

Clarity on Performance of Swiss Private Banks

Recovery of a divided industry

August 2018

17

Industry performance

Bull markets drove significant increases in Assets under Management and profits, but Net New Money continues to disappoint.

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Median bank insights

While the industry is recovering amid positive markets, the weaker half of banks still struggled to improve RoE and Cost-income ratio.

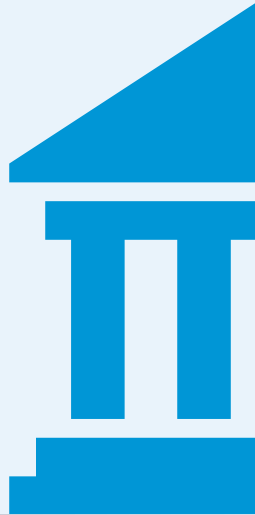




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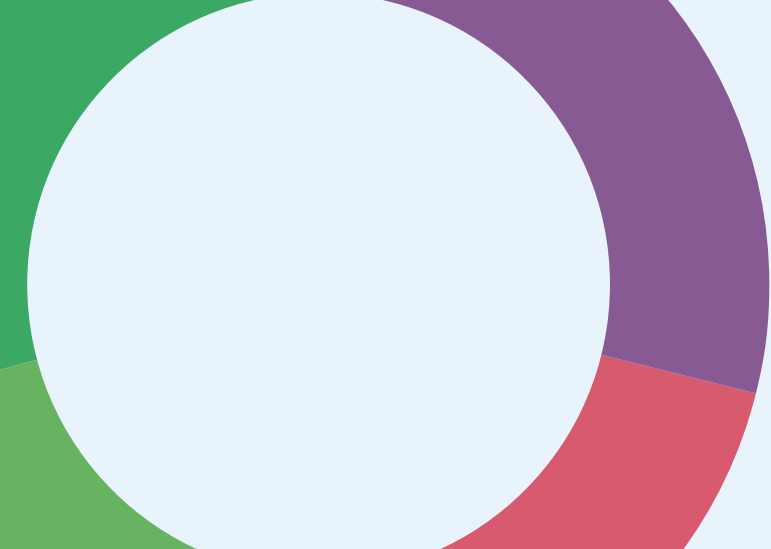


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Recovery of a divided industry

A study by KPMG AG, Switzerland

in cooperation with the Institute of Management
at the University of St. Gallen

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The industry is becoming healthier, laying the foundations for future growth

2017 was a positive year for Switzerland's private banks. After years of struggling with structural change stemming from the financial crisis, the tide has begun to turn. Negative one-off impacts in the shape of asset outflows and penalties appear mostly confined to the past. Many banks have finished implementing the requirements of regulations such as FATCA and AEoI. And many banks are improving some key performance ratios, supported by bull markets.

Booming equity markets led to an increase in AuM of almost CHF 200 billion last year, as well as higher net commission income. Rising US interest rates meanwhile contributed to more net interest income. These factors helped the industry's net profit increase by 18.7% in 2017 and double since 2015. In addition, two-thirds of banks improved their RoE last year.

The improved environment is allowing many of the 90 banks in our sample to turn back to strategy, and to take significant strategic steps to adjust their business models. For instance, a refocus on core markets resulted in a record number of M&A deals in 2017, including strategic exits abroad as well as acquisitions. Challenges remain, of course, and cannot be ignored. NNM is disappointingly low at only 10% of the AuM growth in 2017.

Half of Switzerland's banks still have a long way to go. One-quarter continue to perform poorly, with thirteen suffering operating losses last year (eight of these for have done so for each of the past three years). And another one-quarter are Lower Mid performers that need to enhance their performances to align more closely with the stronger banks. For too many, a question mark hangs over their survival.

More of the market-driven rise in revenue should have filtered straight down to the bottom line. But it did not. Operating costs at many banks rose almost in line with operating income. This is a worrying sign that banks are not paying sufficient attention to cost control and are missing an opportunity to improve shareholder returns. If markets suffer a downturn, many will find themselves back in trouble.

While we understand that management teams wish to breathe a sigh of relief as markets swing upwards, now is not the time to relax. The Swiss private banking industry is in a much stronger position than anytime in the last 10 years, but Switzerland continues to lose market share. AuM in some other financial centers is growing faster.

Banks must take the opportunity to further adjust their business models, apply stricter cost management, and make greater use of technologies such as robotics and process automatization to enhance their operating models and improve the client experience. They must build the momentum of strategic change.

As you look to deal with intensifying competition, and to secure the future direction of your bank, we would be delighted to discuss with you the outcomes of this study. And to share with you specific insights into your organization gained from our digital benchmarking tool (see page 41).



Philipp Rickert



Christian Hintermann

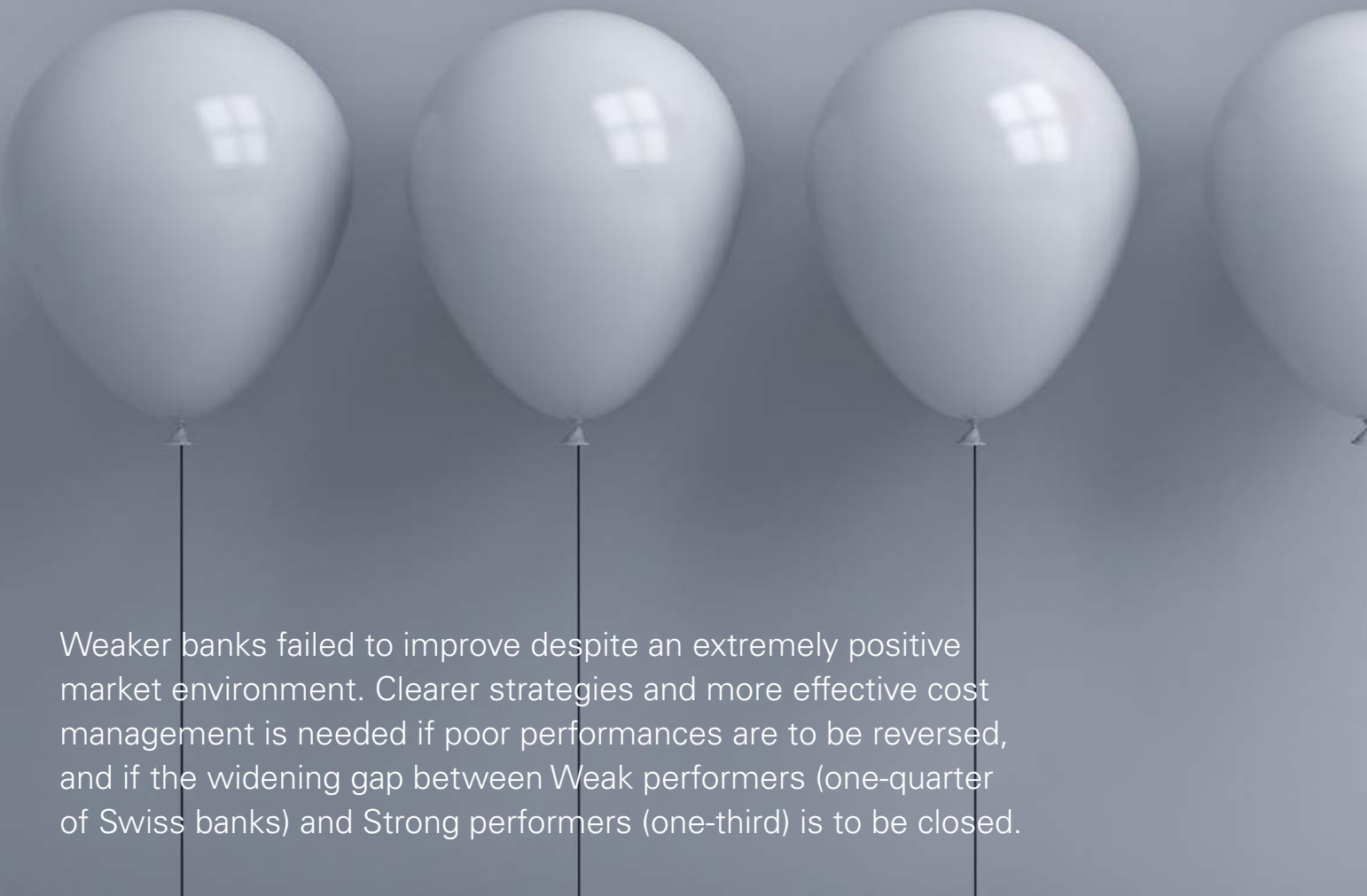
KPMG AG, Switzerland

Recovering, but a sizeable number of banks remain fragile

The Swiss private banking industry has become more stable over the past 18 months. Industry net profit has doubled, and two-thirds of banks have improved key indicators such as RoE, gross profit and cost-income ratio. While the future of the industry looks brighter than at any time in the past ten years, more action is needed across the board on NNM, gross income and cost control.



While the strong get stronger, the weak stagnate

Four white balloons are arranged in a horizontal row, each on a thin black string. The balloons are slightly inflated and have a soft, matte texture. They are set against a plain, light grey background. The lighting is soft, creating subtle highlights and shadows on the balloons' surfaces.

Weaker banks failed to improve despite an extremely positive market environment. Clearer strategies and more effective cost management is needed if poor performances are to be reversed, and if the widening gap between Weak performers (one-quarter of Swiss banks) and Strong performers (one-third) is to be closed.



Excessive reliance on market developments

Ninety percent of AuM growth in 2017 came from market performance. With only 10% arising from NNM, banks remain far too dependent on external developments. Further optimization of business models is needed if banks are to avoid crisis mode should markets turn negative.




Overcoming a false sense of security

Banks have generally allowed costs to continue growing. Only loss-making banks or those whose existence is threatened appear to have aggressively tackled cost control, though their actions may have come too late. Even for profitable banks, improved results are largely driven by market performance, meaning that more challenging conditions could put them into dangerous territory.



