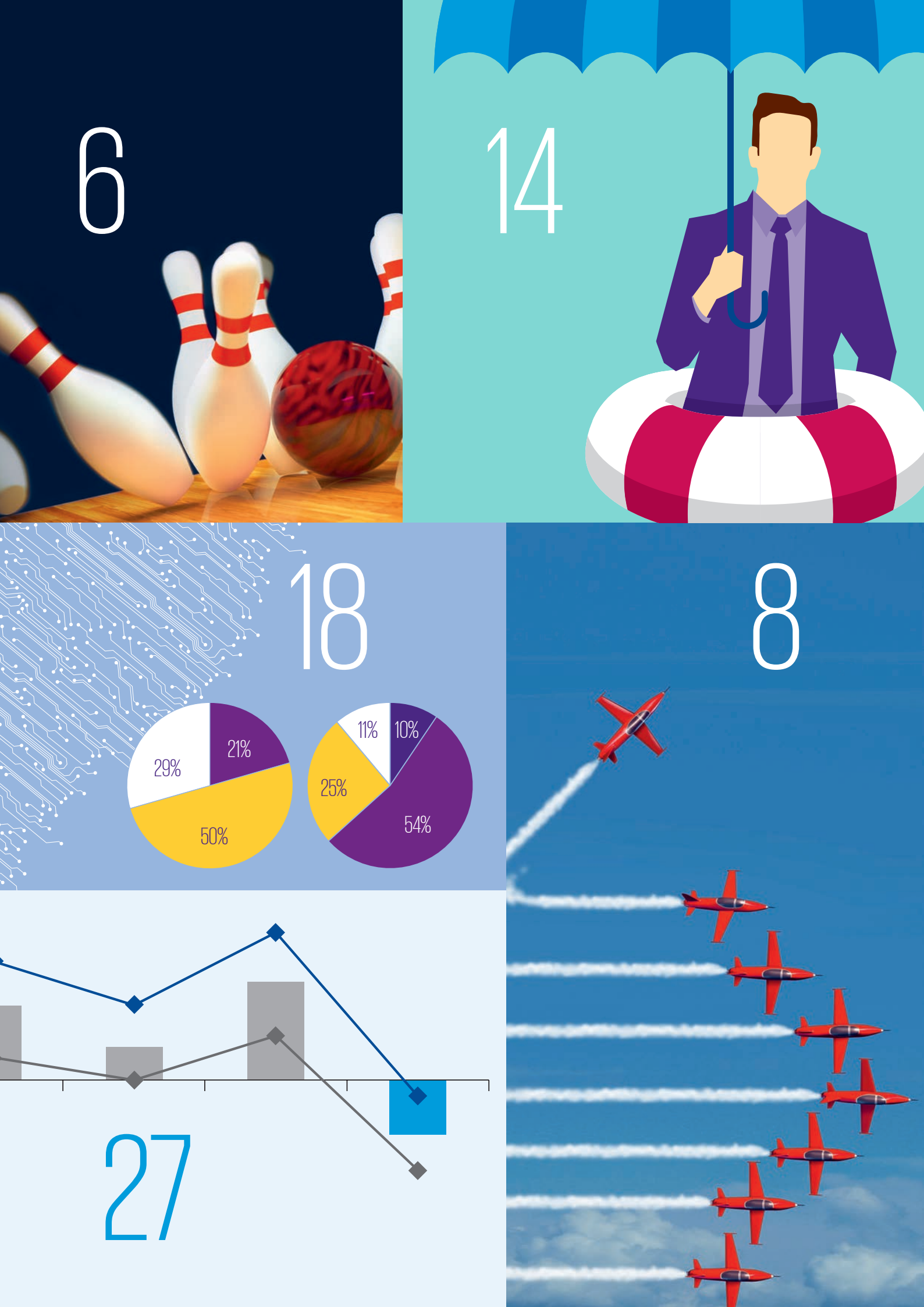




Clarity on Performance of Swiss Private Banks

**Further and faster:
Radical change needed**





Further and faster: Radical change needed

A study by KPMG AG Switzerland
in cooperation with the Institute of Management
at the University of St. Gallen.

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The weak are becoming weaker, and more are joining them

The fact that 10% of Swiss private banks sold up or closed their doors in 2015 is not surprising. Last year, we predicted a 30% fall in the number of Swiss private banks over the next few years. If anything, our prediction may be conservative, as market conditions have become even tougher amid a stronger Swiss franc and negative interest rates. Two-thirds of the 87 banks we analyzed saw results deteriorate in 2015.

Many banks have made strenuous efforts in recent years to restructure, seeking to turn around their performances by refocusing on core markets and revising their business and operating models accordingly. These efforts head in the right direction, but the changes go neither far enough nor fast enough. Despite the exit of some of the poorest performing banks in 2015, the overall performance of the industry did not improve. This strongly indicates that the path is long and painful before the industry returns to good health.

With that in mind, we once again categorize banks into four clusters based on their performance. This time, however, we begin our analysis from 2010. By stripping out the immediate aftermath of the global financial crisis, we provide greater clarity over how banks are faring in the new reality of private banking – transparency, increased regulations, a more demanding new generation of clients and harsher market conditions.

As we look ahead, growth remains a key challenge. It was disappointing to see 2015 yield only negligible Net New Money (NNM) as the industry generally failed to attract new clients. Among stagnant growth, cost-income ratios continue to rise (by staggering degrees in some clusters). This must be addressed by looking more closely at outsourcing arrangements so that banks focus on client service while drawing on others' expertise in back office functions. Although it is tempting to postpone major investments until better times ahead, banks must also not neglect their IT infrastructures. Too many run old core banking systems that, while cheaper to operate, lack the flexibility needed to meet clients' evolving needs and make the step into digital banking.

It is clear that radical change is required, and that banks must go further and faster in their efforts to realign business and operating models. We hope you find this study thought provoking in its implications for current priorities and longer-term trends.

Philipp Rickert and **Christian Hintermann**,
KPMG Switzerland

One year later, one in ten private banks fewer

With 10% fewer Swiss private banks at the end of 2015 than at the start of the year, industry consolidation continues. More foreign banks exited the Swiss market while poorer performing banks decided to sell up or close their doors. Our prediction from last year that the industry would consolidate by 30% in the next few years is further validated.

Two-thirds of banks see worsening returns

RoE declined at two-thirds of banks in 2015 as the industry proved unable to turn around its fortunes. In fact, only six banks have managed to continuously improve their RoE over the past three years.



Urgent need for change as cost-income ratios rise

Weak Performers saw their cost-income ratios rise by almost 10 percentage points in 2015, but they are not alone. Driven by lower revenues, cost-income ratios are up at two-thirds of banks. This reinforces the urgent need to conduct reviews of value chains and focus on core activities (while outsourcing non-core activities) as part of longer-term cost management efforts.

No interest in banking

A fall in net revenue margins at two-thirds of banks was driven by a strong Swiss franc, challenging markets and negative interest rates. All of these factors put even greater pressure on poorly performing banks.

N(o) N(ew) M(oney)

A CHF100 billion fall in AuM in 2015 reflected negative market conditions and a severe lack of NNM into Swiss private banks. Strong Performers struggled, but outpaced Weak Performers by almost 8 percentage points.

In search of growth

In the pursuit of scale and synergies, banks acquired targets both in Switzerland and abroad. Those that completed significant acquisitions saw their cost-income ratios fall by an average of 1.9 percentage points. Banks with a banking subsidiary or branch abroad were more able to attract NNM, though still at relatively low levels.

Lack of investment to impact future success

With only one-quarter of small banks and one-half of large banks running new generation IT core banking systems, many will be unable to adapt quickly enough to evolving client needs and digital banking. Those that cannot afford newer systems should urgently consider core banking system substitution in outsourcing mode to tap into external expertise and ensure they are fit for purpose.

Will the weak survive?

Seven Weak Performers disappeared in 2015, but were rapidly replaced in this cluster by banks with deteriorating performances. After extremely negative developments in 2015, the ability of this group to survive is brought further into question.

THE WEAK ARE GETTING WEAKER, AND MORE BANKS ARE JOINING THEM

As 2015 yielded worse market conditions amid falling interest rates and a strong Swiss franc, the performance of banks in our sample has deteriorated. RoE fell in three of the four clusters, with the only exception being Average Performers – Up. And NNM was flat in our sample. The investments made by some banks to turn around their fortunes do not yet appear to be paying off. Benefits are being outweighed by the ongoing cost of legacy issues and falling revenues and AuM.

The gap between the strongest and the weakest banks continues to widen. Rather than the Strong Performers pulling ahead, however, it is the Weak Performers who are in continuing decline – and more banks are joining them in the lowest cluster. Weak Performers make up one-third of our sample despite seven being sold or liquidated in 2015. A further 22 percent of banks are Average Performers – Down, being banks that have shown a continued negative trend since 2010. This means that Weak Performers and Average Performers – Down constitute more than half of the banks in our sample.

This downward trend is notable in the pessimistic tone of Management Discussion & Analysis content in numerous annual reports as two-thirds of banks in our entire sample saw margins and returns worsen last year. While 2015 was a poor year for the clear majority of banks, however, we still see a growing number (mainly Strong Performers and Average Performers – Up) continuing to take concrete actions to transform their business and operating models. The main focus of their activities is to:

- Refocus on **specific target markets** while exiting non-core clients, in order to be in a better position to provide excellent service to remaining core segments
- Build **scale through M&A** and the hiring of new relationship managers
- Invest in IT platforms and **digital capabilities**
- Reinforce process automation and **industrialization** to deliver operational efficiencies
- Disaggregate value chains, building **outsourcing arrangements** with partners to gain operational efficiency and increase client service quality
- Upgrade front office capabilities and processes to **improve sales effectiveness**
- **Rework value propositions** to reflect a stronger value-add to the client, including:
 - Adjusting service offerings to reflect client needs and to align with the profitability of individual client segments
 - Developing further active advisory services

- Develop **new pricing models** to grow revenue streams and reflect levels of service provided to clients
- **Review distribution channels** to increase their effectiveness, and adopt omnichannel strategies to strengthen market positions and seize new opportunities around digital banking

Of course, the results will not be seen overnight. In the short term such investments may hurt these banks' performance. The hope must be that the short-term pain positions them better for longer-term success.

Some of the Average Performers – Up may be ones to watch in this regard. It will be interesting to see over the next 2-3 years whether this cluster begins to displace some of our current Strong Performers. The chances to do so are real, as some Strong Performer banks appear to be maintaining their positions by minimizing investments and being slower to adapt to the new, fully transparent world of private banking.

In general, however, it must be stated that with overall performance declining, many banks are still not taking enough measures – not even enough to maintain relatively poor performance. There is an urgent need for banks to implement more radical change, and faster.

New clusters to reflect industry changes

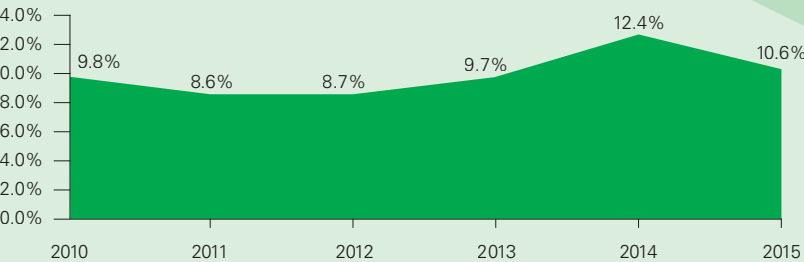
As in our previous studies, we have categorized the banks in our sample into four clusters based on their financial performance. This year, we have taken a shorter time horizon of six years (2010-2015) in order to focus on post-global financial crisis trends to see which banks are managing best to adapt to the new private banking reality.

Strong Performers

More efficient and better positioned to build scale, they are more focused on core markets. Despite higher NNM than other clusters in 2015, will a lack of investment hinder their ability to stay ahead?

AuM	2010	2015
5y AuM growth		26.0%
NNM/Gross AuM	4.0%	1.9%
Revenues		
Net revenues margin on Gross AuM (bps)	94	73
Net revenues/Average FTE (CHF'000)	520	632
Costs		
Cost-income ratio	74.4%	66.6%
FTE/1bn Avg Gross AuM	19	15

RoE development 2010-2015

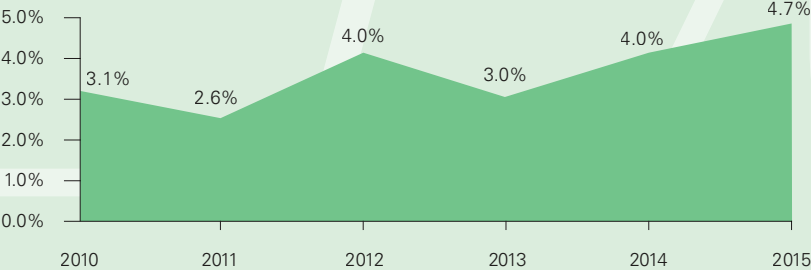


Average Performers - Up

The only cluster to report a rise in RoE, these banks have managed to grow their net revenue per FTE and improve their cost-income ratios. Are they the Strong Performers of tomorrow?

AuM	2010	2015
5y AuM growth		17.6%
NNM/Gross AuM	1.6%	-0.2%
Revenues		
Net revenues margin on Gross AuM (bps)	93	89
Net revenues/Average FTE (CHF'000)	441	484
Costs		
Cost-income ratio	81.0%	77.7%
FTE/1bn Avg Gross AuM	23	22

RoE development 2010-2015

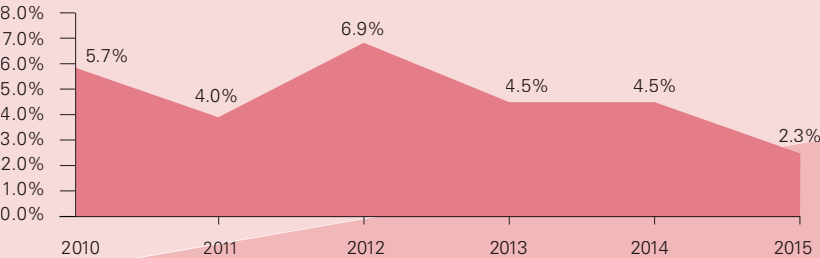


Average Performers - Down

Badly impacted by market conditions despite growing their AuM, are they on their way to becoming Weak Performers if they cannot turn around their fortunes?

