KPMG

Clarity on Performance of Swiss Private Banks

Bigger is better in the quest for success

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Institute of Management & Strategy
University of St.Gallen



Bigger is better in the quest for success

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

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Time for a reality check

In last year's publication, we had cause for optimism about the future of Swiss private banking. Performances seemed to be improving, and efforts to deal with legacy issues, Automatic Exchange of Information and cleaning up client portfolios suggested recovery was possible.

Unfortunately, strong equity markets in 2017 masked poor underlying performances. Banks rode positive financial markets while not doing enough to adapt strategies and models for sustainable success. This translated into disappointing levels of Net New Money, for example, at a median of only 0.2% in 2018, and a loss of global market share. Small banks did particularly badly, with Return on Equity falling and cost-income ratios reaching their highest ever levels. The result is that we have downgraded over one-quarter of banks. We now classify one-third of Swiss banks as Weak performers.

Looking ahead, size is key to success. We believe that banks with Assets under Management of CHF100 billion or more are in a better position to prosper. They have the resources to invest in client products and operating efficiencies as well as to maintain an onshore presence in critical high-growth markets. The other successful model will be Swiss private banking arms of foreign banking groups that have an onshore presence in emerging markets.

It is the small, traditional, pure-play offshore Swiss private banks without sufficient access to emerging market wealth that are being driven to extinction. That segment's performance fared the worst in 2018 and we believe most will be acquired or go out of business. Overall, eight banks exited the market in the past 18 months while one new banking license was issued. This takes the number of Swiss private banks to 101 from 163 less than ten years ago. What is surprising is how that the rate of consolidation to date was not even faster.

Many management teams seem to be hoping for better times rather than focusing on performance improvement. We urge them to look hard at whether their banks can realistically recover. And for shareholders to challenge management on what radical changes or decisions may be needed.

Visit our digital benchmarking toolkit at kpmg.ch/pb to find out how your bank performs against its peers. Or contact us to discuss our insights and help assess the future direction of your organization.





Philipp Rickert **Christian Hintermann**

KPMG AG, Switzerland



Minimum change, maximum exposure

Swiss banks continue to rely excessively on financial markets. While good performances in 2017 were heavily driven by the positive market environment, a more challenging 2018 has exposed how weak banks really are. Most have made insufficient progress to enhance business and operating models or to adapt strategies and set ups to ensure sustainable success. If markets take a downturn, most banks will suffer – many to the point of extinction.



Too little, too late: Accelerated consolidation is overdue

Consolidation remains slower than expected, with only eight banks exiting the market since the start of 2018. While M&A reached a new high in 2018, too many deals simply modified geographic footprints. This is necessary but does not go far enough. Small banks and Weak performers need to be much braver if they are to survive. Shareholders must also play their part by being realistic about their bank's chances of survival and actively challenging management to make difficult decisions and implement radical change.





Losing ground: Market share falls as NNM stagnates

Global wealth is growing, but Net New Money (NNM) at Swiss private banks is stagnating. A small group of banks has consistently achieved NNM of around 5%, but the median in 2018 was a mere 0.2%. After years of blaming low levels on legacy issues, tax transparency (AEoI) and intensive regulation and compliance, banks must face reality. Too many strategies have failed to produce growth or greater profitability, and a lack of onshore presence in high-growth markets is limiting their ability to acquire new clients. As a result, the global market share of Swiss private banks is shrinking.



Downgraded: Weak performers are now the biggest cluster

Most small and medium-sized banks posted their worst ever results in 2018 or managed only to stand still as their income-driven models made it difficult to keep their heads above water. We have downgraded 24 of the 87 banks by at least one performance cluster. More than one-third of Swiss private banks are now Weak performers. Despite some optimism in last year's study, the key ratios for the industry have worsened or remained unchanged for 10 years or more as banks have failed to take advantage of the good times to improve.



Getting weaker: Small banks suffer the most



Small banks' cost-income ratios rose by 4 percentage points last year to their highest ever levels. Thirteen more have become Weak performers since the start of 2018. These are mainly traditional, pure-play offshore wealth businesses which lack the resources to build an onshore presence to access AuM growth in vital high-growth markets. As profitability declines, so do the chances of survival. Many small banks in the Strong or Upper Mid clusters are owned by emerging-market banking groups, which use their Swiss private banking arm as a booking center.



Scale for success: CHF100 billion AuM



A group of Swiss-owned CHF100 billion+ AuM banks has developed over recent years, which has turned out to be the winning model. These banks generally have an international physical onshore network, including in emerging markets. This level of AuM provides greater resources to invest, develop business, leverage the Swiss wealth management brand, and achieve operating efficiencies. It gives an advantage in an industry where expensive onshore presence is necessary for growth in the world's high potential markets.



Required: Top management shake-up



The average age of a Swiss private banking board member rose from 59 years in 2012 to 62 in 2018. That of an executive committee member is up 1 year to 52. Add the fact that more than 40% of banks have not changed their CEO for at least seven years and women hold less than 10% of board roles, the picture is of an industry that lacks diversity. This is at a time when fresh perspectives are needed to deal with changing competitive dynamics, emerging technologies, succession by younger generations, and wealth creation in new markets.



CHAPTER I

Industry overview

We have analyzed the Swiss private banking industry as a whole, based on our sample of 87 private banks.

The industry financial statements presented are the aggregate of the financial statements of the 87 banks. It should be noted that the large banks have the biggest weighting in these figures.

We also look back at the movement in the number of private banks over the past 18 months and assess M&A trends.

Finally, we group the banks into four performance clusters, sharing our insights into their characteristics.

Number of private banks and M&A

2018 set a record high for the number of M&A transactions involving Swiss banks. This activity did not yield a transformational deal, however, had a largely neutral effect on overall levels of Assets under Management (AuM), as it was mainly driven by banks seeking to modify their regional set ups outside Switzerland.

The past 18 months saw the number of banks in Switzerland fall to almost 100. This was the net effect of eight banks exiting the market and one new bank being granted a license by FINMA. Although financial markets remain strong – having dipped sharply towards the end of 2018 before regaining ground in 2019 – banks' performances have deteriorated further, which is likely to prompt a fresh wave of consolidation.

NUMBER OF BANKS MAY FALL BELOW 100 BY THE YEAR END

Eight banks exited the market in the past 18 months. Mbaer meanwhile became the first new private bank to be granted a banking licence by FINMA since Zähringer entered the market in 2015.

Even this level of consolidation appears muted given poor performances. We can reasonably expect the number of banks to fall further by the end of 2019.

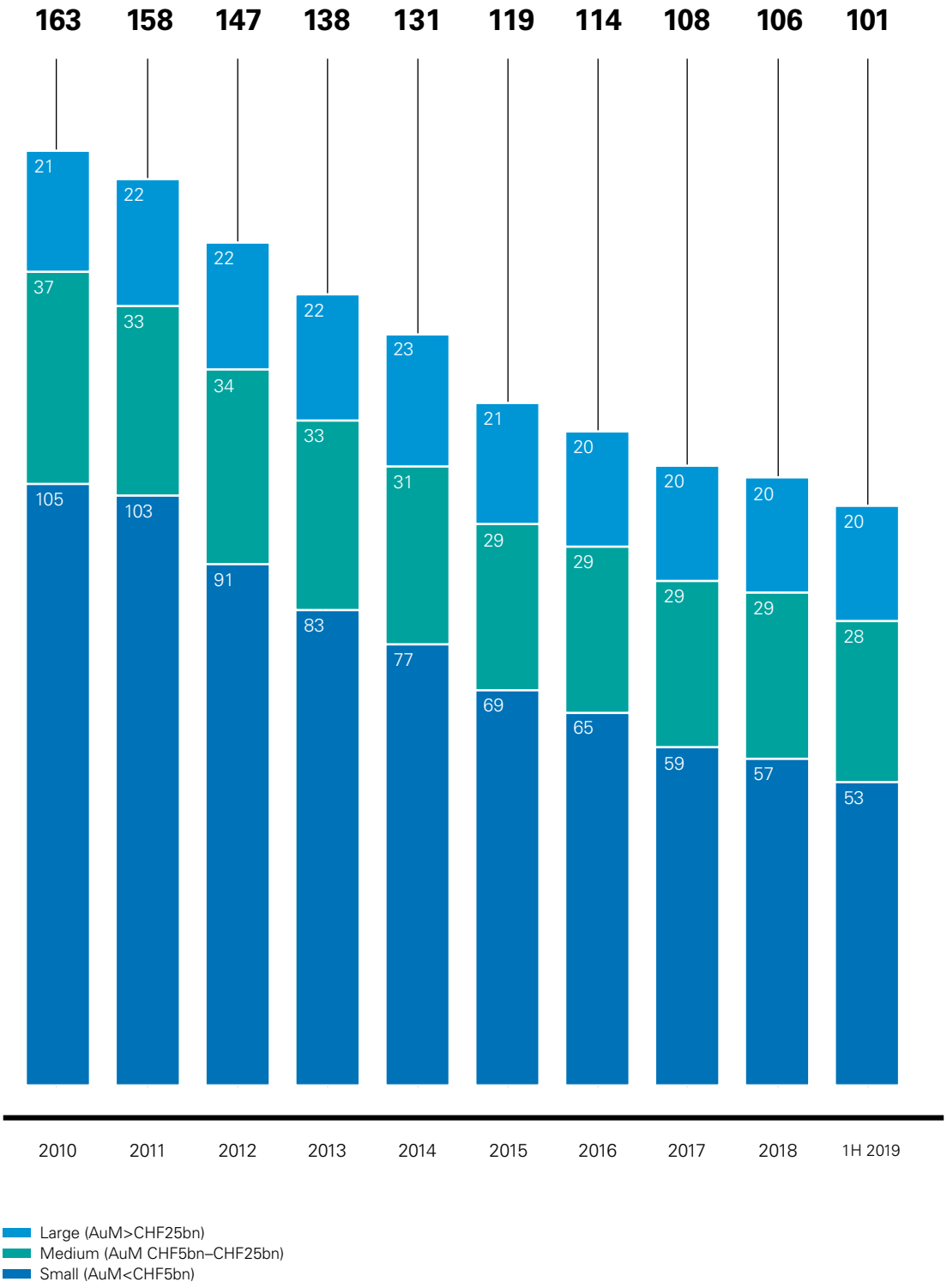
SECOND CONSECUTIVE YEAR OF RECORD M&A

The net fall of seven banks over the past 18 months masks high levels of M&A. 2018 recorded the highest number of deals – at 19 – in our period under review. This was an increase on an already record-breaking 2017.

