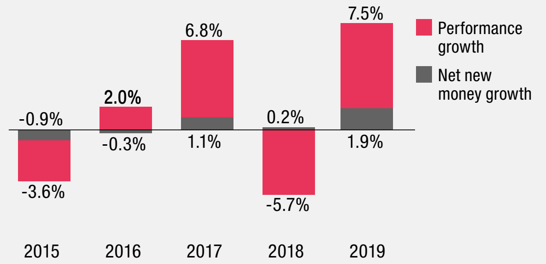
Private Banking Switzerland

80 private banks in 2019	**84 %** market coverage # of private banks in 2019
15 years of data	**7th** edition since 2010
75 KPIs	**3** deals in 2019

PwC's Market Update on the Swiss Private Banking Sector 2020

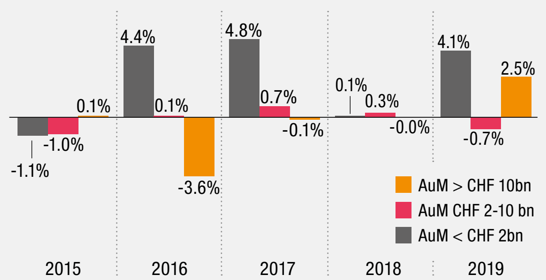
Overall, 2019 proved to be a pleasant year for Swiss private banks. Due to the strong performance of global markets, assets under management (AuM) recorded the highest growth in a decade. However, Swiss private banks reported only a slightly higher median return on equity of 4%, meaning that the majority of banks still did not cover their cost of equity. As in previous years, there was a widening gap between small and large private banks in terms of performance, with small private banks particularly struggling. Their median cost-income ratio further increased to 104%. 2019 saw a decrease in M&A activity as only three private banks changed their owner. In all three transactions the target was a small private bank having problems achieving the critical size to run in a profitable way or two smaller banks merging to increase the combined AuM volume.



Developments in assets under management

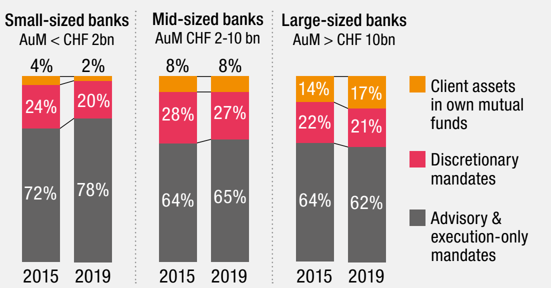
In 2019, global markets made a strong recovery from the previous year's downturn and enabled Swiss private banks to achieve performance growth of 7.5%, which is the highest value in more than a decade.

During the tax dispute episode between 2009 and 2016, Swiss private banks suffered from net new money (NNM) outflows of around 2% of their AuM per year. After that, most Swiss private banks were able to settle their tax disputes and refocus on strategic and organic growth initiatives, leading to a turnaround to positive NNM growth starting in 2017. In 2019 Swiss private banks saw comparatively significant NNM growth of 1.9%, which is also the highest value in a decade.



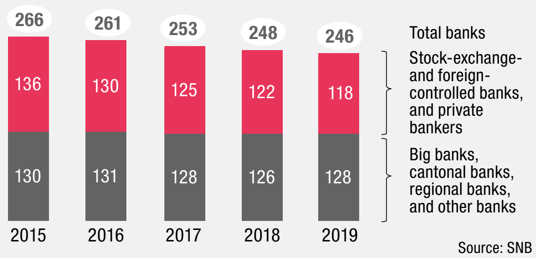
Growth in net new money

Small banks which saw significant NNM inflows in 2016 and 2017 were struggling to attract NNM in 2018. In 2019, they were able to record a plus of 4.1% and thereby reach the high net inflow levels of 2016 and 2017 again. On the other hand, medium-sized banks continued to struggle as their NNM decreased in 2019 by 0.7%. The strongest result was achieved by large private banks. With an increase in NNM of 2.5%, they were a significant factor why the sector as a whole could attract more net new money. Furthermore, this was their strongest NNM increase since 2008 and therefore also since both the financial crisis and the tax disputes changed the Swiss private banking landscape.



