

Clarity on Performance of Swiss Private Banks

What the future holds for Swiss private banks



In KPMG's annual study, "Clarity on Performance of Swiss Private Banks", we analyzed 87 private banks in Switzerland and evaluated their performance and the main industry trends. Overall, 2018 was a very disappointing year for Switzerland's private banks. We saw Net New Money fall to almost zero, declining profitability, and cost income ratios hitting their highest levels ever. The result is that we have downgraded over one-quarter of banks and we now classify one-third of Swiss banks as Weak performers. What does this mean for the industry and will Swiss private banks be able to survive or is rescue already beyond reach?

Up until last year, positive financial markets helped private banks to stay afloat, and even gave the impression that the industry was recovering. Performances seemed to be improving, and efforts to deal with legacy issues, Automatic Exchange of Information and cleaning up client portfolios suggested recovery was possible. A more challenging 2018 has exposed how weak banks really are. Most banks have made insufficient progress to enhance business and operating models or to adapt strategies and set-ups to ensure sustainable success. If markets take a downturn, most banks will suffer – many to the point of extinction.

M&A – NUMBER OF BANKS MAY FALL BELOW 100 BY THE YEAR END

2018 set a record high for the number of M&A transactions involving Swiss banks and in the past 18 months we saw the number of banks in Switzerland shrink from 108 to 101. Eight banks exited the market. Meanwhile Mbaer became the first new private bank to be granted a banking license by FINMA since Zähringer entered the market in 2015.

Of the 19 transactions in 2018, seven were Swiss banks acquiring abroad. Large Swiss banks were a key driver of this activity. Large banks also exited businesses abroad that were no longer considered strategically core (three transactions). Small and medium banks rather embraced opportunities to grow within the Swiss market, mainly by acquiring Independent Asset Managers.

The past 18 months have also shown a trend towards mergers. Three of the four mergers in this period were Swiss banks joining forces with a counterpart from a different region of the country to increase scale, strengthen their respective local presences and expand activities in the other region. All banks involved in these recent mergers had Assets under Management (AuM) below CHF 5 billion and were Weak or Lower Mid performers in 2017 and 2018.



We expect consolidation to accelerate in the near future. As M&A is on the rise, it remains to be seen whether 2019 will produce a transformational deal.

SIGNIFICANT DOWNGRADES MAKE WEAK PERFORMERS THE BIGGEST CLUSTER

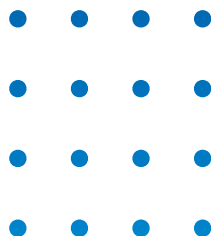
To assess the performance clusters, we used the cost-income ratio as key profitability metric. As the inverse of gross profit / operating income, the cost-income ratio measures gross profitability.

Based on this metric, we determined that banks with a traditional, pure play, offshore model – typically small and medium-sized banks – are facing increasingly difficult times, even if they have a clear focus on selected markets. Banks with this business model saw their operating income margin fall and were downgraded the most.

