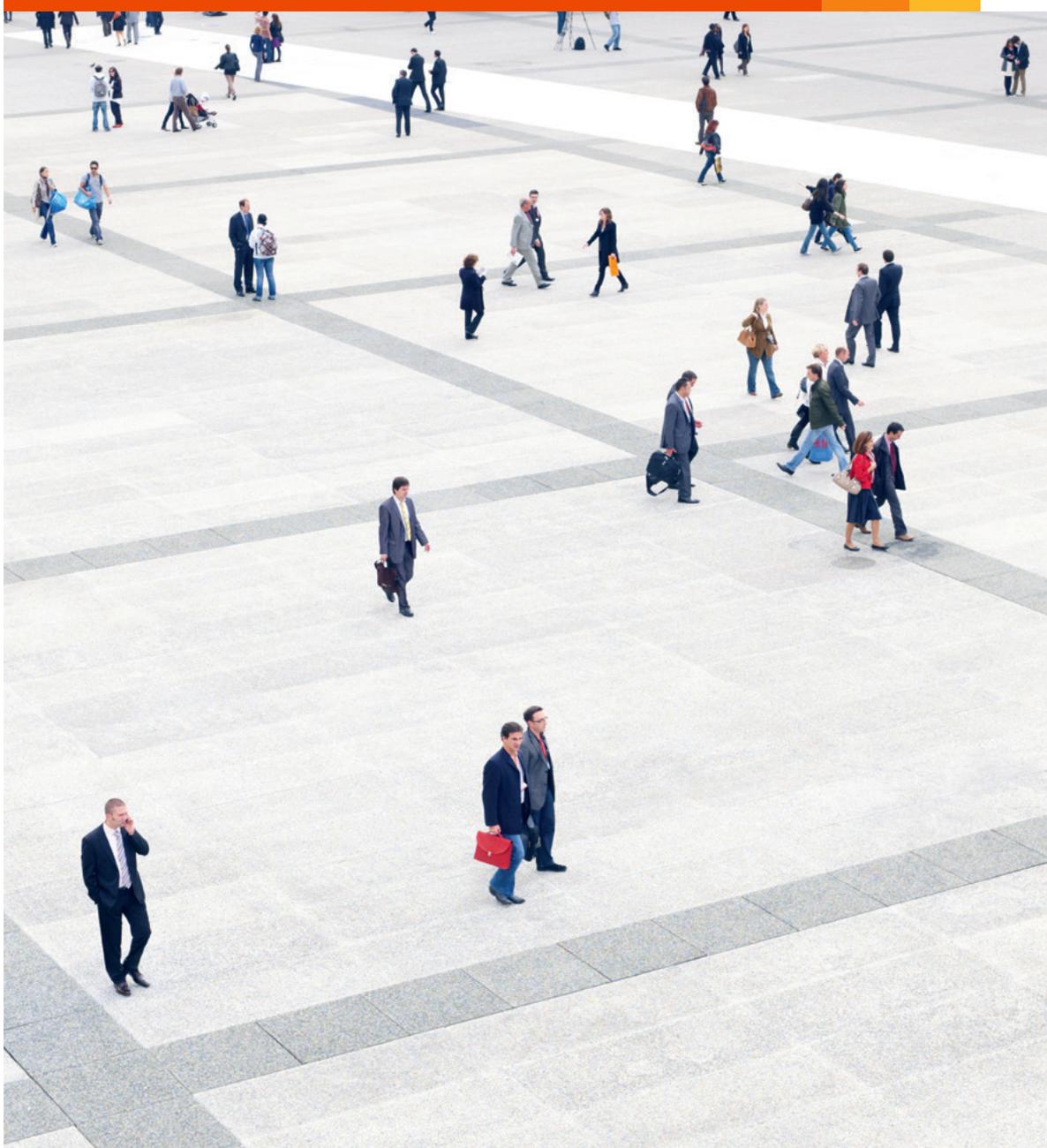


The end of a Golden Age?

PwC Private Banking Study

Our study is aimed at supporting private banks in successfully position themselves in the challenging private banking industry.

January 2013



Contents

Foreword	5
Key Findings	6
1. This study	9
1.1 Background	9
1.2 Description of the study sample	9
1.3 Structure of the study	9
2. The transition process in the Swiss private banking industry	11
2.1 A fundamental change in the offshore private banking industry in Switzerland	11
2.2 Consolidation in the Swiss private banking industry	11
3. Analysis of key performance indicators	15
3.1 Assets under management	15
3.2 Top-line profitability	16
3.3 Operating efficiency	17
3.4 Bottom-line profitability	18
4. Outlook for the Swiss private banking sector	19
4.1 Future environment for private banking in Switzerland	19
4.2 Strategic implications for Swiss private banks	23
5. Contacts and authors	26
5.1 Contacts	26
5.2 Authors	26
6. Definitions	27

Foreword

Due to the financial crisis and increased international pressure on the offshore business, the Swiss private banking industry has undergone a fundamental shift. In the future, all private banks in Switzerland are well-advised to make strategic adjustments to their business models in order to survive in this changed competitive environment. In recent years, there has been a clear trend towards tax-compliant business models, which has had a significant impact on developments in the private banking sector. The more stringent tax regulations have resulted in offshore business models losing their appeal as these are primarily tax-driven. In the last few years, the Swiss private banking industry suffered a significant decline in revenue, whilst the cost of regulation adjustments and improving product and service quality continued to rise. Consequently, cost income ratios (CIR) have continuously increased over the last few years.

Adjusting the business model

Conditions for the private banking industry in Switzerland are not likely to improve significantly in the next few years. Although there will be slightly higher revenues, they will be accompanied by increased costs. Small banks will be particularly challenged as they are unable to rely on economies of scale and are unlikely to have access to the potentially large sums of new money in emerging markets. They must realign their strategic orientation to remain profitable in the short-term. Viable strategic options include focussing on client consulting, outsourcing mid and back-office activities to a professional provider or focusing on selected client segments (e.g. Swiss domestic clients and clients from traditional Western European markets, or clients from CIS member states).

Objectives of the study

Our extensive study on the private banking industry in Switzerland is exclusively based on disclosed and confirmed figures and is intended to provide decision-makers in the Swiss private banking industry with an objective and quantitative analysis of profitability developments in the industry over the past few years. With the insights gained from this study, leadership teams of private banks are encouraged to consider the developments in recent years and to take strategic action in order to position themselves successfully in the private banking world of tomorrow.

There is a future for the private banking industry in Switzerland

In the face of an intensifying debt crisis in the European markets and the dramatic devaluation of the euro, it is once more apparent that Switzerland and the Swiss franc still have the reputation of a safe haven in times of political, economic and social instability and hence that Switzerland is still an important location for private banking. This, coupled with the long-standing private banking tradition in Switzerland and the high quality of employees, provides a good basis for a successful future for the Swiss private banking sector, even in this changed competitive environment. We are convinced that Switzerland will continue to be one of the leading financial centres. However, the leadership teams of private banks will have to proactively face their strategic challenges and make timely and informed decisions to adjust their business models adequately.



Martin Schilling
Head Corporate Finance Financial Services

Key Findings

Our study is based on a quantitative evaluation of individual annual reports issued by banks of varying sizes in Switzerland and is conducted regularly. Our detailed analysis shows that overall assets under management (AuM) at the banks under review decreased by approximately 10% from 2010 to 2011. This decline in performance can be attributed to the uncertainty in the European capital markets and the related weakening of the US dollar and the euro. In the past few years, Swiss private banks were still able to generate net new money inflows, but on a significantly lower level than in 2006 and 2007. Positive results were recorded due to Switzerland's and the Swiss franc's reputation as a safe haven in politically, economically and socially unstable times and inflows from growth markets. Had these not been recorded the outflows from traditional offshore markets would have weighted much more heavily and the regularisation of client assets via tax amnesties and self-declarations would have left much more of a mark.

Marked decline in revenues

Since 2007 revenues from private banks in Switzerland have decreased significantly. There are several reasons for this: Additionally, fees based on the amount of AuM have decreased due to a decline in client assets (approximately 20% lower at the end of 2011 compared to the record high in 2007). On the other hand, the margins on AuM are much lower – this is due to restrained trading activity, high liquidity, a record-low interest rate environment and clients' growing distrust of complex investment products. Furthermore, since a sizeable amount of previously untaxed offshore assets are now being regularised, Swiss banks increasingly face competition from service providers in clients' countries of origin. Moreover, price competition amongst providers in the Swiss private banking industry has intensified, which also puts pressure on margins. The average income per employee has declined by 40% from CHF 656,000 in 2007 to CHF 395,000 in 2011.

Limited cost reduction options

On the cost side, private banks in Switzerland were not able to entirely compensate for the slump in revenues since the record year of 2007. Their CIR before amortisation rose from an average of 60% in 2007 to approx. 85% in 2011. On balance, the participants in the study only managed to reduce their operating expenses (personnel and general & administrative expenses) from CHF 375,000 per employee in 2007 to CHF 329,000 in 2011. The insubstantial cost reduction is most likely the result of the bank's need to invest in know-how and compliance due to more stringent regulatory provisions in the international private banking industry. The fact that personnel expenses were not reduced materially in recent years shows that there continues to be a fierce fight for talent on the market. Moreover, there were no notable reductions in staff numbers in the private banking industry in Switzerland.

The aforementioned effects caused the average net margin (net profit compared to the average AuM) of 35 basis points in 2007 to fall to a record low of 7 basis points in 2011, and net profit per employee to decrease from CHF 204,000 to CHF 37,000.

