Private Banking Market Update – 2023 in a nutshell

76
private banks
in 2023 sample

>80%
market coverage
# of private banks in 2023

19
years of data

11^{th}
edition since 2010

Navigating through turbulence: private banks weather market challenges with success

The year 2023 posed significant challenges for the global environment amidst escalating geopolitical tensions and macroeconomic uncertainties. The financial sector faced its own array of hurdles, including higher interest rates, inflation concerns and the spectre of a looming recession. Global central banks added additional complexity through changes in interest rates, which impacted investors worldwide.

Despite these occurrences financial markets achieved relative stability in 2023, which Swiss and Liechtenstein-based private banks were able to benefit from. In times of geopolitical instability, private banks in Switzerland and Liechtenstein benefit from the political stability of their home countries and their safe haven status, enabling them to achieve solid financial performances. Each private bank size cluster generated strong return on equity figures and cost-income ratios below 80%. The smaller-sized cluster of private banks in particular was able to continue the upward trend which began in 2022, and achieved remarkable results in 2023 thanks to higher interest rates.

Inorganic growth activities via M&A remained low in 2023, as banks prioritised caution and focused on internal stability instead of external expansion. In addition, the historically lower-performing smaller-sized banks in particular benefitted from higher interest rates, which favourably impacted their overall financial results. With the absence of major transactions, deal activity was limited to portfolio divestments or opportunistically-driven asset acquisitions. Nevertheless, we expect M&A activity to accelerate during the second half of 2024, as private banks begin to reassess their capital allocation decisions after two years of a challenging market environment. Further, the positive impact resulting from the interest income, mainly on smaller-sized private banks, starts to evaporate.

In this publication, we delve into the drivers of the market's financial performance in 2023. Discover how banks navigated the turbulent waters, seized opportunities and achieved solid performances. We wish you an interesting read.

Methodology

In this year's market update, the featured banks based in Switzerland and Liechtenstein have been categorised into three clusters depending on their level of average assets under management (AuM) from 2021 to 2023: small banks (AuM < CHF 5bn), medium-sized banks (AuM CHF 5bn – 50bn) and large banks (AuM > CHF 50bn). The study's findings are based on publicly available data from banks that consistently published financial data throughout the observation period, ensuring a reliable assessment of their financial performance under different market settings over the years. The numbers presented within this publication are based on aggregated results and correspond to the performance achieved by the respective size group as a whole. All financial institutions specialising in private banking in Switzerland and Liechtenstein (excl. UBS) have been considered which had released their 2023 annual reports by the time this study was prepared.

Uneven picture regarding volume development across size buckets in 2023

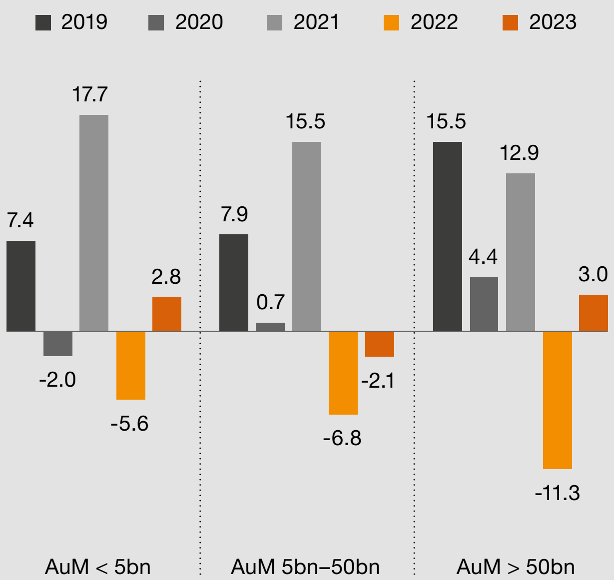
While the general decline in AuM in 2022 marked an end to the record heights seen in 2021, not all size buckets experienced a return to positive AuM growth trajectories in 2023. The net new money growth rates in 2023 also depict uneven trends: while all clusters withstood the challenging environment in 2022, only small and large private banks continued to achieve positive net new money inflows.

In line with the trends observed in previous years, large private banks continued to attract net new money (NNM) in 2023, with an even higher growth rate compared to the prior year. Whilst their total combined AuM reached approximately CHF 2,740 billion, large private banks remain roughly 8% below their peak AuM level in 2021 – a period that was strongly influenced by pre-interest rate hike developments. Despite an increase in the growth rate to 3% in 2023, this figure remains relatively conservative. Several large private banks undoubtedly aimed to achieve a boost in NNM following the downfall of Credit Suisse, Switzerland's second-largest bank, in March 2023.

