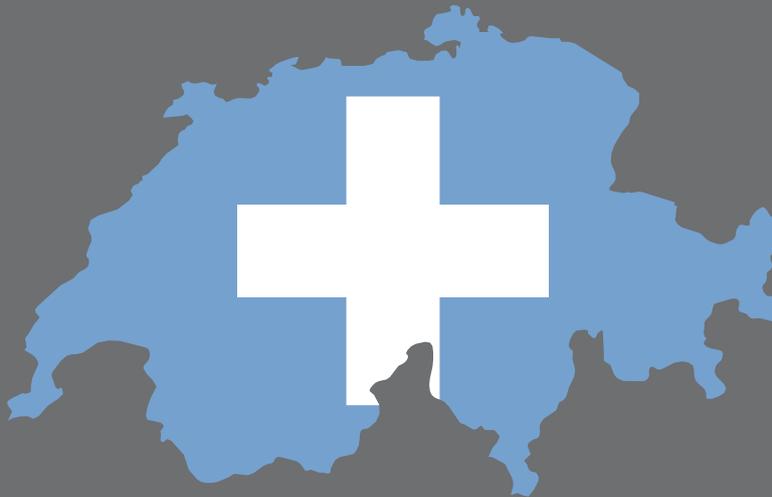




zeb private banking study

SWISS PRIVATE BANKING—A SECTOR UNDERGOING RADICAL CHANGE

2017





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PREFACE

Dear readers,

At zeb we are committed to supporting our markets and clients long term. This involves measuring the pulse of the markets and our business partners on a regular basis—which we understand as every two years. With this in mind, we are pleased to present the 2017 edition of our Private Banking Study.

The Swiss banking sector is currently in an interesting situation. On the one hand, geopolitical developments—or more specifically: geopolitical uncertainty—reveal what makes Switzerland's USP so difficult to copy: security, stability, trustworthiness and tradition. Indeed, it would take decades for other countries to act at the same level. It is no surprise that assets under management in Switzerland are growing at a higher speed than the global GDP. "White money strategy"—What was that again? Those days are long gone!

On the other hand, there is also a downside: successful asset management without profit. If at the end of the seven-year cycle of extraordinary growth, involving significant setbacks such as Brexit, Trump, North Korea, etc. without any signs of slowing down, on the whole no reasonable profits are gained, can that be considered acceptable?

The Swiss private banking sector has not yet fully adapted to the paradigm shift. Some beloved developments of the past are difficult to let go of. Other important factors are necessary investments in digitalization, potentially "expensive" inorganic growth and a more restrictive regulatory framework—and suddenly costs shoot up by 5% per annum. For this reason, our simulations show that it is time to act—that is, assuming the intention to act during friendly conditions exists. Some managers only move into top speed when under pressure, but that is not everyone's style.

Regardless of how the sector decides to go ahead—we will be here to go through the results with you again in 2019. We are glad to see that you are interested in our study and are happy to enter deeper discussions with you.

On behalf of the study team



Heinz Rubin
Partner



Axel Oliver Sarnitz
Partner

MANAGEMENT SUMMARY

INSIGHTS—GROSS AND PROFIT MARGINS CONTINUING TO FALL

The number of private banks in Switzerland has reduced by almost one-third in the last ten years from 186 banks to only 130 now. The 2017 zeb private banking study shows that the AuM in the Swiss private banking market grew by approximately 3.2% in the past five years despite consolidation, while—as our assessed bank sample reinforces—a small number of individual institutions benefited through disproportionate AuM growth. However, this growth is based on M&A to a large extent—pure sales performance of the institutions can be regarded as deficient.

The profitability of private banks remains heavily under pressure—the gross margin in the Swiss private banking market has now fallen to approximately 82 bps. Despite increasing AuM, hardly any economies of scale were able to be achieved, which resulted in a basis of costs that grew proportionally. All in all, our assessed bank sample revealed an average profit margin of only approximately 20 bps—this is a critical value in zeb's perspective!

OUTLOOK—“BUSINESS AS USUAL” IS NOT AN OPTION

The results of our forward-looking scenario simulation reinforce the fact that the three-fold combination of falling gross margins, constantly growing AuM and costs increasing proportionally will lead to a further deterioration of the profit situation in the near future. This applies for Swiss banks operating globally, selectively and locally. For all of these institution types, there is thus significant time pressure to counteract further erosion of the gross margins.

STRATEGY—BACKING EFFECTIVE LEVERS

To face the named challenges, zeb sees effective approaches on both the revenue and cost sides. Heavily focused business models, simple operating models with high levels of standardization and a high level of digitalization will be essential success factors. However, there is not one single, optimal solution for prioritizing measures—depending on the current and desired positioning and existing strengths and weaknesses, the measures to be introduced need to be defined for each institution individually.

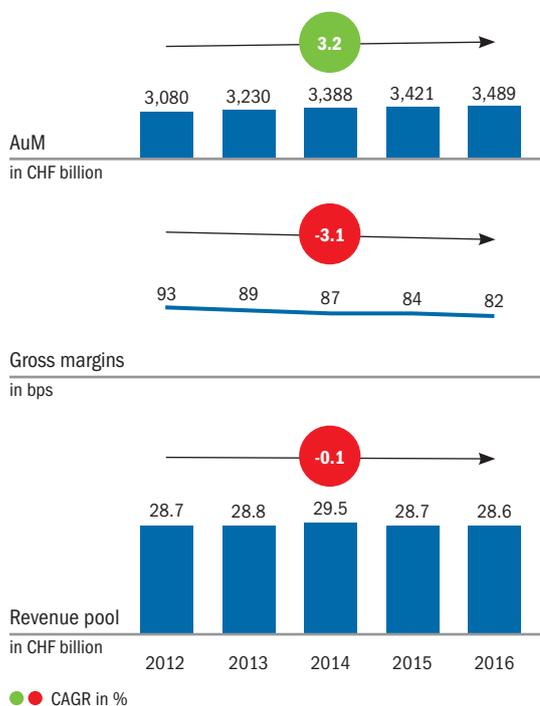
1 LOOK BACK: MARKET AND SAMPLE ANALYSIS

1.1 DEVELOPMENT OF THE OVERALL MARKET (2012–2016)

Already back in our last study from 2015, the Swiss private banking sector was in a challenging market environment: the ongoing low interest rate phase, increasing regulatory requirements, the decoupling of the Swiss franc from the euro and numerous bilateral tax agreements complicated business for private banks in Switzerland as a financial center. Still, banks were able to show considerable growth to their revenue pool at that stage. This growth was however supported by the positive development of assets under management in line with the friendly capital market environment, as gross margins in Swiss private banking had noticeably diminished.

Since then, neither the core challenges, nor the private banking market have essentially changed in Switzerland. Decisive changes such as the implementation of FiDLEG are still pending and will churn up the market again. Also in the last two years, the capital markets have developed positively, which continued to significantly contribute to a positive development of AuM in Swiss private banking. In the five-year period from 2012–2016, AuM grew from CHF 3,080 bn to approximately CHF 3,500 bn. During the same period, the gross margins fell from 93 to 82 bps. The combination of these effects led to a nearly constant revenue pool of CHF 28.6 bn in 2016, although after increasing until 2014, this has fallen for the last two years (see figure 1).

Overall market



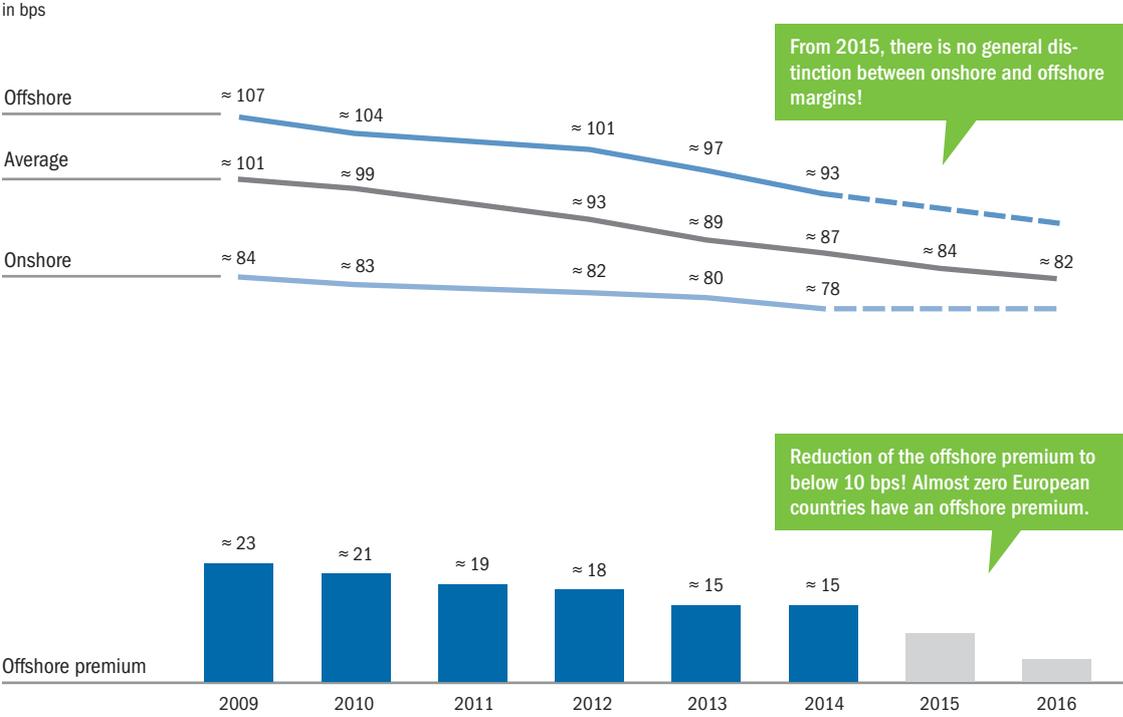
Source: zeb.research

Figure 1: Overview of total market development 2012–2016

Upon closer inspection of the gross margin, one can see that its decline in recent years can be attributed to both the general pressure on the Swiss private banking market and also—significantly—to the erosion of the offshore premium (see figure 2). This premium, that foreign investors historically paid for the ability to invest in the

“safe haven” of Switzerland has significantly fallen due to changed legal conditions (“white money strategy”, automated information transfer) as well as increased price transparency as part of digitalization. Today, offshore customers of Swiss private banks are hardly willing to pay a margin premium.