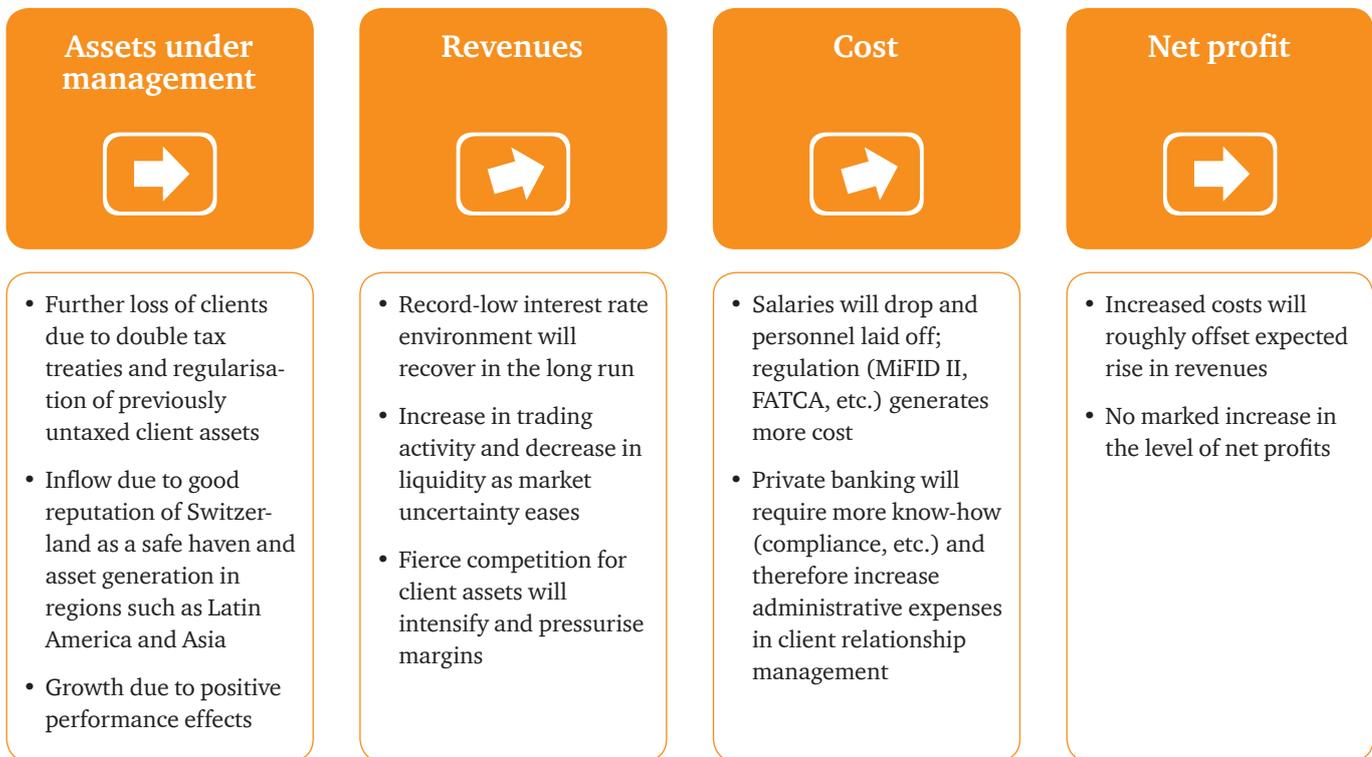
Ongoing consolidation expected

Since the political and economic market environment will remain unstable for some time to come, no notable improvements are likely in the near future. We therefore expect that numerous private banks will not be able to escape the profitability trap, because as the results of the study show: their cost basis can only be reduced to a limited extent. At the same time they should be investing in future growth. But in order to not increase cost they will be reluctant to do these investments. Accordingly, the current consolidation process in Swiss private banking will continue for the foreseeable future.

Chart 1: Development of key figures in Swiss private banking, 2006 to 2011



Chart 2: Medium-term forecast for the Swiss private banking industry



1. This study

1.1 Background

This study is based on a comparative quantitative analysis of the annual reports of Swiss private banks for the period from 2006 to 2011. In this benchmark analysis, we look at key financial indicators in the private banking industry such as the development of AuM and the profitability of such assets, as well as the CIR and various key figures per employee.

1.2. Description of the study sample

This study is based on the 2006 through 2011 annual financial statements of roughly 100 institutions selected from the group of private banks active in the Swiss private banking sector. All of the banks are given the same weight in our benchmarking analysis and the results reflect the arithmetic mean of all the banks involved in our sample. The two big banks, UBS and Credit Suisse, and their private banking activities are not included in our benchmarking group. For the sake of evaluation, we have divided the banks up by size in terms of client AuM:

Number of sampled banks as per year-end 2011 by size

Small size banks with AuM < = CHF 2,000 m	39
Medium size banks with AuM > CHF 2,000 m, < =10,000 m	38
Large size banks with AuM > CHF 10,000 m	23
Total number of banks	100

The sample included banks from the German-speaking, French-speaking and Italian-speaking parts of Switzerland:

Number of sampled banks as per year-end 2011 by head office location

Banks with head office in the German-speaking part of Switzerland	51
Banks with head office in the French-speaking part of Switzerland	35
Banks with head office in the Italian-speaking part of Switzerland	14
Total number of banks	100

The majority of banks included in our sample are controlled by foreign interests:

Number of sampled banks as per year-end 2011 by ownership

Swiss-owned banks	31
Foreign-owned banks	69
Total number of banks	100

In the diversified Swiss banking industry, private banks account for the largest share with 161 institutions at the end of 2011, specialising in stock exchange, securities and private banking services. We analysed the annual reports for the past six years, with the number of private banks contained in the sample differing marginally due to newly founded banks and takeovers during the period we covered. As of the end of 2011, the private banks we analysed managed client assets totalling CHF 1.4 bn. Coupled with the broad market coverage of 100 of the total 161 private banks, the sample can be considered representative.

1.3. Structure of the study

In section 2 we describe the transition process the Swiss private banking industry is currently going through. We consider the impact on m&a activity, number of new incorporations and liquidations.

Section 3 of the study includes the comparative quantitative benchmarking analysis from 2006 to 2011. It offers a snapshot of the current status of the private banking industry in Switzerland by analysing the development of financial key performance indicators in the private banking industry, such as the development of AuM and margins, as well as the CIR and various key figures per employee.

Section 4 of the study provides an outlook on factors that will heavily influence the private banking industry in Switzerland in the next few years, what impact they will have on the financial performance of the industry, and how private banks in Switzerland can react and cope with the future challenges in the industry.

2. The transition process in the Swiss private banking industry

2.1. A fundamental change in the offshore private banking industry in Switzerland

According to a report from BCG (Global Wealth 2011, Shaping a New Tomorrow), Switzerland remains the world's largest financial centre for offshore private banking with a market share of around 27%, followed by the United Kingdom and the Channel Islands (24%). Of the USD 2.1 trillion total offshore private banking assets managed in Switzerland, roughly 50% are attributable to clients from other European countries, where the future growth perspectives are limited and the asset base is at risk due to anticipated asset repatriations. Due to the intensifying competition by other financial centres for offshore money and the recent political and tax developments for offshore assets, it is widely expected that the business model of Swiss private banks active in the cross-border private banking market will be impacted adversely.

As shown in the graph below (figures include assets from private, institutional and commercial clients), the total volume of securities holdings (off-balance-sheet) deposited with banks in Switzerland peaked at CHF 5.4 trillion by the end of 2007. Since then, the volume has decreased to CHF 4.4 trillion as of 30 September 2012. The decline is primarily attributable to negative performance and foreign currency effects. Still, more than half of the volume of securities holdings in Switzerland is attributable to foreign investors, i.e. clients not domiciled in Switzerland. However, this proportion has decreased steadily over the past years and is expected to decrease further in light of the developments described above.

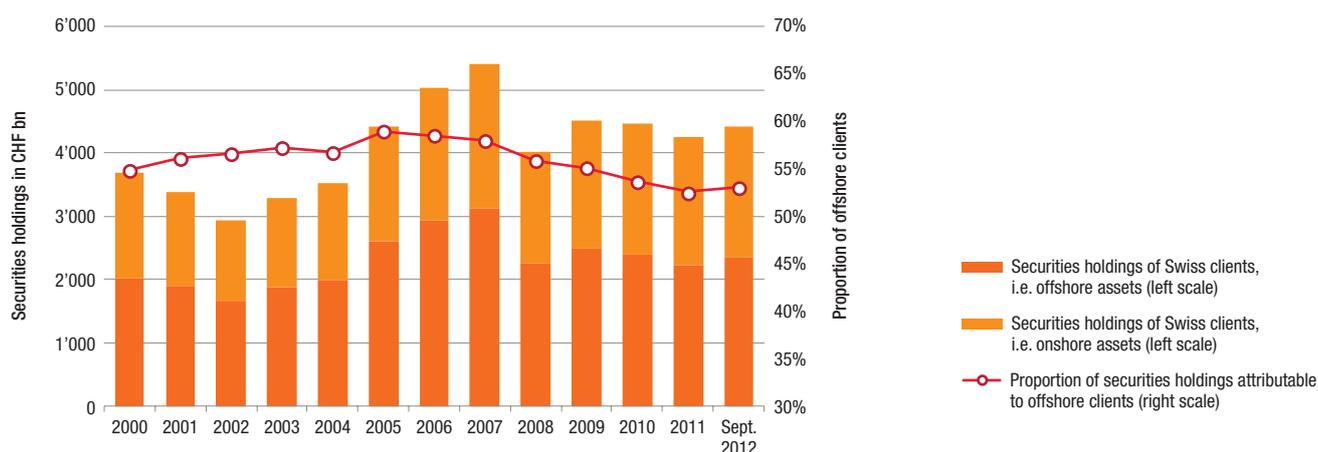
Since the burst of the U.S. housing bubble in 2006 and the subsequent crises in the global financial sector and developed countries' economies, the business environment for Swiss private banking has been adversely influenced by a series of factors. These factors have had a fundamental impact on the business model of banks that focus on the cross-border, offshore private banking business.

