KPMG

Clarity on Performance of Swiss Private Banks

Some limited change. Not radical enough.

September 2017

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Profitability
Low levels of RoE mean shareholder value at most banks is being diluted.

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Growth
AuM for the Swiss private banking industry has remained flat for six years.

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Cost efficiency
Median cost-income ratio rises to its highest level for seven years.

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Institute of Management
Universität St.Gallen


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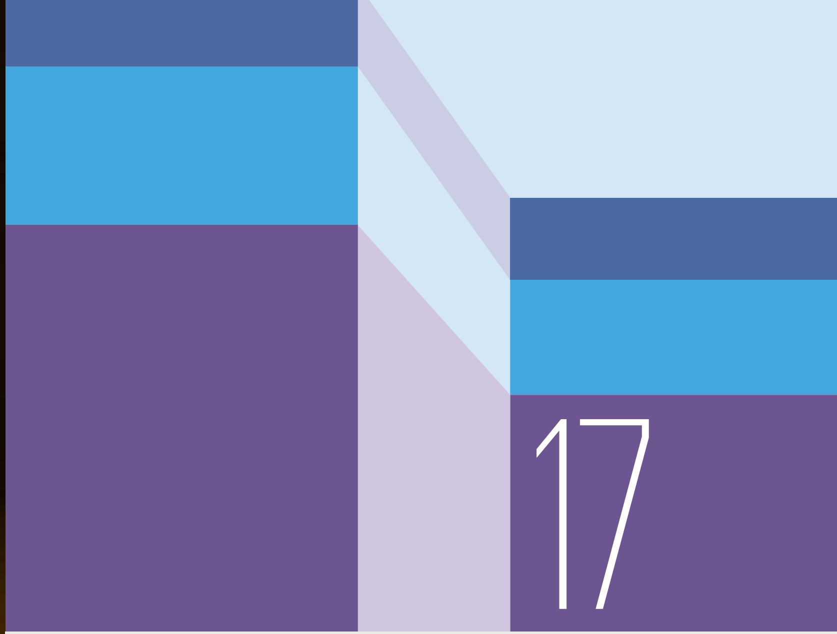
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CONTENT

Some limited change. Not radical enough.

A study by KPMG AG, Switzerland
in cooperation with the Institute of Management
at the University of St. Gallen

EDITORIAL

A small number of banks made progress, but most still need to tackle underlying performance issues

2016 should have been a year of change for Switzerland's private banks. But the need to address rapidly declining profitability was not matched by appropriate action on the ground. Too many banks focused on defensive cost reduction measures or improving existing business and operating models. In doing so, they overlooked what is really needed: a more profound, radical transformation that will allow them to use their core competencies to generate competitive advantage and sustainable growth.

A small minority of banks did take significant steps in the right direction. Some larger banks refocused their strategies onto core markets, and exited geographies and client segments that are no longer central to their businesses. Others put resources into digital solutions and automation to better position themselves for future growth.

Some progress can be seen among Switzerland's small banks. True, they make up the majority of Weak performers. But small banks also continue to represent a disproportionately high number of Strong performers. Having developed and implemented focused strategies over many years, they are evidence that there is a place in the Swiss market for niche players who can differentiate themselves.

Overall, we observe banks taking a step-by-step approach to adapting their organizations. This is insufficient in light of their environments having extensively changed over the past decade – long-term structural disruption and a digital wave that will further alter the competitive landscape going forward.

For most banks, a lack of radical action on both the business and operational sides has worsened their position even compared to last year. Across bank sizes, many median KPIs hit seven-year lows in 2016. Operating income margins are declining. Gross profits are falling. The number of loss-making banks (before extraordinary items) remains very high. And AuM for the industry as a whole has remained flat for many years. In fact, aggregate NNM entered negative territory in 2016 by around CHF43 billion.

In order to map trends based on a stable sample, we analyzed 85 Swiss private banks that existed in 2010 and remained active at the end of 2016. This "constant sample" removes any potential distortions caused by banks entering or exiting the market during the period under review. But even this group of surviving banks continues to face pressure and deteriorating positions.

Our analysis delivers a very clear message. More banks need to grasp the challenge of materially transforming their businesses, rather than incremental steps currently being seen. Nothing less than radical action will reverse the decline.

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KPMG AG, Switzerland

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Repositioning leads to lower AuM

Fifty-six percent of banks experienced net outflows in 2016. The overall loss of CHF43 billion, or 3% of AuM, was the worst NNM result in the past six years. But this could have a positive longer-term effect, as it was largely due to banks exiting non-core markets and client segments in order to achieve a greater focus.

Consolidation slows down

Swiss domestic consolidation fell sharply in 2016 and 1H 2017. Owners are more reluctant to sell, larger banks have less interest in small deals, and there are fewer banks available for sale. Future consolidation may be fuelled by transactions between small and medium-sized players.

Still no improvement in returns

Median RoE has remained at around 4% for the past five years. With banks' cost of capital estimated at 7% to 10%, shareholders' value is being diluted. More than one-quarter of banks in our sample suffered losses before extraordinary items in 2016.

Operating income margin hits new low

At a median of 89bps, the decline in operating income margins accelerated significantly in 2016 to its lowest level in the past seven years. With net commission income under severe pressure and competition for clients more intense, banks must tailor their pricing models, offerings and service levels to reverse this trend.

...while cost-income ratio reaches new high

Many banks are struggling to reduce costs in line with falling operating income margins. The result is the cost-income ratio rising to 84% – its highest level in the past seven years. This indicates the radical change needed.

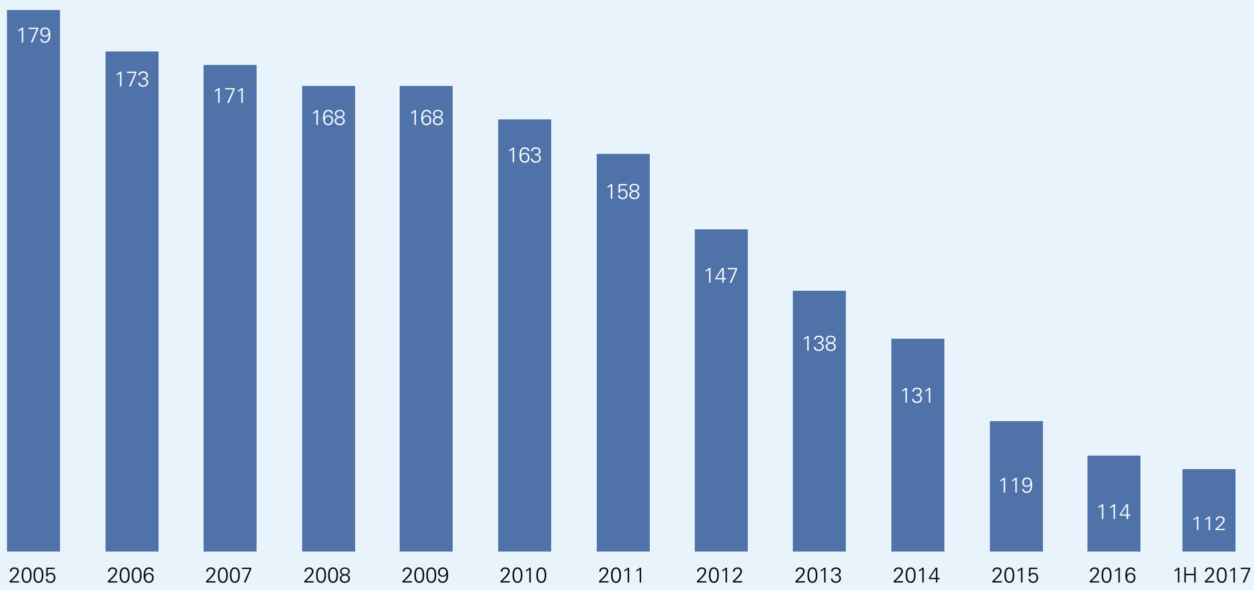
Surviving banks' AuM grew significantly over the past six years, while profit stagnated

Aggregated AuM of our 85-bank constant sample grew by 38% over the past six years, largely due to M&A activity at large consolidator banks. Profitability developed at a much lower level, however, with gross profit falling by 10% and net profit growing by 10%.

Number of private banks

Consolidation slowed down in 2016 and 1H 2017, catching many by surprise. This was due to a reduced appetite among large consolidator banks for small Swiss banks, narrower target criteria among buyers, and fewer banks being available for sale.

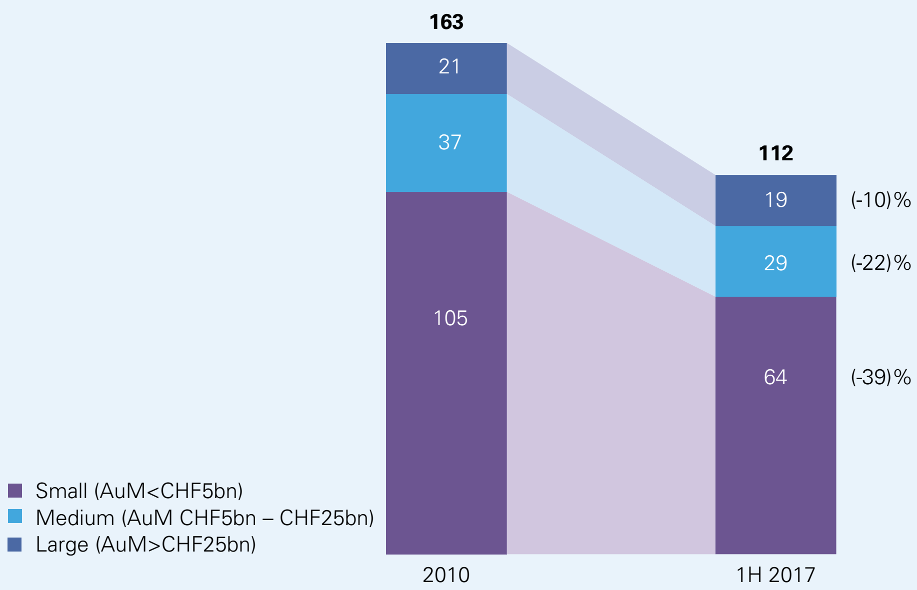
Number of Swiss private banks, 2005 to 1H 2017



Lower levels of M&A played a key part in the slowdown over 2016 and 1H 2017. Large banks – which have typically been consolidators – have focused their acquisition strategies onto large transactions in their core markets. The Swiss domestic market offers few such opportunities. And as buyer banks have spent considerable time cleaning up their portfolios, they are in no mood to consider targets that might have compliance issues.

Together with more clearly defined strategies, significant parts of a target portfolio are often of little interest. The relatively tiny levels of AuM and new clients to be gained by acquiring a small bank, for instance, may be outweighed by the costs and risks involved in undertaking a share deal.