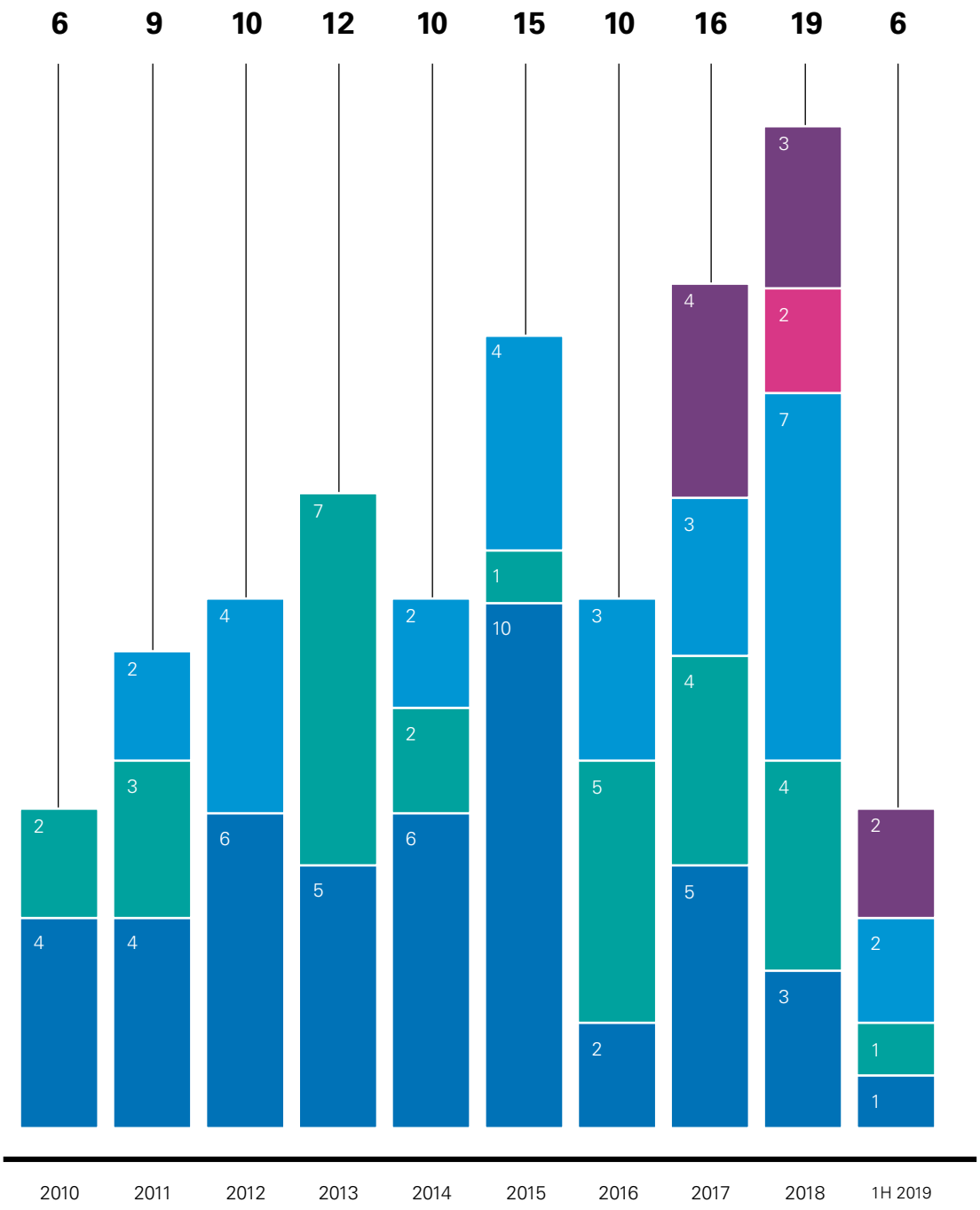
FOREIGN TRANSACTIONS DOMINATE THE FIELD

Of the 19 transactions in 2018, seven were Swiss banks acquiring abroad. Large Swiss banks were a key driver of this activity. Large banks also exited businesses abroad that were no longer considered strategically core (three transactions). Small and medium banks rather embraced opportunities to grow within the Swiss market, mainly by acquiring Independent Asset Managers.

NUMBER OF SWISS PRIVATE BANKS BY AUM (2010–1H 2019)



NUMBER OF ANNOUNCED DEALS WHERE THE BUYER, TARGET OR SELLER IS A SWISS PRIVATE BANK, 2010–1H 2019



Exit abroad: Foreign buyer and Swiss private bank target business located abroad
Acquisition from abroad
Acquisition abroad: Swiss private bank buyer and foreign target
Domestic (Other): Swiss buyer and Swiss target, one of which is a Swiss private bank
Consolidation: Acquisition of a Swiss private bank that has already lost, or is expected to lose its banking license as it is absorbed by the buyer

MERGERS ATTAIN GREATER PROMINENCE
As banks seek to build scale and optimize operating costs, the past 18 months has seen a trend towards mergers. Three of the four mergers in this period were Swiss banks joining forces with a counterpart from a different region of the country to increase scale, strengthen their respective local presences and expand activities in the other region.

All banks involved in these recent mergers had AuM below CHF5 billion and were Weak or Lower Mid performers in 2017 and 2018.

DEAL VALUES ARE ON THE RISE
Prices paid in private banking deals rose in 2018. This increase was driven mainly by a scarcity of quality targets available, combined with a significant number of banks looking for take-over targets in order to build critical scale. A preference for share deals replaced the dominance of asset deals that was observed over recent years.

CONTINUED POOR PERFORMANCE MAKES CHANGE NECESSARY
We expect consolidation to accelerate in the near future as banks' performances continue to worsen. As M&A is on the rise, it remains to be seen whether 2019 will produce a transformational deal.

Bank owners are strongly recommended to consider strategic M&A options when assessing the feasibility of turning around their bank's performance.

Transactions involving Swiss private banks

(excluding asset management deals) – 2018 and 1H 2019

1H 2019

DATE ANNOUNCED	TARGET	BIDDER	SELLER	AUM (CHFbn)	DEAL TYPE
Apr 19	Lombard Odier & Cie (Gibraltar) Limited	J. Safra Sarasin Group	Lombard Odier Group	n/d	Share deal
Mar 19	Shaw and Partners Limited (Australia)	EFG International	Shaw and Partners Limited	11.4	Share deal
Mar 19	NSC Asesores (Mexico) (JB increases its stake from 40% to 70%)	Julius Baer Group Ltd.	Partners	3.5	Share deal
Feb 19	Falcon Private Wealth (UK)	Dolfin Financial (UK)	Falcon Private Bank Ltd.	1.0	Asset deal
Jan 19	A.M.&C. Finance SA	Banque Cramer & Cie SA	n/d	0.2	Share deal
Jan 19	Banca Arner SA	Geneva Swiss Bank SA	n/d	0.7	Merger

- Exit abroad: Foreign buyer and Swiss private bank target business located abroad
- Acquisition from abroad
- Acquisition abroad: Swiss private bank buyer and foreign target
- Domestic (Other): Swiss buyer and Swiss target, one of which is a Swiss private bank
- Consolidation: Acquisition of a Swiss private bank that has already lost, or is expected to lose its banking license as it is absorbed by the buyer

2018

DATE ANNOUNCED	TARGET	BIDDER	SELLER	AUM (CHFbn)	DEAL TYPE
Dec 18	Julius Baer (Netherlands) B.V.	Wealth Management Partners N.V.	Julius Baer Group Limited	1.1	Share deal
Nov 18	Sallfort Privatbank AG (takes 20% of the merged entity)	Banque Heritage SA (takes 80% of the merged entity)	n/d	1.0	Merger
Oct 18	Lombard Odier Investment Managers (LOIM) (USA)	Vontobel Swiss Wealth Advisors AG (VSWA)	Banque Lombard Odier & Cie SA	1.2	Asset deal
Sep 18	Julius Baer Wealth Management Ltd. (40% Stake)	Nomura Holdings, Inc. (Japan)	Julius Baer Group Limited	n/d	Share deal
Sep 18	Öhman Bank S.A. (Luxembourg)	Reyl & Cie Ltd	Öhman Group	0.9	Share deal
Sep 18	Berenberg Bank (Schweiz) (80.1% stake)	A group of shareholders	Berenberg Bank	5.7	Share deal
Sep 18	Banque Pâris Bertrand Sturdza SA (40% stake)	Investcorp (Bahrain)	n/d	4.5	Share deal
Aug 18	Schroder & Co Bank AG (Eastern European PB Business)	Compagnie Bancaire Helvétique SA	Schroder & Co Bank AG	0.7	Asset deal
July 18	ACPI Investments Limited	Union Bancaire Privée, UBP SA	n/d	2.7	Share deal
July 18	Lagane Family Office SA	Banque Eric Sturdza (Coges Corraterie Gestion SA)	n/d	n/d	Share deal
July 18	Mourgue d'Algue & Cie	Gonet & Cie SA	n/d	0.5	Merger
July 18	Dynagest SA	Banque Profil de Gestion SA	n/d	2.1	Share deal
May 18	Banque Carnegie Luxembourg S.A.	Union Bancaire Privée, UBP SA	Carnegie Investment Bank AB	2.1	Asset deal
May 18	Notenstein La Roche Private Bank Ltd	Vontobel Holding AG	Raiffeisen Schweiz	16.0	Share deal
Apr 18	Private Investment Bank Limited (The Bahamas) (85% stake)	IPG Securities Asset Management Ltd	Banque Cramer & Cie SA	n/d	Share deal
Feb 18	Alpe Adria Gestioni SIM SpA (Italy)	Banca Credinvest SA	n/d	0.1	Share deal
Jan 18	Reliance Group (Brazil)	Julius Baer Group Ltd.	n/d	4.5	Share deal
Jan 18	Brickell Bank (USA)	CBH Compagnie Bancaire Helvetique SA	Banco Espirito Santo, SA.	n/d	Share deal
Jan 18	Nordea AB's Lux private banking business	UBS Europe SE, subsidiary of UBS Group AG	Nordea AB	15.0	Share deal

Industry financial statements

Industry financials improved in 2018 despite a much more challenging environment than in 2017. This positive development was driven almost exclusively by large banks. By contrast, many medium-sized banks are surviving through cost-cutting measures, though it is questionable for how long they can postpone their decline. The situation at most small banks continues to worsen, with poor performances pushing them even further into negative territory – raising serious doubts over how many can survive even in the short term.