2.2. Consolidation in the Swiss private banking industry

2.2.1. Transactions in the Swiss banking market

As pointed out in our last study, the predicted wave of consolidations in the private banking sector in Switzerland has not materialised, despite the many negative developments which affected the Swiss private banking sector. Various external influences have led to shrinking margins, increasing compliance costs and decreasing client AuM. We observed a total of 35 transactions in the private banking sector in Switzerland during the period from 2006 to 2012. Although the number of transactions accelerated after 2009, with 8 transactions announced in 2010 and 7 transactions announced in 2011 as a result of the global financial turmoil, several factors might explain the currently slow pace of consolidation. AuM present a different picture, as there was record M&A activity in 2011 due to the sale of Bank Sarasin to the Safra Group, the sale of ABN Amro to Union Bancaire Privée (UBP) and the integration of

Chart 3: Evolution of securities holdings deposited with banks in Switzerland (source: Swiss National Bank)

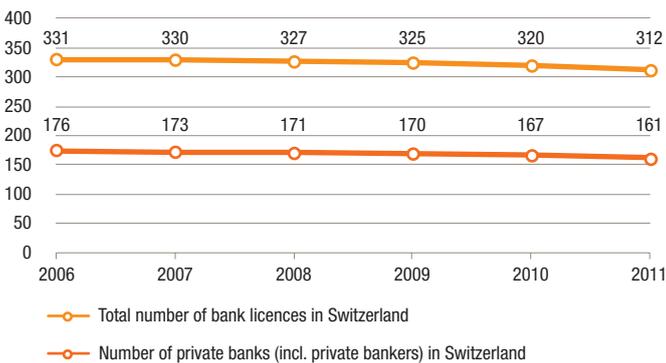


Clariden Leu into Credit Suisse. These transactions were, however, one-off occurrences and not at all representative for the ongoing consolidation process.

The main reason lies in the fact that the number and the quality of interested buyers has decreased in the period under review due to the many uncertainties underlying the business in Switzerland. Risks related to offshore non-tax-compliant assets at Swiss private banks and the overall tax and political situation are further hurdles which have kept interested buyers from engaging in an acquisition, not to mention the failure to meet regulatory requirements. Buyers' profiles have changed in recent years as we see an increase in demand from buyers from emerging markets such as the Middle and Far East, Latin America and Eastern Europe. At the same time, relatively low prices at present have discouraged owners of private banks from selling.

In general and as shown in the following graph, the total number of bank licences in Switzerland decreased from 331 in 2006 to 312 in 2011 (-6%). In the same time frame, the number of banks active in the private banking sector fell from 176 in 2006 to 161 in 2011 (-9%). In view of the current uncertainties and the ongoing consolidation in the private banking market in Switzerland, we expect a further drop in the number of private banks in the coming years. Moreover, the option of liquidating a financial institution's private banking unit has also been considered more seriously in recent years due to increasing difficulty to find an adequate buyer for the entire banking entity.

Chart 4: Trend in the number of banking licences granted in Switzerland, 2006 to 2011

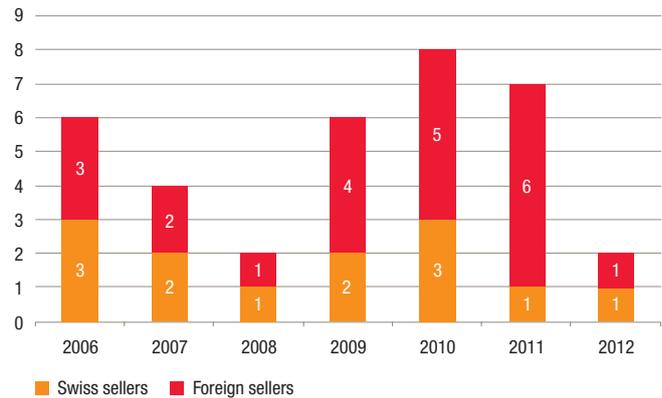


During the past 7 years, there have been as many as 35 transactions in which the majority of the ownership of a private bank based in Switzerland has been transferred to a new owner. As far as the origin of the selling entity is concerned, we noted that most of the transactions involved a non-Swiss seller. This has

been particularly the case since 2009, following the outbreak of the global financial crisis and in response to the international political pressure on Swiss banking secrecy, which has forced foreign owners to divest their private banking subsidiaries in Switzerland.

Whereas disposals prior to 2009 were mainly driven by succession disputes and the reorganisation of banking group portfolios, divestitures since 2009 have often been a direct consequence of the financial turmoil and the current tax and political situation regarding Swiss banking secrecy. The trend towards focusing on core business activities, and exiting from non-strategic assets in the face of new capital requirements (Basel III) has caused many banks to sell. In addition, it should be noted that most of the foreign-owned banks sold had a large number of European non-tax-compliant clients, a segment for which the future outlook is gloomy in view of current developments.

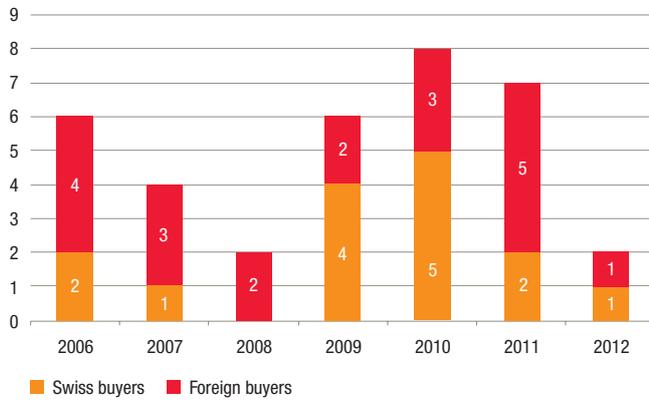
Chart 5: M&A transactions in the Swiss private banking market by seller, 2006 to 2012



A closer look at buyers of private banks in Switzerland over the past two years shows that most deals took place between foreign entities. In 2009 and 2010, the situation looked different as there was a majority of Swiss buyers. Most of those buyers were already present in the Swiss private banking market. Acquisitions were mostly motivated by the following: boosting AuM in order to reach critical mass, diversifying current clients' asset bases, accessing new products and gaining additional market presence.

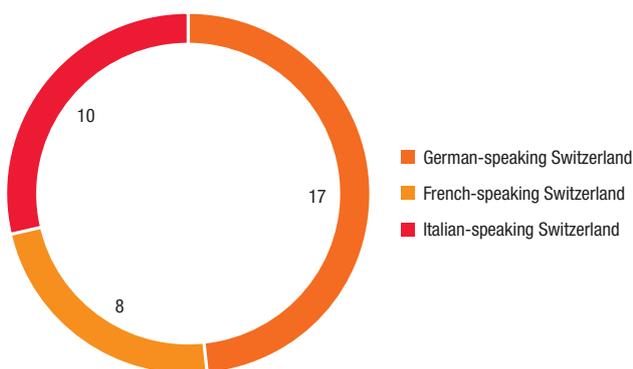
Whilst in previous years the buyers were all financial institutions, we noted a growing interest from private and institutional clients from Middle and Far East and Eastern Europe. Most acquisition plans did not materialise due to various regulatory hurdles, cultural differences between parties and divergences in price expectations.

Chart 6: M&A transactions in the Swiss banking market by buyer origin, 2006 to 2012



From a geographical perspective and in the 2006 to 2012 period, most transactions involving private banks in Switzerland (49%) took place in the German-speaking part of Switzerland (17 transactions in total). Only 23% of all transactions involved banks which had their registered office in the French-speaking part of Switzerland (8 transactions in total). As far as the Italian-speaking part of Switzerland is concerned, we registered 10 transactions over the period. This represents 29% of all transactions that took place in Switzerland and exceeds the percentage share of banking licences issued. The presence of many foreign banking subsidiaries with a clear focus on cross-border private banking and the recent tax and political developments had a significant impact on banks located in the Italian-speaking part of Switzerland.

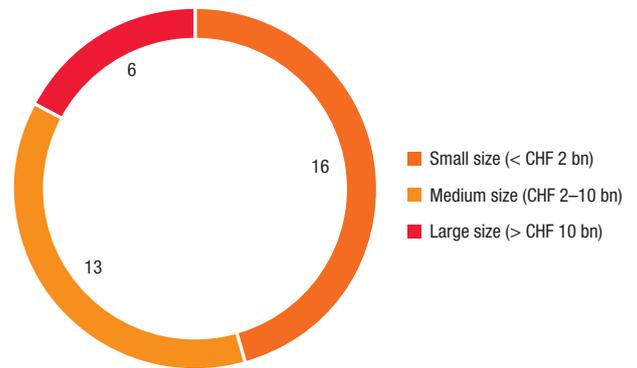
Chart 7: M&A transactions in the Swiss banking market by region, 2006 to 2012



A closer look at the transactions in the private banking sector in Switzerland during the period under review shows that essentially small- (AuM below CHF 2 bn) and medium-sized (AuM between CHF 2 bn and CHF 10 bn) private banks were affected by the consolidation. These banks account for more

than 80% of all transactions in the 2006 to 2012 period. Only 6 transactions involved large private banks (AuM over CHF 10 bn). This comes as no surprise, given that it is the small- and mid-sized private banks whose business models have been impacted the most by recent developments and the ongoing consolidation process in the Swiss private banking market.

Chart 8: M&A transactions in the Swiss banking market by size of the target (measured by volume of AuM in CHF bn), 2006 to 2012



2.2.2. New incorporations of private banks in Switzerland

We also observed a slowdown in the number of newly incorporated private banks in Switzerland. This reflects the current unfavourable business environment. Whilst in 2011 a total of five new banks were founded (REYL & Cie SA, Bank Gutenberg AG, Banco Itaù (Suisse) SA, Dukascopy Bank SA, Globalance Bank AG), only one private bank received a banking licence in 2011 (Neue Helvetische Bank AG, which is not even a pure private bank).

The founders of new private banks in Switzerland are mainly foreign investors, in particular banking groups from Asia, the Middle East and Latin America, entrepreneurs as well as wealth managers wishing to broaden their business model with a banking licence. The founding of a new private bank (Greenfield approach) has been viewed as an increasingly valuable alternative to the acquisition of a private bank. This may be explained by the fact that in many cases the potentially interested acquirer does not want to take over the legacy of the target company (reputational risk), or there is a mismatch in terms of strategy of both the acquirer and the target company. However, the banking application process with FINMA is usually longer than for acquiring an existing private bank.