Number of Swiss private banks by size, 2010 and 1H 2017



Eighty percent of market exits since the end of 2010 have been small banks (through acquisition or liquidation).

Yet, in the current climate, many owners of small banks prefer to continue their businesses on a standalone basis rather than accept a low price or an asset deal.

While there remains significant scope for further consolidation, this will be driven by market exits among the weakest banks, M&A activity between small and medium-sized Swiss banks, and only a limited number of large deals.

Industry financial statements

By aggregating the annual financial statements of our constant sample of 85 banks, we provide an indicative financial overview of the Swiss private banking industry. By focusing on the 85 banks that existed in 2010 and that were still active at the end of 2016, we can track performance without distortions from market entries or exits.

AuM of our constant sample grew over the past six years, largely due to M&A activity at large consolidator banks. Despite this, constant-sample banks reported significant falls in gross profit as operating income margins declined.

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	n.m.	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)% ▼
Net profit	**1,611**	**741**	**1,777**	**10.3 %** ▲	**139.7 %** ▲
Other key data (year-end)					
AuM (CHFbn)	1,189	1,555	1,635	37.5 % ▲	5.1% ▲
FTEs	26,392	28,194	30,715	16.4 % ▲	8.9% ▲

Banks are included in our constant sample when annual financial statements were available for each of the past seven years (2010 to 2016).

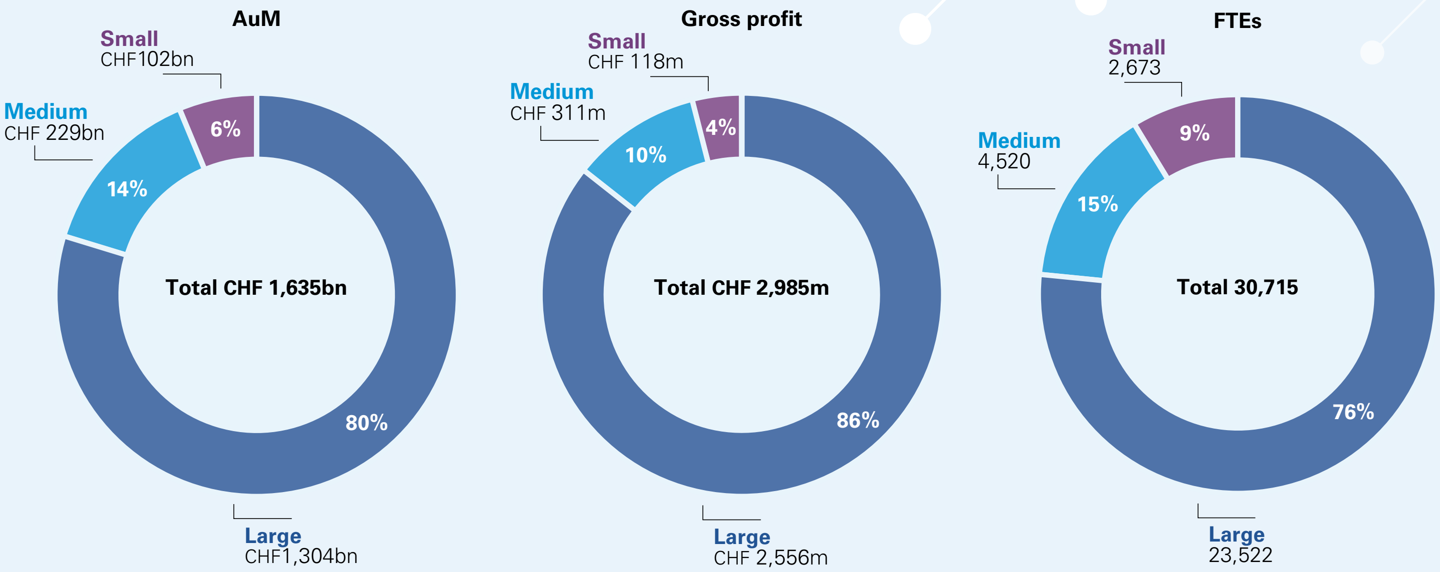
AuM of our constant sample rose by almost 38% between 2010 and the end of 2016, driven by M&A activity. Yet, the number of FTEs grew by only 16%, suggesting either greater efficiencies from cost synergies or economies of scale at large consolidator banks.

Gross profit declined by almost 10% due to the effects of significantly reduced operating income margins as income grew more slowly than volumes. Also as operating expenses rose more quickly than operating income. These trends were seen both between 2015 and 2016 and over the entire period since 2010.

Net profit in 2015 and 2016 was impacted significantly by one-off items. For larger banks in our sample, these included fines payable to the US Department of Justice.

Other notable trends in 2016 were a 15% growth in net interest income, mainly driven by higher US interest rates and loan volumes. And a 9% increase in the number of FTEs due to large M&A transactions that were completed in 2016 but announced either in 2015 or 2016.

Key data by bank size (aggregate), 2016



The industry perspective is driven by large banks. Net profits of small banks grew by 79% over the past six years due to fewer negative one-off items. This was also the only size group that managed to reduce FTEs and operating expenses (both by 6%). Medium-sized banks faced a difficult situation. Their net profit fell by 86% over the period due to more negative one-off items and a 12% increase in operating expenses. This compared to only a 1% growth in operating income. Cost reductions at medium-sized banks are also more difficult due to their often more complex operational set ups.

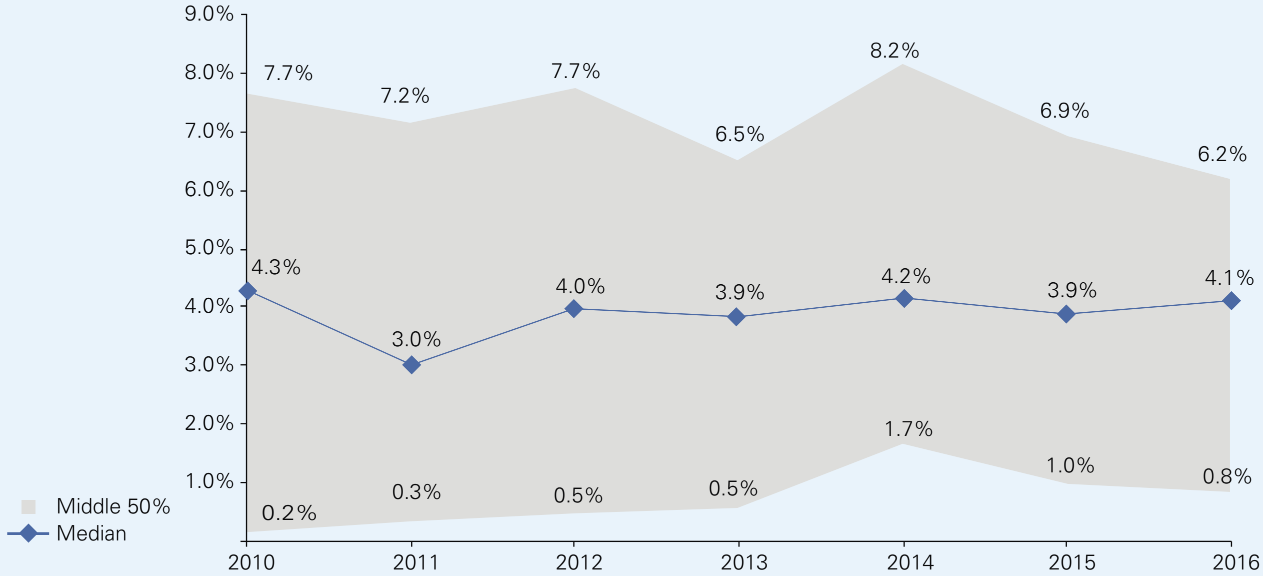
Small banks make up 48 of the 85 banks in our constant sample, but only CHF102 billion (or 6% of the aggregate) of AuM. This helps to explain the fall in domestic Swiss M&A activity, as large banks have little interest in acquiring a small bank due to the minimal impact on the acquirer's performance, yet potentially disproportionate costs and risks.

Going forward, mergers and acquisitions between small and medium-sized banks may be more likely, though will have a limited impact on the competitive landscape due to the size of the participants.

Return on Equity (RoE)

Median RoE remains stable at around 4%, propped up over the past two years by one-off items of income. At an estimated cost of equity of 7% – 10%, shareholders' value at most banks is being diluted.

RoE development, 2010 to 2016



Returns remain substantially below cost of capital
Median RoE has remained stable over the past five years at around 4%, driven by steady net profits. Operating results have declined over this period, however, with the gross profit margin falling from 20bps in 2012 to 14bps in 2016. Median RoE since 2014 has been supported by favorable non-operating results (mainly one-off items of income), without which RoE would have declined – and may do so in the future if banks fail to generate higher gross profits. 45 of the 85 banks in our constant sample reported a fall in RoE between 2015 and 2016.

At an estimated cost of equity of between 7% and 10%, RoE is diluting the value held by owners at the majority of banks.

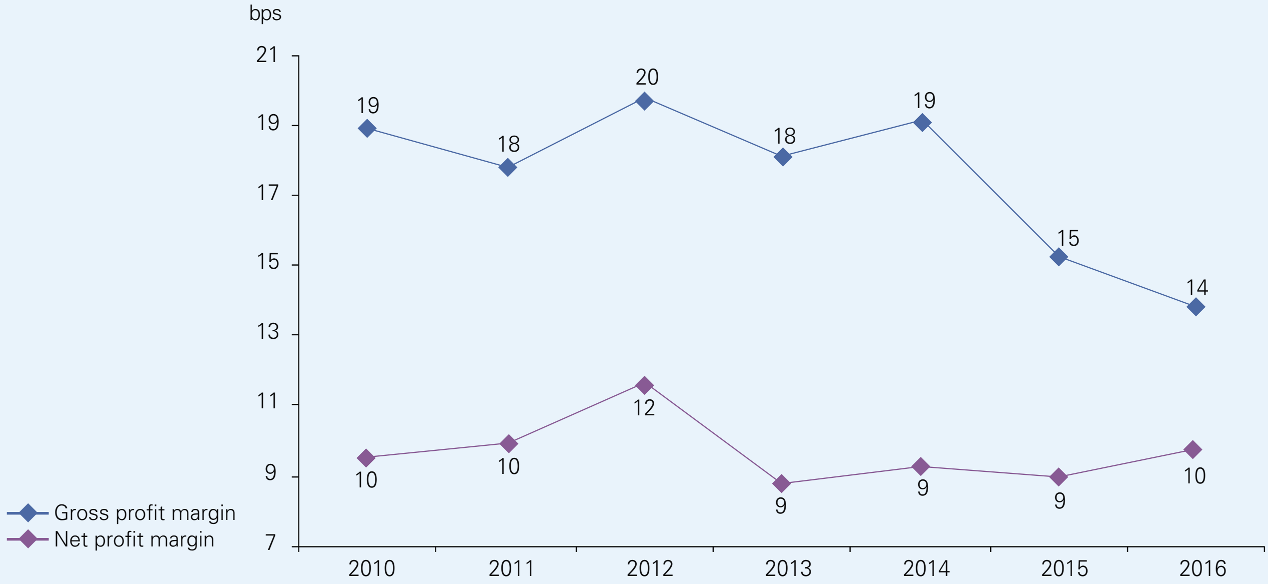
Banks generally hold significantly higher levels of capital than required by regulations. This is primarily to help attract and retain clients by evidencing financial strength.