SYNERGIES AND ONE-OFF ITEMS BOOST PROFITS

Gross profit increased by CHF137 million in 2018, improving the cost-income ratio to 75.2%. A significant part of this is due to EFG reducing its cost base through post-BSI merger synergies.

Net profit rose by 12.2% to CHF3.1 billion. This figure falls below -1% if the CHF375 million one-off gains from asset sales at two banks is excluded.

The industry's Return on Equity meanwhile rose to 7.9%, closing in on the cost of equity of around 8–10%.

FINANCIAL MARKETS DRIVE GROWTH IN OPERATING INCOME

Driven by the rise in the US Federal Reserve rate and an aggressive push to expand loan portfolios at medium-sized banks, net interest income was the largest contributor to income growth.

Net commission income increased by 2.0% as higher average AuM resulted in greater asset-based fees.

The reduction in net other income mainly relates to the spin-off of one bank's outsourcing business.

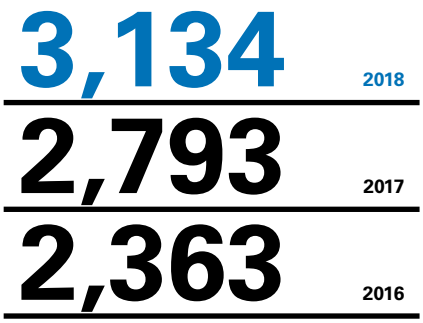
Global equity markets continued their ascent during the first three quarters of 2018, then fell dramatically in Q4. As a result, AuM at the year end was CHF2,514 billion, being CHF109 billion below the prior year end.

OPERATING EXPENSES GROW IN LINE WITH INCOME

Personnel expenses continue to be the largest component of costs, at around 70% of total operating expenses. They rose CHF102 million, or 1.1%, in 2018 while general and administrative expenses grew by 3.0%.

Six large banks reported a significant increase in personnel expenses as a result of expanding their businesses. Only 36 banks saw personnel expenses fall. Medium banks were the only size group able to reduce personnel expenses.

NET PROFIT
in CHFm



INDUSTRY FINANCIAL STATEMENTS FOR THE THREE YEARS ENDED 31 DECEMBER 2018

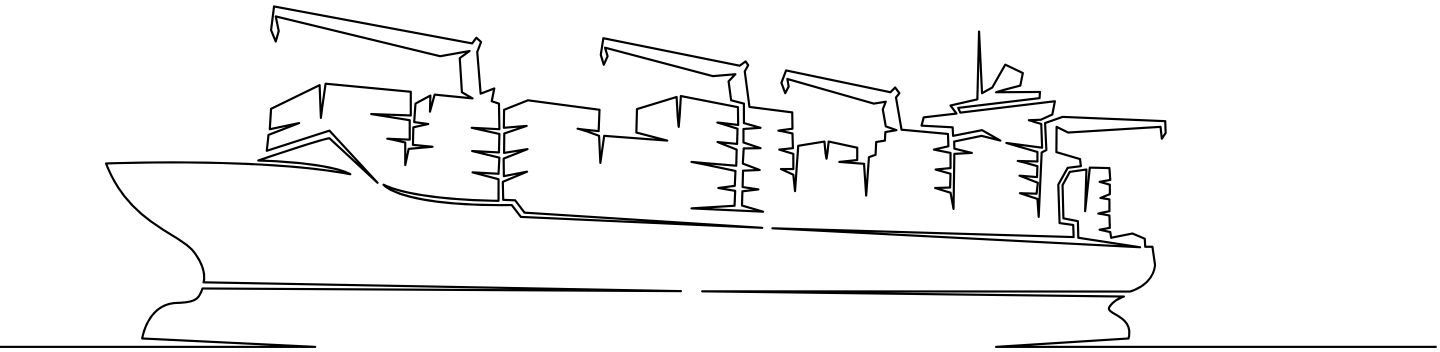
CONSTANT SAMPLE FINANCIAL STATEMENTS – 87 BANKS

				2018 vs. 2017	
CHFm	**2016**	**2017**	**2018**	**Amount**	**%**
Net interest income	3,343	3,809	4,079	270	*7.1%*
Net commission income	10,172	11,329	11,557	228	*2.0%*
Net trading income	2,055	2,158	2,173	15	*0.7%*
Net other income	839	708	557	(151)	*(21.3)%*
Operating income	16,409	18,003	18,365	362	*2.0%*
Personnel expenses	(8,703)	(9,448)	(9,549)	(102)	*1.1%*
General and administrative expenses	(3,867)	(4,141)	(4,264)	(123)	*3.0%*
Operating expenses	(12,570)	(13,588)	(13,813)	(225)	*1.7%*
Gross profit	3,840	4,415	4,552	137	*3.1%*
Non-operating result	(1,477)	(1,622)	(1,418)	204	*(12.6)%*
Net profit	**2,363**	**2,793**	**3,134**	**341**	***12.2%***

Other key data	**2016**	**2017**	**2018**	**Amount**	**%**
Average AuM (CHFbn)	2,343	2,516	2,639	123	*4.9%*
Average FTEs	36,149	37,700	37,797	97	*0.3%*
Cost-income ratio	*76.6%*	*75.5%*	*75.2%*	*(0.3)%*	*(0.4)%*
Return on Equity	*6.0%*	*7.2%*	*7.9%*	*0.7%*	*9.2%*

Notes: Certain reclassifications and adjustments were made to facilitate comparability

Industry financial statements by size cluster



	Large		
CHFm	**2017**	**2018**	**Δ**
Operating income	14,773	15,275	502
Operating expenses	(10,972)	(11,232)	(260)
Gross profit	**3,801**	**4,042**	**242**
KPIs			
Average AuM (CHFbn)	2,122	2,198	76
Income margin (bps)	70	69	(1)
Gross profit margin (bps)	18	18	0
Cost-income ratio	74.3%	73.5%	(0.8%)
Average discr. AuM/Average AuM	21.3%	21.0%	(0.3%)

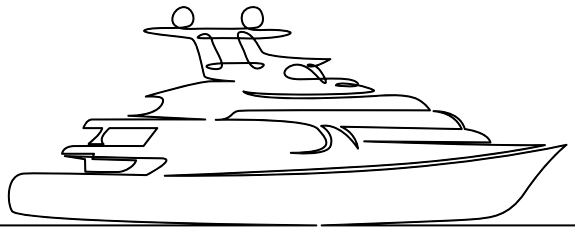
LARGE BANKS

GROWING BUSINESSES

Mainly strong power houses that have improved most key ratios despite a challenging environment. Large banks are generally well positioned and profitable, though NNM remains extremely disappointing. A handful of large banks are rather weak, but even these are showing signs of improvement.

Operating income grew by CHF500 million in 2018. This 3.4% growth is despite more challenging markets in 2018. Net commission income meanwhile rose by 3.5%, compared to falls of 4.6% and 5.0% at medium and small banks respectively. Operating expenses rose more slowly than income in 2018, contributing to a 6.4% increase in gross profit and a slight reduction in the cost income ratio to 73.5%.

Large banks are the only cluster to achieve an RoE in line with economic return expectations – at 9.6% – and to increase RoE in 2018. NNM remained poor, however, at 1.1%. While this average hides considerable differences within the cluster (seven banks generated NNM in excess of CHF1 billion while five banks experienced negative NNM of more than CHF1 billion), the message is clear: improvements are needed across the board. The two large banks that are Weak performers are subsidiaries of large global banking groups. All large banks that are Strong performers have AuM in excess of CHF100 billion.



MEDIUM BANKS

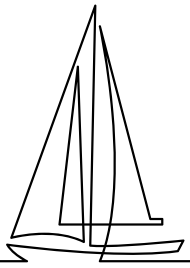
POSTPONING THEIR DECLINE

A diverse group that contains seven Strong and seven Weak performers. Although in decline over recent years, cost reductions mean they have avoided the free fall experienced at small banks. Almost two-thirds of medium-sized banks are subsidiaries of foreign banks.

Operating income fell by 3.8%. This decline would have been significantly bigger if the group had not aggressively grown its loan portfolio and was therefore able to increase net interest income by 14.8%. Careful management of personnel expenses resulted in a 1.9% reduction in average FTEs. Costs per FTE also fell, down 1.0% to around CHF230k.

Due to efforts to keep general and administrative costs under control (-3.5%), the fall in gross profit (-7.4%) and net profit (-3.4%) was much less than at small banks. This remains a disappointing performance and is not enough to secure sustainable profitability going forward. NNM was slightly positive in 2018 after three years of outflows.

	Medium		
CHFm	**2017**	**2018**	**Δ**
Operating income	2,119	2,038	(81)
Operating expenses	(1,714)	(1,663)	51
Gross profit	**405**	**375**	**(30)**
KPIs			
Average AuM (CHFbn)	279	256	(23)
Income margin (bps)	76	80	4
Gross profit margin (bps)	14	15	1
Cost-income ratio	80.9%	81.6%	0.7%
Average discr. AuM/Average AuM	27.4%	23.8%	(3.6%)



SMALL BANKS

DECLINING RAPIDLY

Poor performers that continue to deteriorate at an alarming rate. The number of successful small banks is falling. Business models of most small banks appear unsustainable even after years of investments to adapt to the new world of private banking. Although shareholders have not yet taken the decision to exit the market, it seems unfeasible that many small banks can survive.

Small banks had a very poor 2018, as operating income fell by around 5.3% and operating expenses rose by 1.7%. Their operating income margin is converging with those of the large and medium-sized banks. Gross profit was down by 36% and net profit down by 64%. Cost-income ratio rose by 6 percentage points to 87.2%. RoE fell from 3.2% to 1.2% in 2018, which is far from an acceptable return for shareholders.

Out of the 47 small banks, 12 posted operating losses, and 21 (or 45%) are Weak performers. On the positive side, small banks posted the strongest NNM of the three size segments, at 2.1%. However, it appears that the average operating income margin of this new client base is lower than the current client base – thereby diluting the overall margin. At CHF112 billion AuM, these 47 small banks represent only around 4% of the industry's AuM. Their negative performance therefore has a minor impact on the Swiss private banking industry as a whole.