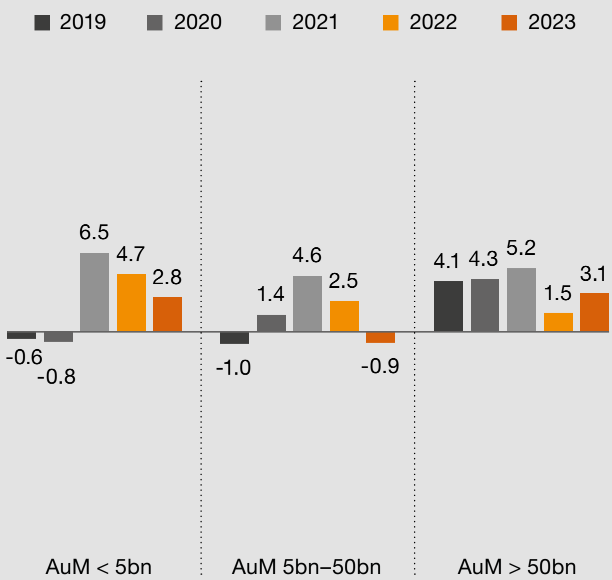
Across all size buckets, NNM represented the key driver for AuM development in 2023. Market effects, including price gains/losses, interest and dividends contributing to AuM, had a comparatively lower impact. This was due to a combination of geopolitical tension and expectations of potential interest rate movements by central banks. Unlike the other size clusters, medium-sized banks failed to capitalise on this driver, and experienced a net new money outflow at an overall bucket level for the first time since 2019. This outcome was predominantly influenced by a few private banks within this size cluster, which also bore the brunt of negative market effects.

Despite operating with notably lower AuM levels, smaller private banks achieved comparable AuM and NNM growth rates to their largest counterparts. This phenomenon could be attributed to various factors, including the possibility that certain ex-Credit Suisse private banking clients may have sought out smaller institutions as their preferred wealth management partners. Additionally, the niche and/or regional focus of many banks within this cluster may have played a significant role in driving positive net new money inflows in 2023.

Assets under management growth
(in % per size bucket)



Net new money impact
(in % per size bucket)



Outlook

With the cut in the key interest rate from 1.75% to 1.5% in March 2024, the Swiss National Bank (SNB) was the first of the largest global central banks to take such a step. The latter institutions are continuously faced with relatively greater inflation-related concerns compared to our domestic economy. Nevertheless, additional rate cuts from the SNB, along with initial rate cuts from both the Fed and the ECB, are widely predicted for 2024, and may serve as catalysts for positive financial market performances. Consequently, this would re-empower the market effects driver as a contributor to the overall positive AuM development for private banks in Switzerland and Liechtenstein. Conversely, the potential absence of rate cuts, as well as deteriorating geopolitical tensions, might negatively impact financial market developments and consequently AuM growth via performance effects.

Furthermore, we predict an annual NNM growth rate of between 2% to 5% across all size buckets as being realistically achievable over the next few years. As a matter of fact, Switzerland's political neutrality and reputation for stability, combined with the industry's expertise and discretion, remain key factors in its recognition as a global hub for private banking services. We anticipate that larger private banks, with their heightened expertise and ability to cater to complex wealth management demands due to their larger organisational structures, will instead position themselves at the upper end of this range. Conversely, small and medium-sized private banks will likely compete at the lower end of this NNM range while emphasising their respective business model focus.

Stellar income margins realised by small private banks thanks to higher interest rates

What became evident in the financial figures for 2022 was further confirmed in 2023: the notable increase in net interest income has resulted in historically high operating income margins across all size clusters. This impact was particularly pronounced in the small-sized bank cluster, followed by medium and large private banks. The fee and commission income, which traditionally has been the main source of income for private banks, remained stable compared to FY22 in terms of margins achieved on the AuM.

