SwissBanking

BCG
The Boston Consulting Group

October 2014

# Actively shaping transition – future prospects for banking in Switzerland

Update of the joint study by the Swiss Bankers Association (SBA) and The Boston Consulting Group (BCG) on the Swiss banking centre 2011

# Actively shaping transition – future prospects for banking in Switzerland

## Table of contents





SwissBanking BCG The Boston Consulting Group

# Introduction

This study on the Swiss banking centre is an update of the study "Banking in transition – future prospects for banking in Switzerland", published in 2011. It describes the developments in the banking centre, the challenges, areas for action, and growth opportunities for banks along the following five business areas: private banking, retail clients, corporate clients, asset management and investment banking.

One of the key issues examined in this study is banking regulation and in particular, the implementation thereof in Switzerland and abroad. The study reveals that many unresolved regulatory issues have been addressed in recent years, and that uncertainty for the banks has decreased as a result. Protectionist tendencies in the area of regulation have, however, also been observed in recent years. As a result, market access for cross-border providers can only be ensured if their regulation complies with that of the target market. The Swiss banking sector – which is traditionally very active in the cross-border wealth management business, and is a leader in this discipline – is affected to a high degree by this trend toward compartmentalisation. Ensured access to international markets, which is vital for future success, cannot, however, result in the indiscriminate adoption of international regulations.

The Swiss banking sector has experienced stable growth in terms of gross revenues, and according to our forecasts, will experience continued growth in future. Against the backdrop of the regulatory and political developments, as well as the economic challenges, it must, however, prepare for the future, minimise risks to the greatest extent possible, and strengthen the competitiveness of the Swiss banking centre. Among other factors, new growth markets in emerging countries should be further developed, the capacity for innovation in the sector should be fostered, and investment management capacities should be strengthened in a targeted manner. The continued provision of a first-rate financial services offering for private and corporate customers is vital for the Swiss economy.

We are certain that economic performance targets can only be achieved if all of the players concerned work together. Adopting international standards one-to-one, perhaps even with the addition of a "Swiss Finish", will not advance the Swiss banking centre, but instead, will tend to limit its ability to compete internationally to the detriment of domestic economic development. Switzerland must therefore take a measured approach when adopting international standards, and must focus on a cost-efficient, unbureaucratic and flexible implementation of banking regulation.

As in the 2011 study, not all statements made here apply equally to all banks. The courses of action outlined and their consequences should be viewed and evaluated in a differentiated manner.

Basel/Zurich, October 2014

Claude-Alain Margelisch
Chief Executive Officer of the Executive Board
Swiss Bankers Association (SBA)

Daniel Kessler
Partner & Managing Director
The Boston Consulting Group (BCG)

# 1 Summary

The Swiss banking centre continues to be in a period of transformation. The international financial and debt crisis triggered a wave of new regulations that are highly relevant for the Swiss banking centre. At the time of publication of the previous study in 2011, the general focus was still on defining these regulations. This focus has since shifted toward the formulation and execution thereof.

Switzerland has reacted to existing international regulations as well as to the need for domestic political amendments, and for its part, has amended the rules of the banking centre or is in the process of doing so. Switzerland is a forerunner in a variety of regulatory areas, such as in the regulation of systemically relevant banks.

There is a discernible overall trend toward formal convergence at the global level. Key reforms such as Basel III are a reality in practically all of the important financial centres. The main differentiators, or rather, the opportunities for competitive differentiation at the locational level now lie in the manner in which international regulations are transposed into the respective national contexts. Depending on the regulatory area in question, Switzerland has in recent years taken a somewhat more flexible or a somewhat stricter approach in comparison to other countries. In cases where Switzerland transposes international standards less pragmatically, it suffers disadvantages as a location. Further to this, protectionist tendencies such as the obligation to have a local branch – originally planned as part of the EU's Markets in Financial Instruments Directive II (MiFID II) – are playing an increasingly important role. As a small, open economy, securing market access is of key importance for Switzerland. Political developments at home arising from the acceptance of the initiative against mass immigration represent a challenge for the banking centre in this regard.

The revenues of the banks in Switzerland have stabilised in the last few years. In 2013, the private banking, retail and corporate clients, asset management and investment banking business areas together generated overall gross revenues of CHF 54.4 billion, which corresponds to an annual growth of 1.1 % from 2010 and 2013. This figure is slightly below the forecast made in the 2011 study (1.8 % per year). The discrepancy is due to the fact that revenues from private banking in particular, were inferior to expectations in 2011. Leading up to 2018, revenues are expected to rise by 2.5 % annually to CHF 61.6 billion, carried by a positive outlook for volumes in all business areas. Private banking will remain the largest business area, accounting for 50 % of total revenues, followed by the retail and corporate client businesses and asset management. The large share of revenues forecast for private banking can be explained by Switzerland's long tradition in the business and its role as the most important global centre for the cross-border wealth management business. It is in this business area in particular, however, that Switzerland stands in direct competition with other financial centres. In terms of cross-border assets under management, the Swiss financial centre is expected to experience less growth than other comparable private banking centres.

Revenues from the retail and corporate clients businesses experienced the strongest annual growth (+2.1 % and +2.3 % respectively) in the past three years, while revenues from private banking reported less growth (+0.6 % annually). For the period leading up to 2018, forecasts indicate that overall, private banking will recover and the revenues from this business area will rise by 2.8 % per year. This is due to a rise in assets under management of 2.8 % per year, driven by inflows from emerging countries and relatively stable profit margins. Gross revenue growth for the retail and corporate clients businesses are forecast at +1.7 % and 2.4 % per year.

This study has identified a tendency across all the business areas under review toward lower profit margins, which in part is attributable to the low interest rate environment, and in part to increasing competition or changes in the use of products. In the context of rising demands on the banking business, the banks have been forced to increase their efficiency on the expenditures side over the past three years – i.e. reducing costs in order to counteract a decrease in profitability. Personnel costs decreased significantly in the Swiss banking centre from 2010 to 2013, by CHF 2.6 billion (-8.8 %).

In terms of opportunities for action in the coming years, the situation is now such that the Swiss banking centre now gets the opportunity to actively and strategically shape its future, albeit with the necessary prudent risk management. While the key global regulatory trends in 2011 were still fraught with uncertainty, international standards now provide a relatively stable global framework for financial services, which stands in stark contrast to pre-crisis times. Pragmatic regulatory implementation of international standards is essential for future success. Equally important in a competitive environment is the sector's ability to be innovative.

Due to its singular importance, the primary focus will continue to lie on private banking in future. This business area, and the cross-border business as an export industry in particular, is in strong competition with other international locations and is currently undergoing a widespread transformation process. Switzerland's traditional and important business with Western European customers must continue to remain profitable, and outflows of customer assets and decreasing revenues must be averted. Market access to the European Union (EU) has to be secured in order to achieve this.

As a highly-developed cluster for cross-border wealth management, growth opportunities exist for the Swiss banking centre in specific segments such as with global UHNWI and HNWI clients[1], as well as with customers from emerging countries[2], in particular from the Middle East and Eastern Europe. Switzerland can differentiate itself in these segments, both through its political and economic stability as well as through its comprehensive product and services offering. It stands in direct competition with other locations in this business, however, in particular with London. In order to realise the growth opportunities, the banks should therefore develop innovative, country-specific business models and strengthen the investment management capacities in Switzerland – also in collaboration with the relevant educational institutions. Depending on the country and customer segment, it can make sense to round out the services provided out of Switzerland with a local presence. Important factors that should be considered are the coordinated promotion of the financial centre in the countries of domicile in cooperation with the banks and the authorities, as well as taking the growing importance of emerging countries into account during the regulatory decision-making process.

Further growth opportunities exist in the corporate client business in terms of providing Swiss companies that conduct business abroad with the services they require in close collaboration with investment banking and asset management. The latter exhibits the highest relative added growth potential, in particular in the business with foreign institutional investors. In order to realise this potential, however, effective and broad-based implementation by the banking centre is required, particularly within the scope of the Asset Management Initiative launched in 2012.

Existing and new regulations will further increase the complexity and the regulatory costs borne by the banks in Switzerland.[3] Add to this the competitive pressures and pressures on pricing that the banking centre is subject to, and this can lead to a loss in profitability for individual services or business areas. The profitability of domestic banks in the retail client business is disproportionately affected by this issue. The banking centre and the government must find the right balance between ensuring compliance with international standards and the cost and revenue effects that individual regulations entail. In general, a cost-efficient, unbureaucratic and flexible application of global regulations in Switzerland must be striven for, an implementation that safeguards the overarching objectives. In addition, a cautious approach must be taken with regard to current political developments in Switzerland. Predictable economic and fiscal policy remain indispensable factors for the competitiveness of the banking centre.

Shaping the future Swiss banking centre requires time, the necessary will and energy. If dealt with intelligently and in careful coordination between the banking groups and the authorities, the changes that lie ahead can provide an opportunity to steer the Swiss banking centre into calmer waters.

This study is structured as follows. Chapter 2 outlines the regulatory and fiscal frameworks as well as the location-specific factors related to the Swiss banking centre. Chapter 3 describes past trends in the Swiss banking centre and expected future developments, also in the individual business areas, and outlines important additional opportunities. The review of the past covers the last three years (2010 to 2013), while the outlook refers to the year 2018. In conclusion, the study presents the key implications and concrete recommendations for action.

**1** High Net Worth Individuals (HNWI): customers with assets of between CHF 1 and 20 million; Ultra High Net Worth Individuals (UHNWI): customers with assets of over CHF 20 million.
**2** For the purposes of this study, the regions designated as emerging countries are Eastern Europe, Asia-Pacific, Latin America, the Middle East and Africa.
**3** This publication analyses trends on the basis of gross revenues. These do not include any costs, and therefore do not reflect the profitability of the banks.

# 2 Framework conditions in the Swiss banking centre

## 2.1 Regulatory and fiscal framework conditions

The wave of global regulation that followed the financial crisis has continued unabatedly over the past three years. Both national and international efforts aim to help provide the financial system with greater stability and to reduce the risks for customers and governments. In contrast to 2011, when the previous study was published, the overall regulatory trend is now more predictable for market participants. The key areas of focus for future regulatory amendments are now widely known. The objective of the current transposition process is to formulate regulation as best-possible by striking a balance between compliance with international standards and the individual requirements of the respective banking centres. Having said this, the ongoing creation of new, stricter regulations represent significant challenges for the banks.

Despite the multitude of regulations that have already been implemented since 2011 or that are currently in the political decision-making process[4], there is a discernible global trend toward formal convergence. Key reforms such as Basel III are a reality in practically all of the important financial centres. *Convergence* does not, however, equal *uniformity*, and protectionist tendencies abroad are putting the integration of the global financial system at risk. The important differences or rather, possibilities for differentiation no longer lie in the adoption of international standards, but much more in the formulation and transposition thereof into the respective national contexts.[5] Considerations with regard to the competitiveness of international locations play a key role in this. There is a danger that certain national provisions comply with international standards from a formal point of view, while more effective, alternative approaches that would be materially equivalent, do not.[6] Switzerland has taken a comparatively more flexible or stricter approach to the implementation of international guidelines, depending on the area of regulation.

In the last few years, protectionist tendencies driven by the need to establish stable and uniform investor and capital market protection for the home market have also increased. Despite the regulatory convergence at the global level mentioned previously, there have been developments in a number of countries and regions that have resulted in certain disadvantages for foreign banks in comparison to domestic institutions. For example, a number of countries such as the US, the United Kingdom or Singapore differentiate between domestic and foreign banks when granting banking licences. A further example of this tendency is the obligation to have a local branch in order to provide services to private investors in the EU. This was originally planned (and then dropped) as part of MiFID II. This obligation may once again become an issue should amendments be made to the EU third-country provisions in future. These types of measures, which can be interpreted as protectionist, affect small, open economies such as Switzerland to a higher degree.

The regulatory frameworks that are particularly relevant for Switzerland can be divided into four groups: banking regulation, customer protection and products, tax issues and money laundering, and financial market infrastructure. The key regulatory developments for each of these groups, some of which extend beyond 2013, are outlined below.

4 At the European level, these include Basel III, the introduction of the too-big-to-fail regime (TBTF), the Markets in Financial Instruments Directive II (MiFID II) and the European Market Infrastructure Regulation (EMIR). At the national level they include the development of the OECD standard for the automatic exchange of information (AEOI) in tax matters, as well as the Federal Financial Services Act (FFSA), the Financial Institutions Act (FinIA) and the Financial Market Infrastructure Act (FMIA).

5 This means that in practice, formal convergence does not automatically lead to regulatory simplification for banks that conduct business in a number of different countries. Instead, the banks tend to be confronted with cost-intensive fragmentation for the operational implementation of global standards.

6 For example: the review of securities for admission to trading by the stock exchange instead of by the supervisory authority (cp. The FMIA consultation draft).

## Banking regulation

A series of far-reaching prudential standards aimed at increasing the stability of financial systems were resolved in the years immediately following the credit and capital markets crisis. These reforms, known as Basel III, are to apply to financial institutions worldwide and among other things, determine the capital and liquidity requirements of banks. The rules for this standard were issued in December 2010 already by the Basel Committee on Banking Supervision (BCBS).

Over the last three years, developments in banking regulation have been shaped by the implementation and technical formulation of the standard at the national level.[7] In Switzerland, the requirements set out by the Basel framework were transposed relatively quickly into national legislation by means of the Swiss Financial Market Supervisory Authority's (FINMA) new Capital Adequacy Ordinance (CAO) and a variety of circulars (implementing provisions) at the beginning of 2013.

In 2013, the BCBS therefore declared Switzerland as compliant both with Basel III and its schedule for implementation. Switzerland has defined varying minimum capital ratios in its transposition of the capital requirements, depending on the category of the bank. These requirements in part far exceed the minimum requirements set out by Basel III ("Swiss finish"). FINMA is following the international timeline in terms of the further steps for the implementation of Basel III, (leverage ratio/liquidity coverage ratio). Regulation for the big banks will, however, follow an accelerated timeline. A liquidity coverage ratio of 100 % will apply for the big banks beginning in 2015.