	Small		
CHFm	**2017**	**2018**	**Δ**
Operating income	1,111	1,052	(59)
Operating expenses	(902)	(917)	(16)
Gross profit	**210**	**135**	**(75)**
KPIs			
Average AuM (CHFbn)	112	114	2
Income margin (bps)	99	93	(6)
Gross profit margin (bps)	19	12	(7)
Cost-income ratio	81.2%	87.2%	6.0%
Average discr. AuM/Average AuM	29.2%	29.2%	(0.0%)

AuM development

The vast majority of Swiss banks generate far too little AuM through NNM or M&A. This is despite a record number of deals, legacy clients having been largely cleaned, and the automatic exchange of information (AEoI) being fully in place. AuM growth is almost entirely dependent on external developments such as financial market conditions. As a result, Switzerland's private banking industry does not seem to be benefiting from global wealth creation and is losing market share.

AUM GROWTH IS AT THE MERCY OF EQUITY MARKETS

In 2017, global equity markets rose by 18.7%. Swiss banks posted performance growth of 8.6%, leading to a 9.1% increase in AuM volume by the year end.

In 2018, global equity markets fell by 14.0%. Swiss banks' performances contracted by -5.5%, causing AuM to fall by 4.2% by the end of that year.

This demonstrates the excessive reliance of Swiss banks on developments outside their control. It also emphasizes the fact that Switzerland's banking industry underperforms in terms of its participation in global wealth creation.

NNM AND M&A IMPACTS ON AUM CONTINUE TO DISAPPOINT

Following the completion of outflows from the AEoI waves in 2016 and 2017, it was expected that NNM growth in 2018 would be far in excess of 1%. This did not happen.

NNM came mostly from large banks, which generated CHF24.6 billion – ten times that of small and medium-sized banks combined. In addition, assets acquired through M&A transactions were close to zero, despite 2018 producing a record numbers of deals.

The deals that took place had a negligible impact on AuM volumes. Combined AuM growth through NNM and M&A was only 1.5% in 2017 and 1.6% in 2018.

Put simply, the majority of banks – and the industry overall – failed to grow organically through NNM, or inorganically through M&A.

AVERAGE AUM IS STILL BETTER IN 2018

As most of the downturn in global equity markets occurred in the last two months of 2018 following a strong first three-quarters of the year, banks continued to benefit from the higher average AuM in 2017 and most of 2018, and therefore higher asset-based fee-earning volumes.

Equity markets moved back into positive territory in the first half of 2019, recovering to the peak observed immediately prior to the dip in late 2018.

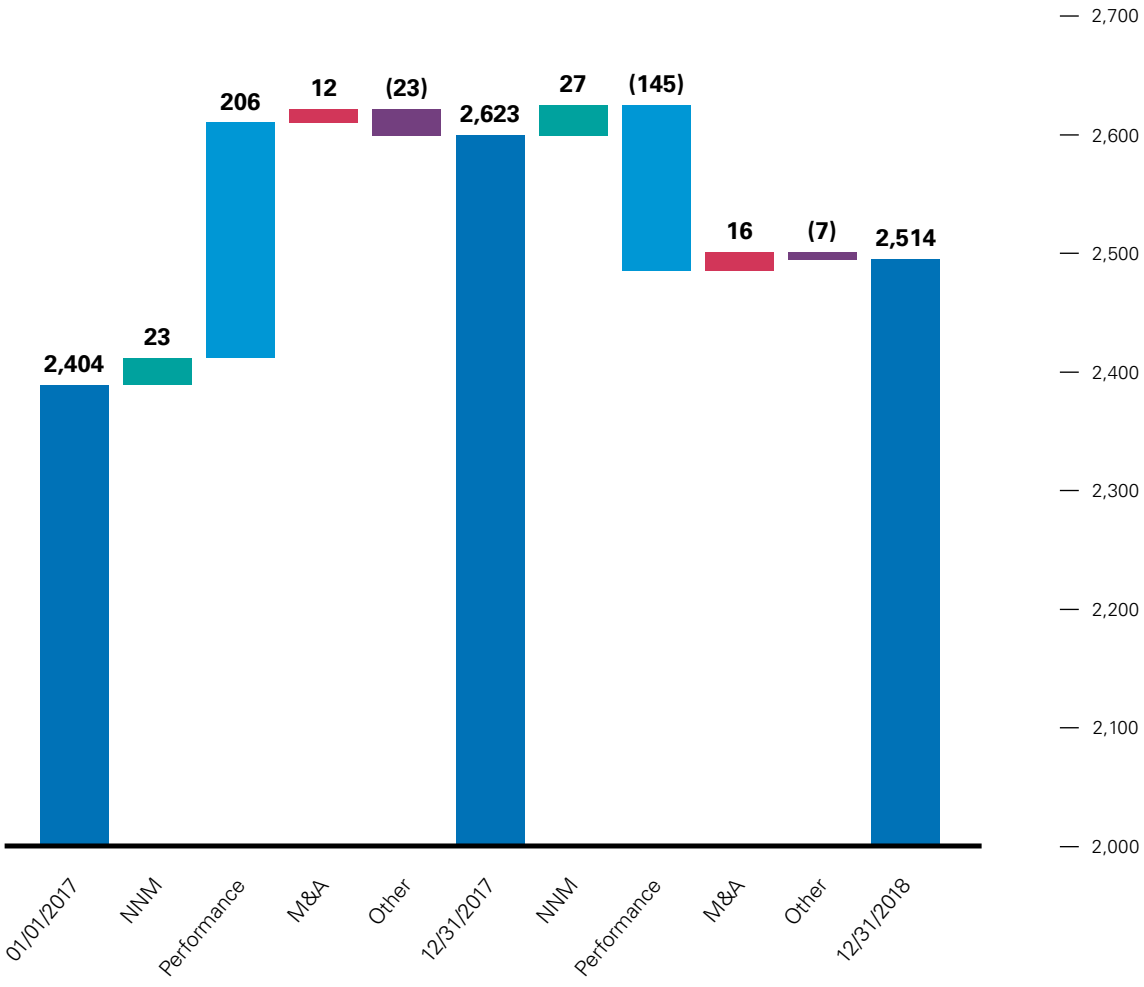
ASSETS UNDER MANAGEMENT
in CHFbn

2,514 12/31/2018

2,623 12/31/2017

2,404 12/31/2016

AUM DEVELOPMENT, 1 JANUARY 2017–31 DECEMBER 2018
in CHFbn



Performance clusters

Significant downgrades make Weak performers the biggest cluster at 34% of Swiss banks. Small banks constitute two-thirds of Weak performers and remain the most vulnerable. Banks with traditional, pure play, offshore models were the biggest type downgraded. Overall, the picture is of an unhealthy – and worsening – industry.

TRADITIONAL, PURE-PLAY, OFFSHORE PLAYERS ARE MOST DOWNGRADED

Banks with a traditional, pure play, offshore model – typically small and medium-sized banks – face increasingly difficult times, even if they have a clear focus on selected markets. Banks with this business model saw their operating income margin fall and were downgraded the most.

NUMBER OF WEAK PERFORMERS RISES BY 50%

Positive financial markets produced good results in 2017. The picture in 2018 was very different: 24 banks were downgraded and only nine upgraded.

The Lower Mid cluster is where the most significant changes took place. While five banks were upgraded to Upper Mid, 12 were downgraded to Weak.

Overall, eight of the 24 downgraded banks were Strong performers that are now classified largely as Upper Mid performers. Of the nine upgrades, four were small banks, of which one is a subsidiary of an emerging-market bank.

Having achieved no substantial efficiency improvements, Weak banks' cost-income ratios have increased significantly. They remain in a vulnerable position due to persistent margin pressure, and too little progress on reducing the number of employees and personnel expenses.

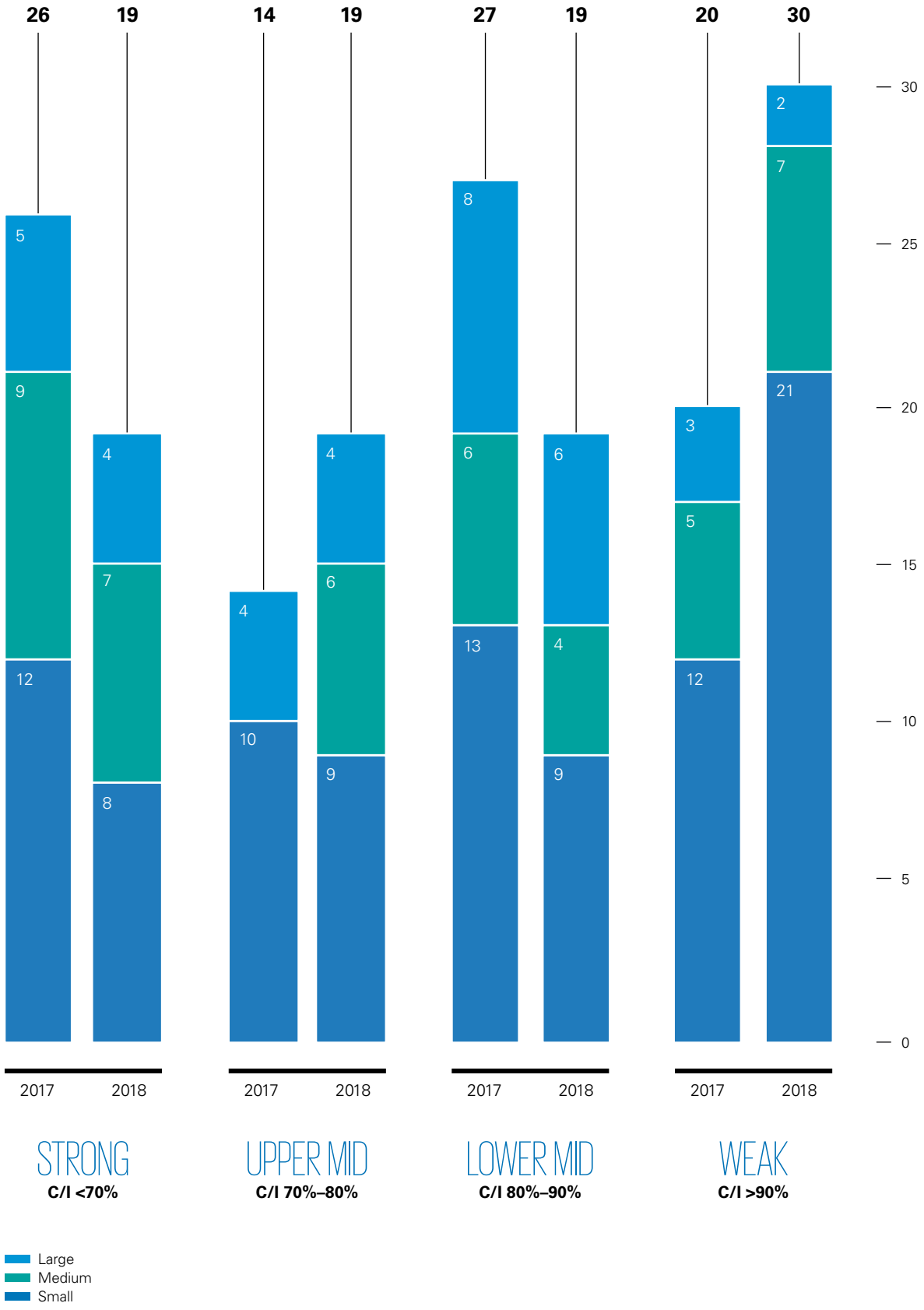
WEAK PERFORMERS ARE NOW 34% OF THE MARKET

At 34% of banks, Weak performers are the largest cluster. Of these 30 Weak performers, 16 incurred operating losses in 2018. Seven of the 16 suffered operating losses in at least each of the past three years.

