Editorial

Swiss banks are sharpening their focus on core business again. That might not seem like headline news, but keep in mind that many banks were preoccupied with an array of other topics until recently: regularizing the past and implementing new legal requirements – regulation rather than innovation, you might say. Now that the new reality is becoming more tangible, and as substantial progress is made in some cases remedying legacy burdens, banks are turning their attention to the strategic development of their business models. Following a period of developments driven by regulatory change, the banking industry is now entering a phase of structural change. EY Bank Barometer 2016 shows that organizations are seeking avenues to secure success in the new environment. Strategic realignment, innovation in electronic channels, digitization of the entire value chain, new markets and business models, next-generation products and services are just some of the topics climbing up the agenda. And the focus is returning to the essence: the customer’s needs.

The Swiss banks surveyed in November 2015 for this study are increasingly concentrating on optimizing the value chain. Outsourcing of non-strategic business units has long since ceased to be a taboo. But transforming business models demands a truly difficult balancing act from banks: in a volatile and exacting market environment, banks have to drive forward changes, while striking the right balance between cost optimization and investment. These efforts span decisions on customer and product portfolios, sales channels and workflows in a bid to raise efficiency and return to growth.

Uncertain geopolitical conditions, heterogeneous economic development in key markets and persistently difficult financial markets, however, are not helping realignment efforts. In addition, the negative interest environment in particular is posing enormous challenges for the financial industry. Not only do negative interest rates put the screws on margins, they also distort the impulses that steer capital as a factor of production, leading to misallocations of capital and liquidity – with currently unforeseeable long-term ramifications.

Having said that, the organizations surveyed are confident that they can ultimately overcome these challenges. Indeed, the majority continue to view the development of business as positive. However, not all institutions are coping well with the structural change: Again in the past year, further institutions have withdrawn from the market, while bank branches continue to close. This consolidation process is set to accelerate, given that not all banks have the strength and substance necessary to see them through the structural change.

EY Bank Barometer 2016 delivers facts and analyses on these developments. This sixth edition of the study is based on a survey of 120 leaders (directors) of various banks across Switzerland, but excluding the two major banks.

We hope you enjoy reading our take on the subject and trust that our report inspires some interesting discussions again this year.

Patrick Schwaller
Managing Partner
FSO Assurance

Olaf Toepfer
Partner
Leader Banking & Capital Markets

Marco Amato
Partner
Leader Wealth & Asset Management
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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 2015
- Survey of 120 banks in Switzerland (excluding the two major banks)
- Sixth edition since 2010

### Type of bank

<table>
<thead>
<tr>
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<th>2015</th>
<th>2014</th>
<th>2013</th>
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<tr>
<td>Private banks</td>
<td>39%</td>
<td>20%</td>
<td>33%</td>
</tr>
<tr>
<td>Foreign banks</td>
<td>20%</td>
<td>11%</td>
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<td>Regional banks</td>
<td>29%</td>
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<tr>
<td>Cantonal banks</td>
<td>12%</td>
<td>16%</td>
<td>11%</td>
</tr>
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</table>

1) Including banks specialized in asset management

### Bank size by customer assets

<table>
<thead>
<tr>
<th>Bank size by customer assets</th>
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<th>2014</th>
<th>2013</th>
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<td>71%</td>
<td>62%</td>
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<td>Between CHF 5bn and CHF 10bn</td>
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<td>10%</td>
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<tr>
<td>Over CHF 50bn</td>
<td>7%</td>
<td>7%</td>
<td>11%</td>
</tr>
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</table>
Development of business operations
Robust operating results

“How would you assess the current operational business development of your organization?”

The vast majority of banks continue to view the development of business as positive, with 81% (prior year: 88%) reporting an improvement in operating results.

Record low interest rates and the strong Swiss franc are not exactly helpful developments for the banking business. Furthermore, many customers continue to take a defensive stance, lowering the volume of transactions accordingly. Nevertheless, banks’ core business has still developed positively, with many banks returning robust operating results. The share of institutions that regard the development of business with skepticism has only increased negligibly, falling short of 20%. One of the factors underlying the optimism is the success of some banks in containing the erosion of margins to a degree.
Both cantonal and regional banks are more positive about the development of business than a year ago. Compared with the prior year, private and foreign banks are somewhat less optimistic.

In recent years, regional and cantonal banks have benefited from strong activity in residential property construction and above-average demand for residential property financing, significantly building up their positions in mortgage loans. So far, mortgage lending has delivered steady interest income and has seen relatively low defaults. In addition, retail banks are not particularly active in cross-border business, which means that they have been less affected by the remediation of legacy burdens and the corresponding realignment of that business from a regulatory perspective. Those are issues that have a greater impact on private and foreign banks active in the private banking segment. Stricter regulatory requirements entail added implementation costs and impact the development of business. In addition, asset managers are more severely affected by the collapse of the euro exchange rate. Many of their revenue streams depend, either directly or indirectly, on the weaker foreign currencies - while they continue to incur costs in Swiss francs for the most part.
Ever more challenging environment – confidence remains unbroken

“What kind of development do you expect for your organization’s operational business in the next 6 to 12 months?”