Gross margins and offshore premium



Source: zeb.research and expert estimates

Figure 2: Gross margins (on/offshore) and offshore premium between 2009 and 2016

1.2 DEVELOPMENT OF THE BANK SAMPLE

In order to be able to conduct detailed analyses, we created a bank sample consisting of 24 private banks. This included CHF 1.45 trillion of assets under management and thus represented approximately 40% of the Swiss private banking market. In comparison to the total market, the bank sample developed on average more positively, which is at least partially due to our sample banks benefiting from consolidation on the market.

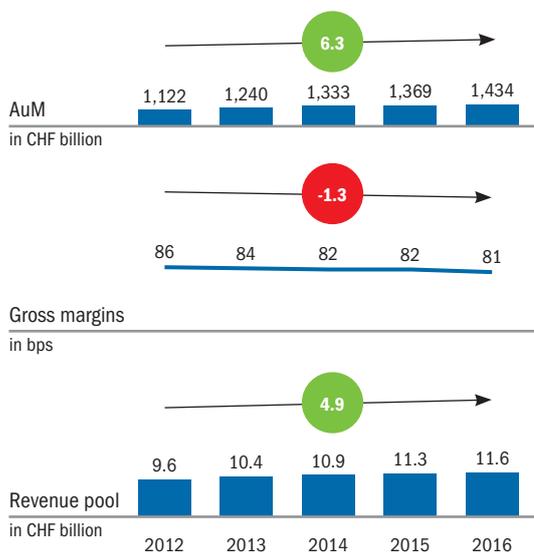
The AuM of our bank sample grew in the past five years by 6.3% per annum, which is twice the growth of the overall Swiss market. Just as the total market, our bank sample was affected by falling gross margins, however, the scope (1.3% p.a.) was much below that of the total market (approx. 3.1% p.a.). Nevertheless, in the year 2016, the absolute gross margins of the sample and the

total market were at an almost identical level (82 bps for the total market vs. 81 bps for the bank sample). In contrast to the total market, the consolidation of the AuM and gross margin effect led to a much higher revenue pool for the bank sample (4.9% p.a.), which can be traced back to the M&A activities of our bank sample (see figure 3).

1.2.1 DEVELOPMENT OF THE VOLUME (AUM)

As already mentioned, in our bank sample between 2012 and 2016, there was considerable growth of the AuM (from CHF 1,122 bn to 1,434 bn). Upon closer inspection, however, only about one-third (32%) of this growth can be traced back to net new money (and thus the sales performance of banks in a narrower sense). A further 43% of the AuM growth is from the M&A activities of some banks, while the rest can be traced back to the performance of some existing assets (see figure 4).

Sample



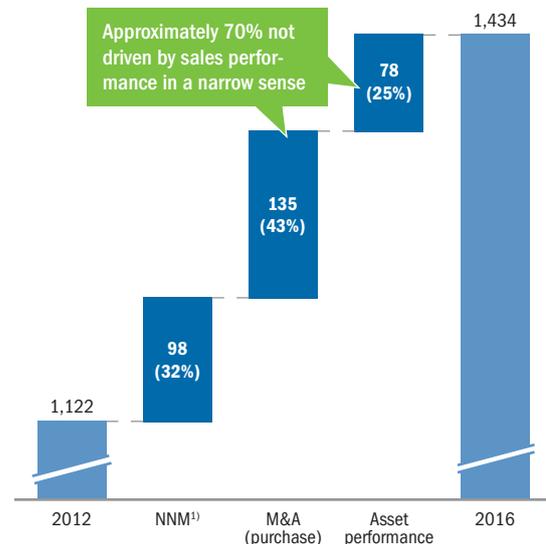
● ● CAGR in %

Source: Own calculation based on sample/business reports from banks (n = 24)

Figure 3: Development of the bank sample 2012-2016

Volume development of AuM

in CHF billion



¹⁾ NNM = net new money, incl. outflows of funds.

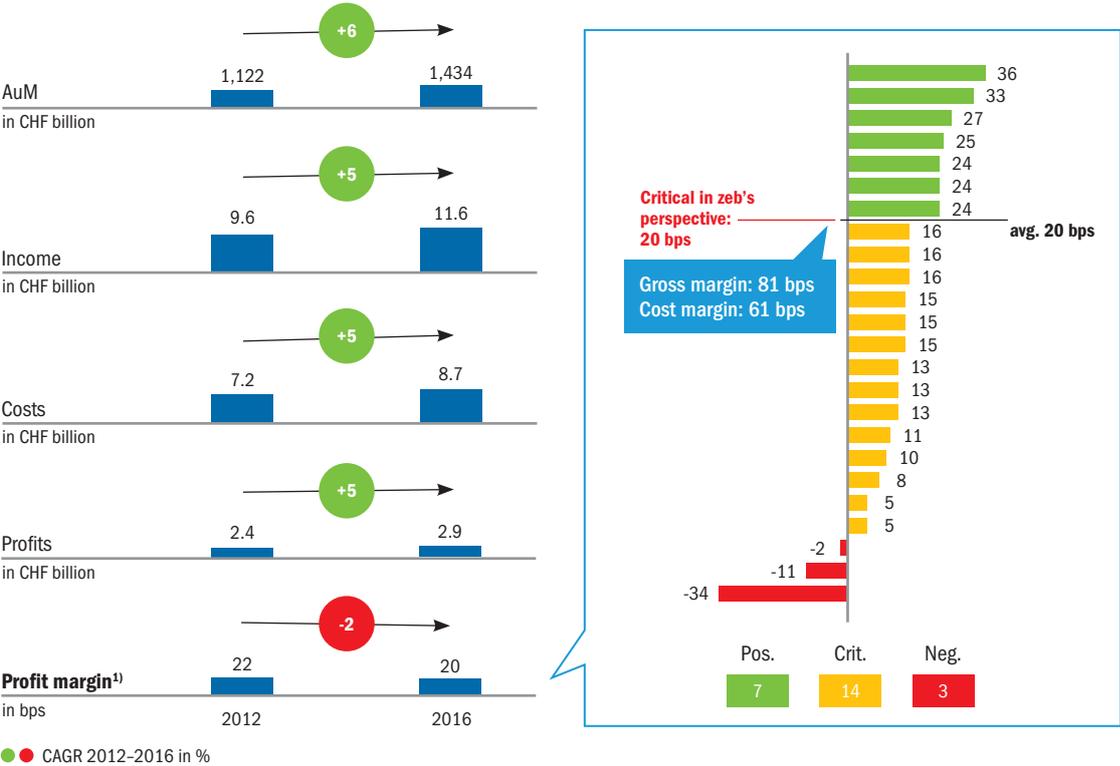
Source: zeb.research

Figure 4: Composition of AuM growth in bank sample 2012-2016

If you view the AuM growth of the year 2016 in isolation, then it becomes clear that the growth of AuM is only to a much lower proportion due to net new money (approx. 25%), which in turn means that the sales performance of our sample banks has significant room for improvement. The strong asset performance—especially at the end of last year—can be partially attributed to the US elections and the subsequent “Trump effect”, which however should be seen to have a short duration.

1.2.2 REVENUE DEVELOPMENT

The revenues of 24 banks from our sample grew by approximately 6% p.a. between 2012 and 2016. The growth of absolute costs was comparably high, which in total led to a growth in profit of 5% p.a. However, the profit margin (gross profit in relation to AuM) sank by approx. 3% p.a. and for 2016 was at 20 bps as the average of our bank sample—this value is critical for private banks’ chances of surviving from zeb’s perspective. Already today, 17 institutions are below this critical limit (three of those even have a negative profit margin), while seven institutions are above it. Having said that, none of the institutions can be considered as having a truly comfortable profit situation (see figure 5).



¹⁾ Profit margin: Gross profits/AuM. In the total sample of all 24 institutions, the profit margin (total gross profit/total AuM) is 20 bps. However, the average of the individual profit margins of all 24 institutions is 13 bps (through “overweighting” lower profit margins especially for locally operating institutions).