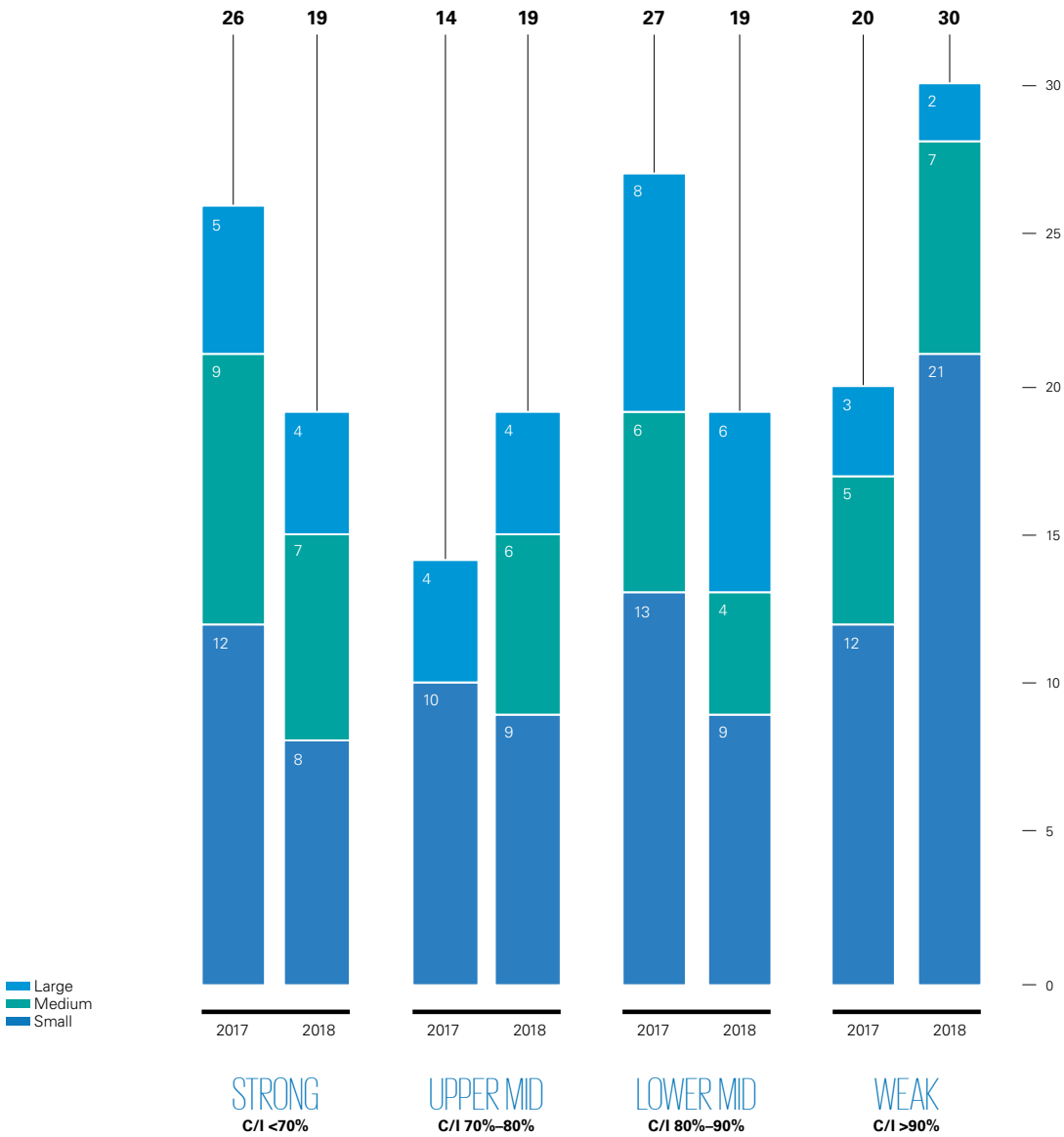
Overall, 24 banks were downgraded by at least one performance cluster and only nine upgraded. The Lower Mid cluster is where the most significant changes took place. While five banks were upgraded to Upper Mid, 12 were downgraded to Weak. Eight of the 24 downgraded banks were Strong performers that are now classified largely as Upper Mid performers. These significant downgrades make Weak performers the biggest cluster at 34% of banks and show a picture of an unhealthy – and worsening – industry.

KEY PERFORMANCE INDICATORS CONTINUE TO DETERIORATE

Even though global wealth is growing, Net New Money (NNM) at Switzerland's banks is stagnating. After years of regulatory changes and the clean-up of client portfolios hindering the generation of NNM, an increase in NNM could have been expected in 2018 but did not happen. However, the median NNM actually fell to 0.2%. Fewer than half of banks were able to improve NNM growth. This shows that the key issue in recent years was not the loss of clients. Rather it was – and still is – the fact that most private banks are unable to attract new clients to compensate for the ones they are losing.