The vast majority of banks still look to the near future with confidence: Three-quarters anticipate an increase in their operating result in the coming 6 to 12 months. However, the optimism is somewhat more subdued than a year earlier.

The economic environment facing financial institutions remains challenging. And it is not only negative interest, the high franc exchange rate and the geopolitical uncertainty that is impacting the development of business; an additional burden is posed by regulatory initiatives such as implementation of the automatic exchange of information (AEI), new duty of care or stricter equity requirements. In the past, however, many banks have demonstrated a talent for mastering such challenges and returning robust operating results.
Private banking – slight decline in confidence

Confidence has declined somewhat across all categories of banks. That said, about 70% of the institutions surveyed still expect the operating result to improve over the coming 12 months.

The greatest change can be seen among private and foreign banks. In the asset management business, income is more heavily impacted by the discontinuation of the minimum exchange rate to the euro because customers hold some of their assets in euro, which means that their value and returns have decreased year on year. In addition, cross-border banking is affected more severely by a tightening of regulation like the introduction of AEI. It is also unclear how institutions can compensate for the erosion of margins in an increasingly transparent business.
Positive signals overall for labor market

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

One-third of banks want to hire at least 5% more personnel in the coming 12 months; a figure unparalleled since 2010. Ten percent (prior year: 13%) of banks still anticipate job cuts of the same magnitude.

In contrast to fears that the banking industry will shed significant numbers of jobs in the near term, the surveyed institutions surprisingly tend to actually anticipate a slight increase in employment numbers in the next 12 months. The fundamental transformation process currently requires more personnel. However, this trend will not continue for long. Instead, sourcing and structural efficiency programs will lead to more jobs being lost to outsourcing or increased automation in the medium term.
Transformation in private banking requires more personnel

Cantonal and regional banks pursue a relatively stable personnel policy. In contrast, the development in private banking, particularly among foreign banks, was far more erratic in the last few years.

This development also reflects the uncertainty surrounding the strategic implications of the new parameters developed in recent years for cross-border financial services. Having obtained a substantial degree of clarity over the last several years, the institutions concerned can now get on with the business of transformation, which will require a build-up of requisite capacity. The magnitude of transformation is less pronounced for cantonal and regional banks, which explains the corresponding lower demand for additional personnel.
3.

Negative interest and minimum euro exchange rate
SNB decisions burden banks

“In January 2015, the SNB discontinued the minimum exchange rate to the euro and introduced negative interest. What is the impact of this measure on your organization in your opinion?”

The Swiss National Bank’s interest and exchange rate policies pose a burden on the surveyed banks. Some three-quarters of survey participants consider negative interest and the discontinuation of the exchange rate target to be negative to somewhat negative.

Private and foreign banks are particularly critical about the measures adopted by the SNB, with 85% of private banks seeing negative consequences for their activities, their business model being more heavily affected by the changes. In contrast, regional banks impart a more neutral assessment of the SNB’s decisions.
Banks are struggling with negative interest

“What measures entail the greatest challenges for your organization?”

2015

Discontinuation of the minimum exchange rate to the euro
Introduction of negative interest
Both are equally challenging

It is the consequences of negative interest that are bearing down most heavily on banks. More than half of the surveyed institutions see the greatest challenge in that decision. This holds especially true for retail banks.

Not only do negative interest rates put the screws on margins, they also distort the impulses that steer capital as a factor of production, leading to misallocations of capital and liquidity – with currently unforeseeable long-term ramifications. The low-interest environment makes investment opportunities difficult and tends to inhibit the transaction behavior of customers.

In addition, it is becoming increasingly difficult to manage bank balance sheets and reliably interpret core financial models that were essentially developed for a positive interest rate environment.

Asset managers are more severely affected by the collapse of the euro exchange rate. Many of their revenue streams depend, either directly or indirectly, on the weaker currencies – while they continue to incur costs in Swiss francs for the most part.
No negative interest for private customers

“Does your organization intend to introduce negative interest in the private customer business as well?”

At present, the majority of banks is not contemplating introducing negative interest in the private customer business. Only 16% plan to take such a step, and only for assets in excess of CHF 250,000. Even in the event of a negative interest rate hike, only 14% of the surveyed banks would be willing to pass on the associated costs to their customers.