AuM	2010	2015
5y AuM growth		18.8%
NNM/Gross AuM	4.0%	-0.9%
Revenues		
Net revenues margin on Gross AuM (bps)	110	100
Net revenues/Average FTE (CHF'000)	473	397
Costs		
Cost-income ratio	68.1%	76.4%
FTE/1bn Avg Gross AuM	24	26

RoE development 2010-2015

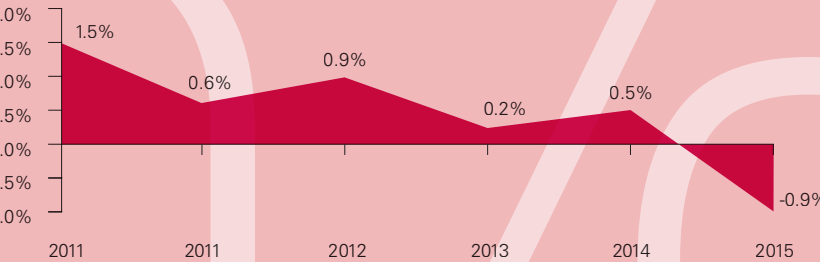


Weak Performers

Poor performances were exacerbated by market conditions. Loss-making, with poorer RoEs and cost-income ratios having declined by almost 10 percentage points in 2015 alone, will these banks still be around in 2-3 years from now?

AuM	2010	2015
5y AuM growth		-6.1%
NNM/Gross AuM	-1.0%	-5.7%
Revenues		
Net revenues margin on Gross AuM (bps)	102	87
Net revenues/Average FTE (CHF'000)	348	315
Costs		
Cost-income ratio	90.6%	106.8%
FTE/1bn Avg Gross AuM	26	27

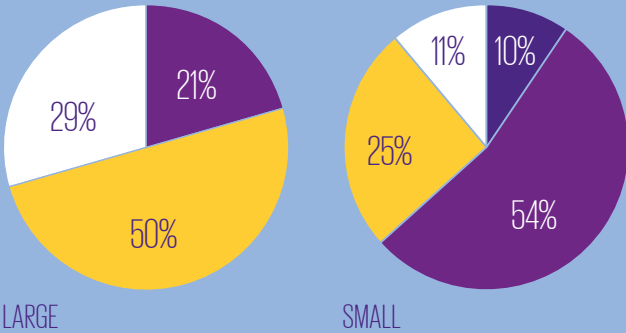
RoE development 2010-2015



Operating models

Only one-half of large banks and one-quarter of small banks run new generation IT core banking systems. For the remaining banks, this might keenly impact their future success by restricting their ability to respond to changing client needs and to compete in the digital banking space. As the costs of migrating to and running newer systems may be out of reach of most small banks, more should consider the merits of outsourcing certain activities in order not to lose competitiveness.

Core banking system category by bank size



■ old generation/renovated packages ■ new generation packages

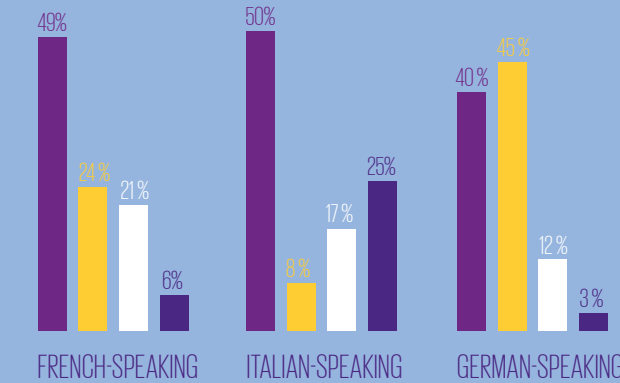
Larger banks have newer systems, but adoption still lags behind

We clustered the 87 banks in our sample into four categories based on their IT core banking systems:

- Old generation: more than 20 years old and no longer supported by the supplier;
- Old/renovated: more than 20 years old but actively renovated by the supplier;
- New generation: less than 20 years old;
- Bespoke: developed and operated by the bank.

The difference between small and large banks is remarkable. New generation packages are used by exactly half of large banks and one-quarter of small banks. A further 10% of small players run old generation/unsupported packages. Most banks recognize the need for a modern, agile IT platform to respond to evolving client needs and face future challenges including digital banking. However, insufficient scale at most small players and the high costs of migrating to a new system (and higher running costs) have deterred many small banks from upgrading their IT platforms. In addition, the complex and long-term transformation involved in replacing a core banking system can be a major execution challenge for many medium- and small-sized banks.

Core banking system category by bank location

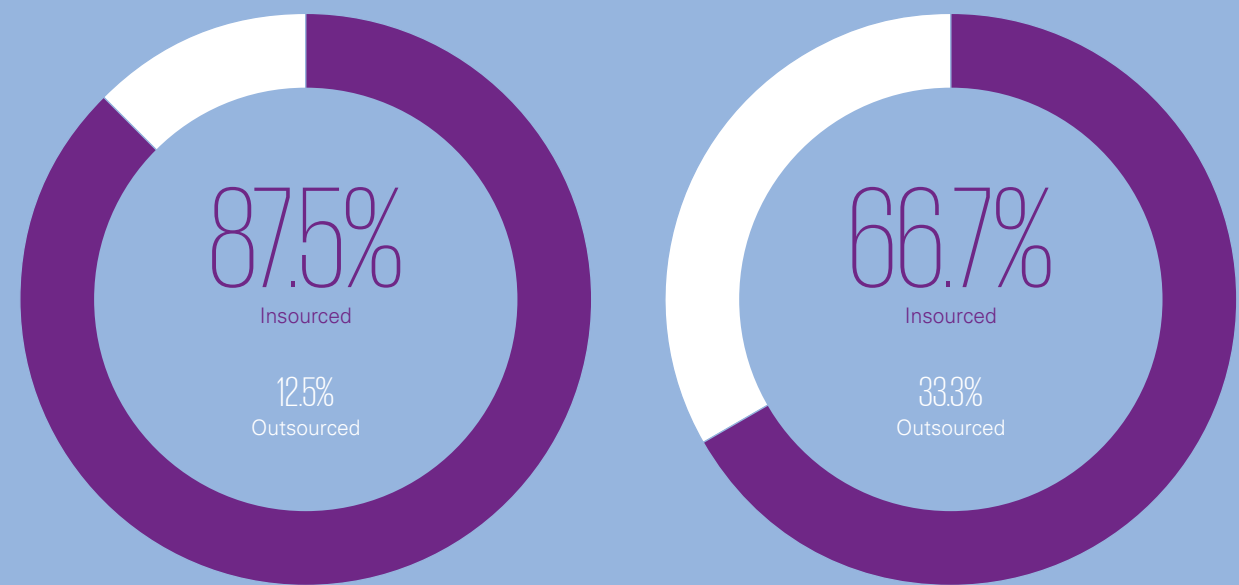


■ bespoke ■ old generation/not supported packages

Much greater prevalence of new systems in German-speaking Switzerland

Banks based in German-speaking Switzerland tend to have more modern IT core banking systems (45% of banks). Almost one-quarter of banks based in French-speaking Switzerland use new generation packages and only 8% of Ticino-based banks utilize a new generation package (most banks in Ticino are small).

Sourcing mode by bank size



LARGE

Small banks more commonly outsource IT and back-office operations to achieve efficiency gains

With many – especially smaller banks – struggling to dedicate the time and financial investment needed to innovate or replace their core banking solution, one-third of small banks (and one-eighth of large banks) outsource at least part of their IT and operations to an ASP or BSP. The ratio difference between bank sizes is likely due to the fact that larger banks can typically capitalize on existing economies of scale and skills and are better positioned to attract and retain specialized IT staff.

SMALL

A period of 12-18 months, together with significant resources, is usually required for outsourcing IT and/or back-office operations. The price of this move is that the bank is typically locked in to the ‘standards of the sourcing company’ for longer. The value, however, is that the sourcing company’s client community may reflect a valid standard to be followed. Efficiency gains and the potential to reduce costs are another key consideration. Small banks that use an ASP and/or BSP solution had a lower average cost-income ratio by 6 percentage points and required 14% fewer FTEs per CHF1 billion of AuM in 2015.

Older packages may be 25% cheaper – but they come at a price

Banks in our sample that run old generation packages or bespoke solutions reported 25% lower IT and communications technology costs per CHF1 million in AuM compared to banks of similar size and sourcing models that use new generation packages. This excludes capitalized costs. Banks with new generation packages, meanwhile, have slightly fewer FTEs per CHF1 billion in AuM, which may indicate back-office efficiency gains due to enhanced Straight Through Processing (STP). Also, the higher the STP, the lower the chance of errors in manual processes.

The lower IT costs related to old generation packages come at a price. These platforms’ weaker functionalities and lack of scalability impair a bank’s ability to meet future needs. Further digitization of the business model and the requirements of a new generation of clients are forcing banks to achieve a better alignment of technology and operations. Banks may be forced to migrate to newer generation platforms if they are to survive. A modern IT core banking system is a prerequisite to fulfilling client needs and enables banks to optimize the total cost of ownership.

Investment needed to create opportunities for change

Overall, only 32.2% of banks in our sample operate a new generation core banking system and only 27.6% utilize ASP and/or BSP. While it is down to each individual bank to analyze the impacts of a new core system and the opportunities related to ASP and BSP, these figures seem very low. As the business digitizes further and client needs change, banks without the right systems in place may struggle even more to retain existing clients and win new ones. The ongoing challenges in the industry mean banks should start looking towards more radical solutions around partnering and outsourcing all parts of the value chain that are not their core competence. By doing so, they may be able to increase efficiency and focus their efforts on the area where their key competency should be – the client.

Key findings

- Half of large banks and only one-quarter of small banks run a ‘new generation IT core banking system’.
- 45% of banks based in German-speaking Switzerland are on new generation IT core banking systems, compared with 24% of banks based in French-speaking Switzerland and 8% of banks based in Ticino.
- Running costs of older IT core systems are generally 25% lower than new systems but older systems restrict a bank’s ability to respond to evolving client needs and digital banking. To survive, banks with older systems need to invest in migrating to newer platforms and/or consider solutions such as outsourcing.
- Outsourcing Application Services (ASP) and/or Business Services (BSP) operations delivers visible efficiency gains. Average cost-income ratios in 2015 were six percentage points lower at small banks that outsource these activities, and they needed 14% fewer FTEs per CHF1 billion of AuM. Despite these benefits, it is an option chosen by less than one-third of all banks.

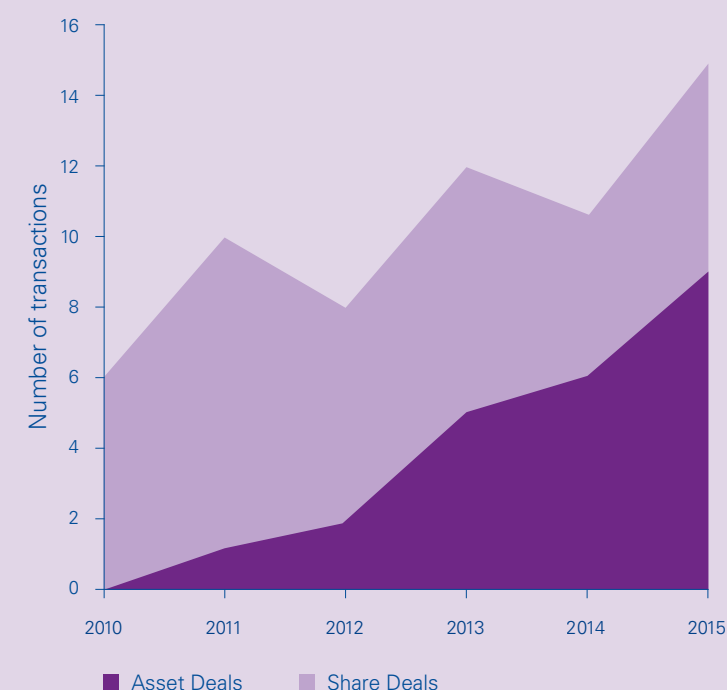
Reaching new heights: M&A peaks as consolidation intensifies

A 10% fall in the number of Swiss private banks in 2015 delivered further on our prediction last year that the number of players will contract by 30% over the next few years. In 2015, M&A activity hit its highest level since 2007. While smaller, poorly performing banks exited the market, the other end of the spectrum saw large Swiss private banks acquire abroad in their drive for scale and efficiencies in their on-shore operations. The clear majority of transactions were asset deals, with many vendors selling their client base before liquidating the bank.

Number of announced M&A transactions involving a Swiss private bank, 2006 to 2016 YTD



Asset Deals vs Share Deals transactions



Key findings

- Consolidation clearly picked up in 2015, the most active year since 2007 with 15 transactions involving Swiss private banks. The number of Swiss private banks fell by around 10% – also the greatest change in a single year since 2007.
- Deal numbers were driven by the disposal of banks that have performed poorly in recent years and that lacked scale – a trend we have expected for some time.
- 60% of transactions were asset deals; the highest proportion in the past 10 years. This reflects buyers' caution about potential legacy risks and reluctance to buy the legal entity.
- Most deals were between Swiss-based players driven by economies of scale and significant synergy potential. Large Swiss banks also expanded abroad to add scale in local markets and improve capabilities for acquiring new clients.
- Foreign banks continued to exit the Swiss market as part of reviews of their global footprint. This included selling the Swiss operations of Coutts International and Royal Bank of Canada.

Activity rises in the second half of 2015

While the six months to June 2015 saw the announcement of only five M&A transactions, activity accelerated in the second half of the year for various reasons:

- Category 2 banks finalized their negotiations with the US Department of Justice. This provided greater certainty and confirmed that the fines levied were in line or below provisions created in earlier years.
- Foreign banks continued to exit Switzerland’s private banking market in line with announced strategies. These included Coutts International and Royal Bank of Canada.
- Management teams and boards were finally able to focus less on regulatory and tax compliance initiatives and more on strategic realignment with core markets and client segments as well as devoting time to external growth initiatives or their exit from the Swiss market.

Pricing pressures grow

We saw increased pressure on pricing levels for private banking deals in 2015. This was partially driven by many deals on the market being smaller deals involving banks that have performed poorly in recent years. Despite a shortage of targets, buyers are exercising caution and have very clear ideas regarding which types of clients/portfolios they are interested in. Generally, significant discounts are applied to clients whose tax compliance is unclear. In particular, for clients from OECD countries most buyers demand a very high certainty regarding tax compliance and are prepared to otherwise exclude clients from the deal.

Proportion of asset deals increasing as buyers try to limit legacy risks

Many sellers had initially sought a share deal but were ultimately forced to accept an asset deal despite the cost and complexity involved in winding down the bank afterwards. Asset deals proved more popular among acquirers keen to choose which specific assets to take over and avoid certain legacy and reputational issues (particularly with

regard to the US Tax Program). The proportion of asset deals has increased in each year since 2012.

We also observe a rise in the number of (often undisclosed) asset deals arising from a need to focus on fewer markets. Such deals enable vendors to divest non-core portfolios and focus firmly on core markets and client segments.

In asset deals, client onboarding procedures are attracting notably closer scrutiny by FINMA, which wants to avoid problematic clients being moved from one bank to another through this type of deal. Banks must therefore define detailed onboarding and remediation plans.