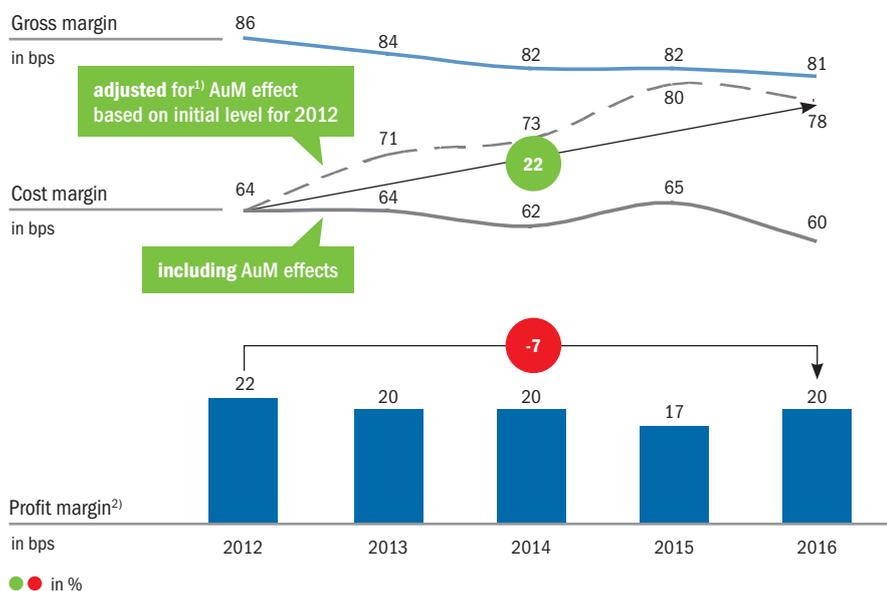
Source: zeb.research

Figure 5: Overview of 2012-2016 results from the bank sample and 2016 profit margins per institution

The average profit margin of the institutions fell from 2012 to 2015 from 22 bps to 17 bps. In 2016, this trend reversed and the profit margin increased to the critical level of 20 bps on average. As already explained, the average gross margin constantly fell from 2012 to 2016. An initial observation of the cost margin indicates that the cost situation of banks improved between 2012 and 2016 (from 64 to 60 bps). A closer assessment however reveals that this is only due to a major increase of AuM. The cost margin adjusted for AuM effects (i.e. the costs of one year in relation to the AuM of the year 2012) increased significantly between 2012–2016 from 64 to 78 bps (22%), while it must be mentioned that the adjusted cost margin fell again in 2016 for the first time. This explains the positive development to the result margin of the year 2016 (see figure 6).

1.2.3 QUANTITATIVE ANALYSIS BY MARKET DEPTH OF THE BUSINESS MODEL

For a further quantitative analysis of the status quo of the bank sample, we divided the institutions into three groups based on the market depth of their business model: banks operating globally, selectively and locally. The first group has multiple branches on different continents, while selectively operating institutions limit themselves to the Swiss market and a few additional, individual branches in foreign markets. The third group only operates at a local level with its corresponding cross-border approach. By following this definition, eight institutions of our sample belong to the group of globally operating banks, nine institutions belong to the group of selectively operating banks and seven belong to the group of locally operating banks.



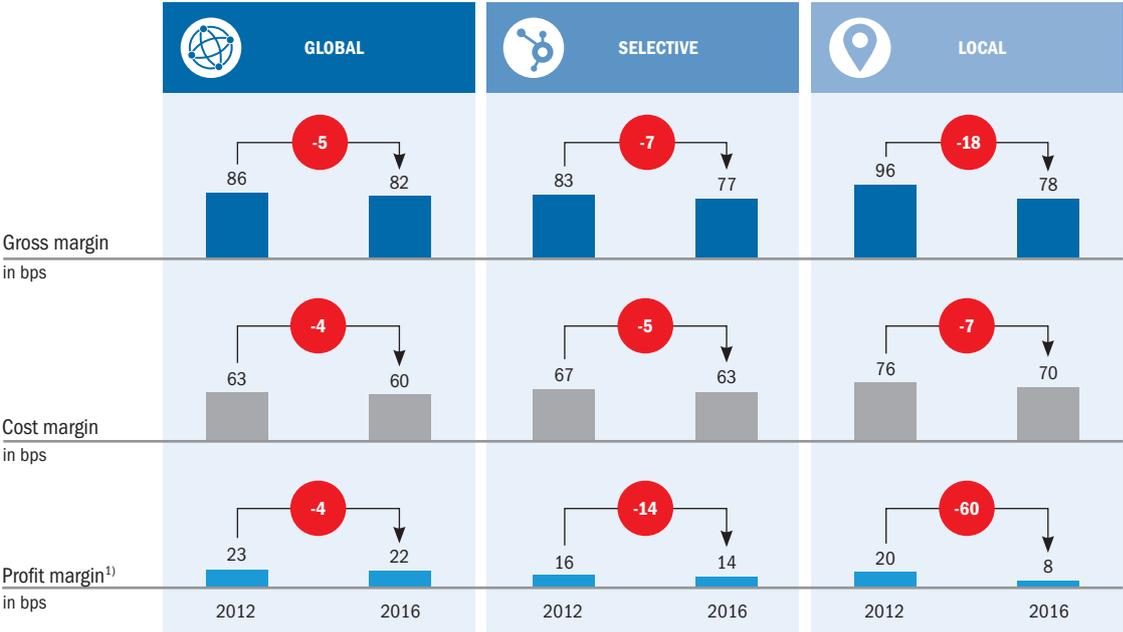
¹⁾ Adjusted = margin calculated on constant 2012 AuM basis.
²⁾ Profit margin = gross profit/AuM.

Figure 6: Development of profit margin of the bank sample 2012–2016

Figure 7 shows a decrease of the profit side in all groups from 2012 to 2016. While this was still moderate for globally and selectively operating institutions (decrease of 4 and 6 bps respectively), locally operating institutions faced a much stronger decline in gross margins (decrease of 18 bps). The gross margin of local banks however is distorted by the poor performance of two foreign banks. All in all, the gross margins of the various institution types can be considered as moving more in line with another.

During the observation period, the cost margin fell by a similar degree for all institution types. For locally operating banks a slightly higher cost margin tends to be per-

ceivable than for the other two groups. For all institution types, the effect of falling gross margins outweighs the effect of improved cost margins, i.e. all institution types were confronted with income losses between 2012 and 2016. While these were comparatively moderate for globally and selectively operating institutions, the locally operating institutions suffered from a drop in profits—driven by plummeting gross margins—from an average of 20 bps to an average of 8 bps. This is mainly due to the negative profit margin of two foreign banks in the sample that are facing a dramatic collapse of the gross margins (especially interest income) and assets. The key fact remains, however, that the average profit margin of all groups was low in 2016.



● in %

¹⁾ Classification by AuM: Local (below CHF 10 bn), selective (CHF 10–50 bn), global (above CHF 50 bn).

Figure 7: Development of the gross, cost and profit margins by market depth of business model

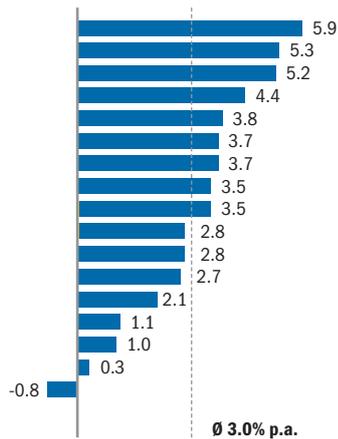
1.2.4 PERFORMANCE DILEMMA OF ASSET MANAGEMENT FUNDS

The average net return (return after costs) of asset management funds of our bank sample in the balanced asset strategies over the last five years is just 3.0% per annum. Through an investment in one of the simplest benchmarks (investment of 50% of assets in stock ETF and 50% in government bond ETF) over the same period, investors would have received 5.4% p.a.

(European benchmark) or 6.3% p.a. (global benchmark). That means that the net return on asset management funds was only approximately half of the passive ETF benchmark. During the five-year observation period, not a single fund was able to outperform the passive ETF benchmark after costs. Only one fund outperformed the European passive benchmark (see figure 8). It thus appears that the performance of asset management absolutely must be improved.

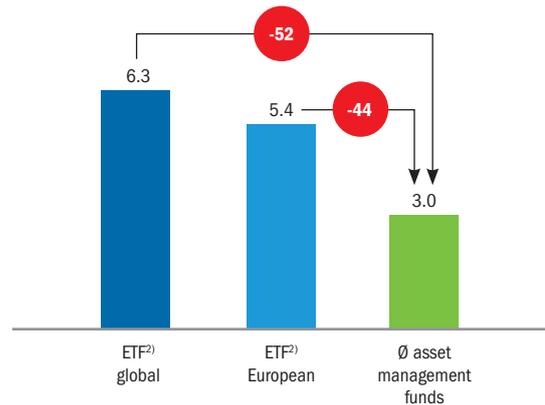
Net return¹⁾ of asset management funds

in % p.a.



Net return¹⁾

in % p.a.