The introduction of negative interest is not an issue at regional and cantonal banks. Only about one-quarter of private and foreign banks are considering passing on the negative interest burden to customers, and only for amounts in excess of CHF 250,000. At present, the vast majority of banks appear to be willing to shoulder the additional cost incurred. And for a good reason: Passing on the costs would presumably have adverse ramifications, exacerbating an already difficult balance sheet management. The question, however, is how long institutions can sustain the economic implications of this situation.
Automatic exchange of information (AEI)
AEI implementation behind schedule

“How far have you progressed with AEI implementation? What do you estimate is the current stage of implementation at your bank?”

Automatic exchange of information is coming. However, the majority of banks have fallen substantially behind schedule. According to the survey results, 26% of respondents have yet to launch a corresponding project or are still in an early phase, while 21% have only completed a small amount of the implementation work.

Banks have to systematically compile information on customers and accounts from 2017 onwards, for submission to their tax authorities from 2018 onwards. The latter will then exchange data with tax authorities in partner states. Banks thus have to modify their systems accordingly within the next 12 months. Foreign banks have the biggest workload ahead of them; 41% are still in the initial phase of AEI implementation. Private and regional banks have made somewhat more progress; about one-quarter of them have already practically completed their corresponding projects.
Banks would like clear implementation guidance

“What are the greatest challenges as regards AEI from your perspective?”

The main factor encumbering banks’ efforts to implement AEI is the lack of clear guidance. Survey respondents also find the costs involved challenging.

The sector is still unclear as to how the guidelines should be implemented at an operational level in particular. Some therefore prefer to hold back with implementation until the key issues are resolved. This notwithstanding, the time frame is certainly tight, given that customer information already has to be compiled starting in 2017. It thus comes as a surprise that only 15% of banks find the time pressure challenging.
Banks are able to compensate for asset outflows

"Have developments in connection with banking secrecy, tax transparency and automatic exchange of information led to significant outflows of foreign customers’ assets at your organization in the last 12 months?"

Registered asset outflows remain within limits. Overall, 66% of respondents (prior year: 69%) reported that they had not registered any significant outflows of foreign customers’ assets in the last 12 months. That said, the number of institutions that have sustained asset losses of 10% or more has increased to 11% (prior year: 5%).

Increasing tax transparency and imminent AEI implementation affect asset managers more severely. According to the results by category, 19% of private banks (prior year: 8%) report a perceptible decrease in assets, compared with 17% of foreign banks (prior year: 0%). It is surprising that, despite the trend toward increased tax transparency, the majority are not witnessing any significant asset outflows. This is attributable to the ability of some banks to largely compensate for losses by attracting new cash. Switzerland’s attributes as a secure and reliable financial hub continue to be in strong demand – and more so in times of uncertainty. Swiss banks are thus largely able to attract fresh funds and thereby stabilize their assets under management. However, it is too early to speak of a lasting inflection point.
Foreign assets largely regularized

“As regards the outflow of foreign customers’ assets, at what stage of the process is your organization in your opinion?”

Of the institutions surveyed, 89% stated that they have largely regularized foreign assets. Private banks see the greatest need for adjustment: Apparently, 17% of surveyed institutions in this category still have to tackle larger transformations.

Banks have already made substantial progress in the remediation of the past. They have come to terms with the new reality and have already implemented corresponding measures for the most part. Only a few institutions still have to drive forward the regularization of their foreign customers. Consequently, the hope at present is that asset outflows will be largely contained in the near future.
AEI for domestic bank customers too at some point?

“Do you expect that current developments in connection with the automatic exchange of information will also apply to domestic banking customers?”

Most banks expect that banking secrecy will be removed for domestic customers as well sooner or later. Overall, 56% (prior year: 54%) expect AEI to be applicable for domestic bank customers at some point.

Only a year ago, banks’ expectations as regards AEI for domestic customers had taken many by surprise. The sector remains firm in its opinion, although there are no political signals at present indicating an imminent removal of banking secrecy for domestic customers. With the recent decision by the Swiss Federal Council to postpone the planned revision of criminal tax law, a speedy end to banking secrecy appears less likely. In addition, a fundamental political decision is approaching with the popular initiative to protect privacy (“Matter initiative”), which wants to enshrine domestic banking secrecy in the constitution and which is expected to come to a vote in 2017.
Financial market regulation
Financial market regulation makes sense...

“The phased introduction of financial market regulation (in particular FIDLEG and MiFID II) intended to close existing gaps in customer protection among other areas and secure equivalence with EU regulation makes sense.”

Most banks believe that financial market regulation at a European level and in Switzerland makes sense. Only in the case of cantonal banks has the approval rating decreased significantly to a mere 36% (prior year: 61%).