Largely negative median RoE among banks acquired or liquidated

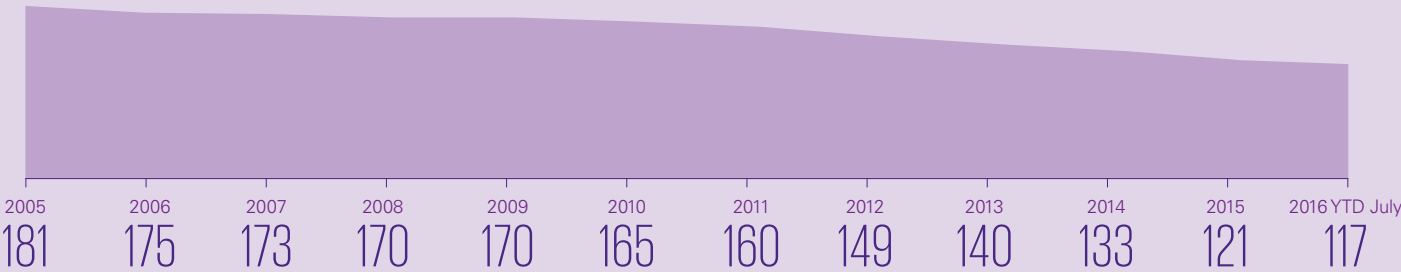
RoE (excluding extraordinary items) of the 10 private banks that were acquired or liquidated was negative 5.3% two years before the transaction and negative 19.3% the year before the transaction. This could indicate that shareholders of poorly performing banks have started to review their options and take decisive actions. Twenty-four banks reported negative RoE (excluding extraordinary items) in 2015. Some of these banks could be ideal candidates for sale or liquidation should the situation not improve in 2016.

Industry contraction: subscale Swiss private banks support the prediction we made last year

A continued stream of deals in 2016 and beyond will lead the number of Swiss private banks to fall further. We have seen the number of banks fall by around 10% in 2015 alone.

In 2015, most banks saw a decline – or limited improvement – in many ratios; even more challenging market conditions in 2016 are adding to their difficulties. More radical change is needed to business and operating models before the industry can declare itself fit and well again. As many players lack the resources to successfully implement the necessary changes, consolidation will continue and the number of banks will decrease further.

Number of Private Banks in Switzerland



Private banking transactions announced in 2015 and first seven months of 2016

Announced	Target	Bidder	AuM (CHFbn)	Transaction Type
2016				
Apr 2016	UBI Banca International (Luxembourg) SA	EFG International	4.0	Asset deal
Apr 2016	Private Client Bank AG (50% stake)	Undisclosed	3.0	Share deal
Apr 2016	Privatbank Bellerive AG (37.5% stake)	Graubundner Kantonalbank	4.5	Share deal
Feb 2016	BSI S.A.	EFG International	88.0	Share deal
Jan 2016	Meridian Wealth Management S.A.	Banque Heritage S.A.	0.1	Share deal
2015				
Dec 2015	Commerzbank International S.A. Luxembourg	Julius Baer Group	3.2	Share deal
Nov 2015	Bank Leumi Luxembourg’s private banking business	Bank J. Safra Sarasin (Luxembourg) AG	n/a	Asset deal
Nov 2015	IDB (Swiss) Bank Ltd	Hyposwiss Private Bank Genève S.A.	n/a	Asset deal
Nov 2015	Hottinger & Cie AG	Banque Heritage S.A.	n/a	Asset deal
Nov 2015	Banco Santander Private Banking Italia	UBS AG	2.9	Asset deal
Nov 2015	Société Générale Private Banking (Lugano-Svizzera) S.A.	Axion Swiss Bank S.A.	n/a	Asset deal
Nov 2015	Fransad Gestion S.A.	Julius Baer Group	1.3	Share deal
Sep 2015	Finter Bank Zurich AG	Bank Vontobel AG	1.9	Share deal
July 2015	NSC Asesores	Julius Baer Group	3.0	Share deal
July 2015	Royal Bank of Canada (Suisse) S.A.	SYZ Group	10.2	Share deal
Mar 2015	Coutts & Co	Union Bancaire Privée S.A.	33.2	Asset deal
Mar 2015	MediBank AG	Bank Alpinum AG	0.2	Asset deal
Feb 2015	Bank La Roche & Co AG	Notenstein Private Bank Ltd	5.4	Asset deal
Feb 2015	Standard Chartered, Geneva Branch	Banque Heritage S.A.	n/a	Asset deal
Jan 2015	KBL (Switzerland) Ltd	Banque Internationale à Luxembourg (Suisse) S.A.	2.5	Share deal

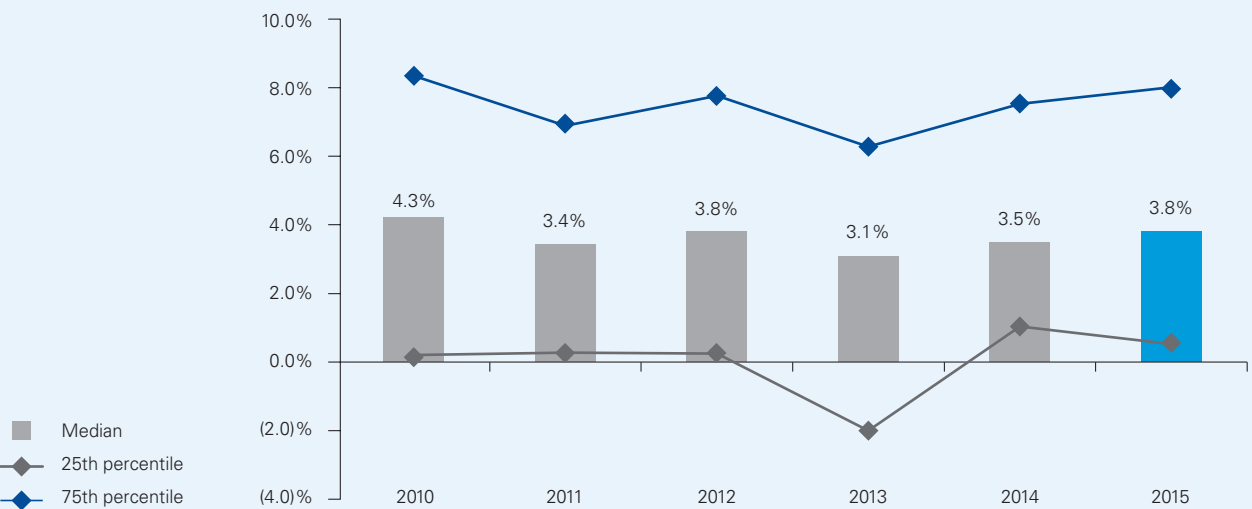


Analysis of performance and trends

Profitability

Two-thirds of banks saw a decline in RoE in 2015 and the industry continued to be unable to turn around its profitability. Despite overall RoE in our sample remaining almost static between 2013 and 2015 on a constant sample basis, only six banks managed to continuously increase their RoE over this period.

RoE development 2010 to 2015

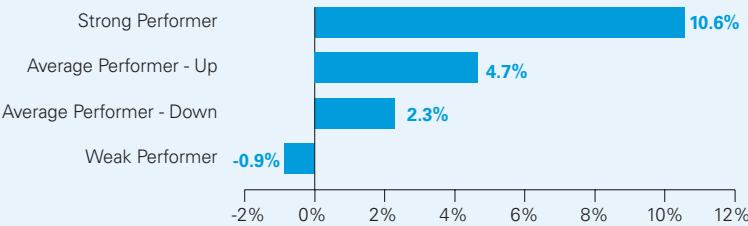


2015 KEY FINDINGS

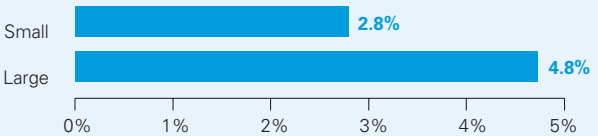
- Median RoE remained static between 2013 and 2015 at 3.7%–3.8% on a constant sample basis.
- A slight increase in reported RoE from 3.5% in 2014 to 3.8% in 2015 is largely due to the exclusion of 10 banks that closed in 2015. The median RoE of these 10 banks in 2014 was negative 16.6%.
- RoE in 2015 fell at two-thirds of banks. The one-third that saw an improvement were mostly Average Performers – Up.
- Only six banks managed to continuously improve RoE over the past three years.
- The lowest performing banks have continued to decline, with median RoE at Weak Performers falling from 0.5% in 2014 to minus 0.9% in 2015.
- Banks were generally impacted by a stronger Swiss franc, negative interest rates, various voluntary disclosure programs and, more generally, clients regularizing their fiscal situation ahead of the introduction of the Automatic Exchange of Information.

RoE 2015

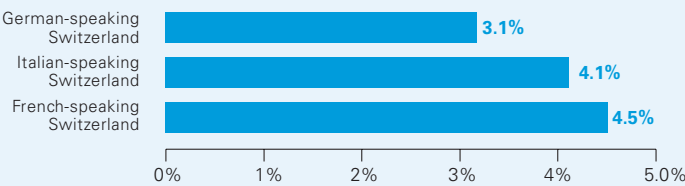
By cluster



By size



By location



Closure of 10 banks improves overall RoE

Reported RoE rose modestly to 3.8% in 2015 from 3.5% in 2014. This hides the fact that 10 banks (with a negative median RoE of 16.6% in 2014) were no longer in our 2015 sample. On a constant sample basis, the RoE of the other 87 banks remained stable at 3.7%–3.8% between 2013 and 2015. We consider 8% to be an adequate return for a private bank. Three-quarters of banks reported lower.

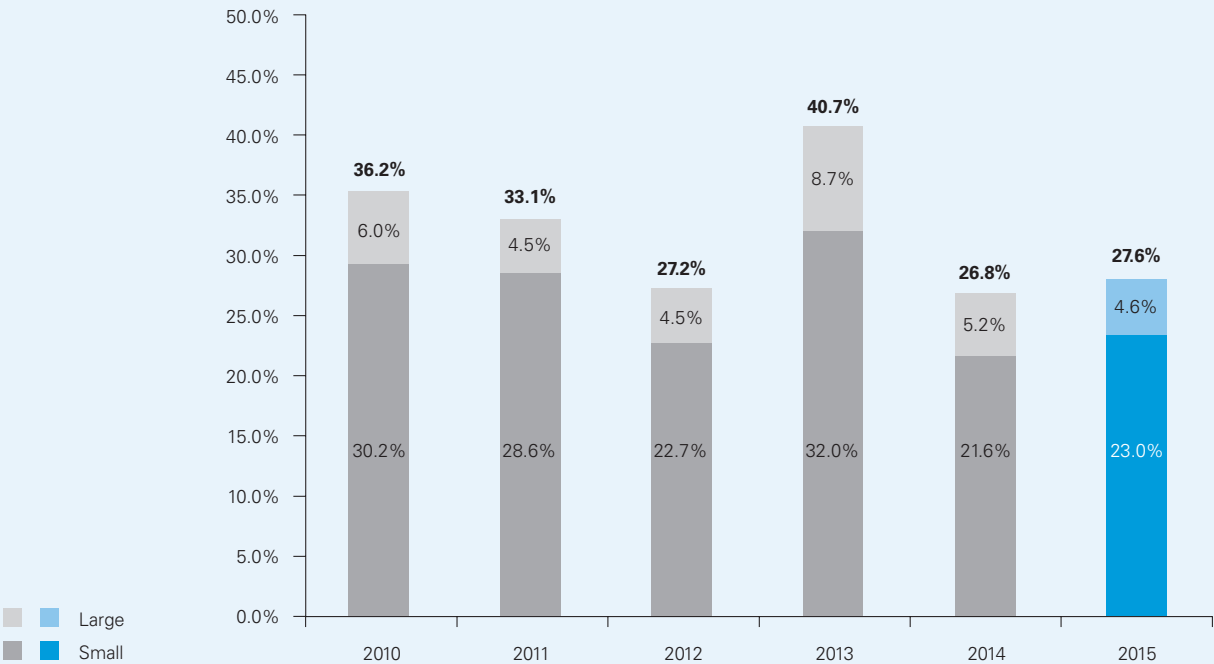
2015 saw one-third of banks (28 banks or 32%) grow their RoE (of which 10 saw an increase in excess of five percentage points). RoE at the other two-thirds fell, by more than five percentage points at 16 banks.

RoE at 26 banks (or 30%) has deteriorated in each of the past two years while rising at 16 banks (or 18%). Only six banks reported a continuous increase in RoE over the past three years.

M&A: acquisitions positively influence performance

2015 once again confirmed the positive impact of significant acquisitions on performance by realizing synergies and building scale. The median RoE of banks which made acquisitions between 2010 and 2014 (where each transaction represented at least 10% of their AuM) rose by 2.8 percentage points in the two years following the acquisition (or one year for acquisitions in 2014).

Percentage of loss-making banks 2010 to 2015 (before extraordinary items)



Number of loss-making banks remains high

Twenty-four banks reported a loss before extraordinary items¹ in 2015. Down from twenty-six in 2014, this change was driven by seven of the loss-making banks in 2014 being those subsequently closed or acquired. Six banks that recorded losses in 2014 meanwhile returned to profit in 2015, though eleven banks turned operating profits in 2014 into losses in 2015.

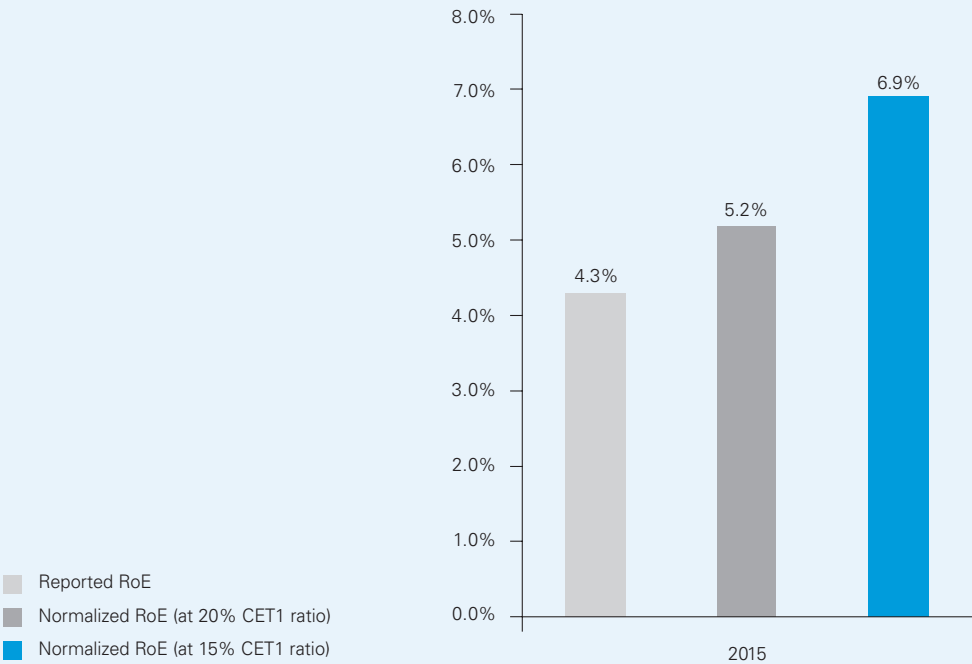
Eleven banks (mostly small Weak Performers) generated losses in each of 2013, 2014 and 2015. Five even reported an RoE before extraordinary items of constantly below negative 5%.