Consolidation creeps on

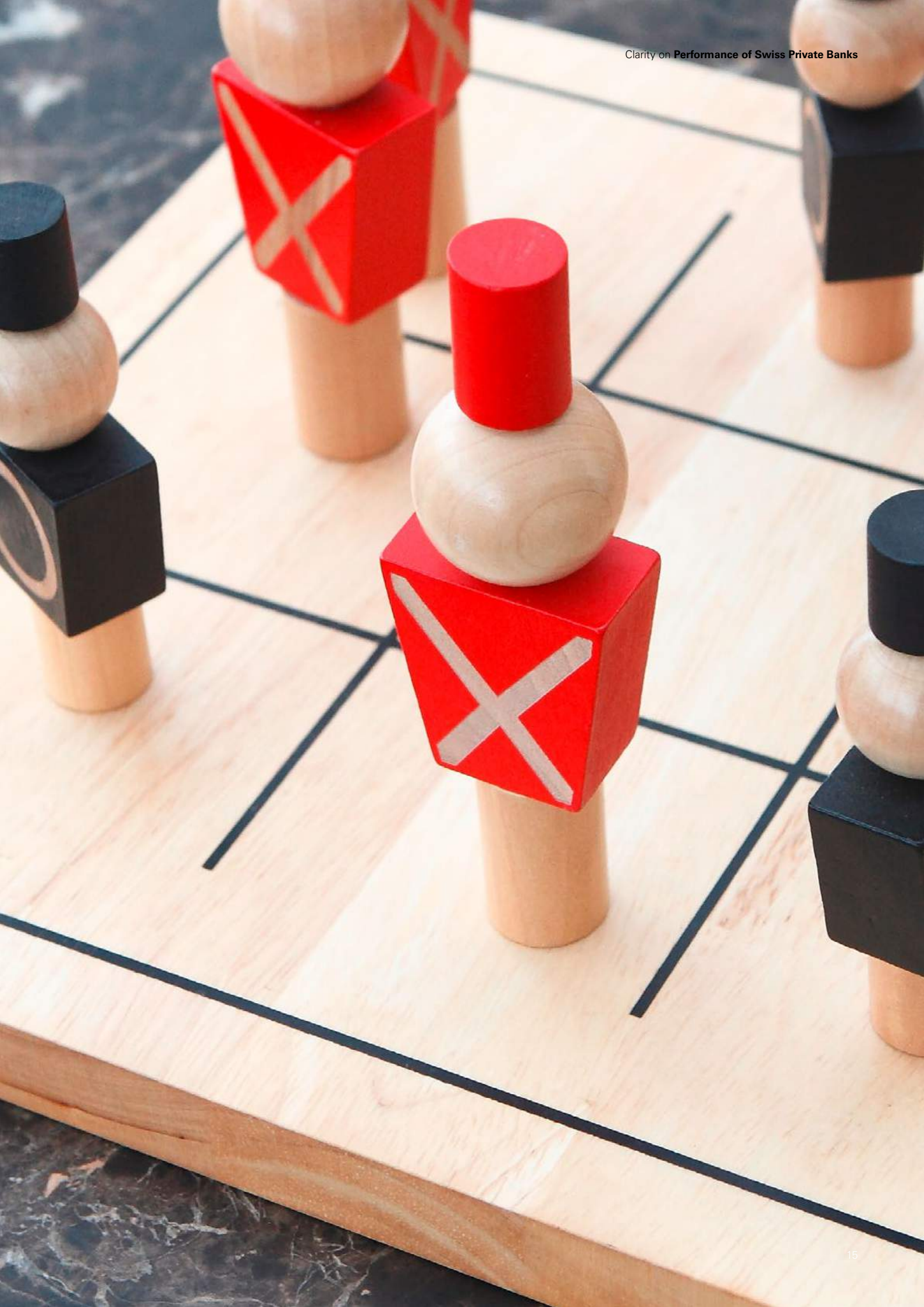


Consolidation may have slowed over the past 18 months but it has not run out of steam. Many banks are still suffering poor key metrics, which they have proved unable to remedy even in the current, positive market environment. Owners of such banks must urgently challenge their current situation and strategy to form a realistic view on what can be changed and whether they should more actively consider selling the bank.



Firefighting gives way to strategy

Having spent years addressing regulatory changes and structural change, banks have once again started to focus on strategy and repositioning. A high number of M&A deals reflects the investment that is taking place to adjust business models as banks seek growth.



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The improved environment is allowing many of the 90 banks in our sample to turn back to strategy, and to take significant strategic steps.

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Industry performance

In this section, we analyze the Swiss private banking industry as a whole. This analysis is based on our sample of 90 private banks.

The industry financial statements presented are the aggregate of the financial statements of the 90 banks. It should be noted that the large banks have the biggest weight in these figures.

We also look back on the movement in the number of private banks over the last 18 months and assess the industry's M&A trends.

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

Our 2018 sample of Swiss private banks



90

Number of
banks



CHF 2,616 bn

Total
AuM



38,166

Total
FTEs



83%

Market
coverage

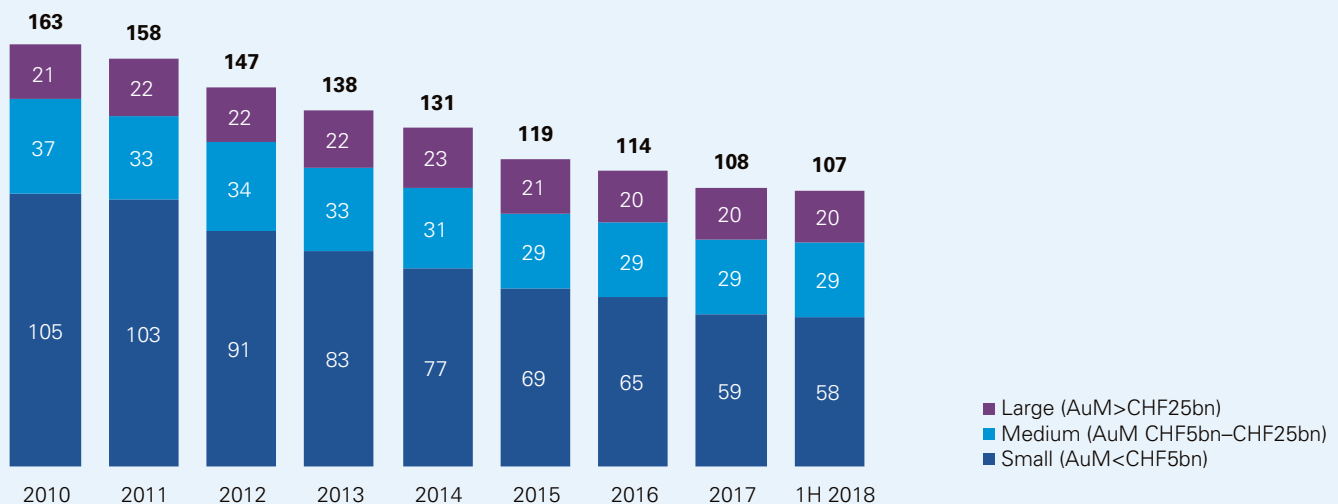
Number of private banks and M&A

Ongoing consolidation saw seven banks exit the market in the past 18 months, taking the number of banks to 107 at the end of June 2018.

2017 produced a record number of deals, at 16. The number of deals abroad (both acquisitions and disposals) peaked in the past year and a half as banks actively adjusted their business portfolios.

Time will tell if the positive macro-economic environment will dissuade more owners from selling, or whether rising prices will encourage divestments.

Number of Swiss private banks by AuM



34% fall in the number of banks since 2010

Fifty-six Swiss private banks have exited the market since 2010. This is largely due to structural changes in the industry, during which consolidator banks have sought to build scale by undertaking acquisitions.

Hardest hit were small – mainly sub-scale – banks, the number of which fell by 45% over this period.

Seven banks exited the market in the past 18 months

Five banks were acquired by other Swiss banks or brokers in the 18 months to 30 June 2018. As a consequence, they either entered into liquidation after their assets were transferred to the new owners, or they were merged into the acquiring entity.

A further two banks entered into voluntary liquidation without selling their businesses.

Record number of deals in 2017

2017 started slowly, with only three deals announced in the first six months. Activity then accelerated to a record of 16 deals over the course of the year – the highest in the period under analysis.

Consolidation remains a small part of M&A

Consolidation – deals between Swiss private banks – paused in 2016 but picked up again with five deals in the second half of 2017. These were mainly acquisitions of small banks.

Only one Consolidation deal took place in 1H 2018, being Vontobel's acquisition of Notenstein La Roche. However, this was the largest transaction in the past 18 months at CHF 16 billion AuM.

Of the six Consolidation deals in the past 18 months, two targets lost their banking licences as their activities were absorbed into the acquirers' businesses. The remaining four are expected to lose their licences in due course.

Growth in acquisitions and exits abroad

Acquisitions abroad were the highest in the period under review at five in the first half of 2018 and eight in the past 18 months overall. These were four in Latin America (three onshore, and one offshore in Miami), two in Luxembourg, one in Asia (Hong Kong and Singapore) and an Italian onshore business.

Exits abroad entered M&A records for the first time, with four transactions in the past 18 months – two Dutch onshore businesses, an Italian onshore business and a Liechtenstein business.

These acquisitions and exits are the result of banks strategically focusing their business portfolios.

The four Domestic (Other) deals comprised acquisitions of three Swiss Independent Asset Managers and a client portfolio in Central & Eastern Europe.

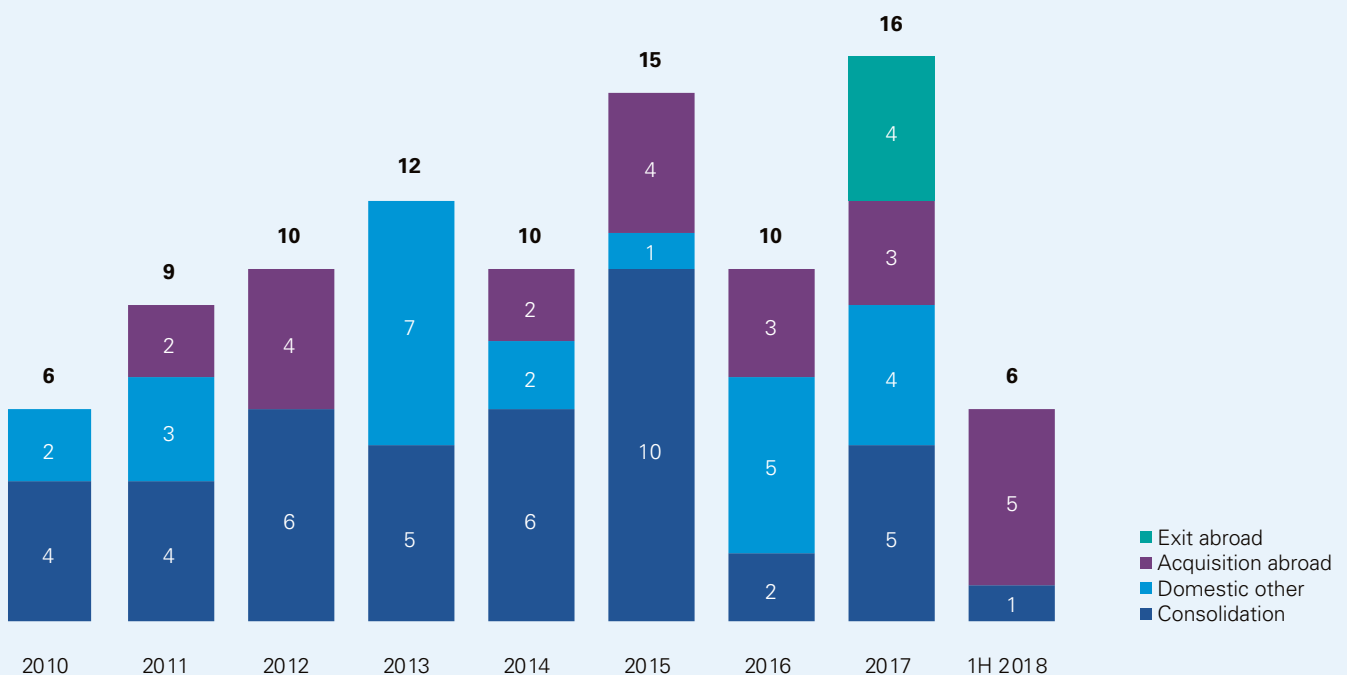
CHF 68.9 billion AuM deal value in 18 months

Taking into account AuM acquired and disposed, net AuM from M&A was positive CHF 51.1 billion.