Composition of assets under management

Advisory and execution-only mandates accounted for the vast majority of small banks' AuM and their share increased even further from 72% to 78% between 2015 and 2019. Obviously a lot of banks were not able to achieve their goal of increasing the portion of discretionary mandates over the last few years. Large private banks increased the proportion of client assets in own mutual funds from 14% in 2015 to 17% in 2019. On the other hand, small private banks slowly withdrew from their own mutual fund businesses, which accounted for only 2% of their clients' assets in 2019. For small private banks, it is difficult to achieve the critical AuM size in their own mutual funds if they do not have a successful flagship fund. Therefore, some small private banks no longer follow a strategy of setting up their own mutual funds, but rely on existing third-party products in the market.



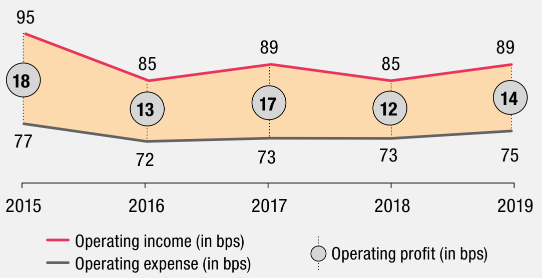
Source: SNB

Note: Some values might deviate from earlier publications due to restatements in the annual reports and updated peer-group constellations in the database.

Number of banks and M&A activities in Switzerland

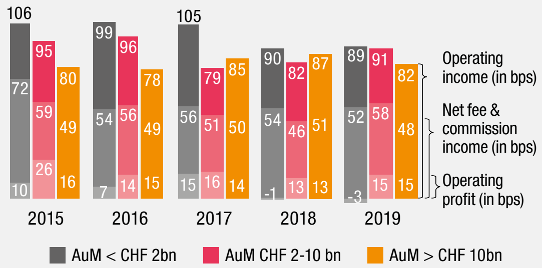
Over the last five years, the 13% decline in the total number of banks primarily operating in wealth management (stock-exchange- and foreign-controlled banks and private bankers) has been significantly more pronounced than the 8% decrease in the total number of Swiss banks. This can be attributed to the fact that many smaller private banks with less than CHF 2 billion of AuM do not reach their critical size to operate profitably and are thus sold. These types of bank have been the most prominent group on our transaction list for the last few years. Moreover, we observe that the number of transactions each year has tended to be lower since the tax disputes ended in 2017. 2019 confirmed this trend as the private banking sector in Switzerland continued its consolidation, albeit at a slower speed. With three announced transactions, the number was not just lower than the average number of M&A deals of around 8 between 2002 and today, but also the lowest since we began our records in 2002. However, in our view, the consolidation process in the Swiss private banking industry has not yet come to an end since up to 20% of players in the market are still struggling to achieve sufficient profitability.

Announced	Target	Stake	Buyer	Seller	AuM
Jan 19	Banca Arner SA, GS Banque SA (Merger)	100.0 %	One Swiss Bank SA	Families Schramli, Del Bue, Sciorilli Borrelli	CHF 1.1bn
Aug 19	Bank am Bellevue AG	100.0 %	KBL European Private Bankers SA	Bellevue Group AG	CHF 1.7bn
Nov 19	Bankhaus Jungholz AG	100.0 %	Alpha RHEINTAL Bank AG	Raiffeisenbank Reutte	CHF 0.3bn



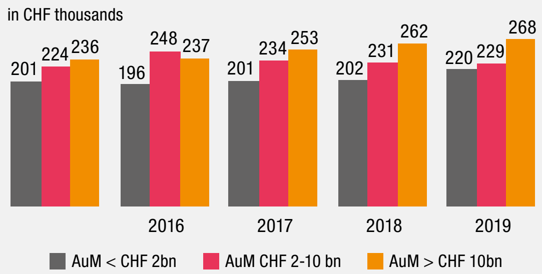
Profitability

Swiss private banks have felt constant pressure on their margins over the last decade. After a drop in the median operating income margin to an all-time low of 85 bps in 2018, the positive developments in global stock markets in 2019 along with the associated performance fees and higher trading income gave an uplift to 89 bps, similar to the friendly market environment witnessed in 2017. Due to the low interest environment with negative interest payments, the interest result made a much smaller contribution to total operating income compared with 2015. The operating expense margin increased only slightly, leading to a improvement in the operating profit margin from 12 bps in 2018 to 14 bps in 2019. We do not expect a significant improvement in the operating profit margin going forward due to ongoing margin pressure and investment amounts to be spent in the context of the digitalisation of banking activities.



