

TRANSACTION SERVICES

Hungry for more?

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

FINANCIAL SERVICES

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Executive summary

With growing numbers of high net worth individuals and increasing wealth creation, the private banking and wealth management industry has traditionally been seen as an area of great growth potential. However, the sector is also facing several key challenges, including: increased pressure from regulatory bodies; changes in the legal and tax environment; and the risks associated with volatile earnings streams and a high fixed cost base. In many countries, asset management fees are dwindling as well due to competition, putting further pressure on margins.

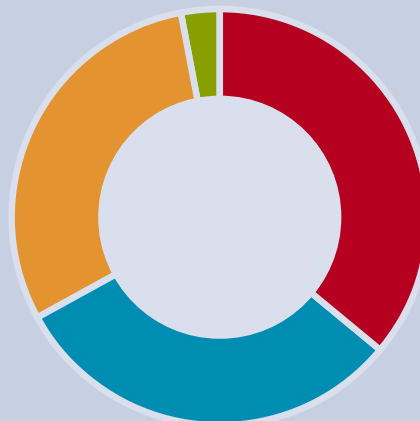
With a few big global players and a large number of small private banks, the industry is naturally inclined to consolidate, although acquisition activity has to date been predominantly domestic. This study assesses the current appetite for acquisition and the strategy surrounding it in the face of the pressures the industry is facing. KPMG asked private banks about:

- Their appetite for domestic versus international acquisitions.
- The key objectives of their acquisition strategy.
- The challenges they have encountered in the transaction process.
- How they measure the success of an acquisition, and subsequent integration.

KPMG's analysis of the results comments on each of these areas and the final section of this study identifies some suggested industry best practices for enhancing the success of acquisition execution and integration activities.

Figure 1 Assets under management by region at 31 December 2002* (percent)

■ North America	36
■ Asia-Pacific and Middle East	31
■ Europe and South Africa	30
■ Latin America	3



*By location of households. Total assets under management: US\$55,905 billion

Source: * Winning in a Challenging Market: Global Wealth 2003*, Boston Consulting Group

Key themes from our study

- Over 80 percent of private banking acquisitions in 2002 and 2003 were domestic transactions.
- Asia-Pacific was identified as the region with most growth potential.
- 44 percent of private banks¹ approached had either considered or completed an acquisition in the last three years or planned to undertake one in the coming three years.
- Private banks intending to complete an acquisition in the next three years expect acquisitions to deliver 36 percent of their growth.
- Although cultural integration is seen to be the most important post-completion activity, insufficient attention is devoted to cultural fit in the pre-completion phase.
- An estimated 10 percent of an acquired private bank's client base is lost within one year of acquisition.

Our approach

Our study was conducted in January and February 2004, through telephone interviews with 190 respondents at 186 private banks around the world. Of the 186 private banks we interviewed, 106 had no recent or current appetite for acquisition²; they are included only in certain analyses within our study, while the 80 private banks (84 respondents) involved in acquisitions are included throughout.

The interviews were conducted by Consensus International Research Ltd, London. The confidentiality of individual responses was guaranteed as a condition of participation.

Reference is made throughout this study to the size of the respondents' private banks. Our classification is based on the number of full time employees as follows:

- 'Small': less than 200.
- 'Medium': 200 – 499.
- 'Large': 500 or more.

KPMG would like to thank all respondents for their participation.

Key findings

Acquisition appetite and growth strategy

- Private banks attribute more importance to organic growth than to acquisitions.
- 44 percent of private banks approached had either considered, completed or planned to undertake an acquisition.
- 24 percent of respondents had completed an acquisition in the last three years; 33 percent of respondents' business strategies assume or call for an acquisition in the next three years.
- Asia-Pacific was identified as the most noteworthy region in terms of growth potential for private banking.
- Acquisition appetite was lowest in Germany, where 71 percent of private banks approached said they had neither considered nor planned to consider making an acquisition.
- North American and Swiss private banks completed the highest number of acquisitions in the last three years.
- Private banks intending to acquire in the next three years expect to derive one third of their growth from acquisitions.
- European and Asia-Pacific respondents intending to acquire in the next three years indicate they plan to do so in their own countries. North American respondents expressed no preference for region or country.

Acquisition rationale and form

- Geographical expansion and increasing market share are the key objectives of acquisitions.
- There was a significant difference between the growth strategy of small private banks and that of medium and large ones where over two-thirds preferred outright acquisitions. Only one third of respondents from small private banks said they envisage making outright acquisitions.

Transaction management

- Although cultural integration is seen to be the most important post-completion activity, insufficient attention is devoted to cultural fit in the pre-completion phase.
- In addition to client profiles and profitability, assessing the caliber of top management is one of the most difficult areas on which to obtain comfort in a transaction process.
- Almost 70 percent of respondents advocated retention bonuses as a means of retaining key client advisors.