Banks view the objectives pursued by the financial market regulation to update and specify investor protection requirements and conversion with EU directives as important factors in order to safeguard the international competitiveness of the Swiss financial market. In general, private and foreign banks rate financial market regulation more favorably than retail banks. These diverging perspectives are to be expected: Clear requirements for cross-border business are particularly important in private banking in order to keep pace with European markets. In contrast, skepticism predominates at some regional banks and at most cantonal banks, not least due to the added cost of regulation.
... but market access remains uncertain

“What are the greatest challenges in connection with the implementation of the new financial market regulation?”

Surveyed banks see the greatest challenge to implementing the new regulation in the lack of exemptions in some instances for smaller institutions focused on the domestic market. Also criticized are the lack of any clear implementation guidance and the insufficient harmonization between Swiss and EU regulation.

Private, foreign and cantonal banks’ reproval for the lack of harmonization allows interesting conclusions to be drawn regarding the pursued equivalence of Swiss and European rules. Banks are evidently of the opinion that this objective probably cannot be achieved with FIDLEG in its current form. Ultimately, that would mean that banks would have to additionally comply with the European standard (MiFID) in the cross-border financial services business.

Regional banks are focused on other topics. Their greatest concern is the lack of exemptions for small banks, especially those active in the domestic market. Regulation does in fact frequently fail to accommodate to the situation of small institutions. Regional banks also struggle with the high cost involved in adjusting processes.
6. Lending business
Real estate market still overheating

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

The majority of banks still perceive the threat of a bubble emerging in the Swiss real estate market. Compared with a year ago, the share of banks that agree with the SNB and FINMA on this point has increased to 65% (prior year: 54%).

This assessment is confirmed by current studies on price trends. Over the last few years, the historically low interest rates have led to a pronounced boom in construction activity in owner-occupied residential property as well as investment property. This is especially the case for prime locations.

Pressure on institutional investors such as pension funds and insurance companies to generate positive returns for their beneficiaries continues to keep real estate prices at lofty levels. This situation is exacerbated by foreign demand for Swiss investment property.
Lack of consensus among banks

With the exception of cantonal banks, all other categories of banks see a tendency toward the emergence of a bubble in the Swiss real estate market. Among cantonal banks, only 29% (prior year: 53%) still see a threat of overheating in the real estate market, compared with 63% of regional banks (prior year: 44%).

A shift from city center locations to the periphery is evident in the office space market. In addition, some regions are seeing pressure ease, while pressure mounts in others. In other words, the real estate bubble phenomenon varies substantially both regionally and by type of property, which would explain the diverging opinion of regional and cantonal banks.
No credit crunch

“How do you expect the lending policy of Swiss banks to develop in the next 6 to 12 months?”

For the second consecutive time, an easing is evident in the lending policy of banks. Only 45% (prior year: 50%) still expect more restrictive lending; the first time since 2010 that the value drops below 50%.

The evident easing suggests that the low interest environment has become the new normal and that banks have found a balance between growth and risk mitigation in their lending policy. In practice, however, banks have also been making more exacting demands on the quality of borrowers and collateral for some time now.

Interestingly, banks seem to maintain somewhat more restrictive policies with respect to residential property financing (47%) compared with the corporates business (43%).
Rising risk of default for SME loans

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

For the second consecutive time, banks see a lower lending risk. Only 38% still anticipate an increase in provisions and impairment losses in the next 12 months. However, banks expect increasing credit risks in the case of SME loans.

Banks are increasingly rating the credit risk for SMEs as substantial: 45% of those surveyed anticipate increasing impairment losses and provisions for corporate customers in the coming 12 months. This reflects the effect of discontinuing the minimum exchange rate to the euro. Some banks expect that SMEs in the export sector will increasingly have difficulties servicing their loans.

By comparison, the need for impairment losses in residential property is lower. So far, banks have not had to endure any notable defaults in mortgage lending; most banks continue to rate the Swiss lending business as healthy. Despite the continued threat of a bubble, the risks carried on balance sheets are deemed low.
7.

Digitization and fintechs
Digitization – just another sales channel?

“Digitization is a popular buzzword at the moment. What in your view is the significance and potential value add of digitization in the financial services business?”

Digitization will change the banking business. However, only a minority currently expect that the technological development associated with digitization will revolutionize the financial services business. The majority of banks recognize the potential of digitization for opening new sales channels in particular.

Both the retail and travel sectors have already demonstrated how digitization can transform an entire industry. Innovations are spreading faster and faster, and those who move too late risk being left behind. Despite the unmistakable tectonic shift, surveyed banks still view the development with reticence at present: Only 27% see the potential in the technological development to completely transform the financial services business. The majority of banks are of the opinion that the core of their business will remain intact and that digitization offers first and foremost an additional sales channel that is not going to revolutionize banking.
Potential of digitization remains untapped for the time being

“Does your organization already have a clear digitization strategy for your business model?”