● in %

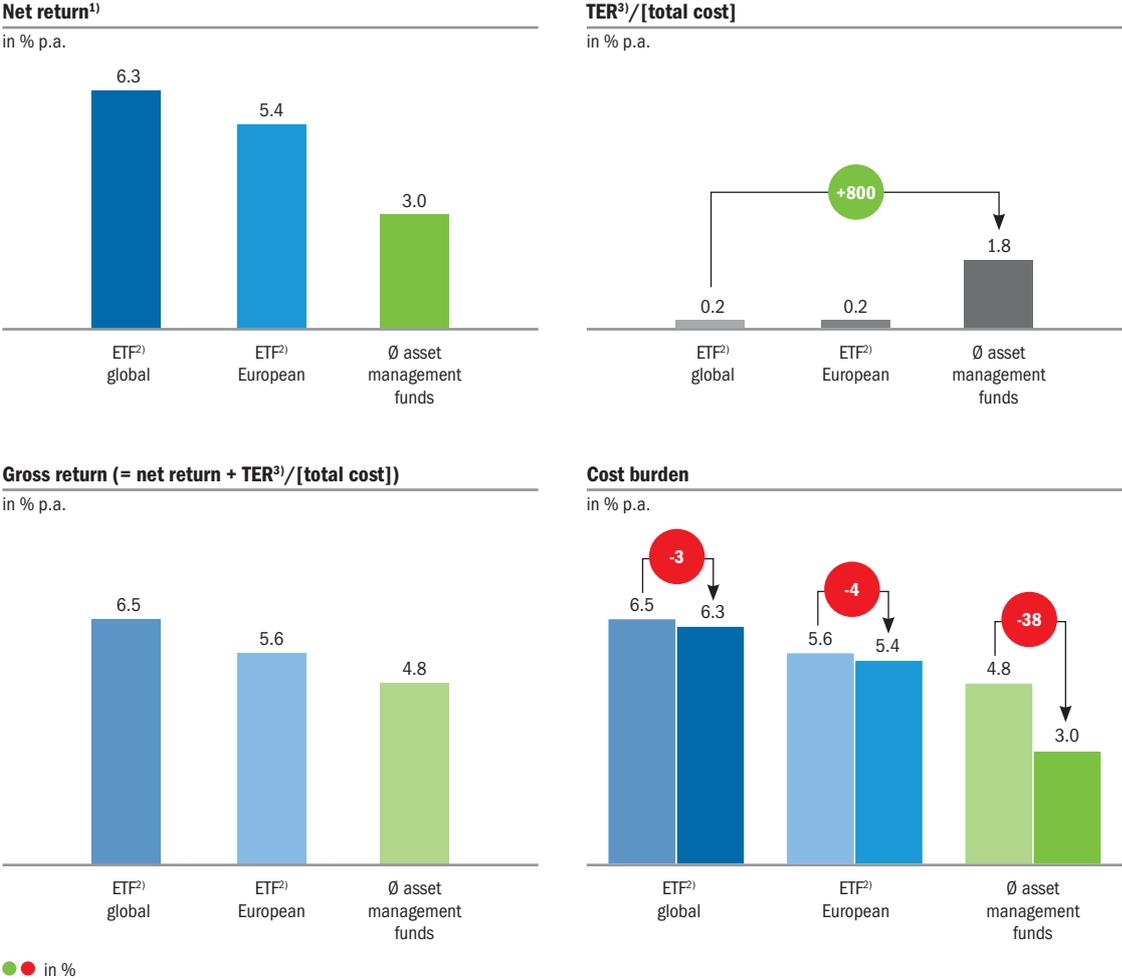
¹⁾ Net return p.a. over the last 5 years (April 1, 2012–March 30, 2017) for 4 funds due to shorter life cycle since launch.

²⁾ European ETF = 50% EuroStoxx 50 + 50% Euro Government Bonds, ETF global = 50 % MSCI World + Global Government Bonds, unhedged in CHF.

Source: Reuters, zeb.research

Figure 8: Performance comparison of AM funds from the bank sample with ETF benchmarks

Despite the poorer performance of asset management funds compared to ETFs, their total cost is approximately 800% higher. This reduces the direct return to customers of AM funds by approximately 38%, while the cost portion of ETFs is only 3–4% (see figure 9). Accordingly, besides a professionalization of the performance side, an adjustment to the pricing strategy in asset management is also necessary.



¹⁾ Net return p.a. over the last 5 years (April 1, 2012–March 30, 2017) for 4 funds due to shorter life cycle since launch.
²⁾ European ETF = 50% EuroStoxx 50 + 50% Euro Government Bonds, ETF global = 50% MSCI World + Global Government Bonds, unhedged in CHF.
³⁾ TER = total expense ratio, total cost according to fund fact sheet.

Source: Reuters, zeb.research

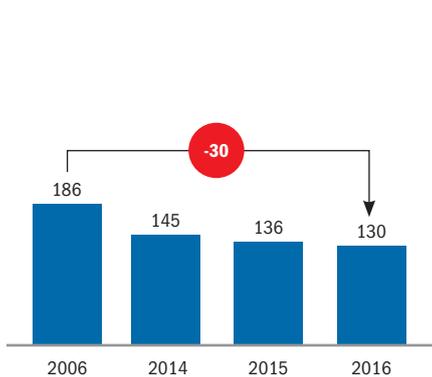
Figure 9: Cost comparison of AM funds from the bank sample with ETF benchmarks

1.3 CONCLUSION

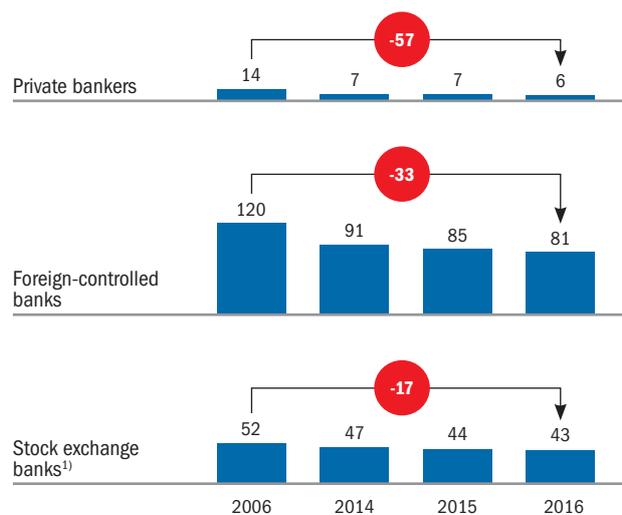
The developments are food for thought for Swiss private banking. The sector is still exposed to a new reality and conditions have changed sustainably. The sector does not appear to have found any answers: pressure on banks' results remains unpleasantly high—even in times of overly positive conditions.

The challenging market environment is also reflected by a strong consolidation of the sector. The number of private banks in Switzerland has reduced by 30% from 186 in 2006 to 130 in 2016. 39 of the 56 closed private banks were part of the group of so-called “foreign controlled” banks. But the number of Swiss private banks also fell by eight institutions, thus halving this group. It must be noted, however, that some of these individual companies were also added to the group of stock exchange banks due to their conversion to a stock company (see figure 10).

Total private banks in CH



Development of each banking group



● in %

¹⁾ SNB definition of stock exchange banks: stock exchange banks are institutions specializing in stock exchange, securities and asset management business.

Source: Swiss National Bank (SNB)

Figure 10: Number of banks in the Swiss market by bank cluster

2 OUTLOOK: SCENARIO ANALYSES AND RESULT SIMULATION

2.1 ASSUMPTIONS AND SCENARIOS

To analyze the development of the Swiss private banking environment and make forecasts for the future, the next chapter will present a scenario simulation from our bank sample (time frame: five years until 2021). This simulation includes three scenarios that differ through the various interpretations of macroeconomic and business-segment-specific assumptions (see figure 11).

SCENARIO 0: CONTINUATION OF TREND

For this scenario, the current trends in Swiss private banking are continued. Especially in terms of the macroeconomic parameters, this means continuing the partially instable political framework conditions, which Switzerland has profited from as a “safe haven”, an ongoing low interest rate level and a steady development of stock markets. Regarding the private banking environment, it is assumed that the current competitive situation remains unchanged. That means that the market will continue to consolidate and that expenditures for M&A activities/integrations remain relatively high. Furthermore, the customer interest in Switzerland as a “safe haven” financial center remains and digitalization is slowly accepted by the market.

The assumptions about central simulation parameters thus largely reflect the development of the bank sample from recent years: It is assumed that AuM growth will continue at a high level of 6.3% p.a., that the gross margin will fall by 1.3% p.a. and the absolute costs increase by 5% p.a.

Simulation to 2021

in % p.a.

| Simulation parameters | SCENARIO 0 “CONTINUATION OF TREND” | SCENARIO 1 “POSITIVE” | SCENARIO 2 “NEGATIVE” |
|------------------------------|--|--------------------------|--------------------------|
| AuM ¹⁾ | +6.3 | +5.0 | -2.0 |
| Gross margin ¹⁾ | -1.3 | +/-0.0 | -1.5 |
| Absolute costs ¹⁾ | +5.0 | +2.0 | +/-0.0 |
| Extraordinary items | One-off effect from FIDLEG/MiFID II: additional -2.0 basis points on the profit margin | | |

Assumption: AuM growth driven by sales performance rather than M&A (→ lower cost increase compared to status quo)

¹⁾ Average values—effective scenario calculation with specific values of the three bank clusters: local, selective, global.

