EY Bank Barometer 2018

10 years after the financial crisis - A new wave of optimism?
Editorial

Ten years have passed since the financial crisis hit, shaking the international financial markets to their core and triggering global intervention by regulators and central banks of unprecedented proportions. Central banks have flooded the markets with liquidity, which so far has not led to any tangible inflationary pressure, although it has prompted a marked rise in asset prices for investments and real estate. In the wake of the new regulations, banks have spent recent years scaling back their trading books, shoring up their equity, drafting emergency plans and gradually implementing more stringent guidelines in the areas of liquidity, derivatives trading and investor protection.

Alongside the extraordinary monetary policy environment characterized by negative interest rates and considerably more stringent regulatory provisions, banks also find themselves confronted to some extent with a raft of new challenges such as increasing competition from outside the sector, ground breaking applications resulting from the digital revolution, and ongoing pressure on margins and costs. The financial industry is in a fundamental state of flux.

In spite of the challenges ahead, the banks surveyed as part of our annual Bank Barometer are looking to the near future with confidence. Only a small minority of 18% (previous year: 32%) expect declining operating results for the next six to twelve months. This figure may seem surprising given the numerous challenges, but there are also plenty of good reasons for this optimism.

Many banks have demonstrated a relatively high level of resilience to the challenges they have faced in recent years, which has given them a new sense of self-confidence. The banking industry is also of the opinion that the wave of regulations has peaked and normalization will follow accompanied by an improvement in framework conditions. It would also seem that some of the geopolitical risk factors that were at play just a year ago (change of power in the USA, uncertainty surrounding the outcome of many European elections, Brexit, etc.) have subsided somewhat – at least in terms of their perception. Moreover, it is reasonable to assume that the economic recovery underway in many parts of the world and the money supply injected by central banks have not quite peaked yet.

This points to a positive economic scenario in the short term, which should also allow Swiss banks to benefit. Banks now intend to hone their focus more on innovation and growth. It remains to be seen, however, whether banks have an equally positive outlook for their long-term earnings outlook and whether this wave of optimism will be sustained for all banks and banking groups. What are banks expecting? What will they be focusing on in the near future?

The EY Bank Barometer 2018 goes in search of answers to these questions. We wish you an enjoyable read and look forward to a stimulating dialog.
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1. Study design
## Study design

- Survey by EY in November 2017
- Survey of 100 banks in Switzerland\(^1\)
- 8th edition since 2010

### Bank size by customer assets

<table>
<thead>
<tr>
<th>Type of bank</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>Bank size by customer assets</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private banks(^2)</td>
<td>31 %</td>
<td>27 %</td>
<td>39 %</td>
<td>Under 5 billion francs</td>
<td>52 %</td>
<td>68 %</td>
<td>55 %</td>
</tr>
<tr>
<td>Banks under foreign control</td>
<td>33 %</td>
<td>23 %</td>
<td>20 %</td>
<td>Between 5 and 10 billion francs</td>
<td>14 %</td>
<td>13 %</td>
<td>17 %</td>
</tr>
<tr>
<td>Regional banks</td>
<td>22 %</td>
<td>34 %</td>
<td>29 %</td>
<td>Between 10 and 50 billion francs</td>
<td>22 %</td>
<td>13 %</td>
<td>21 %</td>
</tr>
<tr>
<td>Cantonal banks</td>
<td>14 %</td>
<td>16 %</td>
<td>12 %</td>
<td>Over 50 billion francs</td>
<td>12 %</td>
<td>6 %</td>
<td>7 %</td>
</tr>
</tbody>
</table>

1 The Swiss units of the two big banks were surveyed and their input was included in the general analysis, but not in the evaluations by type of bank
2 Including investment banks
2. Market environment
The financial and economic crisis shook the financial world to its core when it hit in 2007. Central banks worldwide had no other option but to turn on the money faucet and flood the markets with liquidity. The unconventional measures adopted by central banks, including low interest rate policies and quantitative easing, triggered a massive jump in money supply. The exceptionally expansive monetary policy has thus far not led to any tangible inflationary pressures, but has driven asset prices for investments and real estate skyward, as reflected in the all-time highs recorded on stock markets both at home and abroad.

This has confronted the Swiss economy with a whole new series of challenges. Global uncertainties prompted investors to take drastic measures, one of which was to seek refuge in the “safe haven” of the Swiss franc. This upward pressure on its domestic currency forced the SNB to remove the EUR/CHF floor in January 2015 and introduce negative interest rates on sight deposits at the SNB.

This situation pushed not only short-term rates but also yields on long-term bonds issued by the Swiss Confederation into negative territory, marking new ground for the economy as a whole and bringing with it tremendous challenges for the country’s banks. The historically low interest rate environment coupled with the relatively flat yield curve to date has reduced yields from the maturity transformation and squeezed margins in the traditional bank business.

The long persisting environment of abundant liquidity and negative interest rates has placed the fundamental laws of economics (such as interest rates as a pricing mechanism) virtually into deep freeze. This is increasing the danger of misallocations of capital and liquidity, which in turn could lead to dangerous false assumptions and incorrect valuations. The risk of corrections on the capital market should not be underestimated. It has been possible to contain underlying debt problems in the wake of the crisis, but they are still a long way from being solved. In particular, interest rate levels and balance sheet structures are likely to have severely restricted central banks’ room for manoeuvre.
Volume growth - higher risks, lower returns

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<tbody>
<tr>
<td>Total assets</td>
<td>2'125</td>
<td>2'847</td>
<td>2'715</td>
<td>3'026</td>
<td>3'101</td>
<td>976</td>
<td>46%</td>
</tr>
<tr>
<td>Mortgages</td>
<td>513</td>
<td>647</td>
<td>767</td>
<td>943</td>
<td>968</td>
<td>455</td>
<td>89%</td>
</tr>
<tr>
<td>Customer deposits</td>
<td>885</td>
<td>1'211</td>
<td>1'389</td>
<td>1'723</td>
<td>1'771</td>
<td>886</td>
<td>100%</td>
</tr>
<tr>
<td>Securities holdings</td>
<td>3'716</td>
<td>4'412</td>
<td>4'453</td>
<td>5'588</td>
<td>5'654</td>
<td>1'938</td>
<td>52%</td>
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<tbody>
<tr>
<td>Number of banks</td>
<td>375</td>
<td>337</td>
<td>320</td>
<td>266</td>
<td>261</td>
<td>-114</td>
<td>-30%</td>
</tr>
<tr>
<td>Number of branches in</td>
<td>3'809</td>
<td>3'535</td>
<td>3'442</td>
<td>3'167</td>
<td>3'029</td>
<td>-780</td>
<td>-20%</td>
</tr>
<tr>
<td>Switzerland</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Number of employees (FTE)</td>
<td>124'998</td>
<td>119'464</td>
<td>132'013</td>
<td>123'889</td>
<td>120'843</td>
<td>-4'155</td>
<td>-3%</td>
</tr>
<tr>
<td>Business performance</td>
<td>68.7</td>
<td>68.6</td>
<td>61.5</td>
<td>63.7</td>
<td>61.9</td>
<td>-6.8</td>
<td>-10%</td>
</tr>
<tr>
<td>(in CHF bn)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Business performance/FTE</td>
<td>549.4</td>
<td>574.2</td>
<td>465.9</td>
<td>514.0</td>
<td>512.2</td>
<td>-37.2</td>
<td>-7%</td>
</tr>
<tr>
<td>(in CHF 000s)</td>
<td></td>
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Source: www.snb.ch

Banks have significantly increased their business volumes since 2000. The aggregated total assets of all banks in Switzerland have risen by more than 46% during this period. Mortgage lending by banks has grown even more dramatically (89%). Banks have managed to attract assets in the wealth business as well: the securities holdings of bank customers have grown by 52% over the past 16 years.

However, this massive growth in business volumes is not reflected in banks' income statements. Indeed, banks' aggregated business performance has even fallen by 10% during the same period.

