EY Bank Barometer 2015
The contours of new realities
Introduction

Swiss banks continue to face a number of challenges. They are operating in a difficult macroeconomic climate, with interest rates at record lows and a challenging investment environment. In addition, banks' cost structures and margins are being impacted by both national and international regulatory requirements. Nevertheless, banks' core businesses are performing well, as shown by the EY Bank Barometer 2015. This positive view is supported by the fact that the contours of the new regulatory framework are becoming clearer, and tangible solutions are emerging for some of the issues that banks have been facing for many years.

Banks have to a greater or lesser degree been busily preparing for the new reality they face. A year ago, the EY Bank Barometer revealed that the majority of Swiss banks were anticipating the automatic exchange of information (AEI) to be introduced as a global standard. And it is already evident that banks have moved on since then: according to the latest survey, more than half expect that the AEI will ultimately be introduced for domestic banking clients as well. It appears that this is no longer a taboo. Indeed, given the global nature of the banking business, it is presumably becoming difficult to argue that the standard, which is becoming more commonplace across the globe, should not be applied in Switzerland.

Efforts to implement the tighter regulations and aligning banks with the new reality continue to tie up considerable resources. This, combined with banks' current focus on cost-cutting and efficiency gains, could result in some growth opportunities going untapped. There is no dispute as regards the need to strategically develop the business model during such a period of structural change; what is new for many banks, however, is the need to deal with the new requirements and strategic priorities simultaneously and in the current magnitude. There is a risk that smaller and medium-sized banks in particular will fail to make the necessary investments in new business areas and will not adapt quickly enough to changing customer needs.

The following insights and analyses from the EY Bank Barometer 2015 provide a current overview of the core issues faced by Swiss financial market participants: from the US tax dispute and the appropriateness of the planned financial market regulation to federal government's strategy for the financial sector. The EY Bank Barometer, which has been conducted for the fifth time, is based on a survey of 120 directors (executive board members) of various banks across Switzerland, but excluding the major banks.

The complete EY Banking Barometer 2015 can be downloaded in electronic form from our website at www.ey.com/ch.

We hope you enjoying reading it and look forward to discussing it with you. Please do not hesitate to contact us should you require additional background information, or wish to ask any questions or discuss any specific aspects in more depth.
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1. Study design
Composition of survey sample

- Telephone survey conducted by an independent market research institute (Valid Research, Bielefeld) in November 2014
- Survey of 120 banks in Switzerland (excluding the two major banks)
- Fifth edition since 2010

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<th>Bank size by client assets</th>
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<td>Between 5 and 10 billion francs</td>
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<td>Over 50 billion francs</td>
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1) including investment banks
2.

Operational business development
The majority of banks rate their operational business performance over the past six to twelve months as positive to somewhat positive. In the last five years, confidence was only higher in 2010.

Compared to prior periods, banks’ core businesses have clearly performed well even in difficult conditions: despite ultra-low interest rates and challenging investment conditions, the majority managed to post satisfactory results.

The measures taken by banks to optimize costs and earnings are having an effect for the time being. The bullish financial markets are also having a positive impact on banks’ performance. Ultimately, however, it can be said that far more modest expectations as regards results are being expressed than in the past.
New optimism in private banking?

Private and foreign banks that focus primarily on asset management rate their business performance over the last six to twelve months significantly more positively than one year ago. Cantonal banks are the only group to have seen an increase in the number of banks that rate their operational business more negatively than before.

It is in the investment business in particular that asset managers have benefited from the performance of the financial markets. While margins have continued to fall slightly, they are still at a comparatively high level. By contrast, retail banks (especially cantonal banks) are continuing to struggle with the historically low interest rates and a further deterioration of conditions last year. In addition, the new regulations set to enter into force - in particular with regard to new liquidity provisions and consumer protection - are causing the additional costs involved to spiral, reducing banks' room to maneuver. Nonetheless, banks active in retail banking continue to rate business as somewhat positive. Core business is healthy, and thus far they have generally not had to absorb any major defaults in the lending business.
Despite all the prophecies of doom, banks remain confident

"How do you expect your organization's operational business to develop in the next 6-12 months?"

Swiss banks are still looking to the future with confidence. An astonishing majority of 84% expect an improvement in operating results (excluding special factors) in the next six to twelve months. This figure was only higher in 2010.

The majority of banks appear to have adapted to the new reality or are expecting the business environment to improve noticeably. The contours of the new regulatory framework are also becoming clearer and tangible solutions are emerging for many of the issues that banks have been facing for many years. This has helped eliminate uncertainty, particularly as regards future regulations relating to the automatic exchange of information (AEI). The fundamental change underway in the banking industry is continuing to take shape. However, the structural change is not yet complete and will lead to further changes and waves of consolidation.
Growing confidence in private banking

Private and foreign banks are looking to the future with significantly more confidence than last year. Only among cantonal banks, there has been an increase in the number of institutions expecting operating results to fall.