But equity levels have an inverse relationship with RoE. If the banks reduced their capital levels to 3% above their minimum regulatory requirements, overall RoE in 2016 would rise from 4% to around 6%. Management must, however, consider the practical and reputational implications of a capital reduction in the eyes of clients and regulators.

Large banks and banks in the Swiss Romande have the highest median RoEs
Small banks had a lower median RoE (2.8%) than medium-sized banks (5.3%) or large banks (5.7%) in 2016.

Banks in the French-speaking part of Switzerland enjoyed the highest median RoEs at 5.1%, followed by those in German-speaking Switzerland (4.0%) and those based in Ticino (2.9%). This is in part due to Ticinese banks being generally smaller than their counterparts in the other two regions.

Gross profit and net profit margin development (median), 2010 to 2016



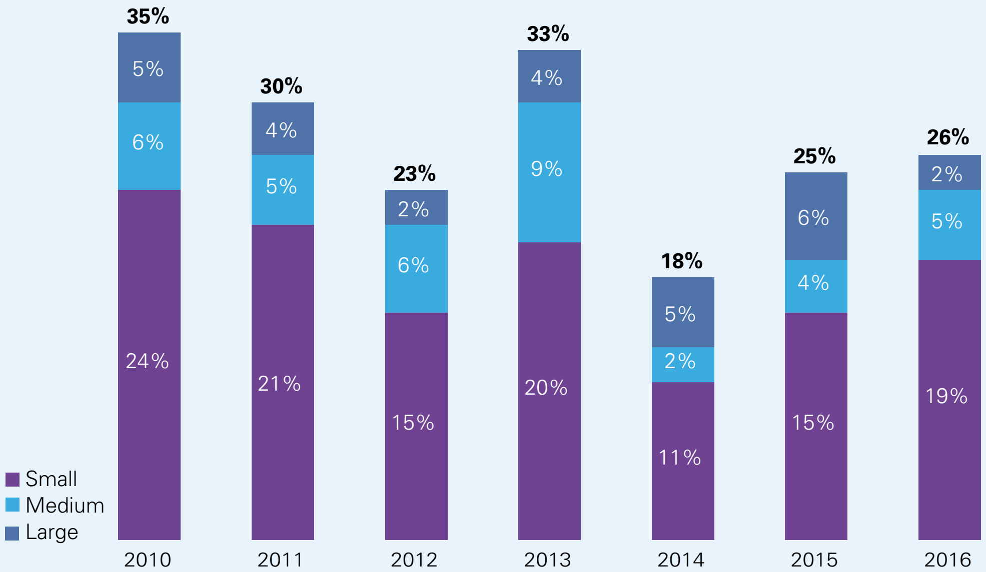
Gross profit margin fell to 14bps in 2016, the lowest level in the past seven years. This is driven primarily by the steep decline in operating income margins against a much slower reduction in operating expenses margins.

Despite this, the steady net profit margin of around 9bps to 10bps over the past few years has been achieved by the non-operating result margin developing favorably since 2014. This was mainly due to gains on the sale of participating interests as well as other extraordinary income items. These one-off positive influences offset the negative gross profit margin trend, bringing steady net profits over the period.

In the long run, we expect the positive extraordinary items to fade. If gross profit also continues to decline, net profit and RoE will fall in the future. This increases the imperative for management to make radical changes to their operations to positively impact financial performance, as they cannot rely on non-operating income such as extraordinary items continuing to maintain results.

In the absence of radical changes to business and operating models, it will not be possible for banks to reduce costs at the same speed as revenues are falling. Improving profitability will therefore not be achievable without such change.

Percentage of loss-making banks (before extraordinary items), 2010 to 2016



There has been a growing number of loss-making banks since 2014, from 15 in 2014 to 22 in 2016. Small banks drove the increase at 9 in 2014 and 16 in 2016. Losses before extraordinary items is an indicator of underlying or recurring losses which usually require investment if profitability is to return. Small banks may struggle to achieve this given their lack of scale.

KPIs most correlated to RoE

The University of St. Gallen carried out a historical, statistical regression analysis on KPMG's Private Banking Database of data between 2010 and 2016 with a focus on the determinants of RoE. The university found two KPIs to be most correlated to RoE: operating income / average FTE (positively) and operating expenses / average AuM (negatively). If a bank increased its operating income / average FTE and reduced its operating expenses / average AuM, an increase in RoE should result. When analyzing performance, therefore, it may make sense for a bank to pay particular attention to these KPIs.

These ratios should not, however, be used in isolation. Rather, they should be considered with other measures of a broader scorecard used to measure and manage a bank's performance.

Many banks have recently taken measures to enhance their business and operating models. Only very few, however, have radically changed their overall approach and set up. Most have much more still to do.

Some of the recent measures taken include:

1) Redefining and focusing on core markets and client segments, shedding those that are unprofitable or risky.

2) Purchasing client portfolios in selected core markets and client segments, and/or hiring RMs. But only following intensive due diligence to assess whether RMs have the relevant experience to attract clients in these markets. This strategy can often lead to longer pay-back periods.

3) Rediscovering the value of Swiss residents that are not subject to cross-border constraints. Particularly under-served wealthy individuals or those that are coming into wealth due to inheritance or business succession.

4) Putting in place more effective set-ups for front office, advisory, asset management, wealth planning and credit. Considering a team-based model whereby the RM's role becomes the coordinator of other functions' to achieve a more holistic approach.

5) Enhancing RMs' skills by formal education requirements, including certification, to raise technical proficiency, become more effective hunters and increase share-of-wallet.

6) Revising pricing policies to be more competitive and align approaches with client expectations and sensitivities. At the same time, enforcing pricing discipline and rationalizing legacy pricing exceptions.

7) Revisiting the product portfolio has led to migrating execution-only accounts to more profitable mandates such as discretionary portfolios or advisory services.

8) Increasing the provision of tax advice by banks to clients, to help clients increase after-tax returns.

9) Investing in new systems that allow the utilization of digital front-office modules to appeal to new clients (e.g. upgrading on-boarding processes), using automation to enhance efficiency and delivery times, as well as the overall client experience.

10) 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.

11) 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.

12) Outsourcing more processes such as the production of client tax reports to reduce costs.

13) Continuing attention on cost efficiency through initiatives to reduce operating and investment costs.

Performance clusters

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. Weak banks remain high in number, however, and may fuel future market exits.

A disproportionately high number of Strong performers are small banks that developed a clear and focused niche strategy many years ago and continue to implement it successfully.

As in our previous performance studies, we have grouped our 2016 constant-sample private banks into four performance clusters: Strong, Upper Mid, Lower Mid and Weak. For 2016, we changed slightly the criteria used to group the banks – this is now based solely on underlying RoE levels over the past few years.

Although only a limited number of banks moved down into the Weak cluster in 2016, their outlook appears poor. Banks in the Weak cluster experienced a sharp decline in median RoE to -9% in 2016, which indicates that they may exit the market sooner rather than later.

Small banks represent the biggest single constituency of Strong performers at seven. These banks have been Strong performers for a number of years, due to having formulated and implemented a clear and focused niche strategy some time ago. Banks that did not do so will find it more difficult now to transform, as the necessary changes involve substantial investment and significant client outflows. It is doubtful whether many small banks would be strong enough to withstand both of these impacts. Even larger banks will struggle, though their size will help them to weather the loss of some client segments or markets.

Only Strong banks produced returns that were close to, or exceeded, the estimated cost of equity for Swiss private banks of 7% to 10%.

The median RoE of Weak banks fell significantly in 2016 to -9% due to more banks having negative RoE (9 in 2015 and 15 in 2016). Weak banks also saw other median KPIs deteriorate in 2016, including operating income margin falling by 23bps to 71bps and cost-income ratio rising steeply from 108% to 142%.

What makes a Strong Bank strong?

Strong banks are characterized by robust business models and efficient operating models. Together, these help to generate relatively high gross profit levels.

Strong banks can be divided into two groups: large banks and smaller niche players

- Large banks leverage their huge operating infrastructures to achieve economies of scale that translate into cost efficiency, profitability, and an ability to offer a broad range of tailored services to clients.
- Niche players focus on specific client segments such as emerging markets. Their narrower focus and offering allows them to better manage their costs as well as charging a premium for their services. A clear downside to being a niche player, however, is limited scale and diversification opportunities.

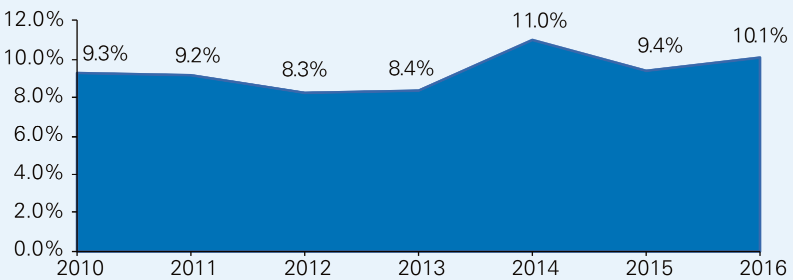
Strong banks' operating income margins in 2016 were actually lower than banks in the Upper Mid and Lower Mid clusters. But Strong banks' business and operating models are able to compensate for this.

Strong Performers

Size of the cluster remained stable in 2016, with a net decrease of one bank to 15. The cluster is characterized by large banks or strong niche players whose RoEs generally exceed their cost of equity.