This trend can be explained by the erosion of margins in the traditional banking business at Swiss banks, with the low interest rate environment squeezing margins from interest rate differentials. Investment customers have become much more price sensitive in recent years for one reason or another, which has placed considerable pressure on margins in asset management. Last but not least, the implementation of various regulatory provisions has had an adverse impact on banks' in-house cost structures.

In spite of this far-from-pleasing development, banks have managed to keep their headcounts relatively stable. By contrast, the number of banks has fallen by 30%, and the number of branches by 20%. This trend looks set to continue in the years ahead and could likely result in job cuts in the banking industry in the longer term.
Income from banks’ core activities has decreased sharply in recent years. As a result, since 2000 net fee and commission income has fallen by 28%, and net trading income by 51%. Customers have become considerably more price sensitive in these businesses, and margins have likely contracted for the long term.

Net interest income was the only parameter that remained stable during the same period. This was achieved primarily thanks to banks’ substantial ramp-up in mortgage volumes (+89% since 2000). This expansion of the lending business naturally comes hand-in-hand with the inherent default risks – even if recent years have been shaped by exceptionally low credit defaults and banks have improved their equity ratios and thus their capacity to absorb losses.

Expenses rose during the same period by a total of 23%. Initiatives to reduce personnel expenses in the banking sector have had a very limited effect so far. In spite of slightly declining headcount, personnel expenses have increased by 8%. Non-personnel expenses rose by as much as 49% during the period under observation. Heightened regulatory requirements have necessitated a significant ramp-up in control functions in recent years. The various adjustments needed to information systems have also been a major driver of costs.
The investment business is an important source of income for Swiss banks. At first glance, securities deposits at Swiss banks recorded a pleasing performance, reaching a new high with a volume of CHF 5'654 billion last year. However, on a closer analysis, it becomes clear that this has involved a rise in institutional customer assets, which brings with it implications for the profitability of the investment business. While the assets of Swiss private customers have maintained a relatively constant trend, the securities holdings of foreign private customers have fallen dramatically, halving to around CHF 500 billion since 2000 – with a commensurate adverse impact on net fee and commission income.

Recognized customer assets are also at a record level. This is not especially surprising given that many customers are still holding onto very large cash holdings in view of the persisting uncertainty. Fearful of large-scale withdrawals, banks have spared private customers the burden of negative interest rates and are ultimately effectively subsidizing savings and current accounts.
3. Operating business development
Mostly positive results

“How would you assess the current development of your operating business (over the past 6 to 12 months)?”

The majority of Swiss banks continue to assess business development as positive. 82% (previous year: 80%) recorded better operating results in the last six to twelve months, with only 6% witnessing a significant deterioration.

Banks’ self-assessment of operating results has been unswervingly positive in the period under observation since 2010. Indeed, many banks have shown themselves to be extremely resilient in recent years and have navigated the challenging landscape relatively well. This striking continuity is surprising insofar as public perception and reporting in the media paints a much more negative picture. National bank data also reveal a less rosy prognosis.

When assessing banks’ past business figures, it should be noted that the good results are also attributable in particular to expanding volumes in the lending business. The effective margins have fallen consistently in all bank business areas.

The banking industry today is in a state of upheaval and finds itself faced with some fundamental challenges. These include geopolitical uncertainties, historically low interest rates, the implementation of new regulatory requirements, and also the increased segmentation of the value chain caused by advancing digitization. Until now the financial industry has done a surprisingly good job of navigating the difficult market environment. Some banks, especially those active in the lending business, have been able to partly offset declining interest income by stepping up lending volumes.
A new wave of optimism?

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

The vast majority of banks have a positive outlook for the near future. 82% (previous year: 68%) expect operating income to rise in the coming six to twelve months. The signs of a possible countertrend that began to emerge in preceding years have failed to materialize. Only 18% (previous year: 32%) forecast future business performance as negative.

While this trend may be surprising at first glance, there are plenty of good reasons for this optimism. Many banks have demonstrated a relatively high level of resilience to the challenges they have faced in recent years, which has given them a new sense of self-confidence. The banking industry is also of the opinion that the wave of regulations has peaked and normalization will follow accompanied by an improvement in framework conditions.

Finally, it should be noted that some of the geopolitical risk factors that still existed last year (uncertainty surrounding the outcome of European elections, change of power in the USA, etc.) have subsided. It can also be assumed that the economic recovery in important parts of the world and the financial injections by central banks have not yet reached their peak. This will create a positive economic scenario in the short term, which should also allow Swiss banks to benefit.

It remains to be seen whether banks rate their longer-term earnings prospects in quite such a positive light. Numerous factors continue to hamper business, and the structural transformation will create additional challenges for banks. Doubts persist, therefore, as to whether all banks will be able to generate satisfactory, sustainable results in the future.
Retail banks are taking the future in their stride

“How would you assess the current development of your operating business (over the past 6 to 12 months)?”

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

Cantonal and regional banks have a predominantly positive view of how their business performed last year. They have dealt with the repercussions of the negative interest rate environment relatively well and shown themselves to be extremely resilient. Cantonal and regional banks in particular will benefit from the demand for mortgages fuelled by central banks’ expansive monetary policies. The sharp rise in lending volumes has enabled banks to partly offset the erosion of margins in the interest rate business. In addition, bank credit defaults have been at a historical low in recent years, which in turn has had a positive impact on business performance.

Cantonal banks are also very optimistic about the future. This is based on the conviction that in these turbulent times for the banking sector cantonal banks will be able to reap the benefits due to their good reputation, their strong customer loyalty and, last but not least, the existing state guarantees. In uncertain times, security is a sought-after commodity. However, this should also pay off financially for cantonal banks. In the case of regional banks, confidence for the next twelve months is on the wane.
Private banks express optimism

“How would you assess the current development of your operating business (over the past 6 to 12 months)?”

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

The framework conditions for private banks have undergone a major upheaval since the financial crisis. They have had to contend not only with economic challenges, but also a raft of political issues and new regulatory provisions. Clean money strategies, the automatic exchange of information (AEI), the US tax dispute, the publication of retrocessions and investor protection regulations are just a few of the buzzwords that have kept private banks awake at night in recent years. Slowly but surely, it would seem, the (remaining) private banks have got used to the new market conditions and are looking to the future with much greater optimism again. With that in mind, 88% of private banks (previous year: 53%) expect income to grow in the coming twelve months.

Now that some of the major uncertainties of recent years have been eliminated, especially with regard to cross-border asset management and tax transparency, private banks have become ostensibly more confident. The regulations that have been put in place create clarity and legal certainty in many areas, allowing private banks to adapt their business models accordingly. The question of market access for smaller institutions with no major international presence is the only issue that so far has eluded a satisfactory solution.

Asset management remains a business with good prospects for the future: global assets continue to record sizeable growth. Many emerging companies are also increasingly setting up occupational pension systems, and the money saved up in these pension vehicles needs to be managed professionally.

Asset management thus remains in strong demand. Private banks in will be able to benefit from this trend thanks to the political and economic stability of the country, the well-oiled legal system and the continued excellent reputation enjoyed by Switzerland as a financial center.

Banks under foreign control are becoming highly confident again and 85% still expect rising earnings going forward – unchanged from last year.
Relatively stable personnel situation expected in the short term

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

The majority of banks surveyed expect headcount to remain relatively constant. Like last year, only a minority of banks (14%) are planning to reduce their headcount by 5% or more. At the same time, 30% (previous year: 28%) intend to hire new staff.

Only a minority of banks still anticipate making job cuts over the whole period under observation. In reality, headcount has fallen by a total of 12,000 FTEs or 7% in the period of observation since 2010, which translates into a year-on-year reduction of around 1%. There have been no large-scale job cuts so far, in spite of declining margins and cost pressures.

Also, according to the banks surveyed, no such measures are in the pipeline in the months ahead.