Extraordinary items at lowest level for five years

At 0.6 percentage points, 2015 saw the lowest proportion of extraordinary items¹ in RoE since 2010. After removing extraordinary items, RoE in 2015 was 3.2% – an increase of 0.7 percentage points over 2014. Banks in our sample reported CHF290.4 million and CHF34.6 million of extraordinary income and expenses respectively in 2015 (2014: CHF649.7 million and CHF178 million), with two-thirds of the extraordinary income arising from sales of participations or fixed assets.

Weak Performers’ RoE was impacted by extraordinary items to a significantly greater extent than other clusters. This suggests that weak performing banks are more prone to trying to improve their results.

Normalised RoE at CET1 capital ratio of 15% and 20%



Higher RoE when adjusted for regulatory excess capital

Most Swiss private banks have significant excess capital. To analyze its impact on RoE, we normalized the CET1 ratio (Common Equity Tier 1) for the 52 banks for which full regulatory capital data is available. When applying a CET1 ratio of 15% and 20%, the median RoE of this group of banks would have been 6.9% and 5.2% respectively, substantially higher than the 4.3% calculated on their actual equity position at the end of 2015. It would be wrong, however, to conclude that the profitability of the industry is close to the 8% that we consider to be an adequate return. First, Swiss private banks generally use their strong capital base as a marketing argument to reassure their clients, who would probably react negatively to a significant capital reduction.

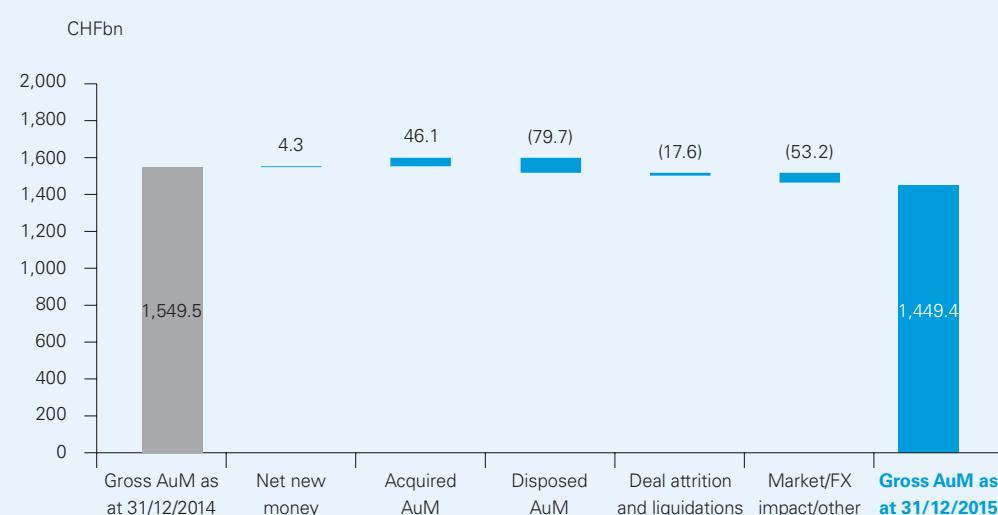
Second, the industry’s profitability should be measured on real, rather than theoretical, figures. And while shareholders of any given bank could proceed with capital optimization measures in order to improve RoE, we have seen very few examples in recent years.

¹ Including changes in reserves for general banking risks

Assets under Management

AuM dropped by CHF100 billion in 2015, as the industry suffers from a current inability to generate NNM. Organic growth is critical to drive higher NNM levels, and banks that have subsidiaries or branches abroad were much more successful in this respect. Positive market conditions over the past three years meanwhile turned negative in 2015, causing a net reduction of CHF53 billion in AuM among our sample, compared to a net increase of CHF99 billion in 2014.

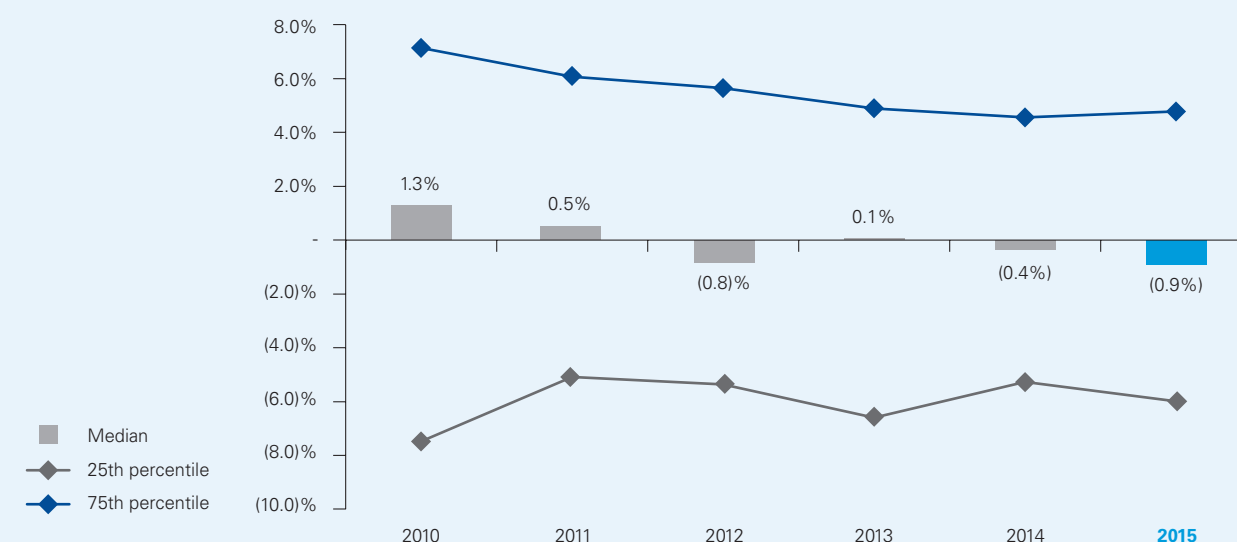
Development of gross AuM, 2014 to 2015



2015 KEY FINDINGS

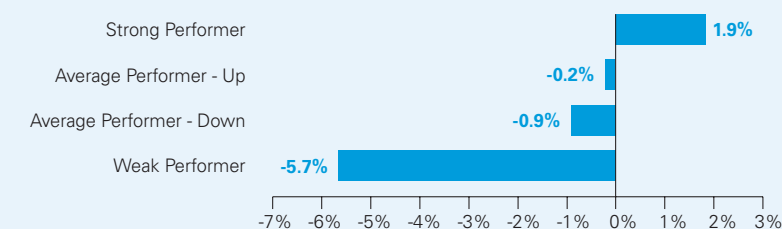
- AuM fell significantly in 2015 by CHF100 billion.
- At CHF4.3 billion (or 0.3% of AuM), 2015 saw the lowest level of NNM generated since 2009.
- Banks with no international presence struggled more to win new clients and NNM.
- The difference in NNM between Strong Performers and Weak Performers was almost 8 percentage points, at positive 1.9% and negative 5.7% respectively. The capability to attract new customers is a key strength that distinguishes Strong Performers.
- Eleven M&A deals representing total AuM of CHF46.1 billion were closed by 10 banks in our sample. As most banks taken over in 2015 were included in our sample in the prior year, the effect was to redistribute AuM among our sample rather than introduce fresh AuM.

NNM contribution to AuM 2010 to 2015

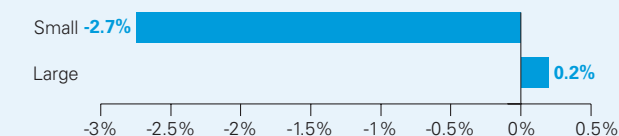


NNM contribution to AuM 2015

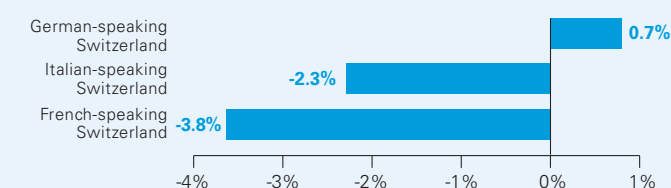
By cluster



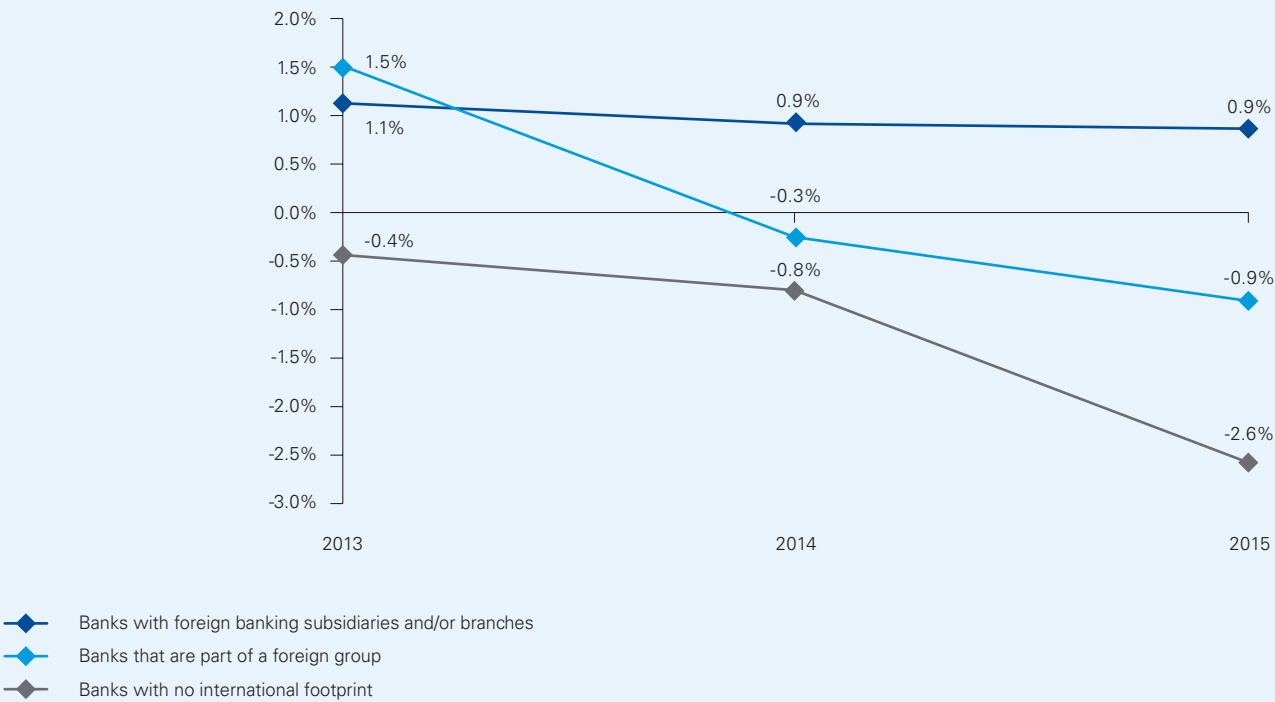
By size



By location



NNM contribution to AuM by bank's international footprint



2015: weakest NNM since 2009

At CHF4.3 billion (or 0.3% of AuM), 2015 generated the lowest NNM in recent years. In fact, 54% of banks reported net outflows: for 15 banks, outflows exceeded 10% of their AuM. This reflects the continuing difficulties most banks face in growing their businesses. Small banks face a particular need – and challenge – to gain scale. More than one-quarter of small banks have suffered continuous net AuM outflows over the past three years and a median NNM of negative 2.7% in 2015.

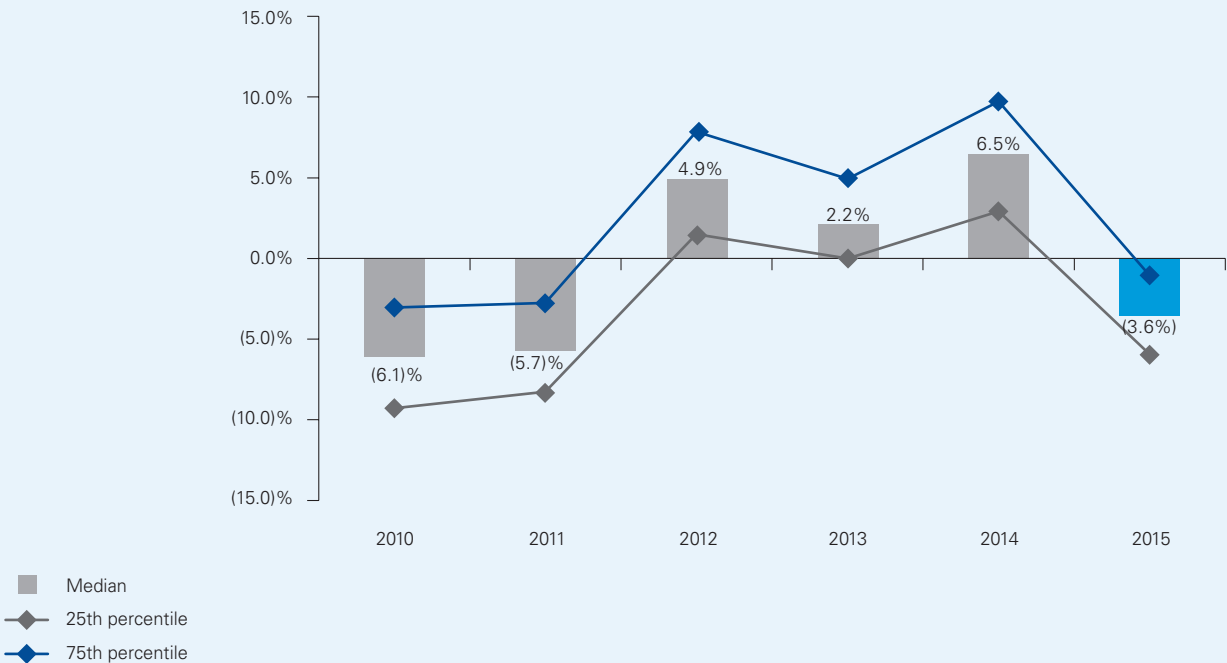
From a geographical perspective, banks based in French-speaking Switzerland reported median net outflows of 3.8% in 2015 – a full 4.5 percentage points worse than banks based in German-speaking Switzerland. This is due in part to the two regions having different core markets with varying growth rates. Also a difference in timing by banks in each region exiting non-core markets and clients. Banks based in Italian-speaking Switzerland saw initial outflows related to the Italian voluntary disclosure program, with the full impact becoming visible only as 2016 progresses.