The positive outlook of private and foreign banks is surprising at first glance. However, it is these banks in particular that are benefiting the most from the decreased level of uncertainty. In addition, asset managers generally have more leeway to adapt their product and earnings mix.

Retail banks are more tightly corseted by the continued low interest rates. Furthermore, the additional costs incurred in implementing the new regulations are weighing on retail banks more heavily by comparison. Another aspect should also be considered in relation to cantonal banks:

There was strong demand for the security-related USPs of banks with state guarantees during the crisis. As fear of another financial crisis begins to subside, this competitive advantage is presumably set to shrink.
No significant job cuts in the coming months

"How do you expect the number of employees in your organization to develop in the next 6 - 12 months?"

The overwhelming majority of banks surveyed do not anticipate cutting a significant number of jobs over the coming months. The number of banks planning to reduce their workforce by 5% or more has fallen to 13% (previous year 20%).

Taking into account increased cost pressures, the banks' outlook as regards job cuts is surprising at first glance. However, banks are faced with the challenge of having to increase efficiency and earnings while at the same time adapting and developing their business models in line with the new regulations. This means that, in the months to come, banks will be taking on major implementation and transformation projects, which will require more staff.

In addition, many banks intend to expand their front-office units for certain client segments. Due to the increasing industrialization of business processes, however, we can expect to see job cuts in the processing and support functions, or for these roles to be outsourced to external service providers.
Private banks again need more staff

Private banks are looking to the future with more confidence. Half of the banks surveyed expect to increase their workforce, the highest value since 2010. This increase will mainly take place in front-office units. The situation at the cantonal banks is mixed: 5% expect to significantly increase their workforce, while 21% anticipate making job cuts. On the other hand, almost one third of foreign banks expect to reduce their headcount.

Although private and foreign banks operate in similar areas, their expectations to cut jobs differ. Private banks are focusing on expanding their front-office units and investing in new consultancy skills. Foreign banks’ caution in this respect can partially be explained by their dependency on their foreign parent companies, which at present do not appear overly willing to invest in the cross-border services of their Swiss subsidiaries.
Increasingly defensive financial market outlook

"How do you think the overall situation on the financial markets will develop in the next 6-12 months?"

Banks view the future performance of the financial markets less positively than in 2013. Just 18% (previous year 36%) expect things to improve, while 37% expect the environment to deteriorate - a figure not matched since 2011.

Banks consider the valuations on the financial markets to be relatively high. This is not only a result of the performance over the previous quarters; the geopolitical situation is marked by several uncertain factors, such as the tense international relationship with Russia as well as developments in Ukraine, the Middle East and China. In addition, the long-term consequences of central banks' expansive monetary policy remain unclear. This is the case even though some central banks have now begun to forge different paths - while the US is scaling back its bond buyback programme, the ECB is continuing to pursue an increasingly expansive any alternative to investing in the equity markets.
3.

Competitive pressure and consolidation
Private banking remains under pressure

"In which business area do you see the greatest competition at present?"

Private banking is subject to the greatest competitive pressure: this is the view shared by 44% of banks surveyed (previous year 55%). Since the study began, this has been the most frequently cited business by respondents.

Competitive pressure remains high in private banking. This is understandable given the large number of challenges currently faced by the sector (US problem, tax transparency, cross-border services and market access, changing client needs, etc.). At the same time, retail banks are confronted with increased competition coinciding with a period of low earnings due to low interest rate environment and high costs to cover the consequences of regulatory changes and IT modernisation as well as the expansion of online services. It is therefore expected that competitive pressure will increase in retail banking as well in the years to come - provided there is no indication that interest rates will rise over the long term.
Consolidation continues apace

"Do you anticipate consolidation in the banking sector in the next 6-12 months?"

More than half of the banks surveyed anticipate increasing consolidation in the next six to twelve months. This is the highest figure since 2011. A further quarter expect consolidation, albeit not for another two to four years.

Consolidation in the Swiss financial sector is already a reality; over the last five years, around 50 institutions have disappeared. In addition, further consolidation can also be expected in the form of increased specialization of banks foreign target markets. At present, further consolidation is being restrained by lower transaction prices as well as major uncertainties as regards potential legacy burdens from previous business models. Many sellers are not (yet) prepared to sell their banks at the low transaction prices being offered. At the same time, potential buyers are generally only interested in specific client segments and markets.
Consolidation: first private, then retail banking

"Do you anticipate consolidation in the banking sector in the next 6-12 months?"

Private and foreign banks that primarily focus on asset management are more likely to expect further consolidation. Cantonal banks believe it is significantly less likely that they will face immediate consolidation pressure.