Chart 9: Number of newly founded private banks in Switzerland, 2006 to 2011

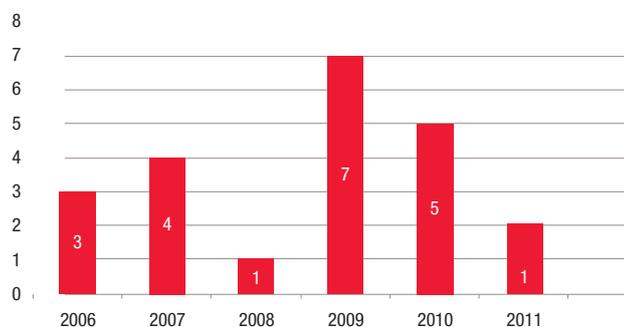


Chart 10: List of newly founded banks in 2010 and 2011

No.	Company	Location	Own funds (CHF 1,000)
1	Banco Itaù (Suisse) SA	Zürich	50,000
2	Dukascopy Bank SA	Meyrin	22,000
3	Bank Gutenberg AG	Zürich	20,000
4	Neue Helvetische Bank AG	Zürich	20,000
5	Globalance Bank AG	Zürich	10,122
6	Reyl & Cie SA	Geneva	10,000

2.2.3. Private banks liquidated or in the process of being liquidated

During the period under review, we noticed that an increasing number of private banks in Switzerland decided or were forced to go into liquidation. In many cases, the impossibility to find an adequate buyer for the bank's assets led to the liquidation of the private bank and the surrender of its banking licence. In other cases, pressure from regulators led to the decision to liquidate the bank.

Currently, there are as many as 8 banks in liquidation proceedings according to the Swiss financial market regulator FINMA (see table below). Not unsurprisingly, all of the concerned banks are owned by foreign investors and most of them are focused on the offshore private banking industry in Switzerland. These market players are impacted the most by the increasing regulatory pressure and the diminishing base of AuM.

Besides liquidation, the possibility of surrendering the banking licence and changing the purpose of the company has been used by certain players to exit their private banking activities and focus on another business activity which does not require a banking licence.

Chart 11: Private banks liquidated in 2011 or currently in liquidation

No.	Company	Location	Status	Own funds (CHF 1,000)
1	Aral Bank AG (branch)	Zürich	liquidated 2011	n/a
2	Mizuho International pac (branch)	Zürich	liquidated 2011	n/a
3	ROSBANK (SWITZERLAND) SA	Geneva	liquidation in progress	80,000
4	BIPIELLE BANK (Suisse)	Lugano	liquidation in progress	60,882
5	Sysbank (Schweiz) AG	St. Gallen	liquidation in progress	39,500
6	Bankque de Crédit et de Dépôts SA, Bankred	Lugano	liquidation in progress	37,158
7	J&T Bank (Schweiz) AG	Zürich	liquidation in progress	20,000
8	RAS Private Banke (Suisse) SA	Lugano	liquidation in progress	20,000
9	Credito Provato Commerciale SA	Lugano	liquidation in progress	11,000
10	BANQUE DIAMANTAIRE (SUISSE) SA	Geneva	liquidation in progress	10,000

3. Analysis of key performance indicators

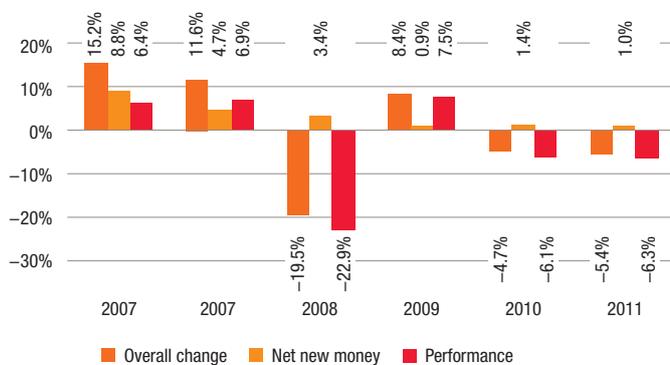
3.1. Assets under management

Swiss private banks' AuM have been adversely impacted by two factors: firstly, negative performance figures in client portfolios in the years 2008 (-22.9%), 2010 (-6.1%) and 2011 (-6.3%); and secondly, a severe drop in net new money growth after 2008, when the annual increase did not exceed 1.4% for three consecutive years (2009 – 2011). In total and on average, these effects led to a decline in Swiss private banks' AuM of roughly 20% compared to the peak level at the end of year 2007.

Despite the international political pressure on Switzerland and its financial centre, Swiss private banks have been able to attract net new money in every single year since 2006, which can be considered a positive point. In the past several years, Swiss banks clearly have benefited from Switzerland's role as a safe haven as the EU experienced times of political, social and economic instability. Moreover, net new money inflows from emerging markets were received, which also helped to partially offset the net money outflows from traditional offshore markets.

On the whole though, the annual net new money inflow rates have been reduced significantly since 2008 and private banks have become very vulnerable to external developments such as plunging share prices or weakening currencies.

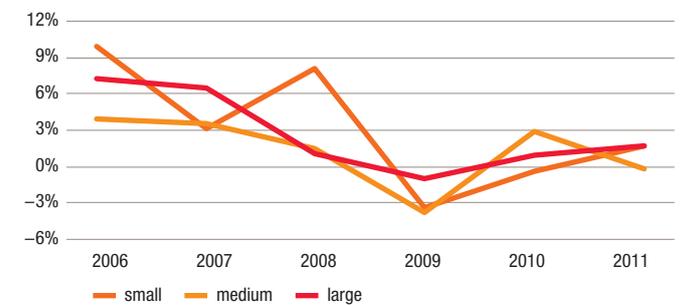
Chart 12: Development of AuM by growth component, 2006 to 2011



At first glance, there is no clear indication of which group of banks - in terms of their size - was able to record the most significant net new money growth rates over the past few years. In this regard, the base effect must be taken into account. This means that small banks mainly have lower volumes of AuM (in absolute terms) and therefore a smaller inflow of net new money (again in absolute terms) is needed to show the same growth in percentage terms. Taking this into account, it

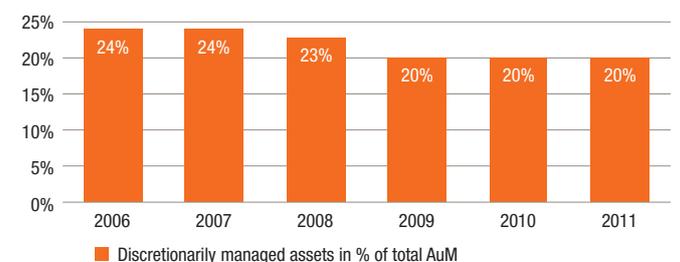
becomes evident that especially the small banks were only able to show a very sluggish pace of net new money growth in absolute terms.

Chart 13: Net new money as % of total AuM by size of bank, 2006 to 2011



Discretionary mandates are an important driver of a private bank's profitability for several reasons: firstly, fees per client are generally higher if the client's assets are managed through a discretionary mandate; and secondly, fees tend to be steadier as they do not depend on the client's trading activity. Also, discretionary mandates can be managed more efficiently through a central portfolio management system. And not least of all, a private bank can reduce its expected (and actual) legal and administrative expenses because the regulatory, legal and tax risks are lower for discretionary mandates.

Chart 14: Share of discretarily managed assets as % of total AuM, 2006 to 2011



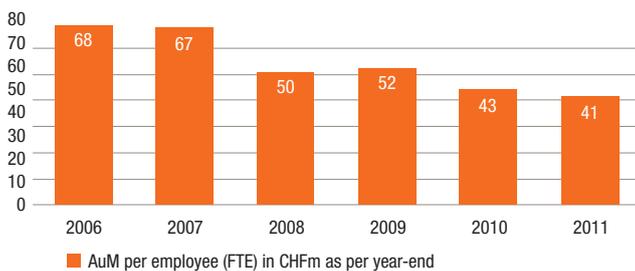
Discretionary mandates are an important driver of a private bank's profitability for several reasons: firstly, fees per client are generally higher if the client's assets are managed through a discretionary mandate; and secondly, fees tend to be steadier as they do not depend on the client's trading activity. Also, discretionary mandates can be managed more efficiently through a central portfolio management system. And not least

of all, a private bank can reduce its expected (and actual) legal and administrative expenses because the regulatory, legal and tax risks are lower for discretionary mandates.

Chart 14 illustrates, on average, AuM in discretionary mandates as a percentage of total AuM have decreased by almost four percentage points since 2006/2007. Clearly, banks have been challenged in selling the value proposition of their discretionary mandate business, as private banking clients' trust in their client relationship manager has declined since the start of the global financial crisis. The associated market turmoil and lower client portfolio in this market environment have indeed taken their toll.

AuM per employee have declined significantly from 2006/2007 to 2011. The decrease amounts to roughly 40%. Nonetheless, the banks have not significantly trimmed their workforce in response to the drop in AuM. Rather, the total number of employees in the Swiss private banking industry has remained relatively stable over the past few years.

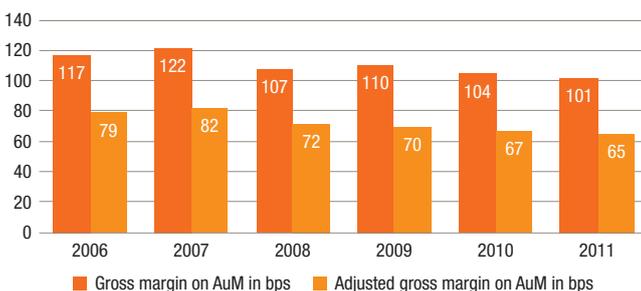
Chart 15: Volume of AuM per employee, 2006 to 2011



3.2. Top-line profitability

The profitability of AuM is highly dependent on various factors which in the past have been developing adversely, with the result being a decrease in the profitability of Swiss private banks. Those factors include client trading activity, client preferences for specific asset classes, interest rates on financial investments and interbank transactions, as well as the bank's fee model (including discounts given to clients) and retrocession revenues.