COST-INCOME RATIO AS A PROFITABILITY METRIC

To assess the performance clusters, we use the cost-income ratio (C/I) as key profitability metric. As the inverse of gross profit / operating income, the cost-income ratio measures gross profitability. Compared to RoE, this ratio has the advantage of not being as impacted by one-off income statement items and being free of influence from differing capital levels.

NUMBER OF BANKS BY PERFORMANCE CLUSTER, 2017 AND 2018



STRONG **22%**

Total banks	**19**
Large	4
Medium	7
Small	8

UPPER MID **22%**

Total banks	**19**
Large	4
Medium	6
Small	9

STRONG
PERFORMERS

This group consists of four large Swiss private banks, five subsidiaries of emerging-market banks, six banks that focus mainly on Swiss onshore business, and four banks with more traditional, pure-play offshore businesses that center around specific developed markets.

One element that sets Strong performers apart from the other groups is their ability to attract new clients. The median NNM of Strong performers was 4.1% in 2018.

A further differentiating factor is that their operations are far more efficient. This is evident in the need for significantly fewer employees than banks in other clusters. For instance, operating income per FTE at Strong performers is CHF610k, compared to CHF460k at Upper Mid performers, CHF389k at Lower Mid performers, and CHF324k at Weak performers.

UPPER MID
PERFORMERS

This cluster contains the more successful small and medium-sized banks that run a more traditional, offshore private banking model, servicing a wider selection of markets and clients. Some achieve better performance by adopting a diversified business model that combines wealth management with additional revenue streams.

Only one Upper Mid performer has AuM in excess of CHF100 billion. Although it was downgraded this year, it is close to being a Strong performer.

Upper Mid performers achieved NNM of 1.9% in 2018. Their performance is held back by a generally higher operating expense margin.

MEDIAN COST-INCOME RATIOS AND ROES OF STRONG PERFORMERS
2016–2018

	2016	2017	2018
C/I	63.7%	61.0%	62.8%
RoE	5.9%	8.9%	6.8%

MEDIAN COST-INCOME RATIOS AND ROES OF UPPER MID PERFORMERS
2016–2018

	2016	2017	2018
C/I	76.4%	74.8%	73.9%
RoE	5.6%	6.3%	6.9%

LOWER MID **22%**

Total banks	**19**
Large	6
Medium	4
Small	9

WEAK **34%**

Total banks	**30**
Large	2
Medium	7
Small	21

LOWER MID
PERFORMERS

Although there is growing evidence that expanding AuM to more than CHF100 billion is a promising approach, three such banks appear in the Lower Mid cluster. Two of them almost meet the requirements to be an Upper Mid performer – one has a very low operating income margin, while the other's operating expense margin is above that of its peers. The third such bank is struggling with a very high cost base and continued AuM outflows.

The median operating expense margin of Lower Mid performers is 20bps higher than that of Strong performers. This is visible in the cost-income ratio, which is also around 20 percentage points higher.

As well as large banks, this cluster contains a mix of standalone Swiss private banks and subsidiaries of foreign banks. Although they have so far avoided falling into the Weak cluster, their results are far from satisfactory. The median NNM for the Lower Mid cluster is negative. Being in better shape than Weak performers means these banks have more strategic options, but sustainable success will depend on taking measures quickly to improve.

MEDIAN COST-INCOME RATIOS AND ROES OF LOWER MID PERFORMERS
2016–2018

	2016	2017	2018
C/I	82.9%	84.9%	84.8%
RoE	5.0%	5.5%	4.4%

WEAK
PERFORMERS

The significant increase in the number of Weak performers in 2018 is due to a drop in operating income margin from 104bps down to 91bps while the operating expense margin remained stable.

Two-thirds of Weak performers are small banks with insufficient scale and resources.

While losing income, it seems that Weak banks are unable to further reduce their cost bases. They are therefore trapped in a very difficult position. The only way out is radical change, if they can afford the investment required. This may be a struggle for the small banks in particular. Continuing on a standalone basis is not a realistic option for most Weak performers.

The fact that nearly half of these banks are subsidiaries of international banking groups may explain why the owners have not exited these low profit businesses. The owners may wish to keep a Swiss private bank as part of their offshore wealth management offering, even if the activities may be insufficiently profitable at a local level.

The two large banks in this cluster are subsidiaries of global banks. One has completed a significant restructuring exercise and has shown small signs of improvement.

MEDIAN COST-INCOME RATIOS AND ROES OF WEAK PERFORMERS
2016–2018

	2016	2017	2018
C/I	92.8%	91.7%	100.8%
RoE	1.3%	1.6%	(1.1%)

Board and executive committee composition

More than 90% of board and executive committee members are male. While the number of women in leadership roles at private banks is generally rising, only six of the 127 CEOs over the past seven years have been female.

The average age of board members has risen by three years, and executive commmittee members by one year. This indicates a lack of younger, fresh perspective when it is sorely needed.

FEW WOMEN IN LEADERSHIP POSITIONS
The share of board of director roles occupied by women doubled between 2012 and 2018, but is still low at 9.8%. There is huge room for improvement.

The German-speaking region has the highest proportion of female board members at 11%, up from 6% in 2012. The French-speaking region saw a rise from 4% to 10%, while the Italian-speaking region has the lowest female representation at 3%, up from 2% in 2012.

The number of female executive committee members fluctuated between 2012 and 2018, starting at 7.6% and ending at 9.5%.

Of 71 banks and a total of 127 CEOs, there have been only six female CEOs in the past seven years. 2018 is a record year with four female CEOs, of which three joined the executive committee in 2018.

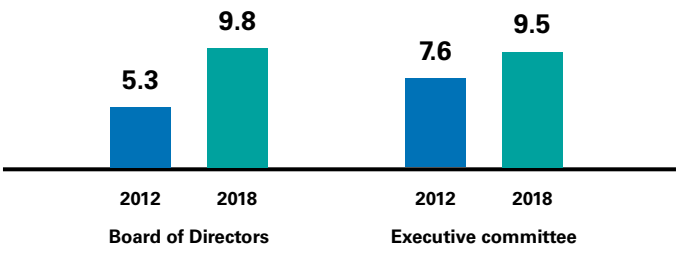
LEADERSHIP AGES INCREASE
The average age of board members rose by three years between 2012 and 2018, and that of executive committee members by one year.

This takes the average age of a board member to 62 years in 2018, and of an executive committee member to 52 years.

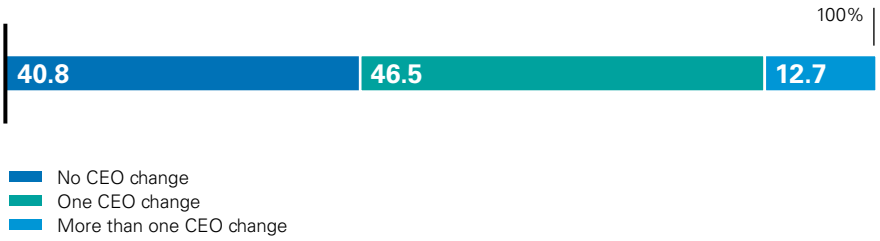
This clearly indicates the lack of 'fresh blood' in Switzerland's private banks in terms of younger managers and board members who might have a different perspective on the industry's future.

Interestingly, private banks established after 2000 do not differ much in age structure.

WOMEN IN LEADERSHIP POSITIONS, 2012 AND 2018
in %



NUMBER OF CEO CHANGES BETWEEN 2012 AND 2018
in %



MORE THAN 40% OF CEOS HAVE BEEN IN PLACE FOR AT LEAST SEVEN YEARS

More than 40% of banks did not change their CEO in the past seven years. Only 12.7% of banks changed their CEO twice or more in this period.

CEO changes among Lower Mid and Weak performers were more frequent than among Strong and Upper Mid performers between 2012 and 2018.

The correlation between performance and boards of directors shows a similar picture, with Weak performers employing a much higher rate of change in board members than Strong performers.

This could indicate that board members of struggling banks have left their positions due to the perceived risk or a feeling that they have been unable to positively influence the bank's strategy and future prospects.

ANNUAL REPORTS AS A CHANGE COMMUNICATION TOOL

In such a period of intense change, it is interesting to observe what proportion of leadership teams discuss change in their bank's annual report.

Only 41% of banks use terms such as digitalization, transformation, innovation and restructuring in their annual reports in the context of change or intention to change. This means that fewer than half of banks focus on transformation. There is also no significant relationship between performance and reference to these words.

Clear regional differences exist. While almost half of banks in the French-speaking area use these terms, a lower number of banks in the German and Italian-speaking areas discuss change in their annual reports (38% and 30%, respectively).

Note: The analysis covers a sample of 71 banks that are also included in the samples of other sections in this study.