Although institutions certainly recognize the potential of digitization, most banks don’t have a strategy to capture it yet. It seems that the possible contribution of digitization to value creation in the financial services industry remains unclear. Under one-quarter of surveyed banks has a clear digitization strategy, and most of those are cantonal and regional banks.

Banks need to play catch-up in the digital space. Retail banks are somewhat ahead of asset managers on their journey to the digital future. Cantonal and regional banks have recognized that, in the mass business in which they are mainly active today, the digital sales channel already creates value. Private banks perceive less pressure to go digital; this is an ambit in which personal contact still plays a central role.

Digitization of the financial industry is not just about extending distribution channels, but also about tackling central challenges related to customer touchpoints. This is an area in which digitization offers a wide variety of options for individual, personalized analysis of customer data, customer needs and customer behavior. Ultimately, this translates to better – in the sense of bespoke – customer advice. In a world that is ever more mobile and personalized, banks not only have to secure customer touchpoints but also learn to use them better in future.
Negligible fear of fintechs

“Do you perceive the developments in the fintech space as a threat to existing business models?”

<table>
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<th>Probably</th>
<th>Probably Not</th>
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<tr>
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<td>13%</td>
<td>11%</td>
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<td>9%</td>
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<tr>
<td></td>
<td>46%</td>
<td>31%</td>
<td>23%</td>
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Banks are relatively unfazed by the emergence of start-ups in the fintech sector. Overall, 70% do not consider the companies attempting to secure elements of the value chain with new technologies as a long-term threat. Interestingly, most skeptical in this regard are cantonal banks, a category in which a relatively large number of institutions have looked into their own digitization strategy.

This aplomb is attributable to the high regulatory barriers to market entry, particularly in Switzerland. The cost of obtaining a banking license quickly outweighs the potential offered by start-ups. Having said that, banks ought to avoid being lulled into a false sense of security. If the new providers succeed in capturing customer touchpoints, banks risk being relegated to the role of mere transaction handling organizations. In that case, they would lose a substantial share of the value add. The emergence of automatically generated investment strategies (“robo advice”) signals one potential development. At present, however, many banks still partly lack the imagination to think up specific ideas and initiatives in collaboration with fintechs.
Priorities for 2016
Core business back in focus

“We which the following topics and activities do you expect to be of particular importance in the financial industry over the next 6 to 12 months?”

Banks are focusing their attention on advancing their core business again, after years of dedicating resources to the remediation of legacy burdens and coping with tighter regulatory requirements. New partnerships, new markets, innovation and sourcing are on an ascending trajectory now.

The topics set to attract the industry’s undivided attention are all related to the realignment of business models. And the focus is returning to the essence: the customer’s needs. The fact of the matter is that compliance with regulatory requirements and efficiency improvements are not enough to ensure survival in the long term. A sustained enhancement of the value chain is decisive. Banks clearly have the capacity again to tackle head on strategic change. However, three key questions remain unanswered: What new strategic avenue should be taken? What does the business model of the future look like? And is it possible to master the complexity of the structural transformation?

Worth mentioning in this context is the digitization of banking, which is expected to irreversibly change the financial services industry. Banks certainly recognize the long-term potential, but the specific contribution of digitization to value add in the financial services sector is evidently still unclear. That might explain why this priority is somewhat lower on the agenda for many banks over the coming 6 to 12 months.
Outlook for 2020
The trend toward greater regulation density continues. In the interim, 97% of surveyed institutions concur that the industry will be more strictly regulated by 2020.

In recent years, banks have been busy implementing new regulatory requirements introduced by regulators following the financial crisis. These regulatory standards, that are increasingly also developed by international organizations or states, essentially focused on capital and liquidity, consumer protection and tax transparency. Following the phase of regulatory orientation and adjustment undergone by the financial services industry over the last few years, there is now a better understanding of the new regulation and its consequences. Next up is the efficient, holistic and pragmatic implementation of this regulation.
All categories of banks expect tightening regulation

I entirely agree
I partly agree
I partly disagree
I entirely disagree
“Where 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.”

The vast majority of banks surveyed continue to anticipate diminishing returns. That said, the share of institutions that hold the opposite opinion has risen slightly to 20% (prior year: 15%).

Stricter regulation comes at a price. Implementation of regulatory requirements is costly, more stringent capital requirements tie up additional capital and limit options for earning a return, particularly in a negative interest environment. Cost improvement measures cannot reverse this development. Against this backdrop, banks and investors will have to make do with lower returns for some time to come.
Optimistic regional banks

All categories of banks anticipate decreasing returns through 2020. Foreign banks show the greatest consensus in this respect; no less than 91% expect sustained pressure on returns. Some regional banks are more optimistic; 34% (prior year: 13%) don't expect returns to decrease further.
Consolidation continues

"Where 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 banking institutions will continue to decline through 2020. Overall, 86% of respondents (prior year: 79%) believe that there will be significantly fewer banks in Switzerland by 2020. For the first time since 2012, more than half of those surveyed agree with this statement.

