M&A and restructuring trends in the Swiss private banking industry

Jean-François Lagassé
Partner
Corporate Finance
Deloitte

Jean-Philippe Fiot
Manager
Corporate Finance
Deloitte

Traditional M&A activity in the Swiss private banking market will continue to be constrained by sector uncertainties: we therefore expect consolidation to increasingly occur via 'asset deals', often in combination with bank liquidations.

Despite significant sector pressure on Swiss private banks to consolidate, few traditional M&A transactions have taken place recently. The most recent initiatives suggest that 'asset transactions', where an acquirer purchases portions of the seller's client assets—rather than an entire legal entity—seem to have become the 'new normal'. Small and large banks alike are increasingly using this route to dispose of selected activities that no longer form part of their core business, or in certain cases, to exit the Swiss market. Such transactions, where a selection of the assets are acquired, reduce the potential legacy risks arising from regulatory or fiscal issues and entail a more straightforward integration process, easing the uncertainties currently faced by sector participants and improving value creation potential for sellers.

Although consolidation has not occurred on the scale many experts had anticipated, it is likely to continue over the short to medium term at an increased pace, but taking a different shape.

Sector uncertainties continue to have a significant impact

The profitability of Swiss banks active in wealth management is coming under strong pressure as a result of diminished organic growth, margin erosion and an increase in operating costs relating to regulation and the implementation of fiscal compliance programmes.

The rapid pace and number of regulatory changes affecting the sector has generated major uncertainty, especially regarding the ability of a number of banks to absorb the price of cross-border fiscal programmes. In particular, the considerable fines that Swiss banks may have to pay as a result of the agreement between Switzerland and the U.S. Department of Justice could significantly impact the equity base of a number of banks, with some potentially requiring recapitalisation or being forced to exit the market. Moreover, the lack of clarity regarding potential future agreements with European countries such as France and Germany, as well as the impact of MiFID II, significantly reduces operational and financial visibility for many market players.

These factors, along with the 'regulatory tsunami', discourage banks from acquiring a legal entity that may bring significant legacy risks. The constrained profitability in the sector is also reducing the number of transactions, as purchasers are not willing to restructure an acquired entity, while sellers are generally unwilling to fund the required restructuring costs. We therefore expect that most of the traditional banking transactions currently ongoing via a 'share deal' will be significantly delayed or fail. Until the regulatory environment is clarified, we believe that few traditional M&A transactions will take place.

Asset deals: the new normal for banking M&A

One of the main consequences that we observe in M&A activity is the increased appetite for 'asset deals' rather than 'share deals'. Under an 'asset deal', a potential purchaser acquires selected business assets (for example parts of the client book and employees) rather than an entire bank or legal entity, thus reducing the risk of taking on historical liabilities. In addition, this structure allows for greater control of the ultimate transaction price, as the price for asset deals is generally based on the client assets transferred to the acquirer.

Many transactions that took place in 2013 point to the popularity of asset deals: the acquisition by *Union Bancaire Privée* (UBP) of Lloyds International Private Banking business was structured like this. UBP also acquired a book of clients from *Banco Santander* (Suisse) in a similar way. Bank Frey sold its non U.S. client book to *Banque* Heritage in 2013, ahead of its announcement that it was going to cease its private banking activities. In June last year, the Eastern European and *LatAm* client books of Hyposwiss Private Bank Zurich AG were sold respectively to Falcon Private Bank and *Banque Privée Esprito Santo SA.* LLB opted to exit its presence in Lugano by selling its client assets to PKB and then liquidating the remaining legal entity. Julius Bär's acquisition of Bank of America Merrill Lynch's HNW private client business was also structured largely as a series of asset deals.

These transactions are of strategic and financial relevance to potential acquirers, as they represent an efficient and profitable way to increase critical mass and assets under management, which is challenging to achieve organically in today's low-growth and intensely competitive market environment. We observe that the prices paid for client assets generally range from one to two years of revenues for fiscally declared clients. Such prices would be difficult to achieve through a 'share deal', which currently remain priced at or below book value.

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A resulting factor—bank liquidations

Going by the asset deals that have taken place, we anticipate that in most cases the legal entity left behind after an asset transaction will opt for run-down and liquidation. Today, there are large numbers of banks being sold in Switzerland. In most cases, at least initially, a sale of the whole bank is being attempted. We expect that several share deals will fail and that the seller will choose to go down the asset deal route followed by a liquidation for a result to be achieved.

A bank can opt for a voluntary liquidation, in which case the approval of the regulator (FINMA) is required. The main challenge of a banking liquidation is to maintain conformity with the regulator until the process is finalised. Efficiently managed, a voluntary liquidation process can be completed in approximately 18 months. Wegelin, which was the first banking institution to liquidate itself in Switzerland after the imposition of U.S. penalties, accomplished this in less than 18 months. Depending on the level of complexity, the process can take longer. Again, one of the main challenges is the management of the U.S. fiscal risk exposure the bank is facing.

Number of asset transactions versus share transactions in Swiss private banking