It would seem that banks are not expecting the accelerating pace of digitization and the emerging process of structural change to result in any major job cuts for the time being. With outsourcing, the deployment of robots and the automation of business processes assuming a more and more central role, it is doubtful whether headcount will be able to be kept stable in the long term.
The majority of cantonal and regional banks expect headcount to remain stable. Among cantonal banks, the number of institutions forecasting job cuts has increased, with 21% (previous year: 11%) anticipating a reduction in headcount by at least 5%. Cantonal banks have managed to keep their cost/income ratios largely stable in recent years. In order to continue doing so, they are working hard to keep their costs in check.

The employment situation at private banks has recovered. While in the previous year more than one quarter of all private banks expected headcount to decline, today this figure is just 16%. At banks under foreign control, the positive trend that got underway last year is continuing. 32% (previous year: 37%) intend to increase their headcount by up to 10%; 9% (previous year: 0%) are even planning an increase of more than 10%. This assessment is reflected in the renewed optimism that has taken hold now that some of the uncertainties abounding in recent years have subsided.
4. Negative interest rates
Banks are suffering due to negative interest rates

“In January 2015, the SNB introduced negative interest rates and is expected to keep rates low for some time. How would you describe the situation for your organization?”

Like last year, 86% of the banks surveyed anticipate negative repercussions for their institution resulting from the SNB’s interest rate policy. This negative assessment among cantonal and regional banks of how the low interest rate policy is affecting their business has sharpened versus last year: 94% of cantonal banks (previous year: 88%) and 95% of regional banks (previous year: 85%) are suffering at the hands of the SNB’s current interest rate policy.

The heightened negative perception of negative interest rates is attributable in particular to the fact that cantonal and regional banks have been able to offset the adverse effects of the policy to a limited degree by making use of unused allowances. Moreover, the fall in yields on the assets side was cancelled out by an even higher reduction in deposit rates. Now that deposit rates have reached zero, a further reduction is no longer possible in practice. Negative interest rates are thus squeezing margins in the lending business and creating a profitability bottleneck in the long run. In addition, the investment crisis caused by the low interest rate environment is pushing more and more institutional investors and non-banks into the lending business, eroding banks’ margins even further.
For the first time, the majority of banks are no longer categorically ruling out passing on negative interest rates. 57% percent of Swiss banks (previous year: 35%) can now envision introducing negative interest rates in the private customer business under certain circumstances. Only 43% of the banks surveyed (previous year: 65%) still do not deem this a potential course of action.

This highlights the significantly differing tendencies between asset managers and retail banks. While the majority of retail banks still reject the possibility of introducing negative interest rates in the private customer business, the willingness among private banks and banks under foreign control has increased dramatically. Only 20% of private banks (previous year: 73%) and 43% of banks under foreign control (previous year: 78%) are fully ruling out such a move.

However, retail customers do not need to worry about having negative interest rates applied to their assets for the time being. Only 16% of banks (previous year: 6%) can envision introducing such a measure for customers with assets of CHF 100,000 or more, compared with 24% of banks (previous year: 13%) for customers with assets exceeding CHF one million. In the case of customers with less assets, banks’ willingness to pass on negative interest would likely be much lower. Cantonal and regional banks are even rejecting such a move outright. This categoric rejection is explained by the fact that retail banks’ customer bases could react very sensitively to negative interest rates if they were introduced. Thus, the additional costs generated by the negative interest rates are mainly being borne by the banks themselves.
Continued sharp decline in deposits feared

“Assuming Swiss banks were to introduce negative interest rates in the private customer business, would you expect a strong (> 10%) decrease in deposits (run on the bank)?”

Banks assess the risk of a run on the bank the same as they did a year ago: 40% expect a decrease of at least 10% of customer deposits if Swiss banks were to introduce negative interest rates in the private customer business. The fear that customers will withdraw their assets is still especially pronounced among regional banks: almost one half of the regional banks surveyed (45%) anticipate a massive outflow of customer assets upon the introduction of negative interest rates. Cantonal banks have a less pessimistic outlook, with only 28% (previous year: 39%) fearful that introducing negative interest rates would lead to a significant withdrawal of customer assets.

Retail banks would be especially hard hit by a massive drop-off in customer deposits, possibly leading to refinancing difficulties, since longer-term fixed-rate mortgages are currently refinanced to a large extent by shorter-term customer deposits. There is no question of passing on negative interest rates to retail customers for the time being.
Only 3% of the banks surveyed have not experienced any serious consequences due to the persistently low interest rate environment. Although banks have dealt with the negative interest rates surprisingly well so far, the main danger posed by the low interest rate policy for the majority of banks is the erosion of margins in the interest rate business. At the outset, banks were still in a position to compensate for the fall in yields on the assets side by reducing deposit rates. Since deposit rates are now virtually at zero, there is practically no more leeway for compensation.

In spite of the undeniably negative repercussions of the low interest rate policy on the banking business, the majority of banks are convinced that the low interest rate environment has so far not led to an increased risk appetite in the lending business. This assessment is due not only to the stricter regulatory requirements with regard to pledging and portability, but also to the extremely low impairments and losses in Swiss bank’s lending businesses in recent years. Banks have additionally improved their equity position and thus their capacity to absorb losses.

This development has long been on the radar of regulators such as FINMA and the SNB given that lending on the part of banks – especially mortgage lending – has almost doubled since 2000. The prices for residential property have also skyrocketed, fuelled by central banks’ expansive monetary policies. The inherent risks in this business area have likely not decreased as a result at least.
No end to interest rate policy expected for the time being

“When do you expect the SNB to increase interest rates into positive territory?”

The vast majority of banks (74%) expect the national bank to end its expansive monetary policy in the medium term (that is, in one to three years), and that interest rates will reverse as a result. However, practically no-one (4%) is ruling out a short-notice rate reversal by the central bank within the next few months.

Although interest rates have risen slightly again in the past twelve months (see the SNB statistics on interest rate trends on p. 8 for more information), SNB has so far not changed direction in its monetary policy; by contrast, it has further increased money supply. The most recent appreciation of the euro against the Swiss franc has been unable to change this situation, at least for the time being.

Building on the now well-advanced economic recovery in the USA, the improved economic data coming out of Europe, and the gradual rise in inflation rates, a normalization of monetary policy is perfectly conceivable in the medium term. It cannot be predicted with any degree of certainty how well banks will be able to digest the repercussions of an interest rate reversal. What is clear, is that an abrupt and sharp interest rate rise would seriously dent banks’ net interest income. It would also entail the risk of significant corrections on the financial and real estate markets, which could have far-reaching repercussions on banks’ bottom lines. Nevertheless, over time, a gradual increase in interest rates would have a positive impact on banks’ balance sheets.
5. Automatic exchange of information (AEI)
Considerable efforts were made around the world in the wake of the financial crisis – primarily through the implementation of a plethora of new regulations – to bring untaxed foreign customer assets to the attention of the respective national tax authorities and to limit intergovernmental tax competition. The legal basis for exchanging customer data entered into force in Switzerland on 1 January 2017. Data between Switzerland and other countries will be exchanged for the first time beginning 2018, making the automatic exchange of information (AEI) a reality.

Within this context, Swiss banks anticipated seeing (in some cases significant) outflows of foreign assets – with commensurate negative financial consequences for the institutions concerned. As before, only a minority of 11% say they saw significant outflows of assets exceeding 10%. Nevertheless, the share of banks which had to contend with losses of assets of 2% or more in the last twelve months increased sharply from 29% to 42%. Only 58% (previous year: 71%) did not see any (that is, less than 2%) outflows of foreign customer assets.

While the AEI triggered outflows of assets, these were able to be partly offset by inflows of net new money, also and in particular from foreign institutional customers. A glance at the recent performance of securities holdings shows that Swiss banks have even managed to increase security holdings year over year for several years. The positive performance of the global equity markets has played a contributing role in this. The security holdings of foreign customers, by contrast, have practically halved since 2000. This is an especially hard pill to swallow, since Swiss banks have generated high earnings with precisely this customer group in the past.
Uncertainty about AEI for Swiss customers

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

For the third year in succession, there is uncertainty among the banks surveyed as to whether AEI will be extended to Swiss customers. While the percentage of banks with a clear opinion (Yes or No) has decreased, the general agreement rate (Yes or Probably) has risen slightly. The majority of banks (58%) currently assume that, sooner or later, bank-customer confidentiality will be discontinued also for domestic customers, and that AEI will be applied to domestic bank customers (previous year: 51 percent). Banks under foreign control (+15 percentage points) and regional banks (+15 percentage points), in particular, deem it more likely than last year that the automatic exchange of information will be applied within Switzerland.