Cross-border private banking was and remains the area hit hardest by regulatory changes. It is therefore no surprise that banks operating in this area are feeling the greatest consolidation pressure. Foreign banks are also having to deal with their group parent companies reassessing their previous business models. Some banks would like to withdraw from the Swiss market and increasingly focus their capital on their core businesses.
Private banking – tax transparency
Long-term consequences of tax transparency remain unclear

"Do you expect current developments in connection with banking secrecy and the automatic exchange of information (AEI) to have an overall positive or negative impact on Switzerland's banking industry?"

There is some disagreement among banks as to how the changes to banking secrecy, tax transparency and the automatic exchange of information will ultimately impact the Swiss financial sector. Half of the banks surveyed believe they will have a positive impact, while the other half think otherwise. Confidence in this area has increased slightly from the previous year.

For a number of years now, the debt crisis in the eurozone and in other countries has been prompting more initiatives aimed against tax evasion and offshore financial centers such as Switzerland. In 2010, the assumption that the withholding concept could be adopted as a possible solution gave rise to confidence that the Swiss financial sector would benefit as a whole. Political statements that banking secrecy is non-negotiable raised hopes that the banks could continue with their old business models. At the time there was no indication of the severity of the changes that would follow in 2013 and 2014 and the resolute action that would be taken against the Swiss financial sector. Since then, however, many uncertainties have been resolved and the contours of the regulatory framework have become clearer. The current survey shows that banks now anticipate full tax transparency for their clients and that they will restructure their business models accordingly. However, a structural change like this will mean that client portfolios have to be cleaned up, increased compliance costs have to be met, and banks have to refocus on changing client needs. Clients will increasingly measure banks' performance against the achievement of risk-optimized after-tax returns; this will increase banks' analysis and advisory costs and will also require new, more comprehensive advisory skills in some areas.
Foreign banks are remarkably optimistic

With the exception of cantonal banks, as a whole the banks surveyed view the developments in connection with the banking secrecy and the automatic exchange of information more positively or generally more positively than in the previous year. Confidence among foreign banks has seen the most marked increase. Confidence among foreign banks has seen the most marked increase. Foreign banks are the most acutely impacted by the developments and structural changes in the cross-border financial services business. This makes the noticeable increase in confidence among foreign banks all the more remarkable. In recent years, however, they have been able to resolve some of the uncertainties surrounding their business models, and internationally applicable standards on the exchange of information are becoming increasingly commonplace. This trend is helping reduce uncertainty and is therefore having a positive impact. Many market participants understand and accept the new reality and have already begun to implement these changes.
Banks will have to deal with US tax dispute for some time to come

"In your view, how long will the US tax dispute continue?"

The majority of banks surveyed assume that the US tax dispute will continue to occupy the Swiss financial sector for some time to come. Three out of ten banks anticipate it lasting for more than two years.

Banks’ hopes that the tax dispute could be resolved in 2014 have been dashed. Staff changes at the US Department of Justice and the large number of Category 2 banks proved the first major stumbling blocks. Since then, the process has been delayed yet further while clarifications are carried out in relation to the procedure for selected Category 1 banks. It also appears that additional and unexpected demands in the non-prosecution agreements (NPAs) for Category 2 banks will stall the process once more. Several Swiss banks view these demands as unacceptable or even unlawful. Some banks even felt obliged to withdraw their commitment to participate in Category 2.

The US tax dispute will probably tie up banks’ internal resources for an indefinite period, as banks struggle to understand the way the US Department of Justice acts in individual cases. Moreover, additional demands will also be made that were not contained in the original agreement.
AEI is no longer a taboo for domestic banking clients

"Do you expect current developments in connection with the automatic exchange of information (AEI) also to apply to domestic banking clients?"

Over half of the banks surveyed expect the automatic exchange of information (AEI) to ultimately apply to domestic banking clients. It is only among the foreign-controlled banks that the majority do not expect AEI to apply.

The fact that banks expect AEI also to apply in Switzerland is surprising. In Switzerland, the relationship between the state and its citizens is marked by the values of liberty and personal responsibility rather than excessive control. Nevertheless, Switzerland cannot ignore international developments and AEI domestic clients no longer appears to be a taboo. Indeed, given the global nature of the banking business, it is presumably becoming difficult to argue that the standard, which is becoming more commonplace across the globe, should not be applied in Switzerland. An important factor in this respect will be the extent to which Switzerland intends and indeed manages to push for a reciprocal arrangement in the upcoming negotiations over the exchange of information. The demand for increased transparency over potential assets held by Swiss residents in banks abroad will also result in increased pressure on banking secrecy in Switzerland. Nevertheless, it can be assumed that the AEI will become a reality for domestic banking clients somewhat later than it will for foreign clients.
No asset outflows yet - the calm before the storm?

"Have developments in connection with banking secrecy, tax transparency and the automatic exchange of information (AEI) led to significant asset outflows at your organization in the last 12 months?"