UBS yielded the largest number of deals at four (three acquisitions and one disposal), and the highest volume of combined AuM at CHF 28.6 billion.

Vontobel's acquisition of Notenstein La Roche, its earlier acquisition of Notenstein's portfolio in Central & Eastern Europe, and the disposal of its Liechtenstein private banking business netted at CHF 16.6 billion in AuM.

Number of announced deals where the buyer, target or seller is a Swiss private bank



Outlook

We expect Swiss M&A activity in private banking to continue at a brisk pace due to a combination of factors:

- Positive industry fundamentals
- Eager buyers
- Ongoing adjustments to business portfolios
- Greater management time spent on strategy
- Implementation of regulatory and tax transparency requirements
- Five banks have realized operating losses in each of the past five years

We have recently observed rising deal prices for Swiss private banks.

Regarding future consolidation, the positive macro-economic environment and rising deal prices make future changes to the number of Swiss private banks uncertain.

While some owners might be dissuaded from selling due to reduced pressure or better prospects, others might believe the time is right to divest while sale prices are increasing. Only time will tell how these influences will impact industry consolidation.

Announced	Target	Stake	Bidder	Seller	AuM (CHF bn)
1H 2018					
May 18	Banque Carnegie Luxembourg S.A.	Asset deal	Union Bancaire Privée, UBP SA	Carnegie Investment Bank AB	2.1
May 18	Notenstein La Roche Private Bank Ltd	100%	Vontobel Holding AG	Raiffeisen Schweiz	16.0
Feb 18	Alpe Adria Gestioni SIM SpA	100%	Banca Credinvest SA	n/d	n/d
Jan 18	Reliance Group	100%	Julius Baer Group Ltd.	n/d	5.0
Jan 18	Brickell Bank	100%	CBH Compagnie Bancaire Helvetique SA	Banco Espirito Santo, SA.	0.5
Jan 18	Nordea AB's Luxembourg private banking business	100%	UBS Europe SE, subsidiary of UBS Group AG	Nordea AB	15.0
2017					
Dec 17	Bank Vontobel (Liechtenstein) AG's wealth management business	Asset deal	Kaiser Partner Privatbank AG	Vontobel Holding AG	1.4
Nov 17	M.M.Warburg Bank (Switzerland) AG's private banking business	Asset deal	St.Galler Kantonalbank AG	M.M. Warburg & CO KGaA	n/d
Nov 17	Lombard Odier's Dutch onshore private banking business	Asset deal	InsingerGilissen Bankiers N.V	Bank Lombard Odier & Co Ltd	1.4
Nov 17	Banca Albertini Syz SpA	64.30%	Gruppo Ersel	Banque SYZ SA	3.3
Oct 17	Bank Hapoalim (Switzerland) Ltd's Luxembourg and Swiss private banking businesses	Asset deal	Bank J. Safra Sarasin AG	Bank Hapoalim BM	4.0
Sep 17	Compagnie Privée de Conseils et d'Investissements SA (CPCI)	Asset deal	Hyposwiss Private Bank Geneva SA	Private individuals	0.7

- Exit abroad: Swiss private bank selling a business abroad
- Acquisition abroad: Swiss private bank buyer and foreign target
- Domestic other: Swiss buyer and Swiss target, at least one being a Swiss private bank
- Consolidation: Acquisition of a Swiss private bank by another Swiss private bank

Announced	Target	Stake	Bidder	Seller	AuM (CHF bn)
Sep 17	HSBC Holdings Plc's Central American and Andean region private banking business	Asset deal	UBS AG	HSBC Holdings Plc	5.0
Aug 17	Banque Morval SA by acquiring Morval Vonwiller Holding SA	100%	Intesa Sanpaolo S.p.A.	Zanon di Valgiurata Family	3.0
Aug 17	Notenstein La Roche Private Bank Ltd's Eastern European client portfolio	Asset deal	Vontobel Holding AG	Notenstein La Roche Private Bank Ltd	2.0
Jul 17	CIC's private banking activities in Asia (Singapore and Hong Kong)	Asset deal (SG), share deal (HK)	CA Indosuez (Switzerland) SA	CIC (Credit Industriel et Commercial)	n/d
Jul 17	Banca Intermobiliare di Investimenti e Gestioni (Suisse) S.A.	100%	Banca Zarattini & Co. S.A.	Banca Intermobiliare di Investimenti e Gestioni SpA	0.4
Jul 17	Fimanor Financial Management AG	100%	Hyposwiss Private Bank Geneva SA	Private individuals	0.1
Jul 17	Dominick Company AG	100%	Telco Vorsorge AG	Peter M. Kennedy III family	n/d
Jun 17	UBS's Dutch onshore wealth management business	Asset deal	Van Lanschot Kempen	UBS Europe SE, subsidiary of UBS Group AG	2.8
May 17	Consenso Investimentos Ltda.	100%	UBS AG	Private individuals	5.8
Feb 17	Wergen & Partner Vermögensverwaltungs AG	100%	Julius Baer Group Ltd.	Private individuals	0.4

- Exit abroad: Swiss private bank selling a business abroad
- Acquisition abroad: Swiss private bank buyer and foreign target
- Domestic other: Swiss buyer and Swiss target, at least one being a Swiss private bank
- Consolidation: Acquisition of a Swiss private bank by another Swiss private bank

Industry financial statements

Net profit in the Swiss private banking industry rose by a considerable 19% in 2017 to CHF 2.8 billion. This was largely due to a 10% increase in operating income, which was the result of a performance-driven 9% increase in AuM and rising US interest rates. Operating expenses grew at almost the same rate as income, however, due to a greater average number of FTEs.

The CHF 1.3 billion of non-recurring fines in 2015 helped net profit to double between 2015 and 2017.

Net profit rose by 18.7% to CHF 2.8 billion in 2017

A significant improvement in AuM performance thanks to positive global equity markets, together with rises in US interest rates, contributed to a 9.7% increase in operating income. This was a key driver of the 18.7% rise in net profit to CHF 2.8 billion in 2017.

Combined with a stable level of equity, RoE rose by 1.2 percentage points to 7.1%. This means a reasonable return is being achieved on total equity employed by the industry.

Industry financials are of course heavily influenced by the performance of the largest banks. RoE of large banks in 2017 was 8.2%, compared to 4.3% and 2.7% at medium and small banks respectively.

Non-recurrence of fines helped net profit to double from 2015 to 2017

The doubling of net profit since 2015 was impacted even more by the non-recurrence of CHF 1.3 billion in one-off fines at four large banks in 2015. This illustrates the extent to which historical net profit was impacted by such fines.

Operating income fuelled by commission and interest

The 7.8% increase in AuM in 2017 was due to the recovery in global equity markets, the main driver of the 11.1% rise in net commission income. A further contributor was the growth of the net commission income margin. Many banks attributed the margin increase to greater mandate penetration as execution-only clients are being shifted into more lucrative advisory or discretionary mandates.

The 14.0% increase in net interest income was driven by two factors. Firstly, US interest rates continued to rise, generating a positive impact due to around 44% of the industry's customer loans being USD denominated. Secondly, there was a 9.9% increase in average customer loan volumes. While the majority of banks grew their loan book, conservative approaches to this growth by most banks led to limited expansion. The absolute volume increase was driven by a few large banks.

Industry financial statements for the three years ended 31 December 2017

CHF m	2015	2016	2017	2017 vs. 2016	
				Amount	%
Net interest income	2,861	3,368	3,840	473	14.0 %
Net commission income	10,587	10,285	11,429	1,145	11.1 %
Net trading income	2,117	2,069	2,174	105	5.1 %
Net other income	793	847	724	(123)	(14.5)%
Operating income	16,358	16,568	18,167	1,599	9.7 %
Personnel expenses	(8,692)	(8,796)	(9,518)	(722)	8.2 %
General and administrative expenses	(3,774)	(3,936)	(4,195)	(260)	6.6 %
Operating expenses	(12,466)	(12,731)	(13,713)	(982)	7.7 %
Gross profit	3,892	3,837	4,454	617	16.1 %
Non-operating result	(2,449)	(1,469)	(1,643)	(175)	11.9 %
Net profit	1,443	2,368	2,811	443	18.7 %
Other key data					
AuM (CHF bn)	2,309	2,427	2,616	190	7.8 %
FTEs	35,287	38,183	38,166	(16)	(0.0)%
Cost-income ratio (C/I)	76.2 %	76.8 %	75.5 %	(1.4)%	(1.8)%
Return on equity (RoE)	3.8 %	6.0 %	7.1 %	1.2 %	19.7 %

By aggregating the annual financial statements of our constant sample of 90 banks, we provide an indicative financial overview of the Swiss private banking industry.

Operating expenses and operating income grew at almost the same pace

General business expansion, combined with the acquisition of BSI by EFG (1,600 FTEs in November 2016), caused the average number of FTEs to rise. Together with higher personnel costs per FTE, total personnel expenses rose by 8.2% in 2017.

Higher IT and communication expenses were responsible for the 6.6% increase in total general and administrative expenses during 2017. Significant banking platform projects at two large banks were behind this increase. Of the 90 banks in our sample, 65 (or 72%) actually increased their IT expenses. In most banks' annual reports, the link between higher IT expense spent and greater investment in digitalization to deliver improved client experience and operational efficiency was not fully clear.