In recent years, Switzerland has been an international forerunner with regard to the specific regulation of systemically relevant banks (too-big-to-fail regime, TBTF). The new requirements dictated by the Banking Act (BankA) for systemically relevant banks came into effect at the beginning of 2012 already.[8] The TBTF package of measures comprises four key measures: stronger capitalisation (by the end of 2018), with requirements exceeding those set out by Basel III, stricter liquidity requirements, improved risk diversification and organisational measures that guarantee systemically important functions for the economy such as payment transactions, even in the case of the threat of insolvency. The result is a differentiated regulatory landscape in Switzerland with significantly higher supervisory requirements for the systemically relevant banks.[9]

## Customer protection and products

The regulatory process relating to customer protection in Switzerland is being driven primarily by the development of the Federal Financial Services Act (FFSA) and the Financial Institutions Act (FinIA). Switzerland is thus on the one hand aligning itself with international efforts aimed at increasing investor protection following the financial crisis, such as the October 2011, G20 High-Level Principles on Financial Consumer Protection, and on the other, it is seeking to preserve market access for the cross-border securities business, in particular with the EU.

The process for the FFSA was launched by the Federal Council in March 2012 following preparatory work carried out by FINMA. The Federal Council mandated the Federal Department of Finance (FDF) to develop regulation for financial products and financial services across sectors, as well as for their distribution. The consultation draft announced in June 2014, in particular lists provisions regarding duties to provide information and investigate, and aligns itself closely with the European MiFID I and II regulation. Customers must receive sufficient

7 And at the EU-level.
8 The majority of the related implementation provisions have been in force since the beginning of 2013.
9 As at July 2014, these are UBS, Credit Suisse, Zürcher Kantonalbank and the Raiffeisen banking group.

information about their financial services provider, and about the financial services and financial instruments available. In addition, financial services providers must advise customers or manage their assets in a manner that reflects their knowledge, experience, financial situation, and investment goals. This increases the demands placed on the banks' processes as well as their information, documentation and training obligations. The exact scale thereof depends to a great extent on how the implementation provisions are formulated.

The consultation draft deviates from some of the individual items in MiFID II[10] to varying degrees, for example on the instruments for legal enforcement, disclosure requirements for retrocessions in portfolio management (in lieu of the ban under MiFID II), or the opting-out clause for wealthy private customers with assets of over CHF five million. Overall, Switzerland has structured the draft in such a way as to enable the possibility of access to the entire EU market for professional customers by means of an EU-equivalent regulation, as foreseen in the EU legislation (EU passport). The draft also adequately reflects the distinct features of the Swiss banking centre. There is a risk, however, that Switzerland is going well beyond the EU regulation, for example in the reversal of the burden of proof. As MiFID II must be implemented by January 2017, the equivalence of the Swiss provisions must be established by that time.

The FinIA consultation draft was published in June 2014. Its primary objective is to establish supervision for financial services providers that provide wealth management services. According to this draft, independent asset managers (IAM) in particular will come under prudential supervision, while existing asset managers can take advantage of the protection of vested rights (grandfathering clause).

Additionally, in the fall of 2012, the Collective Investment Schemes Act (CISA) was revised, followed by the Collective Investment Schemes Ordinance (CISO). These steps were taken with the objective of establishing equivalence with the EU regulations and in doing so, facilitating EU market access for collective investment schemes and the potential obtainment of an EU passport for Swiss asset managers. The catalyst for this was the Alternative Investment Fund Managers (AIFM) Directive, which was approved by the EU in June 2011, and which calls for equivalent supervision, as well as collaboration between the responsible supervisory authorities for the delegation of asset management to third-countries. In June 2013, FINMA signed the corresponding cooperation arrangements with the supervisory authorities from the EU and EEA states. Without this revision, Swiss asset managers would have been denied access to the European market from mid-2013 onward.

### Tax issues and money laundering

One of Switzerland's central issues, in particular for the wealth management business, has for many years been the taxation of private assets invested cross-border.

In the wake of the global financial crisis and even more so of the sovereign debt crisis, awareness has increased at a global level for the issue of dishonesty in tax matters. As a result, international pressure has increased on the Swiss government and the financial institutions in general, and on bank-client secrecy in particular. An example thereof is the tax dispute with the US, in which the Swiss banks are accused of having violated US law by helping American customers to avoid paying US taxes. In 2013, Switzerland and the US signed an agreement which allows the Swiss banks to participate in a unilateral programme led by the US Department of Justice. This agreement permits the banks to settle the past within a clearly defined framework.

10 According to the European Parliament's resolution on 15 April 2014.

In response to the international pressure arising from the tax issue, Switzerland reached tax agreements with the United Kingdom and Austria. These allow for the taxation of assets from these countries of origin that are invested in Switzerland by means of a flat-rate withholding tax. Customer privacy remains protected under the agreements, which came into effect on 1 January 2013. It was not possible to reach a similar agreement with Germany. A simplified exemption procedure for financial institutions was, however established, which facilitates the cross-border wealth management business with Germany as of 2014.[11]

The automatic exchange of information (AEOI) with countries abroad for information regarding taxable persons is most likely to become the future international standard for the resolution of the tax issue. The US took a first unilateral step in this direction with its Foreign Account Tax Compliance Act (FATCA), which came into effect in July 2014. The aim of FATCA is the disclosure by financial institutions of all assets held abroad belonging to US taxpayers. Switzerland signed a corresponding intergovernmental agreement in 2013.

The Organisation for Economic Cooperation and Development (OECD) recently developed a global AEOI standard for the exchange of tax information, which is strongly aligned with FATCA and will allow for a full, reciprocal exchange of tax information. This was presented in the spring of 2014. Over 60[12] countries have agreed to the introduction of the standard to date, including Switzerland. Even though the banks in Switzerland have been committed to a tax compliant strategy for some time now, the introduction of an AEOI will result in a paradigm change for the cross-border wealth management business. It is assumed that the AEOI based on the OECD standard will be introduced at the earliest in 2017.[13]

Switzerland has addressed the issue of regulation against money laundering by implementing the recommendations made by the Financial Action Task Force on Money Laundering (FATF). In November 2013, a related partial revision of the Anti-Money Laundering Act (AMLA) came into effect, which significantly broadens the responsibilities of the Money Laundering Reporting Office Switzerland (MLROS). The MLROS can now for the first time exchange financial information with its partner agencies abroad, and therefore contribute to international collaboration in the fight against money laundering. Further to this, the MLROS will in future be authorised to independently enter into agreements for technical collaboration with foreign anti-money laundering reporting offices. As a result of the revision, the reporting office's powers have also been increased in the area of procurement of information from financial intermediaries. For the implementation of the revised recommendations, the Federal Council proposed a number of legislative measures at the end of 2013 in order to transpose the revised standards into Swiss law, with the aim of preventing the Swiss financial centre from being misused for criminal purposes. The draft legislation is currently going through Parliament.

The new federal act on the freezing and restitution of illicitly acquired assets of foreign politically exposed persons (RIAA) adopted in May 2014, creates a formal legal basis for addressing the issue of dictators' assets and will facilitate the common practice applied previously, which based on emergency legislation. The law governs the procedures and requirements for the freezing, confiscation and restitution of dictators' assets. The procedures and responsibilities of financial services providers are also defined in this new regulation in order to increase transparency and legal certainty. The MLROS will from now on serve as the sole, central reporting office.

**11** The simplified exemption process for banks in Germany that conduct cross-border business came into effect on 1 January 2014.
**12** As at July 2014.
**13** According to the timeline indicated in the statement made by the "early adopters" of the OECD standard on the AEOI.

### Financial market infrastructure

Driven by amendments to regulation relating to the financial market infrastructure in the EU and the US, the Federal Council launched consultations in December 2013 for the Financial Market Infrastructure Act (FMIA). The general direction being taken is therefore in line with the international efforts of the G20 countries, in particular with regard to the improvement of transparency and stability in the over-the-counter derivatives market. Due to the close interconnectedness of Switzerland in particular with the EU, the draft is therefore also closely aligned with the corresponding EU regulation (European Market Infrastructure Regulation, EMIR), which entered into force in 2012. In future, three central duties for derivatives trading will also apply in Switzerland as a result, namely: obligation for clearing (through central counterparties), obligation to report, and the obligation to mitigate risk. Just as with the FFSA, however, there are certain deviations from the European regulation, such as the waiving of a total ban for the operators of organised trading systems, business conducted on an institution's own behalf using an in-house system, or the waiving of a fixed clearing period.

## 2.2 International context

As addressed in chapter 2.1, there is a trend toward formal international convergence between the major regulatory standards. Global standards such as Basel III or the future implementation of the OECD's standard for the AEOI will, in addition to Switzerland, generally be backed and implemented by (almost) all important foreign banking centres[14] such as New York, London, Luxembourg, Singapore and Hong Kong.[15] The possibilities for regulatory differentiation in the competition between the international locations therefore now lie in the formulation and handling of the individual regulations[16], which are often set out in a multitude of detailed rules and provisions. How these details are transposed is also an important factor in terms of the revenue and cost implications of the regulations, and can therefore be a source of location-specific advantages and/or disadvantages. In this chapter the most important distinguishing regulatory features of Switzerland's key competitors will be illustrated on the basis of the following subject areas: banking regulation, customer protection and products, tax issues and money laundering, and financial market infrastructure. Switzerland's relative regulatory positioning will also be addressed.

### Banking regulation

In general, the international rules formulated in the Basel framework will be implemented step-by-step in all of the banking centres under review. In its progress report[17], the BCBS concluded in April 2014, that all of the banking centres listed above will meet the international timeline mentioned previously for the implementation of the Basel III guidelines.[18]

Switzerland is not the only country to go beyond the defined international minimum requirements in order to increase stability in its banking sector. Singapore has also passed capital requirement regulations that are generally stricter than those dictated by Basel III. While capital requirements in Hong Kong meet the Basel III standards, banks domiciled there are already required to meet additional local liquidity requirements until the Basel III liquidity standards are introduced. Stricter liquidity requirements are also already in place in Switzerland for the

14 As at July 2014, Basel III will be implemented in all of the banking centres listed, and with the exception of Hong Kong, all of the banking centres listed have agreed to the introduction of the OECD standard for the AEOI.
15 Hereinafter, these financial centres are considered in comparison to Switzerland.
16 For example: the definition of the components for calculating capital ratios under Basel III, taking into consideration accounting standards, as numerous slight deviations between the EU and the US exist in this area. A further example is the Federal Council's option described in the FFSA consultation draft to designate certain debt securities as being subject to a prospectus review only after issuance, under specific circumstances.
17 Basel Committee on Banking Supervision (Bank for International Settlements) – Progress report on implementation of the Basel regulatory framework, April 2014.
18 According to the BCBS, as at April 2014, only operational details remained to be clarified in the UK before the implementation deadline.

big banks. A comparison between the implementation of Basel III rules in the US and the EU shows a number of divergences; in particular with regard to the US' existing mandatory leverage ratio,[19] which is generally regarded as stricter than the Basel III requirements. That being said, the multitude of differences in calculation methods and accounting standards has a distortionary effect. According to the decision reached by the US Federal Reserve (FED), subsidiaries of foreign banks with combined assets of over 50 billion US dollars must be placed in an intermediate holding company as of July 2016, and stricter prudential requirements apply in accordance with the US rules for US bank holding companies. This results in part in significantly higher capital requirements for these subsidiaries.

Switzerland remains a forerunner with regard to specific supervisory rules for systemically relevant banks; according to the BCBS, it is the only of the financial centres under review in which these rules are already in effect in their entirety. As EU member states, in the United Kingdom and Luxembourg, for example, transposition of the TBTF requirements (Article 131) of the Capital Requirements Directive (CRD IV) into national law must only be concluded by the beginning of 2016. However, under the 2013 Banking Reform Act, the UK has introduced additional rules for retail banks that go beyond Basel III, and that are currently being further specified. With regard to the banking union, the European Central Bank (ECB) will assume direct supervisory responsibility for around 120 important banks in the Eurozone from November 2014 onward. Furthermore, in an effort to ensure efficient resolution, the banking union has created a special committee for single resolution and a single resolution fund. Specific measures for the regulation of systemically relevant banks in Hong Kong and Singapore are currently in the political planning process. The net effects of exceeding the requirements set out by international standards depend on the respective regulatory issue. In the case of rising regulatory intensity there are generally advantages (for example stability and positive effects on reputation), as well as disadvantages (for example implementation and opportunity costs), although the latter tend to dominate from a certain degree of regulation onward. It is for this reason that meaningful regulatory assessments, such as cost-benefit analyses and impact assessments, are necessary and should be carried out by the authorities.

There is a tendency for Swiss prudential regulations to be stricter in international comparison, namely with regard to the regulation of systemically relevant banks. This can potentially lead to higher capital costs for on-balance sheet businesses. Nevertheless, the other countries under review also have a number of specific rules that extend beyond Basel III, or are in the process of introducing TBTF regulations. The overall gap between Switzerland and the other countries with regard to TBTF regulation is therefore likely to narrow in future.

### Customer protection and products

The bankruptcy of Lehman Brothers in 2008 and the global financial crisis were catalysts for international efforts to increase investor protection, such as the G20's October 2011, High-Level Principles on Financial Consumer Protection. Essentially, supervisory authorities around the world are trying to improve customer protection by means of increased obligations relating to information, investigation and documentation. This entails substantial costs for the banks, however. An important example of new regulation in this area is the further development of MiFID to MiFID II in Europe, which was adopted in April 2014. In Asia, steps toward improved customer protection have also been taken – in Singapore by means of the Financial Advisory Industry Review (FAIR) and in Hong Kong with the Treat Customer Fairly (TCF) Charter.

The UK is the forerunner in Europe in terms of customer protection, and has gone beyond the EU requirements (in particular as a result of a complete ban on retrocessions and detailed

19 A significant number of slight deviations in the calculation methods and accounting practices applied should be noted.

documentation and protocol obligations). MiFID II is to be implemented in the UK by 2015, and therefore well in advance of the EU's deadline for implementation, which is 2017. In the UK, complex, unregulated collective investment schemes, for example, are prohibited for retail clients. The UK also breaks customer protection down by segment. By signing the required form, the Financial Promotion Order (2005) allows high net worth individuals[20] in the UK to receive services from financial services providers under simplified customer protection provisions.

Overall, regulation for the protection of customers is furthest reaching in the EU. No full-out ban on retrocessions for portfolio management is foreseen under MiFID II for example, in the US, Singapore or Switzerland. For the distribution of complex investment products to private customers, on the other hand, Singapore has stricter obligations to investigate, which are comparable to the rules in the EU.

Implementation of the FFSA in accordance with the consultation draft would translate into slightly more liberal rules in Switzerland than, for example, in the EU. In particular the opting-out clause for wealthy customers in the obligation to investigate, similar to the UK, as well as the duty to provide information on retrocessions instead of a ban, allow Swiss banks to maintain a certain level of flexibility in the international competition for wealthy customers.