An astonishingly large majority of banks surveyed say they are yet to register any significant asset outflows, or, if they have, they have largely managed to make up for these with new inflows. Larger banks, which are generally further on in the transformation process, have thus far had to absorb proportionately larger asset outflows than smaller banks.

It is surprising that the banks surveyed only revealed insignificant asset outflows. Banks have clearly been able to contain asset outflows resulting from the various tax transparency programs and amnesty programs allowing voluntary disclosures that are not subject to penalties; what is more, in cases where there have been outflows, they have largely been able to compensate for these with new asset inflows. The advantages of the Swiss financial center with its security-related USPs are clearly still a trump card in uncertain times. Despite all the prophecies of doom, there is good reason to believe that Switzerland is and will remain a global leader in private banking and wealth management. Nevertheless, it should be noted that the transformation process is far from over, and the impact of many initiatives, for example the automatic exchange of information, will not be fully felt for some years to come. A detailed analysis also reveals that the larger banks have registered proportionately higher outflows than their smaller counterparts. This can probably be explained by the fact that the transformation process is generally farther advanced at large banks than at small ones. Against this backdrop, it can be assumed that significant asset outflows can be expected in the cross-border financial services business in the years to come. This is likely to impact smaller banks in particular.
No significant asset outflows expected in the coming months

"Do you expect developments in connection with banking secrecy, tax transparency and the automatic exchange of information (AEI) to lead to asset outflows at your organization in the next 12 months?"

The vast majority of banks surveyed (77%) do not expect to see significant asset outflows in the coming months. However, four out of ten medium-sized banks expect outflows of up to 10% and more. Smaller banks still do not expect to register large asset outflows in the near future.

The widespread optimism among banks is astonishing, given that until the automatic exchange of information is introduced in 2018, significant asset outflows should be expected. Banks seem to assume that some of the clients potentially affected will wait to regularize their assets and that, until then, banks will be able to acquire new assets to offset any outflows. Larger banks together with banks holding very large amounts of assets generally initiated structural change at an early stage and have already cleaned up their client portfolios to a large degree. They have therefore already registered asset outflows in recent years. Some smaller banks, however, are only just beginning this transformation process.
Measures to include confirmations, evidence and cash limits

"Which measures has your organization taken with respect to banking secrecy, tax transparency and the automatic exchange of information (AEI)?"

Around two thirds of the banks surveyed say that new clients must confirm that their assets are tax-compliant, for example by making a self-declaration. Considerably fewer (38%) require new clients to provide evidence to this effect, for example in the form of confirmation from an external lawyer. Only around one quarter of the banks surveyed demand evidence of tax compliance for their existing clients. At the same time, however, cash transactions are only permitted to a limited extent, with two thirds of banks indicating that they have introduced limits on cash transactions.

The vast majority of banks have reacted to the regulatory changes. To reduce the risk they bear, it is increasingly important for banks to better acquaint themselves with their client's tax compliance. Two options have emerged in this respect: clients can confirm their compliance themselves, or present an independent third-party confirmation to this effect. The latter course of action is of course more costly and time-consuming because a tax advisor may also have to be consulted.

The fact that the majority of banks now only permit cash transactions to a limited extent is not least a result of the experience gained from the US Depart of Justice's program. It is extremely costly and time-consuming to have to draw up "leaver lists" and to reconstruct transactions from former client relationships. Banks must increasingly be able to provide evidence of the transaction flow for assets. It goes without saying that this is more difficult when cash transactions are involved. In retrospect, the strategy of pursuing quick account closures for former clients with cash payments has not paid off.
Surprisingly high level of approval of strategy for financial sector

"How would you assess Switzerland’s financial sector strategy compared to strategies adopted abroad?"

Two thirds of banks surveyed believe that Switzerland’s financial sector strategy is more target-oriented than its counterparts abroad. Cantonal banks agree with this the most, while private banks agree the least.

Given the criticism frequently leveled at the federal government's strategy for the financial sector, this high level of agreement is surprising. The responses from the banks surveyed reveals that the Federal Council and its authorities have acknowledged the new reality in good time: after having clung on to banking secrecy and then withholding tax for so long, they are now consistently pursuing a global solution with respect to the automatic exchange of information. At the same time, the reversal of opinion within the financial sector is clear. Banks are accepting the AEI as a global standard. Nevertheless, Switzerland has missed or has been too late in recognizing a number of interesting opportunities in recent years (renminbi trading, asset management). Banks have thus far been unable to fully tap into the potential for positioning such elements as additional competencies.
Retail banking – lending business
Bubble on the real estate market

"Do you agree with the view of the National Bank and FINMA that there are currently signs of a real estate bubble emerging on the Swiss property market?"

The majority of banks still share the view of the SNB and FINMA that there are signs of a real estate bubble forming on the Swiss property market. However, this figure has fallen for the second consecutive time and is now just 54%, compared to 77% in 2012.