Regardless of banks’ assessment of the situation, the most recent political signals currently do not point toward a rapid erosion of bank-customer confidentiality in Switzerland. The planned revision of criminal tax law has been met with broad-based political resistance. Parliament and the Federal Council have decided not to tighten domestic criminal tax law. This makes it unlikely that bank-client confidentiality will come to an end in Switzerland anytime soon.
6. Financial market regulation
A great deal has been done in the wake of the financial crisis both globally and at home in Switzerland to correct weaknesses in the financial system. Banks have scaled back their trading books in response to new regulations, shored up their equity and gradually implemented more stringent liquidity and derivatives trading guidelines. They have also improved their resolvability, i.e. their ability to isolate risks through emergency planning. These are just a few of the areas where regulators exerted a direct influence in order to create more stability in the financial system. In the opinion of Swiss banks, the regulatory agenda has had its desired effect: 87% of banks are of the conviction that the financial market is more stable today than it was before the financial crisis.

The key question that remains is whether the financial system in its current form is also stable enough to withstand future, as yet unknown challenges. As the central banks have largely run out of ammunition to mount an appropriate response to future crises, given the exceptional measures they have implemented and massive financial liquidity they have injected, it is to be hoped that the action taken will prove effective in any extreme situations that may lie ahead.
Banks recognize that a lot of the regulations introduced in recent years have made the financial system more stable overall. However, there are also specific areas where the banking industry feels that regulators have been over-zealous.

Banks recognize a tendency to overregulate with regard to the topics of investor protection (71%), liquidity guidelines (62%) and funds regulation (62%). The banks’ scepticism in connection with the topics of investor protection and fund regulation is attributable to the fact that many banks see the rules as a pure exercise in documentation that will not necessarily lead to increased standardization nor will make any tangible contribution to enhancing customer/investor protection. In the opinion of banks, especially small and mid-sized banks, regulators went too far with their liquidity regulations. The related provisions are often much too technical and complicated – not least in view of their relatively straightforward benefit since many banks are waist-deep in liquidity at the moment.

However, when it comes to capital adequacy requirements, which were the focus of international and national regulations following the financial crisis, there is relatively high consensus. Only 43% of banks are of the opinion that the regulators have gone too far in this respect. This is hardly surprising since the lion’s share of small and mid-sized banks meet the new capital adequacy requirements relatively well. Larger international banks are more sceptical about the implications and think that the capital adequacy requirements go too far. These banks are in global competition and have to bear the additional burden of the more strict “Swiss finish”.

In December 2017, the Basel Committee on Banking Supervision announced the final revisions to the Basel III framework, which entails a further tightening of capital adequacy guidelines, especially for large banks with their internal risk models. It remains to be seen how pragmatic or complicated it will be to implement these rules in national supervisory law.

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### Balanced assessment of financial market regulation

“In which of the following areas has Swiss regulation potentially gone too deep and resulted in negative impacts?”

<table>
<thead>
<tr>
<th>Area</th>
<th>Yes</th>
<th>Probably</th>
<th>Probably not</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market conduct</td>
<td>2%</td>
<td>31%</td>
<td>53%</td>
<td>14%</td>
</tr>
<tr>
<td>Derivatives trading</td>
<td>16%</td>
<td>31%</td>
<td>42%</td>
<td>9%</td>
</tr>
<tr>
<td>Cybercrime</td>
<td>2%</td>
<td>20%</td>
<td>51%</td>
<td>27%</td>
</tr>
<tr>
<td>Funds regulation</td>
<td>20%</td>
<td>42%</td>
<td>32%</td>
<td>6%</td>
</tr>
<tr>
<td>KYC</td>
<td>14%</td>
<td>27%</td>
<td>46%</td>
<td>13%</td>
</tr>
<tr>
<td>Tax transparency</td>
<td>15%</td>
<td>32%</td>
<td>40%</td>
<td>13%</td>
</tr>
<tr>
<td>Investor protection</td>
<td>34%</td>
<td>37%</td>
<td>26%</td>
<td>3%</td>
</tr>
<tr>
<td>Liquidity</td>
<td>35%</td>
<td>44%</td>
<td>26%</td>
<td>12%</td>
</tr>
<tr>
<td>Capital</td>
<td>8%</td>
<td>38%</td>
<td>38%</td>
<td>19%</td>
</tr>
</tbody>
</table>

---

Yes
Probably
Probably not
No
Alongside new provisions pertaining to capital and liquidity, new requirements have been enacted worldwide in relation to data protection. The focus in Europe in this area is on the MiFID directive. The Financial Services Act (FinSA) is the Swiss version of the MiFID directive. FinSA is on the finishing straight and is scheduled to come into force in the second half of 2019. FinSA will change the rules of play for providing financial services and offering financial instruments. The overriding goal of the proposed legislation is to strengthen customer protection vis-à-vis financial institutions. A central consideration when drafting FinSA was to create equivalent provisions to the EU law. Fulfilling equivalence requirements is a key prerequisite for market access in European countries.

However, Swiss banks have a somewhat negative perception of the new rules. They fear that FinSA will lead to a more restricted product range (72%) and to higher costs (75%) for end-customers, without any commensurate increase in the quality of investment advice, since only 45% of all banks (previous year: 64%) think quality has improved. Against this backdrop, banks are becoming increasingly worried whether the new rules will achieve the intended objective of the proposed regulation – to strengthen investor protection. Their approval rating has fallen from 58% last year to 49% as a result.

FinSA: negative repercussions outweigh positive effects

“Soon the Financial Services Act will be enforced. Considering the latest draft, which of the following impacts do you expect on your business due to the new regulation?”

<table>
<thead>
<tr>
<th>Impact</th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved consumer protection</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>8%</td>
<td>27%</td>
</tr>
<tr>
<td>2016</td>
<td>41%</td>
<td>31%</td>
</tr>
<tr>
<td>Better quality of investment advice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>13%</td>
<td>25%</td>
</tr>
<tr>
<td>2016</td>
<td>32%</td>
<td>39%</td>
</tr>
<tr>
<td>Outsourcing to specialists</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>10%</td>
<td>14%</td>
</tr>
<tr>
<td>2016</td>
<td>34%</td>
<td>26%</td>
</tr>
<tr>
<td>Improved documentation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>22%</td>
<td>50%</td>
</tr>
<tr>
<td>2016</td>
<td>57%</td>
<td>32%</td>
</tr>
<tr>
<td>Restriction in product range</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>23%</td>
<td>18%</td>
</tr>
<tr>
<td>2016</td>
<td>34%</td>
<td>34%</td>
</tr>
<tr>
<td>Cost increase of banking services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>24%</td>
<td>31%</td>
</tr>
<tr>
<td>2016</td>
<td>51%</td>
<td>47%</td>
</tr>
</tbody>
</table>

- Yes
- Probably
- Probably not
- No

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No doors opened by Brexit

“Do you expect Brexit and the associated negotiations between the EU and the UK to improve Swiss banks’ opportunities for market access to the EU as a financial market in the long term?”

Access to the EU market is critical for the success of the Swiss financial centre. In the wake of the Brexit vote by the British electorate and the accompanying redefinition of relationships between the London financial centre and other European countries, the question begs itself as to whether this situation will also create opportunities for Switzerland in terms of facilitated market access.

Banks remain sceptical about this. Unchanged from last year, the vast majority (68%) of banks do not expect the negotiations between the EU and the UK to unlock new opportunities for Swiss banks. For private banks in particular, market access is of fundamental importance. However, they are very sceptical, with just 10% (previous year: 16%) expecting Brexit to facilitate market access for Swiss banks.