NUMBER OF BANKS BY PERFORMANCE CLUSTER, 2017 AND 2018



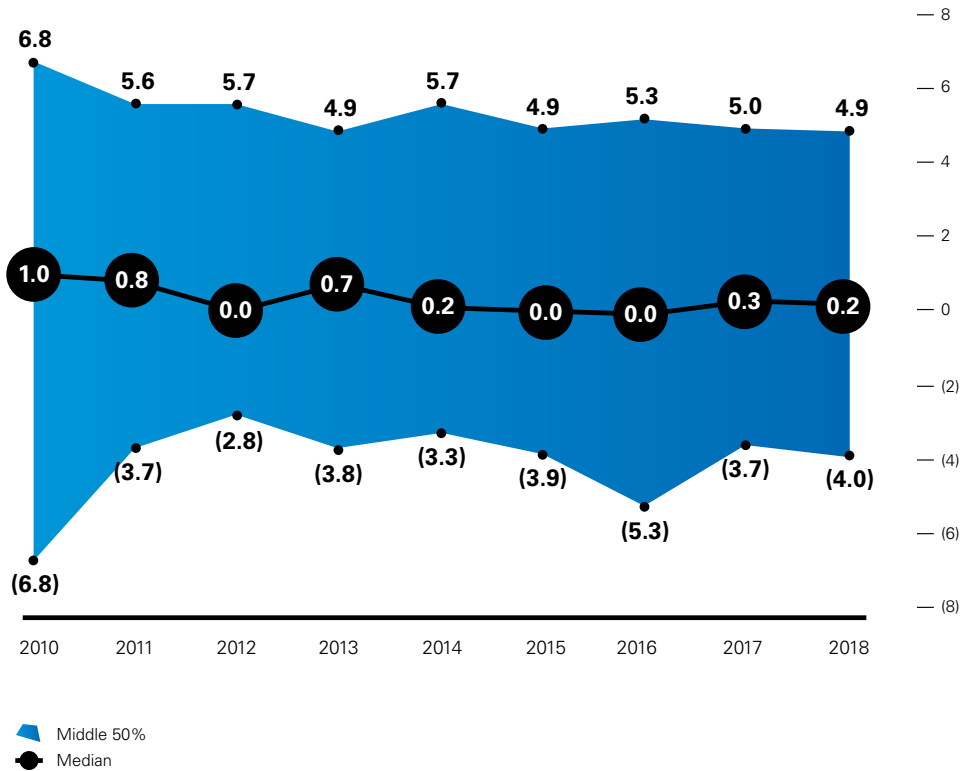
Only one-third of banks improved their cost-income ratios in 2018, as the median cost-income ratio rose by 1.9 percentage points to 83.6%. This is the highest level ever and is mainly driven by small banks and Weak performers. It is the opposite of what could reasonably be expected following resolution of most legacy topics and the clean-up of client portfolios. We found that cost-income ratio depends on bank size. Large banks were able to improve their cost-income ratio by 2.8 percentage points in 2018 to 79.1% from 81.9% in 2017. This is due to income growing faster than expenses. Medium banks operated at a median cost-income ratio of 78.3% (75.1% in 2017) and small banks at 86.3% (82.4% in 2017). This development demonstrates the considerable increase in pressure on small banks over the past 12 months.

The negative trend in return on equity (RoE) continued in 2018, with more than half of private banks seeing their RoE decline. The median value for the analyzed banks came to just 4.1% for the past year, thus nearly on a par with that of previous years. As a result, RoE fell short of approaching a reasonable return of about 8-10% (close to the cost of equity). Large banks stood out as those able to improve their RoE last year: The median RoE at large and medium-sized banks improved by 2.0 and 0.8 percentage points respectively. By contrast, the median RoE of small banks fell by 0.6 percentage points to 3.1%.