Gross profit	**2010**	**2016**
Gross profit margin (bps)	36	28
Gross profit / Avg. FTEs (CHF000)	156	193
AuM growth		
6y AuM growth (2010-2016)	n.a.	78.9%
NNM growth	5.7%	-1.0%
Income growth		
Operating income margin (bps)	109	82
Cost efficiency		
Cost-income ratio	70.9%	63.7%
Operating expenses margin (bps)	73	56

RoE development, 2010-2016

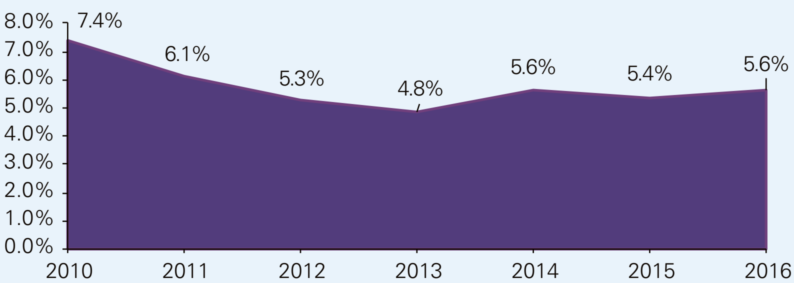


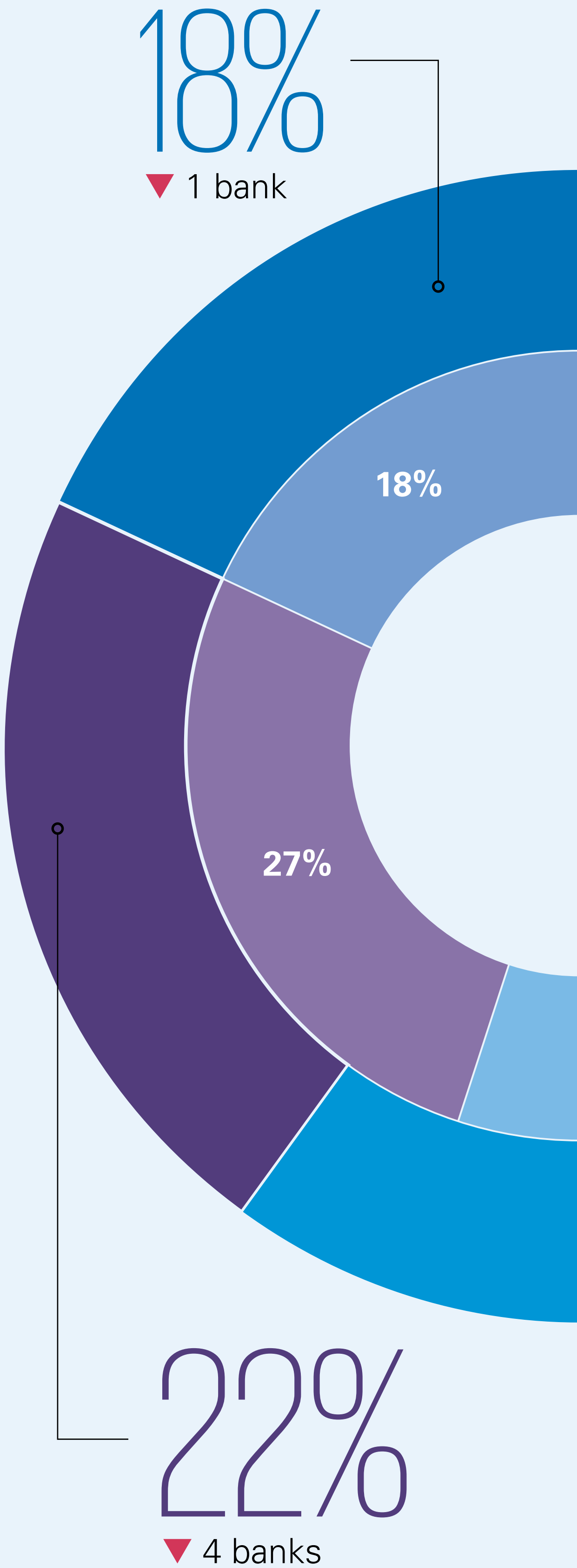
Upper Mid Performers

At 22% of our constant sample, this cluster saw a net reduction of four banks, mainly due to banks moving to the Lower Mid performance cluster. The cluster is characterized by well-performing banks with potential to improve further.

Gross profit	**2010**	**2016**
Gross profit margin (bps)	36	21
Gross profit / Avg. FTEs (CHF000)	155	104
AuM growth		
6y AuM growth (2010-2016)	n.a.	19.3%
NNM growth	3.9%	-1.8%
Income growth		
Operating income margin (bps)	104	86
Cost efficiency		
Cost-income ratio	67.3%	73.9%
Operating expenses margin (bps)	83	64

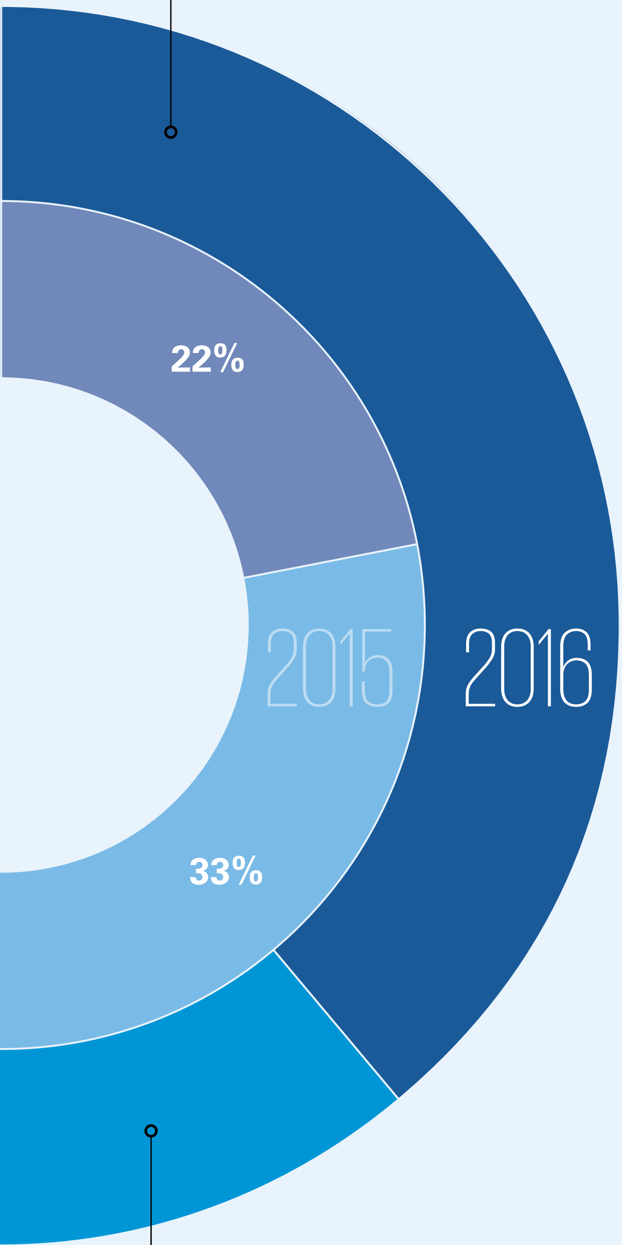
RoE development, 2010-2016





39%

▲ 14 banks

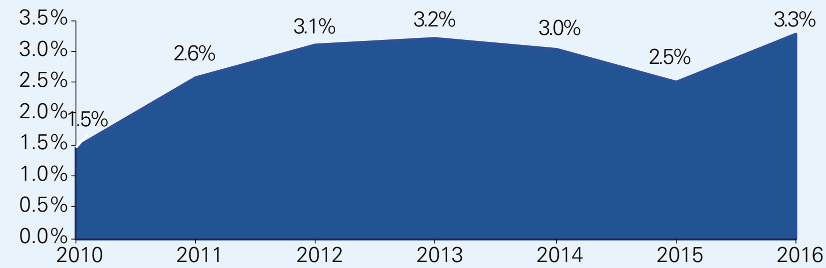


Lower Mid Performers

This is now the largest cluster at 39% due to banks moving from the Upper Mid and Weak clusters. The cluster is characterized by a mixture of banks at various stages of strategic change. The next few years will determine their fate.

Gross profit	**2010**	**2016**
Gross profit margin (bps)	15	14
Gross profit / Avg. FTEs (CHF000)	43	57
AuM growth		
6y AuM growth (2010-2016)	n.a.	21.6%
NNM growth	-0.2%	-2.2%
Income growth		
Operating income margin (bps)	108	98
Cost efficiency		
Cost-income ratio	87.8%	85.4%
Operating expenses margin (bps)	82	83

RoE development, 2010-2016

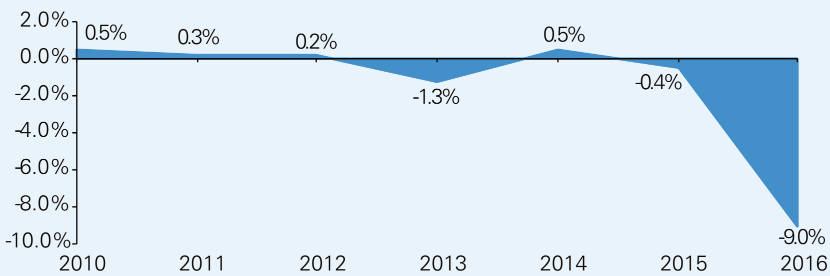


Weak Performers

This cluster shrank in 2016 to 21% mainly by banks moving to the Lower Mid cluster or exiting the market. This cluster is characterized by banks with sharply declining performances in 2016, which indicates more market exits may be to come

Gross profit	**2010**	**2016**
Gross profit margin (bps)	6	-38
Gross profit / Avg. FTEs (CHF000)	19	-96
AuM growth		
6y AuM growth (2010-2016)	n.a.	-22.9%
NNM growth	-4.0%	-2.9%
Income growth		
Operating income margin (bps)	106	71
Cost efficiency		
Cost-income ratio	93.8%	142.3%
Operating expenses margin (bps)	106	117

RoE development, 2010-2016



21%

▼ 11 banks

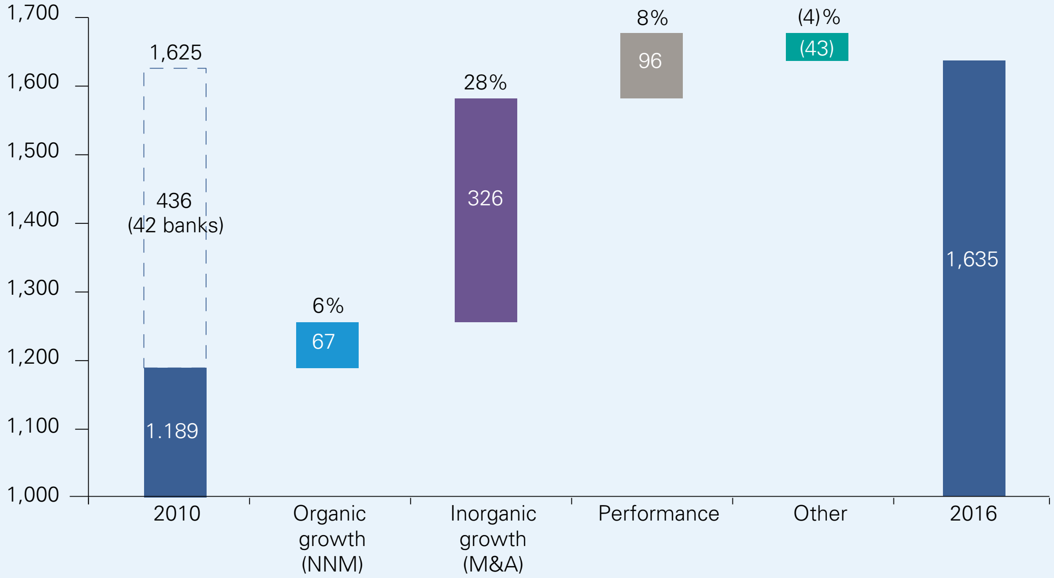
AuM Growth

AuM in the Swiss private banking industry has remained flat for the past six years. Banks in our constant sample grew their AuM by 38% over this period, mostly by acquiring other Swiss banks (around three-quarters of the 38%). This concentrated AuM into fewer, larger institutions.

