

# Clarity on Performance of Swiss Private Banks



**Media Conference, 7 September 2017**

# Schedule

## Welcome and introduction

Andreas Hammer  
Head of Corporate Communications, KPMG

## Swiss Private Banking Environment

Philipp Rickert  
Head of Financial Services & Member of the Executive Committee, KPMG

## Performance of Swiss Private Banks

Christian Hintermann  
Head of Advisory Financial Services, KPMG

## Questions and discussion

## Lunch



# Swiss Private Banking Environment

**Philipp Rickert**

Head of Financial Services & Member of the Executive Committee

# Environment - 2016 development and recent 2017 trends

Environment	2016 development	2017 trend
Client segmentation	<ul style="list-style-type: none"> <li>Redefined core and aggressive purging of non-core client segments</li> </ul>	<ul style="list-style-type: none"> <li>Continued implementation of segmentation strategies to enable future growth</li> </ul>
Innovation in technology: Digitalization & Robotics	<ul style="list-style-type: none"> <li>Invested in new systems to facilitate utilisation of new technologies</li> </ul>	<ul style="list-style-type: none"> <li>Acceleration up the technology curve</li> <li>Increased spend by big houses</li> </ul>
Regulatory change	<ul style="list-style-type: none"> <li>Regulatory stability</li> </ul>	<ul style="list-style-type: none"> <li>Focus on regulatory implementation</li> <li>Basel IV uncertainties continue</li> </ul>
Tax transparency	<ul style="list-style-type: none"> <li>Accepted AEoI as the global standard</li> <li>AEoI implemented for 1.1.17 roll-out</li> <li>NL group request accepted by CH court</li> </ul>	<ul style="list-style-type: none"> <li>42 further countries to enter AEoI with CH in 2018</li> </ul>
FX markets	<ul style="list-style-type: none"> <li>GBP depreciation vs. CHF from Brexit</li> </ul>	<ul style="list-style-type: none"> <li>EUR appreciation vs. CHF</li> </ul>
Interest rate markets	<ul style="list-style-type: none"> <li>25bp Fed rate increase in Dec 2015</li> </ul>	<ul style="list-style-type: none"> <li>75bp Fed rate increase Dec 16 - Jun 17</li> <li>Momentum swinging to global increase</li> </ul>
Equity markets	<ul style="list-style-type: none"> <li>Improved towards year-end</li> </ul>	<ul style="list-style-type: none"> <li>Equity markets continue to climb</li> </ul>

**Improved markets, decreased regulatory uncertainty and an acceptance that the “new normal” is now the “current reality” bode well for the industry; however, it remains to be seen where the rapid advancements in technology will take the Swiss private banking industry.**



