Private Banking Switzerland

Market update **2023**

73 **private banks** compose the 2022 sample	**80%** **market coverage** # of private banks in 2022
18 **years of data**	**10th** **edition since 2010**

The end of an era – curse and blessing for the private banking sector

2022 was marked by the termination of the low interest rates era and the following departure from the prevailing financial environment since the financial crisis. Primarily driven by the pervasive and challenging issue of soaring inflation especially abroad, this paradigm shift has profound implications for global finance and economic policy which also affect the Swiss and Liechtenstein private banking environment.

Despite that, all private bank size buckets demonstrated strong resilience by rigorously managing their cost-income relationship. Therefore, the banks being part of this year's sample achieved on average profitable financial performances.

Especially smaller size buckets benefited from higher interest income that enabled them to cover inherent profitability issues.

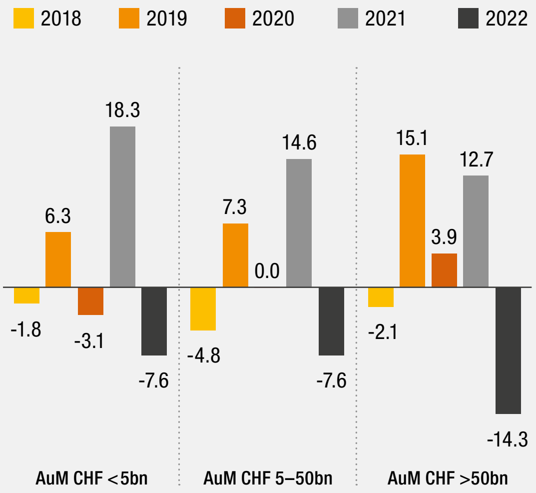
Against this background, a further consolidation dynamic in the Swiss private banking sector did not occur in 2022 and the number of M&A transactions remained on a low basis without the event of large blockbuster deals.

Find out more in this study about the manifold implications of the resurgent interest rate levels and observe whether they were a curse or a blessing for the private banking sector and its size groups.

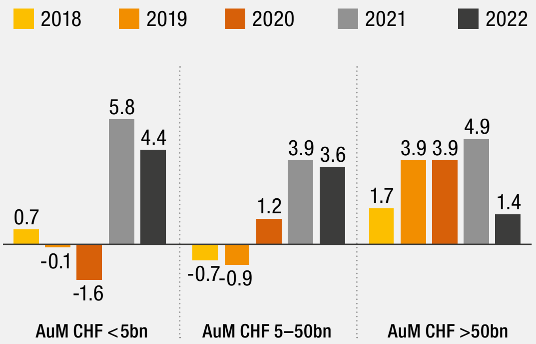
Methodology – Market update 2022:

In this year's market update, the featured banks based in Switzerland and Liechtenstein have been categorised into three groups based on their average assets under management (AuM) size from 2020 to 2022: small banks (AuM CHF < 5bn), medium-sized banks (AuM CHF 5bn–50bn) and large banks (AuM CHF > 50bn). The study's findings are based on data from banks that consistently supplied information throughout the observation period, ensuring a dependable assessment of their financial performance under different market environments.

Assets under management growth (in % per size bucket)



Net new money growth (in % per size bucket)



Challenging market environment in 2022 causes volumes to decline from their record highs

Following a peak year in 2021, which witnessed AuM across all size categories reach unprecedented heights, 2022 marked a notable shift as these AuMs receded to levels reminiscent of 2020. Against this backdrop, the sector displayed resilience, with a measured yet persistent rise in net new money (NNM) growth throughout the year, evidence of its adaptability in navigating the challenges posed by a high-interest environment and the inherent volatility of the 2022 markets.

Large banks witnessed a 14.3% decline in their total AuM to a total of roughly CHF 2'650bn by the end of 2022. This decline was primarily attributed to unfavourable market conditions driven by elevated interest rates, which in turn led to lower company valuations and faded market gains. The situation was compounded by lower yet positive net new money growth in 2022 compared to the previous year, further contributing to the negative AuM trend among these larger institutions.

