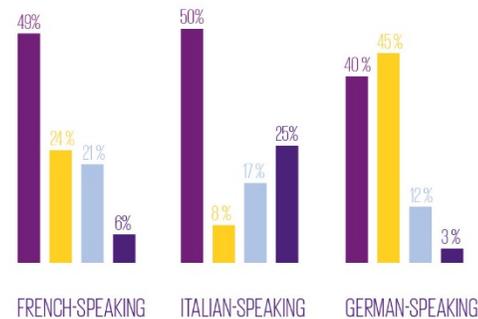
Core banking system category by bank size



LARGE

SMALL

Core banking system category by bank location



FRENCH-SPEAKING

ITALIAN-SPEAKING

GERMAN-SPEAKING

Sourcing mode by bank size



LARGE

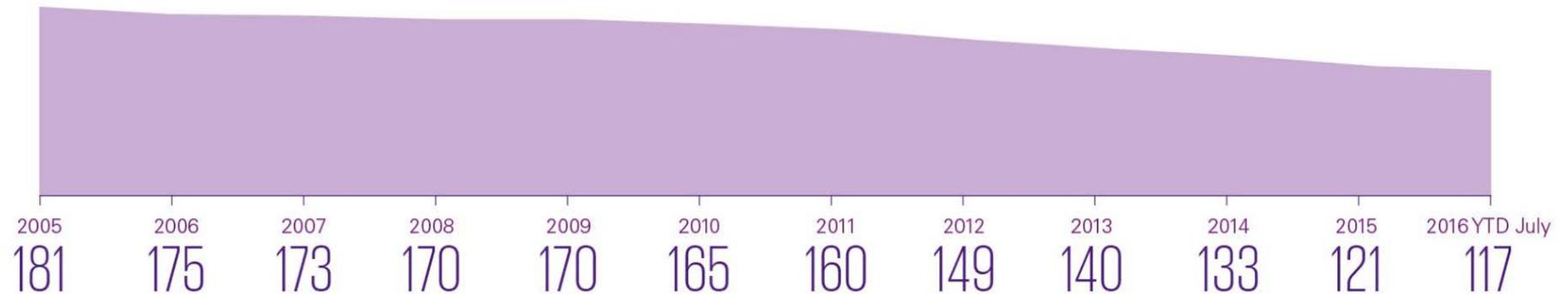
SMALL

■ old generation/renovated packages
 ■ new generation packages
 ■ bespoke
 ■ old generation/not supported packages

- Only Half of large banks and one-quarter of small banks run a 'new generation core banking system'.
- 45% of banks based in German-speaking Switzerland are on new generation IT core banking systems, compared with 24% of banks based in French-speaking Switzerland and 8% of banks based in Ticino.
- Running costs of older core systems are 25% lower than new systems based on our analysis - but older systems restrict a bank's ability to respond to evolving client needs and develop digital banking.
- Outsourcing Application Services (ASP) and/or Business Services (BSP) operations delivers visible efficiency gains - average cost-income ratios in 2015 were six percentage points lower at small banks that outsource these activities, and they needed 14% fewer FTEs per CHF 1 billion of AuM.

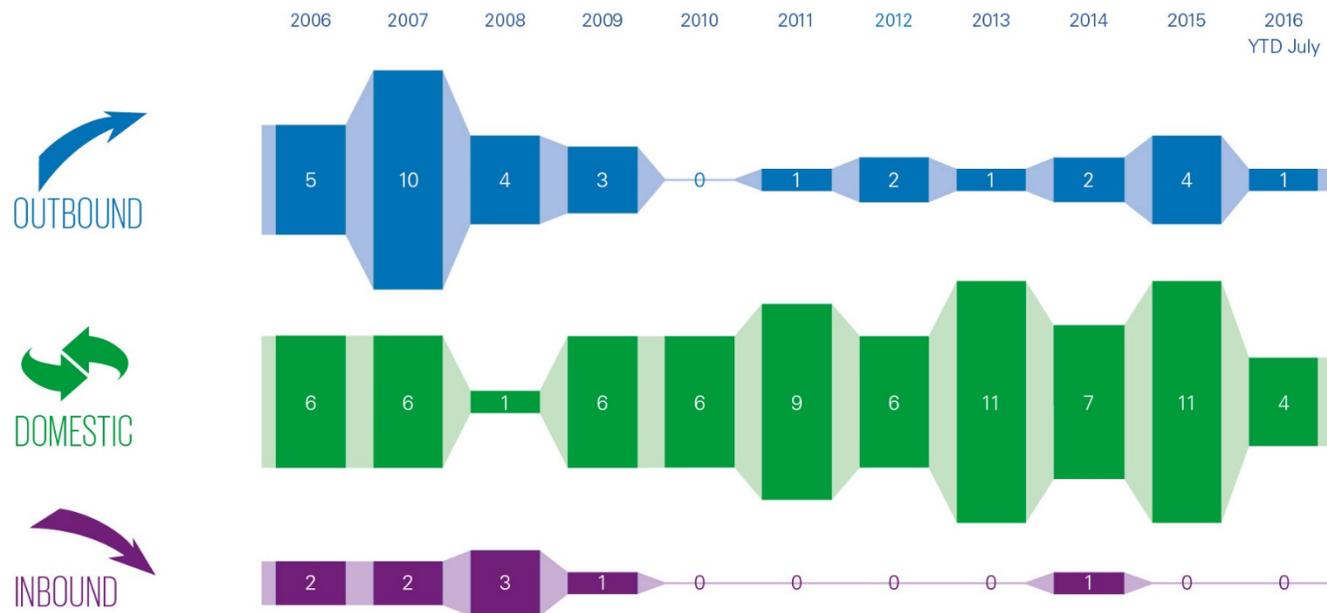
One year later, one in ten private banks fewer

Number of Private Banks in Switzerland



- A 10% fall in the number of Swiss private banks in 2015 delivered further on our prediction last year that the number of players will contract by 30% over the next few years.
- More radical change is needed to business and operating models before the industry can declare itself fit and well again.
- As many players lack the resources to successfully implement the necessary changes, consolidation will continue. We are expecting a reduction below 100 private banks in the next two years.