As far as banks are concerned, the consolidation process in the Swiss financial services industry is picking up momentum again. Some institutions are feeling the strain of a still challenging environment, marked by geopolitical uncertainty, the rising tide of regulation, negative interest and a strong Swiss franc. Some 60 institutions have disappeared off the map since 2010. Eight banks returned their licenses in 2014, followed by another five in 2015. Individual institutions are being sold, others are giving up their banking license to focus solely on asset management. In view of tightening regulatory requirements, smaller institutions are most exposed to the structural change. It is expected that dozens of additional banks will be lost to the structural shift. Moreover, progress in the remediation of legacy burdens is reducing takeover uncertainties, which will accelerate consolidation over the next two years.
Since 2012, it is foreign banks that have anticipated the greatest consolidation. And for a good reason: Some 30 institutions have disappeared from the map in the last ten years. Not only are foreign banks struggling with regulatory requirements; in some instances, parent companies are withdrawing from the Swiss market in response to a challenging economic situation and concentrating resources in their domestic markets.
Incentive systems under pressure again

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

Most banks still expect decreases in remuneration and incentives in the banking sector. Consensus on this point has increased year on year.

Surprisingly, most banks are still intensively dealing with their bonus models. In actual fact, many banks have significantly corrected their remuneration and incentive systems in recent years, and have decreased compensation, bowing not least to pressure from the Minder incentive. But the surveyed banks believe that the adjustment process is still ongoing.
Regional banks also have to adjust their incentive systems

With the exception of private banks, the share of institutions intending to limit their remuneration and incentive systems is increasing across all categories of banks. The biggest change can be seen among regional banks: 74% now plan a revision of their compensation models. Cantonal banks tend to see somewhat less need for adjustment; about half do not currently foresee any further restriction of their remuneration and incentive systems.
Banks beginning to take non-industry competitors seriously

“Where do you see banking in 2020? To what extent do you agree with the following statement?”
Competitors from outside the sector (IT, mobile phone, Internet) threaten market position of banks.

Most banks acknowledge the market entry of competitors from outside the sector. For the first time, more than half of surveyed institutions anticipate a threat to their market position.

Such industry outsiders are considered capable of penetrating significant segments of the banking business – either alone or, more likely, in yet unknown constellations. Attention here is less on small fintech start-ups, but rather on technology and telco majors. Not only do the latter have the know-how and infrastructure to profitably tap value from raw data and information – commodities steadily gaining in importance –, but they also have the financial clout needed to overcome the high entry barriers in the regulated financial services industry. Against this backdrop, banks need to defend key customer touchpoints and come up with more innovative ways of using them. Apart from smart digital strategies, the aim is presumably to strengthen the customer experience in bank branches.
Appealing mass business in retail banking

Regional, and cantonal banks in particular, increasingly consider industry outsiders a threat. Their main concern is large-volume business and the long underestimated payment processing business. Not only does access to payment processing entail access to a customer touchpoint, but in particular access to an enormous mass of individual data points that - intelligently analyzed and combined - offer the ideal basis for individual and personalized customer advice. If the new providers succeed in entering the market with intuitive tools for payment processing, they might successfully capture a segment for themselves. This affects retail banks more than asset managers, given that personal contact is still fundamental for the latter. Having said that, private banks are also keeping a close eye on the competition, since their business model might well come under pressure with the emergence of automatically generated investment strategies.
Branch network still shrinking

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

The streamlining of the network of branches in Switzerland continues. Of the surveyed institutions, 85% (prior year: 76%) expect that there will be substantially fewer bank branches by 2020.

The development of branches is a clear manifestation of the structural change: Their number has declined by about 200 within the last five years. Driven by new technologies and communication media, this process is set to accelerate. Increasing use of bank services on digital platforms is making extensive branch networks practically obsolete.

However, streamlining the network of branches based on cost considerations alone does not constitute a forward-thinking solution, as banks would essentially weaken a customer touchpoint. Instead, the aim has to be to build up digital sales channels further, while strengthening the customer experience at remaining branches. Examples from other industries where flagship stores in upmarket city center locations are used to focus on the customer experience might serve as a reference to some extent.
Foreign and cantonal banks are reducing their branch network

All categories of banks are scrutinizing their branch networks. Foreign banks expect the largest cutbacks. Cantonal banks also anticipate a sizable change: 86% (prior year: 55%) anticipate streamlining. This is remarkable in that Cantonal banks have already significantly streamlined their sales network: Since 2010, they have given up over 60 branches, a decrease of more than 8%. Regional banks have not made much progress along these lines.
Digitization on the rise - customer loyalty in decline

"Where do you see banking in 2020? To what extent do you agree with the following statement?"
Loyalty of bank customers will decrease considerably.