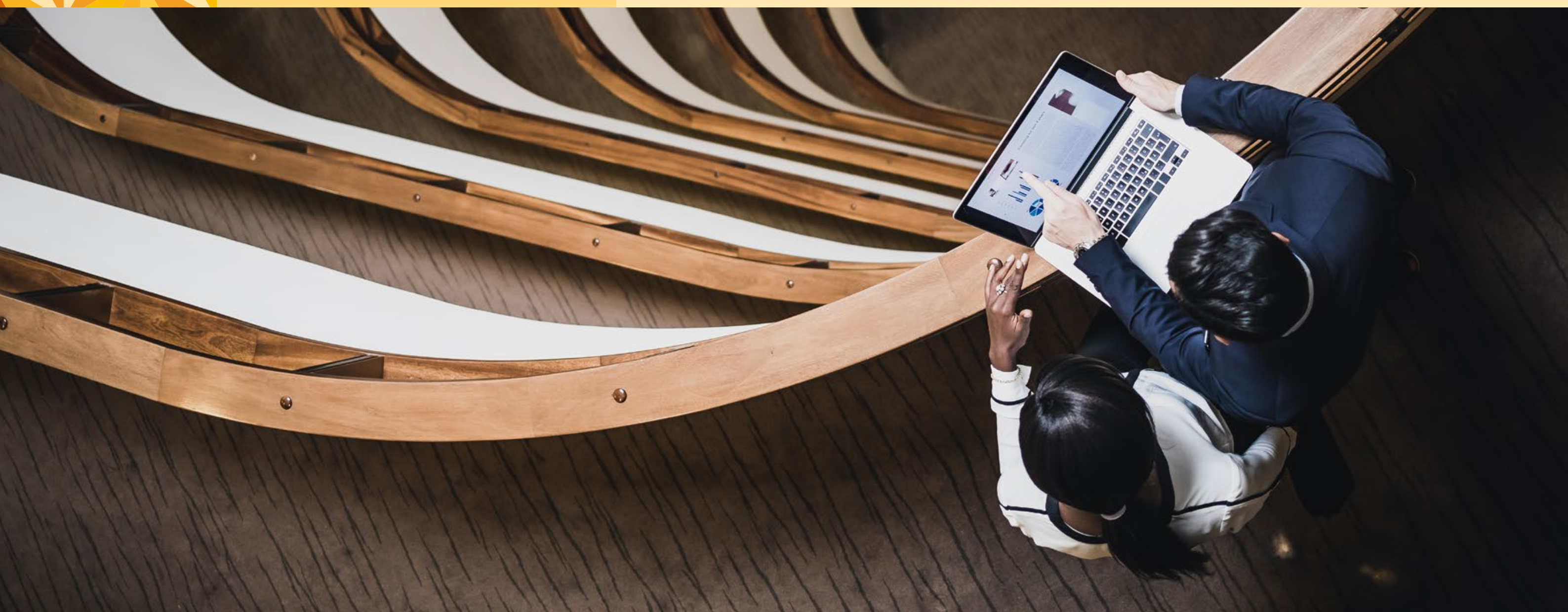
Medium-sized banks navigated a recalibration in 2022 after experiencing a remarkable AuM surge in 2021 too. The principal driver behind the AuM decrease was also the performance on the financial markets, underscoring the pivotal role of market dynamics in shaping their AuM levels. While they did encounter an overall AuM decline, it was notably less severe than that experienced by their larger counterparts.

In relative terms, smaller private banks saw their AuM contracted the least. Although they previously lacked AuM growth pace compared to the other buckets, this bank cluster has performed relatively stronger with the dual challenge of attracting NNM and weathering the financial markets in both 2021 and 2022. A possible component to the results for small and medium-sized banks in 2022 might have been the commencing difficult situation for one of the two large Swiss universal banks in the last quarter of 2022. This occurrence potentially also contributed to the positive NNM inflows at the private banks across the size buckets – with a predominant focus on small and medium-sized banks.