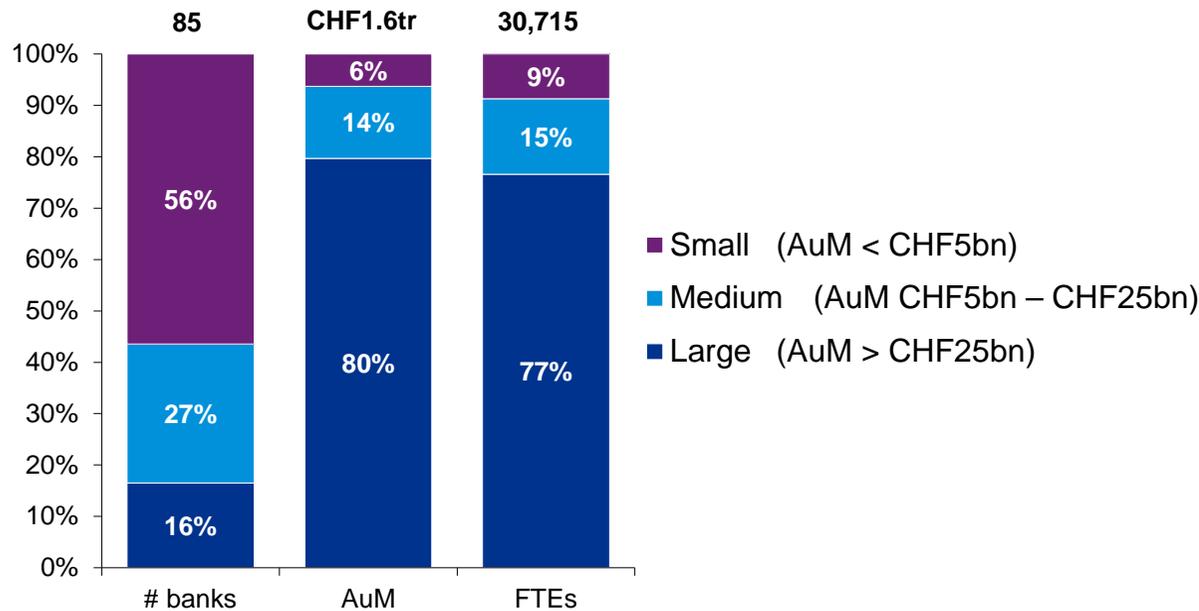
# Performance of Swiss Private Banks

**Christian Hintermann**

Head of Advisory Financial Services

# Basis of preparation and methodology

## Constant-sample dataset – by size

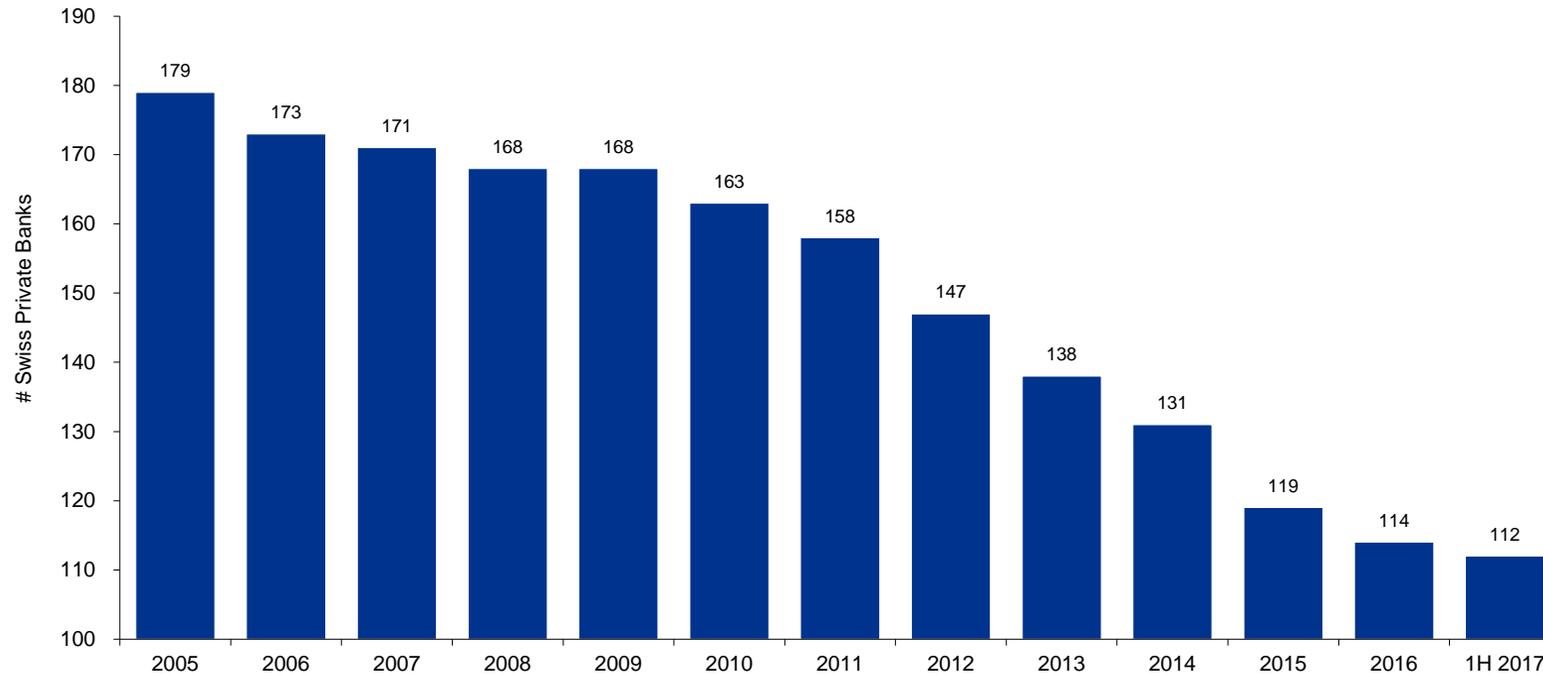


- Annual reports of our 85-bank constant-sample (ie, the “survivors”) analysed over the past seven years.
- 75% coverage (85/114 private banks at 31 December 2016)
- Total AuM: CHF1.6 trillion at 31 December 2016
- Excludes UBS and CS and banks for which we do not have annual financial statements over the past seven years.
- Quantitative analyses leverages KPMG’s Private Banking database.
- Terms and KPI calculations are set out in our detailed report.
- In collaboration with the Institute of Business Administration from the University of St. Gallen (HSG)



# Consolidation slowdown as less exits of Swiss private banks

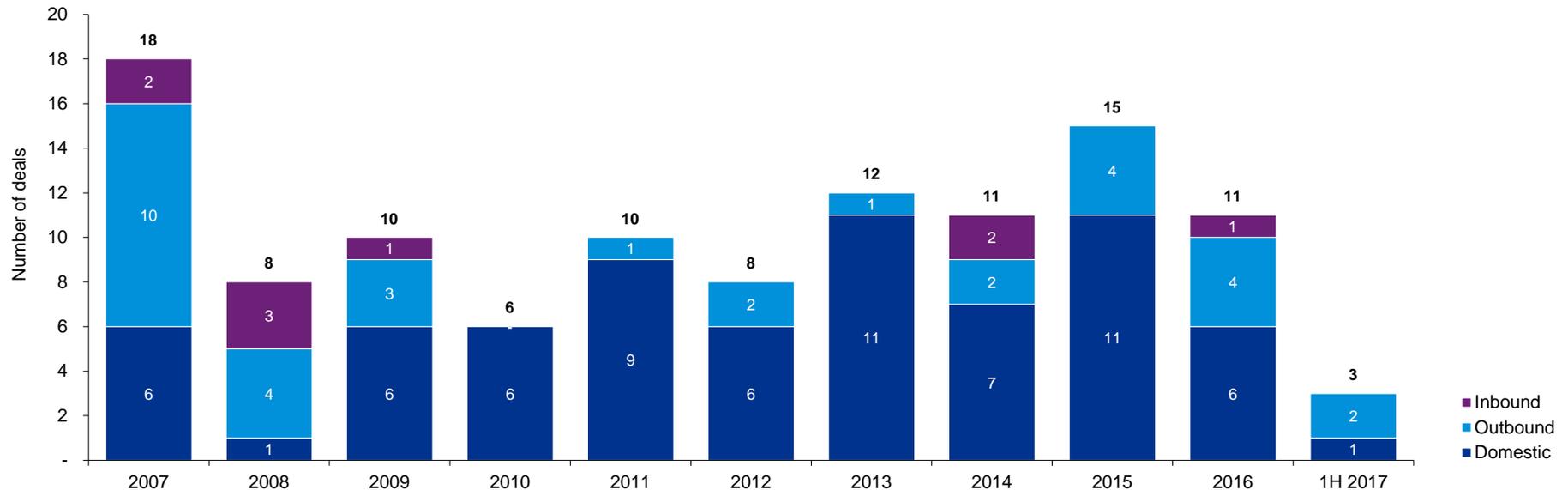
Number of Swiss private banks, 2005 to 1H 2017



- Drivers of slowdown in consolidation: large consolidator banks are no longer interested in small deals in Switzerland, buyers have narrow target criteria and have less appetite for restructuring assets post acquisition, owners are reluctant to sell at sub-optimal deal terms, and fewer banks available.

# Consolidation deals surprisingly slowed in 2016 - 1H 2017

Number of announced deals (buyer or target is a Swiss private bank), 2007 to 1H 2017



- 2016 – 1H 2017 M&A reduction was driven by a lower number of take-overs of private banks by other private banks. This came down from nine in 2015 to two in 2016 (biggest was EFG's acquisition of BSI) and the trend continued in 1H 2017 with zero.
- Continued trend of banks seeking to reinforce their onshore presence, particularly in Europe to be able to approach prospective clients.
- One of the rare inbound deals with Banque Havilland Lux acquiring Banque Pasche in Geneva.
- Increase in deal activity in July and August with 5 announced deals, one of them being a consolidation deal between two private banks in Ticino.

# Industry financial statements (new analysis) - 85-bank constant-sample

Constant sample financial statements – 85 banks						
CHFm	2010	2015	2016	'16 vs. '10	'16 vs. '15	
Net interest income	3,356	2,645	3,035	(9.6)% ▼	14.7% ▲	
Net commission income	7,193	7,568	7,281	1.2% ▲	(3.8)% ▼	
Net trading income	1,599	1,790	1,756	9.8% ▲	(1.9)% ▼	
Net ordinary income	(18)	715	825	<i>n.m.</i> ▲	15.3% ▲	
Operating income	12,131	12,719	12,897	6.3% ▲	1.4% ▲	
Operating expenses	(8,824)	(9,668)	(9,912)	12.3% ▲	2.5% ▲	
Gross profit	3,307	3,050	2,985	(9.7)% ▼	(2.1)% ▼	
Non-operating result (including tax)	(1,696)	(2,309)	(1,208)	(28.8)% ▼	(47.7)% ▼	
<b>Net profit</b>	<b>1,611</b>	<b>741</b>	<b>1,777</b>	<b>10.3%</b> ▲	<b>139.7%</b> ▲	
<b>Other key data (year-end)</b>						
AuM (CHFbn)	1,189	1,555	1,635	37.5% ▲	5.1% ▲	
FTEs	26,392	28,194	30,715	16.4% ▲	8.9% ▲	

## 2016 vs. 2010

- Surviving banks' AuM grew by 38% over the past six years, while profit stagnated.
- 38% AuM growth driven by M&A activity at large consolidator banks. Overall industry AuM growth, however, remained flat as the M&A activity was effectively a redistribution from other market participants who were acquired.
- Profitability developed at a lower level than AuM.
  - Gross profit fell by 10%: falling operating income margins brought slower operating income growth than operating expenses.
  - Net profit grew by 10%: driven by one-off items.

