*White Paper*

# Consolidation in Swiss Wealth Management

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How to ensure value creation through successful PMI? The Swiss wealth management industry continues to consolidate. Each year since 2013, an average of CHF 153 B in assets under management (AuM) have changed hands in deals where a Swiss bank was at least one of the parties.

Acquisitions are often aimed at gaining the scale required to operate profitably in a business where margins are being squeezed. Some seek to buy into growing markets in Asia, the Middle East and Latin America without needing to build a business from scratch. Yet other deals are motivated by sellers offloading unwanted portfolios, perhaps because they distract from core activities or because they carry unwanted risks that other firms are better equipped to manage or willing to carry.

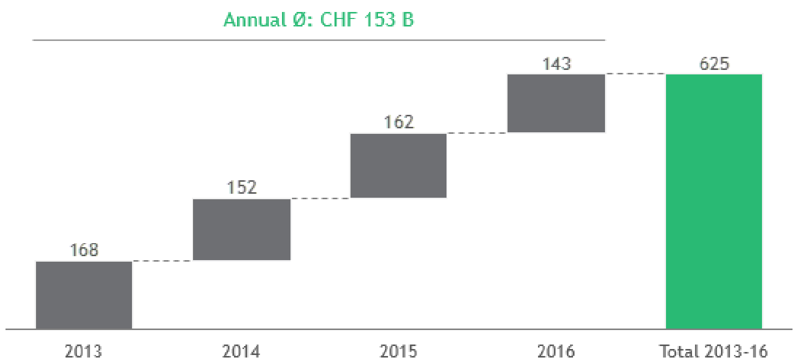
With most wealth managers having a reason to buy or sell either entire firms or client portfolios, this wave of M&A is set to continue – indeed we are in the middle of it. But M&A deals are far from guaranteed to succeed. Even when a target acquisition makes strategic sense and the transaction is well structured and priced, deals often fail to create shareholder value because of poor post-merger integration (PMI).

Bringing together firms with different customers, value propositions, systems and cultures is an enormous task, at which the senior management teams of banks are typically inexperienced. But there is plenty of cumulative experience in the industry. If senior managers learn the lessons of past failures and successes, which are cultural as much as procedural, they are well equipped to make their own M&A deal successful.

## Consolidation is set to continue

Between 2013 and 2016, over CHF 625 B worth of assets changed hands in M&A transactions in which at least one of the parties was a Swiss bank. (See Exhibit 1.)

Exhibit 1 | Assets that have changed hands in M&A involving at least one CH bank (B CHF)




Source: BCG Swiss Wealth Management M&A Deal Database

This M&A activity has significantly contributed to the reduction in the total number of banks in Switzerland from ~320 five years ago to 266[1,2]. If this trend continues, as is expected, the number could fall to 220-225 by 2021. Swiss banks employed roughly 108'000 people five years ago. This number has fallen to approx. 100'000[1] and is expected to fall even further, to approximately 95'000 by 2021. M&A is also increasing market concentration, with the top 10 banks now commanding 80% of AuM, compared with 75% five years ago. Again, if this trend continues, the top 10 will have a market share of 85-90% by 2021.

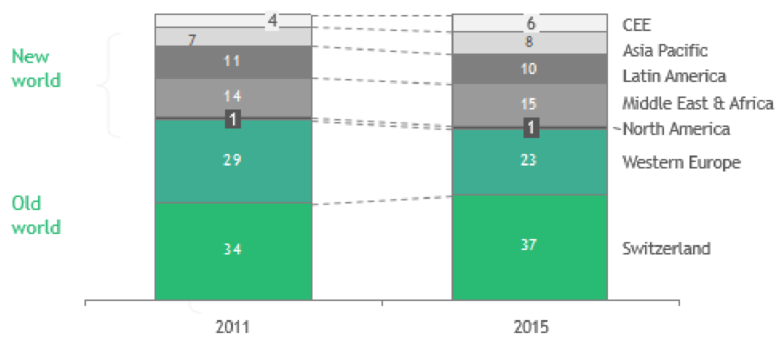
[1] Numbers are for 2016.

[2] Including foreign institutions as per definition in Swiss National Bank Statistics.

In recent years, the composition of assets by client domicile has shifted significantly towards the New World, which now accounts for 39% of AuM booked in Switzerland. (See Exhibit 2.)