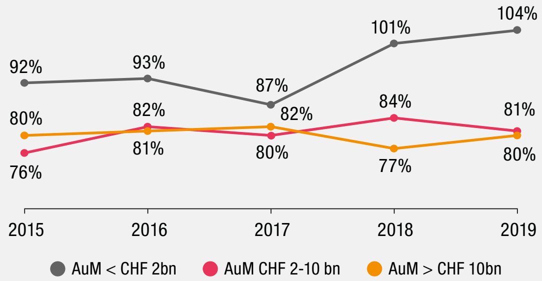
Income margin development

After small banks achieved an operating profit margin of 15 bps in 2017, their operating profit margin has turned negative since 2018 and reached a new all-time low of -3 bps in 2019. This was the result of a further erosion of the net fee & commission income margin as well as of the net interest income margin. A further increase in operating expenses has put an additional strain on small banks' operating profit. This resulted in 65% of small banks making a loss. It shows that small private banks' AuM volume is too low to fully utilise their platform, even with increased efforts to outsource their IT and middle and back offices. As medium-sized banks' operating income margin recovered from 82 bps in 2018 to 91 bps in 2019, their operating profit margin increased slightly as well. The operating profit margin of large banks slightly increased from 13 bps to 15 bps in 2019, despite a slight decrease in their operating income margin.



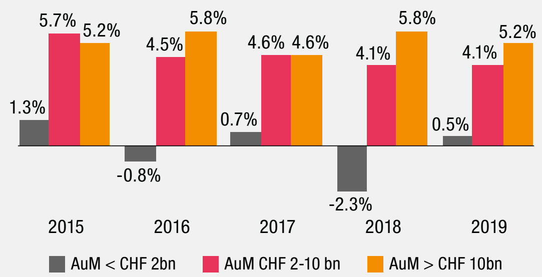
Expenses per FTE

Large Swiss private banks have predominantly paid their employees the highest salaries and the trend of increasing wages continued in 2019 as larger banks' personnel expenses per employee grew by 2.3%. On the other hand, since 2015 medium-sized private banks have been paying slightly less than their larger competitors. However, their expenses per full-time equivalent (FTE) have remained almost stable over the last five years. Most employees in the private banking sector work for a large private bank as their employers accounted for around 90% of all FTEs in 2019. The majority of the remaining 10% work for mid-sized private banks as small banks account for only a tiny fraction of total FTEs. The total number of FTEs continued its shrinking trend in 2019, with a decrease of around 2.4% from 38,300 (2018) to 37,400 (2019).



Cost/income ratio

The cost/income ratio (CIR) measures a private bank's efficiency by comparing its operating expenses to its operating income. Over the last decade small private banks have consistently reported an increasing CIR. Their CIR exceeded 100% for the first time in 2018 and further increased in 2019. This shows that most small banks lack the sufficient economies of scale to be competitive. At the same time, mid-sized and large private banks have been able to stabilise their CIR at around 80% over recent years. As seven of the 30 large banks in our sample report a CIR of below 70%, the efficiency of banks within that group varies significantly. The median CIR has slightly improved from 84.5% in 2018 to 83% in 2019 due to higher AuM and margin. Going forward we consider an average CIR of 80% to be a realistic number for the Swiss private banking industry.



Return on equity

With a median return on equity (ROE) of 4% in 2019, the median ROE has now been below 5% for a decade, whereas ROE used to be well above 10% before the financial crisis in 2007. Since then, most private banks have not been able to cover their required cost of equity. Small banks in particular have underperformed in the recent past. Although their median ROE was just about in positive territory in 2019 – an improvement compared to 2018 – they have now consistently returned a ROE below 2% since 2010. The number of highly profitable banks is limited, as only 13 out of 80 observed Swiss private banks were able to achieve an ROE above 10% in 2019. However, it has to be mentioned that most private banks are heavily capitalised, which has a negative impact on ROE since the capital not subject to regulatory requirements is normally invested in low-risk assets, which generate no or little returns in this low interest environment.

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