Figure 11: Overview of scenarios

SCENARIO 1: “POSITIVE”

Scenario 1 however reflects a positive view of the future: As in the trend scenario, Switzerland will continue to benefit from its role as a “safe haven”. A moderately increasing level of interest rates and ongoing positive developments in the stock markets are assumed. Depending on the business segment, a strong USP of Swiss banking and a strong position of the financial center of Switzerland are assumed, which result in a considerable increase in the sales performance of the sample banks. In terms of digitalization, we assume that Swiss private banking will benefit from technical innovations.

Accordingly, we assume AuM growth of 5% p.a. in scenario 1 (driven by sales performance)—as opposed to the considerably more expensive M&A—which can lead to significant reductions to future cost increases (only 2% p.a.). In addition, a stabilization of the gross margin at the current level of the bank sample of 81 bps is assumed.

SCENARIO 2: “NEGATIVE”

In the negative scenario, a worsening of the conditions both at macroeconomic and business-segment-specific levels is assumed (“crisis scenario”). The global and financial situation is seen as uncertain, causing pressure on the stock markets. The interest rate level continues to remain low. Besides negative impacts on Switzerland due to the global financial situation, the competitive environment of Swiss banks is also toughened by increasingly international competition and fintech companies gaining market shares as customers become more accepting of new technologies. Customer interest in Switzerland as a financial center decreases due to erosion of the USP while the expansion of automated information exchange to other countries also leads to noticeable cash outflows. This leads to the assumption that assets under management will be reduced by 2% per annum while costs will remain constant. The average gross margin will fall annually by a further 1.5% to 75 bps.

In addition to the scenario-specific assumptions, due to regulatory developments (FIDLEG/MiFID II), a one-off effect is assumed: the profit margin will fall once in all scenarios by 2 bps.

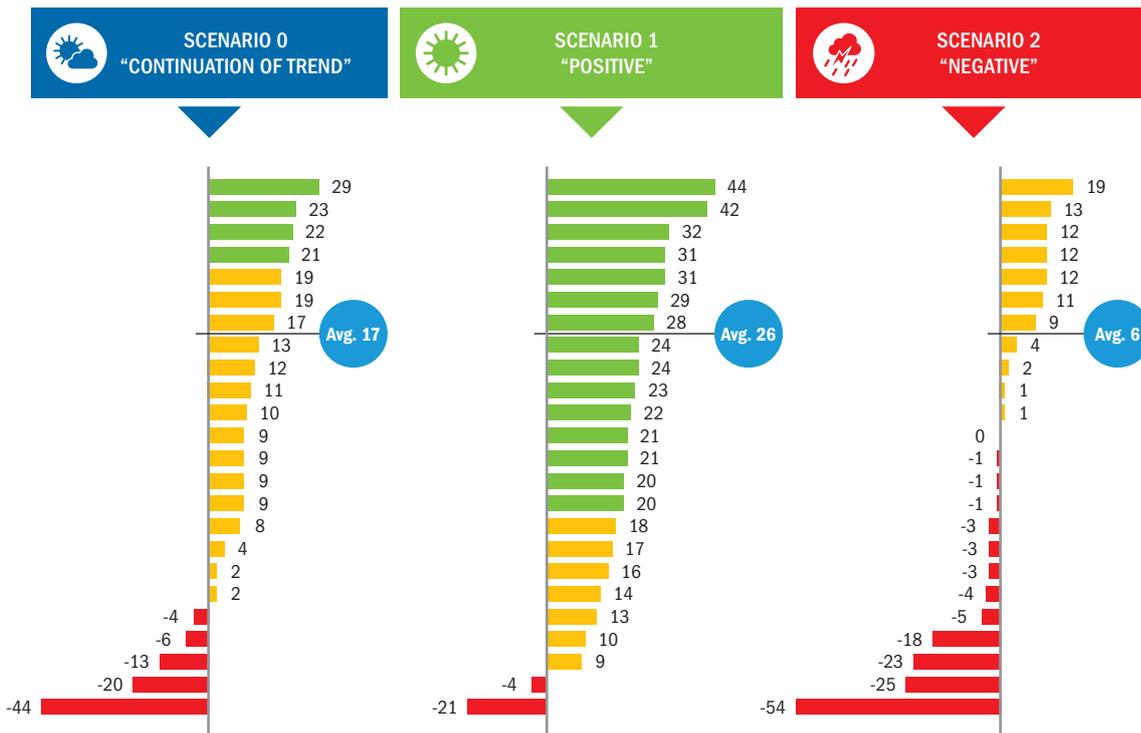
2.2 RESULTS

The results of the scenario simulation to 2021 show that the profit margins in two of the three scenarios would remain under heavy pressure. A continuation of the current trend (scenario 0) would reduce the average profit margin to 2021 by a further 3 basis points and 20 of the 24 sample banks would be in a critical or negative

zone. The “negative” scenario looks particularly bleak: Not even one of our sample banks would be above the critical threshold value of 20 bps in this scenario. Even in the “positive” scenario approximately one-third of the banks would still only achieve a profit margin below this threshold value—still, only two banks would be affected by negative margins (see figure 12).

Profit margin¹⁾

in bps



● in bps²⁾

¹⁾ Profit margin in basis points: Gross profits/AuM

²⁾ Weighted average.

Source: zeb.research

Figure 12: Development of profit margins up to 2021 by scenario

2.3 CONCLUSION

Our analysis of the status quo and the conducted scenario simulation reinforces that private banking in Switzerland is in a phase of radical change. Constantly increasing assets of the bank sample—driven by M&A and market performance—“conceal” the diminishing profit quality. Gross margins continue to fall while absolute costs are growing. Private banking in Switzerland can neither rely on constant growth in AuM through market performance, nor regard growth in M&A as the (only) solution to problems.

From our analysis, we have derived five key findings:



Poor sales performance of Swiss private banks: the share of sales performance in AuM growth is relatively low in comparison to performance and M&A.



Poor product performance and hardly appropriate prices: active management does not bring about an “alpha”—over a five-year horizon, the performance of asset management funds at private banks is lagging well behind the passive benchmark. In addition, the returns to customers are burdened by very high fees.



Gross margin continuing to fall: partly due to the end of bank secrecy, especially in offshore business, the gross margins are subject to a considerable decline—this trend is likely to continue.



High costs: absolute costs are increasing in line with AuM—a realization of economies of scale or positive effects from integrating acquired banks and customers was only visible in 2016 (to a low degree).



Sinking profit margins: a continuation of the status quo (constantly rising AuM and costs and falling gross margins) is not sustainable in the mid to long term. The current average profit margin of 17 bps will continue to fall until 2021.

These challenges are largely independent of the type of institution. All groups should endeavor to intensify their customer communication, to digitalize customer interfaces and to update their advisory approach to be able to retain or improve gross margins. For institutions operating globally or selectively, an additional focus should be on reducing costs and complexity through end-to-end digitalization while locally operating banks should particularly focus on comprehensive advisory services to their customers. Foreign banks on the other hand are facing the task of redefining their entire Swiss banking business model.

3 INSIGHTS: STRATEGIC RECOMMENDATIONS FOR ACTION

3.1 POSSIBLE ACTIONS BASED ON THE MARKET DEPTH OF THE BUSINESS MODEL

The low profitability of the Swiss private banking sector makes further development of the business models indispensable. It is often difficult to say which strategic measures a private bank should follow—and especially which measures should be given lower priority or even skipped. In a world of limited monetary and capacity resources prioritizing is the main task of management.

As shown in figure 13, zeb has made an initial prioritization of necessary measures at the level of institution types. Whether, with which priority and in which form a measure should be initiated by a certain private bank, is however highly individual and must be decided based on the current and desired positioning of the bank and their existing strengths and weaknesses.

Market depth of the business model

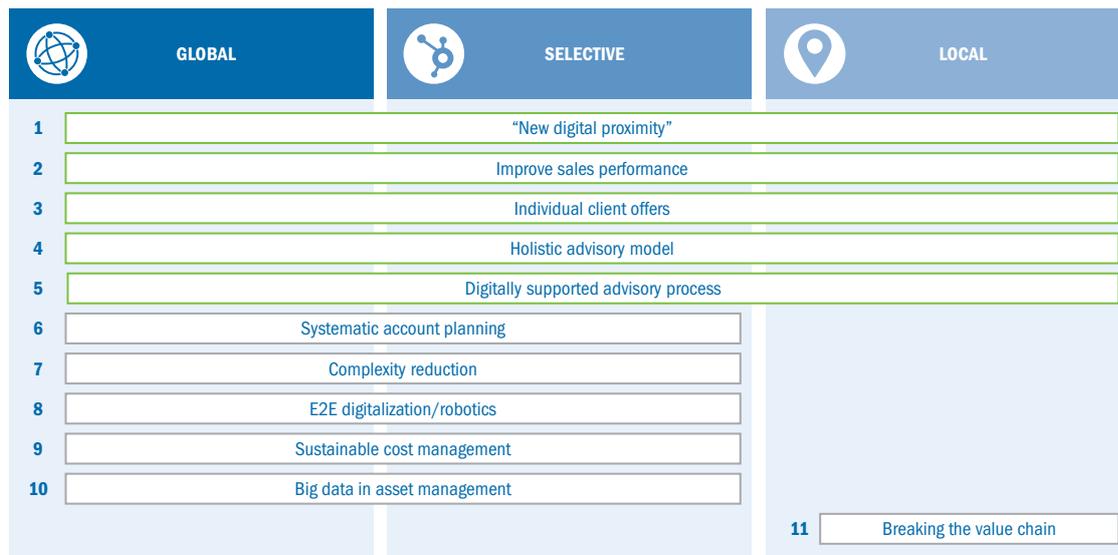


Figure 13: Actions by market depth of the business model

3.1.1 NEW DIGITAL PROXIMITY

Strong customer loyalty is essential for the highly trust-based business of private banks. To achieve strong customer loyalty, new technologies and digitalization play an increasingly important role. While new media may seem impersonal at first glance, upon closer inspection, the decisive contribution that the “new digital proximity” can play in customer loyalty can be recognized:

- **Personal closeness:** digitalization helps make the customer advisor into the central point of reference for a customer even without their physical presence. To do so, digital channels such as apps, chat and co-browsing should be used—it should be easy and smooth for customers to switch between channels.
- **Emotional closeness:** new technologies can contribute to the emotional communication with customers—for example, big data offers the ability to understand customers better and to address them more appropriately and individually according to their preferences. The exclusivity of customer support should also be reflected on digital channels. Selected networks can also offer a high level of added value for customers.
- **Temporal closeness:** digitalization allows banks to have a presence for customers even outside of traditional opening hours. Private banks should especially ensure a 24/7 availability and ability to act in emergencies, i.e. especially being available at moments “when the customers need them”.
- **Trust-based closeness:** digitalization can decisively contribute to fulfilling customers’ increased need for information. In addition, by using algorithm-based and scientifically tested tools, it is possible, for example, to ensure high levels of objectivity and neutrality in advisory services.

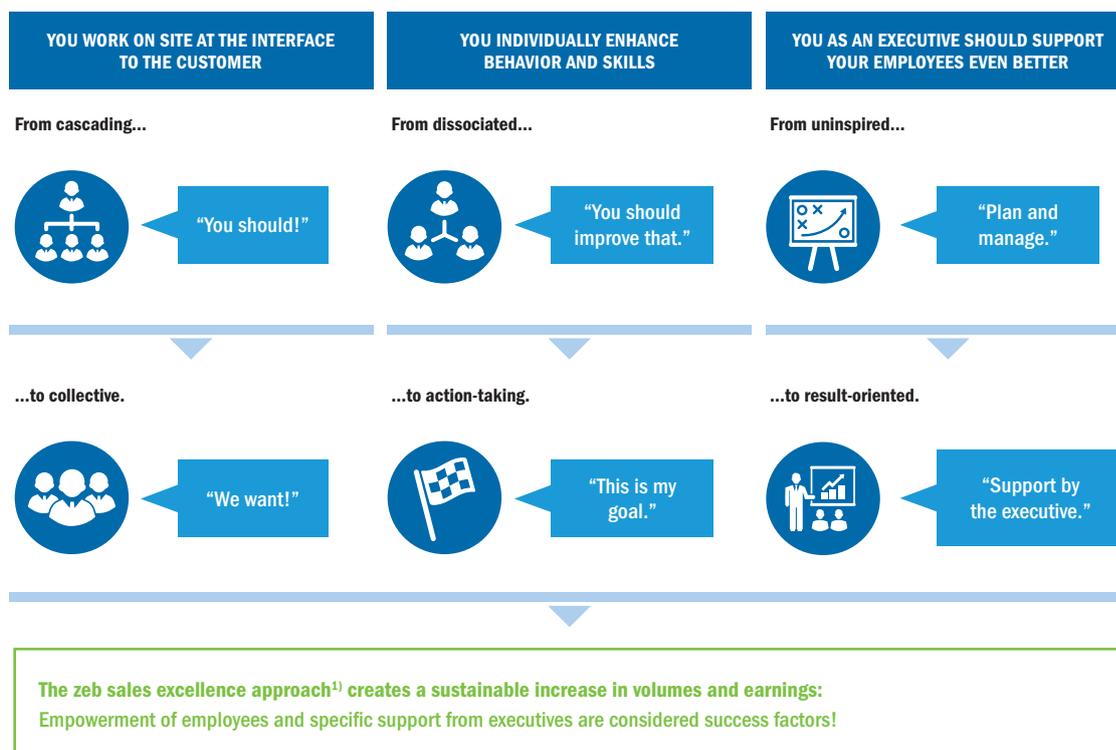
3.1.2 IMPROVEMENT TO SALES PERFORMANCE

Typical approaches to increasing sales performance in banks often only have a minimal impact. Central management and requirements from executives lead to loss of self-determination of customer advisors and can contribute to a lack of self-motivation. Profit-oriented coaching approaches, in which relevant sales performance abilities are taught, are usually not long lasting and finally suffer from transferring the learning objectives into day-to-day work.

With this in mind, zeb has developed a proven approach to measurably increasing sales performance, which is based on science and overcomes the aforementioned obstacles. As part of the multi-level coaching process, employees develop self-reflection and thus an awareness of problems. With support from a coach, the employees set themselves team and individual goals. Being proactive leads to an intention to act (volition), while the collective supports and motivates the individual and—removed from formalized management and leadership—contributes to success control aside from other mechanisms. The individual and regular support of employees by a coach (also virtually) ensures that newly learned matters become routine for the employees (“continuation”). At the same time, executives are trained to support employees in their personal transformation process (see figure 14).

3.1.3 INDIVIDUAL CLIENT OFFERS

Just as in the past, today, the key to tapping new earnings potentials is through customers and their individual needs and preferences. Understanding the customer is thus essential. Today, the knowledge of banks about their customers is based to a large degree on data the customers have passed on (e.g. master data) and data the bank has acquired (e.g. product use behavior). The data is often only used as part of simple assessments such as transaction analyses and analyses of channel use behavior, which banks only occasionally use in customer-specific offers. The use of this kind of approach can lead to a 20% increase in customer penetration p.a. in the first years.



¹⁾ The zeb approach was awarded the Gold title from the International German Training Award 2014/2015 from BDVT.

Figure 14: zeb approach to sales excellence (honored with Gold by the International German Training Award in 2014/2015)

However, there are increasingly new opportunities for individual customer communication through big data. Big data and advanced analytics make it possible to automatically gain and assess customer data in much greater levels as in the past. As a source, the banks have more than just the bank-specific customer behavior, they learn about the customers' entire online life. Valuable conclusions can be drawn both from information that the customer actively shares and from information that they only subconsciously share, for example, about product needs and channel affinities. This allows a 360° view of the client.

From the holistic customer profile generated in this manner, by then using tailored algorithms (multi-dimensional customer classification and suitable trigger points), firstly so-called lifecycle events can be removed and secondly, personalized optimal offers can be created. To take it one step further, this can lead to establishing a bank ecosystem around the customers, thereby allowing for needs-oriented product offers, personalized pricing and a suitable, personalized communication. Through the systematic use of new opportunities through big data, in the mid to long term, a tripling of customer penetration is possible: a significant increase compared to the results achieved based on today's approaches.

3.1.4 HOLISTIC ADVISORY MODEL

Another important measure for private banks—in zeb’s perspective—is the application of a holistic advisory approach in the sense of a “family office light”. This applies more to onshore business than for offshore customers. As a first step, it is important to gain a full understanding of the customer(s). Besides their current life situation and their aims, this also includes the total financial situation: often banks only have an eye for the assets that they manage themselves and thus neglect the assets at other banks, property assets, company shares, etc. as well as liabilities. The gathered information must then be transferred in a second step into a holistic view of the customer. Based on this, in a third steps, a holistic optimization of all assets and liabilities should be conducted and the needs of the customer should be derived—besides product needs, this also includes topics such as tax optimization, succession planning, insurances, provisioning, philanthropy and even concierge services, etc. (see figure 15).