Chart 16: Profitability of AuM, 2006 to 2011

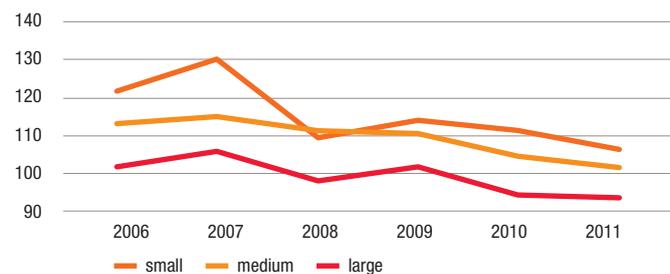


The average gross margin of Swiss private banks decreased further in 2011 compared to the previous year. Their gross margin was highest in 2007 when it reached 122 basis points (bps). Since then, the levels have fallen by roughly 17%.

In the pre-crisis period, clients were considerably more active in securities trading, an aspect which changed completely when clients incurred huge losses in 2008. In addition, clients' risk preferences changed and thus asset allocation underwent a fundamental change, shifting to less risky assets. At the same time, clients put a higher share of their assets aside as cash and reduced their leverage by paying back Lombard loans previously used to boost performance. Besides commission income, operating income also comprises interest income and trading income. In the current low-interest rate environment, banks are not able to generate income from their interest differential business and or financial investments that is anywhere near the pre-crisis levels. Another major driver of the decrease in gross margins is the common practice at many Swiss private banks to use discounts for attracting new clients and for client retention.

Over the past few years, small banks have been able to post the highest gross margins. In interpreting these figures, it must be borne in mind that these banks predominantly serve private clients. Higher margins can be achieved with these clients compared to institutional clients, the latter being served primarily by the larger banks. The margins are higher due to the fact that the clients attach great importance to personal service and continuity and are prepared to pay more for that.

Chart 17: Development of gross margins on AuM in bps by size of bank, 2006 to 2011



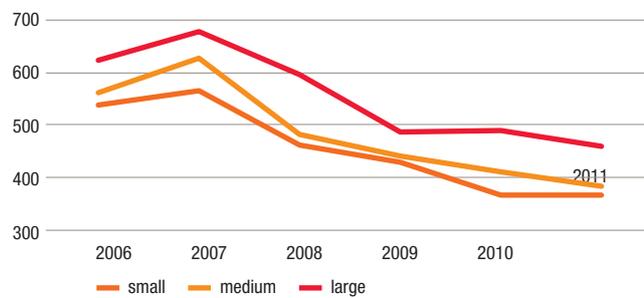
Operating income per employee has come down significantly in recent years. Since 2008, the stricter regulatory environment has forced Swiss private banks to hire an increasing number of back- and mid-office staff. This has caused operating income per employee to decrease further. Compared to the peak year of 2007, the decline in average operating income per employee through 2011 was roughly 40%. The reason for that is to be found in the ca. 20% reduction of AuM over this time frame and a parallel drop in gross margins of roughly the same magnitude, whereas the absolute number of employees has been kept more or less stable.

Chart 18: Operating income per employee, 2006 to 2011



Assessing the data by bank size, we arrive at the anticipated findings. Over the whole analysed period, the small banks showed the lowest figures for operating income per employee. The large banks show better results in terms of operating income per employee compared to the small and medium sized banks. The reason for this lies in the economies of scale. For instance, the proportion of mid and back-office staff who do not generate any income is highest at small banks and decreases the bigger the institution. This effect has become more pronounced since 2008 in light of the heightened regulatory requirements.

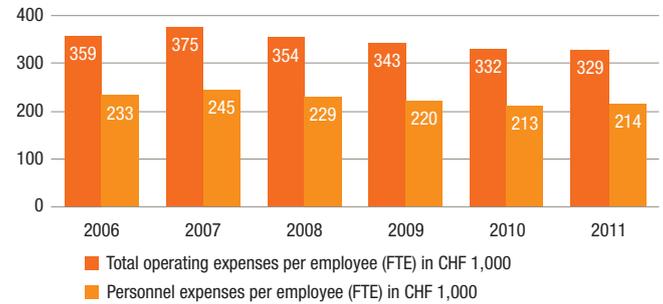
Chart 19: Development of operating income per employee by size of bank, 2006 to 2011



3.3. Operating efficiency

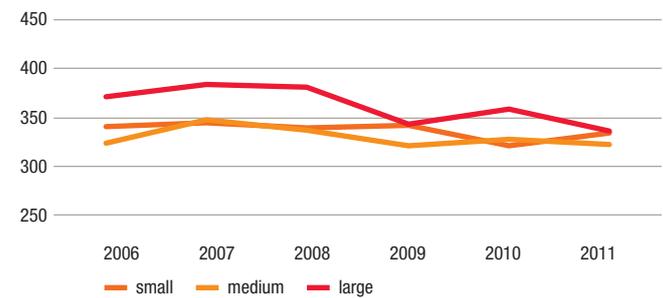
Against the backdrop of sinking gross margins and profitability per employee, reducing operating costs would be of major importance. In terms of expenses per employee, Swiss private banks succeeded in reducing costs over the past few years as shown in Chart 20. Most of the effect stems from savings in personnel expenses per employee, so total remuneration per employee was reduced by roughly 12% during the 2007 to 2011 time frame. To some extent, savings on other operating expenses also made a contribution, but a rather negligible one. However, Swiss private banks on average have increased their number of full-time equivalents (FTE) in response to the increased regulatory requirements, to the extent that overall operating expenses actually rose in absolute terms. By the end of 2011, Swiss private banks on balance recorded operating expenses per employee of roughly CHF 329,000 and personnel expenses of CHF 214,000.

Chart 20: Total operating and personnel expenses per employee, 2006 to 2011



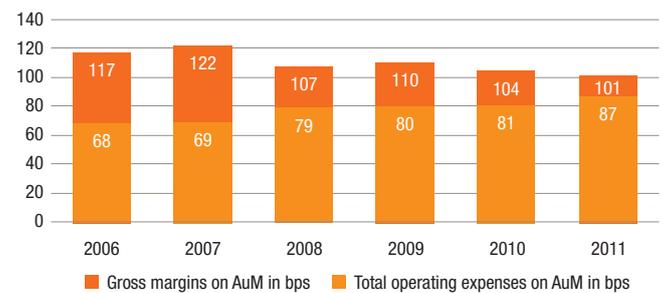
In the period covered, the large banks were able to reduce per-employee operating costs more significantly than the small and medium-sized banks. Compared to 2007, operating expenses per employee in 2011 at small banks were only roughly 4% lower, whereas the same reading for large banks amounted to -13%. The reason for that is again to be found in the economies of scale, as previously mentioned.

Chart 21: Development of total operating expenses per employee by size of bank, 2006 to 2011



Another indicator of operating efficiency is the number of Swiss francs that have to be spent per Swiss franc of AuM. This ratio is measured in basis points. While in 2006, a Swiss private bank had to spend 0.68 centimes per Swiss franc of AuM, it was 0.87 centimes in 2011.

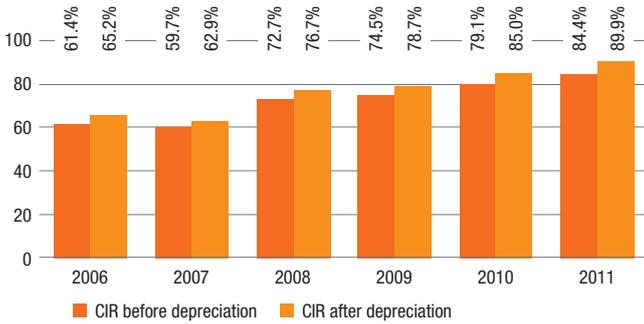
Chart 22: Gross margins on average AuM vs. total operating expenses on AuM, 2006 to 2011



Being the most important performance indicator for the operational efficiency of Swiss private banks, the average CIR increased further in 2011 compared to the previous years and reached almost 85%. Compared to pre-crisis levels, the Swiss private banks' efficiency ratio has gone up by roughly 25 percentage points. In 2011, more than 20 of 100 private banks in

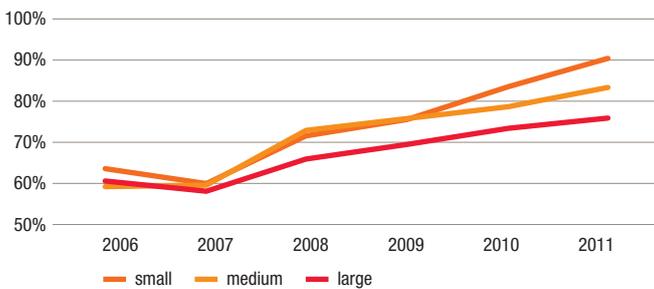
this sample were operating with a CIR of more than 100% and therefore generating a negative gross profit from operating activities (before depreciation and amortisation). The volume and profitability of client assets fell significantly in recent years. Meanwhile, the sector has not been able to reduce costs at the same pace, which has resulted in a steady rise in CIR.

Chart 23: CIR, 2006 to 2012



Looking at the figures by bank size, especially the group of small banks showed a sharp increase in CIR (before depreciation) over the analysed time period. Across all bank categories, the big banks – likely due to economies of scale – were able to achieve a notably better CIR in the years after 2007 than the other two categories.