### Tax issues and money laundering

The regulation of international tax issues and the implementation thereof have played an important role in the past, especially for the cross-border wealth management business. The trend toward convergence can be observed here as well.

By July 2014, for example, Switzerland and the banking centres under review reached an intergovernmental agreement (IGA) with the US on FATCA. The UK was part of the group of countries that first implemented FATCA, and signed a corresponding agreement in 2012. The other banking centres reached similar agreements with the US after Switzerland did so in 2013: Luxembourg signed an agreement in March 2014. Hong Kong and Singapore reached an agreement in substance in May 2014. There are two models for the implementation of FATCA. Interestingly, of the banking centres under review, Hong Kong and Switzerland were the only countries to opt for the model 2 IGA, under which the financial institutions must inform the US supervisory authorities directly. All of the other banking centres under review chose the model 1 IGA, according to which, the local tax authorities gather the information on US taxpayers and forward it to the US authorities. This creates the possibility of a mutual exchange of information (reciprocity). In general, model 1 is viewed as the more attractive, as it provides more legal certainty and scope for implementation. In May 2014, the Federal Council approved the draft mandate for negotiations with the US on changing to model 1.

In terms of the AEOI standards defined by the OECD, by July 2014, all of the banking centres under review with the exception of Hong Kong had approved its introduction.

With regard to the future, Switzerland appears to be moving in line with the other locations under review on tax matters related to cross-border wealth management, with the exception of Hong Kong. Only on FATCA did Switzerland act sooner than the other financial centres, and signed the generally more disadvantageous agreement. For the implementation of the OECD's AEOI standard, it is important that potential disadvantages for the Swiss banks are avoided by ensuring that the implementation is synchronised as best possible with the other competing locations.

20 According to the Financial Promotion Order, high net worth individuals are defined as customers with an annual income of over GBP 100,000 or assets of over GBP 250,000.

There are a number of international standards in place for the fight against money laundering in addition to the FATF recommendations, although the term money laundering is interpreted differently from country to country. The FATF is a global organisation that issues concrete recommendations and monitors the implementation thereof in its 36 member states. All of the financial centres under review are members of the FATF and have implemented the standards against money laundering according to the FATF recommendations at least in part. With respect to provisions for dictators' assets, Switzerland's rules for the import, freezing, confiscation and restitution of dictator's assets are comprehensive in international comparison. Even though a number of other financial centres, such as the US, the UK or Luxembourg have legal tools[21] in place by means of which to freeze or confiscate the illegally acquired assets of politically exposed persons, unlike in the case of Switzerland, these are not based on a specific legal foundation. The EU does not have any specific legislation for dictators' assets and in such an instance applies the legal basis for sanctions.

### Financial market infrastructure

Both EMIR, which was introduced by the EU and came into effect in August 2012, and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) introduced in the US in 2010, have an impact on the supervisory authorities in all of the financial centres under review in terms of financial market infrastructure and the regulation of over-the-counter derivatives. The extraterritorial provisions set out in these rules require, for example, that EMIR also applies to transactions conducted solely between persons domiciled in third-countries, insofar as these transactions have direct, significant and foreseeable effects in the EU, or if this is necessary in order to prevent the circumvention of EU law. Further to this, the third-country provisions set clear incentives for creating equivalent supervisory standards in the countries of the respective trading partner for derivatives traded over-the-counter. EMIR's third-country provisions foresee, among other things, that cross-border intra-group transactions involving a third-country are only released from the clearing obligation through a central, EMIR-compliant counterparty if the third country has clearing, reporting and risk mitigation duties equivalent to EMIR.

Against this backdrop, Asian financial centres, for instance, have also amended rules for reporting, clearing and trading platforms in the OTC derivatives segment, or are poised to do so. Comprehensive global convergence is therefore emerging on this issue, an issue which Switzerland, with its global banking operations, cannot avoid. Without an EMIR-equivalent supervisory regime, the intra-group transactions conducted by Swiss financial services providers, for example, would be subject to cost disadvantages in comparison to European competitors, which would represent a clear location-specific disadvantage.

Overall, it can be concluded that the relative positioning of Swiss regulation must be regarded in differentiated terms depending on the topic area. Some regulations are dealt with more strictly, other less so.

## 2.3 Other relevant location-specific factors

In addition to regulatory and fiscal frameworks, a range of other factors play a role in the assessment of the attractiveness of financial centres.[22] Market access, infrastructure, but also collaboration with authorities and interest groups are examples of criteria that must be taken into consideration when assessing the attractiveness of a financial centre, and are often equated with their competitiveness.

21 In the US and the UK, for example, the confiscation of assets can be carried out on the basis of a criminal conviction or civil forfeiture.
22 The assessment of location-specific factors and the resulting comparison thereof is usually made at the financial centre-level. Therefore, location-specific factors relating to financial centres and not to banking centres, are considered hereinafter.

In the current Global Financial Centres Index (GFCI)[23] ranking published in September 2014, both Zurich (7th place) and Geneva (13th place) rank among the leading global financial centres. New York, London, Hong Kong and Singapore remain the best ranked locations, although the gaps between the top ten have narrowed in recent years. In its ranking of international financial centres, Credit Suisse has found[24] that with regard to location-specific attractiveness, Switzerland lies "significantly behind New York, Singapore and London, largely neck-and-neck with the two important centres Luxembourg and Hong Kong, and considerably ahead of Paris and Frankfurt."

The availability of qualified workers and the quality of education and further training are key dimensions in the international comparison of locations. They also form the basis for the present and future competitiveness of the Swiss banking centre. In this context, Switzerland's vocational training system is receiving increasing appreciation and attention worldwide. The financial institutions in Switzerland build significantly on the system, particularly in the area of training for young talent. The Swiss Finance Institute provides the Swiss financial centre with a leading European and international research and teaching institution specialised in banking and finance. Switzerland offers a wide variety of internal and external possibilities for basic and advanced training, qualification and certification. This ensures an ongoing and institutionalised (by the financial institutions themselves) alignment of employee skills with the growing and increasingly changing requirements. Switzerland must build on this and continue to ensure that it offers a comprehensive range of high-quality bank and finance-related educational opportunities at all levels of basic and advanced training (in particular in research and teaching at universities). Recruiting international expertise for specific fields such as investment management, rounds out the educational scope. The short distances within the country represent a location-specific advantage in terms of recruiting and the further qualification of competent and skilled employees.

A general look at the most important financial centres shows: all of the global financial centres traditionally focus on a small number of business areas.[25] While New York and London specialise in asset management and investment banking, private banking plays a key role in Singapore and Switzerland. Luxembourg, on the other hand, focusses on the funds business. This kind of specialisation enables, among other things, positive economies of scale and cluster effects in the relevant business areas, which increase the attractiveness of the respective business areas. International financial centres often distinguish themselves through active political involvement, targeted marketing and efficient cooperation with authorities, lobbyists and market participants. The efficient administrative processes in Luxembourg and Singapore as well as the strong marketing and systematic promotion of the London financial centre are examples of this. The latter benefits – as do Hong Kong and Luxembourg – from support facilities that promote, influence and strengthen the London location both nationally and internationally.[26] Access to global financial markets is also a decisive location-specific factor, which, as explored in Chapter 2.1, has become more relevant due to protectionist tendencies.

While Switzerland performs very well in many areas relating to location-specific attractiveness[27], it appears to be losing ground in particular in relation to the observations made above. In order to continue to generate and strengthen economies of scale and cluster effects, access

23 The Global Financial Centres Index is a ranking of the competitiveness of financial centres. Some of the factors evaluated include: business environment, taxation, human capital, infrastructure, reputation and market access.
24 Credit Suisse, The Swiss Financial Center - Enhancing Competitiveness through the Combined Efforts of Politics and the Private Sector, August 2014.
25 Further information can be found in The Swiss Financial Center - Enhancing Competitiveness through the Combined Efforts of Politics and the Private Sector, published by Credit Suisse in August 2014.
26 Examples: road shows, the generation of evidence supporting the importance of the respective financial centre as well as active political lobbying.
27 For example: in terms of status as a safe haven, high political, economic and legal stability, an independent, strong currency, or high housing and living standards.

to a qualified – increasingly also international – workforce is necessary. This has not been made easier by the approval of the referendum on mass immigration in February 2014. The issue of access to a qualified workforce becomes even more pertinent due to the fact that Switzerland is seeking to become a leading location for asset management, as this objective changes the demands for attracting talent.

There are no coordinated or true efforts of note in terms of the marketing and promotion of the Swiss financial centre. This has negative consequences when comparing with other financial centres. A key factor here is that EU market access for the banks in Switzerland is uncertain. Possible barriers to market access for Switzerland as a result of the regulatory framework conditions harbour the risk of losing a high degree of competitiveness.

## 2.4 Outlook

The trend toward the formal convergence of regulation at the global level is likely to persist. Extraterritorial regulations are the primary reason behind the increased pressure on countries outside the EU and US to transpose equivalent regulations into national law. Notwithstanding, legislators will at the same time continue to strive for their own, national transposition, in order to create competitive advantages for their location. It remains to be seen how these efforts at differentiation will be received by the EU and the US, and how they will be regarded in terms of market access.

In light of the regulatory developments in the area of taxation, the focus will now move to other location-specific factors. Overall, Switzerland is generally well-positioned, even if significant risks do exist. Particularly the risk of more complicated or no access to important markets must be averted. The possibility that the obligation to have a local branch in certain jurisdictions could one day become a reality, will likely continue to exist. Other challenges are the active marketing and promotion of the Swiss financial centre and the availability of qualified workers. Idleness in these areas could damage Switzerland's competitiveness.

The importance of investment expertise in the asset management business will increase, and will become a deciding factor in terms of the investing of assets. London and New York in particular, have an excellent global competitive position in this area, thanks to their strong asset management capabilities and the performance focus on synergies and positive externalities. Switzerland must catch up in this segment.

Overall, existing and future regulations will continue to increase the demands placed on the banking business, and will put the cost bases of the banks in Switzerland under pressure. Although it is very difficult to gauge the cost of future regulation, estimates indicate that the Swiss banking centre has already had to absorb substantial costs due to the wave of regulation, and will continue to do so for the medium-term. The Association of Swiss Cantonal Banks[28] estimates that the conversion costs arising from the Capital Adequacy Ordinance will total CHF 50–100 million. Estimates for the costs related to possible regulations for the protection of customers (FIDLEG in particular) differ widely, and therefore require careful interpretation. Professor Martin Janssen[29], for example, estimated the annual costs of the FFSA to be one percent of gross domestic product, or half of bank profits, which would correspond to approximately CHF 5–6 billion.[30] Estimates have also been made for the implementation

28 Association of Swiss Cantonal Banks, statement regarding the revision of the Capital Adequacy Ordinance, 11 January 2012.
29 Professor Emeritus of Finance, University of Zurich.
30 Neue Zürcher Zeitung, Eine Strafaktion gegen Banken (Punitive action against banks), 23 August 2014, and Finanz und Wirtschaft, Aufbäumen gegen FIDLEG (Rebellion against the FFSA), 23 August 2014.

costs of MiFID in the EU, which, if applied to Switzerland, would entail annual costs of between CHF 45–980 million.[31] In terms of tax-related regulation, the implementation costs of FATCA and the OECD's AEOI standard were estimated by the SBA to be CHF 200–300 million[32] and CHF 300–600 million[33] respectively. With regard to financial market infrastructure, the costs of the new regulations for the Swiss banking centre could be substantial in light of the fact that the costs generated by EMIR for the EU derivatives market are estimated at EUR 15.5 billion per year.[34]

The Swiss banking centre will continue to place a strong focus on profitable growth as a result of the regulatory cost pressures described.

**31** Application of the EU Commission's calculation of 0.11 % of operational costs results in approx. CHF 45 million in running compliance costs for MiFID in Switzerland. JWG's estimate for a "typical UK investment firm" in 2006 for MiFID I per institution is around CHF 3 million, which results in projected total costs of around CHF 980 million for Switzerland.
**32** Swissinfo, Die USA schlagen eine tiefe Presche ins Bankgeheimnis (The US rips a big tear into banking secrecy), 30 June 2014.
**33** Neue Züricher Zeitung, Neue steuerliche Realitäten (New tax realities), 21 July 2014.
**34** Deloitte, OTC Derivatives – The new cost of trading, 2014.

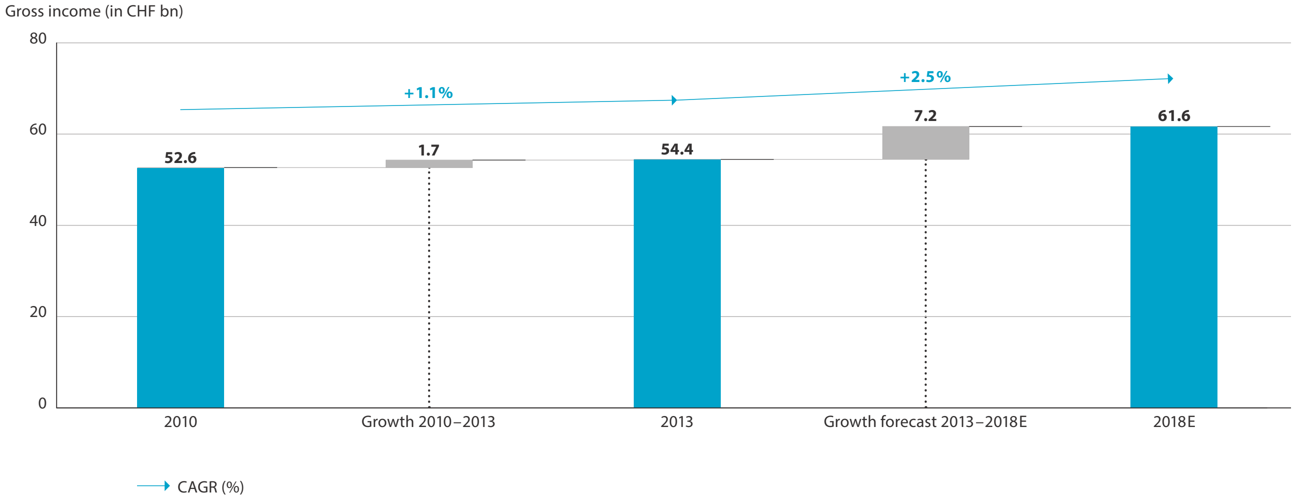
# 3 Quantitative trends in the Swiss banking centre

## 3.1 Overview

The Swiss banking centre generated CHF 54.4 billion in gross revenues in 2013.[35] This is CHF 1.7 billion more than in 2010, which represents an average annual growth of 1.1 %. For the next five years leading up to 2018, an increase of 2.5 % in growth momentum per year is expected for the banks' gross revenues. This corresponds to overall gross revenues of CHF 61.6 billion in 2018 (see Figure 1).