Banks generated only 6% AuM growth through NNM and 8% through performance.

AuM growth development (aggregate), 2010 to 2016

CHFbn



Our constant sample comprises the 85 Swiss private banks that existed in 2010 and were still active at the end of 2016. From 2010 to 2016, 42 banks disappeared by being acquired by large consolidator banks in our constant sample

Although AuM of the overall market remained flat over this period, our constant sample's AuM grew significantly. This was the result of M&A activity by larger consolidator banks in our sample. In fact, 73% of the CHF446 billion AuM growth at our constant-sample banks over the past six years was the result of M&A activity. Four large consolidator banks were responsible for almost 90% of this M&A growth.

The second largest contributor of AuM growth (CHF96 billion) for our sample was banks' performances. These fluctuate with exchange rate movements against the Swiss Franc, prices in the securities and commodities markets, as well as a bank's ability to generate returns for its clients.

Organic growth generated only limited additional AuM. Banks struggled to attract new clients and offset the outflows that occurred over the period.

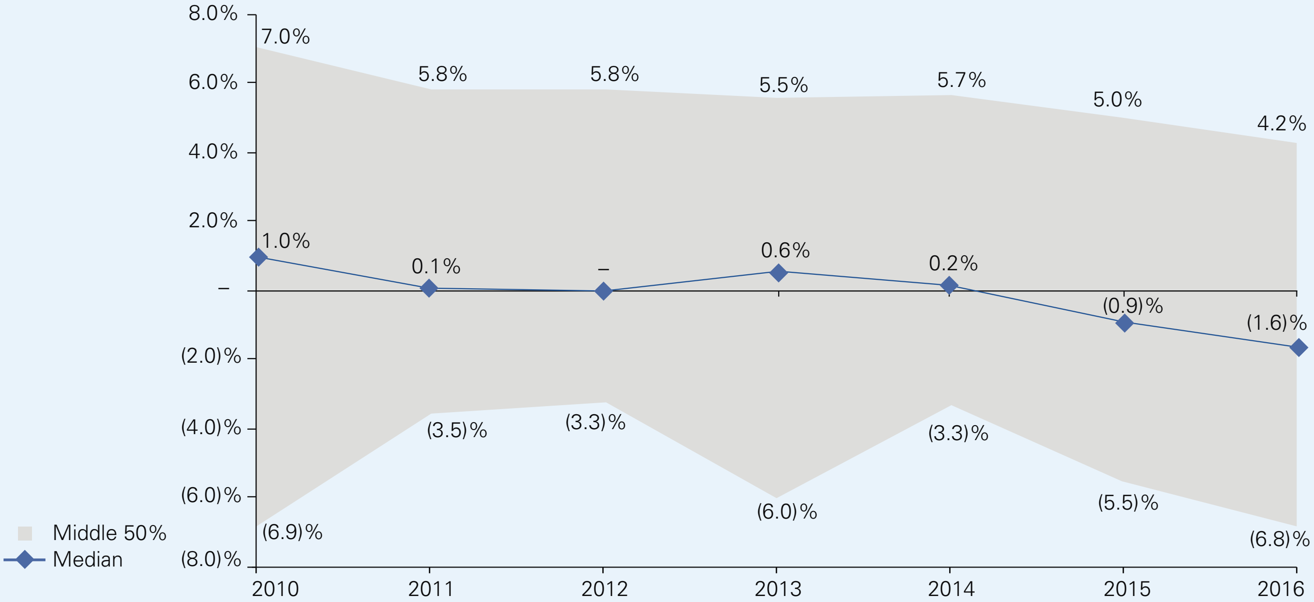
2016 AuM Development

AuM grew by CHF80 billion over the course of 2016, from CHF1,555 billion to CHF1,635 billion. M&A was the largest contributor at CHF90 billion, driven by three large deals. Significant performance improvement of CHF39 billion was seen from positive markets and generally stable exchange rates (although the GBP fell against the CHF due to the Brexit referendum), in contrast with 2015 where banks saw a negative performance impact of CHF58 billion. NNM in 2016 was very poor at negative CHF43 billion. Other movements produced a negative CHF7 billion.

Organic AuM growth (NNM)

Median NNM fell in 2016 to its lowest level in the past seven years to -1.6%. In absolute terms, this was a net outflow of CHF43 billion, which was due primarily to large banks pulling back from non-core markets and client segments.

NNM growth development, 2010 to 2016

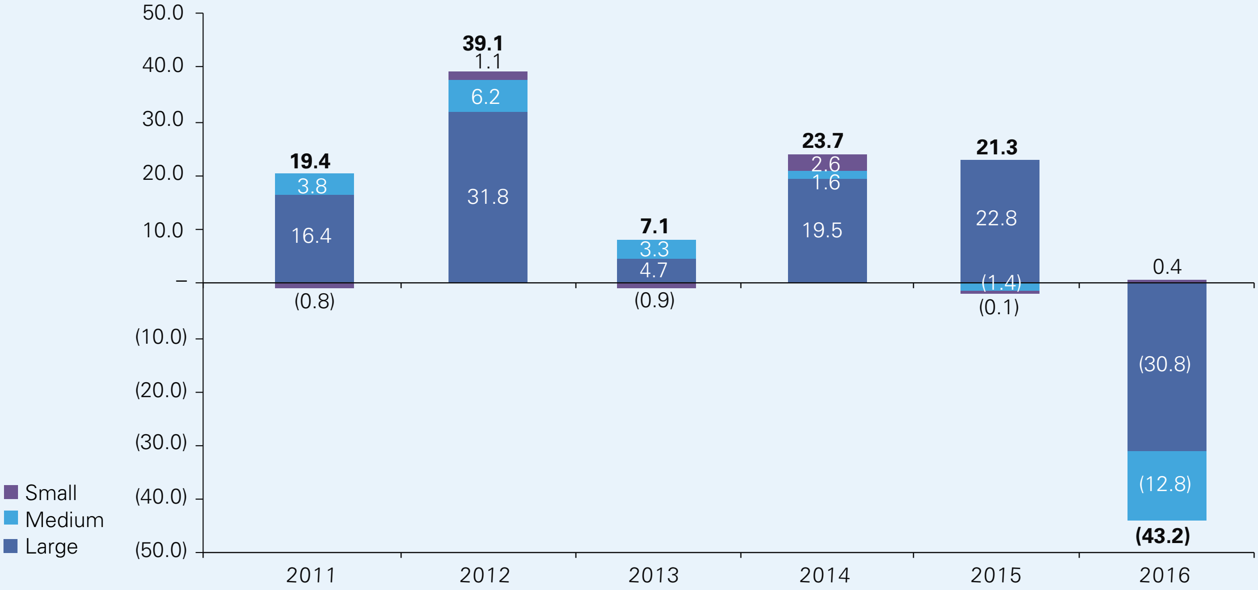


Median NNM growth has been near zero for the past six years but has been on a clear downward trajectory since 2013. Entering negative territory in 2015, it fell further in 2016 as 48 of the 85 banks incurred outflows.

Ticino-based banks saw significant negative NNM growth in 2015 (-2.3%), driven by the 2015 Italian Voluntary Disclosure Programme that resulted in the repatriation of Italian-resident client money from Ticino to Italy. Interestingly, Ticino-based banks managed to turn this around in 2016 to a positive 4.9%.

NNM growth development (aggregate), 2011 to 2016

CHFbn



Looking at the outflows from our sample in absolute terms, 2016 showed the largest annual movement in the past six years. This abrupt fall was driven primarily by large banks exiting non-core markets. While this strategic refocusing is ongoing, it is likely to have been accelerated by the AEoI coming into effect at the beginning of 2017, requiring banks to send annual statements to the tax authority in which the respective client is resident.

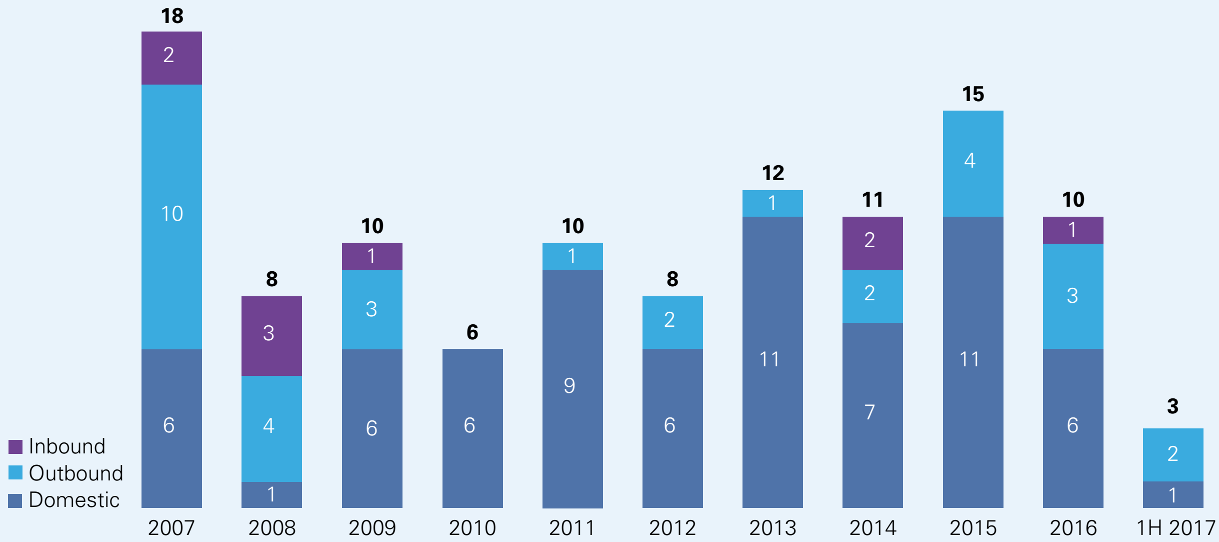
Some banks also exited client segments that are characterized by low wealth or higher risk due to increased pressure from a regulatory compliance perspective.

Overall, the figures still show the challenges private banks face in attracting new clients. While AuM volume is not the only indicator – the quality of client assets is also key – the ability of banks to achieve organic growth will be decisive in realizing economies of scale and improving profitability.