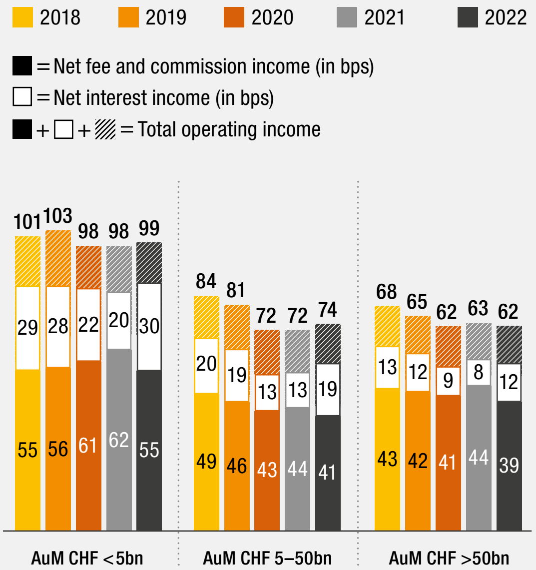
Outlook

In the forthcoming periods, we anticipate a notable resurgence in AuM growth rates, with a particularly robust recovery expected within the large-size bank cluster. This recovery is underpinned by less volatile market conditions with more stable interest rate levels and heightened investor confidence, both domestically and internationally.

Moreover, we project a 5% growth rate in NNM for large banks, bolstered by their ability to attract and retain clients. Going forward, we assume this large size bucket to involuntarily benefit from the strong 2023 headwind for one of the two big Swiss universal banks that resulted in deteriorated confidence in super large financial institutions. Although small and medium-sized banks may be benefiting from this major incident as well, we expect a relatively lower impact compared to large private banks given the highly complex financial needs certain large clients demand from their financial institutions.



Average operating income (in bps of avg AuM)



Read more of our study which we published in May 2023:

Successful private banking business models: what gives smaller players giant-sized powers?

Increased net interest income ensures stable operating income margins

The private banking sector displayed resilience with constant operating income margins compared to the previous years of slightly declining performance. This highlights the different components being inherently important during a changing market environment. The overall margin stability further underscores the sector's ability to withstand challenges and maintain a steady financial footing.

Among the larger banks there has been remarkable steadiness in their average operating income over the last period. The continued stability in 2022 can be attributed to the steady ascent of interest rate levels, which bolstered interest income, even as net commission income saw a modest decline of five basis points (bps) in 2022.

In the medium-sized bank category, the average operating income demonstrated a positive trajectory, suggesting a sustained recovery from the decline experienced in 2020. This upward trend underscores the resilience and adaptability of these institutions in navigating challenging financial environments.

Conversely, banks in the smallest bucket found their average operating income levels remaining at those observed in the prior period. Despite this apparent stasis, net commission income experienced a seven basis points decline compared to 2020. However, relative to their larger counterparts, these banks particularly benefited from the increasing interest rates in 2022, which served as a compensatory factor for the overall income trend.

Referring to our recent PwC study on successful private banking business models, we found that comparatively smaller-sized banks operate a rather multifaceted business model (see the reference to this publication on the left part of this page). They extend their private banking core offering to accentuate different revenue streams. Which, however, is not necessarily turning into high profitability as it additionally adds complexity and drives higher operating expenses (see following section). Nevertheless, such conduct explains higher AuM margins compared to the other buckets, given that not all income streams are dependent on AuM but e.g. on loan volume or liquidity from customers. Not surprisingly then, that the net interest income component has increased by 10 bps – the largest relative increase across the three buckets showcasing the smaller banks' higher dependency on income generated on activities other than AuM-related activities.

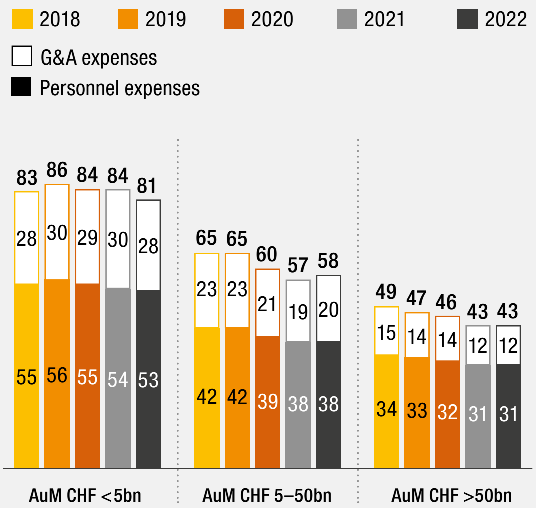
Another important element is the focus on private rather than institutional clients. This usually results in higher margins smaller banks can push through as opposed to larger private banks with a higher share of institutional clients. The latter segment often reduces overall income margins with more favourable pricing conditions. Nevertheless, we generally identified that special pricing conditions are offered with significant willingness to prospective clients to onboard them as a client which leads to extensive price leakage within a bank's pricing structure.