Measuring success

- An estimated 10 percent of an acquired private bank's client base is lost within one year of acquisition.
- There is a lack of cohesion between the stated objectives of acquisitions and the means by which the success of an acquisition is measured.
- Increased profitability is the key measurement of success, but does not appear to be a key short-term objective of acquisitions.
- Private banks overwhelmingly see their acquisitions as successful, though there is much room for improvement in both cultural and technical integration.

Acquisition appetite

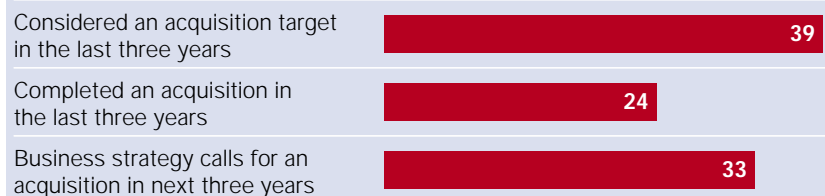
The number of respondents whose business strategy calls for an acquisition in the next three years (33 percent of respondents) is significantly higher than the number that completed a transaction in the last three years (24 percent of respondents, see Figure 2). In addition to those respondents whose business strategy calls for acquisitions in the next three years, a small number of private banks considered themselves to be consolidators.

Of the respondents involved or planning to be involved in acquisition activity, almost two thirds of the medium and large private banks had actually completed an acquisition in the last three years, compared to only 39 percent of small private banks. 62 percent of the large private banks that had completed acquisitions in the last three years acquired two or more targets in this period, compared to 54 percent of medium-sized private banks.

Asia-Pacific most active

Our results suggest that the private banking market in Asia-Pacific will be one of the most active in terms of acquisition activity. This is supported by supplementary research, which indicates that acquisitions in this sector in Asia-Pacific are growing as a proportion of the world's total private banking acquisitions (see page 8). Our results also show that private banks in Southern Europe intend to perform significantly more acquisitions in the next three years than in the last three.

Figure 2 Number of respondents who considered or completed an acquisition in the last three years or whose business strategy calls for an acquisition in the next three years (percent)



'The majority of the acquisitions completed by the respondents in the past three years were valued at less than US\$500 million, with more than one third being valued at less than US\$100 million.'

Offshore assets indicate acquisition appetite

Respondents looking to make acquisitions in the next three years had an average of 71 percent of their assets under management onshore. Nevertheless, we identified a clear relationship between acquisition experience and the proportion of assets under management offshore: private banks with more than half their funds offshore completed significantly more acquisitions in the last three years than those with less than half their funds offshore. It is the larger private banks that tend to have more offshore funds, and have the resources to acquire more readily.

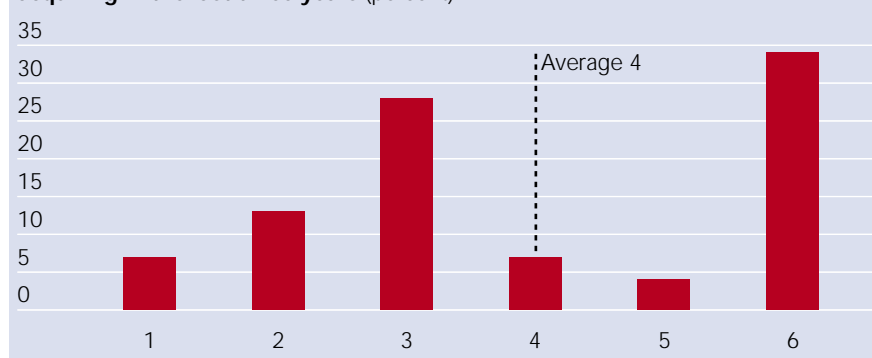
Typical deal is small scale

Our study indicates that the typical private banking transaction is a relatively small, domestic acquisition. The majority of the acquisitions completed by the respondents in the past three years were valued at less than US\$500 million, with more than one third being valued at less than US\$100 million. Our additional research shows that the average publicly disclosed transaction value announced in the private banking sector during 2001 through 2003 was US\$140 million.

Figure 3 illustrates the number of acquisition targets considered by those respondents who had considered acquiring in the last three years; the average is four.

The study results indicate that private banks from North America and Switzerland considered the highest number of targets and completed the highest number of acquisitions during the last three years.

Figure 3 Number of targets considered by respondents who considered acquiring in the last three years (percent)