Fig. 1

### Earnings performance for the Swiss banking centre



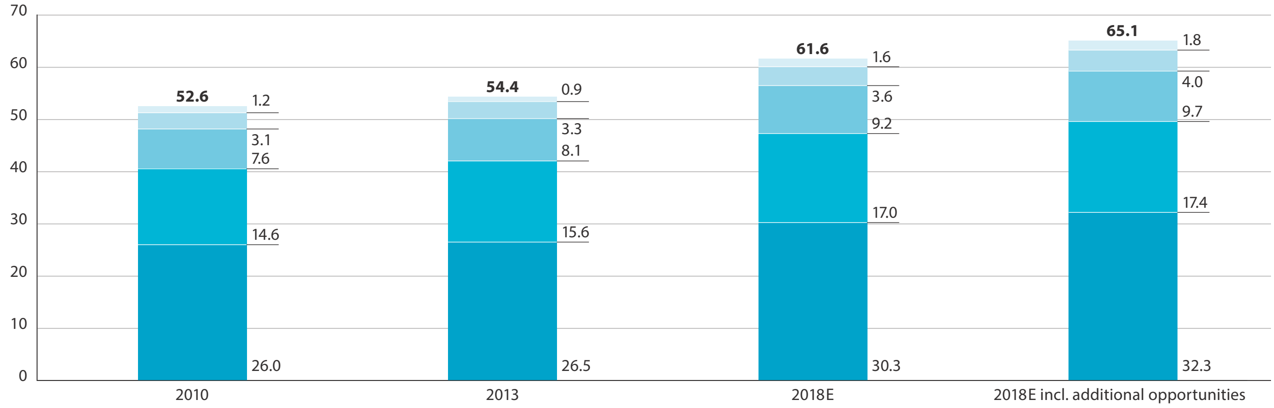

This forecast is based on the following assumptions: positive economic growth in Switzerland at 2.6 %[36], a persistently low interest rate environment, conservative capital market developments and steady exchange rates. In addition, the expectation is that the draft laws relating to banking regulation[37] that are currently under consultation or revision, will have come into effect by 2018 if they are recognised by the EU as equivalent to the relevant EU regulations, and if no negative developments materialise with regard to market access – in particular with regard to the European market.

The biggest business area in the Swiss banking centre is private banking, with gross revenues of CHF 26.5 billion in 2013, followed by the retail client business (CHF 15.6 billion) and the corporate client business (CHF 8.1 billion). Asset management and investment banking are less significant in terms of gross revenues (see Figure 2).

35 BCG calculations, see explanation of methodology in the appendix.
36 Average growth through to 2018 based on forecasts by Oxford Economics.
37 The FFSA, FinIA and FMIA.

Fig. 2

## Trends in revenues and costs by business area




**Expected trends in costs 2013–2018E**

**Private banking**
- Potentially high costs of new regulations for customer protection (FFSA) and taxes (AEOI)

**Retail client business**
- Potentially high costs of new regulations for customer protection (FFSA) and taxes (AEOI)
- Small banks affected in particular

**Corporate client business**
- Higher capital and liquidity requirements as a result of step-by-step implementation Basel III
- Swiss banks well-capitalised

**Asset management**
- New supervision for alternative investment managers under CISA
- Slight increase in obligation to inform for retail clients (FFSA)

**Investment banking**
- Possible regulatory developments not yet finalised and less relevant for business areas under review

In terms of growth momentum, revenues in the retail and corporate clients businesses have experienced the strongest increase since 2010 (+2.1 % and +2.3 % annually), while revenues in private banking rose only marginally (+0.6 % annually). The outlook for the period leading up to 2018 sees a significant recovery for private banking and the revenues from this business, which are expected to increase by an average of 2.8 % annually, driven by a strong domestic as well as cross-border business with wealthy private customers from emerging countries. Growth for the retail client business is forecast at 1.7 %, and at 2.4 % for the corporate client business. The projected 1.5 % annual growth for asset management does not include the effects of the joint Swiss Bankers Association (SBA) and Swiss Funds & Asset Management Association (SFAMA)[38] Asset Management Initiative. These are reflected in the additional opportunities.

Possibilities exist in all of the business areas to increase revenues growth by taking advantage of additional opportunities and leveraging revenue potential that has not yet been exhausted. Overall, the additional opportunities are valued at CHF 3.5 billion for 2018. At CHF 2 billion, the absolute potential in 2018 is most significant for private banking, while in relative terms, asset management holds the greatest potential. Full realisation of the additional opportunities with the inclusion of the Asset Management Initiative could increase annual revenues growth in this business area by 3.9 % by 2018. It is clear, however, that realising the potential described here requires considerable efforts.

Generally speaking, almost all of the business areas were subject to significant competitive and cost pressures. Cross-border private banking in particular experienced a decline in gross margins between 2010 and 2013 due to a change in customer base toward wealthier clients. In the retail and corporate clients businesses, deposit margins in particular shrank significantly as a result of the low interest rate environment, while credit margins developed relatively steadily. In asset management, the ongoing trend toward passively managed products as well as increased transparency requirements resulted in a decrease in profit margins.

38 At the time of the introduction of the Asset Management Initiative, the Swiss Funds & Asset Management Association (SFAMA) was called the Swiss Funds Association (SFA).

In the context of declining profit margins and overall rising material costs due to increased demands on the banking business – also in the area of regulation – the banks in Switzerland were forced to introduce efficiency measures in order to protect profitability. According to the Swiss National Bank's (SNB) statistics[39], the banks in Switzerland reduced their personnel costs by CHF 2.6 billion (-8.8 %) between 2010 and 2013, while their material costs rose by CHF 1.3 billion (+9.7 %) for the period. The reduction in personnel costs is attributable to two factors, on the one hand to a decrease in head count (-3.7 %) and on the other hand, to a reduction in average personnel expenditures (-5.3 %). The cost-income-ratio[40] for the Swiss banking centre overall was 68 % in 2013 (69 % in 2010). The trends described with regard to income and costs were driven to a large extent by the big banks.

Increased cost pressures are expected for the years leading up to 2018 due to regulatory changes, as outlined in Chapter 2.4. The retail client business and private banking will in particular be subject to high regulatory costs. Market consolidation is expected to continue as a result, as smaller institutions will be disproportionately affected by rising costs. How significant the effect will be depends largely on the final content of the implementing provisions. Care must be taken to ensure that the formulation is flexible, pragmatic and in the truest sense of the word, liberal.

As a whole, the Swiss banking centre will remain of great importance for Switzerland. The economic benefits created by the banking centre in many ways go beyond the revenues and jobs that it generates directly. A strong banking centre provides the expertise that export-oriented Swiss companies require for their international business, and the corresponding financial services. Further to this, the existing economic cluster in the banking business comprises not only the banks alone, but also banking-related industries such as financial market infrastructure providers, software developers and other product and services providers. As a result of the strength of the domestic banking centre, important innovations can be developed in Switzerland that can in turn be exported to other financial centres. In the broadest sense, the banking centre also comprises the finance-related educational and research infrastructure, such as the Swiss Finance Institute, which benefits from a strong banking centre and is in turn an important factor for its future strength.[41]

## 3.2 Private banking

### 3.2.1 Trends since 2010

In 2013, private banking in Switzerland managed CHF 3.080 billion in assets and generated gross revenues of CHF 26.5 billion.[42] In terms of revenues, it is the most important business area for the banks in Switzerland. From 2010 to 2013, assets under management grew an average of 5.1 % annually. Of the total assets managed in Switzerland in 2013, 32 % (CHF 970 billion) were attributable to domestic private banking, and the remaining 68 % (CHF 2.110 billion) were attributable to the cross-border business.

While capital appreciation was strong, developments on the revenues side were only somewhat positive. Total revenue growth for the period between 2010 and 2013 was only 0.6 %. Revenues from the cross-border business in particular decreased due to increased competition – also as a result of regulatory developments – and a change in customer base. In concrete

39 SNB, Banks in Switzerland 2013, Income statement.
40 Excluding risk provisions, calculated as the sum of personnel and material costs, divided by the sum of interest income, income from commissions, trading income and other ordinary profit.
41 There are also significant interdependencies between the Swiss banking centre and non-banking related industries.
42 Calculations based on BCG Wealth Management Benchmarking and Market Sizing 2014.

terms, gross margins for the domestic business shrank from 86 to 82 basis points between 2010 and 2013, and for the cross-border business from 107 to 93 basis points.[43]

In the *domestic* wealth management business, customer assets rose on average by 6.4 % between 2010 and 2013, and therefore grew significantly faster than assets under management from other developed countries[44] (0.4 %). Key drivers for this strong growth in the domestic business were the positive capital market developments as well as a positive economic situation in Switzerland. The gross margin further declined for competitive reasons, as previously outlined, and as a result, the average revenue growth of 3.6 % was lower than the rise in assets under management.

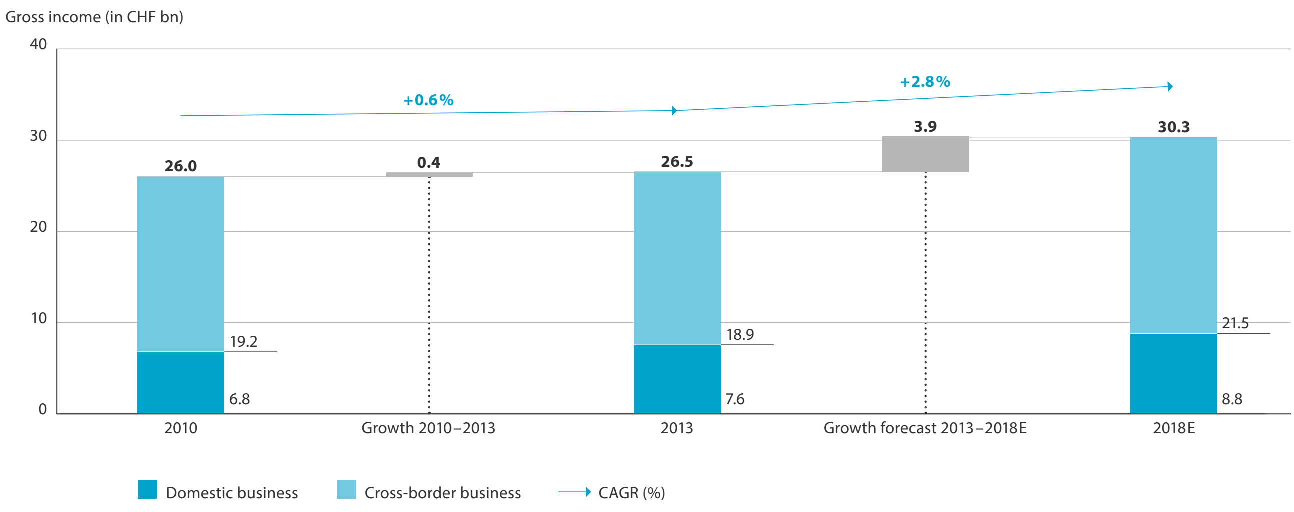
The *cross-border* business was characterised by a continued rise in assets from emerging countries.[45] In 2010, almost half of assets under management were from Western Europe and North America. In 2013, around 55 % of non-domestic assets managed in Switzerland were attributable to emerging countries and only around 45 % to developed countries.[46] This is due to the fact that asset holdings from emerging countries have experienced above-average growth in recent years, and cross-border assets from Western Europe and the US have grown only marginally.

The reason for the discrepancy in developments is on the one hand the strong economic and capital market developments in the emerging markets and the high level of appeal of Switzerland for customers from these countries. The rise in assets under management from emerging countries corresponds to 8.1 % per year for the period under review. Growth regions such as the Middle East, Latin America or Asia are therefore playing an increasingly important role for private banking in Switzerland.

On the other hand, assets from Western Europe and the US decreased following the taxation of these assets and the portfolio adjustments made by the banks in Switzerland. The drivers behind this decrease were customer uncertainty due to political pressure from other countries in Europe and the US, and the implementation of FATCA. The business with affluent customers, that is to say customers with assets of below one million Swiss francs, was most impacted by this.

Fig. 3

## Earnings performance and outlook for private banking




43 BCG Wealth Management Benchmarking. Slight deviations from the 2011 study for the 2010 figures exist due to changes in benchmarking participants and adjustments of data.
44 For the purposes of this study, developed countries are defined as: Western Europe and North America.
45 For the purposes of this study, emerging countries comprises the following regions: Eastern Europe, Asia-Pacific, Latin America, the Middle East and Africa.
46 BCG Wealth Management Market Sizing 2014.

Due to higher regulatory costs and declining gross margins, the strong volume growth over the last few years resulted in only a slight improvement to the cost-income ratio from 77 % (2010) to 72 % (2013).[47] The cost-income ratio for Swiss private banking was therefore still significantly higher than in the pre-crisis years.