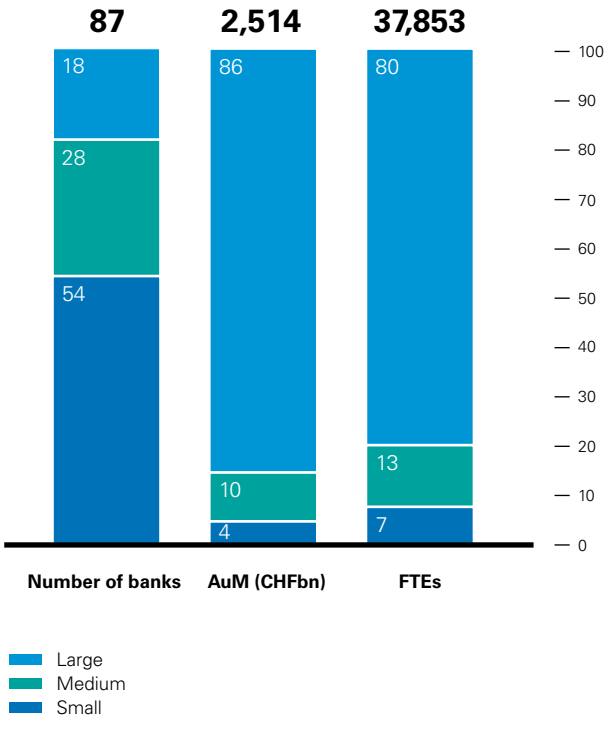
CHAPTER II

Median bank performance

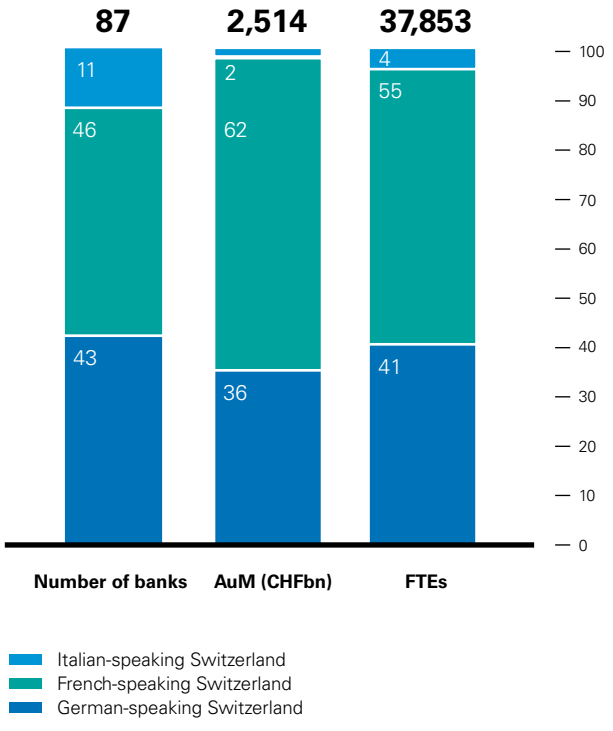
We have analyzed the median – or middle – bank's performance. This is based on our constant sample of 87 banks for 2015 to 2018 and our constant sample of 77 banks for 2010 to 2014. For the purpose of this analysis, we attribute the same weight to each bank irrespective of the bank's size or other characteristics.

The results of this analysis may in some instances contradict the industry overview section, as the latter is based on the sum of absolute figures of all banks and is therefore dominated by the development of the largest banks. The median analysis, however, is more representative of the number of banks in the industry, which is dominated by the development of small banks (54% of the banks in our sample).

KEY STATISTICS BY BANK SIZE, 2018
in %



KEY STATISTICS BY REGION, 2018
in %



Return on Equity (RoE)

RoE has not improved for more than ten years. In 2018, it fell even further at more than half of Switzerland's private banks – mainly small and medium-sized organizations – with the median RoE staying at 4.1%. RoE declined at more than one-third (42%) of Strong and Upper Mid performers and almost two-thirds (59%) of Lower Mid and Weak performers.

ROE REMAINS FAR BELOW THE 8–10% TARGET

The negative trend in RoE continued in 2018, with more than half of banks seeing their RoE decline. Median RoE has remained in a low, very narrow range for around ten years. Instead of approaching a reasonable return of about 8–10% (close to the cost of equity), it continues to fall.

Large banks stood out as those able to improve their RoE last year, with 63% doing so.

GAP IN MEDIAN ROE SHOWS THE IMPORTANCE OF SCALE

The median RoE at large and medium-sized banks improved by 2.0 and 0.8 percentage points respectively. At large banks, this represented an increase to 7.8% – the highest level since 2012 and in line with the target return. By contrast, the median RoE of small banks fell by 0.6 percentage points to 3.1%.

This gap of nearly five percentage points between small and large banks reinforces our message that scale is key in Swiss private banking.

The median RoE of Weak performers fell from 1.6% in 2017 to -1.1% in 2018 – a dramatic downturn.

GENERALLY GOOD CAPITALIZATION AND HIGH CET 1 RATIO

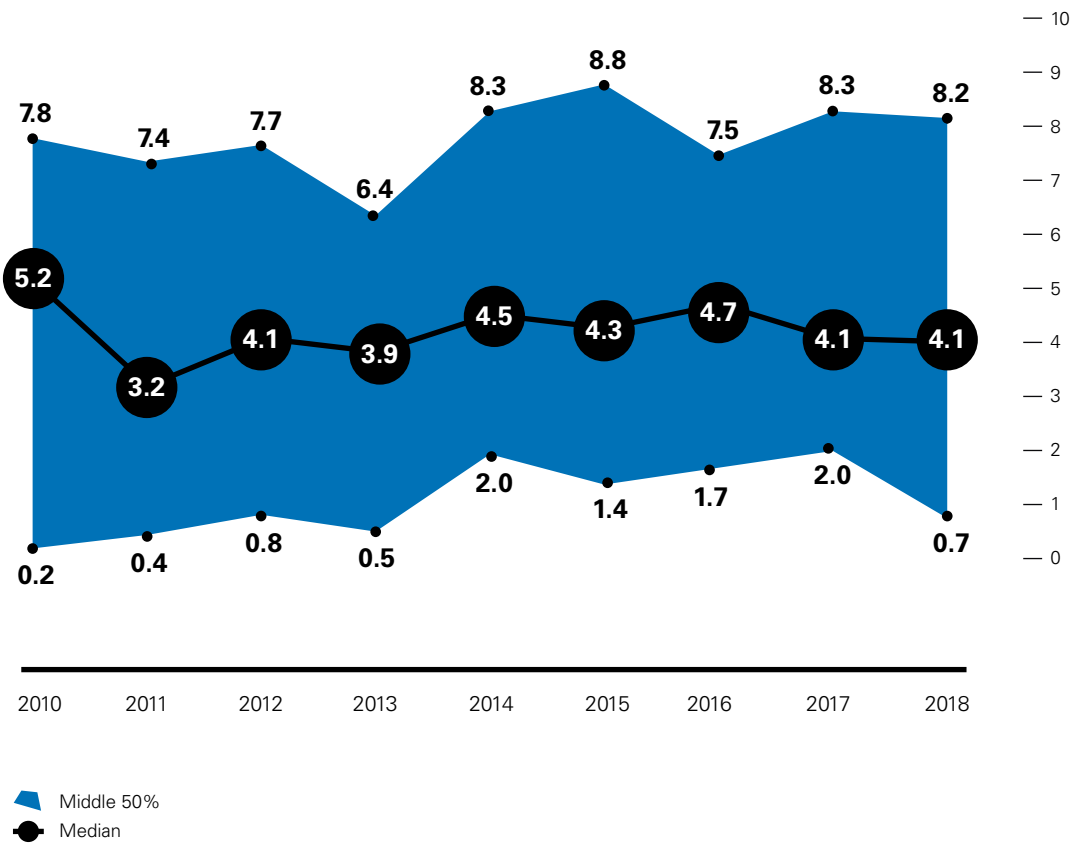
At 27.6%, the median CET 1 ratio is far beyond the minimum required level of 7% for category 5 banks or 8.2% for category 2 banks. This indicates that Swiss private banks are generally very well capitalized.

This has a negative impact on RoE, as banks could show a higher RoE if they distribute part of their excess capital.

PERCENTAGE OF BANKS THAT IMPROVED THEIR RETURN ON EQUITY

48%	**2018**
64%	**2017**
48%	**2016**

ROE DEVELOPMENT
in %



Net New Money (NNM) growth

Despite cross-border legacy outflows having been largely confined, the NNM picture did not improve in 2018. After years of regulatory changes and the clean up of client portfolios hindering the generation of NNM, an increase in NNM could have been expected in 2018 but did not happen.

NNM GROWTH IS NEAR ZERO; NEGATIVE AT HALF OF BANKS

Following the implementation of the second Automatic Exchange of Information wave in 2017 it was expected that NNM would improve significantly in 2018. However, the median NNM actually fell to 0.2%. Fewer than half of banks were able to improve NNM growth.

This is clearly a disappointing result. It shows that the key issue in recent years was not the loss of clients. Rather it was – and still is – the fact that most private banks are unable to attract new clients to compensate for the ones they are losing.

OUTFLOWS AND INFLOWS BOTH FALL, CONVERGING TO ZERO

Net outflows (negative NNM) from banks reduced from CHF63 billion in 2016 to CHF33 billion in 2017 and to CHF25 billion in 2018. However, net inflows (positive NNM) also fell slightly. It seems NNM is converging towards zero. Ten banks recorded positive NNM above CHF1 billion each, while seven banks had negative NNM of more than CHF1 billion each.

Banks in the German-speaking part of Switzerland achieved NNM of 1.5% compared to 0.3% in the French-speaking region and -0.5% in Italian-speaking Switzerland.

The median of Strong performers (4.1%) is by far the highest. Weak performers incurred negative NNM growth in each of the last four years.

