First Swiss banking market insight study in 2022 to simultaneously shed light on both the Swiss private and retail banking sector with striking insights

This publication focuses on the two largest banking segments represented in Switzerland and provides conclusions and insights from six different angles. The analyses describe the specificities of the two different business models and accentuate the implications on their respective profitability including volume, income and cost drivers from 2018 to 2020. These observations provide a solid foundation for our upcoming publications which will focus on investigating best practices of those institutions which performed exceptionally well and achieved outstanding results over the last three years.

All results presented in this study reflect the cluster-accumulated average numbers of the sample banks which have been grouped by their business volume in CHF (≥50 billion; 5 – 50 billion; ≤ 5 billion).

Overall, the analyses demonstrate that retail banks have generally been very resilient over the last few years despite the challenging interest rate environment. On the other hand, large private banks tend to significantly outpace their smaller competitors, showing that size clearly matters in the private banking industry.

Definition – Business volume (BV):

For the purpose of this publication, private banks and retail banks that are part of the respective samples have been grouped in three size clusters (large, medium and small) according to their business volume in CHF. Business volume is defined as the sum of the average total assets under management (AuM) and total loans to customers for the respective year. This key concept allows comparisons between and within these two major banking groups in Switzerland and to draw conclusions about their respective performance, strengths and weaknesses.
Large private banks were in a strong position to attract NNM inflows thanks to their strong brands, international footprint and sophisticated service offering. We clearly expect them to attract significant NNM inflows in the upcoming years and to be less dependent on the general development of the financial markets for further business volume growth as compared to medium and small private banks. In contrast, medium- and small-sized retail banks have been able to constantly grow their business volume over the last few years without any significant tailwind from favourable financial markets. This was due to their strong market positions and less competitive environment in their local markets. We believe there will be a similar growth pattern in the upcoming years. Larger retail banks, however, are estimated to generally outpace their smaller peers in terms of business volume growth due to their broader service offering, larger regional reach and the higher importance of the wealth management activities in their overall business model.

<table>
<thead>
<tr>
<th>Average business volume development (in CHFbn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
</tr>
<tr>
<td>Private Banks</td>
</tr>
<tr>
<td>BV &gt;=50bn</td>
</tr>
<tr>
<td>228.7</td>
</tr>
<tr>
<td>130.9</td>
</tr>
<tr>
<td>BV 5-50bn</td>
</tr>
<tr>
<td>16.6</td>
</tr>
<tr>
<td>28.6</td>
</tr>
<tr>
<td>BV &lt;=5bn</td>
</tr>
<tr>
<td>2.6</td>
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<tr>
<td>4.0</td>
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</table>

Private banks

Despite a rather challenging market environment resulting in a significantly negative performance in 2018, the average large private bank was able to overcompensate this setback with a strong overall performance in 2019 and a positive result in 2020. A significant portion of this increase was attributable to net new money (NNM) inflows.

Whilst medium- and small-sized private banks experienced a relatively similar AuM performance development, with headwinds in 2018 and a subsequent compensation in 2019, they failed to keep up with the performance pace of large private banks in the pandemic-driven financial year 2020. Furthermore, the medium- and small-sized private banks were unable to attract substantial NNM inflows similar to the cluster of the large private banks in the time period from 2018 to 2020. Thus, the main driver for the growth of the business volume for these two size clusters was the performance component. We do not expect a significant change in this regard in the coming years.

Retail banks

In contrast to private banks, Swiss retail banks in all size clusters have experienced continuous growth in business volume with less volatility over the last three years. This is partially driven by the lower AuM share in the business volume, which implies less exposure to global financial markets. Furthermore, many smaller retail banks focus their business activities on a clearly specified geographical region within Switzerland, which reduces the competitive environment. On the other hand, the regional focus also limits the growth potential.

The growth driver of the business volume over the last three years differs across the size clusters. Supported by favourable financial markets in 2019, large and medium size retail banks with an AuM share of between 50% and 60% increased their business volume primarily through higher AuM. A similar development could be observed in 2020. Smaller retail banks, however, were more dependent on the increase of their mortgage volume to further grow their business volume.