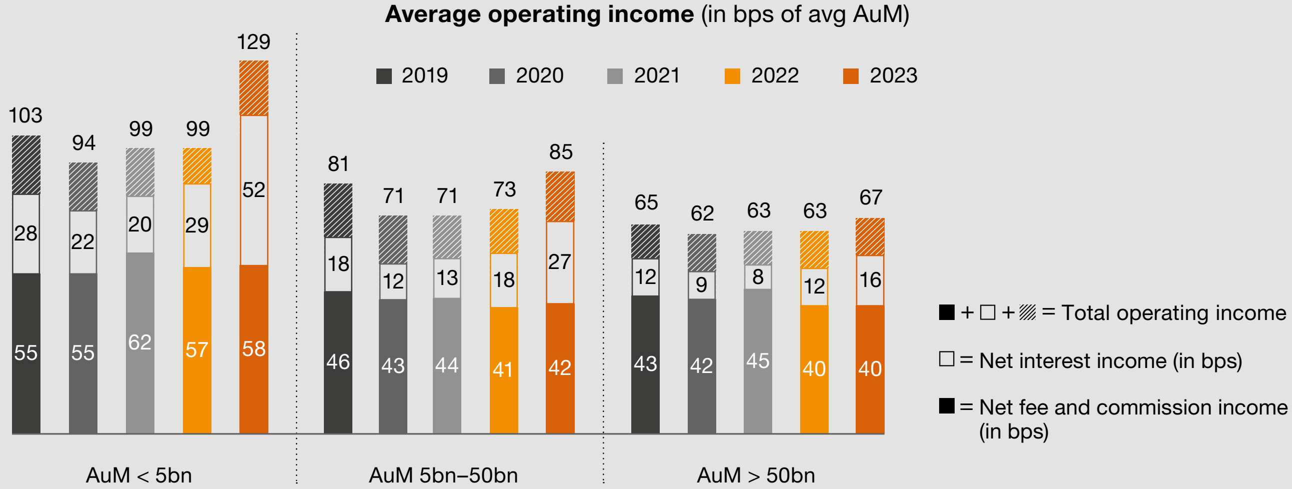
The smallest size bucket benefited the most from the increased interest rates prevailing throughout 2023. In terms of their average AuM levels, the net interest income margin nearly doubled from a total group perspective. However, net fee and commission income remained almost unchanged compared to the prior year, indicating that the peaks achieved in 2021 can no longer be reached.

There are several reasons behind the generally higher total operating income margins achieved by smaller players. To begin with, smaller private banks typically advise a higher share of private client AuM compared to larger counterparts, which also serve institutional clients to a significant extent. Furthermore, smaller private banks have a higher proportion of AuM in discretionary mandates compared to their large and medium-sized peers. This results in a higher net fee and commission income margin compared to their larger peer companies. In addition, the net interest income has a higher impact on the total operating income at smaller banks compared to their larger peers. The reason for that is that the loan business has a higher weight in terms of total business volume (AuM plus loans) at smaller banks, with approximately 9% over the past three years compared to their largest peers with a ratio of only approximately 5% over the same period. No material differences can be observed in the composition of the loan books between smaller private banks and their larger peers (similar portions of mortgage and lombard loans). Furthermore, the client deposit-to-AuM ratio is higher at smaller banks compared to their larger peers. Over the past three years, small private banks have maintained an average client deposit-to-AuM ratio of approximately 20%, compared to 13% and 11% for medium and large-sized private banks respectively. Therefore, these smaller institutions can be said to have benefited more relatively speaking from the higher interest rates that could be earned on the liquidity accounts held at the Swiss National Bank (SNB).

Both medium and large-sized banks nonetheless also took advantage of increasing net interest income margins, albeit to a lesser extent, since the deposit/loan business is of lower importance in terms of their overall business activities. Some of these institutions noted that their customers generally reduced their deposits to capitalise on investment opportunities in 2023. This observation contributes to the comparatively lower increase in the net interest income margin. However, in line with their smaller-sized peers, both size clusters recorded their highest total operating income margins in the last five years driven by the positive impact resulting from the net interest income.

Considerable attention should be given to the net fee and commission income margin, which stagnated at the low level achieved in FY22. Following the overall decline in 2022, private banks appear to be facing challenges in revitalising this income component. This is particularly noteworthy, considering that net fee and commission income has historically been the cornerstone of revenue generation for private banks.

Average operating income (in bps of avg AuM)



Outlook

We are sceptical regarding the sustainability of the high net interest margins and the corresponding income for the private banking sector. Firstly, we anticipate further declines in interest rates in the upcoming periods. Furthermore, a prolonged focus on net interest income generation would ultimately signify a shift in the business model from investment portfolio management to a more enhanced balance sheet management – a function traditionally undertaken by universal banks.