Growth strategy

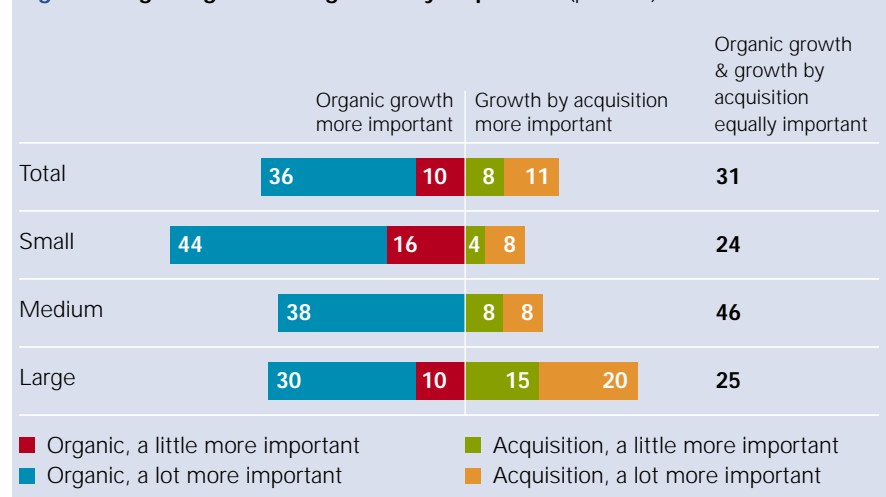
46 percent of respondents consider organic growth to be more important than growth by acquisition over the next three years, with a further 31 percent considering organic and acquisition growth to be equally important (Figure 4).

Larger private banks more dependent on acquisitions for growth

Our results indicate that smaller private banks have a greater focus on organic growth, whereas those from medium and large private banks are more likely to rely on acquisitions to fuel growth. On average, respondents expected 36 percent of their growth to come from acquisitions in the next three years, but respondents from medium and large private banks expected higher percentages of growth from this activity than respondents from smaller private banks. The following factors may contribute to private banks placing a greater emphasis on organic growth: the prevailing high purchase considerations, the difficulty in identifying and acquiring potential targets, and the management attention required for the integration process. This problem is particularly acute for smaller private banks with fewer resources.

'Our results indicate that smaller private banks have a greater focus on organic growth, whereas those from medium and large private banks are more likely to rely on acquisitions to fuel growth.'

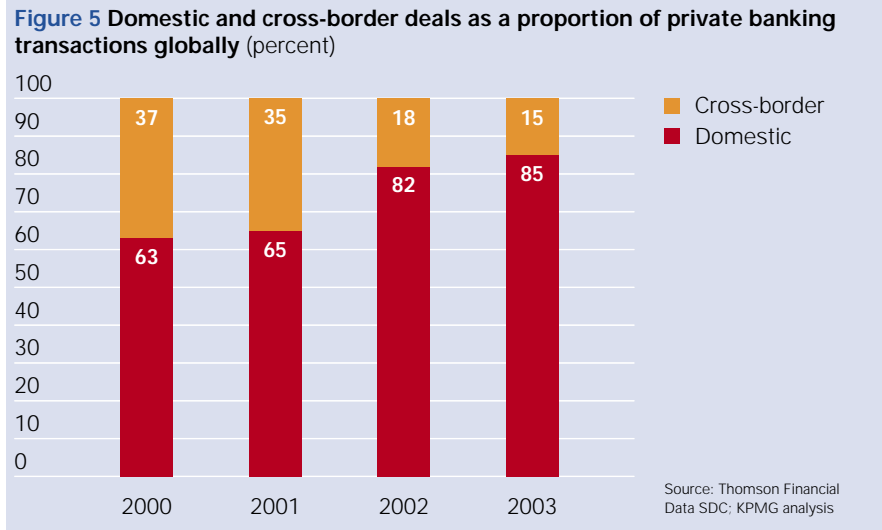
Figure 4 Organic growth vs. growth by acquisition (percent)



Domestic deals dominate

The chart on the following page (Figure 5) shows clearly that there has been a predominance of domestic transactions. From a legal, cultural and regulatory standpoint, domestic acquisitions present fewer challenges. One may also expect fewer integration issues (noted later in this study as an issue of particular concern) in domestic transactions – although our experience shows that corporate cultures tend to override national cultures in business integration.

European respondents indicated that they have a predominantly domestic acquisition strategy. Asia-Pacific respondents also expressed a preference for domestic acquisitions. Respondents from North America expressed no particular preference for region or country, implying that they may take a more opportunistic view of acquisitions.



The map below illustrates the localized nature of acquisition activity in this industry, with only 11 percent of the transactions in the three year period 2001 to 2003 involving acquirers and targets from different regions.