Conclusion

Large private banks were in a strong position to attract NNM inflows thanks to their strong brands, international footprint and sophisticated service offering. We clearly expect them to attract significant NNM inflows in the upcoming years and to be less dependent on the general development of the financial markets for further business volume growth as compared to medium and small private banks. In contrast, medium- and small-sized retail banks have been able to constantly grow their business volume over the last few years without any significant tailwind from favourable financial markets. This was due to their strong market positions and less competitive environment in their local markets. We believe there will be a similar growth pattern in the upcoming years. Larger retail banks, however, are estimated to generally outpace their smaller peers in terms of business volume growth due to their broader service offering, larger regional reach and the higher importance of the wealth management activities in their overall business model.
In private banking size matters in achieving superior operating return on regulatory required equity capital (RORE) whereas in retail banking, a similar size effect cannot be observed.

In 2020, large private banks by business volume achieved a cluster-accumulated average operating RORE of 38.1%, which is significantly above the other clusters. This holds also true for 2018 and 2019. Despite a pandemic-driven 2020, large private banks kept up their strong results due to their global footprint and diverse service offering.

The operating RORE of medium-sized banks significantly deteriorated from 2018 to 2020. The decrease was primarily driven by lower operating income margins to which mainly the Swiss entities of different large European banking groups contributed. Small private banks demonstrated an operating RORE decrease in 2020 as well, after an improved performance in 2019 supported by the favourable financial market environment.

The operating RORE of retail banks presented a relatively stable picture for each volume cluster from 2018 to 2020. Across all volume clusters however, returns were lowest in 2020 due to decreasing income margins.

Besides the persistently challenging low interest rate environment, the responses of the national governments to the COVID-19 pandemic further led to a general decrease of the global interest rate level. This put more pressure on retail banks’ core return from interest activities and led to a general decrease of the net interest margin.

There is no major variation of operating RORE between the volume clusters, i.e. smaller retail banks have profitability levels similar to larger retail banks.

The subsequent analyses show the differences regarding the main drivers of the operating RORE for the different bank clusters (revenue margins generated on the BV; costs incurred to handle the respective BV and risk-weighted assets).

**Conclusion**

Although private banks generally operate a balance-sheet-light business with a significantly lower amount of risk-weighted assets, medium- and smaller-sized private banks did not achieve an equally distinctive higher RORE as large private banks compared to their retail banking peers. This implies room for improvement on the RORE for small- and medium-sized private banks. The comparison further highlights the strong scale dependency in the private banking sector, whereas no similar effect can be observed in the retail banking industry since comparable returns are achieved across all volume clusters.

**Average operating return on regulatory required equity capital (in %)**

<table>
<thead>
<tr>
<th>BV &gt;=50bn</th>
<th>Private Banks</th>
<th>Retail Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>36.6</td>
<td>10.7</td>
</tr>
<tr>
<td>2019</td>
<td>35.1</td>
<td>11.1</td>
</tr>
<tr>
<td>2020</td>
<td>38.1</td>
<td>10.9</td>
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</table>

<table>
<thead>
<tr>
<th>BV 5-50bn</th>
<th>Private Banks</th>
<th>Retail Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>17.5</td>
<td>12.1</td>
</tr>
<tr>
<td>2019</td>
<td>13.9</td>
<td>11.9</td>
</tr>
<tr>
<td>2020</td>
<td>10.5</td>
<td>11.2</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>BV &lt;=5bn</th>
<th>Private Banks</th>
<th>Retail Banks</th>
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</thead>
<tbody>
<tr>
<td>2018</td>
<td>12.2</td>
<td>10.4</td>
</tr>
<tr>
<td>2019</td>
<td>16.4</td>
<td>10.8</td>
</tr>
<tr>
<td>2020</td>
<td>10.4</td>
<td>11.4</td>
</tr>
</tbody>
</table>

**Definition - Operating return:**

Operating return includes net result from interest operations, commission business and services, trading activities and other results from ordinary activities subtracted by personnel and general & administrative expenses.
**Average operating income and operating expense margins on business volume**