Outlook

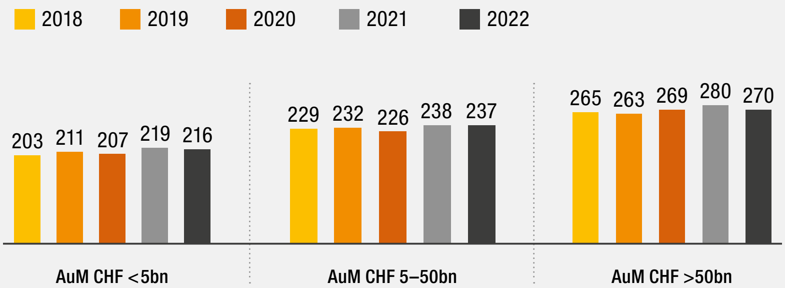
Given our expectation that financial markets turmoil will slow down with a more stable interest rate environment, we assume that investors will regain confidence. The following increase in transaction activity will cause the average net fee and commission income margin to increase again for all size buckets, without regaining the record heights from 2021. In addition, we anticipate that interest income margins will remain at equal levels as in 2022, given that private banks adapted to the elevated but relatively stable interest rate environment and continue to exploit more advantageous spreads.

The phenomenon of offering clients the most favourable conditions simply to get them as bank customers very often leads to price leakage. Profound scrutiny and monitoring of such condition agreements will be crucial going forward to improve bottom-line results.

Average operating expense margin (in bps of avg AuM)



Average yearly expenses per FTE (in CHF thousands)



Although decreasing: personnel expenses stay the largest expense position for private banks

Given the client-centric nature of the private banking business, which demands intensive personal engagement, personnel expenses continue to represent the predominant cost driver. Banks emphasised this fact during our recent PwC survey highlighting that physical meetings and telephone calls remain the primary interaction channels.

Despite a challenging year in 2022, large banks slightly increased their FTE base to approx. 3'050 compared to the prior period. Nevertheless, the average personnel expenses on FTEs reduced to 270k – assumably due to a relatively lower variable component in 2022. Despite this recalibration, the overall operating expense margin remained steadfast. This stability can be attributed to prudent cost management, exemplified by the reduction in personnel expenses during FY22.

Similarly, for medium-sized banks, the overall operating expense margin demonstrated steadiness. In contrast to their larger counterparts, their yearly expenses per FTE experienced only a marginal decline. Smaller banks also observed merely a slight reduction in yearly expenses per FTE in 2022 with a stable overall operating expenses margin.

This margin, however, is comparatively more accentuated as opposed to the other baskets. We conclude that this phenomenon is especially driven by the generally multilayered service offering (described in the previous section) which requires substantial sustaining expenses. Unfortunately, we sometimes observe such multicomponent offering as rather an act of worry to impact profitability positively. Given the constant profitability issues many small banks faced in the past, the latter explained endeavours have rarely resulted in higher returns on equity. We further do not observe accentuated movements in the FTE basis, neither upwards nor downwards. Along with that, salary levels remained stable on average over the observation time.