Nevertheless, creating the conditions for market access remains a key political task. It is ostensibly unclear for many banks how political actors will approach this task.
7. Lending business
Only 25% of banks are still pursuing a restrictive lending policy

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

The lending business remains attractive for Swiss banks in the current low interest rate environment and is even considered to be slightly more attractive than in previous years, since the proportion of banks which are pursuing a more restrictive lending policy has now fallen for the fourth time in succession. Only 25% of the banks surveyed say they will be pursuing a restrictive lending policy in the coming months. Four years ago, this figure was almost 60%.

The vast majority intend to stick with the credit policy they have been following in recent years. The increasingly optimistic outlook should have an especially positive impact on financing for SMEs, say banks. Only 17% of the institutions surveyed anticipate restricting lending in this segment. Now that SMEs in Switzerland have got to grips with the challenges arising from the Swiss franc shock, it would seem that banks want to devote more attention to this segment once more. In the case of residential property financing, by contrast, banks want to take the foot off the gas – something that is likely due to the massive increase in the mortgage volumes of Swiss banks in recent years.
Banks assess the risks arising from the lending business to be even lower than last year. Only 20% (previous year: 30%) think that impairment losses and provisions will increase in the next twelve months. When assessing the risks in connection with SME financing, in particular, banks are much more optimistic than last year.

Indeed, the last few years have been shaped by a phase of exceptionally low credit defaults. In spite of the significant increase in lending, banks have so far not had to contend with any major losses and have even been able to improve their equity situation and thus their capacity to absorb losses. Banks also do not forecast any perceptible credit defaults for the coming months. As long as interest rates remain exceptionally low, real estate and equity prices will remain high and borrowers will be able to pay the currently historically low financing costs without any real problems.

It is unlikely that this scenario will last forever. With that in mind, this trend has long been on the radar of regulators (FINMA and SNB) in view of the fact that bank lending - especially mortgage loans - has almost doubled since 2000. The prices for residential property have also skyrocketed, fuelled by central banks’ expansive monetary policies. The inherent risks in this business area have likely not decreased as a result.

Practically no credit defaults so far...

“In comparison to the prior year, what level of risk provisioning (impairment losses and provisions) do you expect you will need to cover your lending business in the next 6 to 12 months”
The dearth of investments and negative interest rates are forcing many investors onto the investment property market. This has caused banks to become more and more cautious in recent months, with 71% of banks of the opinion that the current housing boom and the price increase for investment properties pose a considerable risk for the Swiss real estate market. With an agreement rate of “just” 62%, cantonal banks are slightly more optimistic than the other banking groups.

In actual fact, prices for investment properties have skyrocketed in many regions in recent years and months, and the income generated by these has fallen dramatically. It is therefore hardly surprising that banks have become considerably more selective in the choice of properties they finance.

It should be noted that, generally speaking, the greatest risks for banks focused on the Swiss market remain the mortgage and real estate market. Should real estate prices take a sudden dive, this could have a knock-on effect on banks. This applies equally to institutional investors and private investors which acquire or finance investment properties.

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**... in spite of rising risks on the real estate market**

“Would you agree with the following statement: The current housing boom and the price increase for investment properties is a considerable risk for the Swiss real estate market?”

![Bar chart showing agreement rates of different banking groups.]

- **2017**
  - Private banks: 7% No, 67% Probably not, 26% Probably yes
  - Banks under foreign control: 7% No, 57% Probably not, 33% Probably yes, 3% Yes
  - Regional banks: 29% No, 57% Probably not, 14% Probably yes
  - Cantonal banks: 31% No, 31% Probably not, 38% Probably yes

---

No

Probably not

 Probably yes

Yes
8. Structural change and FinTech
The vast majority of banks (73%) are of the opinion that the Swiss financial industry is in the grips of a fundamental structural change. Scepticism surrounding this question has surprisingly increased compared with the previous year: More than one quarter of all banks have doubts about the structural change - a marked rise over the previous year (13%). Emerging doubts are especially pronounced among cantonal banks, half of which (previous year: 17%) deny that a fundamental structural change is underway. This trend is also noticeable among banks under foreign control, with 24% saying there is no evidence of a structural change, compared with 4% a year ago.

This view is surprising given the wide range of new challenges confronting banks in the present environment: digitization is forcing banks to fundamentally rethink their business models, competitors from outside the sector are encroaching more and more on banks’ traditional turf, and new technologies are revolutionizing established internal processes. Banks’ differing perceptions of the situation clearly indicate the uncertainty regarding the topic of structural change. This is difficult to grasp, and the implications for existing business models still difficult to quantify. Banks are cognizant of the fundamental changes, but have trouble identifying the concrete implications for them.
Payments most severely affected by structural change

“Which of the following business areas is most affected by structural change in your opinion?”

Last year banks named a wide range of businesses when asked which would be the most severely affected by the structural change. This year banks evidently have a clearer opinion on this issue: more than one half of banks (55%) think that payments is the area most severely affected. This is followed, at quite some distance, by the areas of investment advice (20%) and asset management (13%), which were topics of much greater concern last year.

Indeed, the payments industry has undergone some rapid changes in recent months: on the heels of Twint, Apple Pay and Samsung Pay, several mobile payment systems are poised for launch. Innovative ideas have multiplied in this business area and are increasingly being translated into real applications in Switzerland. The structural transformation is becoming particularly tangible and visible in this area. It should therefore not come as a big surprise that it is this area where banks are feeling the greatest consequences from the structural change. While roboadvisors are considered to have a lot of potential, their importance in practice is currently still rather low.

Given the dramatically changed assessment on the part of banks versus last year, it would seem that, when answering this question, they are taking a short-term view rather than looking at long-term trends. While at the moment the changes underway in the field of payments would appear to be the most pressing, it is to be assumed that, in the long run, other areas will increasingly be implicated in this structural change.
Quo vadis, payments?

“In your opinion, will Swiss banks be able to derive profits from payment settlements in the future?”

70% of all banks are of the current opinion that Swiss banks will no longer be able to operate payments at a profit in the long run. Only among cantonal banks, half of the surveyed institutions believe that payments are still a sustainable profitable business. This fact is surprising given that payments used to be a core service and in the past formed the backbone of the close customer relationship.

The proliferation of payment apps such as Twint, Apple Pay or Samsung Pay is confronting banks with a new reality. The majority of banks no longer see payments as a lucrative business area going forward. The question this gives rise to is whether going forward banks will want to continue offering payment services in light of the negative result or will give up this arm of their business completely.

This question has many different layers, because even though the pure service of executing payments has become less lucrative for banks, there are many reasons that speak in favour of keeping it around: payments serves as an interface to customers, provides banks will valuable customer information and thus is an important link in the chain for a wide range of lucrative business transactions. It therefore plays a key role in the banking business. Thanks to payments, banks have an important source of income in the deposit business at their disposal in the form of the transaction accounts on offer. It will be interesting to see what implications will arise for banks’ deposit business if payment services are discontinued. If payments were eliminated, this would also cancel out income from foreign currency transactions, which today still constitute an attractive source of income for banks.
Banks recognize the extent of digitization

“The term “digitization” is currently a popular buzzword. What is, in your view, the significance and potential value-adding proposition of digitization in the financial services industry?”

The technological development in the financial industry is advancing at breakneck speed and will bring with it far-reaching consequences for the offerings and services of financial service providers. While this realization is nothing new, last year it became much more acute.

One half of all banks (previous year: 26%) now expect technological development to have a fundamental impact on strategies, business models and business processes. 43% of the banks surveyed (previous year: 64%) are still of the opinion that their business will remain fundamentally the same and digitization will simply represent a new sales channel. The share of banks which think digitization is just a hype is still quite minuscule (5%). There is a certain contradiction among banks in terms of their assessment as to whether the financial industry is in the grips of a fundamental structural change. When it comes to this question, the consensus that a long-term structural change is underway has declined versus the previous year.