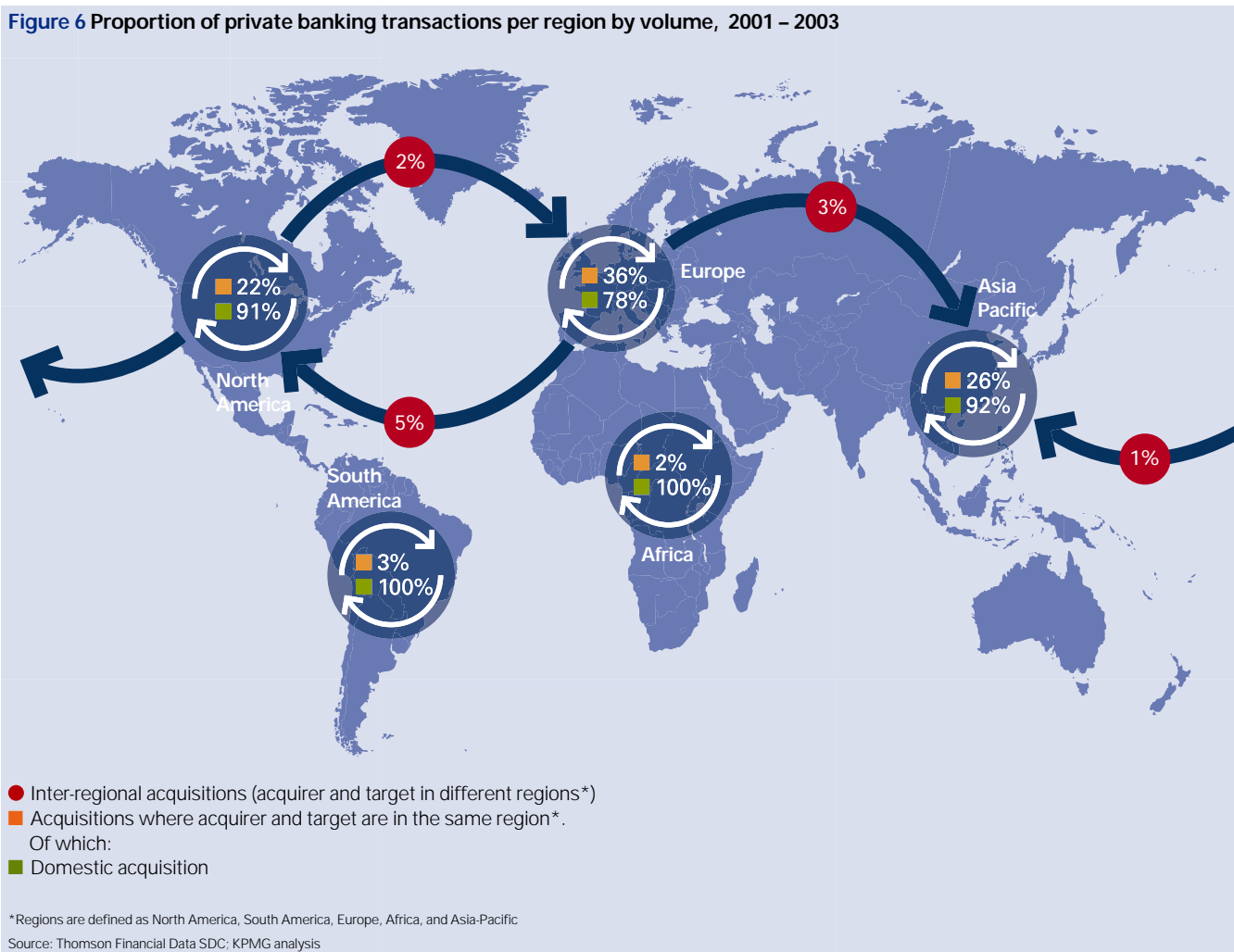
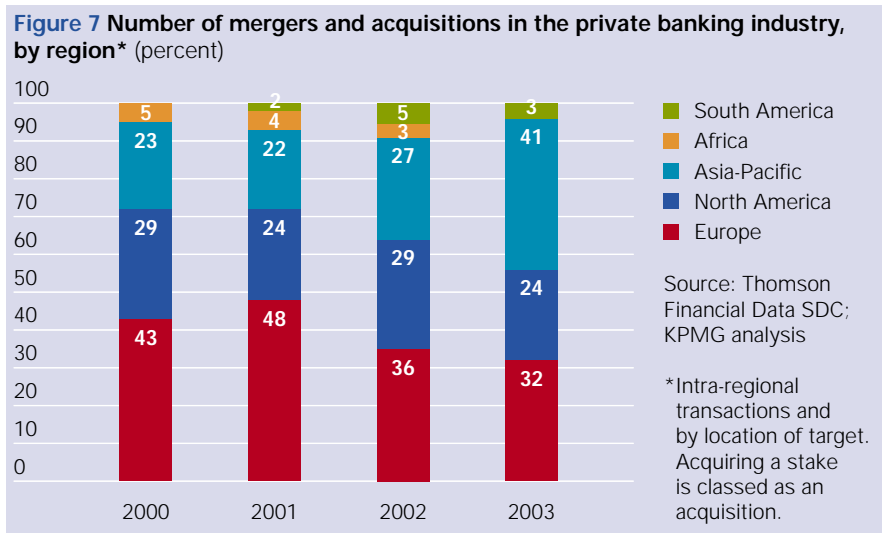


Figure 7 illustrates the growing importance of Asia-Pacific, which accounted for 41 percent of the private banking transactions in 2003.

Furthermore, when asked to comment on the most noteworthy markets in terms of highest growth potential, 24 percent of respondents, particularly European, answered Asia-Pacific, which is a relatively underserved market where wealth is growing quickly.

A Swiss-based respondent said they chose Asia-Pacific because of " Political opportunities, European tax regulations; offshore banking is very dynamic in this region."