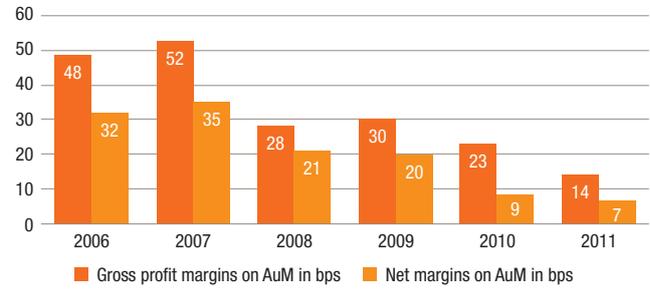
Chart 24: Development of the CIR before depreciation by size of bank, 2006 to 2011



3.4. Bottom-line profitability

Gross profit indicates whether a bank is able to generate more operating income than operating expenses needed for the business. During the course of the financial crisis and the subsequent years, the gross profit margin on AuM has come down significantly. In 2011, banks experienced yet another decrease in operating profitability m– gross margins on average fell from 23 basis points to 14 basis points. Compared to the peak year of 2007, the gross profit margin level in 2011 has fallen by more than 70%. After deducting depreciation, amortisation and taxes from gross profit, net margins show the average bank’s bottom-line profitability. The latter today amounts to only 7 basis points, which is even slightly lower than in 2010. Compared to the peak year of 2007, this means a reduction in bottom-line profitability of roughly 80%.

Chart 25: Gross profit margins and net margins, 2006 to 2011



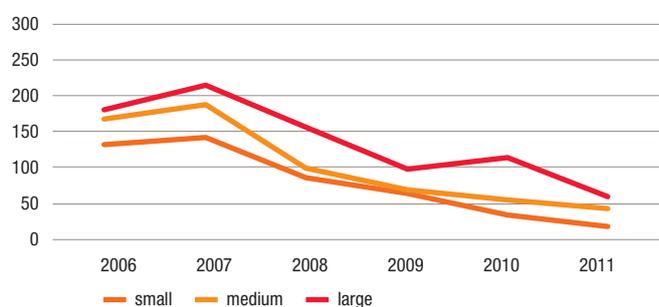
As the headcount has not been substantially reduced in the years since 2007, decreasing profitability can also be seen in the per-employee figures. Gross profit per employee in 2011 was roughly half of the 2009 reading and roughly 70% lower than in the peak years of 2006/2007. In terms of net profit per employee, the reduction in 2011 versus 2007 of more than 80% is even more dramatic.

Chart 26: Gross profit and net profit per employee, 2006 to 2011



Looking at the net profit figures by bank size, the small banks showed the least favourable results and also the most problematic development over the past several years. This category clearly has a much lower AuM per employee than the other two categories. Furthermore, the percentage of mid and back-office staff who do not generate any income is highest at small banks. Since 2008, the Swiss private banks have been forced to hire an increasing number of back- and mid-office staff due to changes in the regulatory environment. This has had a more significant impact on small- and medium-sized banks than on large banks, which benefited from economies of scale also in this respect.

Chart 27: Development of net profit per employee by size of bank, 2006 to 2011



4. Outlook for the Swiss private banking sector

4.1. Future environment for private banking in Switzerland

Thus far, Switzerland has been able to defend its position as a globally leading offshore private banking centre. However, the Swiss private banking industry is currently undergoing a phase of fundamental change which exposes its players to various challenges. The following chart summarises the key factors influencing the private banking industry in Switzerland over the short to medium term. The rows AuM, “revenues” and “expenses” indicate which operating level is affected by the respective factors. The colour of each box indicates whether a factor has a positive (green), neutral (yellow) or negative (red) impact on a private bank’s net income.

4.1.1. Assets under management

- Switzerland has earned a reputation as a safe haven due to its long-standing economic, political, legal and social stability. Thanks to its economic clout, Switzerland will continue to benefit from a strong currency and a low level of national debt. The business environment is characterised by very little corruption and arbitrariness as well as a low risk of expropriation. Furthermore, the high average standard of living and the social security system will play a major role in ensuring social stability. And not least of all, the political system in Switzerland is based on the principles of direct democracy, which in itself guarantees a high degree of continuity. As long as there is political and social turmoil or an economic downturn in certain other regions

Chart 28: Key factors driving the business environment in the Swiss private banking industry over the next few years



of the world, Switzerland can rely on its safe haven status as a key success factor for its private banking industry. Stability in general is expected to become even more important in the future: Various private banks in Switzerland recorded inflows in 2012 from clients domiciled in the euro zone, in particular Southern Europe, who seek to escape the negative impact of the euro crisis and the economic downturn in their home countries. Uncertainty surrounding the future development of North African countries in the wake of the Arab Spring, the smouldering political tensions in the Middle East, and the recent nationalisation of privately owned companies in several Latin American countries have further increased Switzerland's attractiveness as a private banking hub for clients, especially those from the Middle East and Latin America. Inflows of client assets from these regions are expected to continue in the future.

- Although the Middle East and Latin America have gained in importance as offshore private banking markets for Switzerland, the Swiss private banking industry is still significantly dependent on clients from European countries. Many of these countries, in particular France, Italy, Spain, Portugal and Greece are showing only low GDP growth or have even slid into recession recently. The government spending cuts aimed at reducing national deficits in these countries will negatively impact their economic growth. The economic outlook for these countries is mixed, with only moderate or even negative GDP growth expected in the short to medium run. That slow pace of growth will limit the creation of new wealth and, in consequence, reduce the potential AuM inflows from these countries to Switzerland. Despite a recent deceleration of growth in China, Asia will continue to be the region with the most dynamic economic development. Thus the lion's share of new wealth will be created in Asia. Hong Kong and Singapore, as the two major financial hubs in Asia, will benefit most from this development as many Asian clients prefer to have their assets managed locally. The volume of Asian client assets in Switzerland has increased steadily in recent years, but to date still accounts for no more than an estimated 10% of the total offshore wealth in Switzerland and thus remains a niche market.
- Growth of AuM not only depends on net new money, but is also significantly impacted by capital market performance and foreign exchange effects. In 2012, stock markets developed remarkably well despite the euro crisis and the difficult economic environment in major parts of Europe. However, given the guarded economic outlook, there can be no guarantee that the favourable trend in the equity markets will actually continue. Because a substantial part of the offshore private banking assets in Switzerland is invested in foreign currencies, the Swiss private banking industry is exposed to a significant foreign exchange risk: revenues are linked to the volume of AuM and thus dependent on the development of exchange rates, while

a large proportion of expenses are incurred in Swiss francs. As long as the Swiss National Bank defends its minimum EUR/CHF exchange rate of 1.20, the foreign currency effects on the assets managed in Switzerland are likely to be negligible.

- Due to the fact that size will become even more important in private banking, wealth managers in Switzerland will intensify their efforts to increase the volume of AuM. As the Swiss market is already highly saturated, above-average growth can only be achieved by stealing market share from competitors and/or by reducing the outflows from existing clients through client-retention measures. As a result, competition among the players in the Swiss private banking market will intensify, which in turn makes it more difficult to attract net new money.
- As a result of newly concluded tax treaties and tax amnesties, Swiss banking secrecy has become increasingly fragile. This process has led to a regularisation of previously untaxed client assets which, in the past, were protected to a certain extent by banking secrecy. The regularisation is in full swing at present and is expected to continue over the short to medium term. The theft of client data at several Swiss banks has severely and permanently harmed Switzerland's reputation as a financial centre with the highest standards of privacy and discretion. Offshore private clients have been left in uncertainty, and clients with non-tax-compliant assets have opted for a self-declaration. Many clients have already used or will use part of their offshore funds to pay the fines for regularisation of their assets, which will lead to a decline in the volume of foreign client assets managed in Switzerland. A minority of the clients has or will fully withdraw their funds from Switzerland and repatriate them to their home country.
- In summary, we do not expect the AuM of private clients in Switzerland to grow significantly in the coming years, but rather to remain stagnant at current levels. As Switzerland is a small country, the private banking activities are oriented towards an offshore clientele. The inflow of assets from clients seeking political, economic, legal and social stability will continue. These inflows could potentially compensate for the decline in the volume of AuM resulting from the regularisation of previously untaxed assets. Positive market performance could also contribute to growth in AuM, although we consider these effects to be rather inconsequential due to the cloudy economic outlook especially for Europe, which still represents the most important region in terms of client origin for Swiss private banking.

4.1.2. Revenues

- Commission income earned from securities trading activities, i.e. brokerage fees, constitutes the main source of income for private banks. Therefore, the revenues they generate are highly dependent on the trading activity of

their clients. Since the stock market crash in 2008, clients' trading activity has slowed considerably. It has picked up again, albeit reticently, along with the recovery in the stock markets but, compared to the figures of 2006 and 2007, it is still mired at fairly low levels. As stock markets are predicted to show moderately positive performance over the next few years, trading activity might further intensify but most likely will not reach the levels seen in 2006 and 2007. Many clients became more risk-averse in their investment behaviour after the losses they incurred in the 2008 stock market crash and, as a result, increased their cash holdings while at the same time reducing their stock holdings and thereby generating lower trading income for banks. This shift in asset classes is not expected to change materially in the short to medium run.