In particular, residential real estate prices have stabilized overall or fallen slightly. Nevertheless, there are still considerable regional differences. These are caused by factors including varying economic performance across the regions and the implementation of the second home initiative. At the same time, high net immigration is continuing to lead to relatively high real estate prices. The situation remains tense in the area of commercial real estate, where in the past we saw high levels of construction, which is now reflected in high vacancy rates.
Retail banks see bubble deflating

"Do you agree with the view of the National Bank and FINMA that there are currently signs of a real estate bubble emerging on the Swiss property market?"

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About two thirds of private and foreign banks still believe that a bubble is forming. Regional banks have a completely different view on the matter: only 44% see any indication of an overheated market.

Regional banks as well as cantonal banks believe the market to be considerably more stable than private and foreign banks. This is probably because private and foreign banks tend to finance luxury properties. With such properties there is a greater risk of a bubble forming than with the sort of properties generally financed by cantonal and regional banks.
Defensive lending persists – initial signs of easing lending policies

"What developments do you expect with regard to lending policies in the next 6-12 months?"

Since 2011, banks have been pursuing increasingly restrictive lending policies. The current survey shows that lending will not be tightened any further in the coming months. Banks remain defensive, but there are initial signs of them easing their lending policies.

Banks are sticking to the restrictive lending path they have now been treading for three years. As regards mortgages, it is not only the SNB that has become active by introducing an anticyclical capital buffer; in recent years banks themselves have taken various measures to restrict lending. As such, there is no need to tread an even more restrictive path.
No further tightening at cantonal banks

"What developments do you expect with regard to lending policies in the next 6-12 months?"

The most significant change in lending policies can be seen at cantonal banks. Only 32% (previous year 46%) expect to tighten lending even more this year. This does not mean, however, that cantonal banks will lend more; none of the banks anticipate a more expansive policy. Among foreign banks, a quarter intend to increase lending. This will generally involve expanding their Lombard loan business. Cantonal banks are particularly heavily involved in the mortgage business. The risks in the real estate market are now clearly perceived to be lower - as such, fewer banks intend to restrict lending. It is also true that, in the past, cantonal banks have pursued a more restrictive lending policy, meaning there is no need for them to tighten this further.
Decline in impairment losses and provisions

"In comparison to the prior year, how much risk provisioning (impairment losses and provisions) will you need to cover your lending business in the next 6–12 months?

Over the last year, the need for risk provisioning has declined considerably. Now only 27% of banks (previous year 41%) expect an increase in provisions or impairment losses. The need to make corrections has fallen most sharply among private banks. By contrast, foreign banks expect higher impairment losses; no less than 62% assume that an increase in risk provisioning will be necessary.

Traditional lending has until now been characterized by relatively constant returns. Mortgage business is the main revenue stream for Swiss retail banks and has benefited in recent years from the boom on the real estate market. In general, there have not as yet been any major loan defaults and the majority of banks continue to believe that the Swiss lending business is healthy. Risks carried on balance sheets are considered low, as are the impairment losses expected.
Anticyclical capital buffer cannot slow long-term lending growth

"The new anticyclical capital buffer requirements prescribed by the SNB and FINMA for mortgage-backed positions will not restrict growth in lending over the long term."

The anticyclical capital buffer is viewed with a critical eye. Only 43% expect this measure to restrict lending growth over the long term. Cantonal banks are most skeptical: only 33% of banks surveyed (previous year 62%) discern a restricting effect.

As the SNB’s hands are tied when it comes to increasing interest rates as a result of the minimum euro exchange rate, it is aiming to fight the real estate price bubble with the introduction of higher capital adequacy requirements. However, passing on these costs to clients has thus far only resulted in a minimal price increase and has not led to a reduction in lending growth over the long term. At present, the anticyclical capital buffer is merely having the same effect as an additional tightening of capital adequacy requirements for the lending business.
Financial market regulation and consumer protection
Approval of financial market regulation is declining

"The planned introduction of new financial regulations (FIDLEG, FINIG, FINFRAG), which are intended to close existing gaps in areas such as client protection and ensure alignment with EU regulations, is a sound decision."

Banks disagree as to the appropriateness of financial market regulation. The proportion of banks that welcome the rules aimed at protecting clients has fallen significantly over the year from 73% to 54%. Foreign banks still agree with this the most, while regional banks agree the least. This is no surprise: foreign banks have long since gained experience with such investor protection standards, particularly in Europe (e.g. MiFID), and have already implemented these to a large extent.

Swiss banks fundamentally acknowledge the necessity of the new financial market regulations with a view to compatibility with European standards. Nevertheless, there is little enthusiasm for these new rules. They are of greater benefit to larger banks which are in a better position to implement them. Skepticism is also growing as to whether the new rules will actually achieve the defined aim of protecting consumers. The increased formality of the investment advisory process is seen as being counter-productive, complex, expensive and not very client friendly.
Implementing the new financial market regulations costs money

"Implementing the financial regulations will have an impact on the financial industry and will involve implementation costs. How high do you expect will be the cost incurred by your organization?"