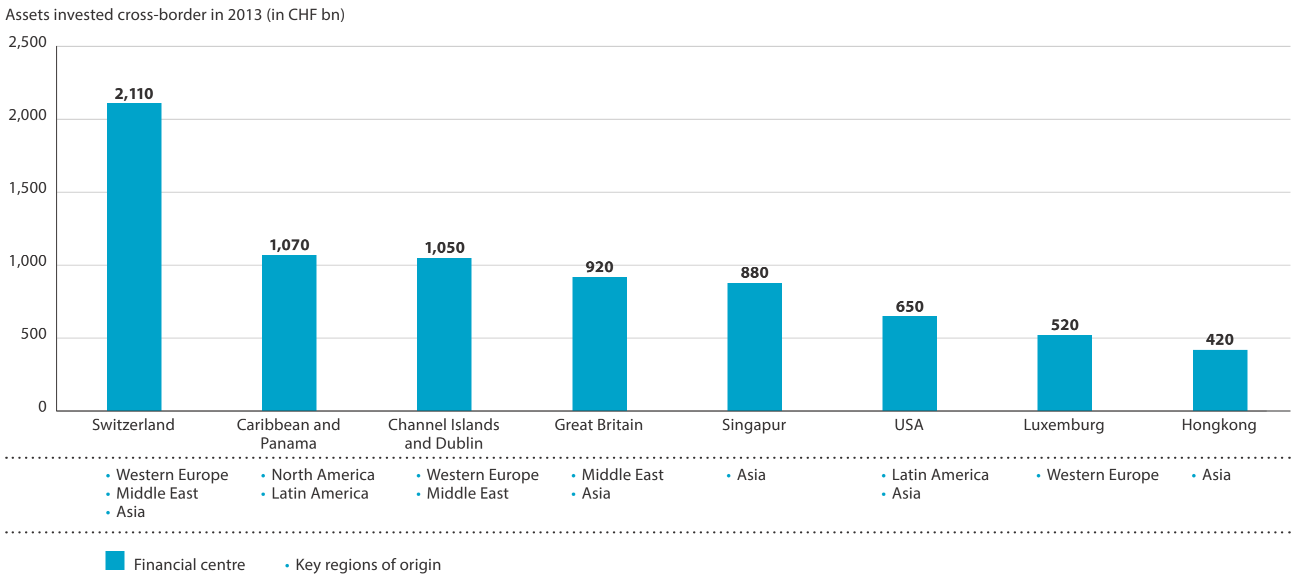
In light of the changes in customer portfolios and the framework conditions for private banking in Switzerland, many market participants have reviewed their existing strategies and business models. A number of international banks with branches in Switzerland also reassessed their local presence as part of a review of their overall business portfolios and decided to focus on other locations or business activities, which resulted in a reduction in the number of foreign banks in the Swiss banking centre.

In international comparison, Switzerland remained the leading global financial centre for cross-border assets in 2013, with assets under management of CHF 2.110 billion.[48] The biggest competitors in terms of volume of assets under management remain the Caribbean and Panama, the Channel Islands and Dublin, as well as the UK, followed by Singapore, the US, Luxembourg and Hong Kong (see Figure 4).

Growth momentum in the individual booking centres is strongly correlated to the breakdown of the respective cross-border assets by region of domicile. While Western Europe and the Middle East are the most important regions of origin for Switzerland, the booking centres in Singapore and Hong Kong focus almost exclusively on customer assets from Asia. The UK, and London in particular, which is in strong competition with Switzerland in the cross-border business, primarily manages assets belonging to customers domiciled in the Middle East and Asia (see Figure 4). This is generally attributable to the historic relationships between the UK and these regions.

Fig. 4

## Biggest private banking financial centres for cross-border wealth management




47 BCG Wealth Management Benchmarking. Slight deviations from the 2011 study due to changes in benchmarking participants and adjustment of data.
48 BCG Global Wealth Report 2014: Riding a Wave of Growth.

## 3.2.2 Projected trends through to 2018

Based on conservative capital market estimates, assets under management for private banking in Switzerland will rise on average by 2.8 % per year, to a total of approximately CHF 3.540 billion. Revenues are therefore projected to rise to CHF 30.3 billion (+2.8 % annually) by 2018.

For *domestic* private banking, an increase in assets under management of CHF 140 billion to CHF 1.120 billion (+2.8 % annually) is expected, carried by positive developments in the Swiss economy. Due to a continued, highly competitive environment and a changing customer base, gross margins for the period under review will likely remain under pressure. This will result in gross revenues of CHF 8.8 billion in 2018, which represents an increase of CHF 1.3 billion.

*Cross-border* private banking is significantly influenced by the international regulatory and economic developments. The current upheavals are expected to continue over the next few years and will have a considerable impact on the development of the Swiss banking centre. An overall rise in assets under management in the cross-border business is forecast (to CHF 2.420 billion or by +2.8 % annually). Due to shrinking margins, gross revenues are expected to rise on average by 2.6 % to CHF 21.5 billion annually, CHF 13.1 billion of which will be attributable to the cross-border business with emerging countries.

International tax-related legislation will continue to play an important role. The introduction of the AEOI in accordance with the OECD standard, which is establishing itself globally[49] and to which Switzerland recently committed, is likely to have the largest impact. By committing to this standard, Switzerland can now lay the foundations for future competitiveness.

In addition to the tax issue, the future form of access to the EU market is also of great significance. As a third-country, Switzerland is exposed to considerable political uncertainties in this matter. In this forecast, it is assumed that Swiss legislation will be equivalent to the EU regulation and that there will therefore not be any negative impact on revenues, such as through new limitations to EU market access. An increase must be expected on the cost side as a result of the regulations.

Due to the regulatory and fiscal developments outlined previously, a further decrease in assets under management from Western European customers, in particular in the affluent segment (assets of up to CHF one million), should be expected over the next few years. This is because in relative terms, the attractiveness of the service offering out of Switzerland for this customer segment is most significantly impacted. This development is compounded by likely further portfolio adjustments for banking institutions that conduct cross-border business. Customers will most likely switch to domestic offerings as a result. At the same time, however, inflows from the HNWI and UHNWI segments are expected. Switzerland continues to distinguish itself through high political and economic stability, a stable currency and outstanding service quality, as well as comprehensive access to products and private banking expertise. These advantages are expected to continue to play a major role in Switzerland's competitiveness in private banking.

For *developed countries*, the overall outlook for assets under management growth in the cross-border wealth management business is -0.3 % per year on average (from CHF 910 billion to CHF 890 billion). The change in customer base goes hand in hand with a decrease in profitability, even if the reduction in affluent customers – as described – can be compensated in part by inflows from customer segments with lower margins. Gross revenues are expected to amount to CHF 8.4 billion for 2018.

49 In May 2014, all of the OECD member countries in addition to other countries supported the declaration on the automatic exchange of information. All of the key financial centres excluding Hong Kong and Dubai have therefore signalled their agreement.

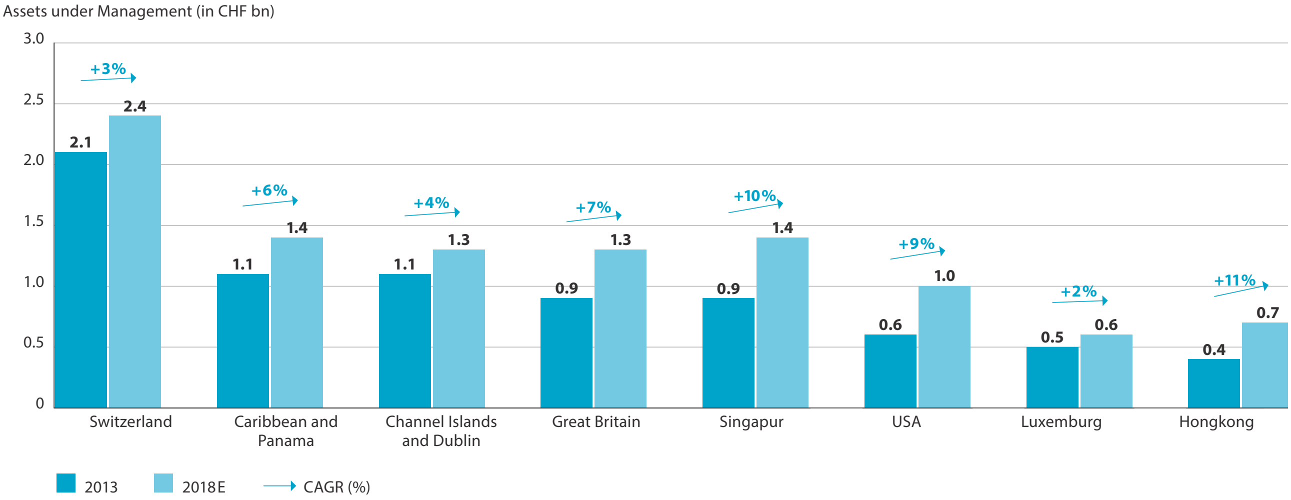
In contrast to the outlook for private banking in developed countries, a further significant rise in assets under management from CHF 1.530 billion (+4.9 % annually) is expected from *emerging countries*. Comparatively superior economic and capital market developments and the Swiss financial centre's strong overall package consisting of stability, expertise, access to products, and an outstanding reputation, are particularly attractive to wealthy private banking customers from emerging countries, and often represent unique selling propositions.

In general, the profitability of Swiss private banking is expected to come under pressure, as the business with domestic and foreign customers will become increasingly expensive due to the rising costs of conducting business. In addition to the operational implementation of the AEOI, the implementation of the FFSA should also be mentioned as an example in this context. Foregoing an EU-equivalent solution would also have cost implications, owing to renewed international pressure and a possible deterioration of market access.

In an international comparison of booking centres, cross-border assets in Switzerland are expected to rise by +3 % annually leading up to 2018. This represents significantly slower growth than for example in Singapore (+10 % annually) and Hong Kong (+11 % annually). The two Asian financial centres will primarily benefit from their strong positions in the growth market Asia (see Figure 5). Swiss growth will be comparable to Luxembourg (+2 % annually) or the Channel Islands (+4 % annually). All three financial centres will experience low growth momentum as a result of their traditional focus on the cross-border business with customers from developed countries, and will report net client outflows, in particular with regard to the business with Western European customers, for the period leading up to 2018. The asset outflows – primarily from the affluent customer segment – will, however, largely not be transferred to booking centres outside of the respective customers' countries of domicile, but will tend to flow to the local banking sectors in the countries of domicile. The growth momentum in the UK (London) and the US (New York, Miami) (+7 % and +9 % annual growth respectively) will benefit from their excellent positioning in emerging countries. In private banking, the UK is well-positioned as a booking centre for Asian customers, while the US enjoys strong inflows from Latin America, and to a lesser degree from Asia. As a result of the increasing regulatory convergence at the global level, the investment performance and thus the investment resources of both locations will gain in relative importance as a competitive advantage in private banking. Overall it can be ascertained that the relative positioning of the individual locations in the emerging markets and their participation in the asset growth taking place there will be the main drivers behind the diverging growth rates.

Fig. 5

## Outlook for biggest private banking financial centres for cross-border wealth management




Generally speaking, private banking will have to come to terms with rising complexity in future. A growing number of regulations at the Swiss and European levels (for example MiFID II), diverging growth outlooks for core markets and not least, the unresolved issue of future market access for Switzerland, are resulting in uncertainty, rising costs and consolidation with regard to the number of banking institutions and the number of markets they operate in. It will therefore be necessary to more than ever address customers and markets with differentiated business models, and to focus on core markets and strengths. The key focus for Swiss private banking in future will have to be on differentiation and profitable growth.

### 3.2.3 Additional opportunities

The banks in Switzerland have the possibility to generate additional revenues in the domestic and cross-border business that extend beyond the forecasted earnings trends.

The first additional opportunity lies in the business with extremely wealthy customers – the UHNWI segment. Key deliverables for this customer group consist of specialised service and a service offering that meets the needs of sophisticated customers. This includes comprehensive wealth planning and the option of multiple providers in the custody management segment. The objective of a focussed UHNWI-offensive must be to seamlessly meet the needs of these customers by bundling product know-how and product expertise, and by providing a further improved service offering and a clear advisory model. Close and comprehensive collaboration with the corporate client business and investment banking must also be achieved in order to address UHNWI needs in a tailored fashion and to take advantage of cross-selling opportunities in a targeted manner. This opportunity is estimated to have a potential of CHF 750 million.

A second additional opportunity, which also builds on taking better advantage of the earnings potential of existing customers, is servicing specific customer needs in the wealth planning segment. Typically, wealthy customers sooner or later begin to focus on making arrangements for retirement and on comprehensive financial planning. Their need for individual solutions therefore increases. Further developing advisory expertise and the range of services related to issues of succession planning, inheritance, and securing customers' standards of living, enables the banks to achieve higher market penetration and increase their revenues per customer. This opportunity is estimated to have a potential of around CHF 130 million.

The emerging countries were identified as an important growth driver for private wealth management in 2011. The continued positive economic developments and uninterrupted rise in the number of wealthy individuals in emerging markets offer an excellent basis for generating additional revenue growth. Switzerland must build on its position as the leading global centre for cross-border wealth management and actively play on its strengths. This, however, requires a clear and specific strategy for every country of domicile in order to participate in the international competition with emerging financial centres. With the help of a strategy focussed on emerging countries, it would be possible to reach potential revenues of CHF 590 million by 2018 by means of this third additional opportunity.

Additional opportunities continue to arise in the business with IAMs as a result of the changing and stricter regulatory framework conditions. Services related to regulatory expertise, for example in the areas of customer reporting and tax declarations, are increasingly being sought out by IAMs, particularly in connection with the expected stricter supervision. If the banks manage to service parts of this new demand, total additional revenues of CHF 220 million can be generated.

A fifth additional opportunity for private banking has been identified in the area of digitalisation. Rounding out classic customer service models with digital technologies allows for more goal-oriented, comprehensive and active interaction with and servicing of private banking customers. Generating tailored information on portfolio developments and investment recommendations results in revenue growth and improved customer retention. Advanced analytics helps to identify and analyse customer needs as well as their timely transfer into the communication and investment process. New interactive channels then facilitate efficient customer advisory services and decision-making. Introducing new price models such as charging for specific additional services, creates a further possibility for revenue generation. Cumulatively, these create an additional opportunity for the banks in Switzerland of CHF 360 million. In addition, operational costs, for example in the areas of compliance or order processing, can be reduced through the targeted implementation of digital technologies.

## 3.3 Retail client business

### 3.3.1 Trends since 2010

In 2013, the Swiss retail client business generated revenues of CHF 15.6 billion.[50] After private banking, the retail client business is the second largest business area for the banks in Switzerland in terms of revenues.

The retail client business is most influenced by the mortgage lending business, while credit, deposit and securities volumes are, in relative terms, much less significant. Private domestic mortgage lending accounted for CHF 623 billion in 2013.[51] Mortgage lending also experienced above-average growth between 2010 and 2013. While mortgage lending rose by 4.6 % per year on average for the period, growth in the other areas of the retail client business was less pronounced.

50 BCG calculations based on SNB volumes and margins from BCG Retail Banking Benchmarking.
51 SNB, Monthly Bulletin of Banking Statistics June 2014, chart 1J Sectoral breakdown of balance sheet items and fiduciary transactions (domestic) - all banks, mortgage receivables.