Inorganic AuM growth (M&A)

Amid expectations that consolidation would continue at speed, 2016 and 1H 2017 were disappointing. M&A levels have historically been driven by domestic activity between Swiss private banks. This dropped off significantly in the past 18 months due to larger consolidator banks being less interested in small deals and buyers being more likely to walk away from deals.

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



The key driver for the reduction in M&A activity was a much lower number of take overs of private banks by other private banks. This number came down from nine deals in 2015 (out of 11 domestic deals and 15 deals overall) to only two in 2016 (out of six domestic deals and 11 deals overall). This trend continued in 1H 2017 with no such deals. This was due to a range of factors, including:

- **Fewer banks are available for sale** due to historical consolidation having reduced the bank population.
- **Buyers are focused** on deals that reinforce their presence in core markets and segments. They are also paying particular attention to how compliant are targets' client assets with regulations.
- **Reduced appetite for restructuring assets post-acquisition.** Banks that have already cleaned up their portfolios are reluctant to repeat the process on acquired assets. Deals in which assets may be in the wrong location or bear higher risk are therefore avoided.
- **Owners are reluctant to sell** in an environment of falling prices and with many buyers preferring asset deals. Many prospective sellers would rather continue to operate as a standalone business.

Swiss private banking transactions – 2016 and 1H 2017

Announced	Target	Bidder	Seller	AuM (CHFbn)	Deal type
1H 2017					
June 2017	UBS's Dutch onshore wealth management business	Van Lanschot Kempen (the Netherlands)	UBS Europe SE, Dutch branch	2.8	Asset
May 2017	Consenso Investimentos Ltda. (Brazil)	UBS Group AG	Private individuals	5.8	Share
Feb 2017	Wergen & Partner Vermoegensverwaltungs AG	Julius Baer Group Ltd.	Private individuals	0.6	Share
2016					
Dec 2016	Banque Leonardo S.A. (France)	UBS Group AG	Banca Leonardo S.p.A.	2.0	Share
Dec 2016	Fibi Bank (Switzerland) Ltd.	CBH Compagnie Bancaire Helvetique SA	First International Bank of Israel Ltd.	0.9	Asset
Aug 2016	GP Gestion Privée SA	Banque Heritage S.A.	Private individuals	0.3	Share
May 2016	Banque Pasche S.A.	Banque Havilland S.A.	CIC - Lyonnaise de Banque	7.0	Share
Apr 2016	UBI Banca International (Luxembourg) S.A. (Luxembourg private banking activities)	EFG International AG	UBI Banca Scpa	3.6	Asset
Apr 2016	PrivateClientBank AG (PCB) (50% stake)	Private individuals (a group of PCB's existing shareholders)	Graubündner Kantonalbank	3.1	Share
Apr 2016	Privatbank Bellerive AG (37.5% stake)	Graubündner Kantonalbank	PrivateClientBank AG	4.5	Share
Mar 2016	Credit Suisse (Monaco) S.A.M. & Credit Suisse (Gibraltar) Ltd.	Bank J. Safra Sarasin AG	Credit Suisse Group AG	n/a	Share
Feb 2016	Banca della Svizzera Italiana SA	EFG International AG	Banco BTG Pactual S.A	58.6	Share
Jan 2016	Meridian Wealth Management SA	Banque Heritage S.A.	Private individuals	0.1	Share

■ Inbound ■ Outbound ■ Domestic

Many banks continue to seek ways to reinforce their onshore presence, particularly in Europe, to be able to proactively approach prospective clients and win fresh NNM.

Deals in 2016 included acquisitions by UBS, EFG and Safra Sarasin in France, Luxembourg, and Monaco and Gibraltar, respectively, and a disposal by UBS in the Netherlands.

Among the few domestic Swiss deals, the most notable was EFG's acquisition of Banca della Svizzera Italiana SA (BSI) from Brazil's Banco BTG Pactual.

Acquisitions of independent asset managers (IAMs) also hit the radar, with Julius Baer and Bank Heritage completing three between them in the past 18 months.

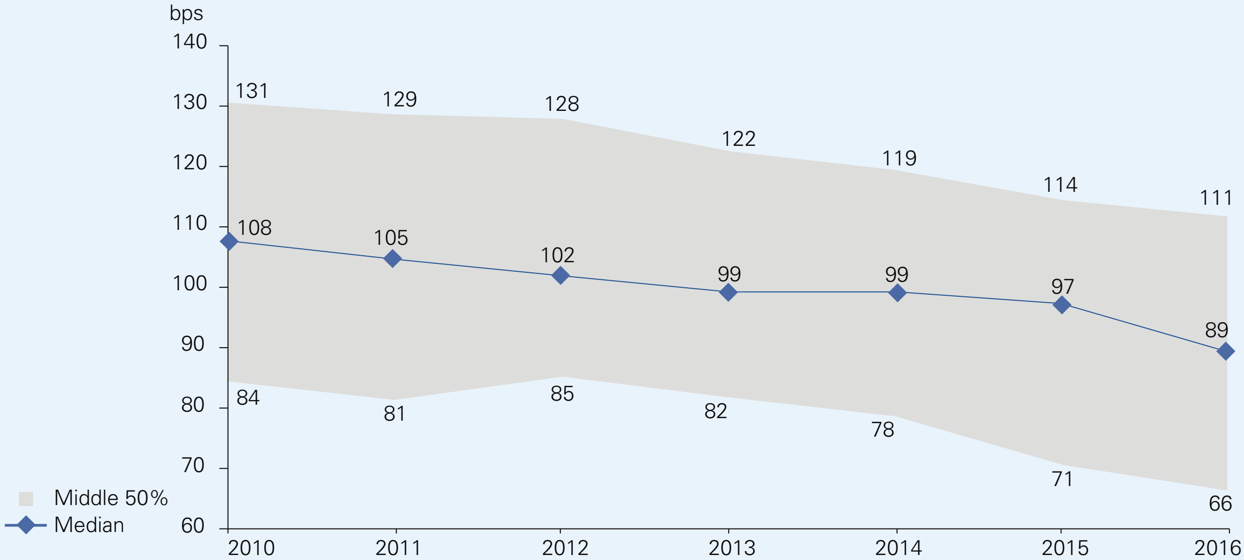
Outlook

- Underlying industry trends point to **further consolidation** as global changes in regulations, demographics, competition, customer preferences and technology require banks to reassess their business models. Current financial performances will also compel many owners to sell.
- There are, however, **fewer banks available for sale** due to historical consolidation. This will make the search for a suitable target even more difficult.
- **Large banks may conclude bigger, bolder deals** as they continue to pursue growth.
- Swiss banks are likely to undertake **further acquisitions in Europe** in order to secure market access.
- **Mergers between small and medium-sized Swiss banks** may be on the uptick, due to similar set-ups and issues easing their integration, and as large banks show less interest in acquiring small institutions.
- There may be **accelerated exits at struggling banks** that may seek to sell some portfolios or assets prior to entering into liquidation.
- We can expect the acquisition of a Swiss private bank by an **Asian-based buyer.**

Income growth

The median operating income margin fell significantly from 97bps in 2015 to 89bps in 2016. A growing number of banks are struggling with falling margins due to a more competitive marketplace and lower levels of undeclared money among other drivers.

Operating income margin development, 2010 to 2016



The median operating income margin has been falling steadily since 2010 but dropped significantly in 2016. Driving this six-year decline was a combination of:

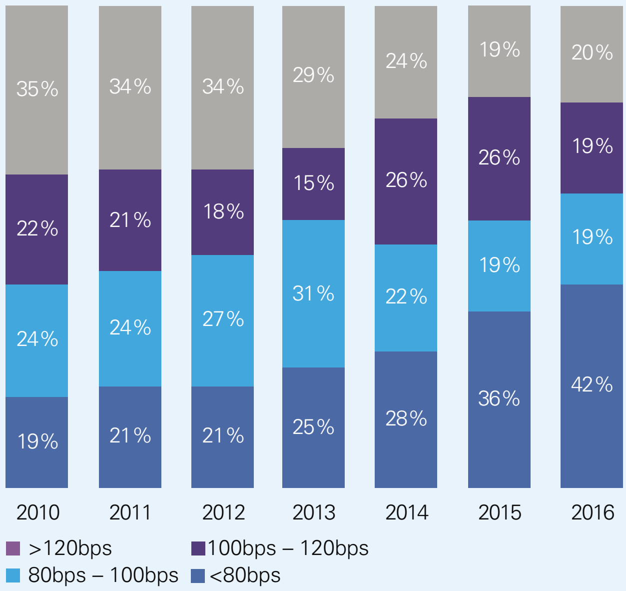
- A lower proportion of undeclared money (such clients tended to be less price-sensitive)
- Stiffer competition
- A growing share of retrocession-free business
- Lower/negative interest rates
- More demanding clients.

Banks cited the drop in 2016 as being due to lower transaction volumes that led to lower net commission income.

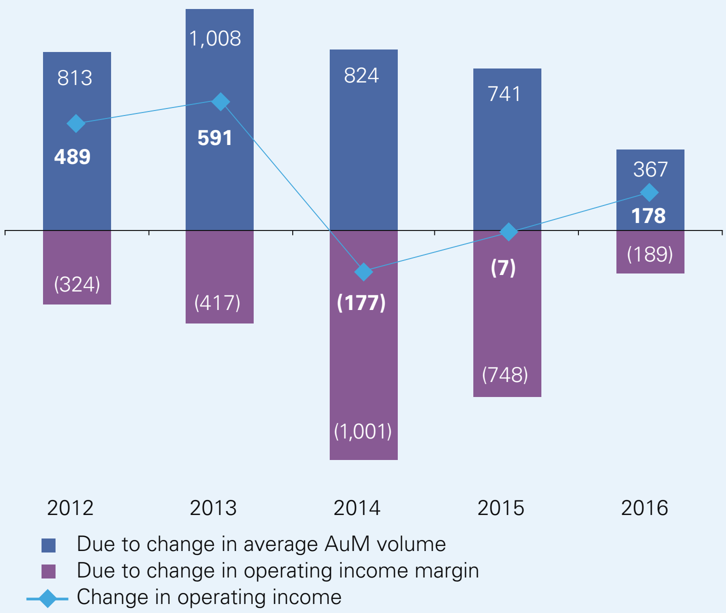
Banks with higher margins generally have more revenue streams such as asset management, IT and business process outsourcing. Such offerings require close cost control, however, due to the additional operating costs involved in offering further revenue streams. Banks that focus purely on core wealth management services generally have a less complex operating model and, therefore, a lower cost base. It is not necessary to have high operating income margins to be profitable; the median Strong bank had an operating income margin of 82bps in 2016, which is below our constant sample's median of 89bps.