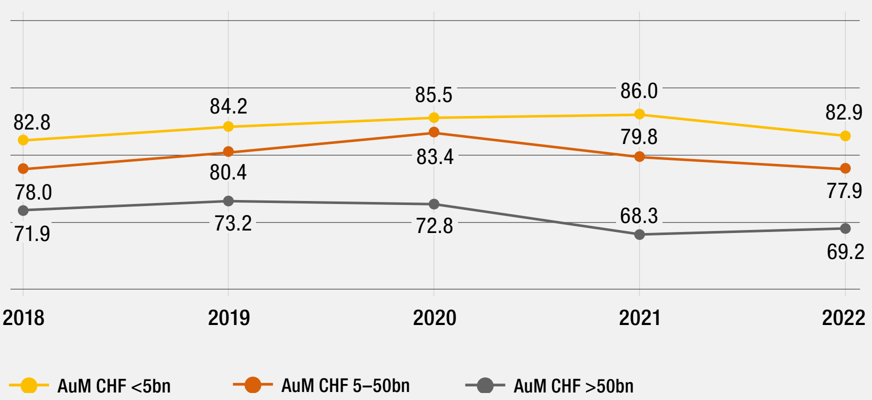
In recent interviews with private banks, we further identified a high share of outsourcing practices at small-sized banks. However, this does not necessarily contribute positively to the bank's profitability. One of the main reasons for this is the respective bank's reluctancy to refrain from internal control functions within the organisation for outsourced activities indicating a lack of fully fledged outsourcing execution. Nevertheless, with a thorough operating landscape assessment, private banks can still reach their operating potential to improve efficiency, operational excellence and decrease costs.

Outlook

In alignment with the continuous importance of personal interactions in the private banking segment we do not anticipate strong reductions in personnel expenses. The prevalent war for competent and well-connected client advisers additionally accentuates this anticipation as banks gradually start compensating such personnel higher. Thus, we expect salary levels to remain at current levels with a tendency to increase over the coming periods and also expect a continuously stable FTE basis. In terms of G&A expenses, we see room for improvement for all banks across the size buckets in our sample. By profoundly assessing the operating landscape and relentlessly sticking to the outcome of it, each bank can optimise its operational efficiency and reduce its cost base.

Nevertheless, we continuously expect to observe that large banks are poised to reap substantial benefits from their economies of scale as they manage a critical amount of AuM. This enables them to maintain a competitive edge by capitalising on lower expense margins that are instrumental in sustaining profitability and financial resilience in an ever-evolving financial landscape.

Average cost-income ratio (in %)



Small and medium-sized banks decreased cost-income ratio thanks to higher net interest income

As further highlighted in the previous two sections, small and medium-sized banks reduced their 2022 cost-income ratios (CIR) through a boost in interest income given their relatively higher dependency on interest-related banking activities. On the other hand, large banks saw their cost-income ratio slightly increasing as they were relatively most exposed to the challenging financial markets environment.

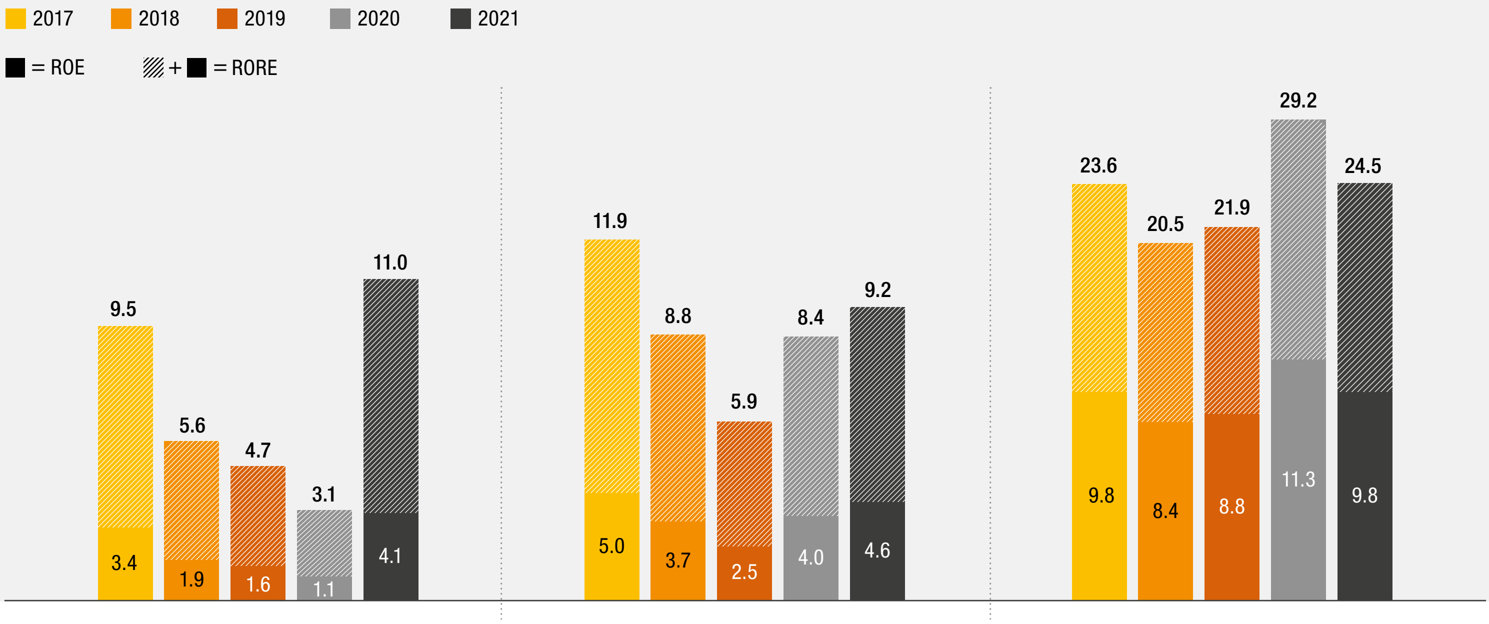
Small and medium-sized banks demonstrated a commendable ability to further reduce their CIR in 2022 to 83% and 78% respectively, largely attributed to the overcompensation of absolute expense figures by their respective income. This achievement was primarily driven by a noteworthy boost in income resulting from interest income to counterbalance the decline in net commission income.