3.1.5 DIGITALLY SUPPORTED ADVISORY PROCESS

As described above, using a holistic advisory model goes beyond providing traditional securities advice. Considering other assets and liabilities increases complexity both for the advisor and the customer. When systematically implementing a “family office light” approach, it is essential for success that a digitally supported advisory process is integrated. This can be accessed by both the customer advisor and the customer over their respective interface to the bank system and essentially represents two different use cases:

The first use case consists of structuring the asset. It involves balancing the individual customer situation with the respective tax, regulatory and provisioning conditions and using that as a basis for simulating various scenarios. Once the optimal structure is defined, the fulfillment of corresponding requirements as part of the second use case—continuous asset monitoring—is ensured. If an event occurs and has a negative impact on

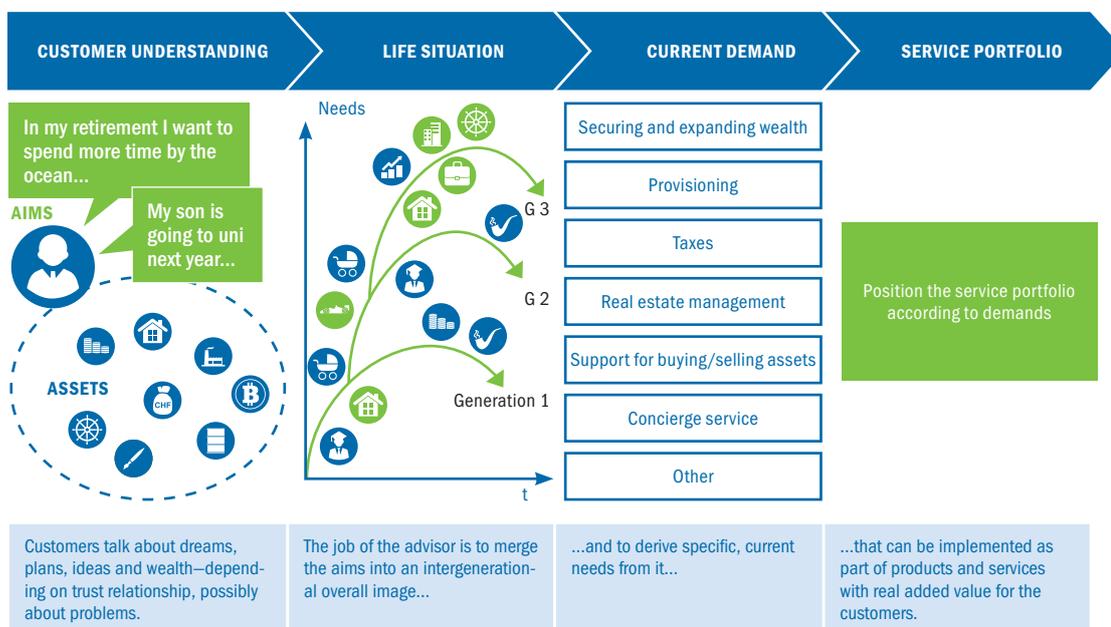
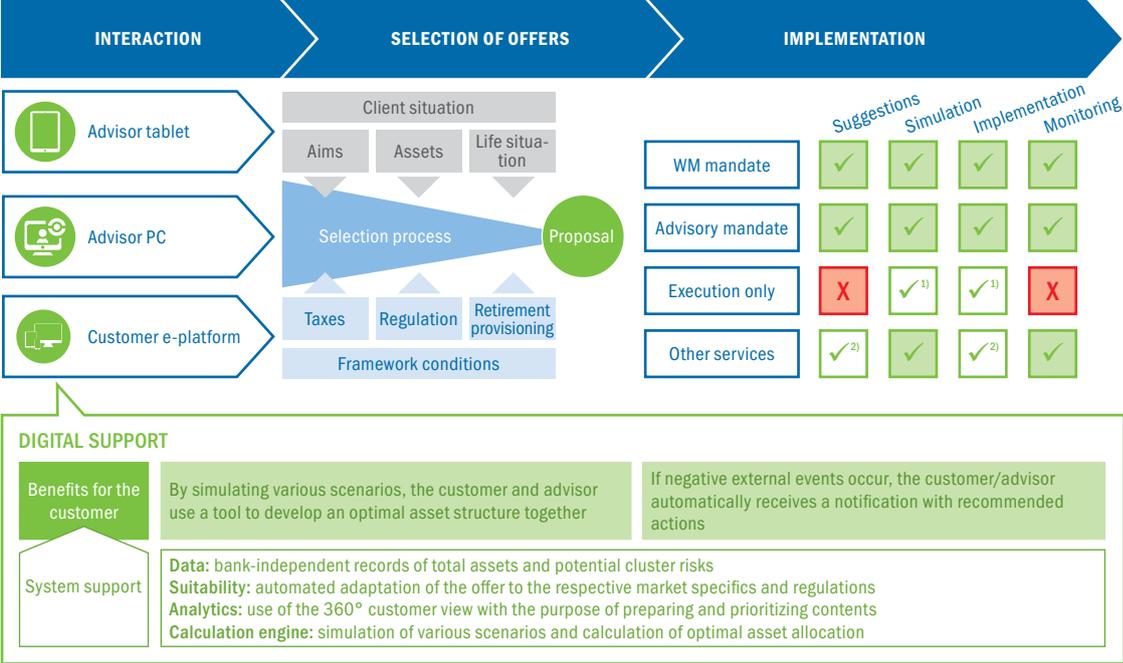


Figure 15: Holistic advisory model

the asset situation, then the customer or customer advisor are automatically sent a notification with possible recommended solutions.

So that both use cases can be smoothly conducted, it must be ensured that all assets and liabilities that are held at other institutions or other facilities are correctly included in the total overview of assets. In order to correctly assess the regulatory framework conditions, a database is required that not only includes the national differences related to retirement provisions and taxes, but also provides information about the valid regulatory requirements for sales of asset management services. The information is not only processed as part of the 360° view of the customer as already explained in chapter 3.1.3, but through quantitative models also leads to optimization of returns (see figure 16).

The described process is no longer a topic for the far away future. Existing technological solutions on the market (e.g. also offered by European fintech companies) show that the individual elements already exist (e.g. integration of third banks, asset simulations and also “industrialized” portfolio management with automatic risk monitoring). However, there are still weaknesses in the links, which have the effect that the maximum achievable added value is still out of reach of customers.



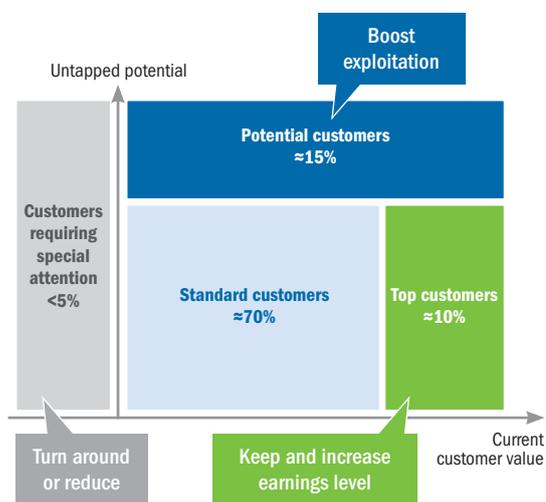
¹⁾ By the customers themselves in online banking.
²⁾ Regardless of service portfolio.

Figure 16: Digital advisory process

3.1.6 SYSTEMATIC ACCOUNT PLANNING

Private banks typically have a historically grown, very heterogeneous customer portfolio without a deep systematization of customers according to their value or potential. The support intensities are often subjectively decided by the advisors—elements such as the perceived closeness of the advisor to the customer often play a considerably more significant role than their assets, etc.

To maximize or improve the returns from the existing customer portfolio, it is important to establish transparency in a first step. Customers can be classified according to their contribution margin and potential. This kind of classification can then serve as the basis for systematized planning and processing of customer clusters, but also as the basis for finding new customers. It also allows optimal allocation of scarce support resources and derivation of specific support approaches and strategies per customer cluster (see figure 17).



Sources: zeb.research, zeb project experience

Figure 17: Systematization of the customer portfolio

3.1.7 COMPLEXITY REDUCTION

In particular for institutions operating globally and selectively, realization of perceivable cost reduction potentials must go hand in hand with a significant reduction of complexity in the operating model.

When viewing historically grown structures and often overlapping responsibilities in support of individual markets, many functions are repeated and spread decentrally. This does not only lead to missing transparency in terms of job allocations and unclear responsibilities, but also to inconsistent business processes, significant extra efforts and finally, higher costs. It is particularly visible in IT, which is often managed specifically per country and institution, which leads to high complexity at a global level.

If these problems are to be dealt with properly, a close interaction between the business model and operating model is needed. In a first step, it is necessary for private banks to focus their business model on certain target groups, markets and booking centers in order to establish the prerequisite for industrialization of the underlying processes. Then, transparency about all existing functions and processes is required so that they can be streamlined as far as possible. As a final step, the corresponding unified starting point subsequently allows the formation of a lean and efficient operating model by means of centralization and automation of important processes.

3.1.8 E2E DIGITALIZATION/ROBOTICS

End-to-end digitalization and robotics can simultaneously contribute to improving the customer experience (e.g. through processing times under one second) and reducing costs for banks (e.g. through a high level of automation). Potential starting points:

- **Robotics:** replacing human operations with virtual operations (robots) for standardized tasks
- **E2E automation:** optimization of complete processes from supported data entry in the customer/sales front end to processing in the bank end
- **Work flow management system:** infrastructure for robotics and automation solutions, which are required for specialized efficient process automation, orchestration of tools and processes as well as resource management.

3.1.9 SUSTAINABLE COST MANAGEMENT

A cost benchmark of the institutions from our bank sample shows a wide spread of costs per billion AuM. While the average institution in 2016 had CHF 6.1 m costs per billion AuM, the best value was CHF 4.3 m and the worst value of our sample was CHF 11.3 m (see figure 18). Thus, according to benchmarking there is a cost reduction potential of 29% for the average institution, and for institutions with higher costs, a much greater potential.

Some obvious starting points include middle and back office, core areas and organizational structures. In the middle and back office, there are high levels of inefficiencies in typical institutions due to complex work processes between various locations and units. Furthermore, manual bookings and manual steps between IT systems often lead to considerable efforts. Creating reports is also often costly. As a result, the area of middle and back office often holds a high potential for streamlining, standardizing and automating. The central functions are also often spread across multiple locations, leading to double efforts, which could be reduced to a large degree or even eliminated by merging locations. Organizational structures typically include a broad middle management, which is partially without result or budget responsibility—a potential for reducing costs exists here by removing leadership levels.