In 2016, small banks had the highest median operating income margin at 98bps against 79bps for large banks and 77bps for medium-sized banks. Small banks typically have higher operating income margins due to providing higher-fee discretionary services. Their smaller clients also generally yield higher income margins. Medium and large banks can offer more diversified and lower-fee wealth management services due to leveraging their bigger operational infrastructures.

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



Change in operating income (aggregate), 2012 to 2016
CHFm



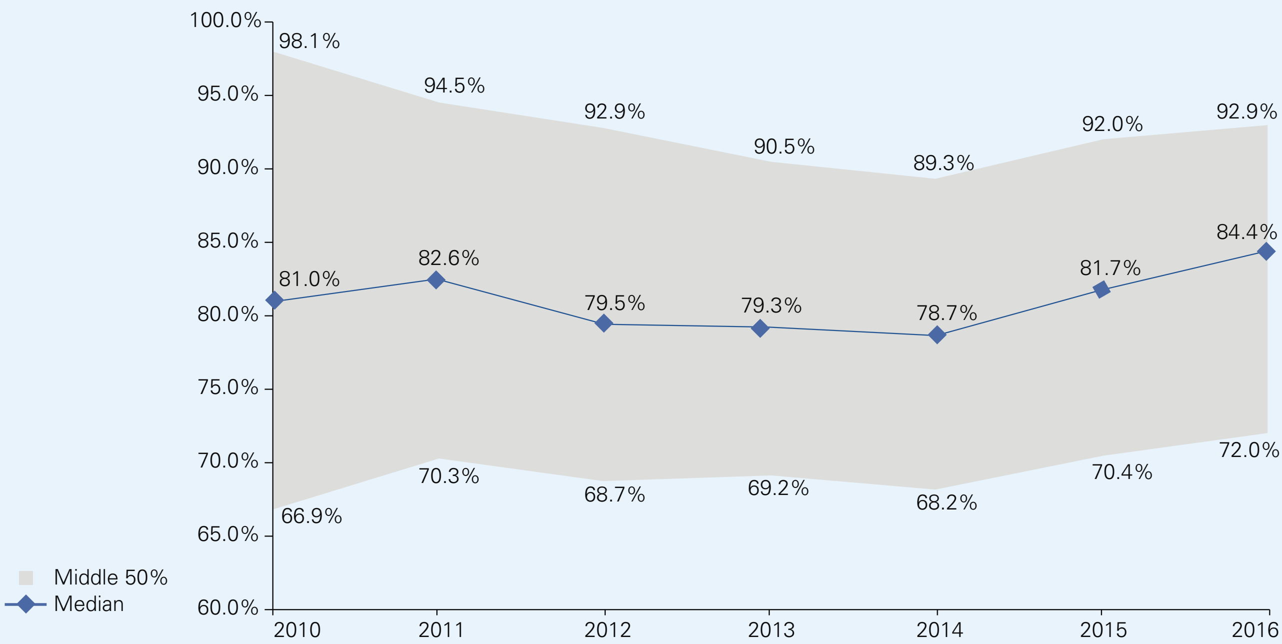
The drop in operating income margin is reflected in a clear shift between 2010 and 2016: the proportion of banks with more than 120bps fell from 35% to 20%, while those with below 80bps increased from 19% to 42%.

In absolute terms, operating income grew by CHF1.1 billion over the past five years. This was driven by higher volumes as a result of M&A transactions, despite the operating income margin falling by 15%. This growth in operating income was largely a redistribution from other parts of the Swiss private banking industry, brought into our sample by M&A undertaken by our constant-sample banks.

Cost-income ratio

As revenue margins continue to fall and the cost-income ratio rises to 84.4%, cost reductions are not enough to halt the deteriorating performance. Some banks have begun radical change to increase income margins and reduce costs. Most have not.

Cost-income ratio development, 2010 to 2016
bps



The median cost-income ratio rose by 5.7 percentage points over the past two years. As median operating income margins fell sharply by 10%, management teams were not able to implement the necessary changes to reduce costs at the same speed.

Initiatives to reduce expenses have been largely positive. Unfortunately, they have generated only limited cost savings as illustrated by the following expense efficiency measures:

- Total operating expenses incurred per AuM fell from a median of 82bps in 2010 to 76bps in 2016.
- Total operating expenses per employee remained stable from a median of CHF338,000 in 2010 to CHF337,000 in 2016.
- Personnel costs per employee fell from a median of CHF233,000 in 2010 to CHF217,000 in 2016.

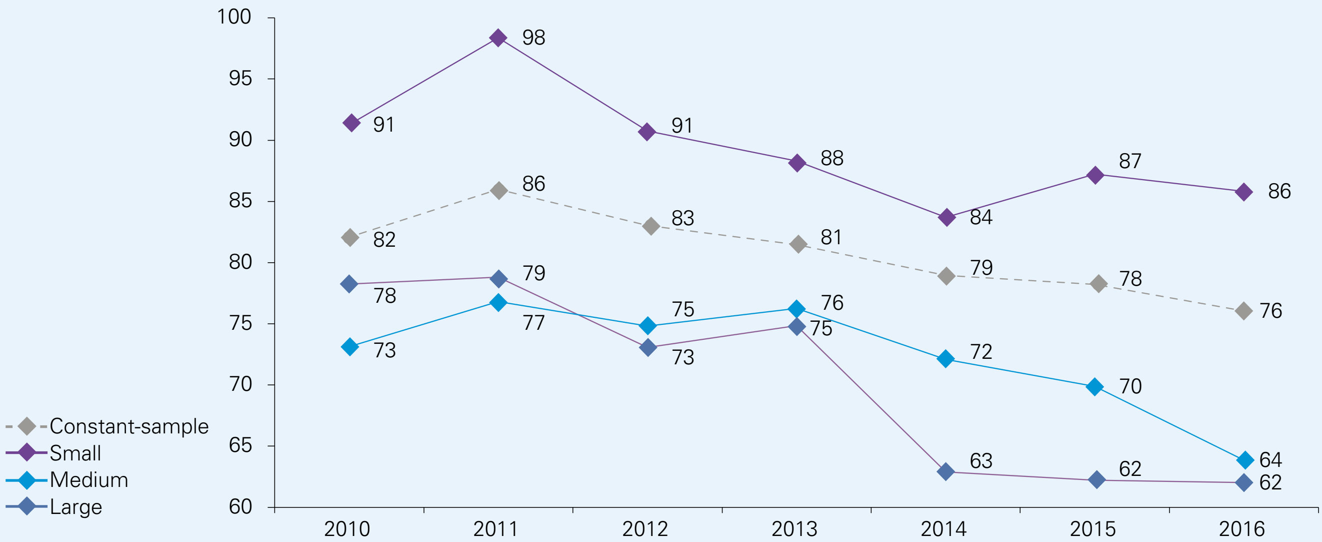
The small reduction in personnel expenses is welcome news, as staff costs represent around two-thirds of a bank's cost base. However, the above benefits are clearly insufficient to counter the effects of an increasingly negative operating income margin.

Small banks had the highest cost-income ratio in 2016 at 86.8%, compared to 83.9% at large banks and 80.1% at medium-sized banks. It is evident that small banks lack sufficient AuM to optimize the use of their operating infrastructure.

By contrast, large banks have a greater opportunity to improve operational efficiency (four of the 14 large banks in our constant sample had cost-income ratios between 60% and 70% in 2016).

Some banks have carried out radical cost reduction programs in recent years while others have progressively reduced their cost bases over time. By focusing only on cost control, however, banks will remain one step behind. Much bigger changes are needed to operating and business models – outsourcing/partnering, optimizing, automating through digitalization and robotics, as well as increasing operating income margins – to counter the headwinds. To do this, banks must look across their entire value chains to identify areas for improvement.

Operating expenses margin development (median), 2010 to 2016
bps



In contrast to the operating income margin which measures total income generated per AuM (expressed in basis points), the operating expenses margin measures operating expenses incurred per AuM (also in basis points).

The median operating expense margin of our constant sample has been falling as improvement measures have begun to take effect. In 2016 it reached 76bps, the lowest level in the past seven years. But this was not enough to offset the 18% decline in operating income margin that has contributed to a lower gross profit margin.

In 2016, the median operating expense margin for small banks was 86bps, medium banks 64bps and large banks 62bps. A significant improvement of more than 20bps in the operating expense margin can be seen at banks with more than CHF5 billion in AuM. This seems to be a threshold banks need to reach in order to achieve a level of scale economies that allows them to reduce operating costs relative to AuM.

The 2016 median operating expense margin for the German-speaking region was 71bps, which performed better than the French-speaking region at 83bps and Ticino at 86bps.

Basis of preparation and methodology

Our analysis covers the 85 Swiss private banks that have been continually active and released annual financial statements from 2010 to the end of 2016 inclusive. We also compile for the first time aggregated financial statements for these banks.

For the purpose of this study, a private bank is defined as a Swiss private bank that holds full FINMA bank and broker-dealer licenses and for which a significant proportion of its business is private wealth management. There were 114 such private banks as at 31 December 2016.

We analyzed the annual financial statements of Swiss private banks that were active and produced financial statements for each of the seven years from 2010 to 2016. We excluded the following banks:

- Those for which we do not have financial statements for each of the seven years.
- UBS and Credit Suisse as, if included, the extremely large size of their businesses would have distorted our results and made the analysis overall less meaningful.
- Two banks that announced they would enter into liquidation in 2017 and accordingly produced their 2016 financial statements on a liquidation, rather than a going concern, basis.

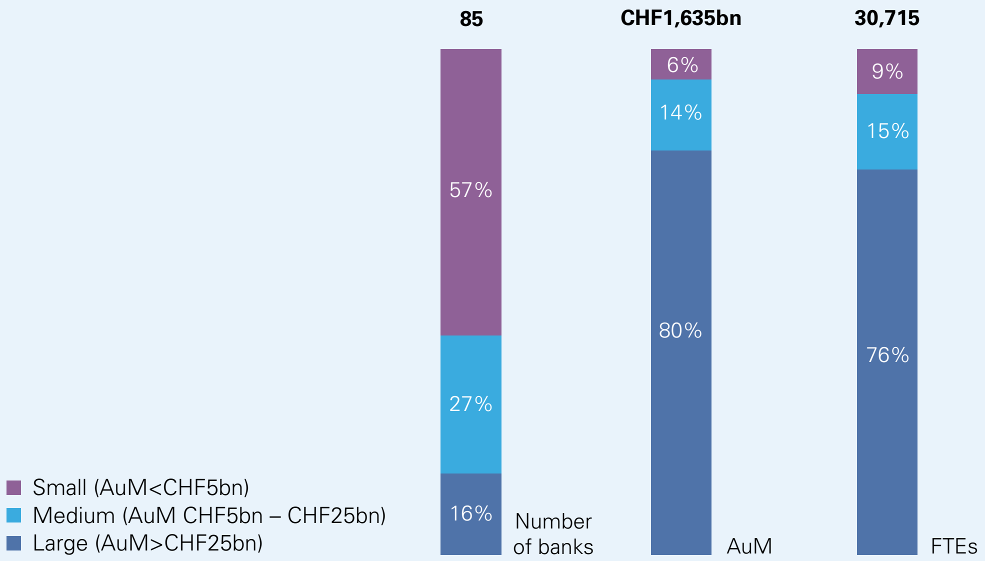
The above exclusions mean that we analyzed 85 of the 114 Swiss private banks, or 75%, in this study.