Conversely, large banks faced a different trajectory in 2022, as their average cost-income ratio experienced a slight increase to 69% on average. This shift was primarily attributed to a more pronounced decrease in operating income compared to the reduction in personnel expenses when analysing the absolute figures. Nevertheless, the 69% are remarkable and remain a very strong rate in comparison with the other observed periods.

Outlook

Anticipating the future dynamics of the banking sector, we forecast that large banks are well-positioned to further keep their CIR below 70%. This is owed primarily to the advantages derived from economies of scale and an expected volume increase given the major 2023 incident at a Swiss universal bank. First mentioned advantages enable them to streamline operations, optimise resource allocation most effectively and attract new customers with a focus on investments. Conversely, smaller and medium-sized banks may encounter greater challenges in further reducing their cost-income ratios and improving profitability – especially when the positive impact from increasing interest rates fades. We anticipate that these institutions may continue to operate with CIR hovering around 80%, reflecting the inherent hurdles they face in achieving the same level of operational efficiency as their larger counterparts.

Average operating ROE and RORE (in %)



Volume still matters, also in 2022

The general mantra that larger size on average drives higher profitability was again confirmed in 2022. In particular, the increased interest income component boosted the return on equity (ROE) and return on required equity (RORE) for small-sized banks. This helped those banks reaching more positive bottom-line results compared to previous years but remain unsatisfactory from an investor perspective.

Although not at the same level as in 2021, large banks maintained their stronghold on the market by skilfully managing their cost-income ratio and leveraging economies of scale to sustain high ROE and RORE in 2022. Despite a decline in operating income compared to previous years, these banks efficiently managed to align their operating expenses, preserving their competitive edge and generated on average satisfactory investment returns for their respective owners.

Medium-sized banks exhibited a modest uptick in their average profitability KPIs. They experienced a 0.6% increase in ROE, primarily attributed to a rise in net interest income. This growth suggests these institutions are modestly navigating market challenges to achieve improved profitability but remain far behind expectations – although they manage comparatively higher asset volumes. It is unsurprising to observe that primarily institutions that struggled to achieve satisfactory returns over the previous periods remain those which also in 2022 achieved comparatively low ROE figures. This emphasises the inherent structural problems such private banks face that might require an overall strategic assessment of their respective business models.

Meanwhile, small-sized banks demonstrated an impressive bottom-line development in 2022, capitalising on an overcompensation of interest income relative to a decline in fee and commission income. This strategy alongside favourable interest rate levels effectively almost quadrupled their ROE and RORE.

Outlook

We do not doubt the observations that private banks managing larger sums of assets remain on average the most profitable. Especially with the expected enhancement of investors’ transaction activities going forward, average ROE figures will remain strong for such institutions. This projection is additionally underpinned by the advantageous economies of scale that larger institutions can harness to bolster operational efficiency and resource optimisation.