56 percent of respondents from the USA and Canada said they considered North America the most noteworthy market in terms of potential for growth, including one Canadian respondent who said this was due to the " Size and wealth... Trans-generation wealth transfer... A relatively underserved market because the banking system is very fragmented."



Acquisition rationale and form

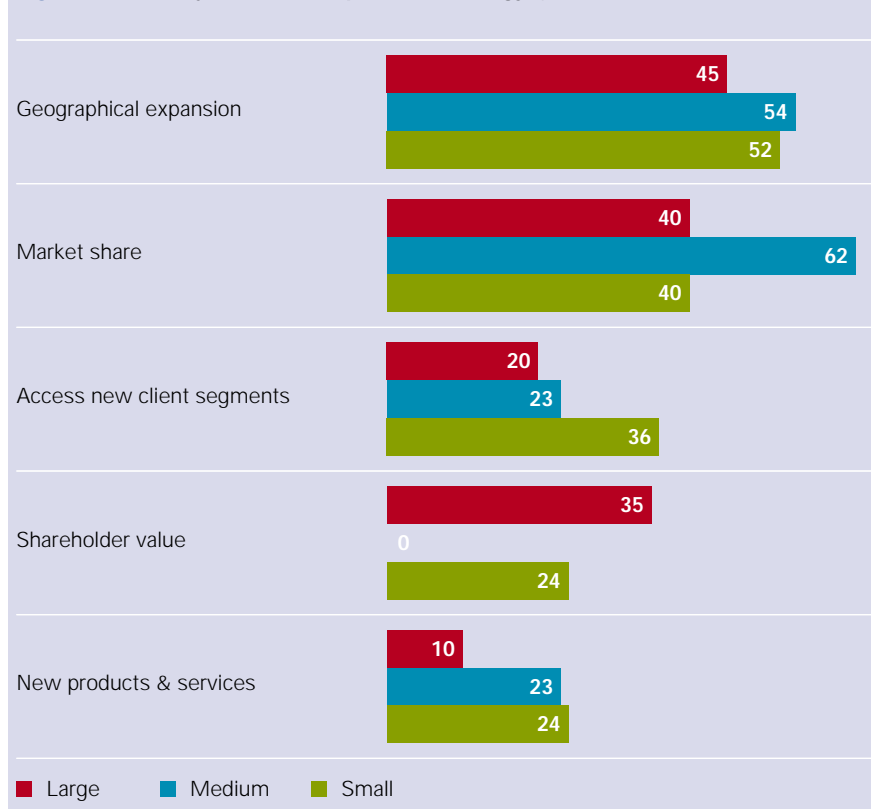
Growth does matter

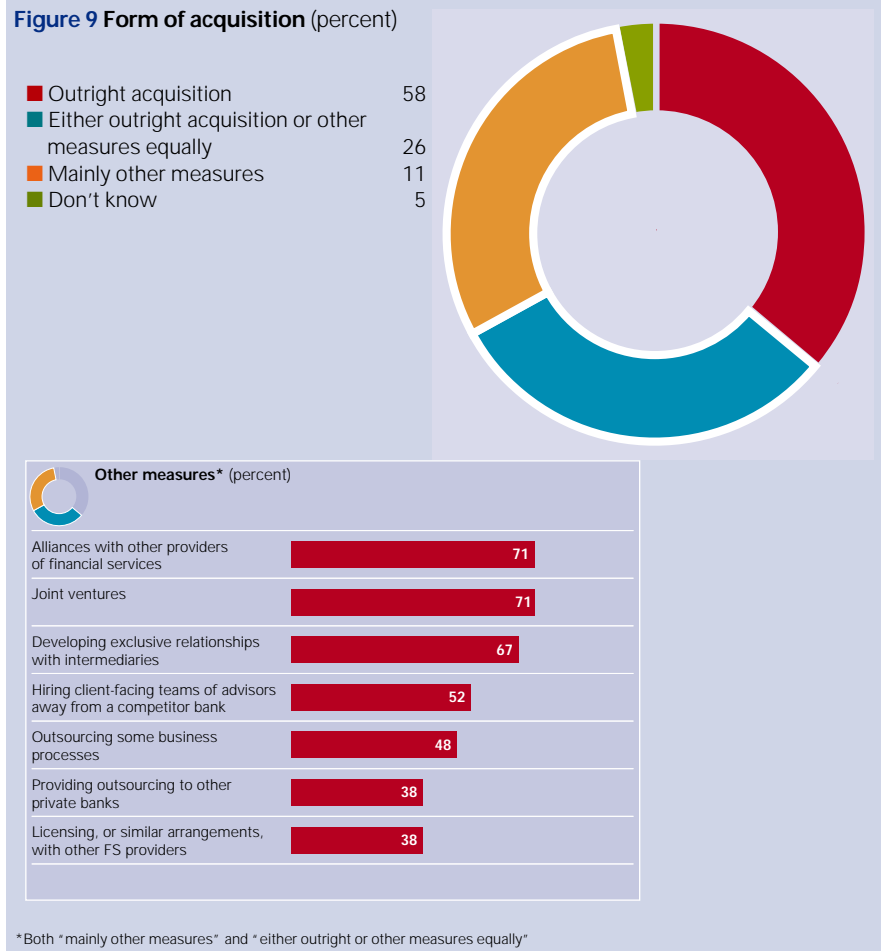
Increasing size is clearly the primary transaction motive, particularly for small private banks, which also plan to expand through access to new client segments and product and service expertise (Figure 8). There is less emphasis in small private banks than large ones on enhancing shareholder value: many smaller private banks will not be publicly quoted companies and thus do not face the same pressures on shareholder returns as some larger, quoted private banks. Medium-sized private banks are evidently under pressure to expand and fill the middle ground.