SWISS-CONTROLLED BANKS LAG BEHIND FOREIGN-CONTROLLED BANKS

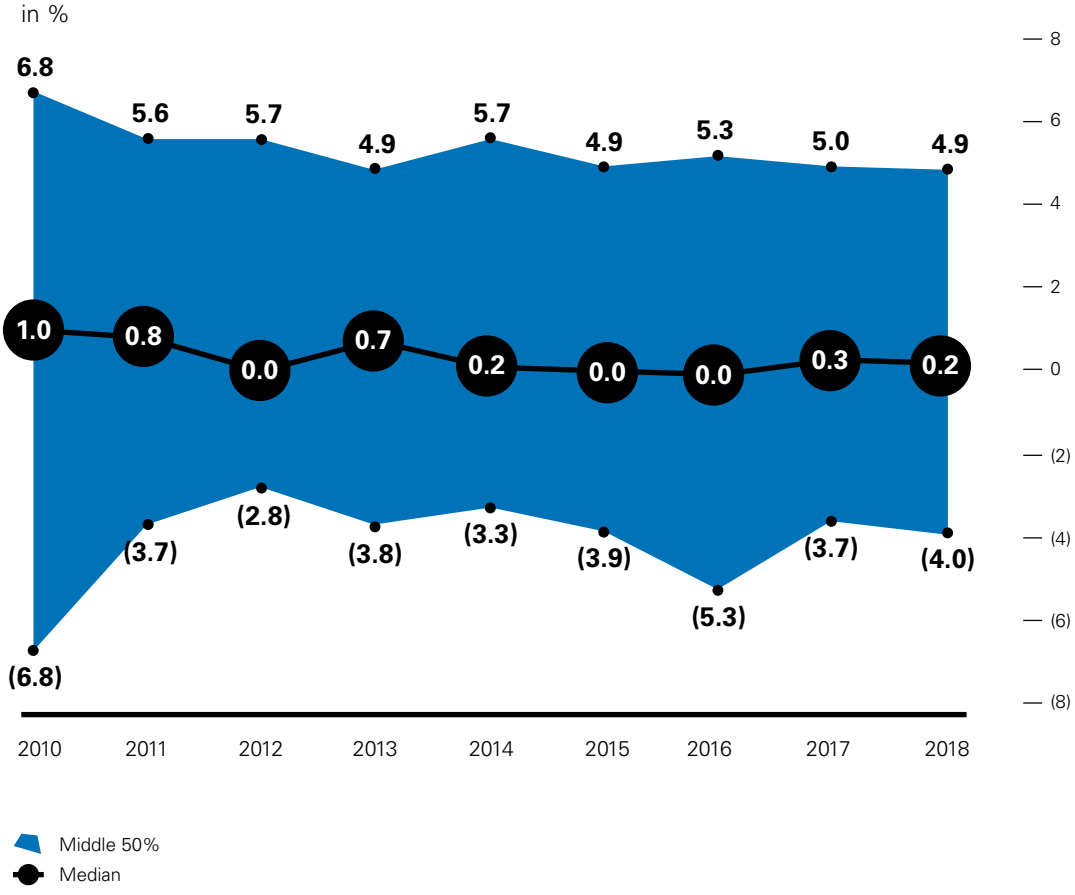
Median NNM growth at Swiss-controlled banks was -0.1% in 2017 and -0.8% in 2018. By contrast, foreign-controlled banks achieved significantly higher median NNM growth of 1.5% in 2017 and 2.6% in 2018. One driver is that subsidiaries of emerging-market banks generated very strong inflows from their onshore network. Subsidiaries of global western banks, however, continued to incur significant outflows.

PERCENTAGE OF BANKS THAT IMPROVED THEIR NET NEW MONEY GROWTH

45%	**2018**
56%	**2017**
48%	**2016**

NNM GROWTH DEVELOPMENT

in %



Operating income margin

After recovering in 2017, the operating income margin eroded in 2018. This was despite strong equity markets for the first ten months of the year and rising interest rates in the US.

OPERATING INCOME MARGIN FALLS BY 5BPS IN 2018

Operating income margin is exposed to market movements. Although the US interest rate rises boosted net interest income, and ten months of positive global market developments increased net commission income, 2018 saw the operating income margin rise at only 39% of Swiss banks.

Operating income margin is converging at around 90bps for all bank sizes, performance clusters and regions. The biggest reductions – of around 10–20bps – were seen at small banks, Weak performers and banks from the Italian-speaking part of Switzerland. The latter have historically had much higher margins.

WEAK PERFORMERS SEE A SIGNIFICANT MARGIN DROP

The median operating income margin of Weak performers fell by 13bps to 91bps. Of the worsening Weak performers, 78% fell by more than 10bps and 35% by more than 20bps. The margin fell to 90bps of small banks that are Weak performers.

Weak performers also failed to reduce their median operating expense margin. With typically much higher operating expense margins, these banks are the likeliest candidates to exit the market in the short term.

OPERATING INCOME PER EMPLOYEE IS ALMOST DOUBLE AT STRONG PERFORMERS

The huge differences in efficiency between banks is also visible from operating income per employee. While Strong performers produce around CHF610,000, Weak performers generate CHF324,000, meaning Weak performers need nearly twice as many employees to achieve a given level of revenue.

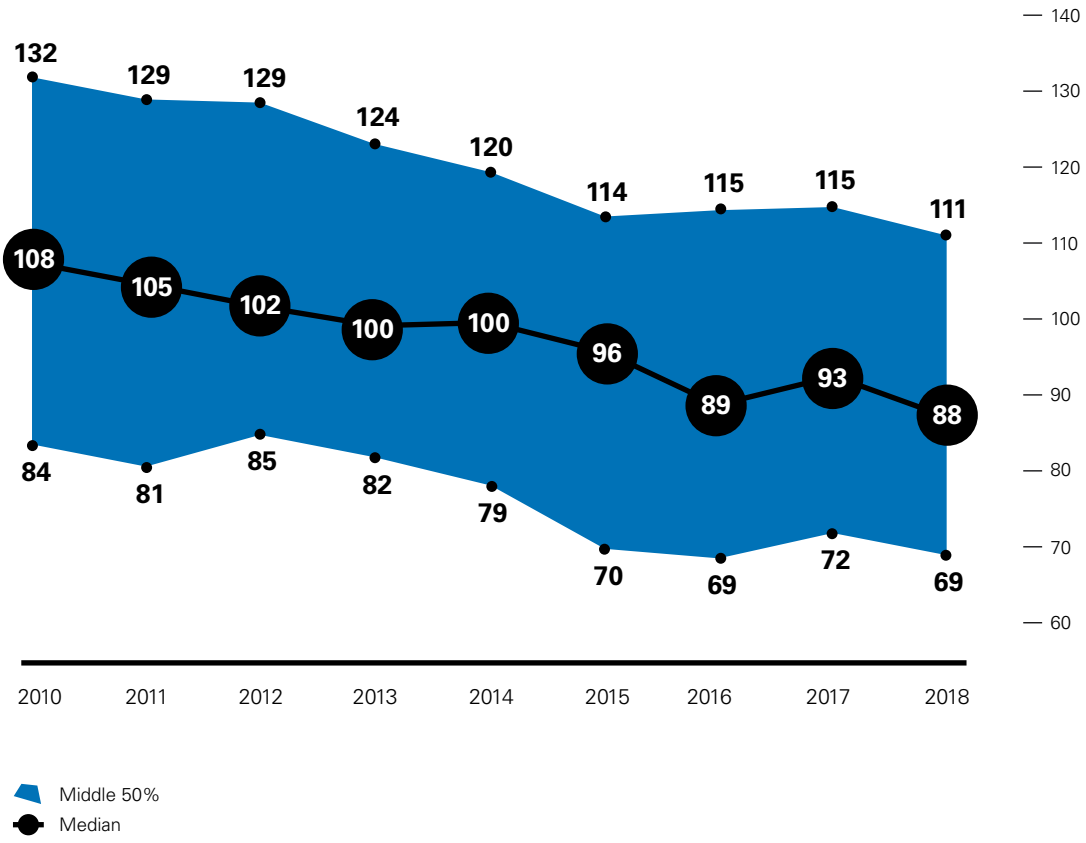
OPERATING INCOME MARGIN IS LESS IMPORTANT

High operating income margins do not always correspond to high profitability, however. This is due to different costs involved in running a given business model. The margin should always be looked at in combination with the operating expense margin.

PERCENTAGE OF BANKS THAT IMPROVED THEIR OPERATING INCOME MARGIN

39%	**2018**
57%	**2017**
45%	**2016**

OPERATING INCOME MARGIN DEVELOPMENT
in bps



Operating expense margin

Banks made no progress in reducing costs, despite an increase in average AuM. The operating expense margin rose for the first time following seven years of reductions.

OPERATING EXPENSE MARGIN RISES BY 2BPS IN 2018

Although average AuM increased, banks were unable to manage down costs and enhance efficiency. While employee bases expanded, operating expense per employee rose by CHF10k in 2018 to CHF359k from less than CHF350k in prior years.

This is driven by large and small banks, at which operating expenses per employee rose by CHF14k on average.

NO SIZE GROUP OR PERFORMANCE CLUSTER IMPROVES

Costs rose in 2017 but were covered by positive performances on the back of equity markets. The higher costs impacted banks more in 2018. Small banks recorded an operating expense margin of 81bps while large banks were at 62bps, Strong performers at 53bps and Weak performers at 108bps. This difference between large and small banks is due to large banks more efficiently utilizing their resources and benefitting from scale economies.

While the gap in operating income margins may be narrowing between the various bank groups, operating expenses are driving the difference in performance. This is noticeable in the huge disparities in operating expense margin by cluster: Strong at 53bps, Upper Mid at 66bps, Lower Mid at 73bps and Weak at 108 bps. This difference filters down to banks' bottom lines.

CHF4K INCREASE IN MEDIAN PERSONNEL COST PER EMPLOYEE

Following a CHF7k increase in personnel costs per employee in 2017, the median rose by CHF4k in 2018 to CHF238k – the highest since 2010.

The contrast between regions is huge. Sixty percent of banks in the Italian-speaking part of Switzerland improved personnel costs per employee, causing the median to fall significantly from CHF180k in 2017 to CHF165k in 2018. The median personnel cost per employee in the German-speaking part remained flat at CHF234k, with 43% showing improvements. Personnel costs in the French-speaking part are stable but remain the highest at CHF250k.