Implementing the new financial market regulations will generate significant costs. The banks surveyed expect implementation costs to average around CHF 2 million per bank. Cantonal banks present the highest cost estimate in relative terms, while regional banks anticipate comparably lower costs.

The new financial market regulations will require significant changes to both business processes and banking systems. As a rule, new competencies and capabilities must also be put in place and expanded upon in the area of client advisory services. This will require significant investment in training and educating staff. As universal banks, cantonal banks are more severely impacted by these changes. In principle, this will also affect the regional banks. It is likely that many of these banks have been unable to properly address the effects of the new financial market regulations and are still hoping for a Swiss compromise that will have less of an impact on banks operating in Switzerland. The costs required to adapt to these regulations are considerable: using the information provided by the banks as the basis for a projection covering the entire Swiss market, a conservative estimate would put such costs at between CHF 500 million and CHF 750 million. Time will tell whether these costs correlate with a corresponding benefit for clients.
Ultimately, the improvement in consumer protection will be negligible

"Which of the following effects do you anticipate for your organization as a result of the new financial regulations?"

Only a minority of the banks surveyed expect the investment advisory process and consumer protection to improve over the long term as a result of the financial market regulations. Most banks are currently focusing on the more adverse effects these regulations will have: the increase in complexity and the formalization of the client advisory process, which will ultimately make banking services more expensive for clients and could even lead to restrictions on the service and product range available to certain client groups.

If the client advisory process becomes more complex and the documentation requirements increase, it is not only costs that will go up. Under certain circumstances, this could also result in counter-productive trends, as there is a risk that certain client groups, in particular retail clients, may not be given access (or only be given restricted access) to wide-ranging investment advisory services. Such a development would most likely be unfavorable. Given the global interconnectedness of the financial sector, there is no disputing the fact that Switzerland requires rules equivalent to those under EU legislation. Banks that focus on the domestic market are generally dismissive of these developments, as the new rules lead to higher costs with little tangible benefit.
Priorities for 2015
Managing regulatory changes remains the top strategic priority

"How important are the following strategic priorities for your organization over the next 6–12 months?"

Managing regulatory changes will be by far the top strategic priority over the next six to twelve months. The reorganization of front-office units to focus on specific markets and changing client needs will not be as important as was previously the case.

It is no surprise that banks will concentrate on regulatory issues in the short term. Given the limited resources available, the focus will also be on regularizing clients’ histories. However, increased importance will also be attached to efficiency gains and improving earnings. This is an indication of movement in the market and of the increasing emphasis on growth. Nevertheless, the question remains as to how banks intend to achieve this, especially given that future-oriented projects, such as the reorganization of front-office units, are not (yet) being given priority. This is particularly true for smaller and medium-sized banks. By contrast, larger banks have already begun to increasingly adapt their service offerings, business processes and front-office operations to changing client needs.
Focus on compliance

"Which topics and activities do you expect to be of particular importance in the financial industry over the next 6-12 months?"

The focus is on regulatory aspects not only at a strategic level, but at an operational level as well. The most frequently mentioned issue here is compliance, in particular the implementation of new consumer protection provisions, as well as tax transparency. Job cuts and balance sheet trimming are viewed as being considerably less important.

Given the abundance of regulatory changes, it is no surprise that banks are currently concerned most of all with supervisory issues.

Compliance, tax transparency and equity planning will also be key issues in 2015. This ultimately has strategic consequences as well, especially given that future-oriented issues, such as outsourcing, offshoring and industrialization, are acknowledged as medium-term goals, but are not currently being given the same attention. Furthermore, investments and activities to improve service offerings, for example in the area of digitalization, are not currently among the overriding priorities. Managing regulatory changes still clearly represents an urgent challenge.
European banks also focusing on regulatory issues

"What are the relevant issues for your organization?"

Switzerland is not an island. European financial institutions face similar problems and have similar priorities. Risk and regulatory topics continue to dominate the agenda for European banks as well. At present, innovation and growth issues are playing a somewhat minor role for European banks compared to regulatory issues. It is remarkable that few banks intend to rigorously take advantage of the structural change to restructure their business model.
Outlook for 2020
Further regulations expected

"How do you see banking in 2020? To what extent do you agree with the following statement?"

In the future, the Swiss banking sector will be substantially more regulated.

The vast majority of banks surveyed anticipate being subject to even more regulation by 2020.

Banks have acknowledged the new reality. It is important to note that regional and cantonal banks are also expecting an increase in regulation. In recent years, the focus has mainly been on discussions concerning cross-border financial services and tax transparency. As a rule, retail banks

focused on the Swiss market have been less severely impacted by these issues. With the introduction of the new financial regulations, however, retail banks' business models will increasingly be affected. This applies in particular with respect to the new consumer protection provisions.
"How do you see banking in 2020? To what extent do you agree with the following statement?"