The focus appears to be on revenue growth rather than cost optimization. Given this result, it is striking that 30 percent of respondents indicated profitability to be the key measure of transaction success (see page 15).

This focus on geographical expansion and increased market share is not surprising. Our 2003 survey of global M&A practices, *Beating the Bears*, found that 57 percent of acquirers across a broad range of industries considered geographical expansion and increased market share to be the main objectives of their transactions.

Figure 8 Main objectives of acquisition strategy (percent)





‘Only a third of respondents from small private banks said they envisage making outright acquisitions.’

Medium and large private banks prefer outright acquisition

Two thirds of respondents from medium and large private banks expressed outright acquisition as their favored approach, with only one third focusing on alternatives for gaining scale, such as developing exclusive relationships with intermediaries, hiring client advisor teams from competitors and outsourcing business processes (Figure 9). Especially in the Anglo-Saxon markets, we are witnessing private banks lifting out front-office and client management teams from competitors. The success of such moves naturally differs between private banks, depending on whether the client’s loyalty lies with the bank or the client relationship manager.

There was a significant difference between the growth strategy of smaller private banks and that of medium and larger ones. Only a third of respondents from small private banks said they envisage making outright acquisitions. Although slightly fewer (26 percent) respondents from small private banks said they would depend on other measures, such as alliances or joint ventures, neither medium nor large private banks showed this level of interest in measures other than outright acquisitions. A number of smaller private banks are considering outsourcing – both as a means of increasing their product range, and in terms of running back-office functions to cut costs and allow them to concentrate on core competencies.

Transaction management

We noted a regional difference in the use of common contracting terms; although price adjustments and earn-out mechanisms are common throughout the world, contractual conditions regarding employee retention are used more extensively in North America, which could reflect the higher fluidity of the US labor market.

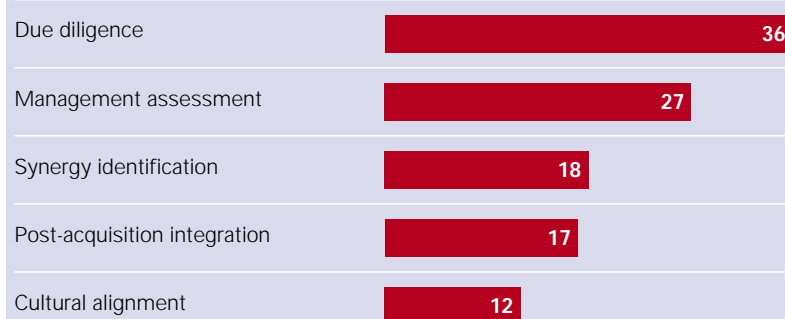
US respondents more attentive to due diligence

More than one third of respondents ranked due diligence as one of the most important pre-completion activities (Figure 10). In addition to this, many respondents mentioned specific forms of due diligence, including financial, legal, regulatory, tax and commercial. The responses clearly show that North American private banks are more attentive to due diligence requirements than European private banks.

Begin integration earlier

We would recommend that much more effort should be expended in the pre-completion phase on the various aspects of preparing for the integration of an acquired business. Although there is no single most important integration activity, the key to success is to start early (i.e. during the transaction process) with a strong focus on the clear identification and achievement of synergies, cultural alignment and retention of key personnel and clients. An effective communication strategy is critical.

Figure 10 Most important pre-completion activities (percent)



Only 2 percent of respondents attributed the highest importance to transaction structuring, which could be attributed to the fact that private banking transactions tend to be domestic deals with simpler structures.

Figure 11 Most difficult vs. easiest information needs to satisfy in a transaction (percent)



It appears from the study that private banks will generally seek advice from external providers on activities that are important to them (especially due diligence), but management assessment is a notable exception to this rule, as only 8 percent of respondents had involved, or would involve, an external provider to advise on this issue. Assessing the caliber of top management was noted as one of the most difficult areas on which to obtain comfort in an acquisition process (see Figure 11 and next section).

Buying blind?