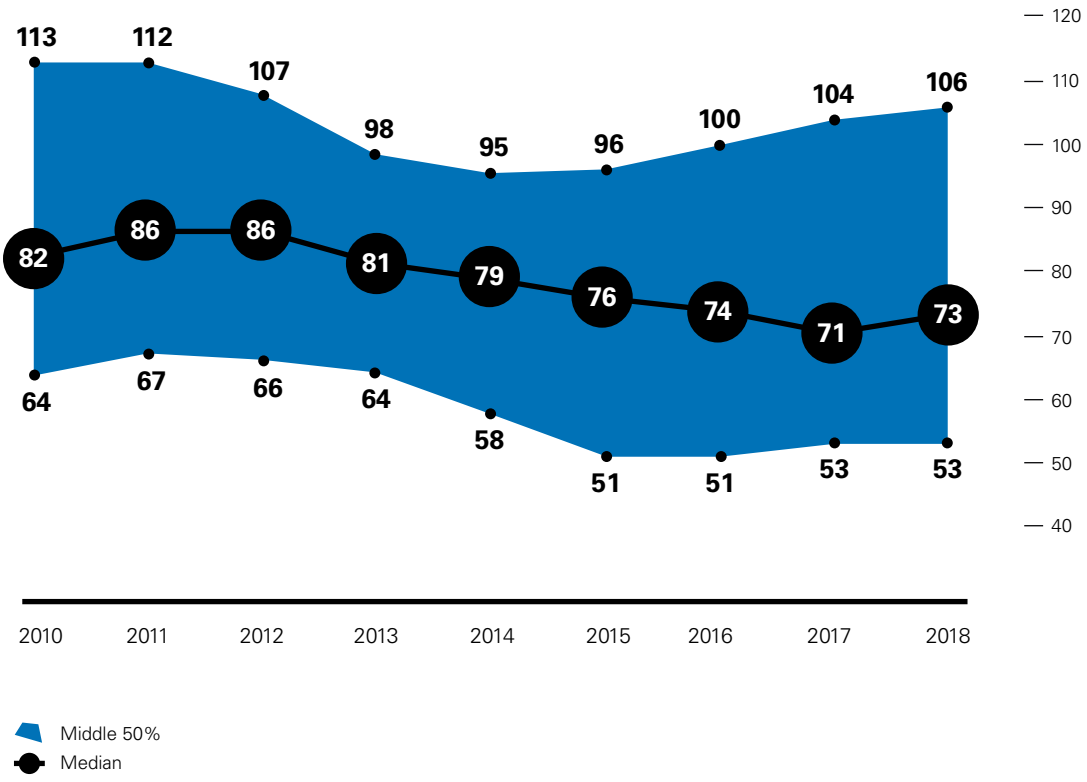
It is more attractive for employees to work for Strong performers, who pay higher salaries. The median cost at Strong performers is CHF270k, which is 27% higher than the CHF213k at Weak performers.

If private banks do not succeed in improving employee efficiency and/or reducing personnel expense per employee, it will not be possible to significantly improve performance.

PERCENTAGE OF BANKS THAT IMPROVED THEIR OPERATING EXPENSE MARGIN

48%	**2018**
57%	**2017**
43%	**2016**

OPERATING EXPENSE MARGIN DEVELOPMENT
in bps



Cost-income ratio

Only one-third of banks improved their cost-income ratios in 2018, as the median cost-income ratio increased by 1.9 percentage points to nearly 84%. This is the highest level ever and is mainly driven by small banks and Weak performers. It is the opposite of what could reasonably be expected following resolution of most legacy topics and the clean up of client portfolios.

WEAK PERFORMERS ARE DRIVING THE MEDIAN INCREASE

The median cost-income ratio rose by 1.9 percentage points to 83.6%. The median of Weak performers increased from 91.7% in 2017 to 100.8% in 2018, a decline of nearly nine percentage points, while remaining stable for the other three clusters.

COST-INCOME RATIO DEPENDS ON BANK SIZE

Large banks were able to improve their cost-income ratio by 2.8 percentage points in 2018 to 79.1% from 81.9% in 2017. This is due to income growing faster then expenses.

Medium banks operated at a median cost-income ratio of 78.3% (75.1% in 2017) and small banks at 86.3% (82.4% in 2017).

This development demonstrates the considerable increase in pressure on small banks over the past 12 months. Shareholders and management teams of many such banks must react quickly.

BANKS IN GERMAN-SPEAKING SWITZERLAND FARE BEST

The cost-income ratio developed differently between the three regions. Banks in the German-speaking part managed down their cost-income ratio from 84.7% in 2015 to 79.1% in 2018. The ratio meanwhile rose from 80.6% to 84.2% over the same period for banks in the French-speaking part, and increased even more dramatically for banks in the Italian-speaking region of Switzerland, from 72.4% to 87.1%.

The driver at banks in the Italian-speaking part was a 25bps reduction in the operating income margin, while banks in the German-speaking part managed to reduce costs and more than compensate for a decline in operating income margin.

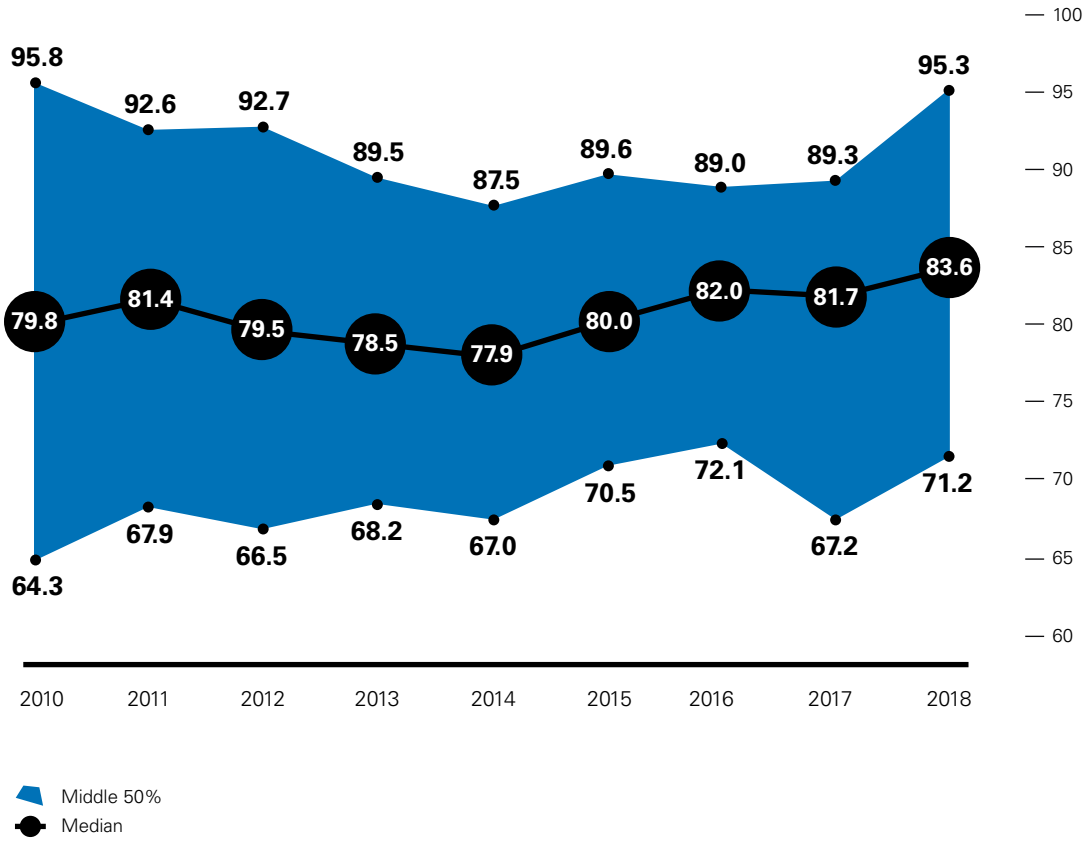
BANKS WITH NEGATIVE GROSS PROFIT UP IN 2018

Sixteen banks – or 18% of our sample – posted a negative gross profit in 2018. This is up from 11 banks in 2017.

PERCENTAGE OF BANKS THAT IMPROVED THEIR COST-INCOME RATIO

38%	**2018**
64%	**2017**
41%	**2016**

COST-INCOME RATIO DEVELOPMENT
in %



Basis of preparation and glossary

Our analysis of the past three years covers 87 Swiss private banks. As the total number of Swiss private banks fell from 108 to 106 at 31 December 2018, our market coverage remains 82%.

OUR DEFINITION OF A SWISS PRIVATE BANK

For the purpose of this study, a private bank is defined as a Swiss private bank that holds a full FINMA bank and broker-dealer licenses and for which a significant proportion of its business is private wealth management. There were 101 such private banks as at 31 December 2018.

87 BANKS ANALYZED FOR THE LAST FOUR YEARS; 77 FOR THE PAST NINE YEARS

We analyzed the annual financial statements of Swiss private banks that made their annual financial statements available.

Our 'Industry overview' section analyzes the 87 banks over the last three years, whereas our 'Median bank performance' section analyzes the 87 banks for the four years 2015–2018 and 77 of those banks for five years 2010–2014. We excluded many banks that disappeared in the last ten years in order to show only the performance of the banks that have 'survived'.

BANKS EXCLUDED FROM OUR STUDY

We excluded the following banks from our study:

- 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.
- Fifteen banks whose financial statements are not available.
- Two banks that announced they would enter into liquidation in 2018 and accordingly produced their 2017 annual financial statements on a liquidation, rather than a going concern, basis.

GLOSSARY

AEoI	Automatic Exchange of Information
AuM	Assets under Management
bn	Billion
bps	Basis points (1/100th of 1%)
CHF	Swiss Franc
C/I	Cost-income ratio
FTEs	Full-Time Equivalents
M&A	Mergers & Acquisitions
m	Million
n/d	Not disclosed
NNM	Net New Money
RoE	Return on Equity
Vs.	Versus

KPMG Digital Benchmarking Tool

We have further enhanced our popular digital benchmarking tool to even better steer Swiss private banks towards increasing their profitability.

The KPMG digital interactive benchmarking tool contains financial data from 87 Swiss private banks and has more than 50 key performance indicators.

Banks can use the tool to undertake a detailed comparison with their peers using unique KPI drill-down capabilities. Our experts are pleased to help you identify areas of performance enhancement for your bank and how they can be delivered practically and effectively.

Get an impression of our interactive Benchmarking Tool:

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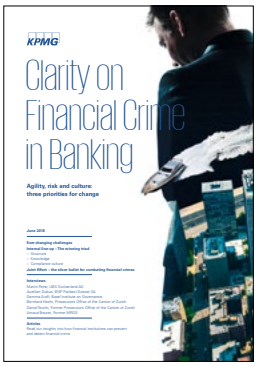
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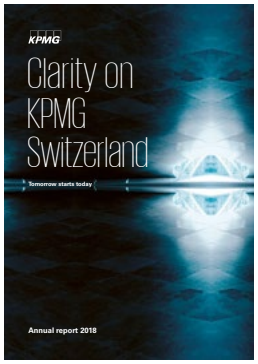
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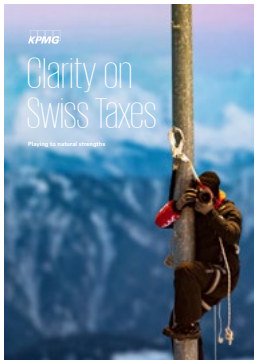
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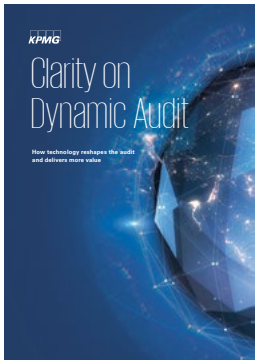
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