## 2016 vs. 2015

- Net profit increased by 140% from negative one-offs in 2015 (mainly fines) and positive one-off gains in 2016.
- Net interest income grew by 15% from higher US interest rates and loan volumes.

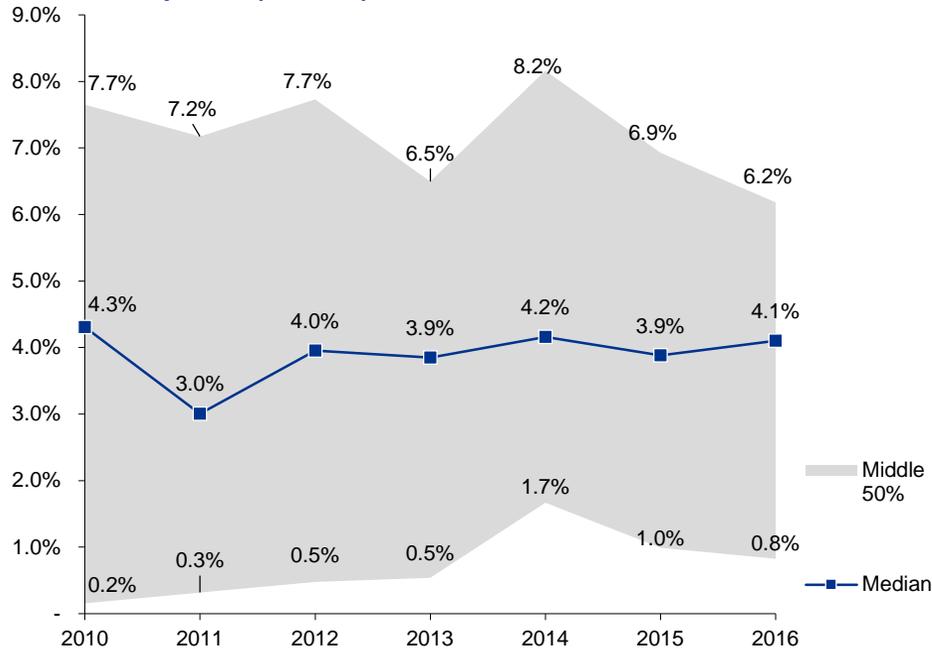
# Industry financial statements - 93-bank constant-sample

<b>Constant sample financial statements – 93 banks</b>			
<b>CHFm</b>	<b>2015</b>	<b>2016</b>	<b>'16 vs. '15</b>
Operating income	16,443	16,642	1.2% ▲
Operating expenses	(12,531)	(12,795)	2.1% ▲
Gross profit	3,912	3,847	(1.7)% ▼
<b>Net profit</b>	<b>1,453</b>	<b>2,378</b>	<b>63.7%</b> ▲
AuM (CHFbn) (year-end)	2,323	2,435	4.8% ▲
FTEs (year-end)	35,448	38,360	8.2% ▲

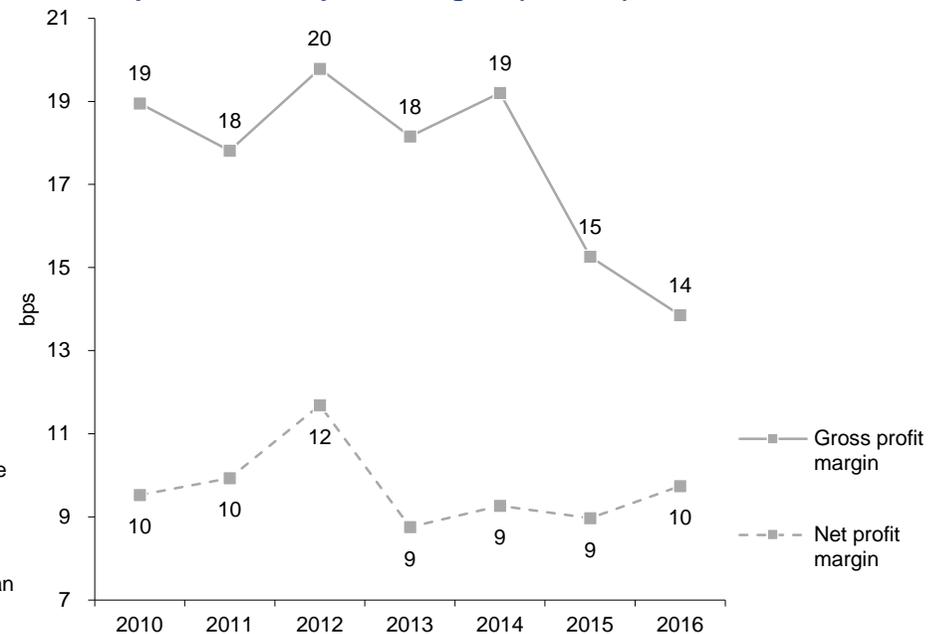
- For the past three years, we have financial data covering eight more banks which take the total banks in our constant sample to 93. These banks include certain large Geneva based Banque Privées that were converted to AGs in 2014.
- As this sample includes those large Banque Privées, the combined size including the eight additional banks is significant.
- However, the general trends and median figures are similar to those from our 85-bank constant sample.

# Median RoE has remained at around 4% for the past five years

**RoE development (median), 2010 to 2016**



**Gross profit and net profit margins (median), 2010 to 2016**



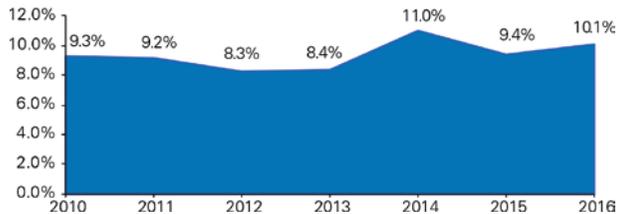
- With banks' cost of capital estimated at 7% to 10%, shareholders' value is being diluted at most banks.
- 26% of banks incurred losses before extraordinary in 2016
- Swiss private banks hold higher capital than required by the regulations. Reducing their capital levels to 3% above their minimum capital adequacy ratio requirement would have increased median RoE from 4% to around 6% in 2016.