This shift of opinion is most pronounced among private banks and banks under foreign control. 50% of private banks (previous year: 24%) and 64% of banks under foreign control (previous year: 26%) expect digitization to have fundamental ramifications on the financial industry.

Digitization is the strongest driver of long-term structural change. The responses reveal that digitization is no longer just a trend, but a materializing reality. Bank responses show that they are gradually realizing the full potential of digitization and they are reacting to this by setting up digital think tanks, so-called innovation hubs where new solutions are tested and developed.

Digitization will fundamentally revolutionize the financial services industry
Digitization will add an important sales and distribution channel
Digitization is overrated and will recede again
67% of the banks surveyed are convinced that their current IT infrastructure is well equipped to deal with future challenges. This conviction is evident among all banking groups.

The results largely reflect the situation that in recent years a lot of banks – especially private, cantonal and regional banks – have updated their core bank applications and the associated peripheral systems. This has given them added flexibility, which also improves their room for manoeuvre in the face of new challenges.

However, this is only the beginning of the wave of digitization. New customer requirements coupled with persistent cost pressures are currently prompting numerous digitization initiatives, especially in the front office. To ensure that the associated changes can be implemented in these business processes as efficiently and cost-effectively as possible, this will require stronger automation of business processes in the back office area.

The rapid pace of technological progress looks set to increase the number of systems and the diversity this brings with it. This will further exacerbate the complexity in the IT landscape and architecture and likely require additional investment. To counteract this trend, alternatives to operating proprietary IT infrastructures such as outsourcing and cloud services are gaining in importance. Finally, challenges and pressure on IT will persist, and what appears to be fit for the future today will have to be reassessed in the new light of tomorrow’s challenges.

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**Are banks’ IT operations “fit” for the future?**

“Would you say that your current IT architecture is “fit for purpose” to face current and future challenges?”

<table>
<thead>
<tr>
<th></th>
<th>Private banks</th>
<th>Banks under foreign control</th>
<th>Regional banks</th>
<th>Cantonal banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>16%</td>
<td>6%</td>
<td>18%</td>
<td>21%</td>
</tr>
<tr>
<td>Probably</td>
<td>44%</td>
<td>62%</td>
<td>59%</td>
<td>51%</td>
</tr>
<tr>
<td>Probably not</td>
<td>31%</td>
<td>24%</td>
<td>18%</td>
<td>21%</td>
</tr>
<tr>
<td>No</td>
<td>9%</td>
<td>8%</td>
<td>5%</td>
<td>7%</td>
</tr>
</tbody>
</table>

---

**2017**

- Private banks: 8% Yes, 44% Probably, 31% Probably not, 9% No
- Banks under foreign control: 14% Yes, 62% Probably, 24% Probably not, 8% No
- Regional banks: 21% Yes, 59% Probably, 18% Probably not, 5% No
- Cantonal banks: 16% Yes, 44% Probably, 31% Probably not, 9% No

---

25% | 25% | 53% | 14% | 8%
There is uncertainty among banks about which FinTech phenomena pose the greatest threat to established financial institutions. The greatest threat potential is currently ascribed to blockchain technology (28%). This is followed, at some distance, by mobile payment systems (22%), new marketplaces (19%) and roboadvisors (16%), all with roughly equivalent values. 10% of all banks surveyed do not perceive any danger the phenomena mentioned.

Even if blockchain has not yet achieved its breakthrough, this technology has been ascribed a great deal of potential and many FinTech companies and banks alike are examining it in greater detail. The technology underlying blockchain brings with it a lot of desirable attributes such as data integrity and accountability, which in turn pave the way for new business models which can operate without financial intermediaries such as stock markets and, in some cases, even banks.

The varying assessments by banks show that established financial institutions still have no clear understanding of the central FinTech phenomena, and these are quite difficult to grasp. While 35% of regional banks perceive an elevated danger in the new marketplaces (for loans), only 14% of cantonal banks do. This differing perception is surprising for two banking groups which otherwise demonstrate so many similarities.

The FinTech scene and its underlying technologies are very dynamic and it is difficult to foresee what concrete implications the individual phenomena will have on banks’ value chains. Banks are reacting to these uncertainties in different ways: while originally they were on a confrontation course with FinTech companies, today banks are courting closer cooperation.

**Blockchain as a game changer?**

“Our which of the following evolving technologies / businesses represent a potential threat for well-established financial institutions?”

- Marketplaces (especially for lending)/peer to peer lending
- Cryptocurrencies
- Roboadvisors
- Blockchain
- Web-based/mobile payments
- None

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Robots are welcome, but not on the front line

“Do you plan on the implementation of robots in your business? If yes, in which main areas?”

The majority of the banks surveyed also anticipate using robots or virtual assistants in the future. A total of 75% of banks are open to the idea of using robots in the future. The potential for robots is considered to be especially high in the areas of analysis and decision-making (e.g. investment recommendations, credit decisions) and in the middle/back office. From today’s perspective, it appears doubtful that the area of application of robots will extend to encompass client advisory and compliance activities.

There is fundamental consensus that automation is a real possibility, particularly in areas where the activities involved tend to be more repetitive or heavily standardized and have a low degree of complexity. Banks do not think that this extends to personal one-on-one customer advisory. This opinion applies in particular to customer advisory for high-net-worth customers, since the value attached to personalized advice increases as the volume of assets rises. Time will tell to what extent this applies to a mass business such as retail banking as well.
9. Priorities for 2018
The last ten years have been shaped by growing regulatory pressure. Regulators have done a great deal to rectify the weaknesses in the financial system. New regulations on equity and liquidity ratios, on consumer protection or on derivatives trading have been established. In recent years, these have now been phased in – or are poised for introduction. Implementing the new and broad-based regulations has required a great deal of resources and banks have had to significantly expand their risk management functions and compliance departments. The issues of risk and regulation clearly took centre stage in the years following the financial crisis.

For some time now, the general priorities have been shifting. In recent years, banks have been increasingly preoccupied with rising costs and have launched various efficiency programs. This trend is continuing.

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For the near future, banks want to focus increasingly on the topics of growth and innovation. Some banks are quite upbeat as they look to the opportunities these changing technologies offer. There is a wave of optimism in the sector.

This shift in mood has extended to almost all banking groups. Regional banks remain somewhat the exception in this regard – their primary focus continues to be cost management (41%).

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Cyber security is the overriding issue

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

<table>
<thead>
<tr>
<th>Topic</th>
<th>Ranking 2017</th>
<th>Ranking 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cyber Security</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Process optimization and industrialization</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Investment in advisory enhancements and sales channels</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Cost reduction</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Investment in digitization</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Culture/Conduct/Reputation/Risk Conduct</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Establishment of partnerships with non-banks</td>
<td>7</td>
<td>15</td>
</tr>
<tr>
<td>Risk management: interest rate risk</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Implementation of consumer protection</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Outsourcing and offshoring</td>
<td>10</td>
<td>17</td>
</tr>
<tr>
<td>Development of (new) investment products</td>
<td>11</td>
<td>9</td>
</tr>
<tr>
<td>Acquisitions</td>
<td>12</td>
<td>11</td>
</tr>
<tr>
<td>Risk management - credit risk</td>
<td>13</td>
<td>5</td>
</tr>
<tr>
<td>Risk management - operational risk</td>
<td>14</td>
<td>10</td>
</tr>
<tr>
<td>Risk management - litigation risk</td>
<td>15</td>
<td>12</td>
</tr>
<tr>
<td>Solvency (equity, liquidity, leverage ratio)</td>
<td>16</td>
<td>14</td>
</tr>
<tr>
<td>Build-up of new business segments</td>
<td>17</td>
<td>16</td>
</tr>
<tr>
<td>Tapping new markets, internationalization</td>
<td>18</td>
<td>18</td>
</tr>
</tbody>
</table>

When asked about their general direction, after years focused on risk and regulation banks now want to shift their strategic focus more firmly to the topics of innovation and growth. When it comes to naming specific topics, however, this re-positioning is not yet as clear as it could be. Topics in relation to risk and regulation, on the one hand, and costs and efficiency, on the other, were again cited. This is likely a realistic assessment of the current situation.