- In recent years, client preferences have shifted away from complex investment products such as funds of funds, derivatives and structured products in response to the Madoff scandal and the collapse of Lehman Brothers Inc., which resulted in the default of various structured investment products. Clients are now demanding more transparent, easier to understand investment products. These simpler products are less attractive for the banks as they generate lower margins. We do not expect that investors' confidence in complex, structured investment products will return in the years ahead. One option for generating more stable, less transaction-dependent revenues is to increase the share of discretionarily managed assets, where clients are charged a fixed fee based on a percentage of AuM. Several banks with which we had discussions recently did in fact indicate that have succeeded in selling their clients more discretionary mandates. But overall, the share of such mandates as a percentage of total AuM has remained stagnant over the past three years. In this regard, we consider the potential for revenue/margin increases to be rather limited.
- The currently record-low interest rate environment weighs heavily on the profitability of private banks. Firstly, the low interest rates of newly issued bonds have reduced their attractiveness as an asset class for investors. Bond trading activity has therefore decreased, leading to lower transaction-related commission income for banks. Secondly, banks earn lower interest income on their own securities holdings and on their (excess) cash placed in the interbank market. Thirdly, the interest margins earned by private banks on Lombard or mortgage loans have narrowed as a consequence of the lower interest rate environment. In light of the economic difficulties in various European countries as well as the high deficits of many developed economies, including the US and Japan, interest rates are not expected to increase significantly in the short run, especially when one considers the currently low inflation risk. Over the medium to long term, however, interest rates are expected to increase again, which should result in higher interest income for banks.
- The margin pressure on fees will become more severe in the future due to several reasons. As mentioned above, competition among the players in the Swiss private banking market will intensify as they fight to acquire client assets. In order to attract new clients, many private banks are willing to offer potential clients their existing bank services, but at lower fees. Alternatively, they are ready to provide a more comprehensive service package for the same fee. Moreover, tax-compliant client assets on average generate lower margins for banks compared to undeclared assets. One explanation is that clients with properly declared funds are no longer willing to pay a "premium" for Swiss banking secrecy. Another explanation is that private banks in Switzerland managing tax-compliant assets of offshore clients directly compete with wealth managers in the respective home countries of the clients and thus are forced to offer competitive tariffs. Along with the ongoing regularisation of previously untaxed assets, margins on average will decline further.
- The Markets in Financial Instruments Directive II ("MiFID II") completely prohibits retrocessions and inducements of any kind for both independent advice and investment management. In Switzerland, banks and independent asset managers have so far been allowed to keep retrocessions if explicitly authorised to do so by their clients. Rather sooner than later, however, the regulation in Switzerland will be adjusted to MiFID II requirements and retrocessions will also be prohibited here. A prohibition will have a severe impact on the income of independent asset managers – as retrocessions from partnering banks constitute a significant source of revenue for them. Private banks primarily earn retrocessions from placing third-party investment products, in particular mutual funds and products, in their client portfolios. On the whole, the negative impact of a prohibition of retrocessions will be less severe on private banks than for independent asset managers.
- To conclude: We estimate that revenues earned in the Swiss private banking industry will show signs of recovery in the coming years, but the growth potential will be limited. Moderately positive stock market performance will stimulate client trading activity, generating more transaction-related revenues. Due to the fact that clients have become more risk-averse since the stock market crash in 2008 and the subsequent financial crisis, cash holdings will remain lower compared to pre-crisis levels and thus, the amount of transaction-related fees earned in the favourable years of 2006 and 2007 will most likely not be achieved anymore. Moreover, client preferences have shifted away from complex, high-margin investment products to straightforward, but lower-margin products. At least in the medium term, interest rates will rise again, which should result in higher interest revenues for banks both from proprietary and client-related activities. However, revenues will be negatively affected by further intensifying margin pressure. Due to the regularisation of untaxed client assets, margins

in the offshore business, which are still comparatively high, will come under pressure and ultimately come to rest at the lower margins of the onshore business.

4.1.3. Expenses

- In order to ensure EU market access for Swiss private banks and asset managers, Switzerland will be obliged to establish MiFID II-compliant regulatory standards, such as customer protection for EU residents. Furthermore, implementation of the Foreign Account Tax Compliance Act (“FATCA”) and the flat rate withholding tax for the UK will necessitate major investments in IT and human resources. The heightened regulatory requirements will force private banks to concentrate on selected key offshore markets and building up dedicated country desks with specifically trained staff. The strategy of covering a wide range of international markets with only a low volume of AuM per country can no longer be operated profitably. In particular smaller, but also medium-sized private banks will therefore be confronted with the decision of whether or not to terminate their relationships with clients from jurisdictions which account for only a small volume of total AuM.
- Switzerland’s system of self-regulation for external/independent asset managers is an exception in Europe. In order to ensure EU market access, external asset managers will need to be supervised by a governmental body such as FINMA. Currently, FINMA is attempting to delegate the enforcement of cross-border rules for custodians. Such an indirect supervision of external asset managers will increase compliance expenses for private banks in Switzerland that act as custodians and might induce them to stop their business relationships with certain independent asset managers.
- In order to adapt to impending MiFID II-compliant regulatory standards, Swiss wealth managers will need to invest in the education of their employees to further improve their know-how, as well as hire additional staff with specific expertise in compliance, tax and legal matters. Consequently, the number of mid- and back-office staff not directly involved in revenue generation will increase, leading to a further deterioration of the CIR for Swiss private banking.
- Not only the mid- and back-office costs are expected to rise. The client relationship process will also become more expensive: the expenses for MiFID II-compliant relationship management will be considerably higher as additional administrative work such as client profiling, preparing meeting protocols, and more comprehensive portfolio reporting will become necessary. Client relationship managers will therefore have to dedicate a higher percentage of their work time to administrative and non-client-related activities. In turn, they will have less time for client acquisition and retention.

- A large number of private banks in Switzerland have recently migrated to more modern, standardised IT platforms. In many cases, these migrations actually allowed the banks to reduce their IT running costs. The introduction of new regulatory standards will, however, require further investments in technology, in particular in CRM tools, tax-compliant reporting systems as well as risk management and compliance tools. These necessary investments will drive up IT running costs and nullify a substantial part of the cost savings resulting from the migration to new platforms.
- In reaction to the decline in revenues, various Swiss private banks have implemented measures to streamline their operational structure, closed down or disposed of non-profitable operations, or reduced their number of locations. This process is likely to continue. To what extent there will be further staff reductions will largely depend on the further development of the volume of client AuM in Switzerland. As the figures from the past show, the potential to reduce personnel expenses by cutting total staff compensation (e.g. lower bonuses, fewer fringe benefits) is limited. Many banks are reluctant to implement such measures due to the risk of losing their high-calibre staff to competitors. New regulatory requirements such as FATCA, as well as adapting to or implementing MiFID II, will force private banks in Switzerland to invest further in the regulatory, legal and compliance areas by hiring additional staff and updating their technical systems accordingly. The client servicing process will require more administration than nowadays and become more expensive. Therefore, we expect operating expenses in Swiss private banking to increase over the next years.

4.1.4. Net profit

- Ultimately, the success of a private bank is measured by its ability to generate net profits for its shareholders. As we show in Section 3 of this study, net income in the Swiss private banking sector has shrunk dramatically over the past few years. Whilst in 2007, the net profit per employee amounted to TCHF 204, it dropped to TCHF 37 in 2011, corresponding to a decline of more than 80%.
- We do not expect net profits to improve significantly in the near future, but rather to remain stagnant at the currently low levels, given the anticipated development of AuM, revenues and expenses. AuM, which constitutes the main source of revenues for private banks, is not likely to grow substantially in the next several years. Revenues will most likely show signs of further recovery and thus influence the net profit positively. However, the potential for revenue improvement is limited as the positive effects of accelerated client trading activities and increased interest rates will to some extent be counterbalanced by the margin pressure stemming from the regularisation of previously untaxed

assets and intensified competition amongst wealth managers in Switzerland. And lastly, operating expenses at Swiss private banks will increase further and thereby negatively impact future net profits.

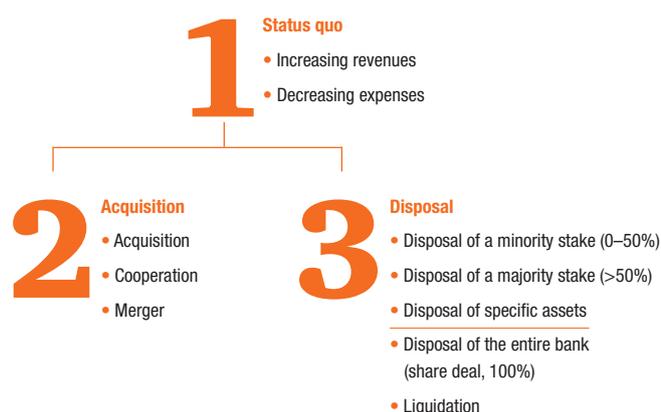
4.2. Strategic implications for Swiss private banks

Basically, there are three garden-variety strategic options for private banks on how to react to and cope with the challenges in the industry:

- **Option 1: Organic growth**, i.e. continuing the present activities on a stand-alone basis, implementing measures to increase revenues and reduce operating expenses;
- **Option 2: External growth**, i.e. joint ventures, acquiring another private bank/wealth manager or merging with a competitor in order to increase the volume of AuM and exploit economies of scale;
- **Option 3: Exit from the Swiss wealth management market** by selling the entity (or its activities) to a third party

The chart below summarises these strategic options. They are described in more detail in the sections below. Which option will actually be chosen depends on the individual circumstances and the market environment.

Chart 29: Overview of the generic strategic options available to private banks in Switzerland



4.2.1. Organic growth

As a first option, a bank can continue to operate on a stand-alone basis and try to grow its business organically. In view of the margin pressure and increasing operating expenses, such a strategy forces a private bank to question its current business model and to seek measures to optimise its existing operational set-up.

A popular measure to increase AuM and thus enlarge the revenue potential for wealth managers in Switzerland is to poach individual CRMs or entire teams from competitors. These CRMs are expected to bring with them a significant part of their existing client base and give their new employer access to their network of client contacts. From the discussions we had with various private banking executives, we got the impression that hiring CRMs from competitors often didn't turn out to be as successful as expected: firstly, many newly recruited CRMs ultimately brought with them a significantly lower volume of AuM than initially promised; and secondly, their network of contacts with potential clients was often less extensive or could not be leveraged to the extent initially promised.

A second measure for boosting revenues is to develop new client jurisdictions. However, as offshore private banking is becoming more and more restricted and increasingly complex due to a bevy of new regulatory requirements, such a strategy often requires establishing a local (i.e. onshore) presence in the respective markets. Building up a branch or subsidiary in a new market is a costly and time-consuming process that is ultimately only feasible for larger-sized wealth managers. If a small to medium-sized private bank wants to become locally present in a foreign market, the sole option in most cases is to establish a partnership with a local player. However, such partnerships involve the disadvantages of limited strategic flexibility (major strategic decisions have to be agreed upon with the partner) and sharing revenues with the partner.

A third measure to generate more revenues is to extend the service offering beyond that of traditional private banking. For example, a private bank can build up a dedicated in-house practice in certain investment niches and develop best-in-class investment products in this area or start offering comprehensive family office services. Alternatively, a private bank can expand its interest differential business by granting mortgage loans on a broader basis or initiating commercial credit activities, including trade finance. A broadening of the service palette requires that the respective competencies be available in-house. Moreover, lending activities create further operational risks which require a higher equity capital basis.