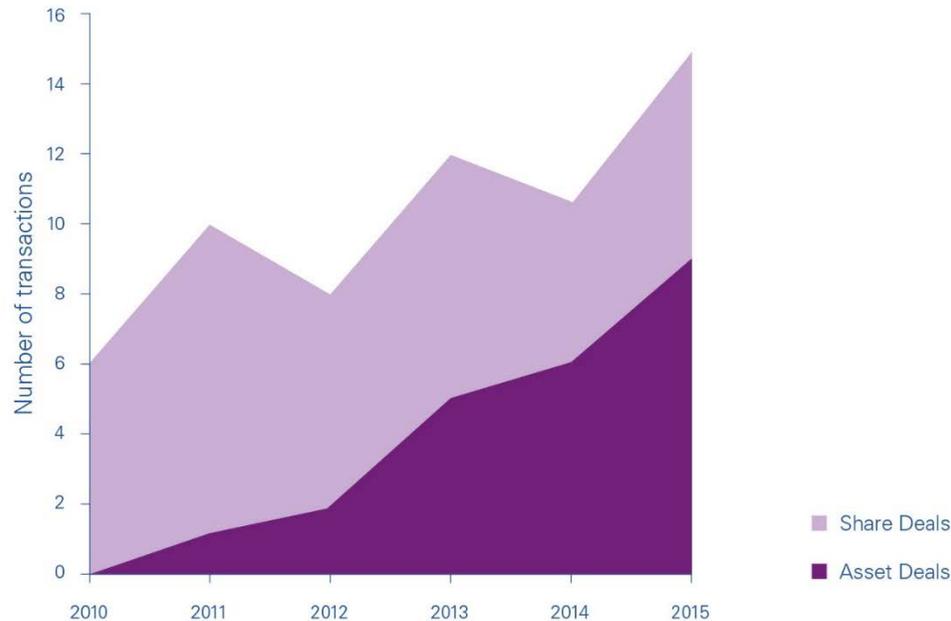
Reaching new heights: M&A peaks as consolidation intensifies



- Deal numbers were driven by the disposal of banks that have performed poorly in recent years and that lacked scale.
- Most deals were between Swiss-based players driven by economies of scale and significant synergy potential. Large Swiss banks also expanded abroad to add scale in local markets and improve capabilities for acquiring new clients.
- Foreign banks continued to exit the Swiss market as part of reviews of their global footprint. This included selling the Swiss operations of Coutts International and Royal Bank of Canada.

Proportion of asset deals increasing as buyers try to limit legacy risks

Asset deals vs. Share Deals transactions



- 60% of transactions were asset deals; the highest proportion in the past 10 years. This reflects buyers' caution about potential legacy risks and reluctance to buy the legal entity.
- We also observe a rise in the number of (often undisclosed) asset deals arising from a need to focus on fewer markets. Such deals enable vendors to divest non-core portfolios and focus firmly on core markets and client segments.

Key Messages

- **One year later, one in ten private banks fewer**

With 10% fewer Swiss private banks at the end of 2015 than at the start of the year, industry consolidation continues. More foreign banks exited the Swiss market while poorer performing banks decided to sell up or close their doors. Our prediction from last year that the industry would consolidate by 30% in the next few years is further validated.

- **Two-thirds of banks see worsening returns**

RoE declined at two-thirds of banks in 2015 as the industry proved unable to turn around its fortunes. In fact, only six banks have managed to continuously improve their RoE over the past three years.

- **Urgent need for change as cost-income ratios rise**

Weak Performers saw their cost-income ratios rise by almost 10 percentage points in 2015, but they are not alone. Driven by lower revenues, cost-income ratios are up at two-thirds of banks. This reinforces the urgent need to conduct reviews of value chains and focus on core activities (while outsourcing non-core activities) as part of longer-term cost management efforts.

- **No interest in banking**

A fall in net revenue margins at two-thirds of banks was driven by a strong Swiss franc, challenging markets and negative interest rates. All of these factors put even greater pressure on poorly performing banks.

Key Messages (continued)

- **N(o) N(ew) M(oney)**

A CHF100 billion fall in AuM in 2015 reflected negative market conditions and a severe lack of NNM into Swiss private banks. Strong Performers struggled, but outpaced Weak Performers by almost 8 percentage points.

- **In search of growth**

In the pursuit of scale and synergies, banks acquired targets both in Switzerland and abroad. Those that completed significant acquisitions saw their cost-income ratios fall by an average of 1.9 percentage points. Banks with a banking subsidiary or branch abroad were more able to attract NNM, though still at relatively low levels.

- **Will the weak survive?**

Seven Weak Performers disappeared in 2015, but were rapidly replaced in this cluster by banks with deteriorating performances. After extremely negative developments in 2015, the ability of this group to survive is brought further into question.

- **Lack of investment to impact future success**

With only one-quarter of small banks and one-half of large banks running new generation IT core banking systems, many will be unable to adapt quickly enough to evolving client needs and digital banking. Those that cannot afford newer systems should urgently consider core banking system substitution in outsourcing mode to tap into external expertise and ensure they are fit for purpose.



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