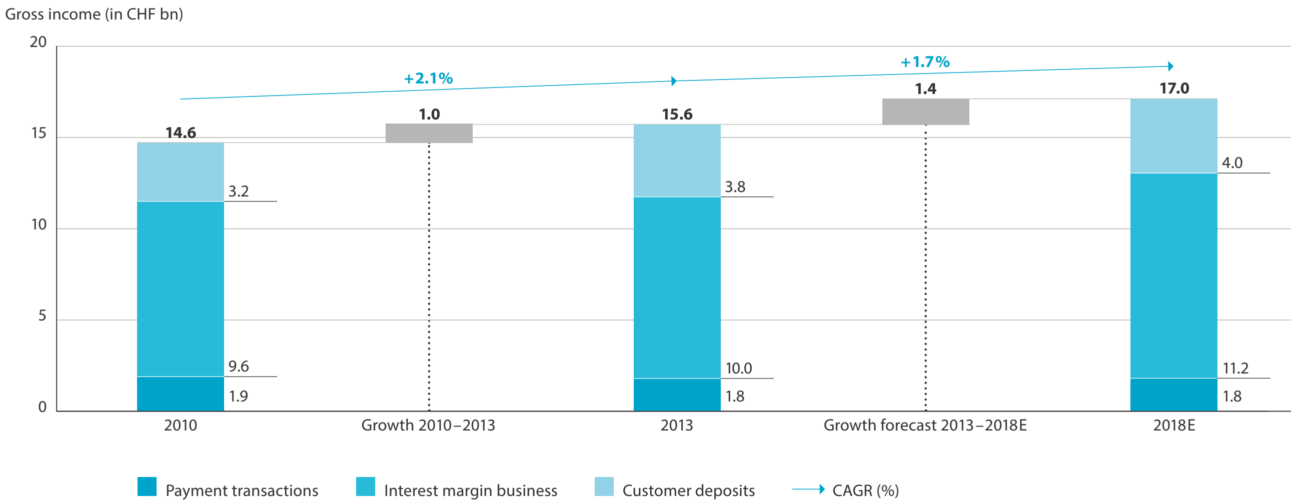
Gross revenues in the retail client business comprise the interest margin business, payment transactions[52] and the securities business. The interest margin business is by far the greatest source of revenue in this business area, and grew 1.5 % per year during the period under review. At CHF 10 billion in 2013, the interest margin business accounted for 64 % of total revenues. Payment transactions rose significantly for the period, from CHF 3.2 billion to CHF 3.8 billion (+6.3 % annually), which is primarily attributable to the inclusion of PostFinance in the SNB's statistics. Revenues from the securities business decreased from CHF 1.9 billion to CHF 1.8 billion. Overall, revenues in the Swiss retail client business rose by 2.1 % per year.

An extremely low interest rate environment and continued strong competition were characteristic of the last three years in the retail client business. Falling interest margins on the assets side, and even more so on the liabilities side, new players in the payment transaction segment, new channels for distribution, information and communication, and changed customer needs increased the competitive dynamics.

On the one hand, new sources of revenue were sought out as a consequence of these developments. They were generally found in increased volumes in traditional segments; in particular in the mortgage lending business, for which there was high demand due to low interest rates. On the other hand, increased cost-savings measures were introduced in order to counteract the erosion of profitability.

Fig. 6

## Earnings performance and outlook for the retail client business




## 3.3.2 Projected trends through to 2018

An annual increase in revenues of 1.7 % to CHF 17.0 billion is forecast for the period leading up to 2018, based on an expected rise in all volume components. The retail client business is expected to remain a stable source of revenue for the banks in Switzerland in future.

Revenues from the interest margin business are estimated to rise by 2.2 % and will be driven by slower mortgage lending growth (+2.6 % annually) at consistent margins. Continued solid demand for home ownership, the low interest rate environment and the trend toward larger living spaces, as well as a simultaneous reduction in risk appetite and increased focus on

52 For the purposes of this study, payment transactions also include non-securities related commissions business, such as safety deposit boxes.

profitability on behalf of sellers will be key trends in this area. Government measures aimed at stemming mortgage lending volumes are not expected. Other lending to private households is likely to develop in line with economic performance. Deposits are projected to decrease while holdings in securities are expected to rise. Margins on the liabilities side will continue to come under pressure due to low interest rates. Increased risk appetite, greater transparency, and further improvements to the quality of advisory services are forecast for the securities business.

In general, it is expected that the banks that conduct business in the retail client segment will continue to seek out alternative sources of revenue, and if possible, invest in innovation. This due to the expectation that the trend toward increased market transparency, competition from outside the sector, and decreasing customer loyalty is set to continue, and will lead to further challenges on the revenues side. The market environment poses difficulties in particular for the smaller institutions. These are generally in a weaker position compared to bigger competitors in terms of developing alternative businesses.

Increasing costs and complexity in the retail client business are predicted as a result of new regulations. This trend will be of relevance to smaller institutions in particular, which could be reflected in changes to the market structure. The economies of scale will play an increasingly important role in this area. A specialisation within the value-added chain with systematic outsourcing of non-core business areas could be a promising strategy for safeguarding profitability.

### 3.3.3 Additional opportunities

As already identified in the 2011 study, additional opportunities for the retail client business exist in the optimisation of distribution channel management, but also in the wealth planning segment.

The optimisation of distribution channels and the resulting improvements to the compilation and analysis of customer preferences and behaviour represents additional potential by addressing customer needs that have not yet been fully explored. This could translate into additional potential of CHF 310 million. The targeted use and integration of alternative channels in retail banking, paired with active ownership and objectives management, facilitates optimised communication with customers. The objectives to be pursued in this area are improved cross-selling and increased customer retention. A review of the existing channels with regard to changed customer needs is also required. Advanced analytics allows for the effective gathering of customer information in real time in order to deduce customer needs. This information can then be actively implemented in the form of sales recommendations that are fully aligned with these needs, and that have a high probability of success and can be placed using the most promising channels.

In addition to classic banking services, there is a possibility to intensify the push for retirement planning as a service, and increase re-investments of life insurance or pension fund assets into banking products. Both of these aspects represent attractive business opportunities, particularly in light of the ageing population. Some of the challenges that must be addressed, however, are tailoring customer communication and efficiently building retirement planning expertise. To this end, collaboration with existing retirement planning consultants could be a resource-efficient means of entering this business. The potential held by this opportunity is estimated at CHF 60 million.

## 3.4 Corporate client business

### 3.4.1 Trends since 2010

Revenues from the corporate client business amounted to CHF 8.1 billion in 2013[53], making it the third-largest business area for the banks in Switzerland in terms of revenues.

Revenues from the corporate client business increased 2.3 % annually from 2010 to 2013; driven in part by a significant rise is lending volumes during the same period. According to the SNB statistics[54], lending[55] to domestic businesses rose by 5.4 % annually to CHF 350 billion in 2013, and foreign lending by 7 % to CHF 144 billion in 2013.

The most important segment in the corporate client business in 2013 in terms of volumes was micro-enterprises (< 10 employees), with a credit volume of CHF 150 billion.[56] This accounted for 43 % of total domestic lending to corporate clients. Lending to small businesses (10–49 employees) amounted to CHF 47 billion (13 %), lending to medium-sized businesses CHF 37 billion (11 %), lending to large businesses CHF 29 billion (8 %), lending to financial and insurance services providers CHF 59 billion (17 %) and lending to public institutions amounted to CHF 28 billion (8 %). Only 50 % of foreign lending was included in the calculation of revenues for the period under review, as such lending is sometimes also allocated to other business areas and frequently does not exhibit the characteristics of the corporate client business.

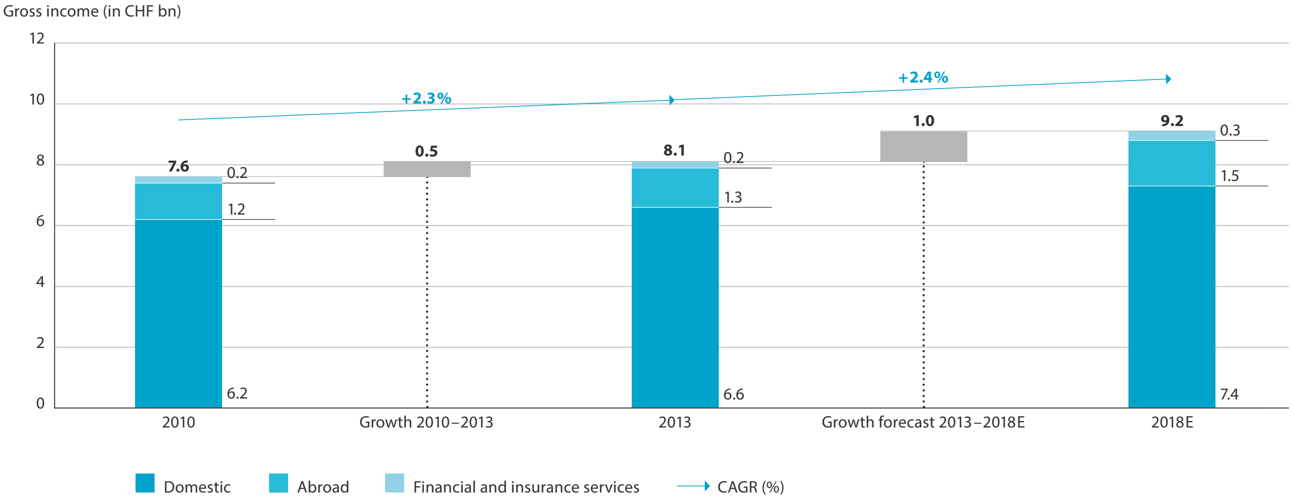
The strong rise in lending spanned all segments, in part as a result of low interest rates, albeit to varying degrees. The largest increase was seen in the public sector, with a yearly rise in lending including mortgages of 9.7 %. Lending to medium-sized companies experienced the lowest level of annual growth at 3.6 %.

Similar to the retail client business, the earnings trend in the corporate client business was characterised by low interest rates, intense competition (also from foreign competitors), and the resulting pressure on margins. The low interest rate environment resulted in noticeably low revenues in particular for the deposits business, which could only be compensated for in part by a stronger focus on the commissions business and a considerable increase in asset transaction volumes. In addition, a slight decline in credit margins was also reported. The combination of these factors resulted in a reduction in the gross profit margin[57] (gross product utilisation).

53 An amendment was made to the calculation methodology applied in the 2011 study for the calculation of revenues for the corporate client business. Revenues are now calculated based on the credit volumes in the SNB statistics and gross profit margins taken from benchmarking results.
54 SNB, Monthly Bulletin of Banking Statistics June 2014, 3A Credit Volume Statistics Domestic and Foreign, and 3Ca Credit Volume Statistics Domestic, to companies by company size and type of loan.
55 Includes mortgage lending.
56 SNB, Monthly Bulletin of Banking Statistics June 2014, 3B Credit Volume Statistics Domestic, by sector/economic activity, adjusted for volumes of the «providers of financial and insurance services».
57 The gross profit margin is defined as the sum of gross revenues (from the credit business, but also from deposits, commissions business and trading income), divided by credit volume incl. mortgage lending.

Fig. 7

## Earnings performance and outlook for the corporate client business




## 3.4.2 Projected trends through to 2018

Revenues for the corporate client business are expected to rise 2.4 % annually for the period leading up to 2018. This is lower than the forecast for economic growth in Switzerland, and corresponds to a rise in gross revenues to CHF 9.2 billion in 2018.

This forecast is based on a slowing in domestic credit volume growth from 5.4 % (2010 to 2013) to 2.6 % annually, which corresponds to expected annual economic growth for the period under review leading up to 2018. At the same time, a significantly slower increase in foreign lending is expected (3.8 %) for the period leading up to 2018. From 2010 to 2013, foreign lending rose by 7 %.

The stricter capital requirements under Basel III and the introduction thereof in Switzerland by means of the new June 2012 CAO, could in particular result in lower risk appetite for the medium-term and therefore in more restrictive and more margin-oriented credit lending by the banks in Switzerland. This is consistent with global developments in the corporate client business. The outlook for a slowing in volume growth is based on this development.

At the same time, a slight decline in margins is expected for all segments of the corporate client business. The driver behind this tendency is a light reduction in credit margins due to continued intense competition. This cannot be compensated for by increasing the focus on the commissions business. The anticipated introduction of the EU passport for professional investors as part of MiFID II should also be mentioned in this context, as it will facilitate active cross-border securities transactions with corporate clients.

On-balance sheet lending will become less attractive due to the increased liquidity and capital requirements. For the corporate client business, the banks will therefore have to increase their focus on transaction-based banking and providing advice and services for corporate financing on the capital markets. This will require closer collaboration between the corporate client business and investment banking within the individual financial institutions. In order to generate return on equity in line with the market, systematic cost management and an increased focus on profitable customers will be necessary.

Despite the somewhat cautious outlook, the corporate client business remains a stable revenue generator in the Swiss banking centre.

### 3.4.3 Additional opportunities

In addition to the forecast for trends in revenue growth, the banks in Switzerland have further opportunities to generate revenues in the corporate client business: providing holistic advice and services to Swiss companies for foreign transactions, and improving coverage of the trade finance business. Both additional opportunities were listed in the 2011 study, but the extent of these opportunities has been adjusted.[58]

The first business opportunity relates to the provision of holistic advice and services to Swiss companies for foreign transactions. This corresponds on the one hand to the offering provided by banks to SMEs with a foreign component to their business. The rising focus on business activities abroad conducted by small and medium sized enterprises is resulting in growing demand from these companies for specific and increasingly sophisticated products and services. Some examples include financing in non-freely convertible currencies, international liquidity pooling and finance management, as well as foreign guarantees. A broadened offering of these complex products, for example through the corresponding networks at partner banks, must be paired with appropriate advice that specifically addresses the needs of this customer group.

On the other hand, market share for large Swiss and foreign companies can be increased in the context of providing passive cross-border services, which are typical in these segments of the corporate client business. This can be achieved through a holistic product offering, including advice and services for activities abroad, as well as by offering investment banking services.

In order to implement this opportunity, it would be necessary to build up specific capabilities in the foreign business. Closer collaboration across business areas, for example with investment banking, would also be required in order to ensure a comprehensive service offering with high service quality. There is a trend across Europe in this context toward sector-specific specialisation for the servicing of big customers. Establishing Switzerland as a renminbi hub would be one such supporting element (see box). Realisation of this growth opportunity could generate total additional revenues of CHF 310 million.

#### Renminbi

The Swiss banking centre is interested in becoming a European centre for the offshore-renminbi business (RMB hub), and is well-positioned to do so. Despite the fact that London and Frankfurt already offer RMB clearing, there is nonetheless significant long-term potential for the Swiss financial centre in this area.