Cost-income ratio flat despite exceptional income growth

The cost-income ratio has remained largely flat over the last three years (2015: 76.2%, 2016: 76.8%, 2017: 75.5%). This is surprising, as greater income from bull markets could have been expected to affect banks' bottom lines as operating leverage would keep expense levels fairly stable. Instead, costs rose with the increased income.

Only the medium-sized group reduced costs

Only medium-sized banks as a group managed to reduce operating expenses, by 1.4%, while operating expenses at small and large banks grew by 4.1% and 9.4% respectively.

Medium-sized banks were under the biggest pressure as they recorded the lowest AuM and income growth. It seems that poor performance compelled them to take action to reduce their cost bases.

Industry financial statements – growth by size

Growth in	CAGR 2015 to 2017		
	Small	Medium	Large
Operating income	5.7 %	(1.7)%	6.5 %
Operating expenses	3.5 %	(1.5)%	6.0 %
Gross profit	17.4 %	(2.1)%	7.8 %
Net profit	(2.2)%	(19.5)%	59.8 %
AuM (year-end in CHF bn)	8.7 %	0.4 %	7.0 %

Outlook

There are macro-economic and structural reasons to be optimistic about the industry's future performance.

Continued US interest rate rises and possible interest rate rises in the Eurozone and Switzerland would increase net interest income. Although there is a risk that further interest rate rises could turn future equity market performance negative at some point.

On the structural side, significant implementation costs to comply with new tax and regulatory requirements introduced as a result of the financial crisis (FATCA, AEOI, MIFID II, etc) are largely confined to the past. NNM growth should increase as cross-border legacy outflows should recede from 1 January 2018 following the implementation of the AEOI in 2016 and 2017.

Many banks are seeing some success in enhancing penetration of managed mandates (advisory and discretionary). This should cause net commission income to stabilize at a higher level.

In addition, technology enhancements through digitalization and automation should improve the client experience and operational efficiency, and thereby profitability.

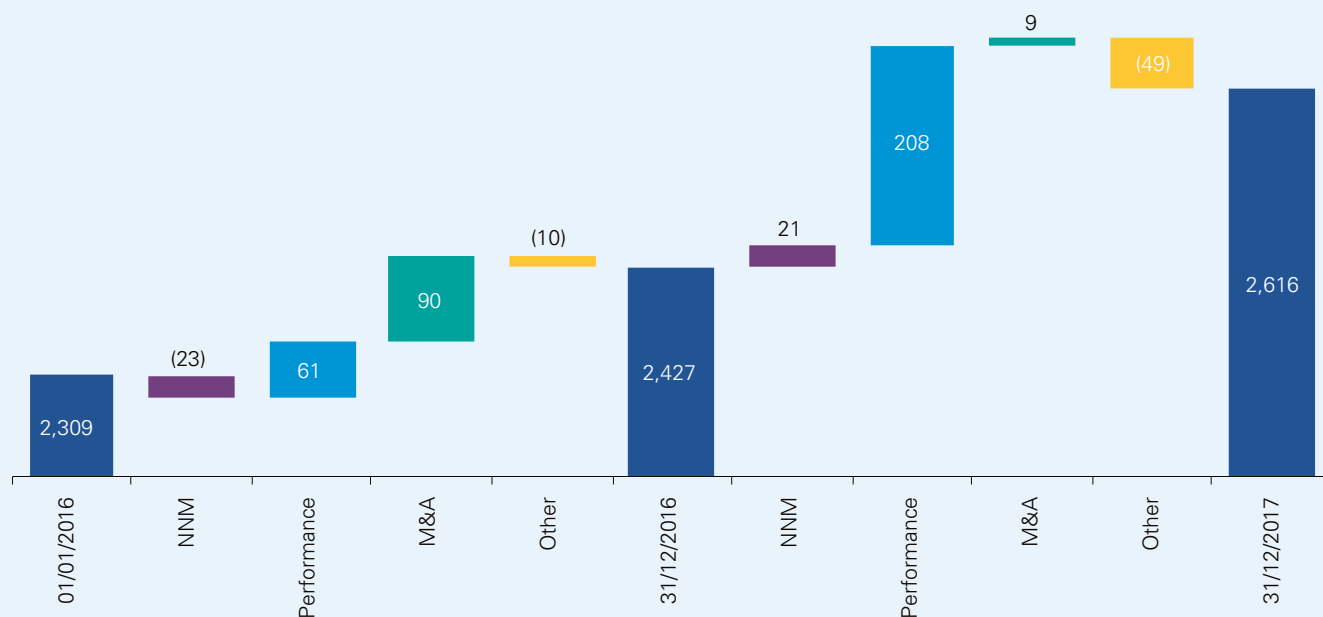
Overall, therefore, a number of positive elements have the potential to further improve the performance of Swiss private banks. Looking at individual banks' current situations, however, a significant number of banks continue to struggle and are likely to disappear.

AuM development

Favorable global equity markets drove performance increases and the 7.8% AuM growth in 2017. Despite turning positive, NNM contributed was still very low.

Of the size groups, small banks' NNM growth improved the most as their 2016 NNM doubled (3.9% AuM growth). Large banks' 2017 NNM of CHF 23.1 billion was only half their 2015 level. Medium banks continued their streak of outflows in 2017.

AuM development (CHF bn)



Equity market performance supports AuM growth

AuM grew by 7.8% in 2017 to reach CHF 2,616 billion, up from 5.1% growth in 2016. While the main driver in 2016 was M&A, in 2017 it was performance. Global equity markets grew in excess of 20%, contributing 8.6% to the increase in AuM. Other movements, mainly an intra-group outbound transfer of an asset management business, partially offset the performance growth in 2017.

Disappointing NNM contribution in 2016 and 2017

NNM was barely positive in 2017 at CHF 21.3 billion (0.9% AuM growth). This followed a negative run in 2016 (-1.0% AuM growth), and was only half of 2015's NNM of CHF 44.7 billion (2.0% AuM growth).

54% of banks achieved net inflows compared to 49% in 2016. This means nearly half of banks experienced net outflows in 2017.

Many banks cited strong inflows from their core markets being partially offset by outflows from their non-core client segments in 2017. Some outflows arose in jurisdictions covered by the second wave of AEoI that took effect from 1 January 2018.

This result is surprising, as the bulk of outflows from non-core client segments – including non-tax compliant clients – should already have taken place. Stronger NNM should therefore have been expected in 2017.

M&A was the big contributor in 2016, but minor in 2017

AuM from M&A fell in 2017 to CHF 9 billion, being 10% of the CHF 90 billion recorded in 2016. Acquisitions and disposals mostly netted off in 2017, while 2016 had been dominated by EFG's acquisition of BSI (CHF 58 billion).

Negative intra-group adjustments

Other AuM in 2017 represented mainly an outbound strategic transfer of an asset management business to another part of a global banking group. Other negative movements included the removal of custody-only assets from AuM in 2017 which were previously reported as AuM.

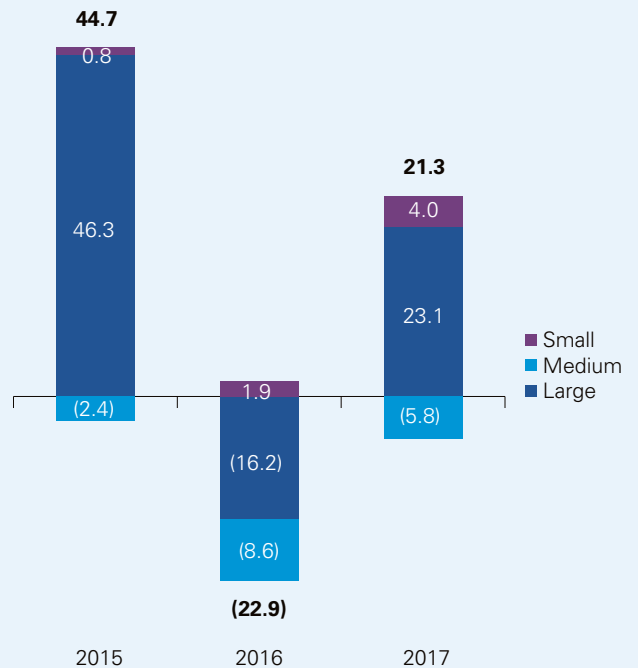
Small banks were top in NNM growth in 2016 and 2017

Small banks improved the most in 2017 by doubling their NNM to CHF 4.0 billion, representing 3.9% growth on opening AuM. Medium banks fared worst, experiencing net outflows in all three years. Large banks recovered in 2017 with NNM of CHF 23.1 billion (1.1% growth on opening AuM), but that was only half of their 2015 NNM of CHF 46.3 billion (2.4% growth on opening AuM).

Greater proportion of cash was invested in 2017

Customer deposits, generally the cash component of AuM, fell by 4.8% in 2017 from CHF 334 billion to CHF 318 billion. Fiduciary deposits and security investments rose by 14.4% and 9.7% respectively. Rises in US rates and improved equity markets drove this revenue-beneficial shift.

NNM development (CHF bn)



Outlook

There are four primary reasons for optimism about future NNM growth:

- As the last of the significant AEoI country agreements came into force on 1 January 2018, net inflows should increase as cross-border legacy outflows at most banks should be a thing of the past
- Global economic growth looks set to continue, translating into greater global private wealth, particularly in Asia, and therefore NNM growth
- Switzerland remains the world's wealth management capital and the largest offshore global safe-haven destination for UHNWs and HNWs
- Improvements to NNM inflow growth should also result from banks' new strategic initiatives

Performance clusters

Revenue improvements helped a net of six banks become Strong performers in 2017, making this the largest performance cluster at almost one-third of banks. Characteristics of Strong performers are that they are large players who leverage economies of scale, or small niche players with a clear focus.

A net of three were elevated to Upper Mid performers on the back of cost reductions. Weak performers meanwhile stagnated at 23 banks, or one-quarter of Swiss banks.

Net six banks promoted to Strong and three to Upper Mid in 2017

2017 saw significant movements between the performance clusters:

- New Strong performers: Substantial increases in net commission income at six banks were driven by strong market performance and/or AuM growth. Pushing their cost-income ratios below 70% resulted in them moving up to the Strong performance cluster. The net commission income at most of these banks was enhanced by high proportions of discretionary mandates.
- New Upper Mid performers: Four banks in the Lower Mid cluster improved their cost-income ratios to below 80%, becoming Upper Mid performers. The performance driver in this case was not income, rather reductions in personnel expenses due to internal restructuring that yielded a lower number of FTEs.