Henceforth, we anticipate the net fee and commission income proportion to regain share relative to the other operating income drivers. However, it will remain a challenge for private banks both in Switzerland and Liechtenstein to improve their current commission income margins. This is particularly due to the fact that traditional private banking services are becoming increasingly commoditised, with the emergence of numerous new (tech) players leveraging cutting-edge technology in their business models. Differentiation will be crucial in order to achieve sustainable success. A handful of successful private banks have already demonstrated this by offering innovative service modules, emphasising on niche markets or focusing on a clearly defined group of clients.

Operating expenses soared to new heights fuelled by record personnel expenses

The private banking sector continues to be highly competitive, with skilled and compassionate relationship managers playing a predominant role for the success of the different players in this industry. In 2023, personnel-related costs reached new heights, both in absolute and relative terms across the five previous periods. In addition to expensive acquisition costs for individual relationship managers or entire teams, the overall increase in full-time equivalent (FTE) bases in particular has contributed to these higher expenses.

With a total increase in full-time equivalent numbers of almost 7%, large private banks posted the highest growth rate among the three size buckets and over the past five periods (see graph on following page). In addition to their general growth strategies, many of these large players have been actively recruiting former relationship managers from Credit Suisse, which collapsed in 2023. However, attracting these industry experts is costly and has led to higher absolute costs. Despite the increase in the total number of FTEs, personnel expenses at large private banks grew at a lower rate, suggesting that not just expensive front-line employees were hired but variable components were also granted subject to tighter restrictions. This is evidenced by the fall in personnel costs per FTE, which amounted to CHF 265k for 2023 compared to CHF 271k in the previous year.

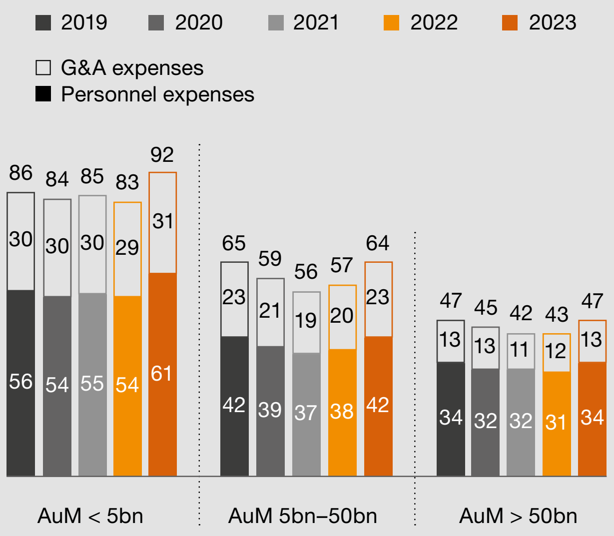
In 2023 many medium-sized and smaller private banks continued their growth endeavours, resulting in higher overall FTE numbers. Medium-sized private banks increased their FTE base by 3%, while smaller private banks experienced growth of 6% compared to 2022. The continuous FTE base increase, especially since 2021, underscores the ongoing vitality of the private banking market. Despite a general tendency towards efficiency optimisation, FTE numbers are not primarily affected, which indicates that the segment remains active in employing additional skilled staff.

Examining the increased expenses per FTE, this could either be influenced by higher bonus payments compared to the previous year or the intense competition for competent and well-connected client advisers with attractive salary packages.

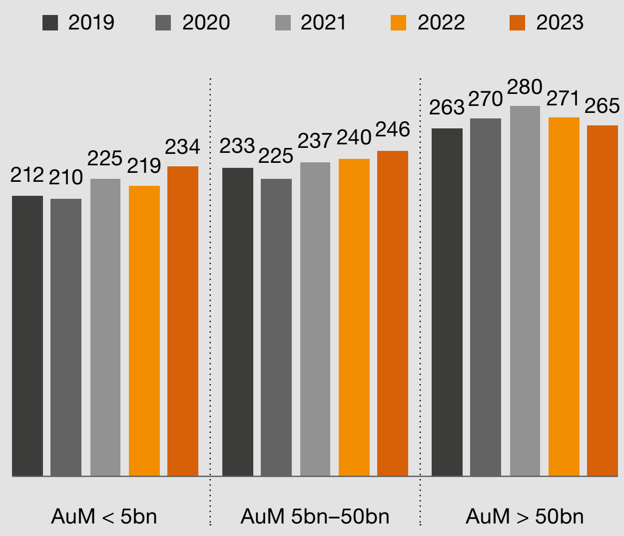
While the staff increase is primarily attributed to client-facing employees, continuous regulatory requirements have compelled banks to expedite the hiring of proficient experts in this area and permanently enhance the skills of existing employees.

On the other hand, general and administrative (G&A) expense margins have remained relatively consistent with prior periods thanks to strict cost discipline being displayed by the private banks in the sample. Nevertheless, the slight uptick in 2023 is primarily attributable to increased costs related to information & communications technology and equipment expenses. This increase may also be driven by higher regulatory scrutiny to ensure full compliance.

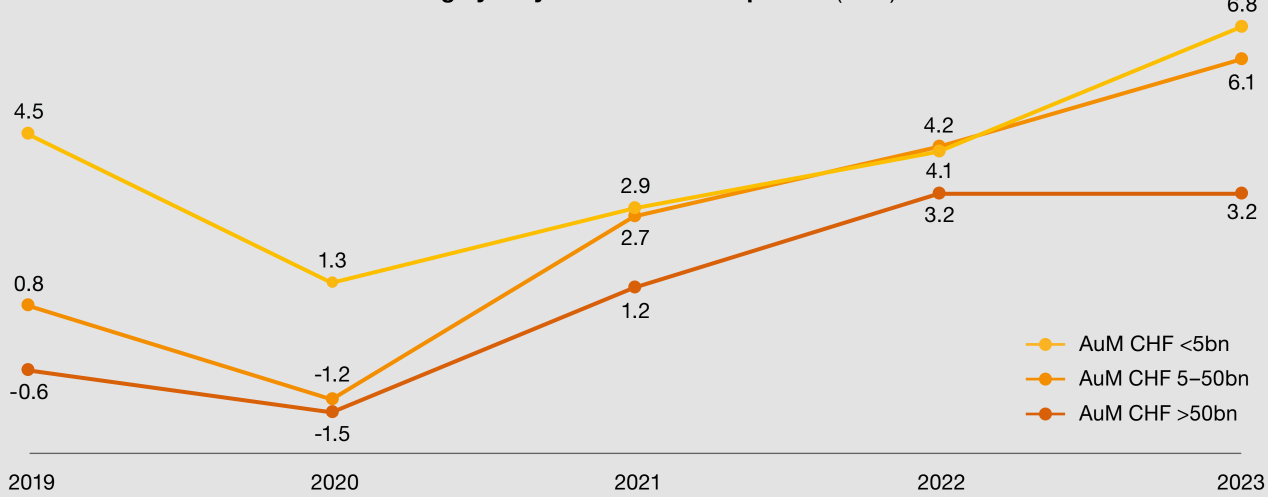
Average operating expense margin
(in bps of avg AuM)

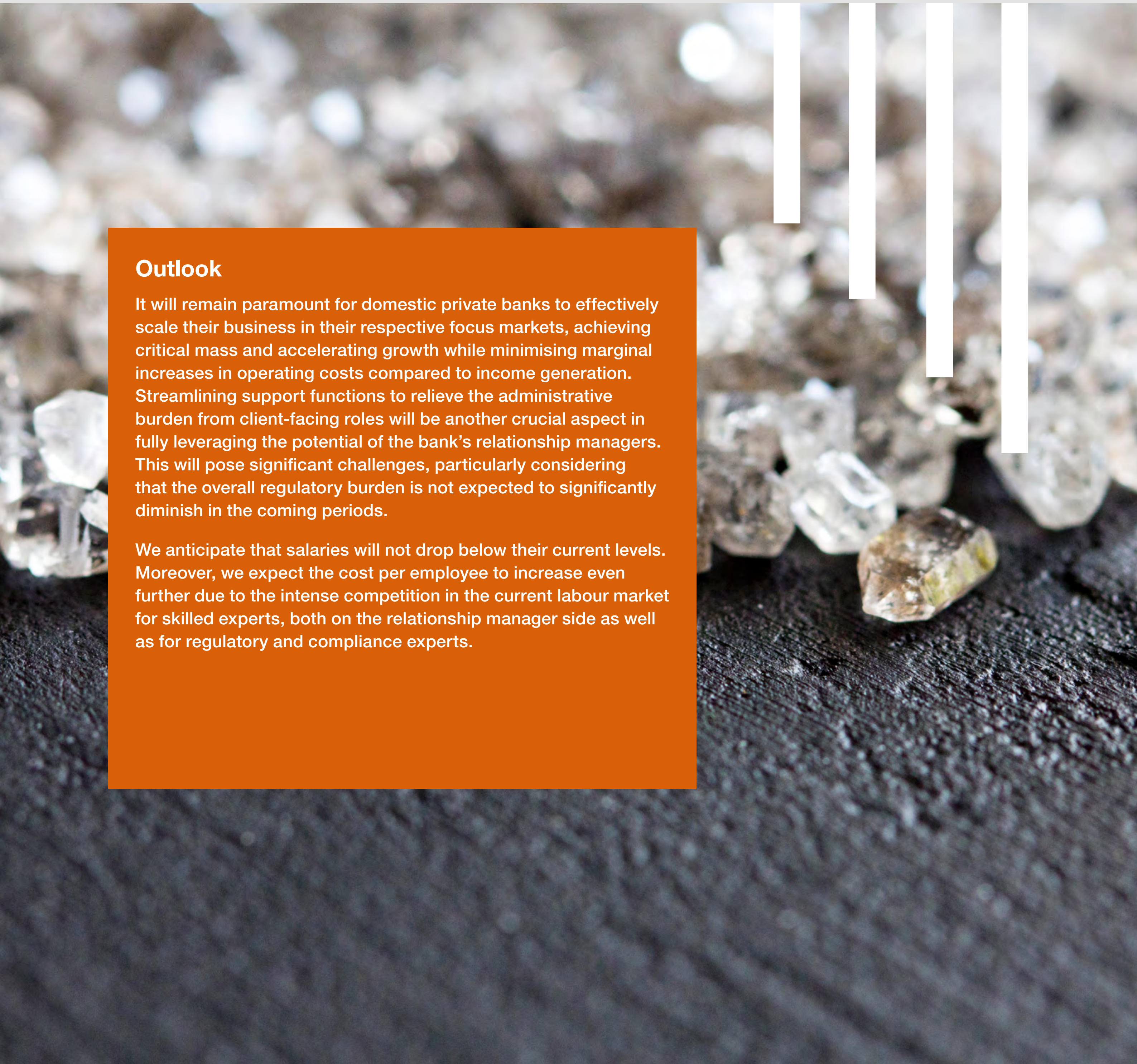


Average yearly expenses per FTE
(in CHF thousands)



Average yearly FTE base development (in %)





Outlook

It will remain paramount for domestic private banks to effectively scale their business in their respective focus markets, achieving critical mass and accelerating growth while minimising marginal increases in operating costs compared to income generation. Streamlining support functions to relieve the administrative burden from client-facing roles will be another crucial aspect in fully leveraging the potential of the bank's relationship managers. This will pose significant challenges, particularly considering that the overall regulatory burden is not expected to significantly diminish in the coming periods.

We anticipate that salaries will not drop below their current levels. Moreover, we expect the cost per employee to increase even further due to the intense competition in the current labour market for skilled experts, both on the relationship manager side as well as for regulatory and compliance experts.

Historically solid cost-income ratios achieved through extraordinary net interest results

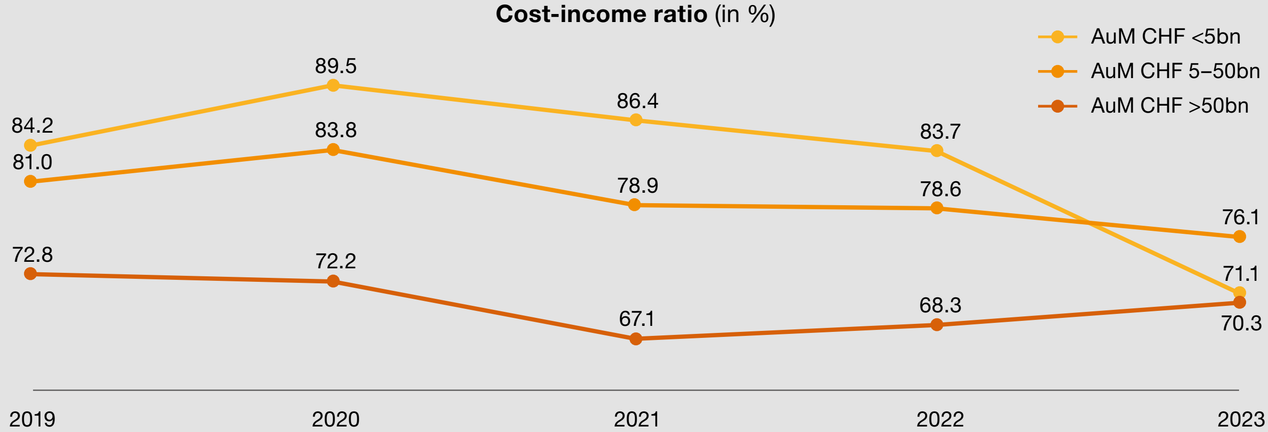
For many years, large and medium-sized private banks have consistently outperformed their smaller counterparts in terms of cost-income ratio (CIR). However, this trend has drastically shifted, with smaller private banks achieving a total CIR of 71% in 2023, as highlighted by the drivers discussed in the previous two sections of this study.

The relatively stronger emphasis on interest-related banking activities, coupled with the generally high interest rates, has led to a reduction in the CIR for small private banks from 84% in 2022 to 71% in 2023. The net interest income contribution to overall operating income not only compensated for the increase in operating expenses but also paved the way for this impressive improvement.

Medium-sized private banks failed to generate equal excitement, as their combined CIR only decreased by 2.5 percentage points compared to 2022. Further reduction was hindered by the lower importance of interest-generating revenues compared to their smaller peer companies. This meant that the CIR achieved by this size cluster was clearly higher than that of their smaller peers, which has not been the case before in previous years.

The largest banks in our sample reported an increase in their CIR to 70% in 2023. The decline in net commission income as well as the continuous rise in operating expenses on an aggregated absolute basis are the predominant causes of the negative CIR development in 2023 compared to previous years. This has not been offset by a sufficient increase in net interest income generation, since these specific revenue streams are of lesser importance to these large private banks.

Cost-income ratio (in %)



Outlook

As outlined earlier, we predict shifts in the dynamics of the private banking market. With a decrease in interest rates, the emphasis on commission income will proportionally become more important again over the coming periods – even for smaller private banks. Therefore, we estimate that a CIR of around 80% would be a good ratio for small and medium-sized private banks. Achieving this result on a permanent basis will require a focused business model and disciplined operational cost management. We provided further insights into these topics in our recently published report on successful private banking business models.

We project that large private banks will continue to leverage their high AuM volume base, therefore realising economies of scale and operational efficiency. In a favourable financial market environment, we estimate that their constant CIR will tend towards 65%.

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

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

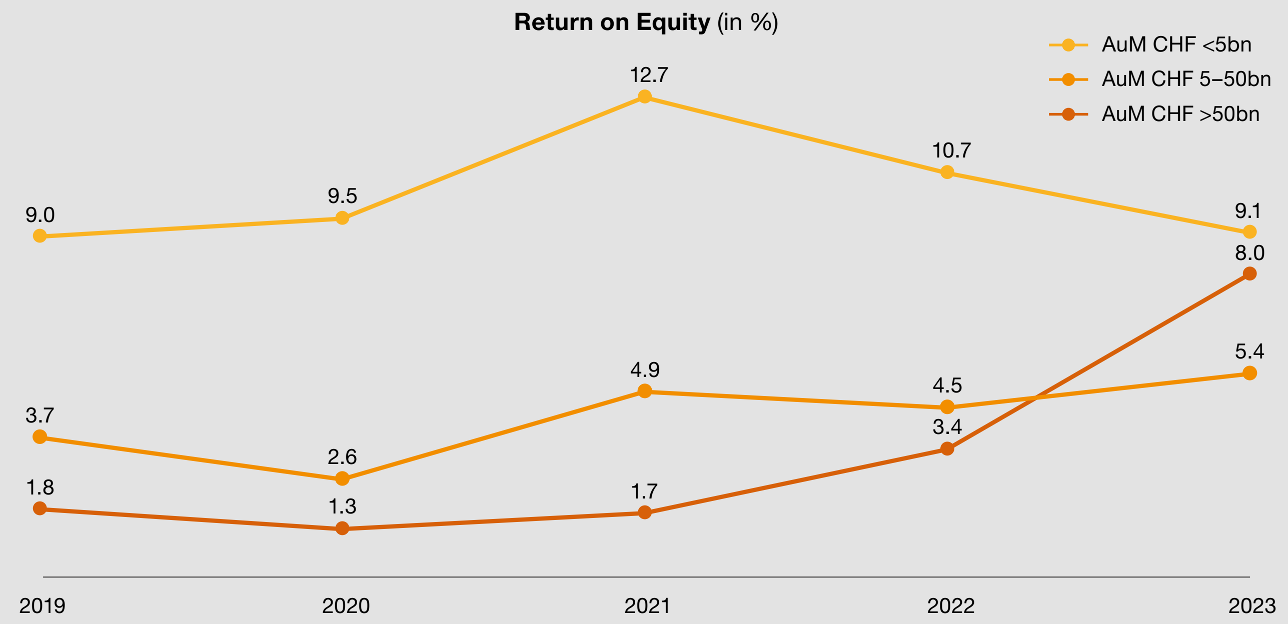
Strong interest results with significantly positive impact on bottom-line results for smaller private banks