International presence supports growth

Banks with one or more banking subsidiaries or branches abroad find it easier to gain new clients. In 2015, they reported positive NNM of CHF4.0 billion (a median contribution of 0.9%). By contrast, banks that have no banking subsidiaries or branches abroad and that are not part of a foreign group remained in negative territory at minus CHF1.3 billion (a median contribution of minus 2.6%). Stringent cross-border banking rules are having a clear negative impact. However, building and maintaining an international presence requires considerable investment and is therefore not an option for many banks.

Interestingly, banks that are part of a foreign group but that have no subsidiary or branch abroad seem to benefit only to a very limited degree from intragroup referrals of clients as they are also showing a negative NNM (a median contribution of negative 0.9%). In addition, they have seen a continuous decline in NNM over the last three years.

Performance contribution to AuM 2010 to 2015



Acquisitions redistributed AuM within the Swiss market

Ten of the banks in our sample made 11 of the M&A transactions that closed in 2015, representing total acquired AuM of CHF46.1 billion. As almost CHF37 billion of this AuM is related to banks previously in our sample the net impact on total AuM was marginal. The effect was rather to redistribute AuM within our sample, and of course to help the acquirers grow.

Aside from the transactions mentioned above, disposed AuM of CHF79.7 billion included a CHF42 billion outflow following a group internal reorganization at one bank in our sample.

To estimate how many clients left banks that were taken over or liquidated in 2015 prior to the deal or the bank closure, we compared AuM at the end of 2014 with AuM actually transferred. This AuM attrition impact amounted to CHF17.6 billion. Significant outflows occurred on some of the asset deals, with outflows being generally higher than on share deals.

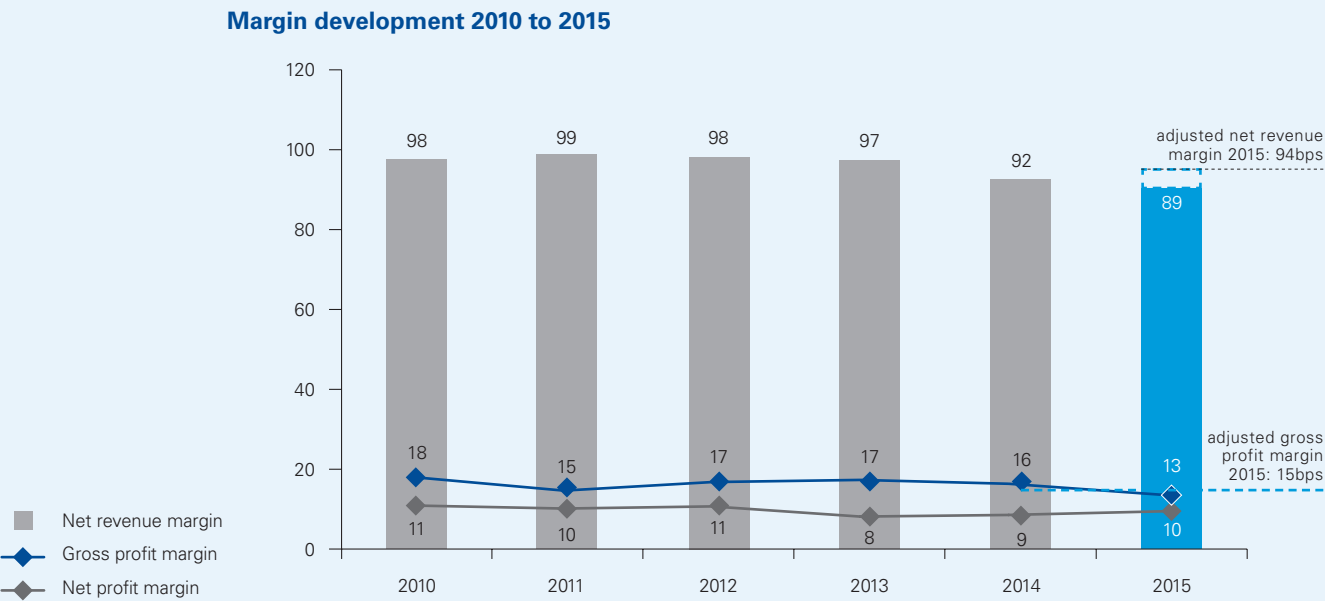
Three years of positive market impacts turn negative in 2015

While performance helped banks to increase AuM by CHF98.9 billion in 2014, financial markets did not contribute positively to AuM in 2015. On the contrary, AuM decreased by CHF53.2 billion due to negative performance.

The negative median performance contribution of 3.6% in 2015 was driven by the appreciation of the Swiss franc against the euro (+10.6% in 2015) and pound sterling (+4.9% in 2015) and less positive (or even negative) returns in certain asset classes. This followed in particular the Swiss National Bank's decision to lift the peg between the Swiss franc and the euro in January 2015. Overall, 77% of banks reported negative performance impacts with no discernable difference between small and large banks.

Revenue development

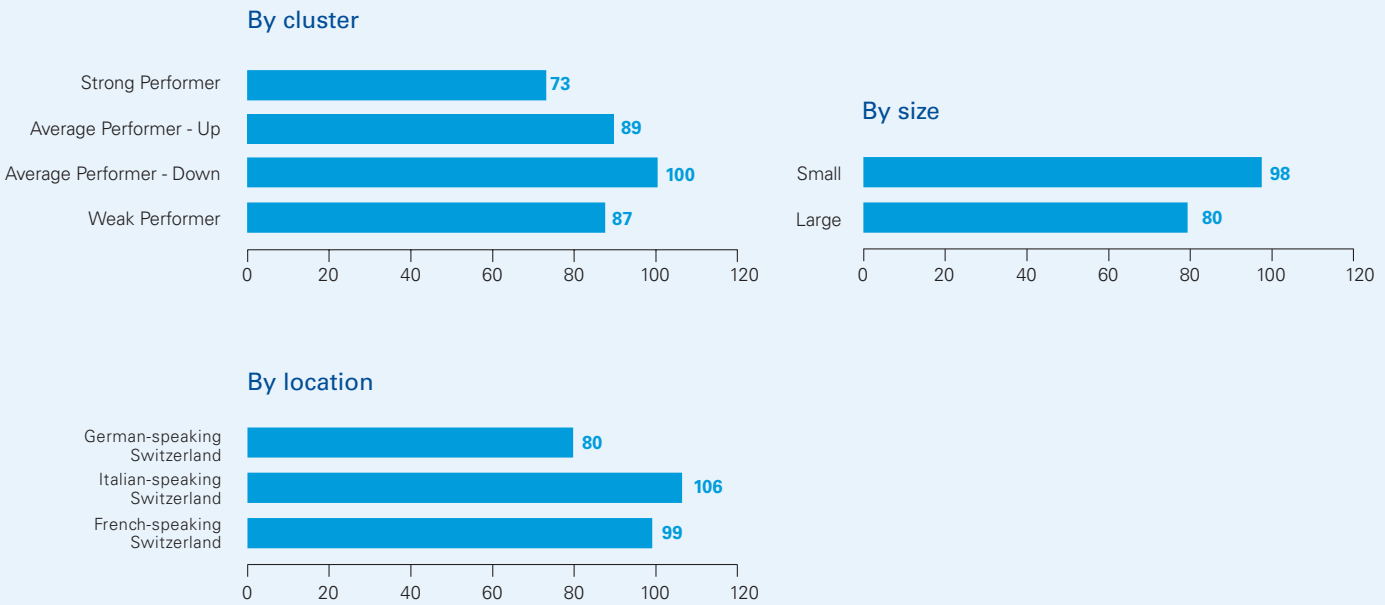
Net revenue margins fell at 68% of banks in 2015, caused principally by negative interest rates and continuing pressure on commissions. Median revenue per FTE meanwhile declined by 2.6% due to the decrease in AuM, a greater number of FTEs and the SNB's introduction of negative interest rates. This last move alone led banks in our sample to incur cumulative negative interest payments of CHF247 million.



2015 KEY FINDINGS

- Sixty-eight percent of banks saw net revenue margins decline – by more than 10bps at almost one-quarter of banks. The median net revenue margin remained stable at 94bps¹, however.
- The fall was mainly due to ongoing pressures on commission margins and the introduction of negative interest rates.
- These negative interest rates saw banks pay a total of CHF247 million in negative interest, equating to around CHF10,000 per FTE.
- Strong Performers suffered the largest fall in net revenue margins (-22bps since 2010) and generated lower margins than other clusters.
- Median revenue per FTE fell by 2.6% to CHF408,085¹ due to a lower CHF-denominated AuM base, a higher number of FTEs and the impact of negative interest rates.
- With net revenue per FTE higher than other clusters and continuing to grow (+CHF112,584 since 2010), Strong Performers have widened their lead over Weak Performers by 69% since 2010.

Net revenue margin 2015



Stable median net revenue margin masks a fall at 68% of banks

Median net revenue margins¹ in 2015 remained relatively stable at 94bps. The median masks the fact that net revenue margin actually fell at 59 banks (or 68%). For 40 banks (46%), the decline was more than 5bps and at 21 banks (24%) it was in excess of 10bps.

Changes in accounting standards resulted in value adjustments for default risks and losses from interest operations (mostly credit-related provisions) now being recorded as part of net interest income (they were previously posted below gross profit). This impacted median net revenue margins by 5bps (reported: 89bps vs adjusted: 94bps).

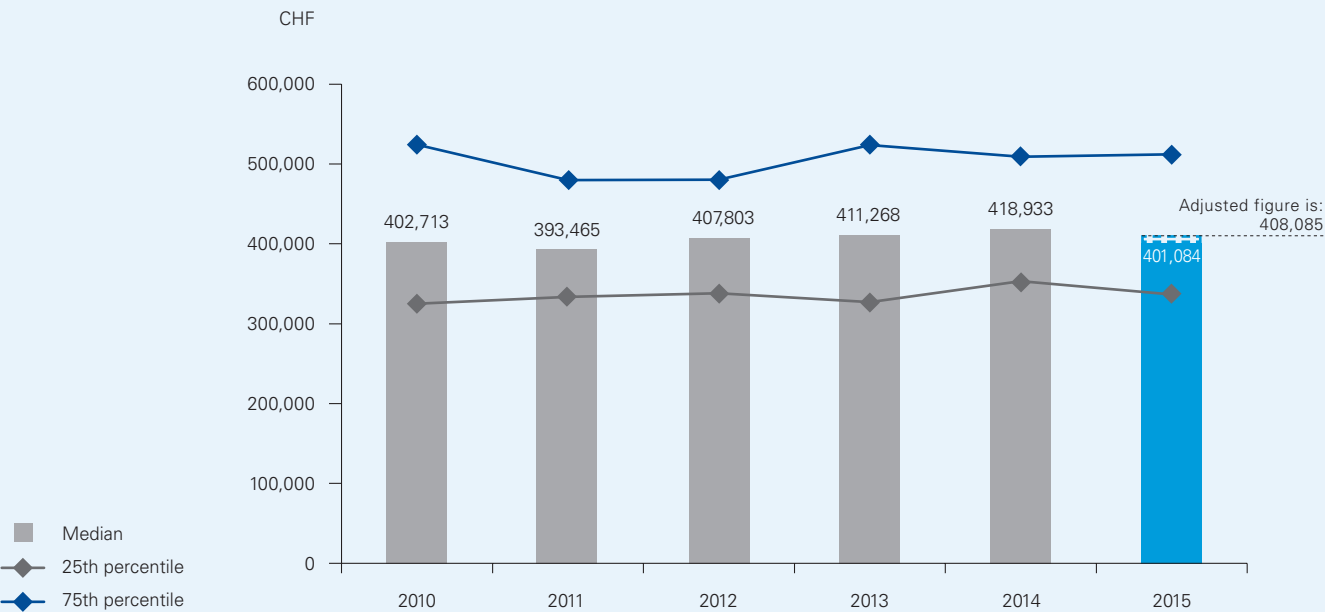
As in previous years, margins were driven lower by: ongoing pressure on commissions and fees due to increased competition; lower brokerage volumes related to difficult

financial markets and cautious investment behavior by clients holding a greater proportion of their assets in cash; and lower margins on tax-compliant client assets. In addition, the introduction of negative interest rates on sight deposits at the SNB impacted net revenue margin by 1.3bps as banks paid a total of CHF247 million in negative interest.

Banks based in German-speaking Switzerland earn the lowest median revenue margins and saw the largest fall, from 92bps in 2010 to 80bps in 2015. In French-speaking and Italian-speaking Switzerland, net revenue margins were 99bps and 106bps respectively – reflecting a slightly less abrupt fall of 9bps each since 2010. The impact from the Italian voluntary disclosure program is not yet apparent for banks in Ticino – it will be visible in 2016 as tax-compliant customers generally generate lower revenue margins.

¹ Adjusted for the impact of changes in accounting standards

Net revenues per FTE 2010 to 2015



Net revenue per FTE: Strong Performers extend their lead

Although net revenue margin has declined almost continuously since 2010 across all clusters, it is significantly lower for Strong Performers (at 74bps) than for other clusters. Strong Performers also suffered the biggest margin decrease since 2010 (-21bps compared to -15bps for Weak Performers).

Net revenue per FTE at Strong Performers is nevertheless twice that of Weak Performers. This demonstrates the ability of Strong Performers to secure greater efficiencies and economies of scale. The gap between Strong Performers and Weak Performers has grown by 69% since 2010. Strong Performers were able to lower their FTE to AuM ratio over the period by growing AuM while increasing their employee base. By contrast, net revenue per FTE at Weak Performers fell despite headcount reductions.