In the future, there will be substantially fewer banking institutions in Switzerland.

The number of financial institutions will fall noticeably in the future. Over three quarters of banks surveyed assume that there will be substantially fewer banking institutions in Switzerland by 2020.

The consolidation process is well underway, but this has gone largely unnoticed by the general public.

While individual banks are being sold, others are relinquishing their banking licenses, instead choosing to operate as pure asset managers. Around 50 institutions have disappeared over the last five years in Switzerland. This process is far from over. It can be assumed that this will primarily impact smaller banks.
Fewer branches

"How do you see banking in 2020? To what extent do you agree with the following statement?"
The number of bank branches will decrease considerably.

Three quarters of banks expect the number of bank branches to decrease considerably by 2020. There has been no change in this view over the last two years. Private banks are most likely to agree with this statement (87%), while only around half of cantonal banks expect branch closures.

New technologies and communication tools are changing distribution channels, which has a direct impact on the branch network. In this respect, banks have to be clear what kind of added value branches will generate in the future. While currently the majority of older clients carry out their banking activities in the branches, the younger generation primarily uses web-based channels. In recent years, this has resulted in many banks streamlining their branch networks. While this process is well underway at cantonal banks, regional banks are lagging behind. The question is whether it will be necessary to realign the added value generated by branches a lot more toward profitable earnings growth.
Industrialization – a necessity

"How do you see banking in 2020? To what extent do you agree with the following statement?"

The overwhelming majority of banks surveyed (92%) assume that the industrialization and sourcing of business processes will increase considerably - the highest figure since 2012. This trend can be seen among all banking groups.

The issue of industrialization and sourcing has been correctly acknowledged by banks to be a strategic necessity, as there is still some potential in the sector for standardizing and industrializing business processes. At present, however, banks are primarily concerned with managing the increased regulatory and transparency requirements. Time will tell when it will be possible to realize the major industrialization and outsourcing projects in the sector.

Two scenarios are possible: First of all, market acceptance for settlement services increases substantially, both as a result of the step-by-step expansion of the service on the part of providers and increased demand from banks. Secondly, the continually high strategic importance of increasing efficiency over the long term requires measures in excess of tactical cost reduction, with more and more banks beginning to apply the concept of industrialization to their own value chains. The focus here is on centralization, standardization and automation.
Decreasing client loyalty

"How do you see banking in 2020? To what extent do you agree with the following statement?"

The loyalty of bank clients will decrease considerably.

The proportion of banks expecting a significant decrease in client loyalty is becoming ever higher. Two thirds already expect to face this challenge going forward. This primarily impacts retail and cantonal banks, while foreign and private banks believe there is less risk of this happening.

Clients are better informed thanks to growing online offerings and comparison services. The increased use of web-based banking services can weaken client retention and, in turn, client loyalty. At private banks, the personal relationship with an advisor is more important, which presumably explains the lower incidence of this effect at these banks.
Pressure from competition outside the sector

"How do you see banking in 2020? To what extent do you agree with the following statement?" Competitors outside the sector (IT, mobile phones, Internet) will threaten the market position of banks.

The pressure from competition outside the sector is increasing. Today no fewer than 44% of those surveyed (previous year 32%) feel that this is threatening their market position. The greatest threat is felt by regional and foreign banks.

Until now, banks have driven away the threat from competitors outside the sector or have probably not taken it seriously enough. Currently an increasing number of banks are seeing new providers enter the market. Even if the majority still do not see any threat from IT firms or other innovative companies, competitive pressure will continue to increase. International banks rate the threat posed by new competitors as being much greater than in previous years. Based on their experience in other markets, they are already seeing specific examples of this change. The fact that regional banks are increasingly expecting to face new competitors can be explained by innovative retail banking business models based on the Internet and mobile applications. Many Swiss banks have probably underestimated both the threats and opportunities presented by competition from outside the sector for too long; now they must make sure they do not miss out on these new technologies. Their European competitors are much quicker and more agile in this field. The real innovation drivers, however, are banks operating in Asia.
New fee models – no lower fees though

"How do you see banking in 2020? To what extent do you agree with the following statement?"
The price of bank services will fall.

Astonishingly, banks do not expect to face much price pressure. Barely 20% of those surveyed (previous year 46%) still anticipate the price of bank services to decrease by 2020. This trend is particularly widespread among regional banks, where only 13% still expect a fall in prices.

The implementation of regulatory changes requires significant investment. In light of this, price reductions are not an issue for banks. Banks will instead aim to boost earnings with new service offerings and fee models. It is therefore to be expected that some services will become even more expensive, especially comprehensive advisory services. However, time will tell whether the market will actually accept the new fee models.
Cuts in incentive systems

"How do you see banking in 2020? To what extent do you agree with the following statement?"
There will be a fundamental overhaul (and reduction) of remuneration and incentive systems in the banking sector.