In the areas of innovation and growth, especially compared to last year, banks are increasingly focusing on investments in new sales channels and in digitization, as well as on partnerships with non-banks.

The topics of costs and efficiency are also very high up on banks’ agendas. Banks need to reduce their costs on a sustainable basis in order to keep sharply falling margins under control. Industrialization is still not as advanced as many banks had hoped it would be.

The significance of risk and regulation topics, especially with regard to the management of primary risks, has decreased overall. The topic of cyber security is an exception to this trend, which this year was selected as the top priority more frequently than any other by the vast majority of banks.

Many of the cyber attacks that have happened in recent months on private email accounts of well-known politicians, secret services, companies, central banks and the SWIFT payment network have highlighted in no uncertain terms the massive threat posed by cyber risks. Banks have not been spared in this process. Quite the contrary: mobile banking has created numerous new gateways for hackers which harbour new risks for banks’ IT security. Since the losses arising from cyber-attacks can quickly run into the millions and entail serious consequences for a bank’s reputation, it is hardly surprising that the topic of IT security is currently the highest priority.

Our Global Banking Outlook 2018 revealed similar results. Innovation is also a burning topic among the global banks surveyed, while the regulatory agenda has faded somewhat into the background. Cyber security is also the most frequently cited priority for 2018 among the banks included in the global survey. Moreover, global banks want to focus on the digital transformation of their business processes and business models in the months ahead. This would also seem necessary, since around 80% of the banks surveyed say that they are still not yet very far advanced in the digitization of their business.
10. Outlook - Banking in 7 to 10 years
Is the wave of regulation nearing an end?

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”

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

The regulatory authorities, both internationally and at home, did a great deal in the wake of the financial crisis to rectify existing weaknesses in the financial system. This action was long overdue against the backdrop of the dramatic events that occurred following the outbreak of the financial crisis, and the unprecedented dimensions it took, leading to massive job cuts and numerous government bail-outs. The last ten years were shaped by a wide range of different regulatory projects in the areas of capital and liquidity requirements, derivatives trading and investor protection. Today the rules of play are very different, and generally place significantly stricter and more complex requirements on banking institutions.

In recent years, banks scaled back their trading books, improved their resolvability (their ability to isolate risks through emergency planning), shored up their capital and gradually implemented more stringent liquidity and derivatives trading guidelines. Banks are convinced that the financial system is more stable today than it was before the financial crisis. Moreover, many banks have demonstrated a relatively high level of resilience to the challenges they have faced in recent years, which has given them a new sense of self-confidence. The banking industry is also of the opinion that the wave of regulations has peaked and normalization will follow accompanied by an improvement in framework conditions. 37% anticipate that the industry will be subjected to the same level of regulation in the coming 7 to 10 years (previous year: 11 percent).

![Survey Results Graph]

**Entirely agree**
**Partly agree**
**Partly disagree**
**Entirely disagree**
Regulation: cantonal banks expect the trend to reverse

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
In the future, the Swiss banking sector will be substantially more regulated.

The trend is evident across all banking groups that regulation in the financial industry will likely decrease going forward.

This trend reversal is most keenly anticipated by cantonal and private banks. 46% (previous year: 12%) of cantonal banks or 44% (previous year: 12%) of private banks agree with this assumption that regulation will not become any more stringent. These are the highest values since we started conducting our surveys.
Banks seem to be a lot more relaxed than in previous years when it comes to forecasting their yield prospects. One quarter of all banks (26%) disagree that shareholders will have to adapt to falling yields in the years ahead. This is a sharp rise on the previous year, when only 8% shared this view. While this trend may be surprising at first glance, there are also plenty of good reasons for this optimism. Many banks have demonstrated a relatively high level of resilience to the challenges they have faced in recent years, which has given them a new sense of self-confidence. The banking industry is also of the opinion that the wave of regulations has peaked and normalization will follow accompanied by an improvement in framework conditions.

It would also seem that some of the geopolitical risk factors that existed just a year ago (uncertainty regarding the outcome of the European elections, change of power in the USA, etc.) have subsided - at least in terms of their perception. Moreover, it is reasonable to assume that the economic recovery underway in many parts of the world and the money supply injected by central banks have not quite run their course. This represents a positive economic scenario in the short term - one that could also benefit banks.

“Higher yields in the forecast again?“

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”

In the future, banks’ shareholders will have to accept lower returns.
Optimism is on the rise among all banking groups

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
In the future, banks’ shareholders will have to accept lower returns.

Higher yield expectations are evident among all banking groups. Private banks and banks under foreign control have seen the strongest rise: 34% of private banks (previous year: 3%) and 24% of banks under foreign control (previous year: 0%) do not anticipate that yields will fall any further, based on current assumptions. Optimism is also on the rise among cantonal banks: 31% (previous year: 17%) no longer forecast that yields will continue to contract going forward.

Hope is burgeoning among regional banks as well: only 14% of those surveyed (previous year: 51%) agree unreservedly with the hypothesis that lower returns are to expected in the future.
Consolidation not yet complete

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
In the future, there will be substantially fewer banking institutions in Switzerland.

Even though around 114 banks - that is, approximately 30% of all banks - in Switzerland had already disappeared during the period from 2000 to 2016, followed by a further three banks in 2017, banks still expect the number of institutions to see a further decline. 89% of the banks surveyed (previous year: 90%) forecast that there will be significantly fewer banking institutions in the next seven to ten years.

The consolidation process in the Swiss financial industry will continue, banks say. Even the burgeoning optimism among banks will not be able to stem this trend for the time being. Past experience has shown that smaller institutions in particular suffer under the weight of new regulatory requirements.
No topic in this year’s survey generated greater consensus among banks than the question surrounding the future of the branch network. 96% of banks – a new high – expect a continued streamlining of the branch network going forward.

The structural transformation is having a major impact on branches, with more and more customers favouring digital channels such as e-banking or mobile banking apps. Traditional over-the-counter transactions have lost much of their significance, meaning customers only have to visit their bank branch very occasionally. This is making them superfluous, and as a result they are being closed for cost reasons. Just how far this development can go, is demonstrated by the market success of Europe’s largest direct bank, ING-DiBa, which operates in full without a branch network and has already commanded significant market share in the private customer business in Germany. To make sure that this branch streamlining process does not weaken the customer interface, it will be important to expand digital sales channels further while at the same time enhancing the customer experience in those branches that are left.
Banks have competition from outside the sector on their heels

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
Competitors outside the sector will threaten the market position of banks.

Banks are increasingly starting to realize that competitors from outside the sector are threatening their market position and thus putting more and more pressure on banks’ traditional business models. The share of banks which are not taking competition from non-banks seriously is falling from year to year and currently stands at just over one quarter (27%).

Given the rapid pace of technological development, it is to be expected that going forward more providers from outside the sector will enter the market and come into direct competition with banks for selected components of the value chain. This will expose banks to an increased pressure to innovate. Customer expectations are changing all the time, and digital communication is increasingly becoming a selling point for customers. Consequently, it will be vital for banks to succeed in defending their customer interface. A promising strategic option in this regard would be for banks to enter into partnerships with selected FinTechs so that they can develop innovative services faster.

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Entirely agree
Partly agree
Partly disagree
Entirely disagree
Cantonal banks appear more relaxed

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
Competitors outside the sector will threaten the market position of banks.

Among three-quarters of banking groups, the expectation that their market position will be threatened by competition from outside the sector has increased versus the previous year. This trend is most evident among banks under foreign control, where the agreement rate has increased from 52% to 79%.

Cantonal banks are considerably more relaxed than they were last year: only slightly less than one half of the cantonal banks surveyed (46%) still feel threatened by competition from outside the sector (previous year: 83 percent). There is a widespread conviction among cantonal banks that they will be able to defend their market position and fend off new competitors due to their strong local roots and customer proximity.
Customer loyalty sees further decline

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
The loyalty of bank customers will decrease considerably.