NNM GROWTH DEVELOPMENT

in %



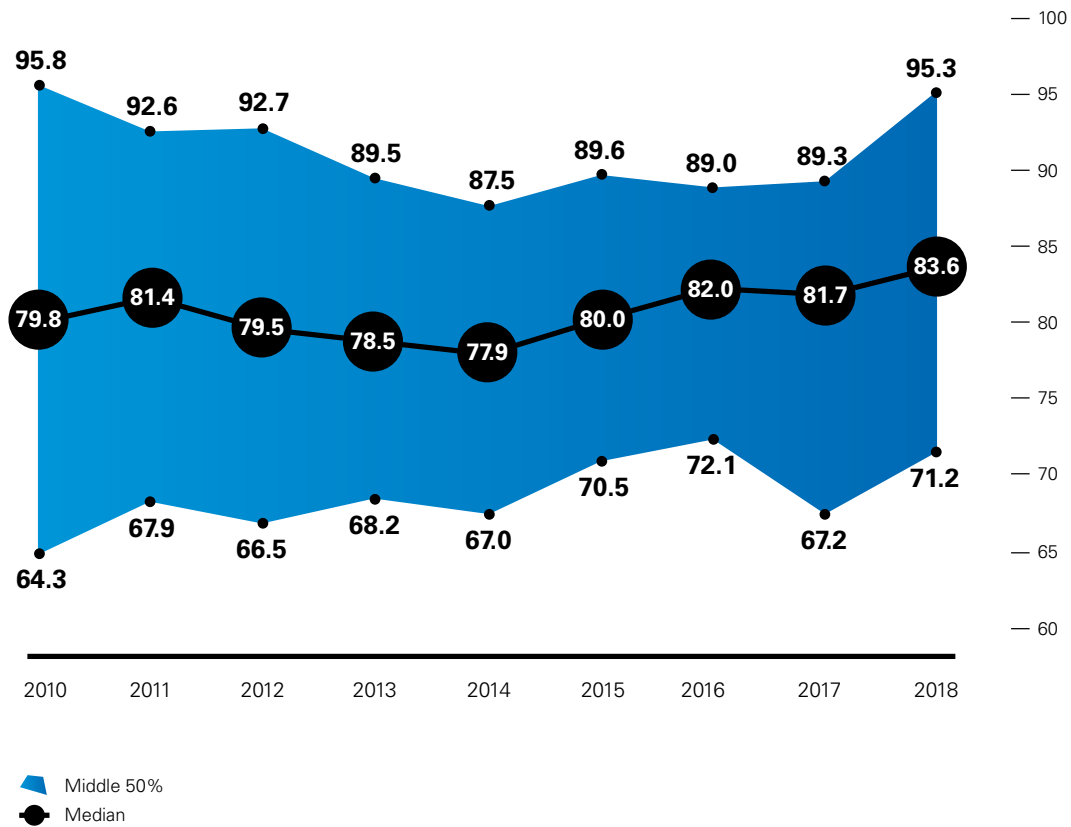
WHAT ARE THE IMPLICATIONS FOR THE INDUSTRY AS A WHOLE?

As banks' performances continue to worsen, we believe consolidation will re-center the industry around two models: Fewer, Swiss-owned large banks that have the necessary scale and smaller subsidiaries of foreign-owned banks that use the Swiss entity as a booking center. We have identified AuM of CHF100 billion as the critical mass. These larger banks generally have an international physical onshore network, also in emerging markets. This provides greater resources to invest, develop business, leverage the Swiss wealth management brand, and achieve operating efficiencies. It gives them the advantage in an industry where expensive onshore presence is necessary for expansion in the world's high potential markets.



COST-INCOME RATIO DEVELOPMENT

in %



TIME FOR A REALITY CHECK AT SWISS PRIVATE BANKS

Despite the challenges set out in this article, we are optimistic about the future of the Swiss private banking industry. There are cold, hard facts that need addressing, but Switzerland has a number of advantages that can help its banks regain ground globally. These include its economic stability, reputation for service quality, and a broad service offering. However, banks will succeed only once genuine improvements are made to underlying profitability and performance.

Boards of banks should objectively assess their situations and be realistic about the chances of survival of their bank. They need to look closely at what can be done to turn around the bank's fortunes – including changes to the business and operating models, mergers and acquisitions. Consequently, fresh perspectives are needed to deal with changing competitive dynamics, emerging technologies, and wealth creation in new markets.



CHRISTIAN HINTERMANN
Partner, Head of Financial Services Transformation
KPMG Switzerland

SOURCE

Clarity on Performance of Swiss Private Banks
Bigger is better in the quest for success, August 2019:
www.kpmg.ch/pb

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The scope of any potential collaboration with audit clients is defined by regulatory requirements governing auditor independence. If you would like to know more about how KPMG AG processes personal data, please read our Privacy Policy, which you can find on our homepage at www.kpmg.ch.

© 2019 KPMG AG is a subsidiary of KPMG Holding AG, which is a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved.