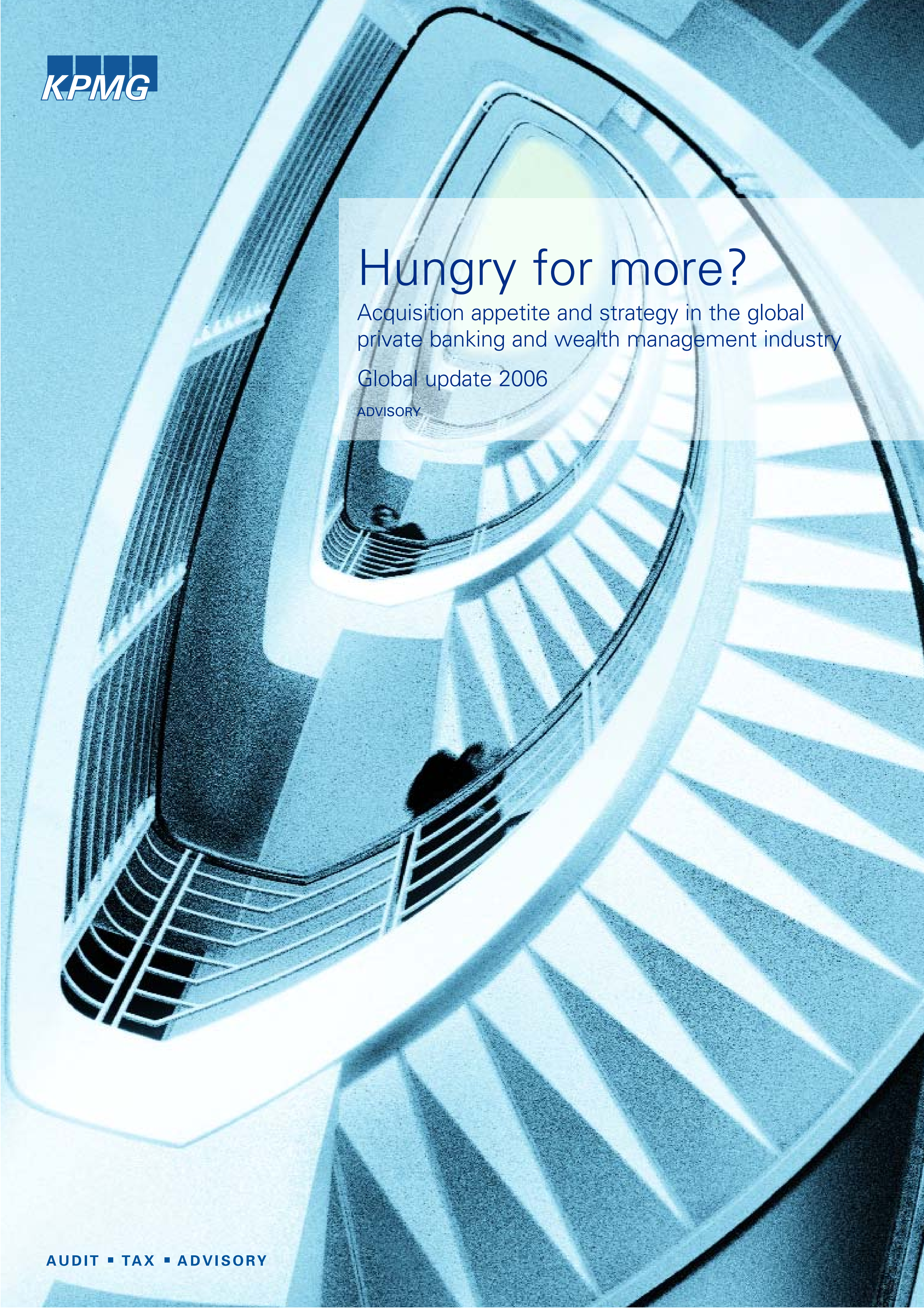

KPMG

Hungry for more?

Acquisition appetite and strategy in the global private banking and wealth management industry

Global update 2006

ADVISORY

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Contents

Introduction

The private banking and wealth management industry remains in a confident frame of mind. As the number of high net worth individuals around the world continues to increase, and as their assets grow in value thanks to recent strong performance in the capital markets, there is no shortage of demand for what was once a niche service in the banking industry.

In addition to new opportunities at home and abroad, private banks face a number of challenges. Traditionally this has been a highly fragmented industry, characterized by a large number of smaller players and no dominant market leader, however, this may be changing as smaller banks get squeezed out by rising costs and competition.

Regulatory trends also tend to favor larger, consolidated players. For example, stricter rules have been brought in to counter money laundering and block the financing of global terrorism over the past few years. This has placed private banks under even greater scrutiny from regulators, and forced them to put in place compliance measures that are ramping up an already high fixed cost base.

'Hungry for more? Global update 2006' is the third in an annual series of studies by KPMG International of senior executives in the private banking and wealth management industry. The results reveal:

- Pressures that are fuelling appetites for consolidation
- Regional differences in acquisition strategy
- Primary obstacles in the acquisition process.

Approach

This study was conducted in March and April 2006 through a survey of 147 private banks and wealth management institutions around the world.

Supplementary to the survey results, interviews were conducted with a limited number of senior executives at leading organizations in the sector.

The underlying survey and interviews were conducted by the Economist Intelligence Unit. The confidentiality of individual responses was guaranteed as a condition of participation.

Reference is made throughout this publication to the size of the respondents' private banking operations. The classification is based on the number of full-time employees as follows:

- Small: fewer than 200
- Medium: 200 – 499
- Large: 500 or more

Comparisons throughout this survey are to the previous KPMG International 'Hungry for more?' surveys, published in 2004 and 2005.

KPMG International would like to thank all respondents for their participation.

Please note that the terms 'private banking' and 'wealth management', and any derivations thereof, are used interchangeably throughout this publication.

Key findings

Acquisition appetite

- More than 90 percent of private banks surveyed believe that there are good prospects for growth in the industry over the next three years. Confidence was slightly higher in Asia than in Europe or North America.
- Smaller banks are more optimistic than their larger counterparts about growth prospects.
- 258 deals were completed in 2005, up from 142 in 2004. The Asia-Pacific region continued to dominate activity, accounting for 45 percent of all deals in 2005 (up from 38 percent in 2004).
- 89 percent of respondents are either actively seeking acquisition targets or would consider acquiring if the right opportunity arose.
- 29 percent of survey respondents had acquired another private banking business in the past three years. Among those companies in the survey that had made an acquisition, the mean number of transactions in the past three years was 2.7.
- Small banks appear to be under pressure, with 55 percent citing increased competition from larger, consolidated competitors as being the primary driver of structural change in the sector.
- Acquisitions worth more than US$1 billion are far more common in North America than in Europe or Asia.
- The average deal size in 2005 (ignoring the five largest deals) was US$103 million, which is consistent with 2004 (US$100 million).
- Domestic acquisitions continue to dominate the sector, at 78 percent of all deals in 2005.

Growth strategies

- One of the most important objectives for acquisitions made in the past three years were geographical expansion and increasing market share.
- Although respondents overall continue to attribute greater importance to organic growth than acquisitions, the number citing growth by acquisition as being more important jumped to 31 percent from 15 percent last year.
- European and North American respondents were most likely to favor organic growth over acquisitions, while in Asia the two approaches are broadly balanced.
- North American banks are more likely to be actively seeking acquisitions than those in Asia or Europe.
- China and Eastern Europe are seen by a high proportion of respondents as having the greatest potential for growth in the industry.
- Almost 22 percent of respondents expect to spend more than US$1 billion on acquisitions over the next three years.

Obstacles and success factors

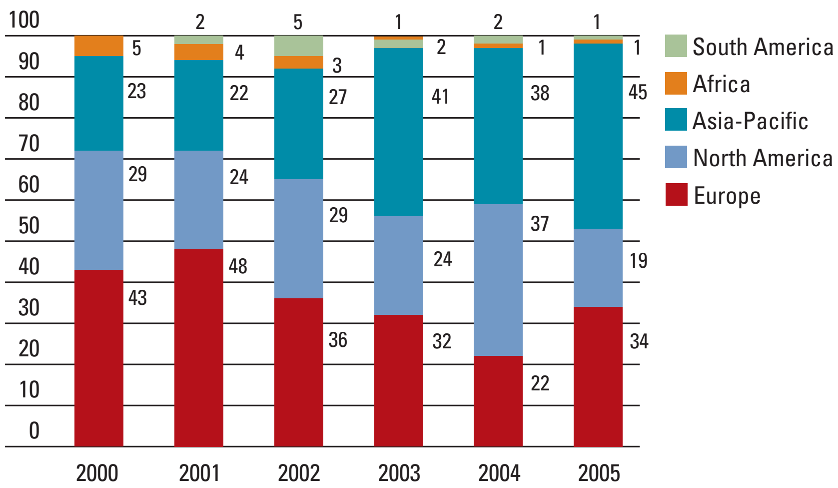
- Regulatory barriers are widely seen by respondents as hindering the pace of consolidation in the industry. In previous years this factor has not weighed as heavily on acquisition prospects but it is clearly gaining significance.
- Deals in North America were most likely to be thwarted by excessive price expectations from target companies.
- Fully 67 percent of respondents lost some proportion of the acquired company's client base within one year of completing their largest acquisition. 39 percent of companies lost over 10 percent of the target company's customer based following the acquisition; this does not indicate a significant shift over the original survey two years ago.
- Despite this, more than 80 percent of respondents said that acquisitions made in the past three years had increased shareholder value.
- Contracting issues post-integration are rarely a significant problem, and no respondents had to resort to arbitration or involved legal processes.

Acquisition appetite is growing

The total number of mergers and acquisitions in the industry increased sharply in 2005 to 258, compared with 142 in the previous year and 113 in 2003 (Source: Thomson Financial Data SDC). This may reflect the drive by larger banks to gain economies of scale through acquisition; 39 percent of respondents from companies with 500 or more employees said they had acquired another private banking business over the past three years, compared with 28 percent for mid-sized companies (200 to 499 employees) and 20 percent for the smallest.

Excluding the top five deals of 2005, the average deal size was US$103 million, consistent with US$100 million the previous year.

Number of mergers and acquisitions in the private industry by region (percent)

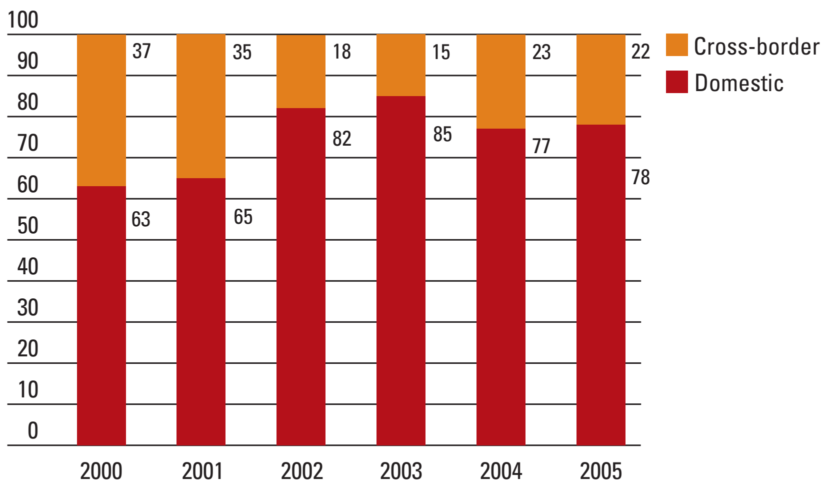


Source: Thomson Financial Data SDC, KPMG analysis 2006

The Asia-Pacific region saw most M&A activity last year with 45 percent of the total, followed by Europe with 34 percent. This continues a three-year trend, in which Asia-Pacific accounted for 42 percent of activity between 2003 and 2005.

The proportion of cross-border deals last year was 22 percent. This figure is virtually unchanged from the previous year, indicating that domestic activity continues to dominate global M&A transactions. Over the past three years, 96 percent of deals between private banks based in North America and 91 percent of transactions between Asian private banks, were domestic (see map on page 7 of M&A transactions by region). By contrast, only 73 percent of acquisitions that took place between European-based banks were domestic, a much higher level of cross-border activity in the region than in Asia and North America.

Domestic and cross-border deals as a proportion of banking (percent)

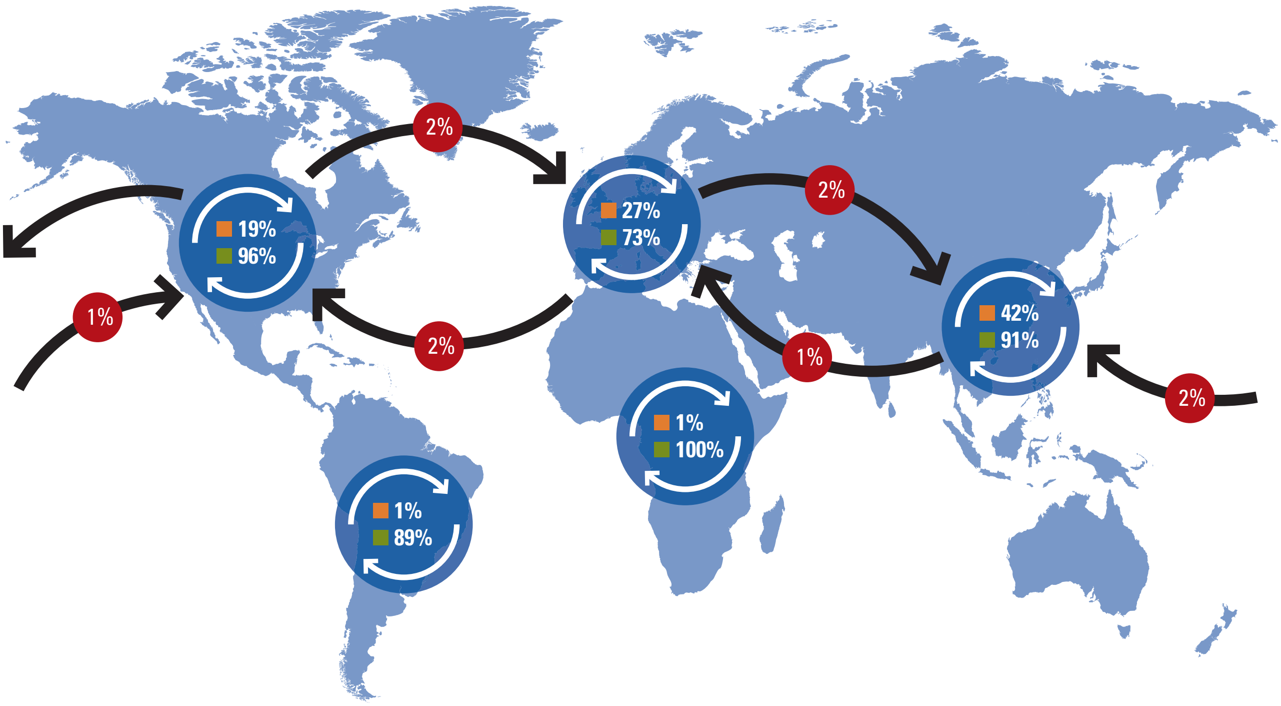


Source: Thomson Financial Data SDC, KPMG analysis 2006

Despite North American and European respondents' high interest in acquiring companies in Asia, in practice only a small proportion of acquisitions in Asia over the past three years were made by banks from these regions. Indeed, the number of acquisitions made by North American and European banks of Asian firms dropped to 2 percent of the global total in the 2003-5 period, from 3 percent in 2002-4, indicating in part how difficult it is to find classic private banks in the region.

The purchase of North American private banks by Europeans also fell, to 2 percent from 3 percent in the previous three year period. High price expectations on the part of North American sellers is likely to have played a part in this drop.

Proportion of private banking transactions per region by volume (number of deals), 2003-2005

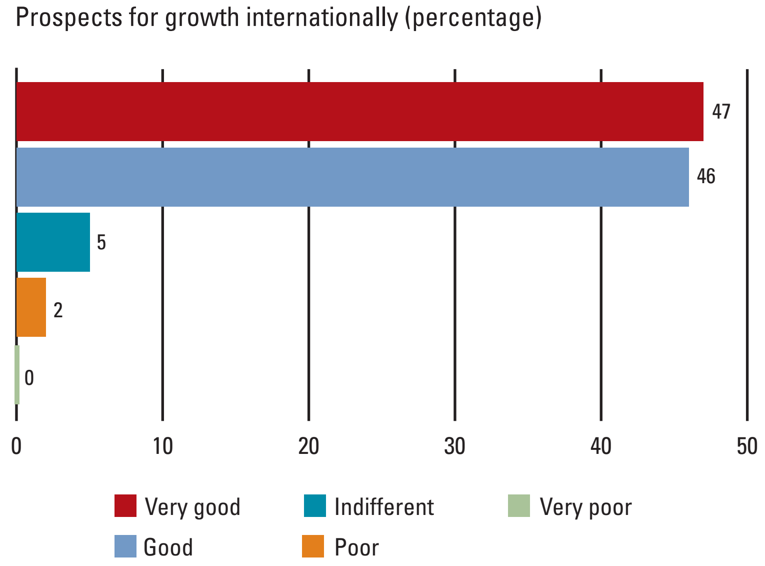


- Inter-regional acquisitions (acquirer and target in different regions*)
- Acquisitions where acquirer and target are in the same region
- Domestic acquisition

*Regions defined as North America, South America, Europe, Africa and Asia-Pacific

Source: Thomson Financial Data SDC; KPMG analysis 2006

Growth prospects are strong, particularly in Asia



The private banking industry is in a confident mood, with more than 90 percent of survey respondents anticipating good growth prospects over the next three years. Confidence was particularly high in Asia, reflecting the rapid creation of new wealth in the region, especially in China. The traditional Asian markets, including Hong Kong and Singapore, also continue to be attractive.

Smaller banks are more optimistic, with 51 percent of respondents considering prospects for growth to be very good, compared with 33 percent and 41 percent of medium and large banks respectively.

Outside Asia, the emerging market countries of Eastern Europe, notably Russia, and Latin America continue to attract attention. In these regions banks are seeing opportunities both on- and offshore, as wealthy individuals seek to place income in the safe havens of known and trusted international financial institutions.

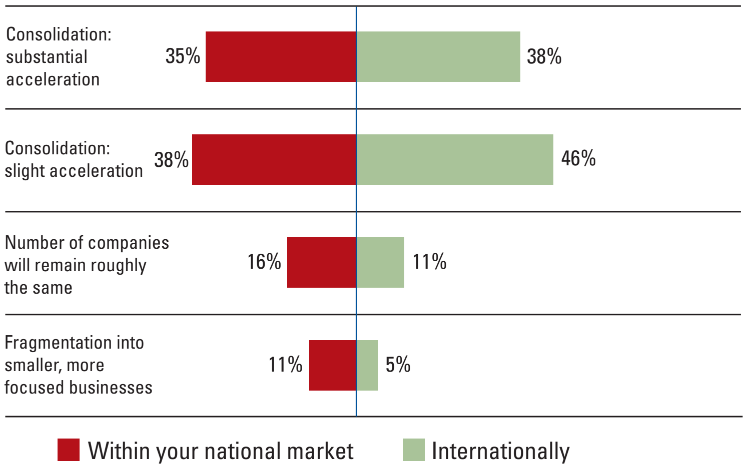
In Western Europe, individual countries with a relatively unexploited private banking sector are targets for expansion. Spain, which has witnessed considerable takeover activity in its corporate sector in recent years leading to wealth creation, and a strong increase in GDP, is one example. Javier Marin, CEO of BANIF, a subsidiary of Banco Santander, observes: “The potential is big, but this is a small market compared to the UK or Italy. And for foreign banks coming here, Spain is an ideal route into Latin America.”

"Larger organisations appear less personal to wealthy clients, so the efficiencies of scale they provide hinder their market growth," says a U.K.-based respondent.

Consolidation is expected to accelerate

Private banking remains a fragmented industry, populated by many small institutions. However, this is changing as the large universal banks seek to both move into this relatively stable and high margin business and to achieve economies of scale, either by acquisition or organic growth, in turn putting pressure on their smaller rivals to consolidate. Among medium and small banks in the survey, over 50 percent expected substantial consolidation within their domestic market, compared with 35 percent overall.

Expectations for further consolidation over the next three years

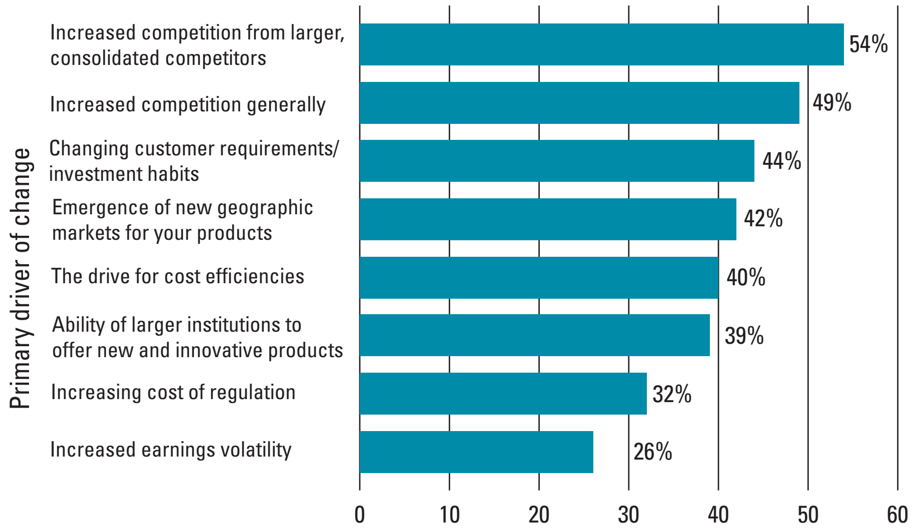


Fully 73 percent of executives said they expect further consolidation within their domestic market and 82 percent said the same with regard to the international private banking market. However, the prospects for consolidation varied between regions. For example, only half of the Latin American respondents expect any further consolidation in their home markets over the next three years, compared with three-quarters in the Middle East and Africa who believe the pace of consolidation will pick up substantially.

In North America the expectation of consolidation at home was also higher than average at 79 percent. This is interesting, as it may mark a change in direction for the U.S. market, where the majority of the North American respondents came from. In previous 'Hungry for more?' surveys, many U.S. private banks saw being "small and local" as a strength. However, this year's results suggest a shift towards larger, consolidated private banks in the U.S., a trend that is also supported by some of the interviews.

"I see further consolidation in North American wealth management," says Steve Jacobs, Head, Group Strategic Advisory at UBS, which recently bought Piper Jaffray's private client network for US$500 million. "Many of the smaller regional participants are being squeezed by competitive pressure."

Primary forces driving structural change (multiple mentions)



Asked what forces are driving structural change in the private banking and wealth management industry, 54 percent cited increased competition from larger consolidated competitors. In North America, 60 percent pointed to the emergence of new geographic markets for their products while in Asia-Pacific 55 percent cited increased competition generally, in line with the flood of new entrants into that region.

"Almost every major bank in the world has a private banking operation here," says Bob Cormie, head of wealth management at CIBC in Hong Kong. "Competition is fierce and you are seeing the big banks lifting out teams from other institutions as they seek scarce talent."

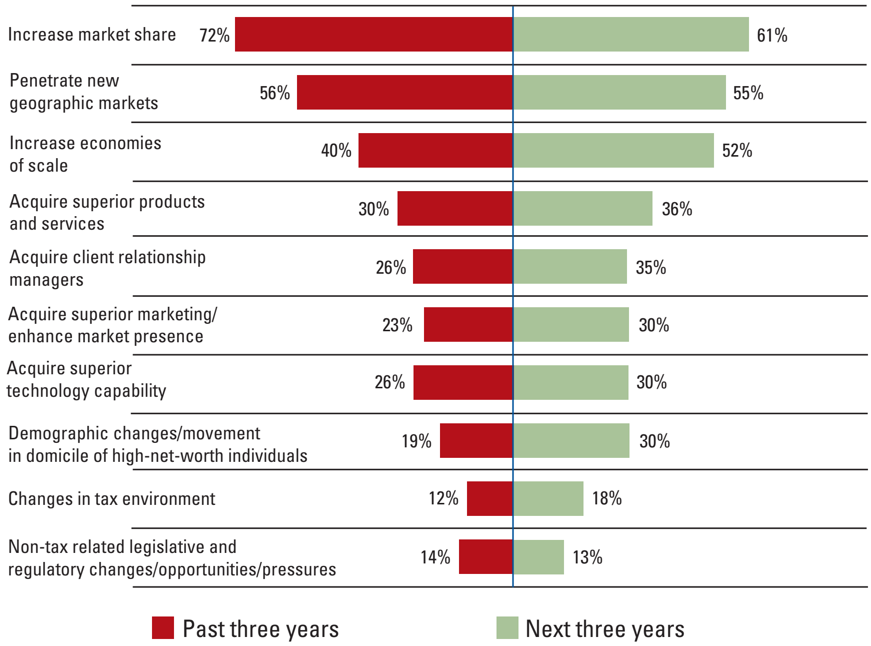
Small banks are evidently feeling the pressure more, with 55 percent saying that increased competition from larger, consolidated competitors is the primary driver of change. The concerns of medium-sized banks lay elsewhere: a huge 71 percent considered increasing earnings volatility to be the secondary driver of change (compared with only 39 percent and 41 percent of small and large banks respectively).

"Competition is fierce and you are seeing the big banks lifting out teams from other institutions as they seek scarce talent," says Bob Cormie, Head of Wealth Management at CIBC in Hong Kong.

Executives in the survey say the main objective for acquisitions (both past and future) is to increase market share and to penetrate new markets. The latter reflects the desire to reach a growing number of high net worth individuals in Asia and other fast-growing markets.

A third objective that appears to be becoming more important is to achieve increased economies of scale. While 40 percent of respondents cite economies of scale as an objective of past acquisitions, that proportion rises to 52 percent for future acquisitions and in Asia it is the predominant goal (60 percent).

Main objectives for acquisition

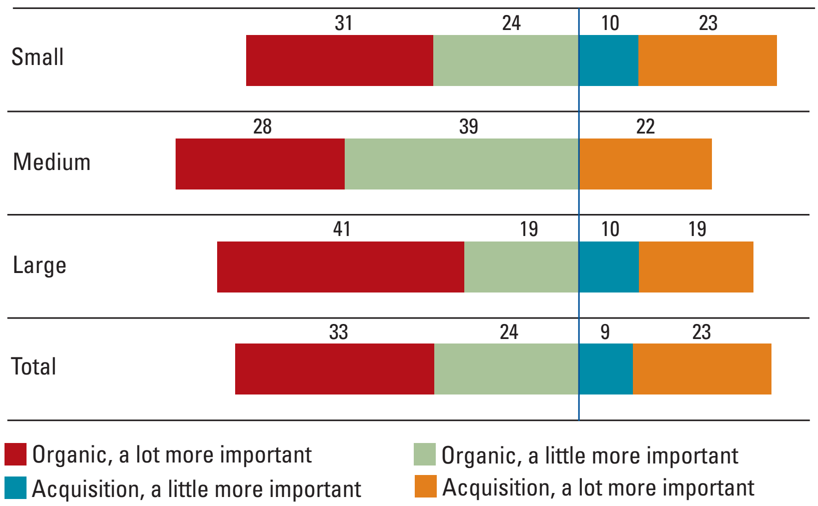


Growth strategy

As in last year's survey, the majority of companies (57 percent) believe that organic growth will be more important than growth by acquisition. However, 33 percent of overall respondents said acquisitions will be their primary route to growth over the next three years, a significant increase over 13 percent in the 2005 survey.

The number of companies that see acquisitions as their primary growth strategy was particularly high in Asia: 42 percent of the respondents from this region emphasized acquisition over organic growth (although, as discussed later, finding suitable targets in Asia is a difficult task).

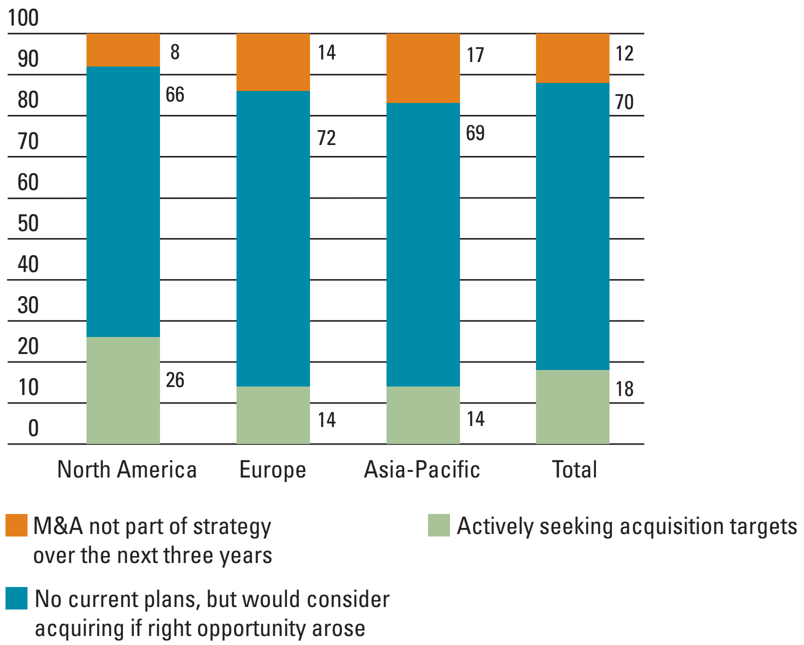
Organic growth versus growth by acquisition



Over the past three years, almost one-third of respondents have acquired another private banking business and among those the mean number of transactions was 2.7. Looking ahead over the next three years, only 18 percent of respondents say they are actively seeking acquisition targets.

This initially seems at odds with the view that consolidation will accelerate, but probably reflects the fact that a large proportion of acquisitions are opportunistic. The vast majority of executives in the survey (71 percent) said their companies will consider acquisitions if the right opportunity arises, compared with only 12 percent who say that acquisitions are not part of their strategy. Indeed, many private banks see M&A as a complement to their organic growth strategies. "We treat acquisitions as accelerators for our overall strategy of raising our presence through organic expansion," says Mr. Jacobs at UBS. "In some jurisdictions the market is so fragmented that to gain and build on a foothold is just too long a process and too risky."

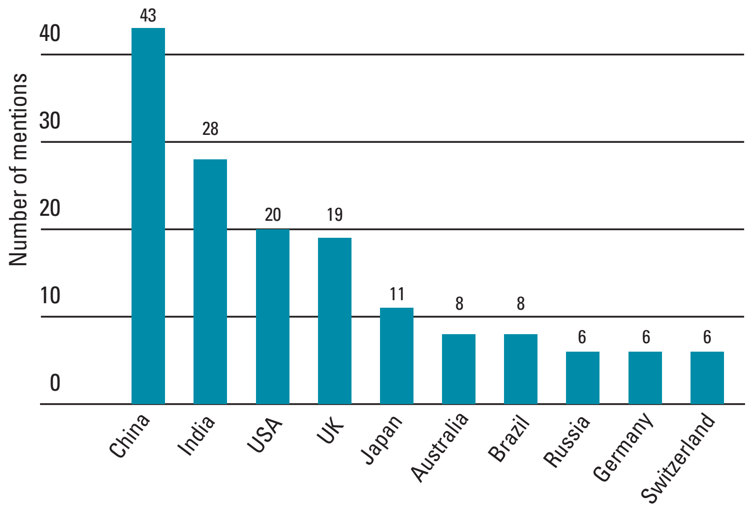
Acquisitions plans (percentage)



Even so, respondents in some countries were more likely to actively seek out acquisition targets. In North America the proportion of respondents that are actively seeking an acquisition is much higher (26 percent) than in the overall sample, probably reflecting the fragmented state of that market together with a keen interest in reaching new geographical markets.

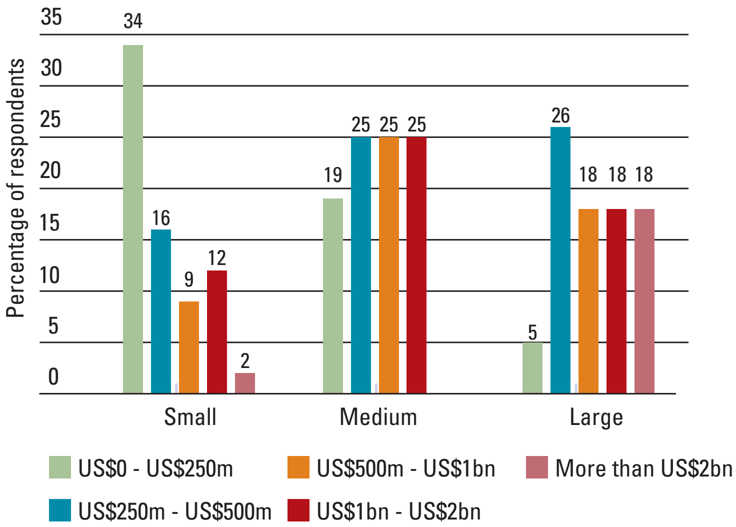
When respondents who said they were actively seeking acquisitions were asked which countries they were targeting, China came out top, closely followed by India. A number of respondents are also scouting the U.K., Japan, Australia and other mature markets for potential acquisitions.

Most noteworthy countries (growth potential) in this sector (top 10)



Among those respondents looking to acquire, one-third say that they expect to spend between US$250 million and US$1 billion over the next three years and 16 percent predicted expenditure of between US$1 billion and US$2 billion. As for additional assets under management resulting from acquisitions over the same period, 42 percent said they expected an increase of between 11 percent and 20 percent.

Acquisitions plans over the next three years (percentage)

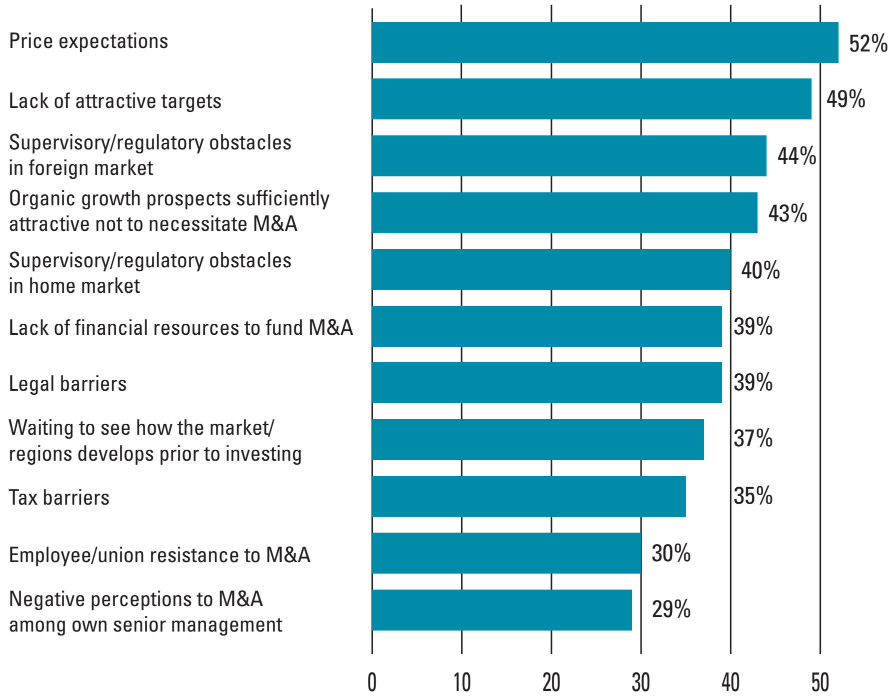


Asked if they would consider buying a retail bank as a means of gaining access to wealthy individuals, only 29 percent of executives in the survey responded in the affirmative, although among large banks the proportion jumped to 46 percent.

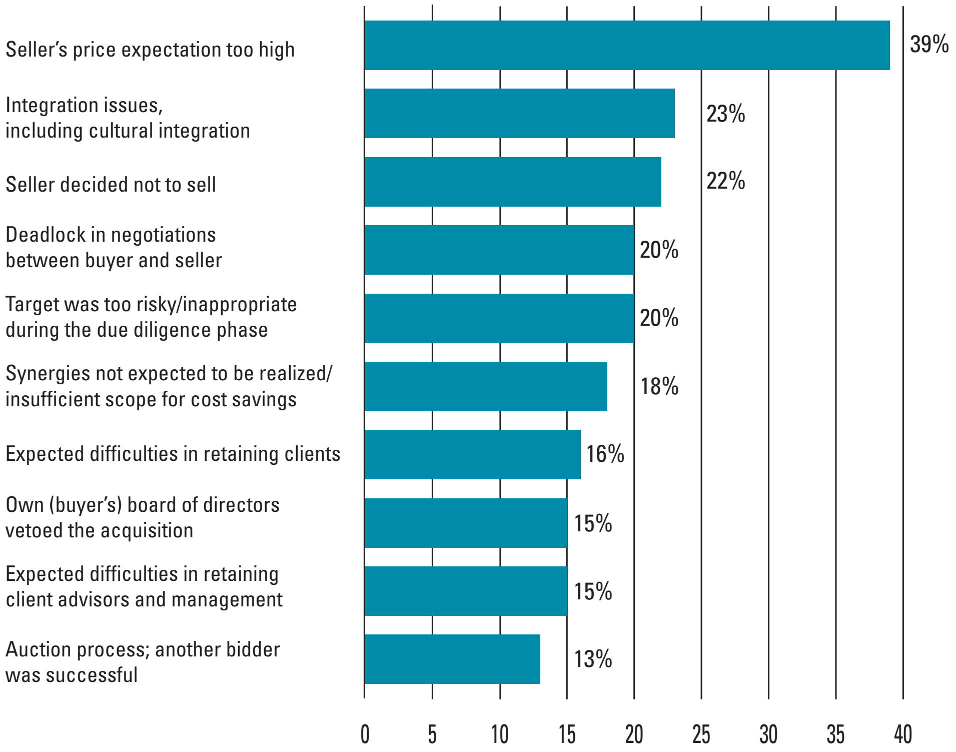
Obstacles to growth and acquisition

In almost all regions the survey showed that price expectations were the most likely factor preventing more investment in M&A. More than half (52 percent) of the overall sample cited this as a barrier and the proportion was higher in both Europe (58 percent) and North America (57 percent). Lack of attractive targets was mentioned by 49 percent overall – 35 percent of medium-sized companies said this was a major barrier – and regulatory barriers were cited by 44 percent. A similar proportion said that organic growth prospects were sufficiently attractive not to necessitate M&A.

Perceived obstacles to acquisition activity



Deterrents to acquiring a specific target in the last three years



Asked what deterred their organization from making an acquisition after considering specific companies as targets, respondents again pointed to high price expectations (39 percent), although 23 percent underlined integration issues, including cultural factors. In North America both factors received much greater attention, with 63 percent citing the price issue and 40 percent integration.

The above helps to explain regional differences in acquisition strategy. Since prices in North America are generally high, the objective must be to find a willing seller. Underperforming businesses provide one source of opportunity. In the case of the purchase by Fortis of Dryden Wealth Management, for example, an international business with offices in Europe and Asia, Dryden was a loss-making operation that was no longer considered core to Prudential's business.

"For every acquisition that takes place here three new institutions appear, looking for targets," says one Hong Kong-based respondent.

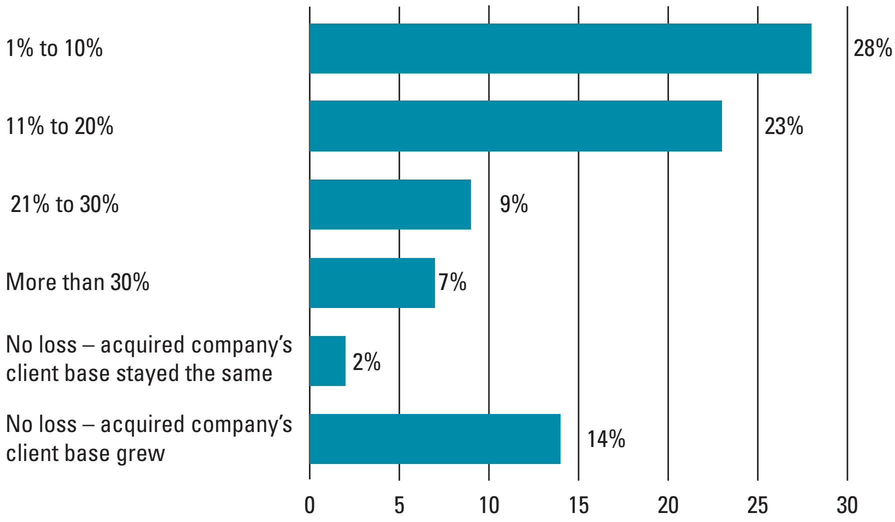
In Asia, foreign buyers outnumber sellers by such a wide margin that it is very difficult to acquire companies at an attractive price.

Organic growth in Asia is not without its problems, however. The price of well educated and talented staff is high and rising. But perhaps a deeper issue, as described by Mr. Jacobs at UBS, is the lack of understanding of private banking as a value proposition. "Some incumbents in Asia, the big local banks, typically do not segment the wealth advisory process for net worth individuals from other banking services. So in these countries you effectively have to create the market by offering something new and distinct."

After the acquisition

The research also sheds light on some of the issues that arise post-acquisition. The first of these relates to client retention. Since the relationship between private banker and client is frequently a close one, acquisitions may well trigger client defections. In their largest acquisition performed over the past three years, purchasers in this survey said that around 10 percent of the acquired company's client base, in terms of assets, was lost within one year.

Proportion of acquired company's client base (in terms of assets under management) lost within one year of acquisition*



* With reference to the respondent's largest acquisition in the last three years

These figures are interesting in that they indicate very little improvement from the first survey of two years ago. The implication is that, despite the efforts of private banks to improve the integration process in recent transactions, customer defection from the acquired bank remains a persistent and difficult problem.

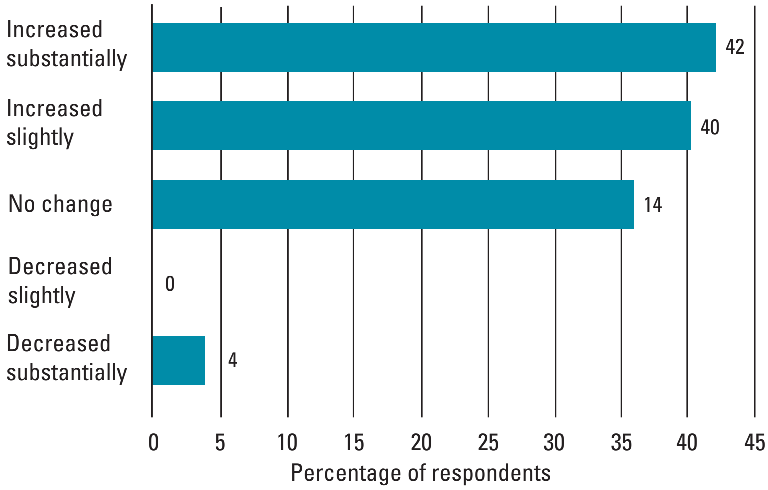
Interestingly, smaller banks appear to fare better. Only 6 percent said they had lost more than 20 percent, compared with 40 percent of medium-sized banks and 24 percent of large banks.

Integration therefore needs to be carried out quickly and smoothly. Otherwise not only clients but staff may leave in the face of uncertainty. "If you take too long to resolve important issues post-acquisition, the results are often painful," notes a senior executive at a Dutch bank. "On the other hand it is not always easy to find people who can oversee the integration which is why we will not do more than one or two acquisitions at a time."

"If you take too long to resolve important issues post-acquisition, the results are often painful," says a Dutch respondent.

Cultural issues can be alleviated by starting due diligence early. "Regulatory hurdles are always there but our biggest concern with potential acquisitions is to avoid any kind of culture shock," says Mr. Marin at BANIF. "Spain is not a big market and we have been in this business for more than 40 years so we know which firms focus properly on their clients, as opposed to simply pushing product."

Impact of acquisitions over the past three years on shareholder value in your company



Contracting issues post-acquisition are rarely a problem according to the survey, and no respondents reported having to resort to arbitration or involved legal processes.

Ultimately, acquisitions must increase shareholder value to be deemed a success. Many banks have internal measures and targets for returns on investment following an acquisition and if the goals are met this should translate into higher value for shareholders. In the survey, 82 percent of respondents who had absorbed another company over the past three years said their acquisitions had increased shareholder value. That proportion was much higher in Europe (92 percent) but lower in Asia (62 percent).

Conclusions

Growth rates in the private banking and wealth management industry are likely to accelerate in line with increasing wealth creation and buoyant capital markets. To take advantage of this growth, the world's major banks are pursuing a path of organic expansion to increase market share and at the same time achieve significant economies of scale. As they build a significant presence in key markets, medium-sized and smaller banks are likely to come under pressure and face ever-increasing competition.

Acquisitions will have a role to play as the large private banking institutions seek to accelerate growth through opportunistic purchases and smaller players succumb to competition. What is now largely a fragmented industry is likely to consolidate, initially within domestic markets but increasingly across borders as buyers take advantage of even greater size-induced economies.

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