The majority of banks still expect there to be a fundamental overhaul (and reduction) of remuneration and incentive systems in the banking sector. Nevertheless, the number who believe this has declined for the second year running. An increasing number of foreign and cantonal banks, in particular, expect remuneration and incentive systems to be restricted.

In recent years, many banks have significantly changed their remuneration and incentive systems and reduced compensation, whether as a result of the Minder Initiative or for other reasons. In the past, margins in private banking were generally higher than in retail banking. This in turn led to more generous remuneration systems. It is safe to assume that the underlying adjustment process is not yet complete.
Lower returns for shareholders

"How do you see banking in 2020? To what extent do you agree with the following statement?"

In the future, banks' shareholders will have to accept lower returns.

In future, banks' shareholders will have to accept lower returns. A consistently large majority (85%) agree with this statement. This development is expected by all banking groups.

Margins are being diminished and shareholder returns are falling as a result of a number of factors within the context of client and product strategies as well as new competition from outside the sector, the discontinuation of banking secrecy and the higher costs for implementing the new regulatory requirements. Furthermore, banks are still having to improve their capital adequacy and increasingly reinvest profits. A reversal of this trend is not on the horizon.
Key messages
Key messages

The contours of the new reality are now taking shape.

Banks' core businesses have clearly performed well even in difficult conditions: despite ultra-low interest rates and challenging investment conditions, the majority of banks managed to post satisfactory results. Tangible solutions are emerging for some of the issues that banks have been facing for many years. In particular, the contours of the new regulatory framework are becoming clearer, especially with respect to the automatic exchange of information. The fundamental change underway in the banking industry is continuing to take shape, and uncertainties that previously hampered the business are receding. At the same time, new challenges are emerging, for example in the area of digitization.

Automatic exchange of information (AEI) is no longer a taboo for domestic banking clients

A year ago, the majority of banks agreed that the automatic exchange of information would be adopted as a global standard. Now banks have gone one step further: more than half of the banks surveyed expect the automatic exchange of information to ultimately apply to domestic banking clients as well. AEI is no longer a taboo. Given the global nature of the banking business, it is presumably becoming difficult to argue that the standard, which is becoming more commonplace across the globe, should not be applied in Switzerland.

Very few asset outflows - the calm before the storm?

The majority of banks surveyed indicate that they have only registered insignificant asset outflows. This suggests that many banks have already been largely successful in offsetting any outflows with inflows of new money. Nevertheless, the transformation process is far from over. It is the cross-border business that is expected to witness the largest outflow of assets, with the smaller banks likely to be the most adversely affected.

Continuing high consolidation pressure in private banking

Consolidation is a fact - around 50 institutions have disappeared over the last five years in Switzerland. It is also to be expected that banks will increasingly specialize in selected foreign target markets. At present, further consolidation is restrained by lower transaction prices as well as major uncertainties as regards potential legacy burdens from previous business models. Many sellers are not (yet) prepared to sell their banks at the low transaction prices being offered. At the same time, potential buyers are only interested in specific client segments and markets.
Key messages

Strategic focus on regulation and costs instead of innovation and growth

A great deal of resources are still being dedicated to the implementation of the tighter regulations. The strategic focus is also on efficiency gains and cost cutting. Those banks surveyed are currently placing less emphasis on reorganizing their front-office units to target specific markets and changing client needs. As long as banks are focusing on regularizing their clients’ histories, new opportunities, including those arising out of the ongoing structural changes, will be missed.

Consumer protection regulations could miss the mark

Banks generally accept the new financial market regulations. To remain active in the European market, Switzerland needs rules in line with those in the EU. Nevertheless, skepticism is also growing as to whether the new rules will actually improve consumer protection. Because of the increased formality of the advisory process, the majority fear that bank services will become more expensive and that the service and product range will be corseted. There is a risk that this regulation will miss the mark. The increased formality of the advisory process is seen as being counter-productive, complex, expensive and not very client friendly.

Anticyclical capital buffer with no long-term effect

The majority of banks still believe that a bubble is emerging on the real estate market. Nevertheless, the anticyclical capital buffer is viewed with a critical eye, with only a minority of banks expecting the SNB to be able to restrict lending growth over the long term. The survey shows that most banks view the Swiss lending business as being in good health. Traditional lending is characterized by relatively constant returns, and in general there have not as yet been any major loan defaults. This trend is expected to continue over the coming months.

Banking 2020: client focus, digitization and industrialization among the determinants of success

An increasing number of banks are seeing new providers entering the market. Technological developments have resulted in the launch of new client-centric business models. However, as banks are currently focused on regulation and cost optimization in particular, there is an increased risk that they will fail to make the required investment in new business areas. The increase in competitive pressure is also evident in the assumption that the number of banks and branches will continue to fall by 2020.
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