<table>
<thead>
<tr>
<th></th>
<th>BV &lt;=5bn</th>
<th>BV 5-50bn</th>
<th>BV &gt;=50bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>62</td>
<td>77</td>
<td>87</td>
</tr>
<tr>
<td>2019</td>
<td>59</td>
<td>74</td>
<td>92</td>
</tr>
<tr>
<td>2020</td>
<td>57</td>
<td>65</td>
<td>83</td>
</tr>
<tr>
<td><strong>Operating income (in bps)</strong></td>
<td>16</td>
<td>12</td>
<td>9</td>
</tr>
<tr>
<td><strong>Operating expense (in bps)</strong></td>
<td>16</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td><strong>Operating profit (in bps)</strong></td>
<td>42</td>
<td>56</td>
<td>74</td>
</tr>
</tbody>
</table>

**Retail Banks**

<table>
<thead>
<tr>
<th></th>
<th>BV &gt;=50bn</th>
<th>BV 5-50bn</th>
<th>BV &lt;=5bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>73</td>
<td>44</td>
<td>118</td>
</tr>
<tr>
<td>2019</td>
<td>68</td>
<td>42</td>
<td>118</td>
</tr>
<tr>
<td>2020</td>
<td>68</td>
<td>40</td>
<td>108</td>
</tr>
<tr>
<td><strong>Operating income (in bps)</strong></td>
<td>31</td>
<td>29</td>
<td>57</td>
</tr>
<tr>
<td><strong>Operating expense (in bps)</strong></td>
<td>29</td>
<td>34</td>
<td>56</td>
</tr>
<tr>
<td><strong>Operating profit (in bps)</strong></td>
<td>40</td>
<td>30</td>
<td>52</td>
</tr>
</tbody>
</table>

**Market insights**

**Definition – Operating income (OIC):**

OIC includes net result from interest operations, commission business and services, trading activities and other results from ordinary activities.

**Smaller private and retail banks generally generate higher operating income margins. However, smaller private banks fail to achieve higher returns due to their high operating cost base to manage the existing business volume**

For both private and retail banking, banks with large business volumes generally have lower OIC margins compared to medium- and small-sized banks over the three years observed.

The average OIC margin for large private banks amounted to between 57 and 62 basis points during the period under review which is significantly lower than the average OIC margin of the other private bank volume clusters. The same pattern is observable for retail banks where the average OIC margin for large banks ranges between 68 to 75 basis points.

The lower OIC margins are due to the higher proportion of institutional and corporate clients, where generally lower margins are earned compared to private clients. Especially small-sized private and retail banks demonstrate their ability to achieve higher average operating income margins on their business volume since they mainly focus on a private clientele.

The comparably high OIC margins for small retail banks is mainly driven by the higher share of mortgage business in the overall business volume. The benefit of the higher OIC margin is however offset by the higher risk weighted asset density and thereby higher capital requirements.

In general, the average OIC margin relative to the business volume has decreased from 2018 to 2020 for all clusters. In the retail banking environment, this was mainly due to further decreases in the general interest environment caused by the uncertainties driven by the COVID-19 pandemic. A significantly higher level of impairments of defaulted loans could not be observed. The reduction of the OIC margins of the different size levels in the private banking industry from 2018 to 2020 was also mainly driven by a reduction of the net interest margin. In contrast, the commission income margin as well as the trading income margin have been rather stable over the observation period.

On the cost side, smaller banks in particular experience higher average personnel cost (being the primary driver of total operating costs) relative to their business volume compared to large banks. This is both the case in the private banking as well as in the retail banking industry. Further details on the magnitude of this cost driver are outlined on the next page.

A clear difference in the average OPEX margin between medium-sized private and retail banks can be observed. In the private banking industry, medium-sized banks show clearly higher OPEX margins, whereas in the retail banking industry the difference between large and medium-sized players is only small in this respect.