- Despite falling gross profit margins in the last two years, net profit levels have remained stable thanks to one-off gains that are not expected to continue in the long term.

# The Lower Mid cluster outnumbered the Weak cluster in 2016

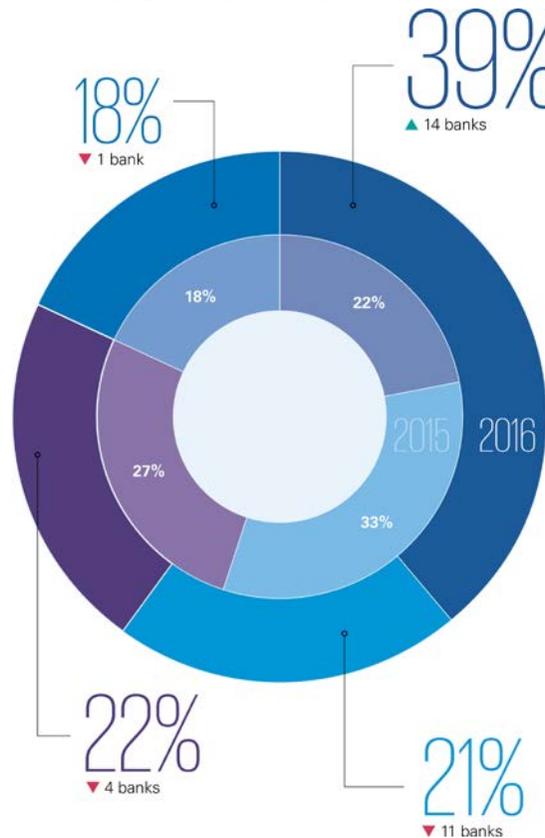
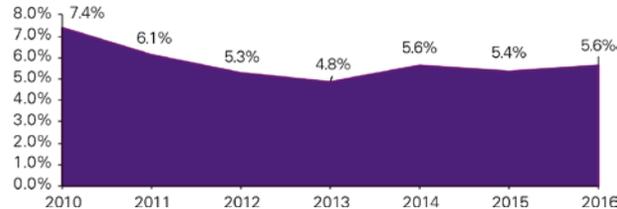
## Strong Performers

RoE development, 2010-2016



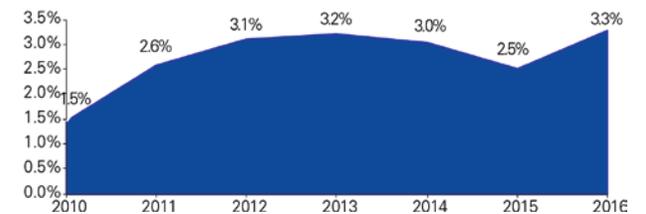
## Upper Mid Performers

RoE development, 2010-2016



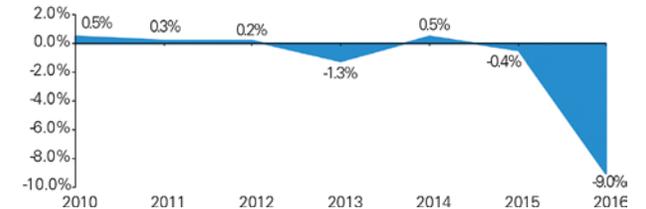
## Lower Mid Performers

RoE development, 2010-2016



## Weak Performers

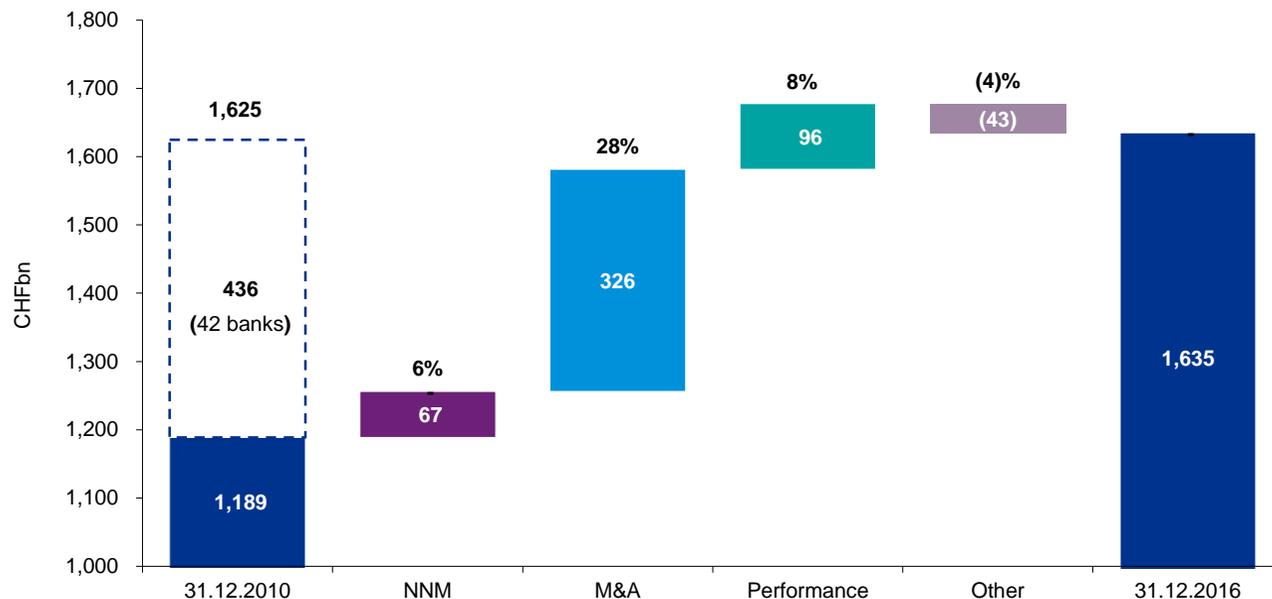
RoE development, 2010-2016



- Performance cluster criteria changed slightly – now based on solely on underlying RoE levels over the past few years.
- Lower Mid replaced Weak as the largest cluster in 2016 due to worsening performances at many Upper Mid banks, and some Weak banks either improving or exiting the market.
- Almost 50% of the Strong are small banks that developed a clear and focused niche strategy many years ago and continue to implement it successfully.