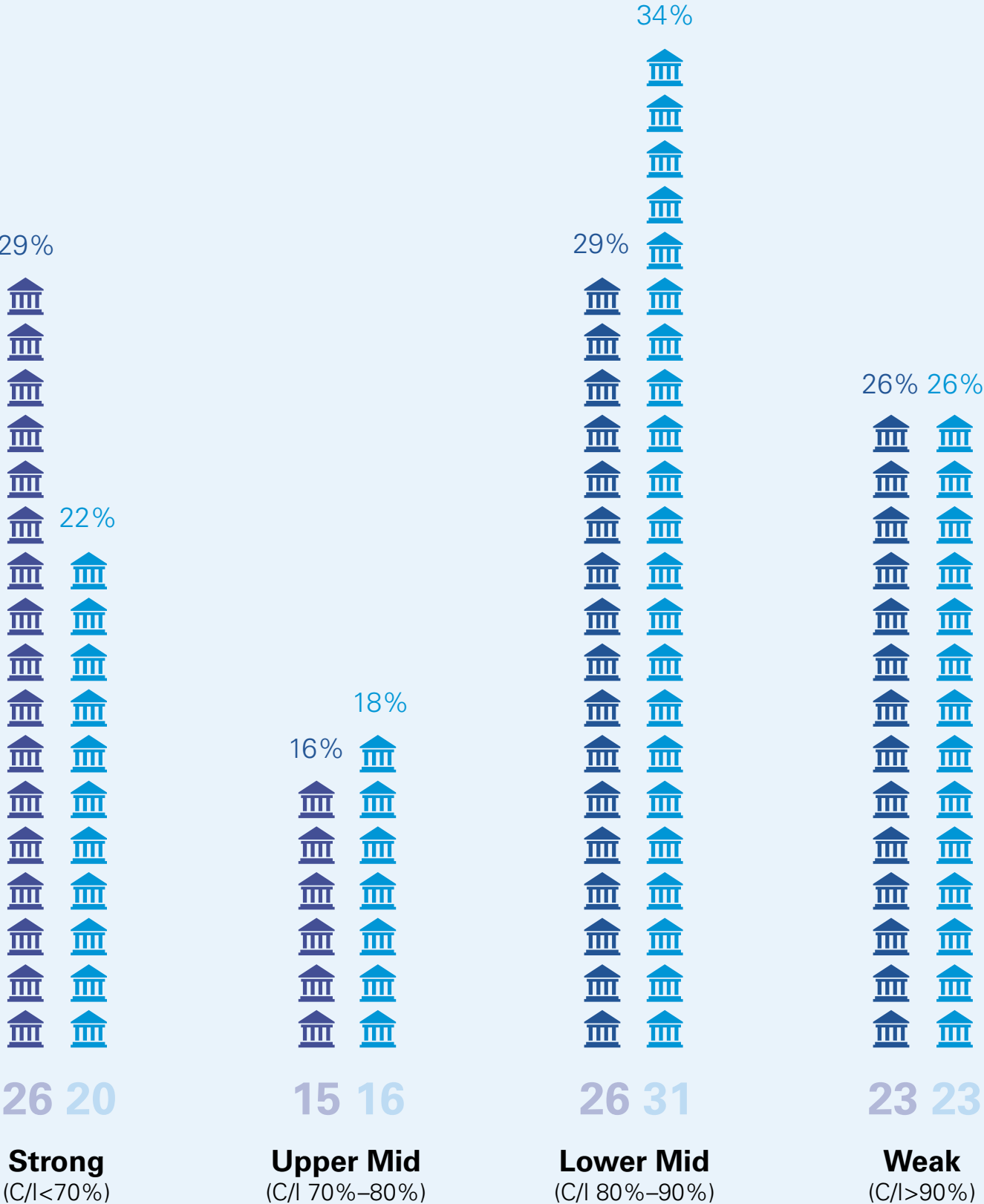
Weak performers stagnated at 26% of the market

Of the 23 Weak performers, 13 incurred operating losses in 2017 despite the extremely positive market environment. Eight of these 13 have suffered operating losses for each of the past three years.

New profitability metric: cost-income (C/I) ratio

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

Number of banks by performance cluster



🏛️ 2017 🏛️ 2016

Strong Performers

Strong performers fall into three categories:

- Large, Swiss-headquartered banks that leverage their infrastructures to achieve economies of scale and win NNM through their local presence around the world. Most have asset management businesses in addition to private banking. Five of the seven largest Swiss-headquartered banks are Strong performers.
- Eleven foreign-owned offshore niche banks that specialize in the Middle East, Latin America, Benelux or UHNWs. They are able to use their client focus and specific offering to achieve a strong brand and efficient operations.
- Ten Swiss-owned niche banks that provide tailored services to Swiss residents, including UHNWs.

Key figures: Strong performers

	2015	2016	2017
Cost-income ratio	65.5%	65.2%	61.7%
RoE	6.0%	6.0%	8.7%

Large banks should continue to leverage their size to realize further economies of scale. They are best positioned to utilize digital technologies to both improve client service and reduce costs. Small banks should continue to focus on strengthening their niche positions.

29%

Total banks 26

- 6 Large
- 8 Medium
- 12 Small

Upper Mid Performers

Surprisingly, no bank in this category had AuM greater than CHF 16.8 billion at the end of 2017.

Ten of the 15 are foreign-owned banks that mainly provide wealth management services in selected emerging market countries, or to clients from a small number of European countries.

The other five are Swiss-owned banks that provide services to particular client niches.

Key figures: Upper Mid performers

	2015	2016	2017
Cost-income ratio	76.1%	76.3%	73.7%
RoE	5.4%	4.7%	5.9%

Compared to the Strong performers, however, the niche strategies are less important. Many Upper Mid banks service a wide selection of clients and markets in addition to their focus segments.

Considering their size and less focused market strategy than Strong performers, these banks have achieved very good performances. Significant improvements will be attainable only by further sharpening the market strategy or generating significant growth, however.

16%

Total banks 15

- 0 Large
- 6 Medium
- 9 Small

29%

Total banks 268 Large
6 Medium
12 Small**Lower Mid Performers**

This cluster represents a mix of very different banks, including all size categories and various business models.

Five or six banks in the cluster have clear potential to move up. These are mainly larger players that didn't yet achieve similar revenues as their competitors.

Otherwise, this cluster is made up of banks that struggle to post satisfactory performance results on account of their business models. Many show no visible trend towards performance improvement despite the very positive market environment.

Weak Performers

Two-thirds of this cluster are small banks that lack size and focus. Weak performers fall into three categories:

- Seven Swiss subsidiaries of large global banking groups. The Swiss subsidiary banks appear to be managed as part of the larger group rather than on a standalone basis. Their standalone performance may not, therefore, be a reliable indicator of the value they add to the wider group. Some may be burdened by high costs from their group. We see some specialist private banks struggle as they are required to use group-wide systems they may not contain the functionalities to handle specialist private banking activities.
- Eleven Swiss subsidiaries of large regional banks that mostly lack both size and focus. Many seem to be in survival mode but struggle to find strategies that can significantly improve their situations.

26%

Total banks 234 Large
4 Medium
15 Small

In terms of NNM, this cluster was by far the weakest.

The poorer performance of some banks relates to the fact that some are subsidiaries of large foreign banking groups. As a result, they operate the core banking platforms for other entities in their group, which is generally a low margin activity.

To improve performance, banks need to look at their individual business and operating models to understand the significant performance gaps compared to their competitors. As the median cost-income ratio for this cluster is more than 20% higher than that of the Strong performers, there is significant scope for improvement.

Key figures: Lower Mid performers

	2015	2016	2017
Cost-income ratio	84.8%	86.1%	85.0%
RoE	4.1%	4.4%	3.6%

- Five Swiss-owned banks whose sub-scale, given their business model, means they cannot generate sufficient revenue in excess of their cost base. Two of these banks appear to still be in start-up mode.

The performance of most Weak performers is so far apart from the rest of the industry and what is considered a reasonable performance that it will be very difficult to turn these banks around. Shareholders of Weak performers should consider all options, including exiting the market. Should the market environment turn negative, these banks would be hit hard. Current buoyant markets environment would seem to support the case for disposing of these banks sooner rather than later.

Key figures: Weak performers

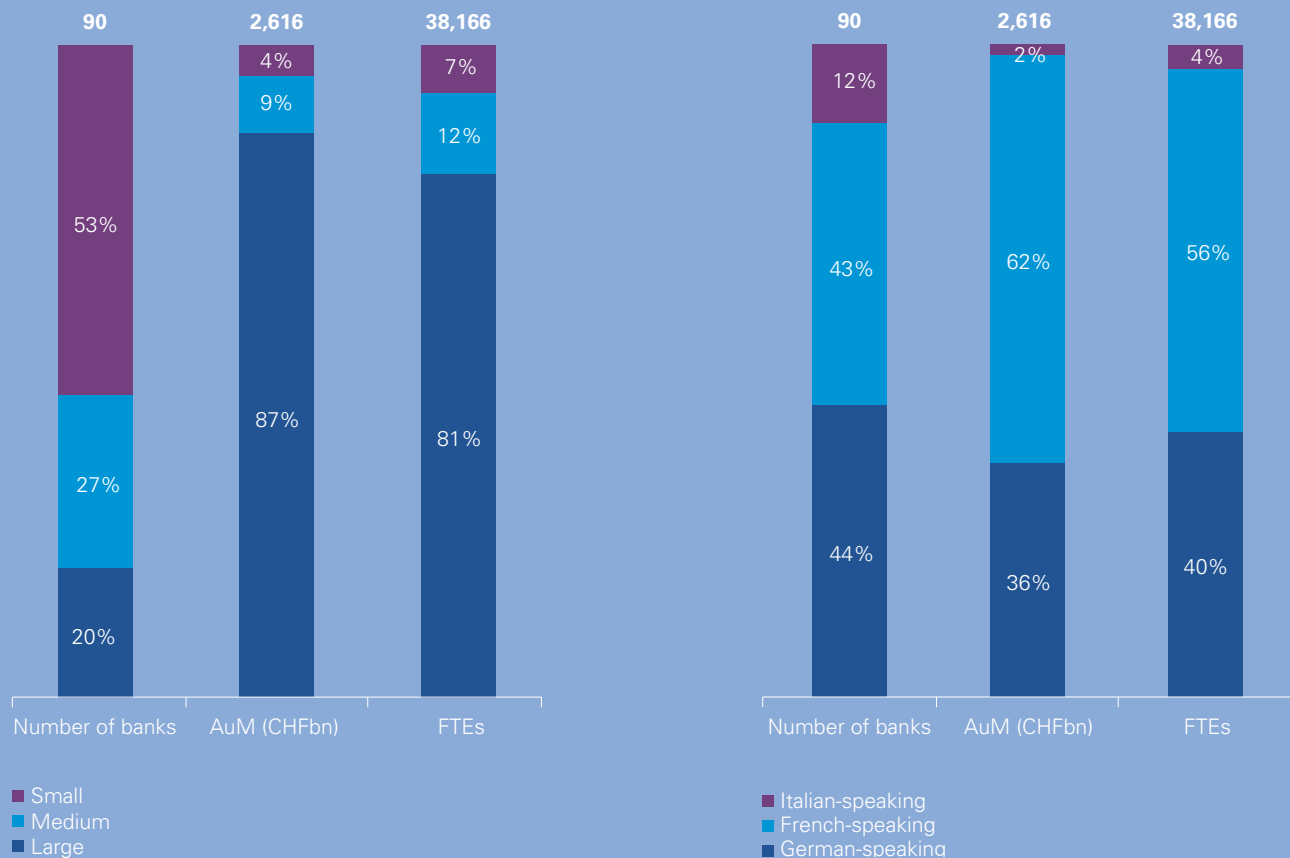
	2015	2016	2017
Cost-income ratio	97.2%	119.6%	101.7%
RoE	0.2%	(2.8)%	(3.0)%

Median bank insights

We analyzed the median – or middle – bank’s performance. This is based on our constant sample of 90 banks for 2015 to 2017 and our constant sample of 80 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.