The Swiss banks welcomed the CNY-CHF currency agreement (swap line) between the Swiss National Bank and the People's Republic of China reached in July 2014. They also back the presence of Chinese banks in Switzerland and offshore RMB clearing through a bank in Switzerland. These steps help to avoid liquidity shortages, reduce the price of currency transactions in renminbi, and highlight Switzerland's role as a privileged partner with China. This is beneficial for trade and investments made by Swiss and Chinese

58 Further opportunities also exist in structured finance, mezzanine finance, capital goods leasing, factoring and succession planning.

companies, financial institutions and the financial markets in both countries, as well as for private and institutional investors in Switzerland, China and third-countries.

Switzerland and China complement each other in a number of respects and are predestined for closer collaboration in the area of finance. Switzerland has hundreds of years of experience in private and institutional wealth management, while China is just beginning to satisfy its rapidly-growing need for investment products and in general for social security measures and public services (pension funds, insurance). Switzerland has the necessary assets and expertise. With the Swiss franc, it also has a stable and proven currency for diversification purposes, and Chinese companies and state agencies are striving to reduce their dependence on the US dollar. Last but not least, financial institutions in Switzerland have in-depth knowledge of the Chinese market and in addition to products, offer extensive research and advisory services in this area.

The second opportunity comes in the form of increasing market share in the trade finance business in the Swiss market for international commodities trading. Further growth of this business by the banks can result in additional revenues amounting to CHF 180 million for the Swiss banking centre. The potential held by this opportunity has reduced since the publication of the 2011 study, due to the fact that trade finance is, generally speaking, no longer as attractive as a result of the capital requirements dictated by Basel III. In general, an attractive tax regime in Switzerland is an important prerequisite for continued international commodities trading in Switzerland and for related services such as trade finance.

## 3.5 Asset management

### 3.5.1 Trends since 2010

The description of asset management is based on the available statistics on units of collective investment schemes held in Swiss custody accounts.[59] In addition to the management, administration and distribution of collective investment schemes, asset management also consists of the management of assets in the form of mandates. Private banking mandates are included in the gross revenues for that business area. There is also a mandates business for institutional investors, however, there is no solid basis of data for this segment. It is therefore not possible in this study to include this important business area in the revenues for asset management.

In 2013, CHF 1.557 billion in collective investments schemes were held in Swiss custody accounts. Around 27 % thereof can be attributed to private investors (CHF 415 billion), and 73 % to institutional[60] investors (CHF 1.142 billion). Of the domestic institutional investors, pension funds account for 50 % of investments, followed by financial and wealth management institutions (27 %), insurance companies (17 %), and other institutional investors (7 %).

From 2010 to 2013, the total volume of assets in collective investment schemes experienced an annual rise of 5.6 %. The positive overall development was driven primarily by institutional investors (+8.4 % annually), whereas foreign private investors in particular redeemed or did not re-invest units (-3.2 % annually).

59 Units of collective investment schemes on foreign accounts are not taken into consideration.
60 For the purposes of this study, institutional investors include both commercial as well as institutional investors as defined by the SNB. The figures should, however, be qualified. The volumes attributed to foreign institutional clients in the SNB statistics can also in some cases include assets belonging to foreign private customers (for example through foundations or through assets managed by foreign banks).

Revenues without sales performance[61] amounted to approximately CHF 3.3 billion and at 1.9 % average annual growth, experienced less growth than the volume side. This is due primarily to the change in customer preferences toward passively managed investment instruments as well as to tougher (also international) competition. An increased focus on performance and costs can be observed, and is reflected in a slight downward trend in gross margins.

As a result of the reduction in units held by private investors mentioned above, the share of revenue attributable to institutional investors has been further accentuated: institutional investors now account for 60 % of revenues from the management and administration of collective investment schemes.

The Asset Management Initiative was launched in December 2012. Its objective is to develop the Swiss financial centre "in the coming years to become a leading asset management location[62]", that is, to increase the number of collective investment schemes managed in Switzerland. As the initiative was launched relatively recently and the ramp-up time and findings phase has been correspondingly short, it is still too early for any significant results. Another important development since 2010 is the partially revised Collective Investment Schemes Act. The partial revision, which came into effect in March 2013, aims to secure access to the internal EU market, and improves and completes the regulation in the areas of investor protection, management, custody, and distribution. It remains to be seen how the market will develop as a result of the revision.

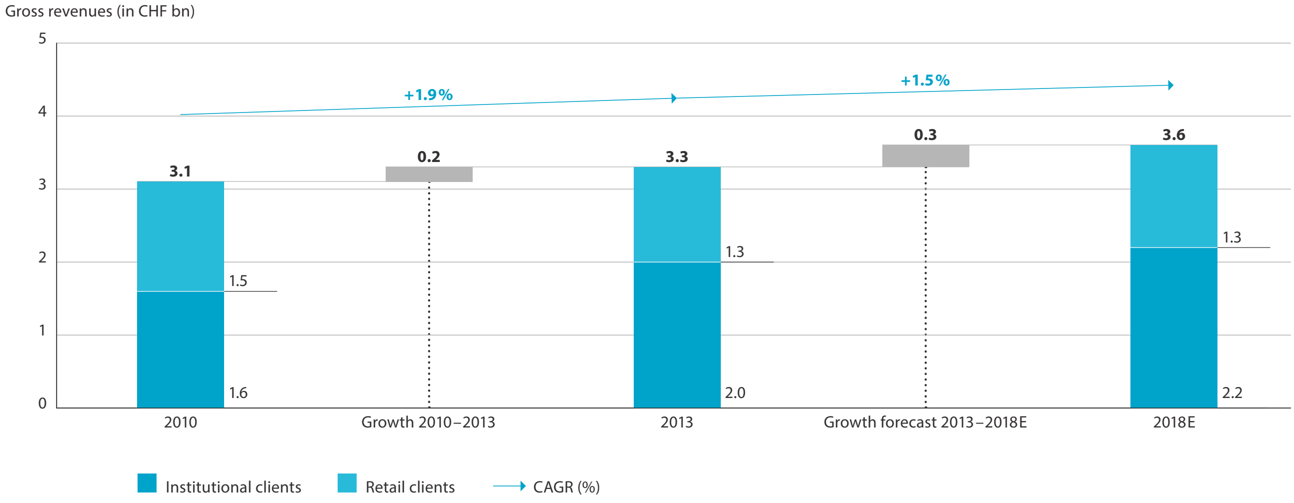
Asset management will also be affected by the upcoming FFSA and FinIA regulations, particularly with regard to distribution. The aim of FinIA is to create a common supervisory standard for providers of wealth management services. The FinIA will not result in any material changes for providers that to date have been under prudential supervision. IAMs, on the other hand, will come under prudential supervision for the first time. The new rules to be introduced under the FFSA are particularly relevant on the one hand for fund distribution, but also due to the mandatory disclosure of retrocessions.

Despite greater cost-awareness, costs in the asset management business have risen globally in recent years, in particular in the systems area. The rise in costs has been lower than the increase in volumes, and the resulting revenue growth. Notwithstanding, there is a continued trend toward consolidation of providers, in particular in the area of passively-managed products.

61 An amendment was made to the methodology applied in the 2011 study. It is assumed that 75 % of investment management revenues for the units of collective investment schemes under review were generated in Switzerland, and 100 % of the revenues from the administration of units according to Swiss law, or 0 % for administration of units according to foreign law, were generated in Switzerland.
62 SBA and SFA, Press release: Asset Management: a new pillar of the Swiss financial centre, 6 December 2012.

Fig. 8

## Earnings performance and outlook for asset management




## 3.5.2 Projected trends through to 2018

A continued rise in the volume of assets in collective investment schemes is expected for the period leading up to 2018. The trend toward passively managed products will continue. Gross margins are expected to be relatively stable following their downturn in the last few years.

Taking conservative capital market estimates as a basis, volumes in collective investment schemes are forecast to rise by 1.9 % annually to CHF 1.710 billion for the period leading up to 2018. This growth will be carried almost exclusively by institutional investors, as it is assumed that foreign private investors will continue to redeem their units in collective investment schemes. This is attributable to the anticipated outflows in private banking of assets from affluent customers in developed countries. Asset inflows from the UHNWI segment will be less reflected in collective investment schemes. Revenues are expected to rise by CHF 300 million to CHF 3.6 billion.

Customer behaviour is expected to remain largely constant. Transparency, focus on performance and cost-awareness will remain top priorities for investors. In the area of transparency, the disclosure of retrocessions – as provided for under the FFSA – will have a positive effect. This could also lead to changes in cooperation models between distribution channels and asset management providers. In addition, competition will remain strong as a result of new joiners to the business and the possible expansion of online offerings.

Challenges for the sector will arise in the form of EU market access, continued strong cost pressures, as well as regulatory amendments and new pricing models. Thanks to the revised CISA and the signed cooperation agreements with the supervisory authorities in the EU countries, the requirements for the access of alternative Swiss investment funds to the internal EU market planned for 2015 by means of an EU passport are basically in place. The final decision on the introduction of an EU passport for third-countries is still pending. In terms of the active distribution to institutional EU investors out of Switzerland (EU passport for the provision of services to professional investors), recognition of equivalence of FINMA by the European supervisory authority ESMA is still required for the FFSA/MiFID II.

Switzerland is of marginal importance as a location for administrative fund management and more attractive investment vehicles can be created abroad, however, its role is considerably stronger in investment management. In general, this "relative strength" is expected to increase for the period leading up to 2018.

### 3.5.3 Additional opportunities

In terms of gross revenues, asset management in Switzerland is considerably less significant than private banking. It is, however, an important component of the Swiss financial centre as a product supplier for a strong private banking and for the management of the investment volumes held by insurance companies and pension funds. It offers potential for additional revenue generation for the Swiss banking centre in the business with foreign institutional clients.

The joint SBA and SFAMA Asset Management Initiative actively works to strengthen asset management in Switzerland and establishes the framework for the implementation of the following additional opportunities. Generally speaking, the pillars defined in the Asset Management Initiative must be translated into concrete goals that are carried forward by the entire Swiss financial centre, and must be developed based on a comprehensive strategy and realistic plan of action. It is also important that stable political and economic framework conditions are created.

A clear and realistic focus must be taken in the definition of the goals for asset management. If, for example, a focus on niche and specialised products is chosen, then the framework conditions that must be created will be different from those required for a copycat strategy (me-too strategy) which is without a unique selling proposition for Swiss asset management. The first option would require employees with special qualifications which are not readily available in the Swiss market.

The creation of a basis for decision-making is essential for the systematic establishment of goals and strategies. This includes, for example, creating an appropriate, comprehensive database on Swiss asset management, which is essential to the Asset Management Initiative, both as a basis for decision-making as well as for monitoring results. At present, neither mandates for foreign institutional clients managed in Switzerland nor the units of collective investment schemes held in foreign accounts are recorded for the purpose of statistics.

The concrete additional opportunities in asset management will be described briefly below. These include attracting new asset managers, moving up the value-added chain, and asset management for foreign institutional investors.

The overall attractiveness of the Swiss financial centre as a location can be viewed as a positive factor in terms of the settlement of asset managers. The final goal is the acquisition of additional inflows from foreign institutional investors, in particular from the retirement segment (e.g. pension funds). This will allow for an increase in overall revenues in asset management for the Swiss banking centre. In some areas, however, the framework conditions in Switzerland have been questioned in recent years due to political developments in the country; attracting new asset managers has therefore not become easier. Switzerland's framework conditions must thus be revised in a targeted manner and realistic milestones must be defined. The active recruitment of new asset managers can lead to additional revenues of CHF 120 million.

The second additional opportunity relates to increased investment management coverage for collective investment schemes booked in Switzerland. This creates an opportunity for the generation of an additional CHF 150 million in revenues. In addition to the necessary framework conditions, this second opportunity also requires the relevant investment management expertise. In the areas where this expertise is focussed on specialist knowledge and niche products, this must be systematically fostered or recruited.

Finally, better coverage of foreign institutional investors out of Switzerland can be achieved through increased marketing of the experience and expertise of asset management in Switzerland. Swiss asset management must create and promote concrete unique selling propositions to this end; a stable legal environment is equally necessary. This additional opportunity is estimated at CHF 180 million.

## 3.6 Investment banking

### 3.6.1 Trends since 2010

With revenues of CHF 0.9 billion, investment banking as a business area is the smallest contributor to overall revenues in the Swiss banking centre. Investment banking as regarded in this study comprises activities in the areas of debt issuance (DCM), equity issuance (ECM), as well as mergers and acquisitions advisory services (M&A).[63] Revenues from Swiss investment banking fell by 3.7 % in 2011 to CHF 1.2 billion, before rising 88.5 % in 2012 to CHF 2.3 billion. In 2013, revenues fell once again; by 61 % to CHF 0.9 billion.

The described progression was driven by single large issuances and M&A activities, and is typical of the highly volatile investment banking business. The number of M&A transactions[64], for example, ranged as follows between 2010 and 2013: 305 (2010), 378 (2011), 313 (2012), and 263 (2013), and were therefore relatively constant overall. Transaction volumes, on the other hand, had a considerably more volatile pattern: CHF 21 billion (2010), CHF 25 billion (2011), CHF 62 billion (2012) and CHF 6 billion (2013).

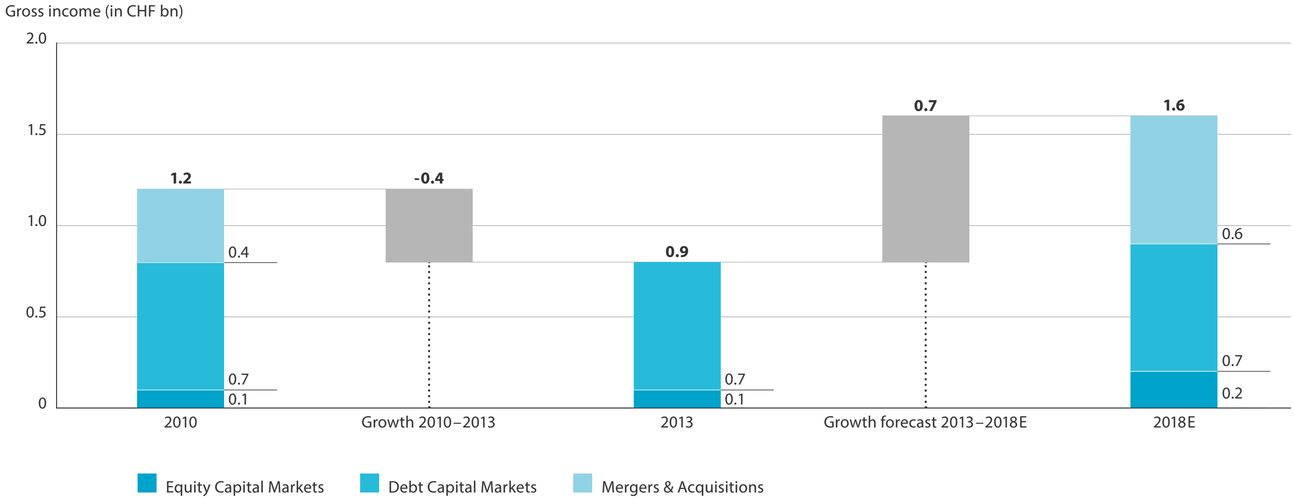
Bond issues accounted for the lion's share of investment banking revenues in 2013 at CHF 0.7 billion, followed by the banks' M&A business (CHF 0.1 billion), and equity issues (CHF 0.1 billion).