Getting satisfactory data on client profitability and client profiles was identified as the most difficult area for acquirers. Due to confidentiality constraints, a transaction in this sector involves paying for a client base which the acquirer has difficulty in assessing during the transaction process. To obtain greater comfort on a target's client base, a potential acquirer may wish to consider:

- Key client data such as AuM, gross margin and product penetration.
- Client profiles including age, nationality and length of relationship.
- Internal benchmarking of client relationship managers.
- External benchmarking of key performance indicators.
- Regulatory and financial reports.
- Discussion with client relationship managers.
- Discussion with the auditors.

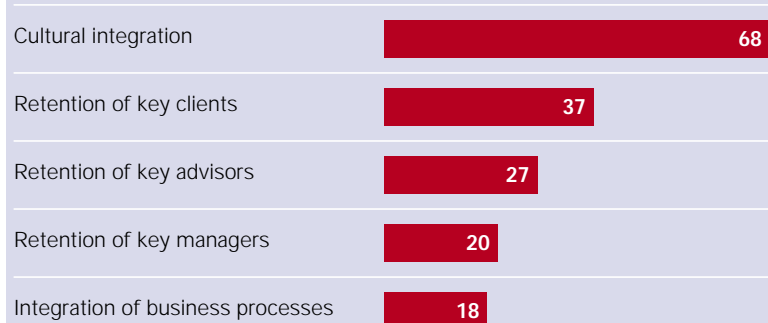
A common pitfall is not adequately understanding – or not being informed by the target – the commission income structure and basis of fee charging, particularly where special arrangements with key clients may exist.

Difficulty in obtaining basic data regarding client profiles and profitability is not an uncommon problem in private banks. In our experience, private banks are only now implementing more effective systems to capture this information.

Uncertainty surrounding the target's income stream is a key driver of the earn-out structures that, as noted earlier in this study, are common in sale and purchase agreements in this sector.

Management fit

Assessing the caliber of top management was also an area where private banks had difficulty in obtaining comfort. Potential acquirers may try to mitigate this risk by pressing for maximum access to the senior management team during the transaction process. Where possible, we would recommend human resources due diligence involving interviews between key personnel and a human resources consultant.

Figure 12 Factors critical to successful post-acquisition integration (percent)

'It is therefore not surprising that cultural integration was noted around the world as the most critical factor in ensuring successful post-acquisition integration.'

Golden rules for smooth integration

Private banking is a service quality-oriented industry, characterized by one-to-one relationships. It is therefore not surprising that cultural integration was noted around the world as the most critical factor in ensuring successful post-acquisition integration (Figure 12). Retention of key clients was stressed as the second most important activity. Our experience shows that successful integration can be optimized by the following activities, all of which enable management and client advisors to focus on their daily business with minimal interruption:

- Alignment of the management teams.
- Clearly identified management and team structures.
- Extensive and open communication.
- Adequate incentive structures.

Business process integration can be considered from two perspectives: to ensure a well-run business able to serve clients and to streamline processes to save costs (e.g. in back office functions). A respondent from Germany commented " .. buying a company is a quick process, which can be achieved easily. But to integrate business processes, to increase efficiency advantage, is something we could still improve upon."

It is interesting to contrast cultural integration being viewed as the most important post-completion activity with the fact that only 12 percent of respondents said cultural alignment was one of the most important pre-completion activities. In our experience, businesses in all industries place great weight on cultural integration but almost always begin too late in the transaction process.

Measuring success

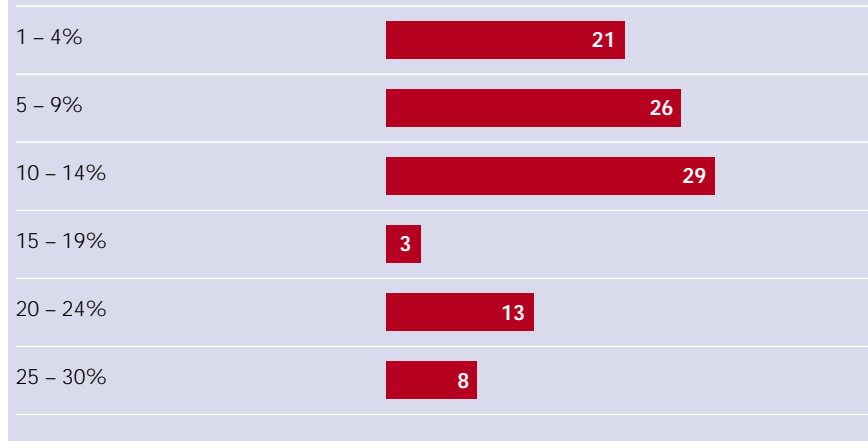
There is a definite lack of cohesion between the stated objectives of acquisitions and the means by which they are measured. For example, directly acquiring market share or successfully entering a new geographical market were not mentioned as measures of success, even though both were stated as primary objectives of acquisitions. This could imply that the success of these factors is often implicit in the growth of profitability and assets under management.

Approaches to measuring success differ widely, with 30 percent of respondents using multiple measures (Figure 13).