Costs per billion AuM

in CHF m

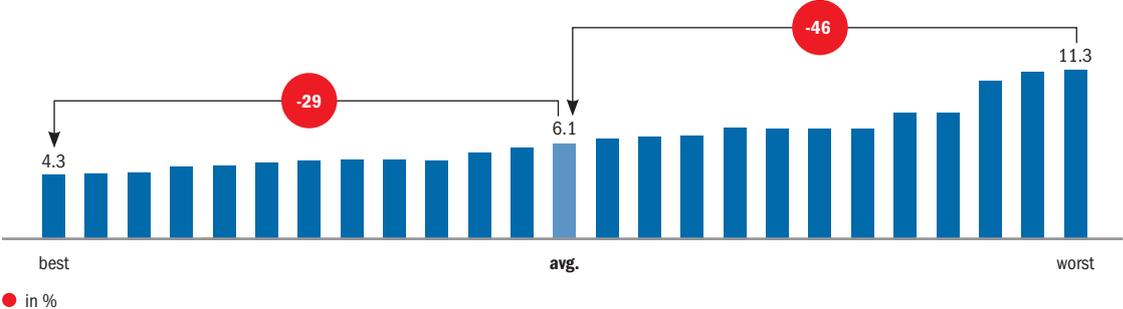


Figure 18: Cost benchmarking of bank sample

3.1.10 BIG DATA IN ASSET MANAGEMENT

Above-average and sustainable performance is a major competitive factor in private banking. However, it has been shown that the majority of banks and asset managers are incapable of generating more returns than the market (“alpha”). There are promising approaches for active portfolio managers around the corner through the combination of big data and artificial intelligence. Attractive investment opportunities can be identified by gathering and analyzing highly topical structured data (e.g. company and market data such as prices, KPIs, etc. and credit ratings) and unstructured data (e.g. journalism, social media, etc.) in a targeted manner. To do so involves combining diverse analysis methods such as analyzing traditional KPIs, identifying patterns (machine learning), analyzing credit ratings and analyzing text in various contexts.

3.1.11 BREAKING THE VALUE CHAIN

For larger institutions, (increased) complexity is often a central obstacle to sustainable efficiency gains. Smaller institutions, on the other hand, are missing out on economies of scale and dependencies on individual employee capacities arise. Particularly for smaller institutions, the value chain needs to be broken.

In terms of the back office, the question of outsourcing (or entering partnerships) for tasks that hardly allow any visible distinction from other banks (and thus for customers) must be asked. Doing so can leverage economies of scale and reduce the cost margin, which according to the study is relatively high for small institutions.

Breaking or reconsidering the value chain is however not only limited to the processed units. Another adjustment to the value chain can also be justified in terms of the customer interface and the products with the primary aim of selectively adding to the product portfolio and sharpening the bank’s USP. Several innovations have been revealed in this context in recent months. Traditional (private) banks add to their product portfolio with external products, enter partnerships or bring investors on board, which facilitates expanding the breadth of the service portfolio.

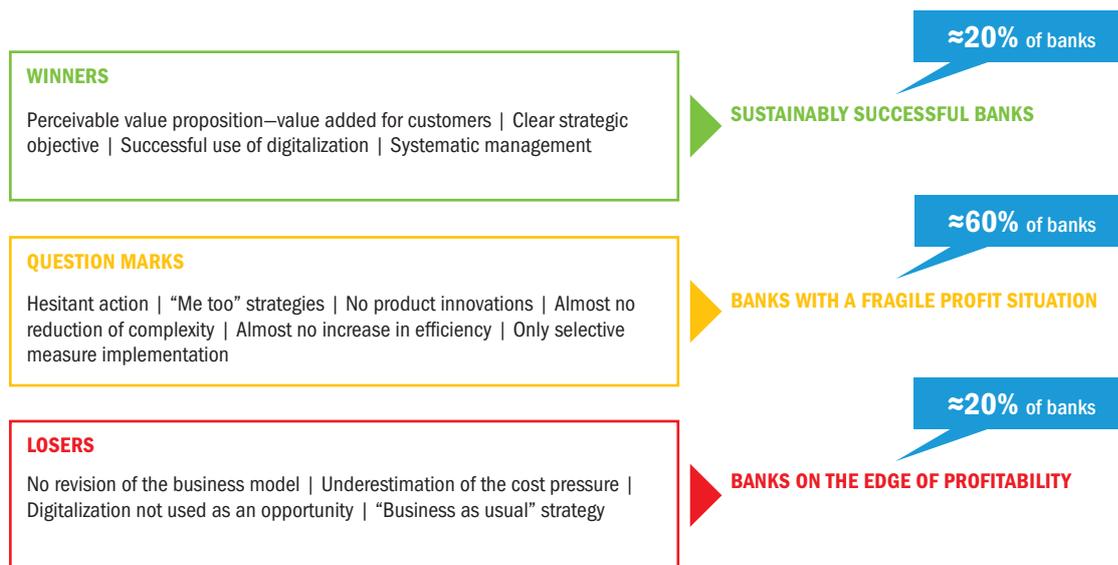
Breaking the value chain is thus not simply a matter for saving costs of the back office, but is rather a topic of specific development for smaller banks with limited capabilities to invest, who know how to use partnerships appropriately.

3.2 CONCLUSION

As our scenario simulation showed, Swiss private banking institutions may be approaching unpredictable times—many of the banks will be running at or below the profitability threshold. So it is essential that they immediately launch countermeasures. The major success factors of the future will be a highly focused business model, simple operating models with high levels of standardization and a high level of digitalization. Just as in our last study, the motto to be followed is: “Focus on the client, keep things simple and do them in a smart way!”

4 FORECAST FOR 2021: ONGOING CONSOLIDATION

The outlook of the 2017 zeb private banking study hardly differs from the forecasts from the 2015 edition. Only those (likely few) institutions in Swiss private banking that manage to stabilize their profit basis, get their costs under control and benefit from digitalization will belong to the winners by 2021. Sustainably successful banks will manage to create a perceivable value proposition for customers, to considerably improve sales performance and to implement innovations timely and systematically. On the other hand, the losing side will see institutions that already have serious profitability issues and that miss out on realigning their business model to stabilize incomes and asset outflows.

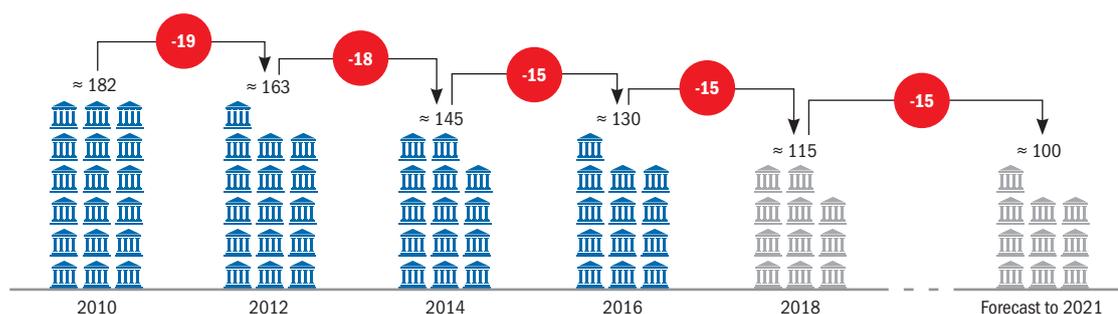


Sources: zeb.research, zeb project experience

Figure 19: Success determinants for 2021

We expect further consolidation on the market in the next years. So we at zeb stick by our forecast from the year 2015 for approximately 100 private banks in Switzerland. In light of the growing target group focus, “asset deals”—i.e. takeovers of portfolios with focused target groups—will continue to be conducted alongside “share deals”. Institutions that do not manage to implement the aforementioned success factors to remain profitable will become targets of takeovers. This will have the effect “the fittest will survive”.

Forecast development of the banking landscape



Continuation of M&A activities

Shift of deal structure from “share deals” to “asset deals”: portfolio sales with a focus on certain customer groups

Figure 20: Consolidation up to 2021

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LIST OF ABBREVIATIONS

| Abbreviation | Explanation |
|--------------|---|
| AM | Asset management |
| AuM | Assets under management |
| avg. | average |
| bn | billion |
| bps | basis points |
| CAGR | Compound annual growth rate |
| CH | Switzerland |
| CHF | Swiss franc |
| e.g. | For example |
| E2E | End-to-end |
| ETF | Exchange-traded fund |
| FIDLEG | Financial Services Act (Finanzdienstleistungsgesetz; Switzerland) |
| GDP | Gross domestic product |
| IT | Information technology |
| m | million |
| M&A | Mergers and acquisitions |
| MiFID II | Markets in financial instruments directive II (EU) |
| NNM | Net new money |
| p.a. | per annum |
| PC | Personal computer |
| SNB | Swiss National Bank |
| TER | Total expense ratio |
| USP | Unique selling proposition/point |

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