We have financial data for the past three years for eight of the excluded banks. While the combined absolute size of these eight banks is significant, the general trends and median figures are around the same as those from our constant sample.

Introduction of the industry financial statements
We expanded our analysis by aggregating the financial statements of each bank in our sample, presenting this as a single set of industry financial statements. Please be aware that this aggregate analysis effectively reflects the performance of the 14 largest banks as these comprise 80% of the analyzed banks' aggregate AuM.

Changes in accounting and disclosure standards
Revised accounting and disclosure rules for banks (FINMA Circular 2015/1) came into force in 2015. Profit and loss figures before 2015 are presented under the former accounting and disclosure rules. While there is therefore an accounting impact when comparing 2015 to 2014, the seven-year performance trends were not materially impacted by this change.

Data set of our study



Change in bank sampling approach

Changing our analysis to focus on the constant sample of 85 banks from 2010 to the end of 2016 inclusive contrasts with our previous years' publications in which we also analyzed banks that had exited during the period under review. This previous "historical sample' approach meant that each year analyzed contained fewer banks than the prior year.

By focusing on the 85 banks, we are able to present a constant sample over the seven-year period, and therefore results that are on a like-for-like basis. Accordingly, we refer to our sample – the basis for this study – as the "constant sample'.

Glossary

AEoI	Automatic Exchange of Information or The Common Reporting Standard, which became legally effective in Switzerland on 1 January 2017
AuM	Assets under Management
Avg.	Average
bn	Billion
bps	Basis points (1/100th of 1%)
CHF	Swiss Franc
Constant sample	Our sample is 85 of the 114 Swiss private banks as at 31 December 2016 that produced annual financial statements for each of the past seven years (2010 to 2016)
e.g.	exempli gratia
FINMA	Swiss Financial Markets Authority
FTEs	Full-Time Equivalents
IT	Information Technology
KPI	Key Performance Indicator
M&A	Mergers & Acquisitions
m	Million
n.m.	Not meaningful
NNM	Net New Money
RM	Relationship Manager
RoE	Return on Equity
vs	Versus
YTD	Year-To-Date

KPI calculations and financial statement caption explanations

Following are the calculations for the KPIs used in this study:

KPI	Calculation
AuM growth (%)	$\frac{\text{Closing AuM - Opening AuM}}{\text{Opening AuM}}$
NNM growth (%)	$\frac{\text{Net New Money inflows / (outflows)}}{\text{Opening AuM}}$
RoE (%)	$\frac{\text{Net profit}}{\text{Year-end Book Equity}}$
Cost-income ratio (%)	$\frac{\text{Operating expenses}}{\text{Operating income}}$
Operating expenses / Average FTE (in CHF000)	$\frac{\text{Operating expenses}}{\text{(Opening FTE + Closing FTE) / 2}}$ / 1,000
Personnel expenses / Average FTE (in CHF000)	$\frac{\text{Personnel expenses}}{\text{(Opening FTE + Closing FTE) / 2}}$ / 1,000
Operating income margin (bps)[1]	$\frac{\text{Operating income}}{\text{(Opening AuM + Closing AuM) / 2}} \times 10{,}000$
Operating expenses margin (bps)[1]	$\frac{\text{Operating expenses}}{\text{(Opening AuM + Closing AuM) / 2}} \times 10{,}000$
Gross profit margin (bps)[1]	$\frac{\text{Operating income - Operating expenses}}{\text{(Opening AuM + Closing AuM) / 2}} \times 10{,}000$
Non-operating result margin (bps)[1]	$\frac{\text{Net profit - Gross profit}}{\text{(Opening AuM + Closing AuM) / 2}} \times 10{,}000$
Net profit margin (bps)[1]	$\frac{\text{Net profit}}{\text{(Opening AuM + Closing AuM) / 2}} \times 10{,}000$

[1] 2010 margin-related KPIs used year-end 2010 AuM figures in the denominator instead of average AuM as the year-end 2009 AuM figures are not available

Following are explanations of the financial statement captions used throughout this study:

Operating income
Net interest income + Net commission income + Net trading income + Net other ordinary income

Operating expenses
Personnel expenses + Office space expenses + Expenses for information and communication technology + Expenses for vehicles, equipment, furniture and other fixtures, as well as operating lease expenses + Fees of audit firms + Other operating expenses

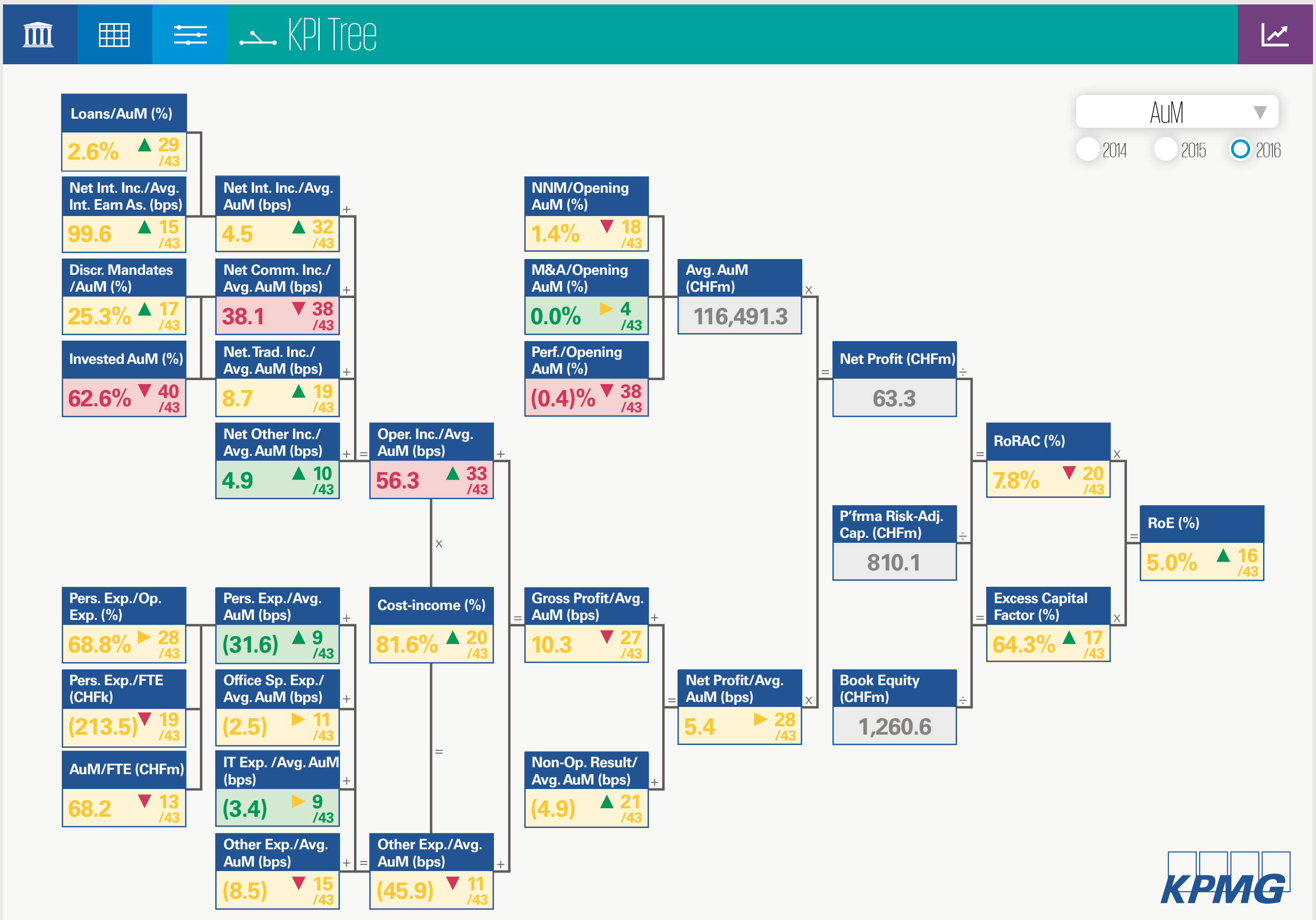
Gross profit
Gross profit/(loss)
Operating income less Operating expenses

Non-operating result
Net profit less Gross profit

Net profit
Net profit/(loss)

KPMG Digital Benchmarking Tool

Our digital, interactive benchmarking tool with over 50 key performance indicators covering 93 Swiss private banks can pinpoint where a Swiss private bank's performance can be improved.



Leveraging our private banking database which contains financial data from 93 Swiss private banks – over 80% of the market, KPMG's digital, interactive benchmarking tool contains more than 50 key performance indicators.

Identifying where a bank can improve its performance, the tool enables a detailed comparison of a bank with its peers using its unique KPI drill-down capabilities.

The tool is best utilized in a workshop setting where we help to identify specific performance improvement areas and how these can be delivered practically and effectively.

Clarity on publications

This series of publications from KPMG Switzerland provides insights, analyses and studies on a range of topics. All publications are available as hard copies as well as online. For more information, please contact **kpmgpublications@kpmg.com**

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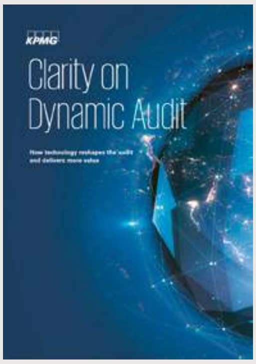

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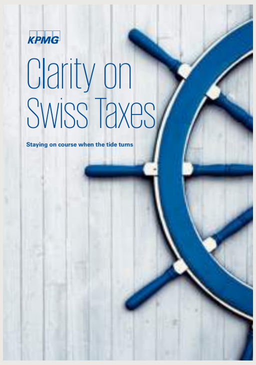

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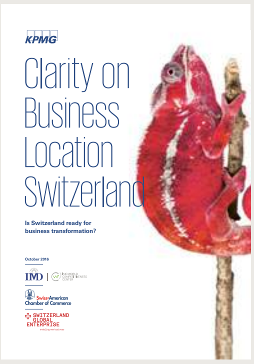

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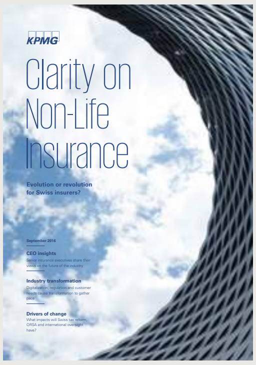

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