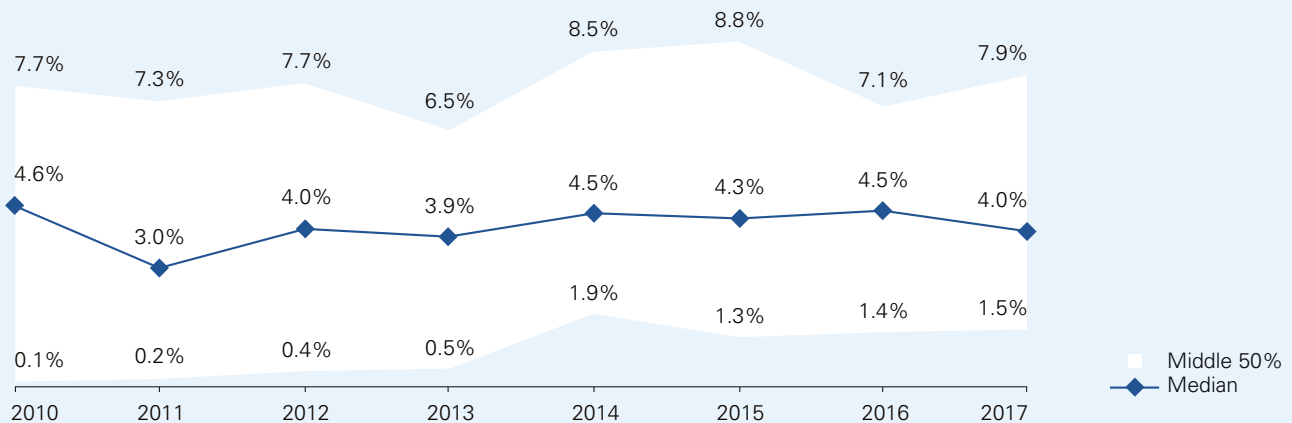
Key statistics by bank size and region 2017



Return on Equity

Two-thirds of banks improved their RoE in 2017, up from one-third in 2015. Yet the industry remains divided: more than 80% of Strong and Upper Mid performers increased their RoE significantly, while fewer than half of the Lower Mid and Weak performers improved, and to a much lesser extent. Despite these overall positive developments, median RoE fell by 0.5 percentage points to 4.0% in 2017, driven down by the weaker banks in our sample.

RoE development



RoE	2015	2016	2017
Improving banks	33%	46%	67%
Declining banks	67%	54%	33%

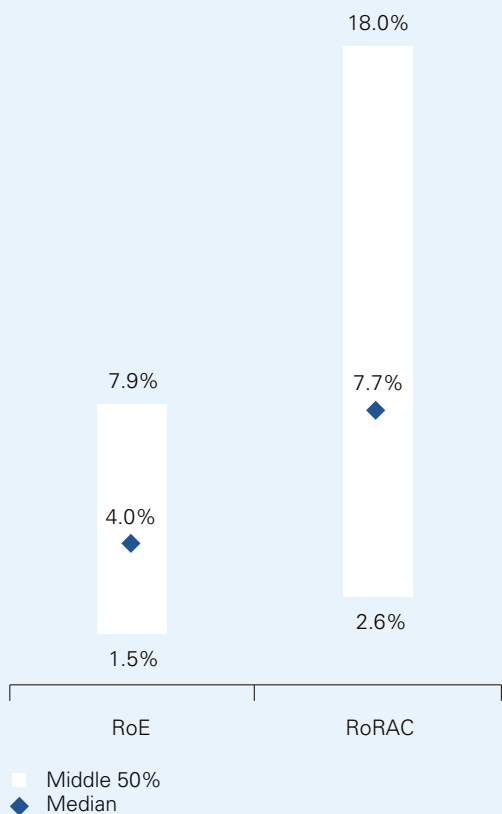
Significantly more banks improved RoE in 2017

Positive financial markets in 2017 contributed to two-thirds of banks managing to increase their RoE. By contrast, only 46% managed to do so in 2016, and 33% in 2015.

Thirty-six banks, or 82% of banks above the median (the better performers) increased RoE by an average of 1.8 percentage points in 2017. One-half of banks below the median meanwhile increased their RoE, by an average of 0.8 percentage points. In other words, the more profitable banks performed better than the less profitable ones.

Median RoE fell 11% from 4.5% to 4.0% in 2017

Despite banks above the median increasing their RoE, the median RoE actually fell in 2017 from 4.5% in 2016 to 4.0%. As the median represents the middle bank out of the 90 analyzed, and the RoE improvement happened primarily in the top half of the banks (while half the banks in the bottom saw an increase and half saw a decrease), the median value has not changed much. It is important to note that it does not reflect the industry's overall positive development.



RoE is higher on a risk-adjusted basis

To arrive at a risk-adjusted capital level, we recalculated the book equity of each bank in our sample based on minimum regulatory capital, and added a subjective 20% operational buffer. 2017 was the first year in which the necessary figures were available for all banks.

The 2017 median return on risk-adjusted capital (RoRAC) was 7.7%, compared to an RoE of 4.0%. The difference in the 75th percentile was even higher at a RoRAC of 18.0% and RoE of 7.9%.

Higher RoRAC levels are an indication that Swiss private banks are generally very well capitalized.

RoE can be improved by reducing capital levels or by investing free capital in RoE-enhancing projects. It remains to be seen if Swiss private banks will maintain their very high capital levels, which is a measure of financial strength, or redeploy their capital to boost future RoE. As interest rates rise, shareholders may be increasingly inclined to consider alternative uses of capital instead of leaving it in banks at low RoEs.

While large banks and subsidiaries of foreign banks tend to distribute profits, we have seen a general increase in the capitalization of banks. This has a negative impact on RoE.

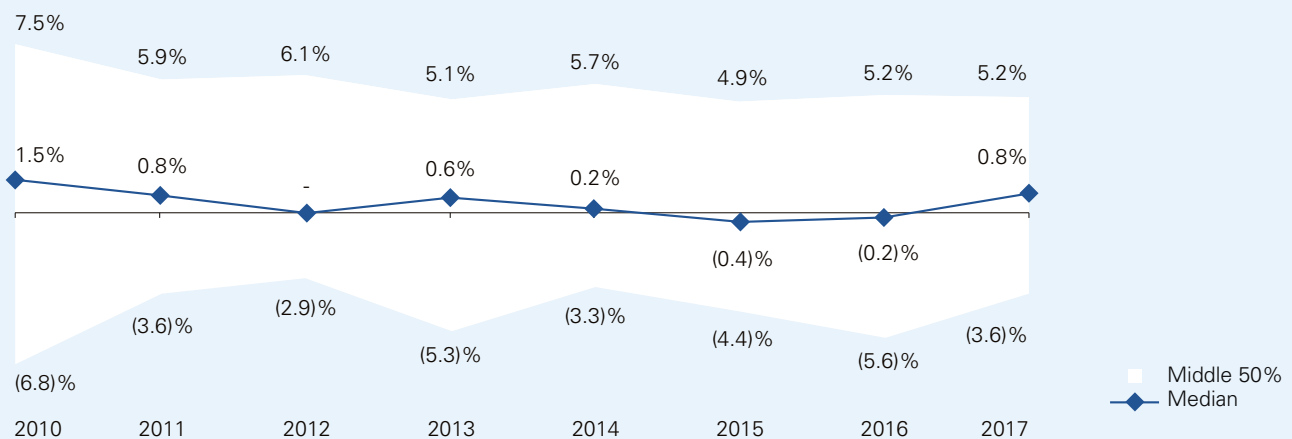
Small banks record inadequate RoRAC

It is interesting to see on a RoRAC basis that small banks are failing to achieve adequate returns. The median RoRAC of small banks is 6.2%, compared to 11.8% at medium-sized banks and 8.7% at large banks.

NNM growth

Median NNM returned to positive territory in 2017, albeit remaining very low. Instead of being driven by a general increase in NNM, this improvement was due to less substantial outflows at some banks. Implementation of the second, and final significant, wave of AEoI in 2017 resulted in negative NNM impacts at many banks.

NNM growth development



NNM growth	2015	2016	2017
Improving banks	44%	46%	58%
Declining banks	56%	54%	42%

Median NNM is back in positive territory

After two years of negative median NNM growth due to legacy outflows, NNM growth increased by 1.0 percentage point to a positive 0.8% in 2017. This reversal was primarily driven by the 2016 implementation of the first AEoI wave, which had resulted in large one-off outflows in 2016 and involved mainly EU-resident clients. Negative NNM of banks with outflows was CHF 65 billion in 2016, compared to CHF 36 billion in 2017. Only seven banks achieved positive NNM above CHF 1 billion each, while 12 banks each had negative NNM of around CHF 1 billion in 2017. The proportion of banks that increased their NNM rose from 44% in 2015 to 58% in 2017.

Second AEoI wave may have impacted 2017 NNM growth

Our analysis suggests that banks with LatAm exposure suffered increased outflows in 2017. This may be attributable

to 2017's implementation of the second AEoI wave, which affected mainly LatAm and CEE-resident clients. It is hoped that the second wave of AEoI implementation puts the worst of the legacy outflows behind us, and that NNM in 2018 may be significantly better.