Most banks still expect a decline in customer loyalty. Overall, 61% (prior year: 65%) expect to be confronted with this challenge through 2020.

Not only does digitization open up new sales channels, it directly impacts customer behavior. It allows a more convenient and faster comparison of products and services, and customers are generally better informed. At the same time, the cost of changing providers is decreasing. The logical consequence is a decline in customer loyalty.

Accordingly, banks need to dedicate a corresponding amount of attention to the customer touchpoint if they are to defend their market position going forward.
All categories of banks are affected by decline in customer loyalty

There is broad consensus among the different categories of banks as to the development of customer loyalty. Although personal relationships generally carry more weight in asset management, not only retail banks but also private and foreign banks anticipate decreasing customer loyalty. A year earlier, foreign banks had assessed the threat to be significantly lower, but now more than half view declining customer loyalty as a challenge.
Prices in banking business are coming under pressure again

"Where do you see banking in 2020? To what extent do you agree with the following statement?" Prices for banking services will fall.

Banking prices are still under pressure. Overall, 44% of respondents (prior year: 20%) anticipate falling prices for banking services through 2020.

Only a year ago, the prevailing opinion was that further price reductions were avoidable. Some institutions had tried to boost income with new service offerings and fee models, while others expected price hikes for certain services. This optimism has cooled off somewhat; individual institutions are apparently skeptical as to whether the new models will in fact gain traction in the market.
Mounting pressure on prices in asset management

Cantonal and regional banks are generally unperturbed about the pressure on prices. In contrast, private and foreign banks anticipate significantly higher price pressure. It is in fact mainly asset managers who are most exposed to the indirect effects of increased tax transparency. In the past, investors were less price sensitive; assets under management with higher margins have presumably been pulled out in response to the introduction of new regulation. Funds invested today tend to have lower margins on average.
Industrialization and sourcing are determinants of success

"Where do you see banking in 2020? To what extent do you agree with the following statement?"
The industrialization and sourcing of business processes will increase considerably.

The topics of industrialization and sourcing of business processes maintain the high level of importance that they had reached in the last two years. Overall, 89% (prior year: 92%) of respondents anticipate a significant increase in importance.

Banks are rightly awarding increasing importance to industrialization and sourcing again as essential strategic topics. So far, the financial services sector has seen relatively little in the way of industrialization. However, the market maturity of settlement services is increasing substantially.

The high strategic importance of sustained efficiency improvements requires measures that go beyond tactical cost cuts, encouraging the application of industrialization concepts in the in-house value chain. Such efforts focus on centralizing, standardizing and automating processes.
All categories of banks concur that industrialization and sourcing of business processes will intensify substantially. That indicates that the entire industry still has considerable potential for standardizing business processes and re-engineering the value chain. After years in which banks have been primarily preoccupied with coping with the tighter regulatory requirements, attention is rightly returning to such aspects of essential importance to the development of business.
Key messages
Core business back in focus

Banks are focusing their attention on advancing their core business again, after years of dedicating resources to the remediation of legacy burdens and coping with tighter regulatory requirements. New partnerships, new markets, innovation and sourcing are on an ascending trajectory now. Customers’ needs are shifting back to the center of attention.

Despite a challenging economic environment, many banks have been able to return satisfactory to good results. And these are critical: To tackle the process of structural transformation, banks are in need of financial resources and, indeed, more personnel in some cases, with one-third of surveyed institutions indicating that they intend to create new jobs in the coming 12 months. Those who are too late or who fail to make the urgently needed structural investment risk falling behind or being overwhelmed by developments in the coming years.

Potential for digitization sporadically used only

Digitization will change the banking business. All banks agree on this point. However, only a small minority currently expect that the technological development associated with digitization will revolutionize the financial services business. The majority of banks recognize the potential of digitization for opening new sales channels in particular. Although institutions certainly recognize the potential of digitization, most banks don’t have a strategy to capture it yet. It seems that the possible contribution of digitization to value creation in the financial services industry remains unclear.

At present, many banks still lack the imagination to think up specific ideas and initiatives, such as in collaboration with fintechs. Private and foreign banks are still taking a wait-and-see approach to digitization: Only few dare make the initial investment as early movers. For Switzerland as a financial center, with its outstanding reputation in private banking, that is unquestionably an unfortunate development. It seems that private banking 2.0 is not quite ready to make an entry.