# AuM Movement

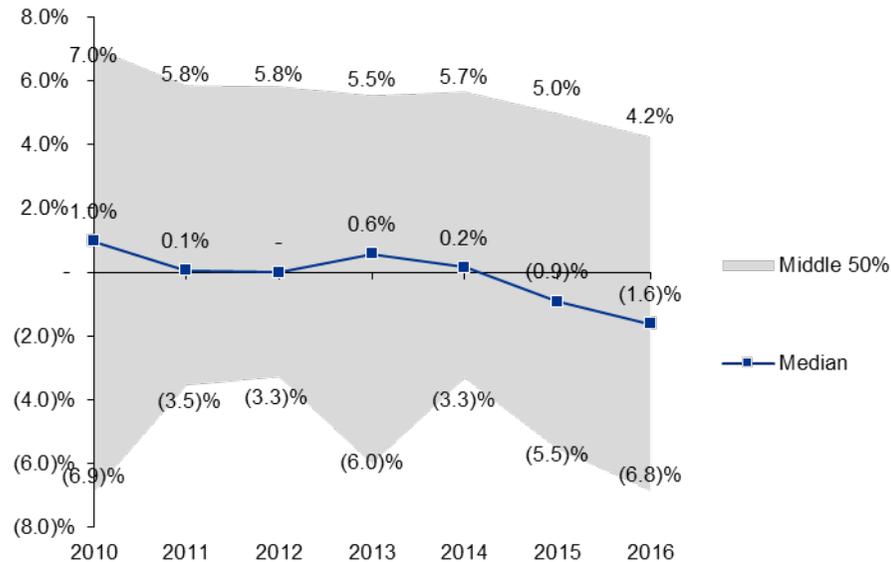
## AuM development (aggregate), 2010 to 2016



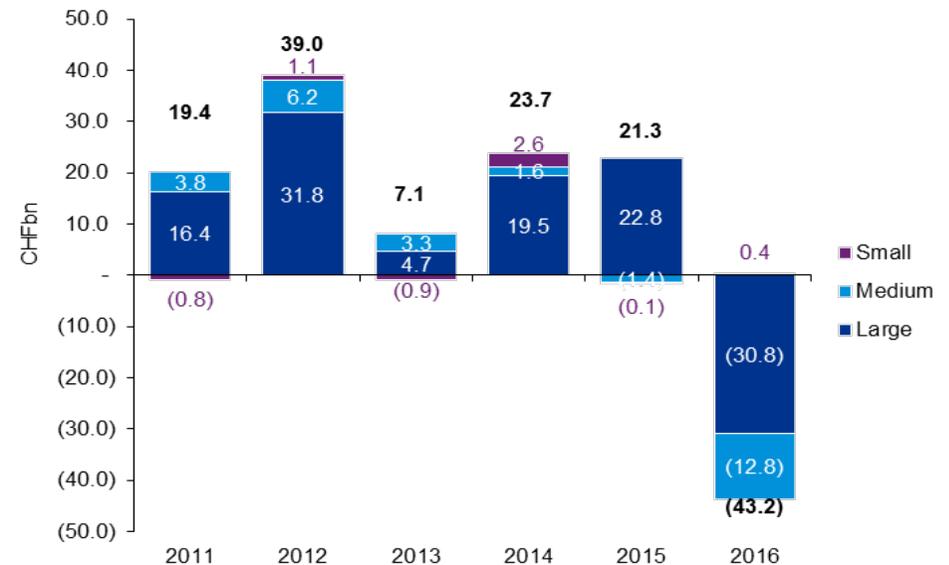
- 38% AuM growth in the constant-sample was driven by M&A activity at large consolidator banks. Overall industry AuM growth, however, remained flat as the M&A activity was effectively a redistribution from around 42 market participants that were acquired.
- Four large consolidator banks were responsible for almost 90% of the M&A growth over the period.
- The second largest contributor of AuM growth was banks' performances.
- Organic growth (NNM) generated only limited AuM. Banks struggled to attract new clients and offset out the outflows that occurred during the period.

# Median NNM growth hit a low in 2016; in aggregate, outflows of CHF43bn

NNM growth development (median), 2011 to 2016



NNM development (aggregate), 2011 to 2016

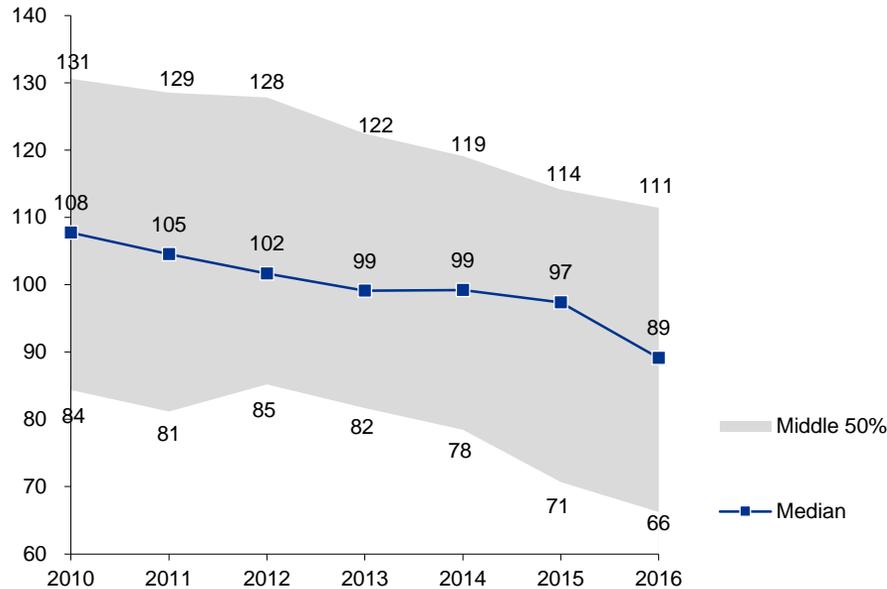


- Median NNM growth has been near zero for the last several years. It entered negative territory in 2015 and fell further in 2016 to the worst level in the past seven years.
- Fifty-six percent of constant sample banks experienced net outflows.

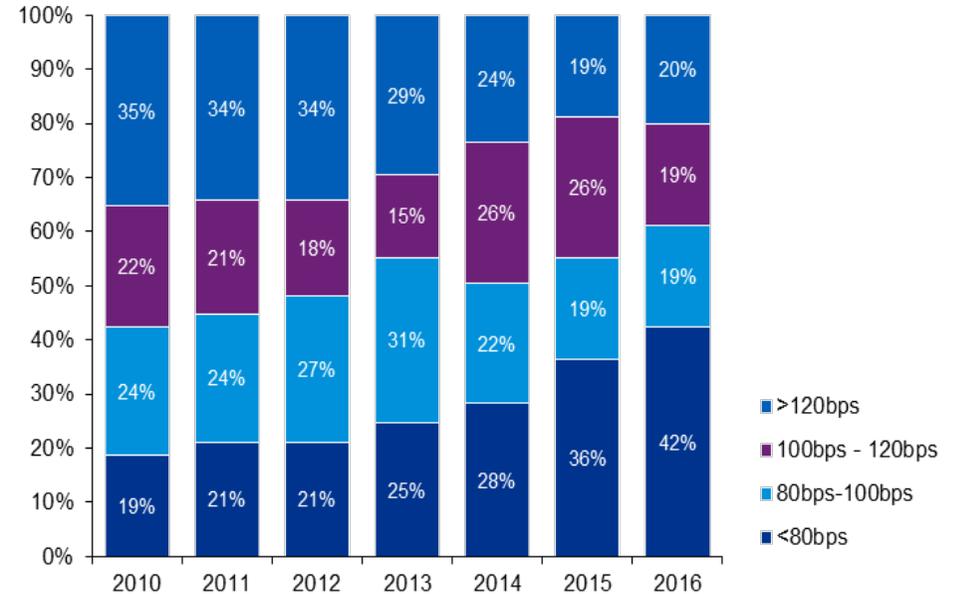
- The overall loss of CHF43 billion in 2016, or 3% of AuM, was the worst NNM result in the past seven years.
- Reason was mainly large and medium-sized banks exiting non-core markets and client segments. This refocus was likely to have been accelerated by the AEoI, coming into effect at the beginning of 2017.