Small banks led NNM growth in 2016 and 2017

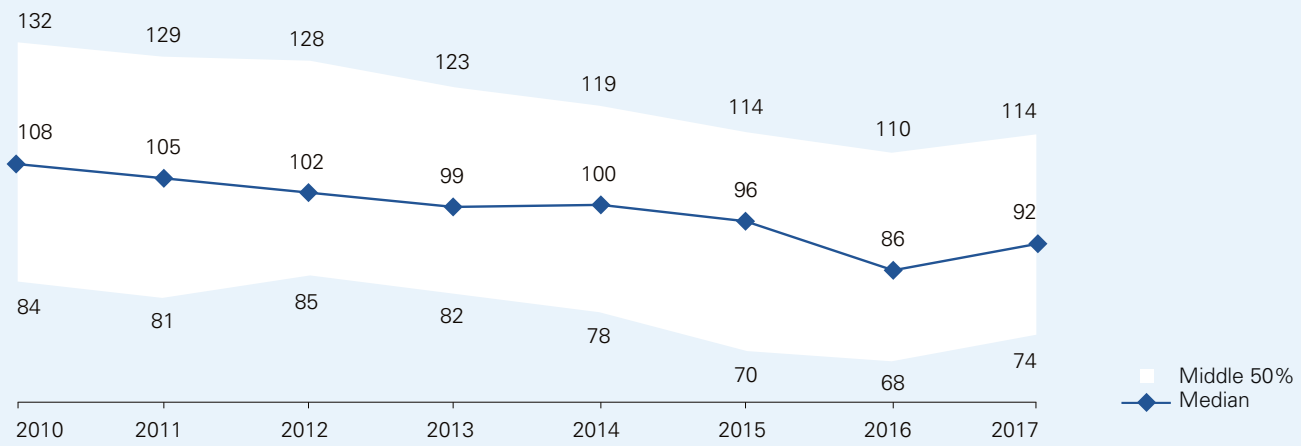
Median NNM growth at small banks was 3.9% and 2.6% in 2016 and 2017 respectively. This compares to negative NNM growth for large and medium-sized banks. There were significant variations in the NNM performance among large banks. Some of the best performances were posted by large Swiss-headquartered banks while some of the highest outflows were seen at large subsidiaries of global banks.

As a group, medium-sized banks struggled most, with two-thirds of them reporting negative NNM.

Operating income margin

A 6bps recovery in the operating income margin in 2017 was achieved on the back of strong global equity markets and rising US interest rates. This followed the largest margin reduction in 2016.

Operating income margin development (bps)



Operating income margin	2015	2016	2017
Improving banks	51%	44%	60%
Declining banks	49%	56%	40%

Operating income margin rose by 4bps in 2017

Following a 10bps fall in 2016, the median operating income margin rebounded by 6bps to 92bps in 2017. This was due to improved global equity markets, which boosted net commission income, and the rise in US interest rates, which boosted net interest income.

Sixty percent of banks saw their operating income margins rise in 2017 compared to margins rising at 44% of banks in 2016 and 51% in 2015.

Likely end of the 100bps operating revenue margin

Small banks grew their margins by 5bps to 102bps, and medium-sized banks by 10bps to 93bps, returning to 2015 levels. Large banks have maintained stable operating income margins over the past three years at around 76bps.

For most sizes of bank, 100bps operating income margins are history with the departure of legacy clients and migration to retrocession-free products. Smaller, niche banks are still able to charge a premium and generate operating income margins well above 100bps.

This is also driven by the fact that they often service small clients. Smaller banks often also have much higher operating expense margins. The higher operating income margin does not therefore lead to greater profitability.

Discretionary mandates and loans

Banks did not manage to increase the percentage of discretionary mandates. The median stagnated at 21.8%. As information on advisory mandates is not disclosed, it is not possible to assess whether margin improvements relate in part to a greater mandate penetration as presented by listed banks.

We saw no push on loans as a possible means to increase AuM and operating income. Loan volumes generally stayed at a low level.

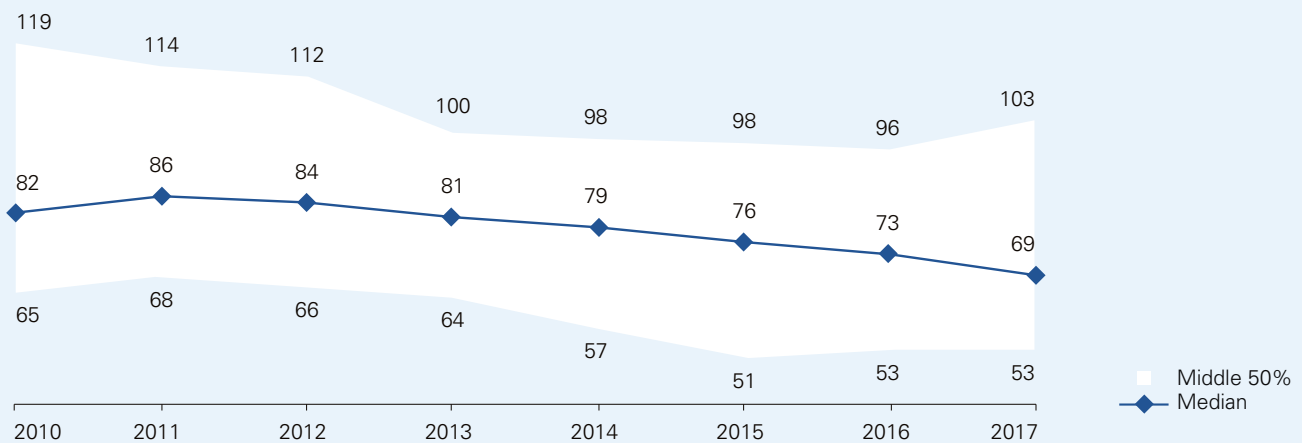
Operating income margin less important as a KPI

Operating income margin varies between banks, as it is a function of a bank's particular business model. High operating margins do not always correspond to high profitability due to different costs involved in running a given business model.

Operating expense margin

Although the operating expense margin continued to fall in 2017, the drop should have been more significant given the considerable increase in AuM. Banks should have been more stringent with regard to cost management, taking the opportunity to improve profitability and better prepare for potentially less favorable future markets.

Operating expense margin development (bps)



Operating expense margin	2015	2016	2017
Improving banks	41%	43%	58%
Declining banks	59%	57%	42%

Operating expense margin fell by 4bps in 2017

The further decrease in the operating expense margin in 2017 is mainly attributable to the growing AuM base, and only partly to banks' efforts to reduce costs.

The contrast between bank sizes is huge. Small banks recorded operating expense margins of 78bps while large banks stood at 60bps, Strong performers at 52bps and Weak performers at 108bps.

Hugely disparate cost management efforts

It appears that, in many cases, substantial cost reduction measures are taken only if a bank is suffering operating losses or declining business volumes.

Only seven banks reduced their cost base by more than 10%. Six of these banks lost significant business volumes.

But despite their measures, only three were able to generate a positive gross profit. Meanwhile, 23 banks increased their cost bases by more than 10%. Of these, 20 also managed to improve gross profit.

Personnel expenses are still the biggest cost driver

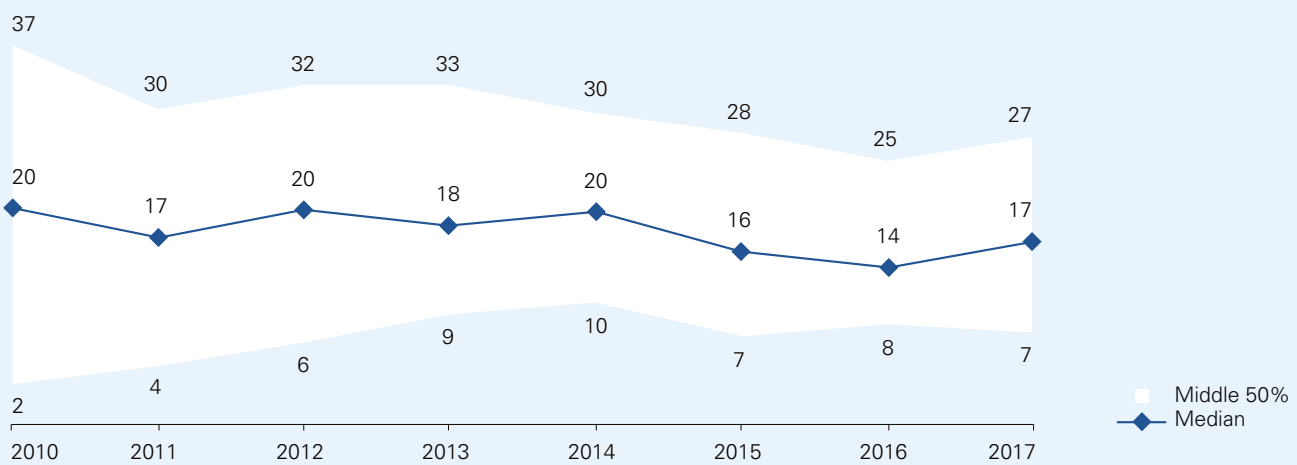
The cost per employee has not moved much over the past few years. The median value remained at around CHF 230k per employee. Costs in Lugano are still by far the lowest at CHF 179k, up from CHF 173k. Only the medium-sized bank group was able to reduce personnel expenses. This reinforces the fact that medium-sized banks were the only size group that worked systematically on their cost bases.

Banks' performances have a significant influence on employee pay. The cost per employee at Strong performers is CHF 279k, compared to CHF 207k at Weak performers.

Gross profit margin

A rise of 3bps took the median gross profit margin to 17bps in 2017. This follows a two-year decline. The improvement was driven by the favorable environment but remains moderate considering the bull markets.

Gross profit margin development (bps)



Gross profit margin	2015	2016	2017
Improving banks	41%	43%	66%
Declining banks	59%	57%	34%

Gross profit margin grew 21.4% to 17bps

Median gross profit margin rose 21.4% from 14bps in 2016 to 17bps in 2017. But while favorable financial markets had a significant, positive impact on revenue, the effects on the gross profit margin were limited due to costs continuing to increase at many banks. Some cost increases may relate to investments to grow and develop business, but overall banks seem to have missed a crucial chance to post greater improvements.

Sixty-six percent of banks saw gross profit margins improve in 2017, compared to 41% of banks in 2015. Thirteen banks reported a negative gross profit.

Similar gross profits across size, business model or region

Interestingly, gross profit margin is comparable for different groups of banks: whether defined by size, business model or region. All these groups have median gross profits in the range of 14-20bps. The only area that is significantly different is when banks are defined by performance cluster.