After years of reporting return on equity (RoE) figures that clearly fell below expectations from an equity investor's perspective, small private banks achieved a remarkable profitability upswing in 2023. While medium-sized private banks also recorded their highest RoE numbers across the five-year period presented, large private banks experienced a reduction in RoE for the second consecutive year.

Large private banks have long been praised for their ability to leverage their high AuM volume into adequate profitability, though they faced challenges in both 2022 and 2023 in increasing their aggregated return on equity. With a combined RoE of 9.1% in 2023, the group saw profitability decline to levels last seen in 2019. The group as a whole struggled in 2023 with a higher operating cost base (mainly due to increased personnel expenses resulting from higher FTE numbers) compared to previous years, which outweighed the AuM volume growth and the positive effect resulting from the interest-bearing business activities, whereas the profitability on the commission business stayed flat.

Medium-sized banks achieved only a modest progression in their RoE to 5.4% in 2023. While this marks the highest return since 2019, it is still clearly too low in our view from an equity investor's perspective. This implies that banks within this size cluster would need to pursue higher volume growth or improve their income margins to effectively scale their existing platform. This would enable them to achieve a satisfactory RoE that adequately compensates investors for the risk associated with investing in a private banking entity of this kind.

By contrast, smaller private banks present a completely opposite picture. This size cluster demonstrates its ability to leverage the opportunity presented by higher interest rates by achieving a record-high combined RoE of 8%. Nonetheless, there remain a few institutions within this size group that were still loss-making in 2023 as well as the previous years. Therefore, small private banks that have already been profitable in previous years were the predominant driver of this overall positive result in 2023 by further enhancing their strong market position and turning it into increased profitability.



Outlook

Heading into periods where interest rate cuts are expected will first and foremost present challenges for the cluster of the small private banks that has significantly benefited from the high interest rate environment in 2023. We therefore expect small private banks to be most affected by RoE volatility. From our perspective, it is highly questionable whether the outstanding results seen in 2023 are sustainable. Instead, we expect smaller private banks to lose ground again going forward compared to their larger counterparts. It will become increasingly challenging for inherently loss-making banks in particular to navigate the upcoming periods and become profitable again.

From our point of view, larger private banks are instead poised to derive greater advantages from a lower interest rate environment. This environment, which exerts a positive influence on financial markets, facilitates growth in AuM through a combination of net new money NNM influx and performance effects. This consequently enables these banks to realise economies of scale on their existing platforms.

We expect this group to clearly outperform their smaller and medium-sized counterparts on an aggregated basis over the next few years as well as in the long term, as AuM volume effects will become even more crucial in the private banking industry going forward.

Contacts

Martin Schilling
Managing Director
Deals Financial Services –
Asset & Wealth Management Leader

+41 58 792 15 31
martin.schilling@pwc.ch

Sandro Di Bernardo
Senior Associate
Deals Financial Services

+41 58 792 10 94
sandro.di.bernardo@pwc.ch

Special thanks go to the PwC FS Deals team for the creation of this publication.

Coming soon

Stay tuned for more insights about the Swiss banking sector by reaching out to the authors. Contact us to take advantage of our sophisticated financial benchmarking tools as well as qualitative insights into successful private banking business models of smaller-sized institutions.