# Operating income margin hits new low...

Operating income margin development (median), 2010 to 2016



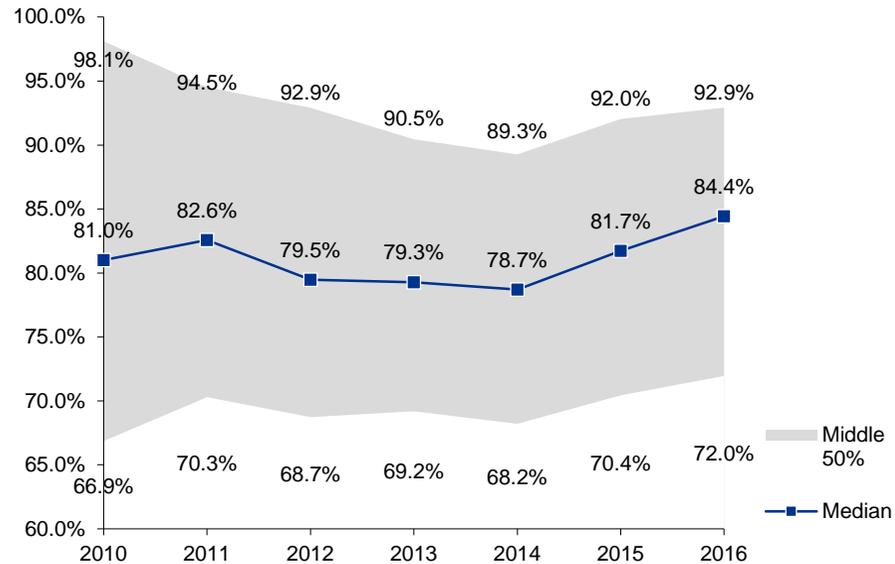
Proportion of constant-sample banks by operating income margin band (%), 2010 to 2016



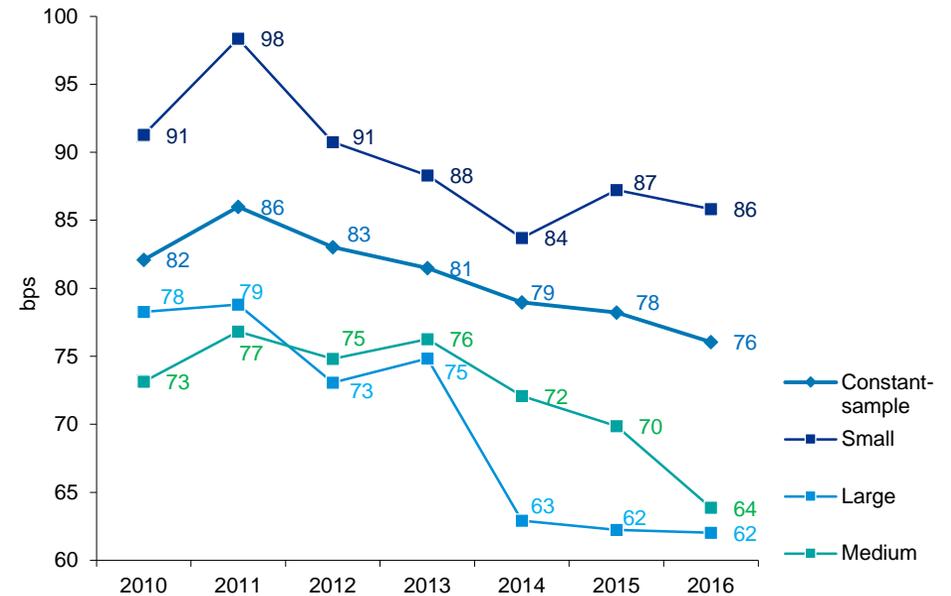
- Median operating income margin reached a new low of 89bps over the past seven years from: lower proportion of undeclared money, stiffer competition, lower/negative interest rates and more demanding clients.
- The proportion of banks with operating income margins >120bps fell from 35% to 20%; those below 80bps increased from 19% to 42%.
- The 9bp decline in 2016 was driven mainly by net commission income.

# ...while cost-income ratio reaches a new high

Cost-income ratio development (median), 2011 to 2016



Operating expenses margin development (median), 2011 to 2016



- Banks are struggling to reduce costs in line with falling operating income margins. The result: cost-income ratio rising its highest level in the past seven years, at 84.4%.
- Constant-sample, median operating expenses margin improved to 76bps in 2016, the lowest level in seven years; however, it was not enough to offset the 18% decline in the median operating income margin in the last seven years.
- Operating expenses margin for banks with AuM >CHF5 billion is more than 20bps lower than banks with AuM <CHF5 billion.
- Whilst some banks have started with radical change to increase income margins and reduce costs, most of the banks have not.

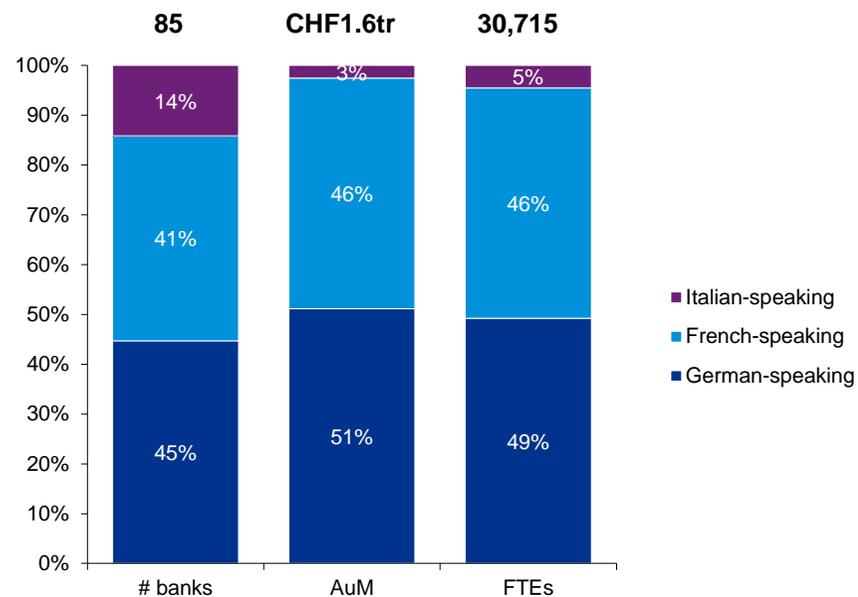
# Banks have taken limited improvement measures, but not radical enough