Measures to cut operating expenses are easier and less time consuming to implement than are measures to increase revenues. Therefore, many private banks have already taken those steps in recent years. As a result, there is not much potential left to reduce costs further. A typical measure is to analyse the profitability of branches and subsidiaries (if there are any) and, based on such analyses, to decide whether it is economically justifiable or not to continue operating those branches/subsidiaries.

In view of the increasing regulatory requirements, it will no longer be profitable for smaller to medium-sized private banks to service clients from a wide range of different jurisdictions. Instead, they will have to focus on those client segments and

jurisdictions which account for a significant part of their AuM, and terminate the relationships with clients from markets which in total account for only a few million in AuM. The drawback of such a measure is that it further reduces their AuM and thus the revenue basis.

The anticipated increase in the operating expenses will sooner or later force private banks to reassess their business model and decide which parts of the value chain are key and thus still need to be covered in-house, and which parts can be outsourced to external providers. Until recently, there was considerable reluctance among private banks in Switzerland in terms of outsourcing and only a limited number of players made use of outsourced services. Now, there are indications that outsourcing might become more popular: the majority of newly founded banks in Switzerland are front-office entities with most of the mid- and back-office functions outsourced to specialised providers. Various smaller and medium-sized private banks are currently in the process of reassessing the pros and cons of outsourcing.

To conclude: Many of the measures aimed at increasing revenues, such as poaching CRMs from competitors, extending the service offering by building up new competencies in-house or developing additional markets, give rise to further operating expenses in the short to medium term and their positive effects on a private bank's profitability will only show up in the long run. The potential to reduce operating expenses is limited and many cost-cutting measures will have a negative impact on the bank's ability to grow. The situation will become most difficult for medium-sized private banks as they will be trapped in a kind of a "vicious cycle": on one hand, they are too small to establish local presence in foreign markets and thus are unable to reduce their dependency on the Swiss market; and on the other, they are too big to pursue a clear niche strategy.

4.2.2. External growth

If the anticipated growth cannot be achieved organically, external growth measures should be taken into consideration. Such measures include joint/cooperative ventures with other partners, the acquisition of a competitor or a merger with another wealth manager.

By cooperating or joint venturing with another private bank or a specialised asset/investment manager, a bank can gain access to additional resources and thereby better position itself in niches to gain differentiation from the competition. A cooperative arrangement may also allow a bank to tap another client base or an additional distribution channel for its proprietary investment products. In order for a cooperation/joint venture to become successful, it is crucial that

- the rights and obligations of the partnership are clearly defined;
- there is a clear decision-making process; and
- all parties involved are highly committed to further developing the cooperation/joint venture and mutually benefiting from their commitment.

In practice, many cooperative or joint ventures did not turn out to be successful because the critical preconditions were not fulfilled.

The acquisition of a private bank, a wealth manager or product specialist may help a bank to increase its AuM significantly and to achieve critical mass in the short run. Reaching the same volume of AuM organically would often take several years. Given the limitations of the available organic growth measures, we expect the consolidation process in the Swiss private banking industry to accelerate further. However, finding the right target is difficult insofar as many banks have legacy problems from their former cross-border activities and thus are not attractive from a risk perspective. Whether or not an acquisition turns out to be successful depends on factors such as:

- **Financial power of the acquirer:** An acquirer must have realistic price expectations with regard to potential targets and be aware of the fact that prices for targets in the Swiss private market vary substantially depending on the quality of the client base, the profitability and the growth potential of the target. Moreover, an acquirer needs to have sufficient financial means to conduct a transaction through to the end. In this respect, the financial backing of the transaction by the owners of the acquiring bank is key.
- **Cultural fit:** When contemplating an acquisition, an acquirer should define the acquisition criteria in detail and make sure that there is an adequate cultural fit with the target. One of the reasons why M&A transactions have failed in the past is that acquirers only focused on hard factors such as financials, but neglected soft factors such as cultural similarity/differences or leadership styles. A good cultural fit facilitates the integration process and the subsequent achievability of strategic goals. Furthermore, the risk of outflows of client assets or the loss of CRMs is substantially lower if the target and acquirer have a similar business culture and/or cover similar client segments and markets.
- **Commitment:** Management's strong commitment and available personnel resources both on the buy- and the sell-side are crucial for an efficient execution of the transaction process. The longer an acquisition process lasts, the lower the chances of success are because the commitment of the involved parties tends to wane over time. In addition, a lengthy process leads to a high level of uncertainty amongst employees and clients and may well result in a bank losing its best employees and most attractive clients.

- **Integration:** Initial considerations regarding the post-merger integration aspects should be taken into account at an early stage of the M&A process. Especially retaining the key employees of the target company is a prerequisite for a successful acquisition. New organisational structures and leadership schemes should be put in place immediately after the completion of an acquisition as they enhance a successful integration.

If two banks are similar in terms of size and neither of them has the necessary financial resources to acquire the other, a merger could represent a suitable option. In a merger, two or more banks are combined into one single entity which then operates jointly under a single brand, with the share capital held by the former owners of the merged entities. Like a joint venture or cooperative undertaking, a merger is successful only when all parties involved mutually benefit from the combination. The fact that a merged entity will be owned by several shareholders increases the complexity of the decision-making process and in worst case might lead to a situation in which the different shareholders block each other.

In summary, size has become an important driver of a private bank's efficiency as investments in infrastructure and know-how are largely scalable. Smaller to medium-sized private banks therefore have come under pressure to increase their volume of AuM. An acquisition allows a bank to grow its AuM significantly at a single shot and to take a step forward in ensuring its long-term prosperity. Often, it takes several years for a bank to reach the equivalent business volume created by an acquisition if it grows organically. However, acquisitions do not come without risks. Firstly, it is difficult to find a suitable target as many private banks in Switzerland have legacy problems from their former cross-border activities. Secondly, if there isn't a sufficient cultural fit between target and acquirer and if integration aspects are not considered early in the transaction process, there is a high risk of CRMs leaving and client assets being withdrawn.

4.2.3. Exit from the Swiss private banking market

A partial or full exit from the Swiss private banking market might have to be considered as an option of last resort if

- the long-term prosperity of a bank can no longer be guaranteed if the business is continued on a stand-alone basis;
- no sufficient financial resources are available for an acquisition;
- no suitable acquisition target or merger/joint venture partner can be found.

The sale of a minority stake (below 50%) via a share deal is a viable option if there is a business partner (senior private banker or independent asset manager) who desires to have a stake in the bank in exchange for granting bank access to his network of client contacts. In our experience, the likelihood of finding such a business partner is rather low as many of them want to remain independent or obtain full control over a bank.

Alternatively, the sale of non-core assets or portfolios of client assets from jurisdictions which are no longer regarded as core markets can be taken into consideration. This option may be attractive if a bank wishes to terminate its business activity in a specific jurisdiction or region for profitability reasons. The sale proceeds can then be reinvested to further develop the core activities. In recent years, the number of asset deals in Swiss private banking increased as many buyers preferred to take over client portfolios rather than acquiring entire banks for legal reasons (no inherited legacy problems), as well as out of pricing considerations (no necessity to take over full-blown infrastructure and (excess) equity capital).

If the current owners of a bank want a clear and immediate exit, then they should opt for a disposal via a share deal. Here, all rights and obligations of the acquired bank pass to the buyer, which takes full juridical control. In the case of a disposal, timing is of the essence. In recent years, we have observed several cases where bank owners waited too long until they finally decided to sell. This created uncertainty, which induced CRMs and clients to take their leave. As a result, the financials of the respective banks deteriorated further and further, so that ultimately no buyer was interested anymore. Thus if the owners of a bank are considering an exit, it is important that such an exit be realised at a time when a bank is still attractive in terms of its client structure and profitability.

In case the proceeds from a disposal are not higher than those from a liquidation, the latter may represent the sole available option. However, both the direct and the indirect costs of a liquidation, e.g. reputational effects, have to be taken into consideration. As mentioned in Section 2.2.3 of this study, several banks entered into liquidation in 2011 and 2012.

To conclude: A partial or full exit from the Swiss private banking market in the form of a share or asset deal represents an option of last resort if a bank has no attractive growth prospects on a stand-alone basis, if there are no sufficient financial resources available to conduct an acquisition, or if no suitable acquisition target or merger/joint venture partner can be found. If the owners of a bank are considering a disposal, it is important that such a disposal be realised at a time when the bank is still attractive in terms of its profitability and client portfolio. If a company waits too long, it can be that no buyers will be found and, in the end, the only option left is liquidation.

5. Contacts and authors

5.1. Contacts

Philipp Hofstetter

Head Corporate Finance Practice Switzerland

Phone +41 58 792 15 06

Email: philipp.hofstetter@ch.pwc.com

Martin Schilling

Head Corporate Finance Financial Services
Practice Switzerland

Phone +41 58 792 15 31

Email: martin.schilling@ch.pwc.com

5.2. Authors

Martin Schilling

Adrian Heuermann

Andreas Flachsmann

Andreas Müller

Pablo von Siebenthal

6. Definitions

Adjusted gross margin

Subtotal commission income/average AuM

Gross margin

Total operating income (earnings from ordinary business operations)/average AuM

Cost income ratio, CIR (before depreciation)

[Subtotal operating expenses]/total earnings from ordinary business operations

Cost income ratio, CIR (after depreciation)

[Subtotal operating expenses + depreciation on fixed assets]/total earnings from ordinary business operations

Net margin

Annual profit/average AuM

Growth in net new money

Net new money/AuM at beginning of year

Performance on assets under management (AuM)

[Change in AuM – net inflow of new money – acquisitions + divestitures]/AuM at beginning of year

Return on equity (ROE)

Annual profit including minority interests/average shareholders' equity before appropriation of net income including minority interests (as per statement of shareholders' equity)

Pre-tax margin

Earnings before taxes/average AuM