Gross margins for the individual investment banking areas remained relatively constant between 2010 and 2013.

63 The chosen definition comprises only transactions carried out by companies headquartered in Switzerland and is based on data from Thomson Reuters.
64 It should be noted that a large number of transactions are conducted without bank involvement.

Fig. 9

## Earnings performance and outlook for investment banking




## 3.6.2 Projected trends through to 2018

A positive revenue trend is expected for investment banking for the period leading up to 2018. Due to the business area's high volatility in volumes and gross revenues, as well as to the relatively low revenues in the business area for 2013, an annual review of growth rates is indicative only to a limited extent.

The outlook for debt issuances (DCM) and mergers and acquisitions advisory (M&A) was therefore forecast based on the average transaction volume and revenue levels from 2010 to 2013. An annual growth rate of 20 % was applied only for equity issuances (ECM). This corresponds to total gross revenues from investment banking of CHF 1.6 billion in 2018. This is lower than the revenues generated in 2012, which was a positive, anomalous year.

Broken down by segment, gross revenues for 2018 for the debt issuance business are forecast at CHF 0.7 billion. Expected gross revenues for the M&A business are CHF 0.6 billion and a further CHF 0.2 billion is forecast for equity issuances.

This positive growth outlook is the result of a variety of positive qualitative developmental tendencies. One of these is that investment banking is becoming increasingly important as a product and services provider to the private banking and corporate client businesses. In these areas, banks can differentiate themselves from competitors through stronger cross-business collaboration and by providing holistic advice and services to demanding UHNWI clients or large and medium-sized enterprises. Another example is that the advisory businesses mentioned previously require very little capital resources, which considerably increase their relative attractiveness as a business segment in the context of higher capital and liquidity requirements. In the corporate client business in particular, banks will be looking to compensate for stricter lending policies by offering equity and debt financing on the capital market.

In light of the regulatory environment, investment banking could be faced with a number of significant changes leading up to 2018.

In July 2014, the Federal Council charged the FDF with developing a consultation draft on the issue of withholding tax in conjunction with the group of experts for the "further development of the financial market strategy". The general approach being taken is that the withholding tax should be addressed in a more differentiated manner and should in particular facilitate capital raising in Switzerland, including bail-in bonds for the big banks. A switch to the paying agent principle is also being considered.

Further to this, there is a political discussion surrounding the abolition of stamp tax. In March 2012, stamp tax on debt capital was abolished as part of the TBTF package of measures. The Council of States suspended the abolition of stamp tax on equity capital in December 2013 at the request of the Federal Council, as the latter was seeking to abolish this tax as part of its corporate tax reforms. In its 2014 spring session, however, the National Council voted against a suspension, which sent the matter back to the Council of States. In June 2014, the Council of States once again agreed to a suspension of the draft.

Because these fiscal developments are not yet definitive, their respective effects on investment banking in Switzerland is not reflected in the growth forecast.

In a further development, the provisions in the FFSA consultation draft allow the Federal Council under certain conditions to designate debt securities as being subject to a prospectus review only after issuance, in order to enable quick bond issues at market value under the new rules. This development could potentially result in increased attractiveness for the Swiss location in terms of bond issues if a comparison is made to the MiFID II rules in the EU, which stipulate the prior review of bond issues for distribution to private customers.

Finally, a question arises in connection with the FFSA and MiFID II with regard to access to the EU market for the servicing of professional investors in capital market transactions. Should the ESMA not establish equivalence and the Swiss banks therefore not receive an EU passport for professional investors under MiFID II, Switzerland's attractiveness as a location for advisory services for issuers could be negatively impacted.

### 3.6.3 Additional opportunities

The additional opportunities in the Swiss investment banking market for the advisory and underwriting business are finite. Although the services offered are of high importance for the economic activity and the growth potential of companies in Switzerland, the opportunities for expanding the business are limited, above all due to the size of the business location and the lack of an investment banking tradition in Switzerland.

The opportunity therefore lies in the active collaboration between investment banking and the corporate client business with a view to offering a variety of combined financing possibilities. Financing and transaction advice are part of a complete service offering for medium-sized companies. Providing holistic advice and meeting the needs of customers should encompass regular exchanges with companies as well as discussing potential M&A activities and debt and equity financing on the capital market.

In order to realise this opportunity, the Swiss banks must not only be well-positioned in this area, but financing on the capital market must also be rendered more attractive, for example through the abolition of stamp tax on equity capital or the planned amendments to withholding tax. Should this be achieved, the systematic collaboration between investment banking and the corporate client business for increased corporate financing on the capital market could translate into additional gross revenues of around CHF 160 million for the Swiss banks.

# 4 Implications for the Swiss banking centre

Changes and challenges have made and still make an impact on the Swiss banking centre. Recent years have been a period of regulatory orientation and reaction, and revenues have since stabilised despite the rising pressure on costs and prices. There is now an opportunity to actively and strategically shape its future, albeit with the necessary prudent risk management. Switzerland can therefore now actively create a basis for the preservation of the banking centre's competitiveness.

The key focus will remain on private banking in particular. Private banking continues to generate around half of the banking sector's gross revenues. The cross-border business as an export industry in particular, is in strong international competition with other locations. This important business area is undergoing a widespread transformation process. In the future global context of the convergence of regulatory and fiscal framework conditions, cross-border assets from developed countries around the world, especially from affluent customers, will flow back to the customers' countries of domicile. Switzerland will be significantly impacted by this, due to its high percentage of client portfolios belonging to foreign customers, especially from Western Europe. In addition, there is a risk that the profitable business of providing services to Western European customers will become much more difficult or even impossible to conduct as a result of restrictions to EU market access. This would translate into substantial revenue losses. In this context, the government is called upon to ensure that these profitable services can still be provided to such customers in future by securing cross-border market access. In doing so, the loss of customer assets and the revenues they generate would be averted.

Building on traditional strengths such as political and economic stability, the stable currency and the high level of expertise in the provision of services, Switzerland should continue to seek out growth in specific segments of cross-border wealth management. This pertains on the one hand to the servicing of global UHNWI and HNWI customers. Compared to local private banking providers in their countries of domicile, Switzerland can offer these customers a more comprehensive range of products and services. On the other hand, Switzerland can build on its traditionally strong position in a number of developing regions, particularly in the Middle East and Eastern Europe. Switzerland is in competition with London for this segment. The Swiss banking centre can, however, differentiate itself by developing innovative and country-specific business models. Relevant factors in the definition of such business models, including the decision of whether or not a local presence makes sense, are the countries of domicile that are covered, the target customer segments and their needs, as well as the existing position and characteristics of the bank in question.

Further to this, the coordinated promotion of the financial centre in the countries of domicile can be strengthened through close collaboration between the banks and the authorities. In order to reduce possible competitive disadvantages vis-à-vis London, investment management capacities must be expanded as part of the existing financial centre cluster. This calls for access to a qualified workforce, competitive and predictable regulation, a strong research and educational infrastructure, and close interlocking with asset management. And finally, the growing importance of customer assets from emerging countries should also be given its due attention in the regulatory process.

A further key building block for growth in the Swiss banking centre is the interplay between the corporate client business and investment banking. The appropriate servicing of large and medium-sized Swiss enterprises that conduct business abroad provides revenue opportunities for the banking centre and is a relevant competitive factor for the Swiss economy. In order to ensure an appropriate and comprehensive service offering, effective collaboration between the corporate client business and investment banking is required.

The Asset Management Initiative represents an important building block for the future strategic positioning of the banking centre. On the one hand, it contributes to a strengthening of investment expertise in the interplay with private banking. On the other hand, it targets the increase in the volume of assets from foreign institutional investors such as pension funds. Switzerland can build on its experience and knowledge in comprehensively servicing those clients. In order to effectively realise the goals of the initiative, however, close and focussed collaboration between all the players in the banking centre and the relevant authorities is a prerequisite.

Existing and future regulations will continue to increase the complexity of the banking business and put pressure on the cost bases of the banks in Switzerland. Due to the competitive and price pressures that the banking centre is exposed to, this can result in a loss of profitability for certain services or business areas and therefore, to significant repercussions for the structure of the banking sector. The profitability of the retail client business in particular could suffer, which as a stable source of revenue for the banking centre is an important business area. This is because local domestic banks with a focus on the retail client business are disproportionally affected by rising costs. The right balance must be maintained from a banking centre and government perspective, between ensuring adherence to international guidelines and the effects of individual regulations on costs and revenues. Essentially, for the national implementation of global regulations, attention must be paid to ensure a cost-efficient, unbureaucratic and flexible implementation while protecting the fundamental objectives. Further to this, the government is called upon to take into account the interests of the sector to the best of its ability in the context of political developments in Switzerland, such as the implementation of the mass immigration initiative.

It is clear that shaping the future Swiss banking centre requires time, the necessary will and strength. This cannot, however, be a reason to not make every effort possible to coordinate between the banking groups and the authorities in such a way as to take advantage of the upcoming changes and steer the Swiss banking centre into calmer waters.

# I. Appendix: Definitions and methodology

## Definitions

This study deals primarily with gross revenues from five business areas. Gross revenues are defined as the sum of interest income, income from commissions, and trading income, insofar as this is relevant for the business areas under review. They are a measure of the importance of the banking sector. The examination of gross revenues in this study does not, however, make any assertions with regard to the profitability of the Swiss banking centre and its areas of business. The business areas are defined as follows:

**Private banking**

Domestic wealth management business with customers with assets starting at CHF half a million, as well as all cross-border wealth management and retail client business out of Switzerland.

**Retail client business**

Commissions, payment transaction and interest margin business with Swiss customers as well as securities business with Swiss customers with assets of below CHF half a million.

**Corporate client business**

Banking services provided out of Switzerland for public institutions and companies of all sizes based in Switzerland.

**Asset management**

Investment management and the administration of units in collective investment schemes held in Swiss bank accounts. On the one hand, this includes not only the revenues generated by the banks, but also those generated by all the institutions involved in investment management and administration. On the other hand, the definition is limited to the units of collective investment schemes booked in Switzerland and does not take into consideration asset management mandates for institutional clients.

**Investment banking**

Commissions business related to equity and debt issues as well as mergers and acquisitions advisory for companies that are headquartered in Switzerland. The trading business in investment banking (capital markets) is not considered.

## Methodology

The methodology applied in this study follows similar principles to that used in the 2011 study. The Swiss banking centre and its business areas are defined in terms of volumes and revenues using public sources and benchmarking results. The results are therefore directly comparable to those from the 2011 study. Occasional deviations in methodology are due to changes in publicly available data, changed or improved benchmark fundamentals, as well as the adjustment of data. Significant changes are indicated in the text.

# II. Appendix: List of figures

# III. Appendix: List of abbreviations

| | |
|---|---|
| **III.** | Appendix: List of abbreviations |
| **AEOI** | Automatic Exchange of Information |
| **AIFM** | Alternative Investment Fund Manager |
| **AMLA** | Anti-Money Laundering Act |
| **BankA** | Banking Act |
| **BCBS** | Basel Committee on Banking Supervision |
| **BCG** | The Boston Consulting Group |
| **CAO** | Capital Adequacy Ordinance |
| **CAGR** | Compound Annual Growth Rate |
| **CHF** | Swiss francs |
| **CISA** | Collective Investment Schemes Act |
| **CISO** | Collective Investment Schemes Ordinance |
| **CRD** | Capital Requirements Directive |
| **DCM** | Debt Capital Markets |
| **Dodd-Frank Act** | Dodd-Frank Wall Street Reform and Consumer Protection Act |
| **ECB** | European Central Bank |
| **ECM** | Equity Capital Markets |
| **EEA** | European Economic Area |
| **EMIR** | European Market Infrastructure Regulation |
| **ESMA** | European Securities and Markets Authority |
| **EU** | European Union |
| **FAIR** | Financial Advisory Industry Review |
| **FATCA** | Foreign Account Tax Compliance Act |
| **FATF** | Financial Action Task Force on Money Laundering |
| **FDF** | Federal Department of Finance |
| **FED** | Federal Reserve (US central bank) |
| **FFSA** | Federal Financial Services Act |
| **FinIA** | Financial Institutions Act |
| **FINMA** | Swiss Financial Market Supervisory Authority |
| **FMIA** | Financial Market Infrastructure Act |
| **GBP** | Great Britain pound |
| **GFCI** | Global Financial Centres Index |
| **HNWI** | High Net Worth Individuals |
| **IAM** | Independent Asset Manager |
| **IGA** | Intergovernmental Agreement |
| **M&A** | Mergers & Acquisitions |
| **MiFID** | Markets in Financial Instruments Directive |
| **MLROS** | Money Laundering Reporting Office Switzerland |
| **OECD** | Organisation for Economic Cooperation and Development |
| **OTC** | Over-the-counter |
| **RIAA** | Federal Act on the freezing and restitution of illicitly acquired assets of foreign politically exposed persons |
| **RMB** | Renminbi |
| **SBA** | Swiss Bankers Association |
| **SFA** | Swiss Funds Association |
| **SFAMA** | Swiss Funds & Asset Management Association |
| **SME** | Small and medium sized enterprises |
| **SNB** | Swiss National Bank |
| **TBTF** | Too-big-to-fail |
| **TCF** | Treat Customers Fairly |
| **UHNWI** | Ultra High Net Worth Individuals |
| **US** | United States of America |

SwissBanking

Swiss Bankers Association
Aeschenplatz 7
P.O. Box 4182
CH-4002 Basel
T +41 61 295 93 93
F +41 61 272 53 82

office@sba.ch
www.swissbanking.org
twitter.com/SwissBankingSBA
www.facebook.com/SwissBanking
www.swissbanking.org/home/blog