Strong performers have gross profit margins of 31bps, compared to 25bps at Upper Mid performers, 14bps at Lower Mid performers and (1)bps at Weak performers. Successful players therefore exist irrespective of size, region or business model. In other words, the emphasis is on individual banks to define a strategy that places them in the Strong performer group.

Net profit: stable margin but higher quality

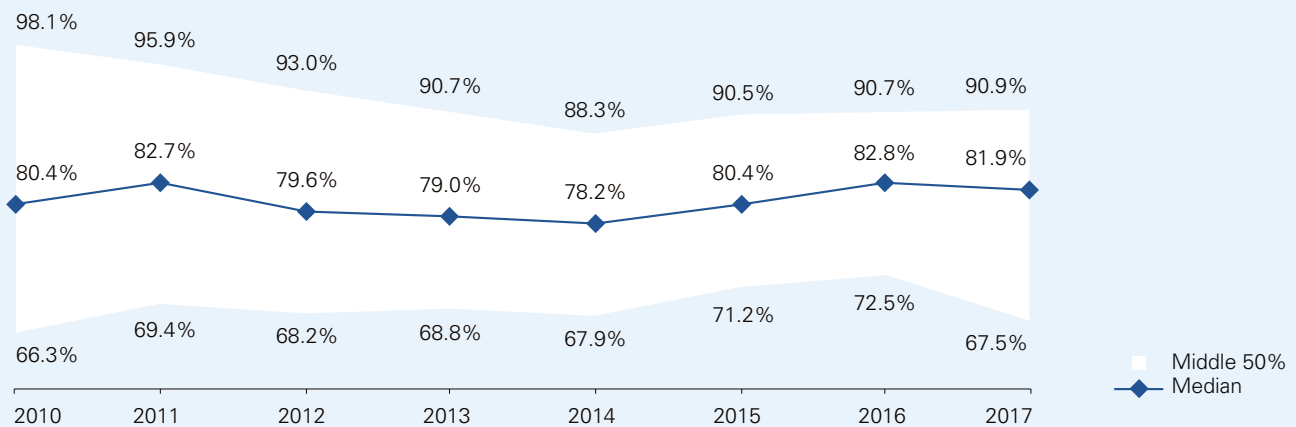
While net profit margin was stable, the quality of net profit increased as one-off items decreased. Previous years saw many banks improve net profit by selling non-core assets and reducing provisions. In addition, large players in particular incurred significantly lower fines in 2017. The margin continued to decline at medium-sized banks, while small and large banks displayed positive trends.

The total tax expense of all 90 banks rose from CHF 426 million in 2015 to CHF 637 million in 2016 and CHF 753 million in 2017.

Cost-income ratio

Two-thirds of banks improved their cost-income ratios in 2017, compared to only 40% of banks in 2016. The median cost-income ratio fell only slightly, as while Strong and Upper Mid performers improved it, there was almost no change in the weaker half of the industry.

Cost-income ratio development



Cost-income	2015	2016	2017
Improving banks	37%	40%	67%
Declining banks	63%	60%	33%

Low C/I ratio banks improved significantly in 2017

C/I improved in 2017, albeit to a very limited degree. This relates in part to ongoing trends, including costs continuing to rise at many banks while revenues also grow. It should be noted, however, that around 80% of banks in the stronger half of the industry saw C/I improve significantly. In the weaker half of the industry, fewer banks improved, and even these improvements were smaller. The middle group, which is most relevant for the median, displayed little change.

As a consequence, the median bank's C/I ratio improved by only 0.9 percentage points to 81.9%. At the top quartile of banks, the C/I ratio improved by 5.0 percentage points to 67.5%. The proportion of banks with improving C/I ratios grew to 67% in 2017 from around 37% in 2015.

Better C/I at banks with asset management activities

Private banks that have sizeable institutional asset management units had a better median C/I ratio in 2017 (at 74.4%) than pure-play private banks (82.3%). This correlation has been fairly consistent over the past three years.

Gaps in C/I ratios are widening

There are huge differences in C/I ratios as a key measure of operational performance. To be a Strong performer, a bank needs stringent cost management as well as a clearly defined business model to produce a strong revenue base. Differences of 20 or more percentage points in the C/I ratios between banks that appear to have similar business and operating models are probably due to management teams actively managing their banks and strategy while others remain unclear about the way forward, with a consequent lack of clear guidance and focus.

Basis of preparation and methodology

Our analysis of the last three years covers 90 Swiss private banks. This represents a market coverage of 83%.

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 licence and for which a significant proportion of its business is private wealth management. There were 108 such private banks as at 31 December 2017.

90 banks analyzed for the past three years; 80 for the past eight years

We analyzed the annual financial statements of Swiss private banks that published such.

Our industry performance section analyzes the 90 banks over the past three years, whereas our median bank insights section analyzes the 90 banks for the three years 2015–2017 and 80 of those banks for the five years 2010–2014.

Adding a net five banks, coverage increased to 83%

This year we increased our sample size to include 10 banks for which we have obtained figures for the last three years. Five banks, however, left the market due to consolidation.

The number of banks in our study therefore increased by a net of five from 85 in 2016 to 90 in 2017 out of 108 banks. This represents a market coverage of 83%.

Included in this year's sample are three large Banque Privées, which changed their legal structures in 2014 to corporate partnerships and have been publishing their figures since. With these banks, AuM in our 90-bank sample increased by CHF 847 billion in 2017.

Banks excluded from our study

We excluded the following banks from our study:

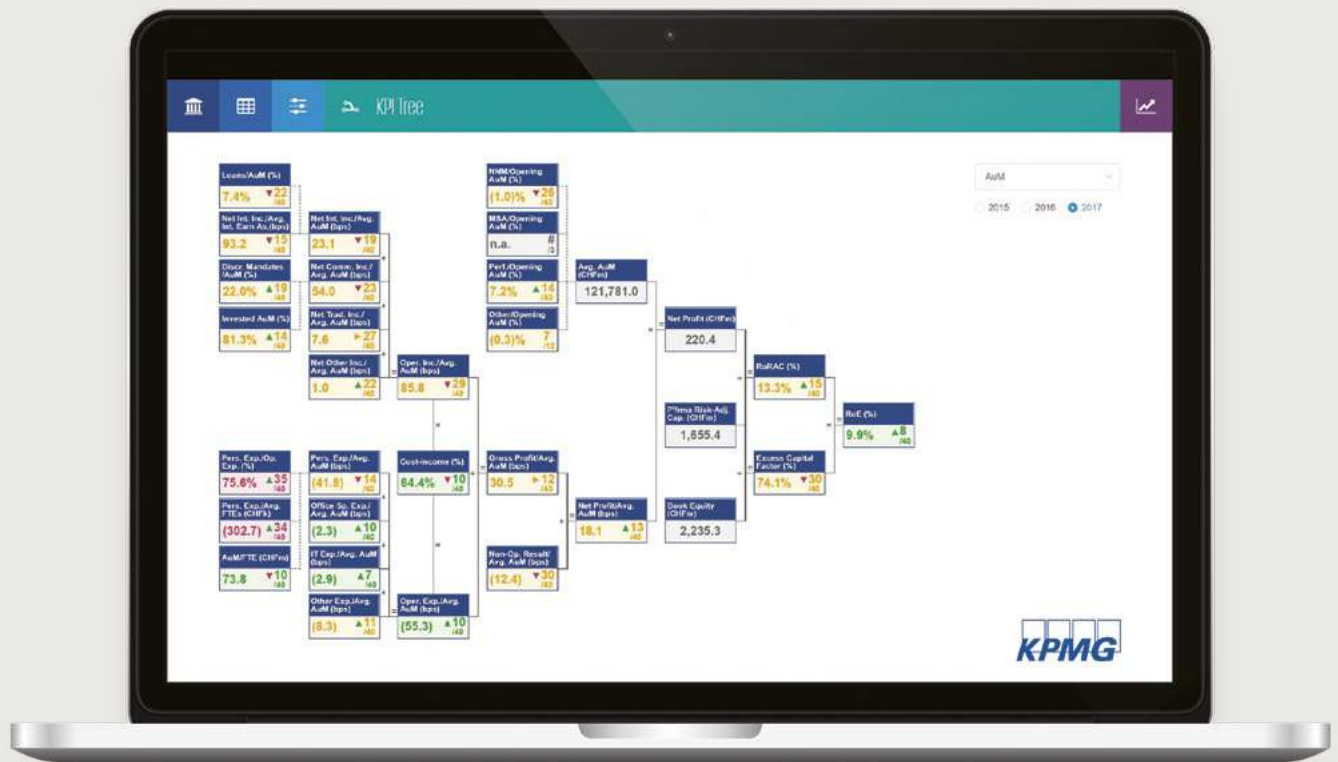
- UBS and Credit Suisse as, if included, the extremely large size of their businesses would have distorted our results and made the analysis overall less meaningful
- Fourteen banks whose financial statements are not available
- Two banks that announced they would enter into liquidation in 2018 and accordingly produced their 2017 annual financial statements on a liquidation, rather than a going concern, basis

Glossary

AEoI	Automatic Exchange of Information	k	Thousand
AuM	Assets under Management	KPI	Key performance indicator
bn	Billion	LatAm	Latin America
bps	Basis points (1/100th of 1%)	M&A	Mergers & Acquisitions
CAGR	Compound annual growth rate	m	Million
CEE	Central and Eastern Europe	n/d	Not disclosed
CHF	Swiss Franc	MIFID II	Markets in Financial Instruments Directive II
C/I	Cost-income ratio	NNM	Net New Money
FATCA	Foreign Account Tax Compliance Act	RoE	Return on Equity
FINMA	Swiss Financial Market Supervisory Authority	RoRAC	Return on risk-adjusted capital
FTEs	Full-Time Equivalents	UHNWs	Ultra high net worth individuals
HNWs	High net worth individuals	USD	US Dollar
IT	Information Technology	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 90 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. We have enhanced the tool's drill-down capabilities by adding two new sample filters regarding a bank's business model and operating model.

Get an impression of our interactive Benchmarking Tool:
kpmg.ch/pb

Our experts are pleased to help you identify areas of performance enhancement for your bank and how they can be delivered practically and effectively.

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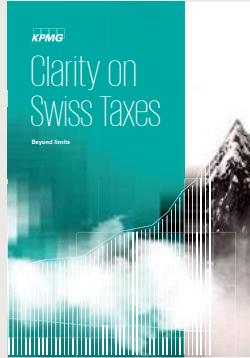
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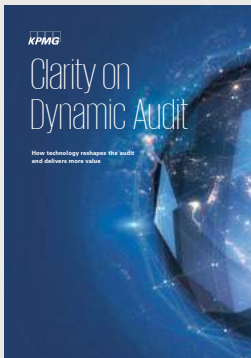
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