Exhibit 2 | AuM Composition and Value in M&A deals

AuM of an average Swiss private bank (2011-15, in %)




| | 2011 | 2015 |
|---|---|---|
| % Old world | 65 | 61 |
| % New world | 35 | 39 |

1. Switzerland and Liechtenstein 2. CEE incl. Russia
Note: Numbers may not add up to 100% due to rounding
Source: BCG Global Wealth Report 2017

Despite this trend, New World markets face challenges that could hinder growth in the offshore business in the future. For example, increased pressure from regulators in offshore centers and the Automatic Exchange of Information (AEOI) between tax authorities are reducing some of the envisaged benefits of using offshore wealth managers. In Brazil and Argentina for example, tax amnesties have led to the repatriation of AuM, causing an outflow from offshore players despite uncertainty about how these assets will be regulated and taxed domestically. And, in Russia, capital controls limit the potential for AuM growth.

Buying banks in emerging markets also brings with it compliance risks: for example, when onboarding clients in jurisdictions with which the acquiring bank is unfamiliar. There can also be specific risks associated with any loan books included in the acquisition. For example, while margins on loan books in Switzerland averaged 103bps in 2015, they averaged more than 200bps in Eastern Europe driven by different loan types – indicating the higher prices required to cover greater default risk. In the context of an M&A transaction, it is important to look at any loan books involved, which can be a significant portion of what is being acquired.

Pricing models for acquisitions vary from deal to deal, from a fixed bps amount based on book value to revenue sharing over two or three years. Book values (expressed in bps of AuM) vary widely. Overall, book values have risen over the last three to five years as banks strive to optimize their AuM composition and regulatory instruments such as the AEOI have increased the value of assets from offshore.

## M&A activity has become a strategic imperative

What's driving all this activity? In our experience, M&A in wealth management currently has six motivating factors:

- Banking groups offloading non-core books, locations, markets or specific client segments to shift resources towards new strategic priorities. For instance, several major international banks have recently decided to sell their wealth management businesses in the US to local players and refocus on more strategic locations, such as Asia Pacific and the Middle East and Africa (MEA).

- A desire to decrease compliance risk by selling client books involving high risk segments and locations. These deals allow acquirers who are better equipped to handle the risk to take over part of the client base without acquiring the related legal entities and their legal liabilities.

- An aspiration to achieve scale efficiencies required for profitability and for operational leverage. Smaller players join forces to reach a viable level of AuM and generate revenue or cost synergies. The importance of scale in the competitive Swiss market has caused many international banks with insufficient AuM to withdraw from the wealth management arena.

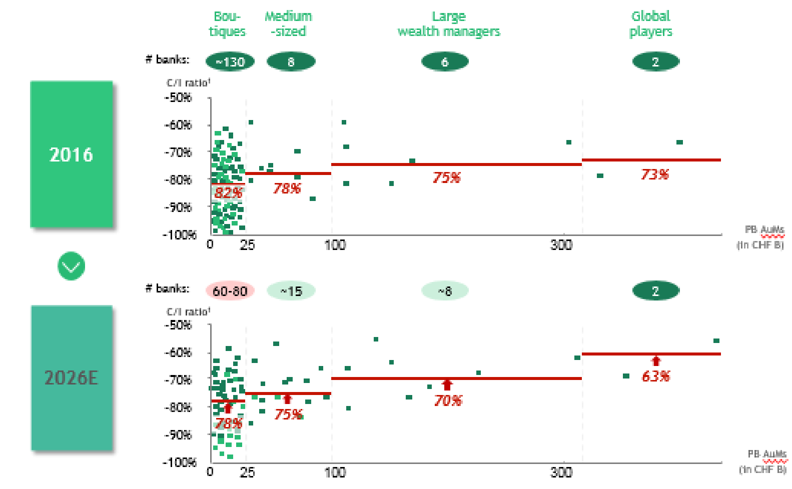
- For mid-sized players, the ambition to become large global wealth managers with sufficient scale and global reach in all major markets and hubs. For players of any size, the PMI activities following an M&A deal provide the opportunity to design an effective operating model and optimize processes, which in turn facilitates achieving scale.

- Distressed banks looking for healthier partners to provide a “fresh start”. Several banks affected by money laundering or tax evasion scandals have had to take this option as a last resort. On the other side of these deals, strongly performing banks are buying cheap troubled banks whose performance they believe they can turn around.

- Foreign institutions entering new markets by acquiring the operations of a local player rather than building everything from scratch. Such transactions often boost the financial resources of the target, improving its competitive position in its home market and abroad.

These strategic moves are creating a wealth management industry with fewer players managing more AuM more efficiently. (See Exhibit 3.)