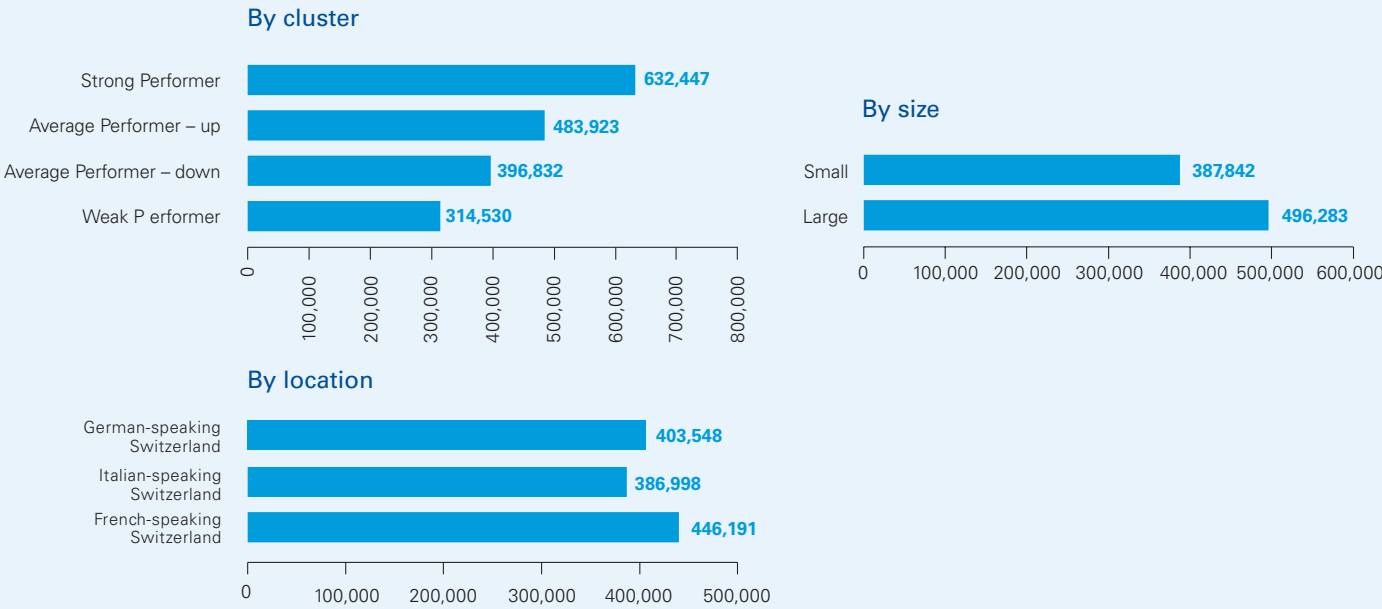
A return to 2012: net revenue per FTE falls back

At around CHF408,000¹, net revenue per FTE fell back to 2012 levels after increases in 2013 and 2014. The change in accounting standards impacted median net revenue per FTE by CHF7,001 (reported: CHF401,084 vs adjusted: CHF408,085). Two-thirds of banks reported a fall in net revenue per FTE, with a 2.6% median decrease in 2015 being due primarily to a lower CHF-denominated AuM base, more FTEs and the negative interest rates. The impact of these factors on the median was partially offset by the 10 banks dropping out of our sample as they recorded below average net revenue per FTE of CHF350,852 in 2014.

The gap between small and large banks continued to widen in 2015. At small banks, net revenue per FTE fell by 4.7% to CHF387,842 while at large banks it rose by 3.2% to CHF496,283. Although small banks benefit from significantly higher (though declining) net revenue margins (98bps compared to 80bps for large banks), their lack of scale effects (26 FTEs manage CHF1 billion of AuM compared to 17 FTEs at large banks) is the key driver of this lower margin.

¹ Adjusted for the impact of changes in accounting standards

Net revenues per FTE 2015



M&A: positive impact on net revenue per FTE for acquirers

Banks that made significant acquisitions (representing at least 10% of their AuM) between 2010 and 2014 saw their net revenue per FTE rise by a median 6.9% in the two years following the acquisition (or one year for acquisitions in 2014). This demonstrates the efficiency gains achieved by increasing the size of the bank.

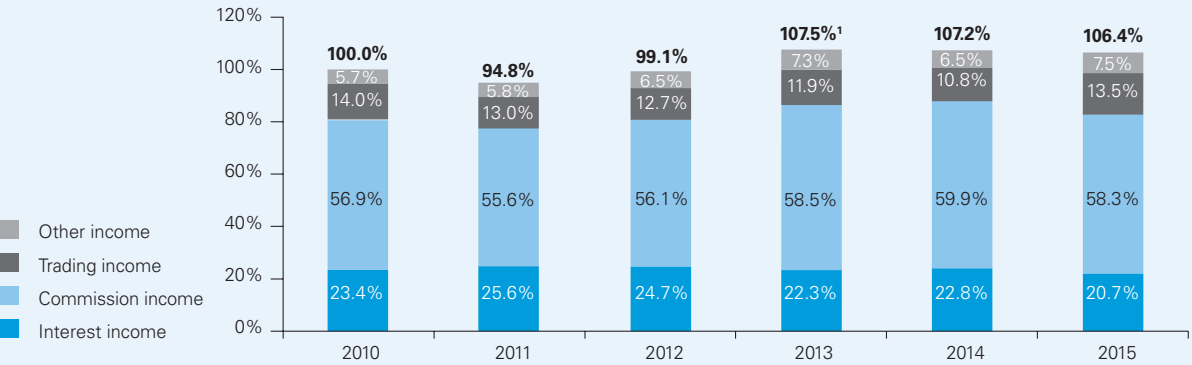
Slight shift in favor of trading and other income

Commission and interest income as a share of total revenues decreased slightly in 2015 from 82.8% to 79.0% while trading

and other income rose proportionately. The increase in trading income was driven by higher client-related foreign exchange transaction volumes due to market volatility.

Small banks generate a larger proportion of their revenue from commission income (65.4% vs 57.2% at large banks) while interest income represents a higher proportion of large banks' revenues (21.4% vs 16.1% at small banks). Large banks have more possibilities to increase revenue through the active management of their much larger balance sheets.

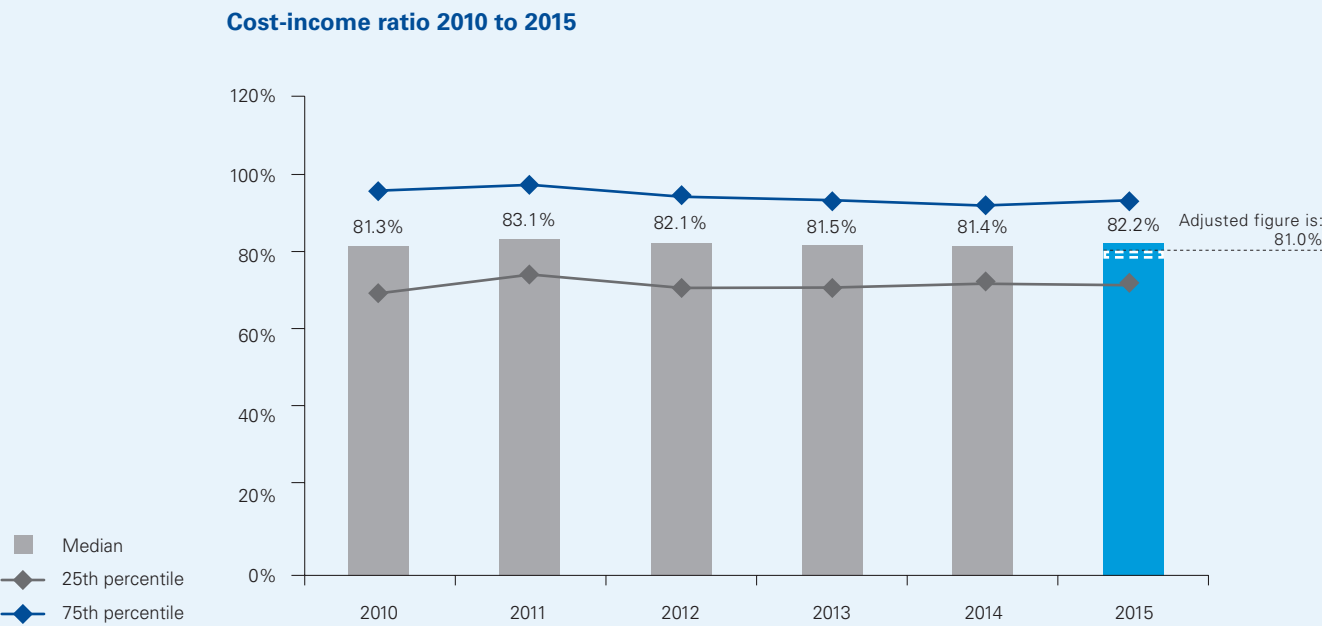
Net revenue development 2010 to 2015 (base: net revenue 2010, constant sample)



¹ 2013 increase mainly due to specific M&A transactions

Cost development

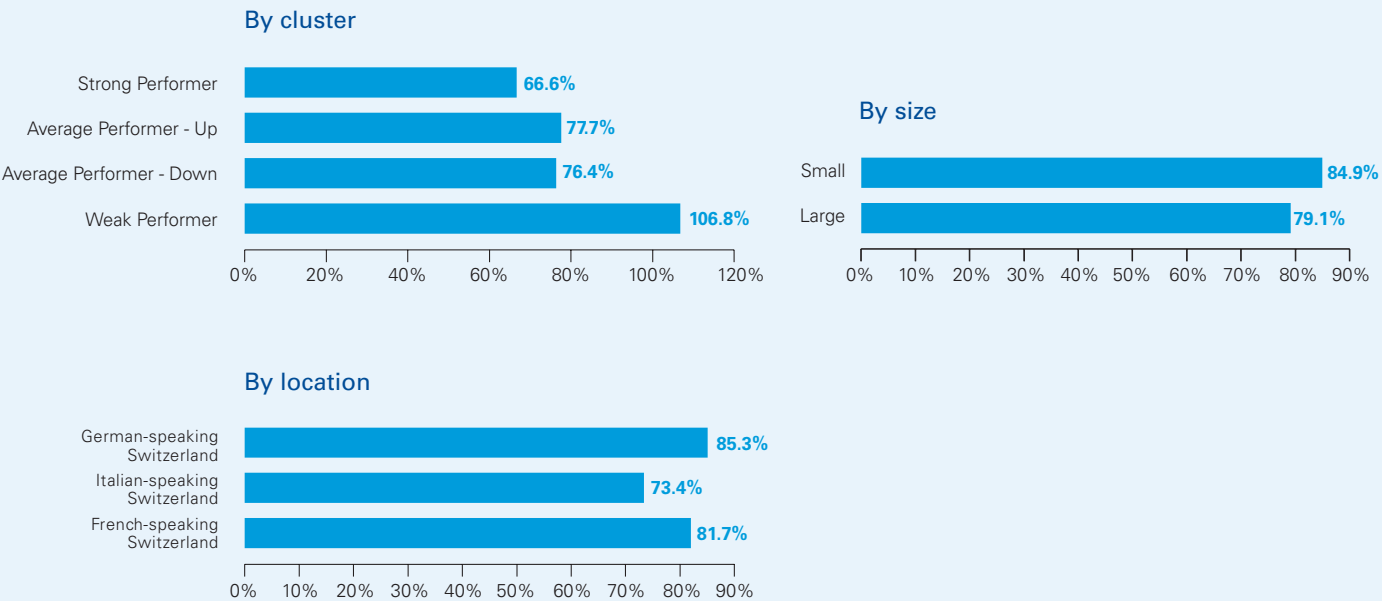
Cost-income ratios at two-thirds of banks climbed as the industry proved unable to reduce its cost base amid falling revenues. Weak Performers saw their cost-income ratios rise by almost 10 percentage points. The fall in the total number of FTEs was largely due to acquisitions and liquidations. Unless banks get a handle on employee numbers and personnel costs per head, the cost-income ratio is likely to deteriorate further.



2015 KEY FINDINGS

- Declining revenues were largely responsible for the median cost-income ratio rising by 1.3 percentage points in 2015 on a constant sample basis. An increase was seen at two-thirds of banks.
- Weak Performers were the most affected, with the median cost-income ratio rising by 9.5 percentage points in 2015 due to higher total operating costs and lower revenues.
- Strong Performers have meanwhile improved their cost-income ratio over the past five years by 7.8 percentage points, widening the gap vis-à-vis other clusters.
- An average of 23 FTEs is employed to serve CHF1 billion of AuM. This ranges from 15 FTEs at Strong Performers to 27 FTEs at Weak Performers.
- The total number of FTEs in our sample fell by 7.3% to 24,949, though this was driven by 2,200 FTEs at banks taken over or liquidated in 2015. The median number of FTEs per bank grew slightly and average personnel expenses stayed the same.
- Seventeen percent of banks have seen an increase in costs and a decrease in revenues since 2010. Only 9% of banks managed to increase revenues and reduce costs at the same time.

Cost-income ratio 2015



Weaker revenues drive cost-income ratios higher

Fifty-four banks (or 62%) reported an increase in cost-income ratio in 2015. For 27 banks (31%), the rise was higher than five percentage points and for 15 banks (17%) it was higher than 10 percentage points. Twenty percent of banks have seen a continuous increase in cost-income ratio over the last three years.

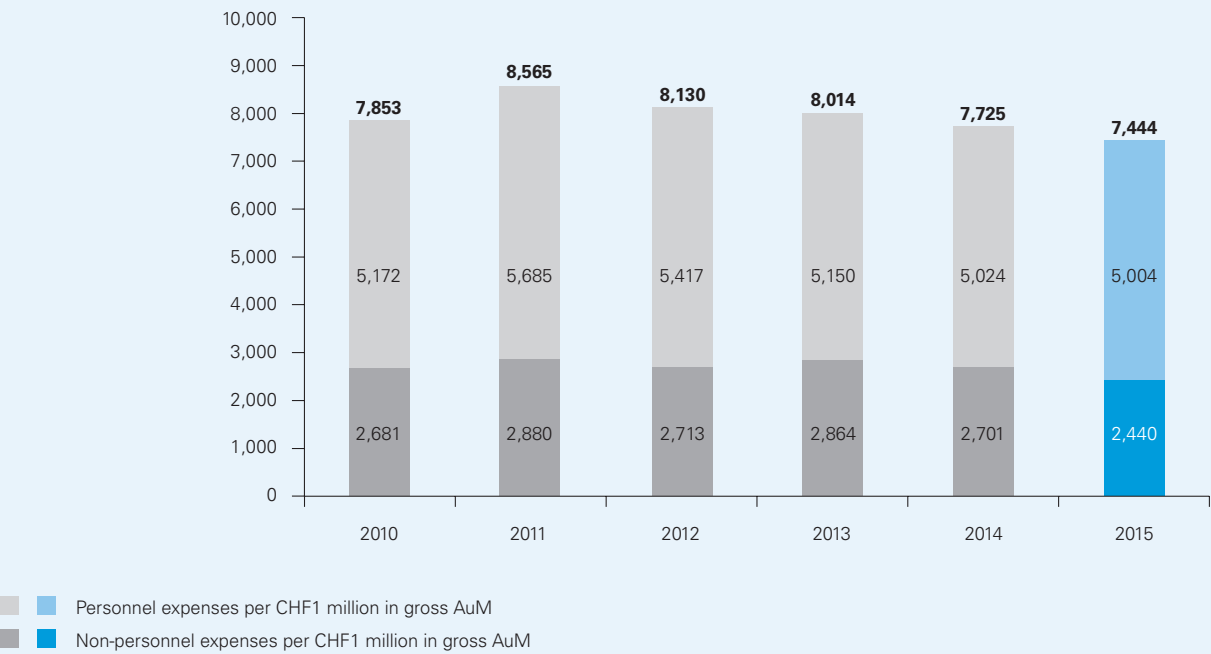
The median cost-income ratio¹ fell in 2015 by 0.4 percentage points to 81.0%. This was, however, mainly due to the 10 banks that dropped out of our sample this year, as they reported a high median cost-income ratio of 96.7% in 2014. Excluding the impact of these 10 banks, the cost-income ratio rose in 2015 by 1.3 percentage points. An overall decline in revenues is chiefly to blame. Although 18 banks (or 21%) were able to reduce their total operating expenses by more than 5%, net revenues at 46% of banks fell by more than 5%. All clusters except Average Performers – Up reported an increase in cost-income ratio in 2015. Even Strong Performers struggled to improve their ratio, reporting an increase of three percentage points.

Since 2010, Weak Performers reported an increase of 10.8 percentage points (nearly all of which happened in 2015). Strong Performers meanwhile reported an improvement of 7.8 percentage points driven by an increase in scale (+26% median increase in AuM since 2010) and improved productivity, as illustrated by fewer FTEs per CHF1 billion of AuM (-21%) and higher revenues per FTE (+22%).

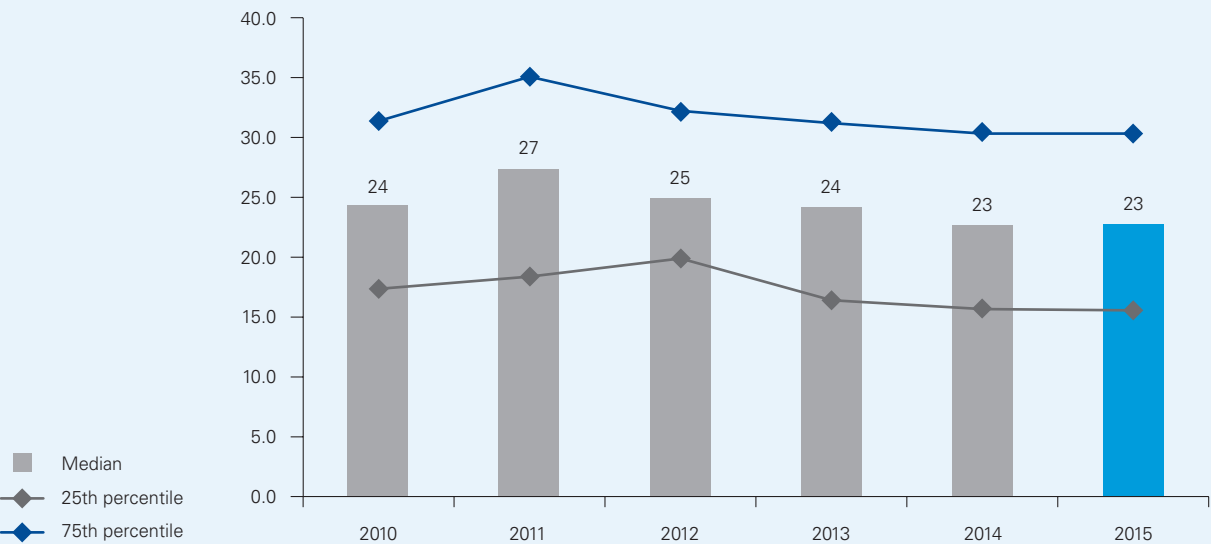
Changes in accounting standards also played their part, impacting cost-income ratios by 1.2 percentage points (reported 82.2% versus adjusted 81.0%). This is due to value adjustments for default risks and losses from interest operations (mostly credit-related provisions) now forming part of net interest income (they were previously posted below gross profit).

¹ Adjusted for the impact of changes in accounting standards

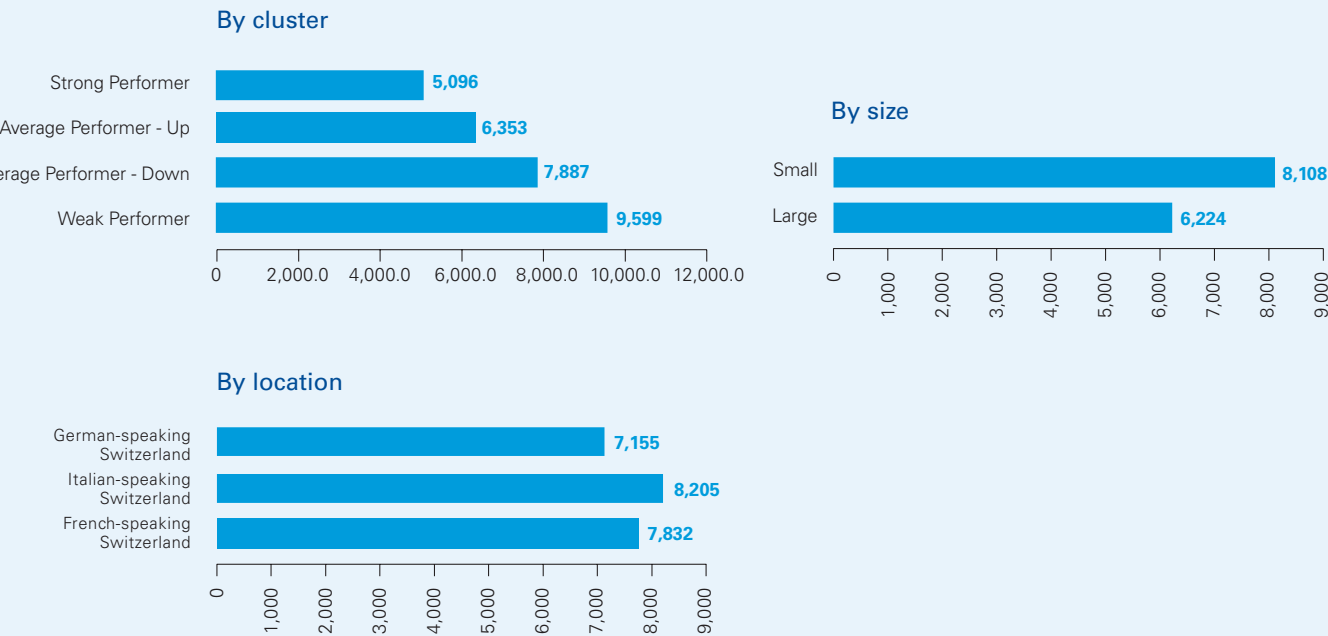
Total operating costs per CHF1 million in AuM 2010 to 2015



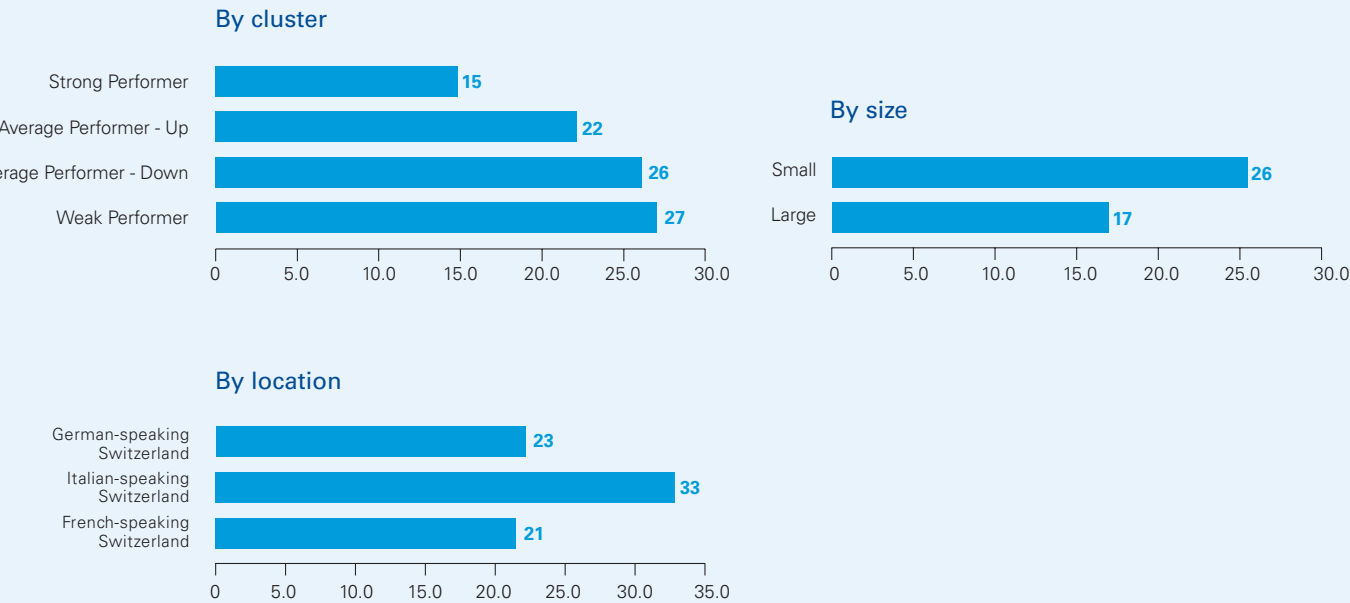
Number of FTEs to serve CHF1 billion in AuM 2010 to 2015



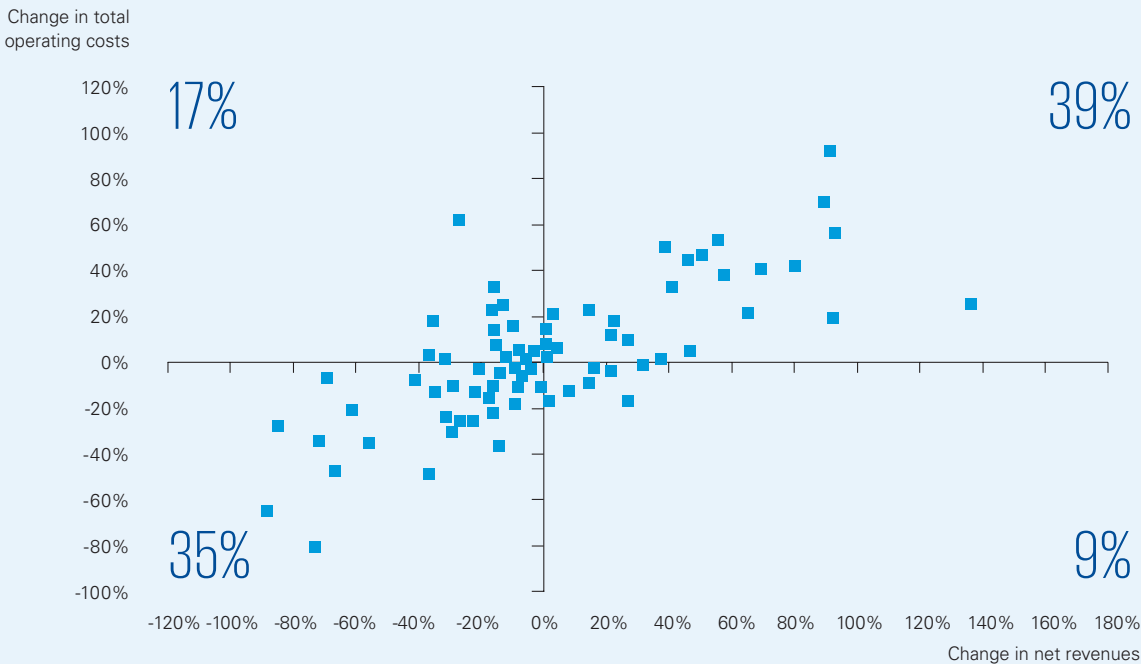
Total operating costs per CHF1 million in AuM 2015



Number of FTEs to serve CHF1 billion in AuM 2015



Evolution of revenues and costs 2010 to 2015



Category 2 banks finally see conclusion of US Tax Program

2015 and early 2016 saw all Category 2 banks sign non-prosecution agreements with the US authorities, effectively ending uncertainties around the impact of the US Tax Program. Thirty-eight banks in our sample¹ paid penalties totaling CHF931 million. This represents an average of 3.4% of the maximum US AuM held during the relevant period. Banks continued to incur professional fees as part of the negotiations with the US authorities in 2015, contributing to the pressure on cost-income ratio.

Falling operating costs per AuM put greater distance between Average Performers – Up and Weak Performers

Average Performers – Up saw the biggest fall in operating costs per average AuM in 2015 (-15.3%). Two-thirds managed to reduce non-personnel expenses. In addition, the increase in their FTEs over the last two years (5.1%) was more than offset by the median increase in average AuM (6.1%). Generally better economies of scale and more efficient operational setups mean that this cluster requires 19% fewer FTEs to

manage CHF1 billion of AuM compared to Weak Performers. The difference is even larger at Strong Performers, which need 44% fewer employees than Weak Performers.

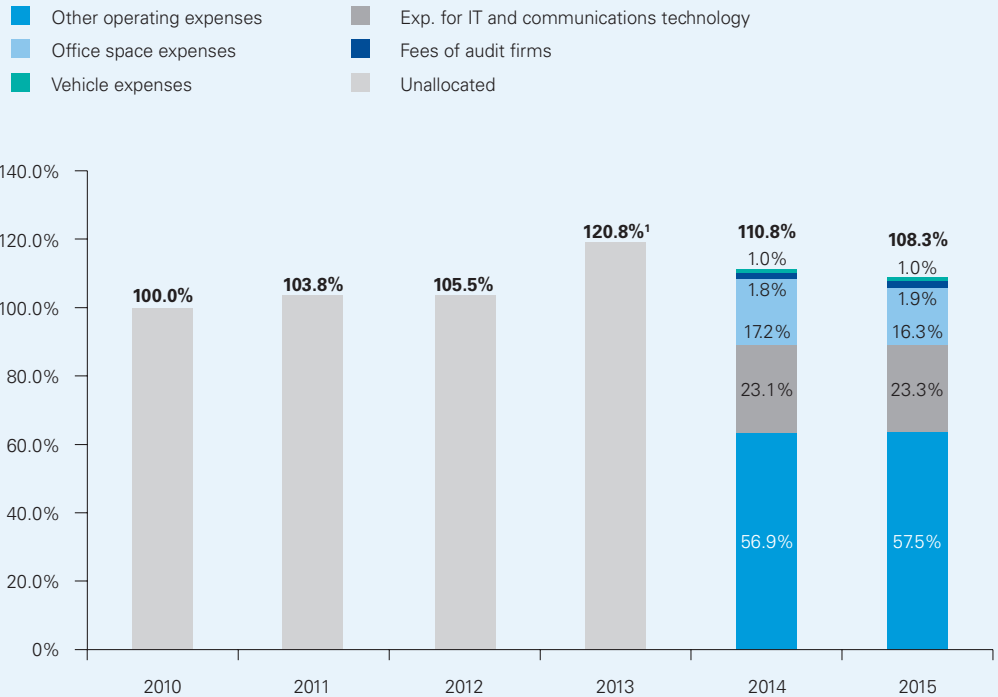
Fewer than one in ten banks increased revenues while managing down costs

Compared with 2010, 35% of banks shrank in terms of both revenues and costs. A further 39% of banks reported an increase in both revenues and costs over the period. Only 9% of banks (all Average Performers – Up) managed to grow revenues while reducing costs. Finally, 17% of banks (71% of Weak Performers and Average Performers – Down) suffered a decline in revenues and increase in costs over that period.