9 percent of respondents said that client retention was one of the key measures of success. Our study demonstrates that respondents are broadly satisfied with the level of client retention achieved, though the results show that an estimated 10 percent of a target's client base is lost within one year following acquisition (see next section).

Figure 13 Primary measures of success (percent)

Multiple measures	30
Profitability	30
Growth in assets under management	11
Economies of scale/synergy realization	11
Client retention	9

Figure 14 Proportion of client base lost one year after acquisition (percent)

An estimated 10 percent of clients lost 12 months after acquisition

Retaining clients post-acquisition is naturally a key concern for private banks when undertaking a transaction. Our study reveals that an average of 10 percent of a target's client base is lost in the first year following the transaction (Figure 14). The larger private banks were slightly more successful than the smaller ones at retaining clients, though the difference was not marked (8 percent versus 13 percent loss).

For clients, switching their private bank is an involved process, as it requires liquidating assets. However, as contracts often change following an acquisition, clients may take the opportunity to reconsider their provider. Furthermore, it should be noted that more clients may be lost if a longer period of time were to be considered.

Learning from experience

Asked to rate the success of their own transactions, respondents awarded themselves an average of 7.6 on a scale of one to ten (ten being very successful). Notably, only 12 percent of respondents who ranked themselves gave a score of five or less.

20 percent of respondents said there was nothing they would do differently if they could re-perform their latest acquisition. As an Australian respondent put it, "We have a lot of experience in assessing the deals... A lot of research is done and we feel that our targets are currently well considered."

'Of those respondents who would approach some aspects of their most recent transaction differently, integration and communication were the key concerns.'

Of those respondents who would approach some aspects of their most recent transaction differently, integration and communication were the key concerns, particularly post-acquisition integration (both cultural and technical). This is consistent with our experience that many companies underestimate potential integration issues, overlooking the need for speed and devoting insufficient management attention to the planning and execution of the integration plan. Typical comments included:

"Try to improve communication of objectives and plans." US respondent

"A better comprehension of the human factor." French respondent

"A better assessment of cultural integration." Swiss respondent

Commenting on the most successful recent transactions in the industry (not involving their own private bank), respondents gave three overriding reasons why they perceived a transaction as successful:

- A clear acquisition strategy and approach.
- Efficient deal execution.
- Smooth integration of the target post-acquisition.

A Swiss respondent commented on recent transactions undertaken by a European private bank: "They had a clear and strict strategy that they stuck to... fast and efficient execution."

Enhancing acquisition success: agenda for action

Our study has shed light on some of the best practices in the private banking industry, which those planning an acquisition can apply to enhance their chances of success.

Setting the acquisition strategy

- Be rigorous in setting acquisition criteria that meet your objectives.
- Set out clearly what should be achieved and why this is right for the business.
- Rigorously analyze potential acquisitions against these requirements.

Integration

- Both this study and our experience confirm that acquirers begin the integration process too late.
- Develop an integration plan as early as possible in the pre-completion phase, in particular to bridge the management vacuum which commonly arises in the initial period following completion. Devote more time and management attention in the pre-completion phase to prepare for integration.
- Integration plan should focus on value: preserving it, realizing it and creating it.
- Recognize that integration is a complex project and treat it accordingly, devoting appropriate resources and skills.
- Communication is key. Acquirers should not underestimate the human factor in all acquisitions: communication can be critical to employee retention.

Obtain maximum comfort during due diligence

- While honoring confidentiality constraints, obtain maximum comfort on client profile and client profitability. Insist on discussions with key relationship managers on client profile analyses, commission fee structures and other key areas.
- Caliber of senior management:
 - Obtain detailed job descriptions and curricula vitae.
 - If permissible, conduct interviews through a human resources consultant.
 - Objectively assess the individual's performance in his/her respective field.

Retention of key clients

- Prepare a formal retention plan, particularly in the major onshore markets where client loyalty tends not to be as strong.
- Ensure that earn-out structures are subject to levels of client retention.
- Understand what drives the target's customer base, addressing such questions as:
 - Which types of client does the target's brand attract?
 - Will the target's clients be attracted by our brand?
 - How does our bank compare to the target in terms of reputation and approach?
 - Will the target's client base prefer the services offered by a smaller bank or a larger bank?
 - Can we determine the target clients' appetite for new products?
- Access to, and communication with, clients at the earliest opportunity is critical. Organize meetings with clients in the immediate post-completion period.

Retention of key client advisers

- Include key employee retention clauses in the sale and purchase agreement.
- Avoid surprises: check whether any special arrangements or guarantees have been awarded to a client relationship manager that he/she will expect to continue post-acquisition.
- Relationship managers are typically attracted by share option schemes and performance-related remuneration, particularly when it is tied only to the wealth management unit.

Measuring success

- Link the measures of acquisition success with the acquisition objectives.
- Apply selected measures to track success; don't simply ask the question "Is the business growing?"
- Develop a performance management process that links right into the pre-acquisition valuation assumptions.

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