Conversely, it is expected that small and medium-sized banks will not tremendously improve their current ROE and RORE levels, as their capacity to significantly reduce the cost-income ratio and, subsequently, enhance profitability remains constrained. Nevertheless, we estimate that with an ideal business model mix profitability can be increased despite lower AuM levels. In this evolving financial landscape, prudent financial management strategies will be of crucial importance for all institutions to secure their long-term stability and competitiveness.

Decent 2022 M&A activity in the private banking sector

As presented in the table – consisting of selected transactions with Swiss private banks as targets in 2022 – the largest deal in terms of AuM involvement entails Graubündner Kantonalbank's 70% stake acquisition of BZ Bank. As opposed to the independent asset manager segment, where we observe higher activities especially driven by regulatory requirements, the general uncertainties on the financial markets in 2022 have led the private banking sector to experience a relatively low number of M&A activities.

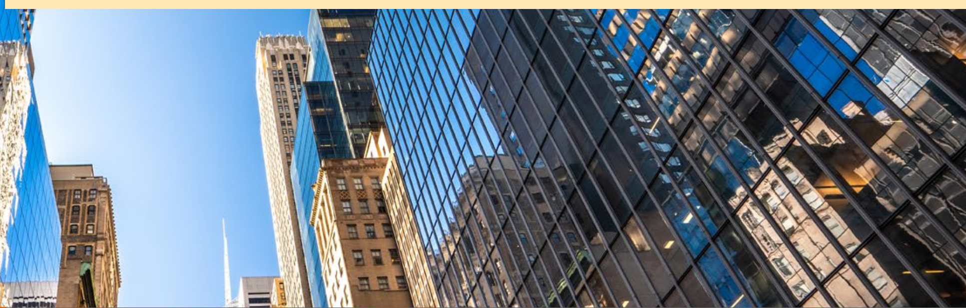
Date	Target	Buyer	Seller	AuM (CHFbn)
June 2022	BZ Bank	Graubündner Kantonalbank	Existing shareholders	13.2
February 2022	Bank zweiplus ag	J. Safra Sarasin Group	Aabar Trading, Luxembourg	7.2
November 2022	Gonet & Cie SA	Arab Bank (Switzerland) Ltd.	Gonet Holding	5.1
January 2022	Banque Degroof Petercam (Suisse) SA	Gonet & Cie SA	Banque Degroof Petercam, Belgium	0.8

Outlook

We clearly observe that numerous private banks are open to hold talks regarding a potential acquisition with only limited numbers of players envisaging a strategic disposal. While in 2021 very attractive financial market development supported smaller private banks in avoiding immediate scrutiny of their challenging profitability situations, 2022 additionally contributed to such avoidance thanks to higher net interest income.

As many small and medium-sized private banks operate on an equity basis often significantly higher than the regulatory requirements, such institutions may absorb upcoming negative results. However, we assume that this will not be sustainable in the longer term which eventually will lead to more accentuated consolidation dynamics. In those developments, we do not necessarily expect only larger players being on the buy-side but also see potential in 'mergers amongst equals'.

On the other hand, we perceive significantly more M&A activity in the EAM sector where the transaction numbers have increased – primarily since mid-year 2023. Thus, we observe a higher consolidation tendency in that area which was additionally sparked by new regulatory requirements by the end of 2022. We estimate that this deal activity will continue from a short to medium perspective and also outpace the number of deals in the private banking sector.



Coming soon

Stay tuned for more interesting insights about the Swiss banking sector by reaching out to the authors. Contact us to take advantage of our sophisticated financial benchmarking tools for both the Swiss private and retail banking industry including qualitatively driven business model benchmarking of smaller-sized private banks.

Contacts

Martin Schilling
Managing Director
Deals Financial Services –
Asset & Wealth Management
Leader
+41 58 792 15 31
martin.schilling@pwc.ch

Sandro Di Bernardo
Senior Associate
Deals Financial Services
+41 58 792 10 94
sandro.di.bernardo@pwc.ch

Authors
Martin Schilling and Sandro Di Bernardo

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