**Conclusion**

The average OIC margins generated on the business volume by retail banks is higher in all clusters as opposed to the private banking industry. Both large private and retail banks generate a lower OIC margin due to their higher proportion of institutional and corporate clients compared to private clients. Large retail banks also have a higher proportion of wealth management activities in their business mix compared to the medium- and small-sized peers, which additionally lowers the blended overall OIC margin. Smaller-sized banks, however, face higher operating expenses both in the private as well as retail banking industry, which offsets the advantage of their higher OIC margins.
**Private Banking & Retail Banking Switzerland**

### Higher cost-income ratios (CIR) for private banks than for retail banks due to higher OPEX and lower OIC relative to the business volume

The previous analyses have shown that the cost and income drivers affect retail and private banks differently. These differences are also reflected in their respective CIR.

#### Private banks

Private banks experience higher operating expense margins and lower operating income margins on their respective business volume as opposed to retail banks. As a consequence, the CIRs are significantly higher than those of retail banks.

Over the last three years, large private banks clearly outperformed the small- and medium-sized banks regarding efficiency as reflected in the level of the underlying CIR.

At small private banks, the average CIR in 2020 was similar to the one achieved in 2018 with an improvement in 2019 thanks to the favourable market environment which positively impacted their operating income.

Medium-sized private banks on average reported a continuous CIR-deterioration over the observation period with a strong increase of their CIR both in 2019 and 2020. Especially the Swiss entities of different large European banking groups have seen their operating profit margins cut in half from 2018 to 2020.

#### Retail banks

Retail banks managed to keep their respective cost-income ratio stable in general.

In contrast to their private banking peers, medium and small retail banks demonstrated higher efficiencies as observable in their lower CIRs compared to larger retail banks in the period under review. The higher efficiencies could be explained by a simpler and more standardised product offering combined with a focus on higher yielding segments and products (e.g. private individuals, mortgages, etc.).

The average CIR of large retail banks is also adversely impacted by the wealth management business which per se generates a lower OIC margin and a higher OPEX margin than the on-balance-sheet business. When measuring the operating RORE, the lower net operating profit margin of the wealth management business is compensated by a lower capital consumption of the business.

### Conclusion

During the last three years, the average CIR for each private banking volume cluster is significantly higher than the corresponding retail banking cluster. This is mainly driven by private banks’ larger OPEX base to handle the underlying business volume. The comparably higher OPEX base is driven by the distinctively higher personnel costs compared to their retail banking peers as well as the more diverse and tailor-made product offering and clientele. On the other hand, small- and medium-sized retail banks benefit from their regional focus and more standardised product offering.

### Small private banks suffer from the comparably high fixed costs components in the middle- and back-office functions

One of the reasons why especially medium- and small-sized private banks fail to achieve a higher operating RORE is their high personnel expenses and high FTE base in relation to the overall business volume.

Whilst large private banks reported average personnel costs of between 29 and 32 basis points in terms of their business volume, small private banks exhibit distinctively higher numbers of 50 to 52 basis points.

This can be explained by the fact that the proportion of employees covering non-client-facing activities with fixed cost character (e.g. compliance officers, back office employees etc.) is clearly higher at small private banks compared to their medium- and especially large-sized peers.

Consequently, this leads to a significantly lower business volume per FTE and higher personnel costs in relation to the business volume.

One solution could consist in modernizing and digitalizing processes and procedures. This however would require a certain level of investment power. Another option would be a significant increase of business volume through acquisitions or the hiring of additional teams of relationship managers. Again, for such measures sufficient capital must be available. An increase of efficiencies could also be realised by simplifying and standardising the product and service offering.
Due to their focus on lending activities, the RWA density of retail banks is significantly higher compared to private banks.

Small retail banks also have certain fixed costs disadvantages which are, however, lower compared to their private banking peers.

Analogously to the view on private banks, smaller retail banks report the highest average personnel costs in basis points relative to their business volume. Similar reasons as for small private banks apply and explain this result.

The analysis also demonstrates that medium-sized retail banks manage their business at the same personnel cost margin and at even higher business volume per FTE than large retail banks, implying that scale in this volume cluster is no longer of relevance to improve efficiencies.