Exhibit 3 | Projected Private Banking Consolidation




Source: BCG Wealth Manager Performance Database 2015

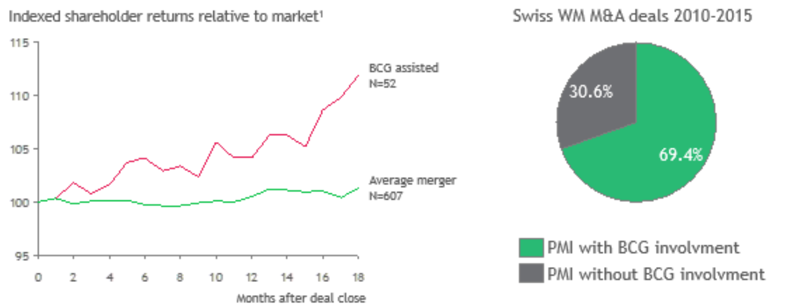
## Successful M&A depends on successful PMI

An M&A deal has three important elements: the search for a target, the transaction itself and the post-merger integration (PMI) – the latter being the key to success. Even when a target acquisition is well selected to serve a strategic purpose, and the terms of the transaction are favorable, acquisitions often fail to deliver shareholder value because of poorly executed PMI. Integrating banks with different customers, systems and cultures is a significant task, which is too often underestimated.

**Exhibit 4 | BCG's Contribution to Swiss WM PMI**

Our proven ability to extract maximum value out of a Wealth Management PMI…

… convinced most Swiss PBs involved in a PMI to ask for BCG support




1. Analysis includes worldwide deals for companies with greater than US$10 B market cap; each deal computed relative to local market index. Lines represent median of groups. BCG assisted mergers not included in average merger group
Source: Mergermarket, Compustat, Bloomberg, BCG ValueScience Center

Our experience (See Exhibit 4) has taught us that a successful Wealth Management PMI depends on six critical initiatives:

1. **Retaining RMs and clients.** Senior management needs to devote significant time to defining the target RM set-up and how to reach it, both in terms of retaining key RMs as well as planning no-regret attrition where needed. RM retention will not be achieved through attractive compensation alone, but will include a central aspect of winning over hearts and minds, with a comprehensive value proposition for staying. In turn, successful RMs will retain their clients by contacting them early on in the process (ideally pre-closing) and by providing a convincing story for why to stay. Client communication is not to be underestimated and thorough alignment is required early on by both parties involved.

2. **Managing communication with internal stakeholders.** Doing this effectively initially requires the mapping of internal stakeholders into different groups. Each of these groups should receive tailored communication in terms of content, frequency and channel in order to address their specific needs. Clear and consistent communication across all stakeholder groups will give the

organization confidence that the integration is well underway. Often key stakeholders in the existing organization may feel threatened and key functions beyond the front become second priority in an integration process. Non-RM and non-front functions should be an equal priority in the whole process and in the future delivery of the value proposition to the clients after integration and migration.

3. **Building a unified culture and organization.** This is vital for success in light of the unavoidable anxieties that acquisitions create, but often neglected in Wealth Management acquisitions as deadlines for operational deliverables dominate the priority list. Successful organizations will take into account the stakes at the individual level and provide clear incentives for collaboration and integration, e.g. growth perspectives for senior staff and resolution of issues created by the transaction with ongoing or previous internal initiatives. Potential tensions can also be avoided by centralizing the most sensitive interactions to the program management office (PMO). Informal events can be a good way of building relationships between staff from the acquirer and the acquired firm.

4. **Planning well in advance.** A detailed joint plan and integration roadmap must be developed early on. Management should anticipate challenges that might derail progress along the critical path. This means considering alternative scenarios and challenging them with key stakeholders – on both sides. Anticipating any potential legal challenges, arising from the transaction itself or from operating in a new jurisdiction, is an important part of the planning process.

5. **Aligning the strategy, business, operating model and the organization.** This includes harmonizing of product offering, service model, approach towards client risk profiles and pricing scheme – to name just a few of the key dimensions. Strategic alignment must occur early so that it can provide the

foundation for designing the IT structure and operational processes as well as minimize any disruption for the clients.

6. **Designing a common and lean IT and back-office operating model.** Fast, fact-based decisions on the target IT platform are needed. They must balance functional breadth, future agility, time, cost and risk. Following the IT design, all migration scenarios need to be mapped and tested to ensure a seamless end-to-end client migration.

A post-merger integration is a once-in-a-career event for most senior managers in private banks or other wealth management firms. Getting it right is critical, reaping its fruit and realizing synergies and growth from the acquisition equally so. Whatever resources are invested in an integration effort, they will cost far less than the price of a failed acquisition.

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