Some of the recent measures taken include:

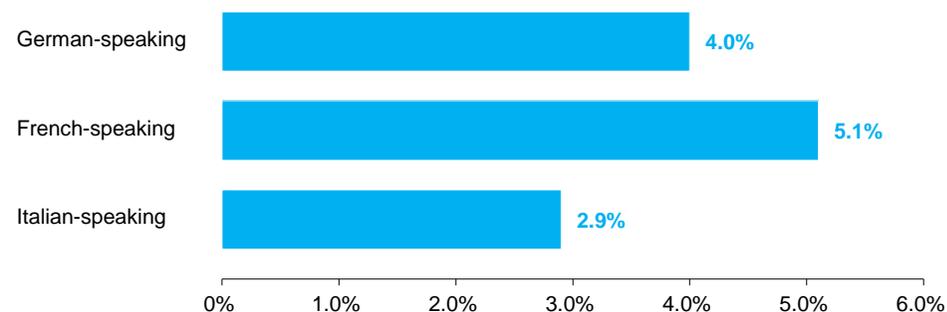
- Redefining and focusing on core markets and client segments, shedding those that are unprofitable or risky.
  - Purchasing client portfolios in selected core markets and client segments, and/or hiring RMs.
  - Rediscovering the value of Swiss residents as clients who are not subject to cross-border constraints.
  - Putting in place more effective set-ups for front office, advisory, asset management, wealth planning and credit.
  - Enhancing RMs' skills by formal education requirements, including certification, to raise technical proficiency, become more effective hunters and increase share-of-wallet.
  - Revisiting the product portfolio. In many cases this has led to migrate execution-only accounts to more profitable mandates such as discretionary portfolios or advisory services.
  - Increasing the provision of tax advice by banks to clients, to help clients increase after-tax returns.
- Investing in new systems that allow the utilization of digital front-office modules to appeal to new clients, using automation to enhance efficiency and delivery times, as well as the overall client experience.
  - Investing in digitization and robotics to enable the bank to automate labor-intensive IT and back-office processes as a viable alternative to off/near-shoring.
  - Centralizing IT and back-office processes in a separate division or legal entity (captive service company) in Switzerland or abroad to standardize and streamline processes.
  - Outsourcing more processes such as the production of client tax reports to reduce costs.
  - Continuing attention on cost efficiency through initiatives to reduce operating and investment costs.

# Regional analysis (1/2)

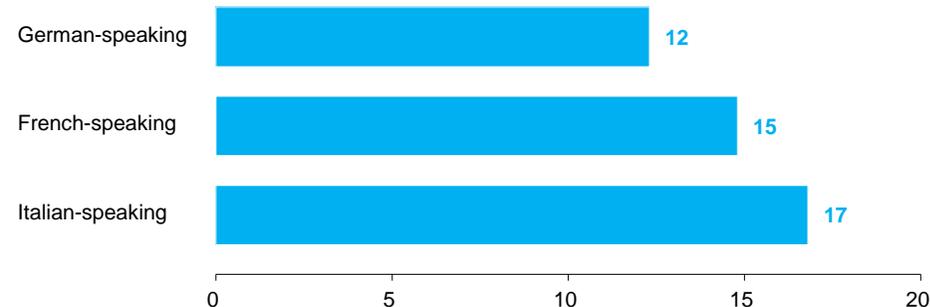
## Constant-sample dataset – by region



## RoE (median), 2016



## Gross profit margin (median) in bps, 2016

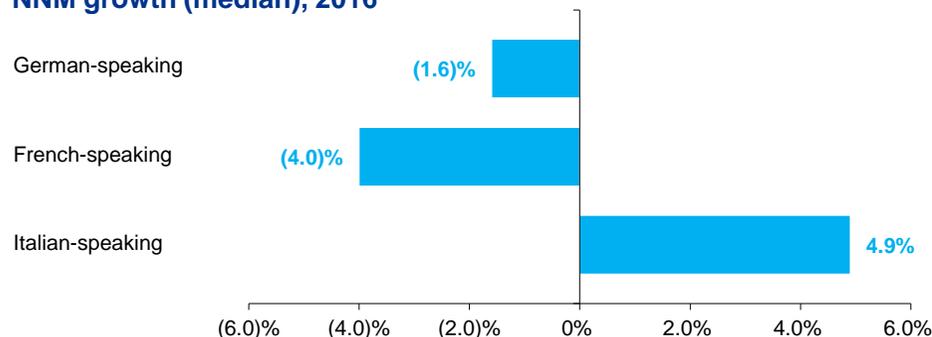


- After the acquisition of Lugano-based BSI by Zurich-based EFG, Italian-speaking AuM fell to only 3% of our constant-sample total and FTEs to 5%.

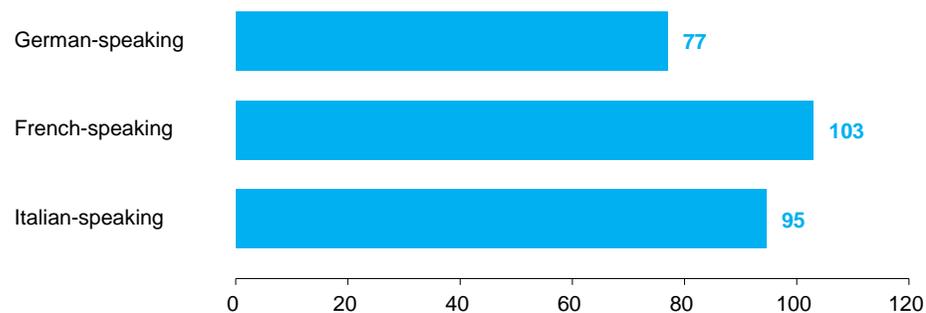
- Banks headquartered in French-speaking Switzerland generated the highest RoE in 2016.
- Despite having the lowest RoE in 2016, Italian-headquartered banks produced more gross profit per AuM.

# Regional analysis (2/2)

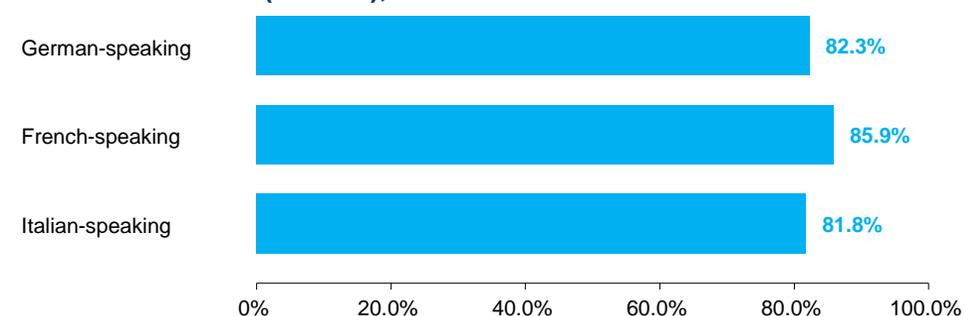
## NNM growth (median), 2016



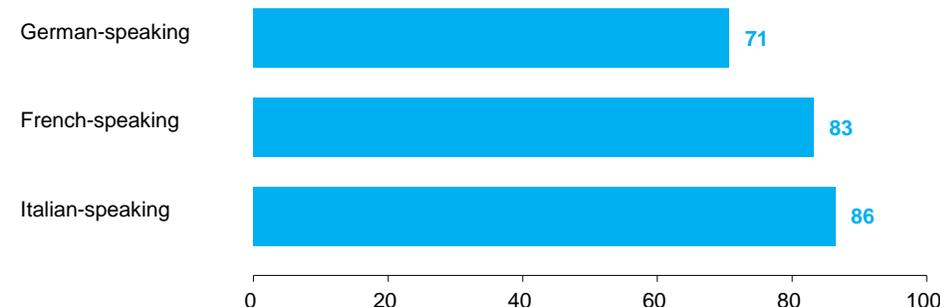
## Operating income margin (median) in bps, 2016



## Cost-income ratio (median), 2016



## Operating expenses margin (median) in bps, 2016

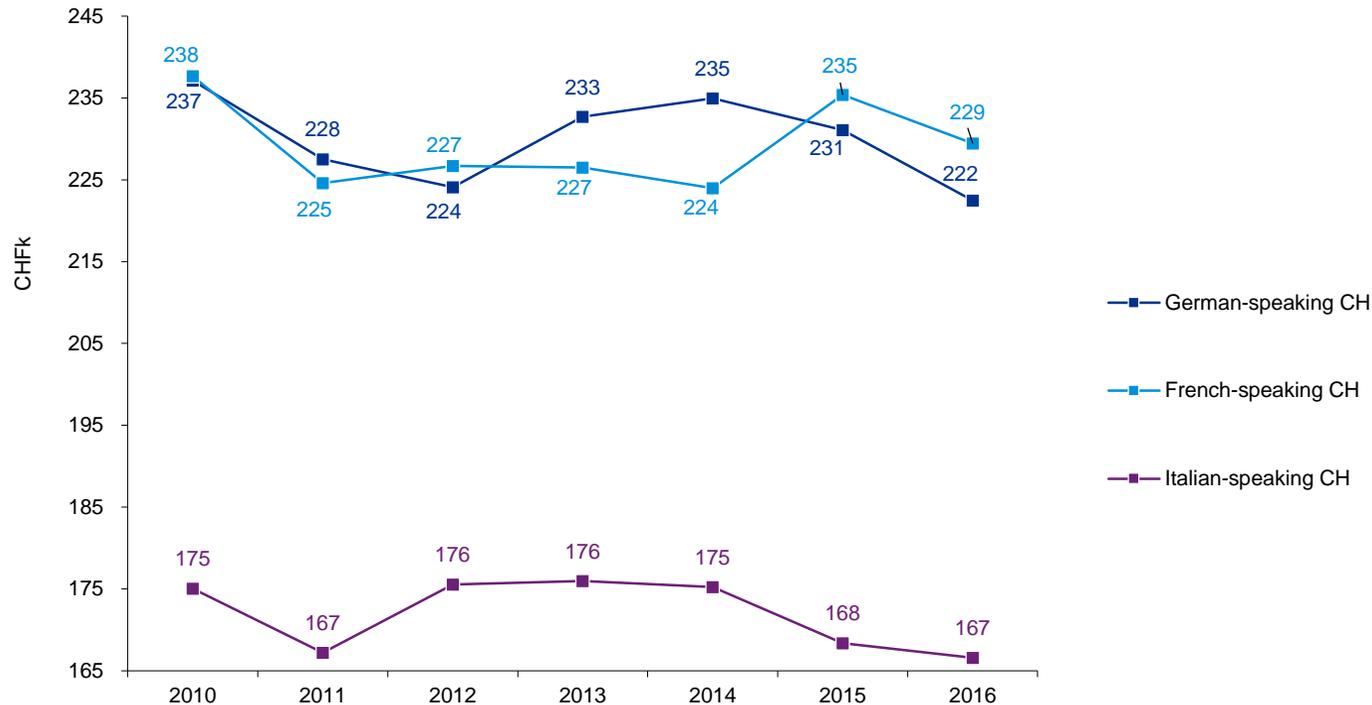


- The Italian-speaking region saw outflows in 2015 (2.3%), driven by the 2015 Italian Voluntary Disclosure Program. However, this trend reversed in 2016 with a 4.9% inflow.
- The operating income margin in the Italian-speaking region fell from 115bps in 2015 to 95bps, which was potentially related to the outflows in 2015.

- All regions had high cost-income ratios in 2016.
- The German-speaking region's costs incurred per AuM was the lowest.

# Personnel analysis

## Personnel expenses / Avg. FTE development (median) by region, 2010 to 2016



- Banks in the German and French regions appeared to take measures to reduce personnel costs per FTE in 2016.
- Personnel costs per FTE in the Italian-speaking region were around CHF50,000 lower than the other regions.

# Performance study headlines

- CHF43bn net outflows (3%) in 2016 – the only net outflow year in the last six – from purging non-core client segments.
- Swiss domestic consolidation deals slowed in 2016 and 1H 2017.
- Median RoE continued to stagnate in 2016 at  $\approx 4\%$  – far below cost of equity.
- Median operating income margin fell to a seven-year low of 89bps.
- Median cost-income ratio rose to a seven-year high of 84% as banks struggled to reduce costs in line with falling operating income margins.
- Surviving banks' AuM grew significantly over the past six years, while profit stagnated.

# What are the options?

Strategy	Description	Available for
<p><b>Building scale</b></p>	<ul style="list-style-type: none"> <li>• Swiss offshore combined with onshore presence in key markets</li> <li>• Build international/global operating platform</li> <li>• Drive efficiency through scale</li> </ul>	<p>max 10 – 15 banks</p>
<p><b>Niche player</b></p>	<ul style="list-style-type: none"> <li>• Focus on very specific niche and provide superior service</li> <li>• Outsource / Partner in all areas that are not USP</li> </ul>	<p>20 – 30 banks</p>
<p><b>Optimizing current model / Exit</b></p>	<ul style="list-style-type: none"> <li>• Cut operating expenses 20-30%, mainly personnel expenses</li> <li>• Consider M&amp;A to increase size</li> <li>• Exit if profitability expectations of share holders cannot be met</li> </ul>	<p>60 – 70 banks</p>

# Clarity on Performance of Swiss Private Banks





## Media requests

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