Overall, the average personnel cost for all three clusters have been constant over the three years highlighted in this study. This reflects the stable and well-yielding business environment retail banks find themselves in.

Due to their focus on lending activities, the RWA density of retail banks is significantly higher compared to private banks.

### Private banks

As opposed to retail banks, only a small amount of private banks’ business volume is tied up in the lending business which merely is an add-on business to the traditional private banking activities (e.g., Lombard lending). This results in much lower RWA levels of regulatory required equity capital.

The average RWA density (RWA over business volume) ranges between 3.4% and 7.8% in the period under review. Small- and medium-sized private banks report a clearly higher RWA density compared to large private banks. One key aspect of the higher capital consumption of small- and medium-sized banks is their higher loan penetration (LP). While smaller-sized private banks reported an LP-ratio of roughly 8% to 11%, large private banks’ LP-ratio amounted to approximately 6%.

Besides the positive scale effects, the on-average lower RWA density is an additional reason why large private banks outperform in terms of operating RORE.

### Retail banks

Retail banks have a significantly higher RWA density and, consequently, are required to hold a higher amount of regulatory required equity capital compared to private banks. The reason for that is their strong focus on the lending business.

Smaller-sized retail banks experience much higher RWA densities compared to their large- and medium-sized peers. This is primarily due to the fact that small retail banks have a higher proportion of their business activities tied up in the lending business whereas large- and medium-sized peers have a more diversified business model, including off-balance-sheet wealth management activities.

### Conclusion

Private banks have significantly lower RWA density compared to their retail banking peers. However, only large private banks can turn the lower capital consumption into a distinctively superior operating RORE. Lower efficiencies of small- and medium-sized private banks erode the benefits of having lower capital consumption at least to a certain extent.
Merely large private banks generated significant value for their shareholders, whilst other private and retail banking clusters only achieved limited value generation over the last few years. Thus, they have to adjust their business models to improve their performances going forward.”

Martin Schilling
(Director Deals Financial Services)
Overall conclusion

The private banking industry in Switzerland can deliver very attractive operating RORE numbers if scale effects are achieved. Thus, volume clearly matters which is underlined by the significantly higher operating RORE generated by large private banks compared to their small- and medium-sized peers. The scale benefits even outweigh the lower operating income margin of larger institutions.

Large private banks also achieve higher operating RORE numbers compared to their retail banking peers. This is driven by the lower RWA density and the corresponding lower regulatory capital requirements of the wealth management business.

Swiss entities of different large European banking groups in the medium-sized cluster as well as small private banks were struggling to achieve attractive operating RORE numbers. Assuming that investors would expect a post-tax return of roughly 8.0% to 9.0% from a private banking organisation, neither small- nor medium-sized players would have generated significant value for their shareholders in 2020 on a post-tax basis. Consequently, they clearly must improve their performance in the coming years.

In the retail banking segment no scale effect can be observed similar to the private banking industry. Smaller retail banks were able to achieve operating RORE numbers comparable to their larger peers over the whole period under observation.

The similar performance of smaller players is due to their regional focus with comparably less competition, better efficiencies due to more standardised product offerings and the focus on higher yielding lending products.

However, the overall performance of this industry must be subjected to critical evaluation. Given that investors would expect a post-tax return of roughly 6.0% to 7.0% from an equity investment in a retail bank, the operating RORE numbers achieved – taking into consideration tax effects in addition – would indicate only limited value generation in this industry over the last few years.

To fulfill the return expectations of investors, achieve attractive returns on the invested equity capital and generate value, the retail banking industry as a whole also has to improve their operating performance going forward.

## Coming soon

In our next publications, we will analyse the business models of different private and retail banks which achieved the highest operating RORE numbers in the three volume clusters. This will provide distinctive insights on what certain banks do exceptionally well and outline useful ideas for other banks so that they can adapt their business models and service offerings to achieve similar results.

Stay tuned for more interesting insights about the Swiss banking sector by subscribing to our distribution list and contact us to take advantage of our sophisticated benchmarking tools for both the Swiss private and retail banking industry.

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