Overall non-personnel cost composition remain stable

Around 23% of non-personnel costs relates to IT and communication technology, and a further 16% to office space. Median office space expenses amount to CHF18,000 per employee per annum.

Non-personnel costs development 2010 to 2015
(base: net non-personnel costs 2010, constant sample)



M&A generates cost synergies and drives down the number of FTEs

While there was a median increase of 1.1% in FTEs across the bank, the total number of FTEs in our sample fell by 1,956 (-7.3%) to 24,949. This was mainly due to 2,200 employees who were employed by the 10 banks in our sample that were taken over as part of an M&A transaction or were liquidated in 2015. This demonstrates how acquisitions can drive scale and lead to synergies. In fact, significant acquisitions (representing at least 10% of the acquirer's AuM) enabled banks to reduce their cost-income ratios by an average of 1.9 percentage points in the two years following the acquisition.

One of the main challenges still facing banks is how to reduce the number of employees and personnel expenses by employee. Twenty-three banks (26%) increased their number of FTEs by more than 5% during 2015 while only 12 banks (14%) cut their FTE base by more than 5%. Overall, personnel costs per employee remained stable over the past three years at around CHF220,000. Personnel expenses at Weak Performers have fallen the last five years by 2.0% to CHF207,678 while rising at Strong Performers by 9.0% to CHF285,762 in 2015.

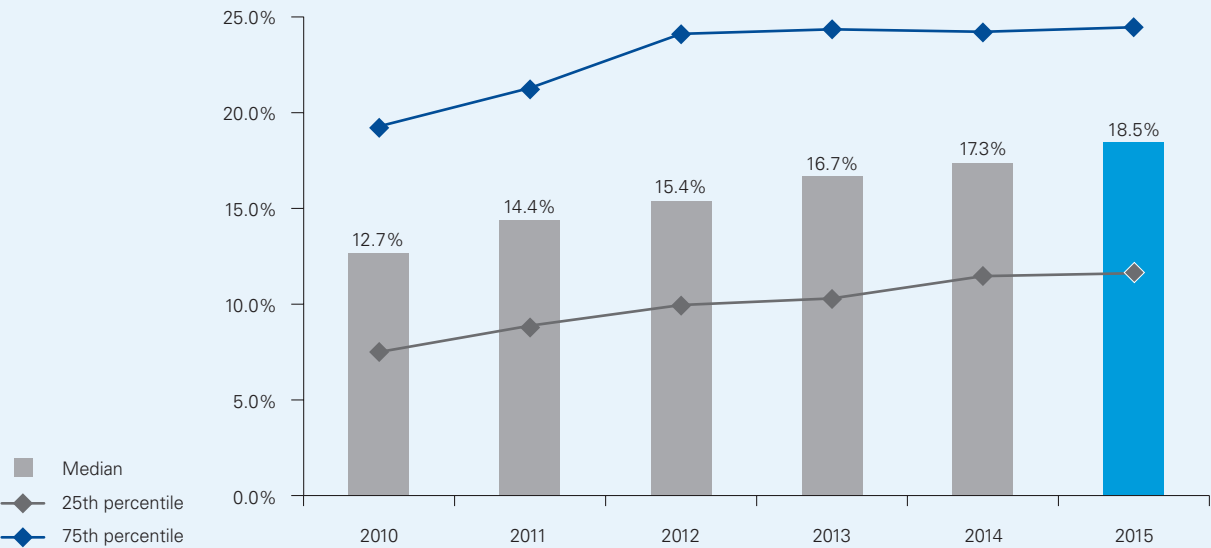
¹ Including eight banks that dropped out from our sample in 2015

¹ 2013 increase mainly due to specific M&A transactions

Balance sheet and regulatory ratios

Cautious clients have led to a higher proportion of AuM being held in cash, resulting in lower earnings potential for banks. Following the SNB’s introduction of negative interest rates, several banks have reduced the liquidity held in sight deposits at the SNB.

Customer deposits¹ as a percentage of net AuM 2010 to 2015

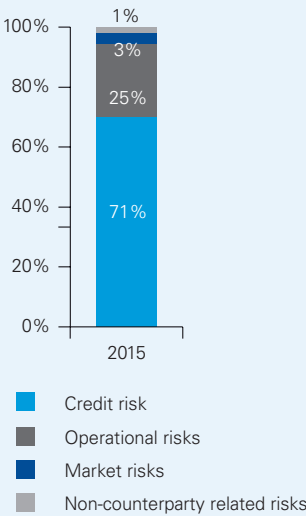


2015 KEY FINDINGS

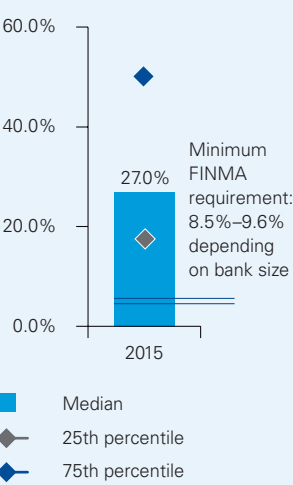
- Clients are holding a greater proportion of their portfolios in cash than at any time in the past 10 years, causing a reduction in banks’ earnings potential.
- Liquidity withdrawals from the SNB have been observed following its introduction of negative interest rates. Reported liquid assets as a percentage of total balance sheet values fell by three percentage points.
- Most banks have maintained comfortable regulatory ratios with regard to minimum capital requirements.

¹ The 2015 ratio was not adjusted for the change in accounting standards on the classification of liabilities from securities financing transactions as the impact is only marginal.

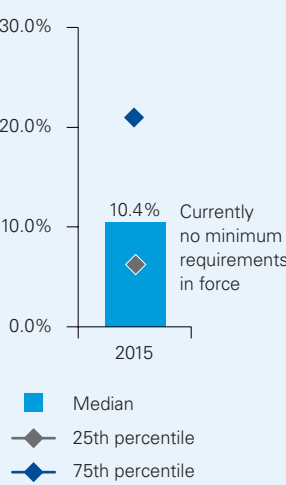
Risk-weighted assets composition



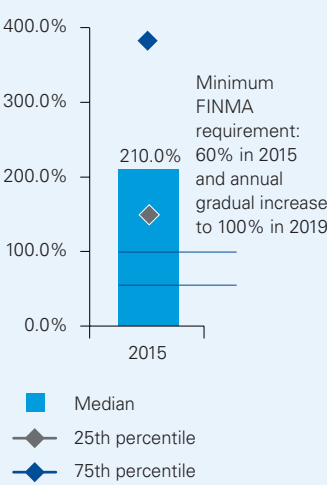
Tier 1 capital ratio



Leverage ratio



Liquidity coverage ratio



Ten-year high in the proportion of AuM held in cash

Client deposits rose from 12.7% of AuM in 2010 to 18.5% in 2015. This takes cash holdings to the highest proportion of AuM seen in the past 10 years. The trend was generally higher at Average Performers – Down than at Strong Performers (20.1% vs 11.6% respectively) and at banks in Ticino than in German-speaking Switzerland (20.3% vs 15.4%).

Clients’ ongoing risk aversion explains this trend. With more cash being held in bank accounts rather than invested in other asset classes, banks’ earnings potential has been reduced. On the other hand, the median loans-to-deposits ratio actually rose to 42% compared to 37% in 2014. This increase in loan take-up by clients may be driven by some client segments taking advantage of the low interest environment.

Liquidity shifts follow the SNB’s move

Reported liquid assets (which can be used as a proxy for sight deposits at the SNB) as a percentage of total balance sheet values fell from 20% in 2014 to 17% in 2015. This indicates a shift of cash towards other counterparties, mostly other banks, and is part of the measures taken by many banks to avoid paying negative interest on their deposits with the SNB.

Only a small minority of banks in our sample introduced interest charges on customer deposits, with such charges being mainly for financial institutions, institutional investors and high net worth individuals. The question might be raised

as to whether introducing charges on other clients’ accounts might make clients reconsider holding such a large proportion of their wealth in cash.

Most banks maintain comfortable regulatory ratios

At a large majority of banks, regulatory capital, leverage and liquidity coverage ratios do not appear to be a major concern as the median ratio is generally significantly greater than the minimum requirements.

Tier 1 capital ratios were generally lower at large banks (median 22.0% compared to 29.2% for small banks). Banks based in Ticino had a median tier 1 capital ratio of 26.0%, which is slightly lower than banks in French- and German-speaking Switzerland (28.2% and 26.7% respectively). Weak Performers had a significantly higher ratio (33.0%) than other clusters.

Leverage ratios were also generally lower at large banks (median 6.5% compared to 12.1% at small banks). Romandie banks saw lower leverage ratios at 10.3% than banks in Ticino (12.0%) and German-speaking Switzerland (10.8%). Weak Performers had the lowest ratio (8.7%) of any cluster.

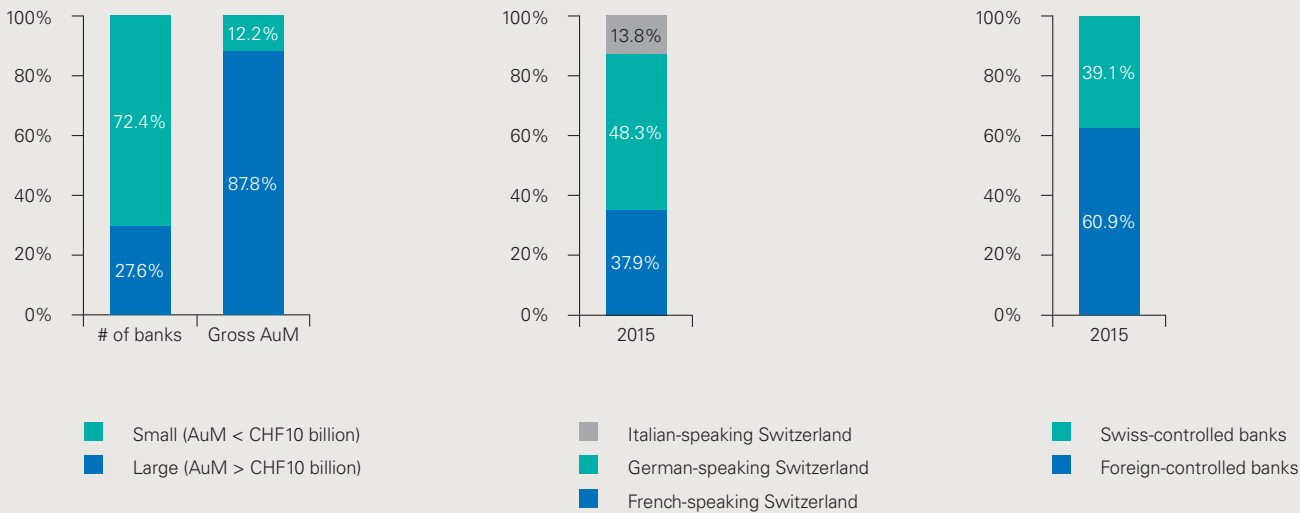
Liquidity coverage ratios were generally lower at large banks (median 180.8% compared to 225.0% at small banks). The highest ratio (223.2%) was at banks in German-speaking Switzerland compared to 178.7% and 193.8% at banks in Ticino and Romandie respectively. The highest ratio (271.5%) among the clusters was seen at Weak Performers.

Methodology and basis

The study assessed the annual reports of 87 private banks (2014: 91) with AuM totaling CHF1,449 billion and with 24,949 full time employees. Excluded from the data set are:

- Credit Suisse and UBS;
- Branch offices of foreign banks;
- “Banquiers privés” and those that changed their legal form during 2014 and published a full-year annual report only in 2015;
- Private banking units of cantonal banks and regional banks (separate private banking subsidiaries of cantonal banks are included in the sample).

The data set Sample composition

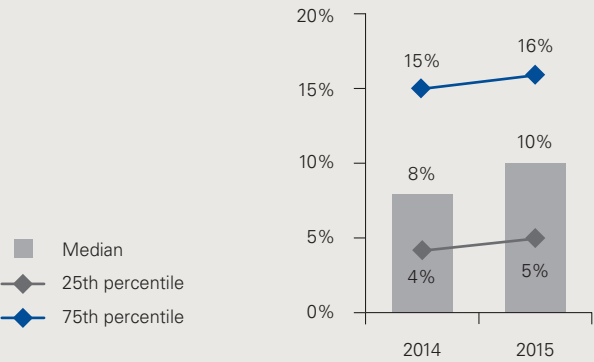


In this fragmented market, 72.4% of the 87 banks managed less than CHF10 billion in AuM in 2015. Conversely, a mere 27.6% of banks managed 87.8% of AuM.

Changes in accounting standards

Revised FINMA accounting rules for banks and securities dealers came into force in 2015 (FINMA Circular 15/01 replacing Circular 08/02). We have based our analysis for 2015 on the new accounting standards and, where relevant, have analyzed the impact of the new rules. Our analysis for 2010 to 2014 is based on the old accounting rules.

Example: percentile chart

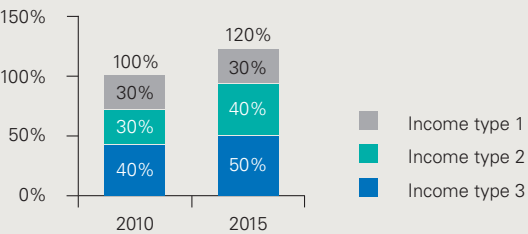


25% of banks show a value of more than 15% in 2014. 75% of banks are below 15%.

50% of banks are below 10% in 2015, 50% are over 10% (50th percentile = median).

25% of banks show a value of less than 5% in 2015. 75% of banks show a value of more than 5%.

Example: standardized development (base: 2010)



In 2015, the total of income amounted to 120% of that of 2010.

Methodology used

The study mainly uses two types of chart:

- *Percentile charts:* The evaluation is based on a percentile presentation of selected performance indicators, with equal weight given to each bank irrespective of size. The median shows the middle value of the banks analyzed. Half of the banks show either a higher or lower value.
- *Standardized charts showing developments:* Evaluation is based on the sum of the absolute figures for the constant sample of 82 banks for which financial information could be obtained for the entire period under review. This allowed bank sizes to be factored in.

Due to the differentiated consideration of size, percentile and standardized development, charts could provide contrary statements. As smaller banks tend to perform less well than larger banks, values shown in percentile charts are usually lower than those in standardized development charts.

GLOSSARY

ASP	Application Service Provider	IT	Information Technology
AuM	Assets under Management	M&A	Mergers & Acquisitions
Avg	Average	m	Million
bn	Billion	n/a	Not applicable or not available
bps	Basis points	NNM	Net New Money
BSP	Business Service Provider	OECD	Organisation for Economic Co-operation and Development
CET1	Common Equity Tier 1	RoE	Return on Equity
CHF	Swiss Francs	SNB	Swiss National Bank
FINMA	Swiss Financial Markets Authority	STP	Straight Through Processing
FTE	Full Time Equivalents	vs	versus
FX	Foreign Exchange	YTD	Year To Date

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