Threat from industry outsiders

For the first time, more than half of surveyed institutions anticipate a threat to their market position from competitors from outside the industry. The latter are considered capable of penetrating significant segments of the banking business – either alone or, more likely, in yet unknown constellations. Attention here is less on small fintech start-ups, but rather on technology and telco majors. Not only do the latter have the know-how and infrastructure to profitably tap value from raw data and information – commodities steadily gaining in importance –, but they also have the financial clout needed to overcome the high entry barriers in the regulated financial services industry. Against this backdrop, banks need to defend key customer touchpoints and come up with more innovative ways of using them. Apart from smart digital strategies, it is important to strengthen the customer experience in bank branches.

Accelerating consolidation

The consolidation process in the Swiss financial sector is picking up considerable momentum. Some institutions are feeling the strain of the still challenging environment, marked by geopolitical uncertainty, the rising tide of regulation, negative interest and a strong Swiss franc. Over 60 institutions have disappeared off the map since 2010. It is expected that dozens of additional banks will be lost to the structural shift. Progress in the remediation of legacy burdens is reducing takeover uncertainties, which will accelerate consolidation over the next two years.

At the same time, branch networks are being streamlined in response to the increasing use of bank services on digital platforms. However, now is not the time to thin out the network of branches any further. If banks want to secure the customer touchpoint, they have to build up digital offerings, while strengthening the customer experience at remaining branches.

Key messages
Threat of misallocations of capital and liquidity due to negative interest

The decision by the Swiss National Bank to introduce negative interest is putting more pressure on banks than the discontinuation of the minimum exchange rate to the euro. Not only do negative interest rates put the screws on margins, they also distort the impulses that steer capital as a factor of production, leading to misallocations of capital and liquidity - with currently unforeseeable long-term ramifications. It is becoming increasingly difficult to manage bank balance sheets and reliably interpret core financial models that were essentially developed for a positive interest rate environment. Despite these challenges, institutions have so far opted against indiscriminately cross-charging negative interest on to private customers. And for a good reason: Passing on the costs would presumably have adverse ramifications. The question, however, is how long institutions can sustain the economic implications of this situation.

Still no major outflows of assets

According to the banks, the trend toward greater tax transparency has not resulted in any notable outflows of assets. As in the prior year, two-thirds of banks did not register any outflows; the share of private banks that has registered outflows is higher, but only slightly. Many banks are evidently largely compensating for outflows with inflows of new cash. That’s good news: Switzerland as a banking center is still able to attract substantial volumes of fresh funds. Its attributes as a secure and reliable financial hub continue to be in strong demand - and more so in times of pronounced uncertainty. However, it is too early to speak of a lasting inflection point.

Rising risk in SME lending

Banks are increasingly rating the credit risk for SMEs as substantial: 45% of those surveyed anticipate increasing impairment losses and provisions for corporate customers in the coming 12 months. This reflects the effect of discontinuing the minimum exchange rate to the euro. Some banks expect that SMEs in the export sector will increasingly have difficulties servicing their loans. This notwithstanding, banks have no plans to curtail lending to SMEs. Compared with prior years, institutions are taking a more restrictive course in the case of residential property financing, presumably influenced by the continued threat of a real estate bubble.

AEI implementation behind schedule

Automatic exchange of information is coming. The time frame for AEI implementation is tight, given that early adopter countries already have to deliver customer information concerning 2016 at the start of the following year to the tax authorities of participating foreign countries. Since Switzerland does not plan to introduce AEI until 2017, Swiss banks have until the beginning of 2018 before they have to start submitting information to the Swiss Federal Tax Administration. However, one-quarter of surveyed banks has yet to launch a corresponding project, apparently. The institutions concerned argue that, apart from the costs involved, there is currently a lack of clear implementation guidance and official interpretations.
Banking 2020: Regulation, digitization and industrialization

Although no less than 97% of surveyed institutions expect regulation to continue rising, banks are increasingly seeing other topics that likewise have a fundamental impact on strategy, business models and business processes: the digitization of the financial services sector and the industrialization of business processes.

The digitization of the financial services industry is not just about extending distribution channels, but also about central aspects related to customer touchpoints. Digitization lowers to some extent the barriers to market entry for competition from outside the industry and is expected to lead to a decline in the strong customer loyalty seen in the past. On the other hand, digitization offers a wide variety of options for individual, personalized analysis of customer data, customer needs and customer behavior. Ultimately, this translates to better - in the sense of bespoke - customer advice. In a world that is ever more mobile and personalized, banks not only have to secure customer touchpoints but also learn to use them better in future.

Banks are rightly awarding increasing importance to industrialization and sourcing again as essential strategic topics. So far, the financial services sector has seen relatively little in the way of industrialization. However, the market maturity of settlement services is increasing substantially. The high strategic importance of sustained efficiency improvements requires measures that go beyond tactical cost cuts, encouraging the application of industrialization concepts in the in-house value chain. Such efforts focus on centralizing, standardizing and automating processes.
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