Almost three-quarters of all banks (72%) expect customer loyalty to decrease in the future. This is the highest value since the start of study (previous year: 67 percent).

Digitization often has a direct impact on customer behaviour. Customers can find out about products and services, better and faster, whenever they want, wherever they want, and compare the offerings of different banks almost at the touch of a button on specially designed platforms. This means that customers are better and more comprehensively informed and the relevance of personal advice as a way of purely disseminating information is falling. New digital solutions also make it convenient and inexpensive to switch to a new bank.

The popularity of mobile banking is eroding customer loyalty and presents a challenge for banks. On the one hand, it is important for banks to offer comprehensive, intuitive and user-friendly mobile solutions and to continually align these to new developments and changing client requirements. On the other, banks need to find new ways of fostering proximity to their customers and offering added value through comprehensive, personalized advice. Interaction with customers - the customer interface - is and will ultimately remain decisive for a long time to come.
“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”

The price of bank services will fall.

67% of the banks surveyed expect the prices for banking services to fall in the next seven to ten years. Price pressure on banks has risen again versus the previous year (previous year: 52 percent).

Competitors from outside the sector are encroaching on the traditional turf of banks and are enticing away customers with cheaper services. In addition, customers are increasingly on the lookout for digital solutions, for which they are no longer willing to pay such high prices.
Growing price pressure in private banking

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”
The price of bank services will fall.

Private banking is evidently subjected to stronger price pressure than retail banking. 82% of banks under foreign control (previous year: 63%) and 78% of private banks (previous year: 65%) expect banking services to become cheaper in the next seven to ten years. These banks are feeling the effects of increased tax transparency: while they are managing to keep the total volume of assets stable, or even to increase them, they have had to deal with significant outflows of high-margin offshore funds on the part of private customers.

Cantonal banks and regional banks are more optimistic: more than half of the institutions surveyed (62% and 55% respectively) are convinced that the prices for banking services will fall in the next seven to ten years. One reason for this optimism could be the wide variety of business relationships and the strong customer focus regionally anchored banks can offer their customers. Among cantonal banks, the higher security they provide due to the available state guarantees plays a role that is not to be underestimated.
The topics of industrialization and sourcing of business processes will retain the high importance they have had in the past. For five years now, around 90% of all surveyed banks have expected business processes in the banking industry to become more and more standardized. The topic of sourcing has been a buzzword for a long time now and is regarded as a strategic necessity by many banks. There has been relatively little movement in this area. Industrialization is not yet as advanced as many banks had hoped it would be.

Lots of banks have evidently not been in the position in recent years to standardize their business processes in such a way that they can then be effectively industrialized and outsourced or automated.

Given the persistently high pressure on costs and the groundbreaking possibilities offered by digitization, there is no way around standardization and industrialization for many business processes. Banks are also faced with the important question of which parts of the value chain they want to retain responsibility for and which parts would be better to outsource.

**Industrialization and sourcing remain important**

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”

The industrialization and sourcing of business processes will increase considerably.
Banks are concerned about the next generation of talents

“How do you see banking evolving in 7 to 10 years? To what extent do you agree with the following statement?”

Talent recruitment will become increasingly difficult

70% of all banks forecast that it will become increasingly difficult going forward to recruit talents. This perception is shared by all banking groups, especially by regional banks.

Digitization and structural transformation are changing the world of work. Old job profiles are being replaced by new, more complex and more challenging career paths. This trend is being underpinned by the fragmentation of the value chain and the associated increase in the degree of specialization. In order to navigate this process of change, banks need new employees who are better able to meet the new requirements. The challenges that are expected to arise in recruiting new talents could therefore lead to problems for banks.
The banking industry is in a state of upheaval – both internationally as well as in Switzerland. Banks find themselves confronted by a wide range of challenges, some of them fundamental in nature. Even if banks have so far succeeded in asserting themselves in this adverse environment, the future prospects of all established business models of Swiss banks need to be subjected to a critical examination.

When asked about the future prospects for the Swiss banking industry, banks are optimistic. Almost 80% see good prospects for private banking in Switzerland, compared with two-thirds for asset management and retail banking. Only when asked about the future of the investment banking business model in Switzerland, more than half express scepticism.

The very optimistic assessment of private banking may seem surprising at first glance. The traditional business of cross-border asset management was the focus of some difficult discussions regarding tax transparency and bank-customer confidentiality, and since then has witnessed a sharp drop-off in margins. However, there is also plenty of justified hope for the future.

The financial centre has dealt with many of its past issues with the resolution of the US tax conflict and the introduction of the automatic exchange of information, resulting in an atmosphere of legal certainty.

Global assets continue to see substantial growth. The number of millionaires worldwide has almost doubled since the financial crisis to around 16.5 million1, corresponding to an annual growth rate of approximately 8%. The assets of this continually growing clientele require not only appropriate investment products and professional advice, but also security and stability to protect the accumulated assets.

The private banking arms of Swiss banks will be able to benefit from this trend thanks to the political and economic stability, the well-oiled legal system, and the excellent reputation enjoyed by the country’s financial centre.

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1 World Wealth Report 2017, Capgemini
11. Key messages
Exceptional macroeconomic conditions

The financial and economic crisis shook the financial world to its core when it hit in 2007. Since then, central banks have kept interest rates low and flooded the markets with liquidity. The prices of many asset classes have skyrocketed as a result, as reflected by the all-time-highs on stock markets around the world and real estate prices.

This situation is presenting banks with tremendous challenges. While they have managed to deal with them relatively well so far, this does not detract from the fact that income from their core activities has fallen dramatically in recent years. The only area where banks have been able to keep their income constant is in the interest rate business – and this is only thanks to a massive rise in lending volumes. Overall banks have had to take a significant hit to their margins in the traditional banking business.

The exceptional macroeconomic conditions have held strong for several years now and the risk of corrections on the capital markets should not be underestimated. Given this prolonged glut of money, the fundamental laws of economics (such as interest rates as a pricing mechanism) have been placed virtually into deep freeze, which could lead to dangerous false assumptions and incorrect valuations. Furthermore, the room for manoeuvre of central banks to react to future crises is likely extremely restricted in view of their balance sheet structures and the current exchange rate.

Financial market regulation - target achieved? Banks are now expecting an end to the wave of regulation

A great deal has been done in the wake of the financial crisis both globally and at home in Switzerland to correct weaknesses in the financial system. Banks have scaled back their trading books in response to new regulations, shored up their equity and gradually implemented more stringent liquidity and derivatives trading guidelines. They have also improved their resolvability, i.e. their ability to isolate risks through emergency planning. The vast majority of banks are of the clear conviction that the financial market is more stable today than it was before the financial crisis.

Against this backdrop, the banking industry increasingly believes that the wave of regulations and normalization will follow accompanied by an improvement in framework conditions. 37% of banks already think that the sector will not be subject to more stringent regulation in the future, compared with just 11% last year.

Banks are suffering due to negative interest rates – but no negative interest rates for retail customers

Banks are feeling the strain of negative interest rates. Their negative perception of the low interest rate policy is increasing, year after year. Now that deposit rates have hit zero, it is practically impossible to reduce them any further. This has put pressure on interest margins again. What is more, the extended phase of negative interest rates has created a dearth of investments, pushing more and more institutional investors and non-banks into the lending business – with undesirable consequences for the margins of traditional players in the lending business. As a result of these developments, over one half of banks are no longer categorically ruling out passing on negative interest rates. Only for retail customers does such a measure remain taboo for the vast majority of banks. The fear of massive cash outflows in this customer segment is just too high.

The vast majority of banks expect the central bank to end its expansive monetary policy, at least in the medium term. It cannot be predicted with any degree of certainty how well banks will be able to digest the repercussions of an interest rate reversal. A moderate increase in the yield curve would be a desirable scenario here. An abrupt and sharp interest rate hike could be dangerous.
Strategic focus on innovation and earnings growth

The implementation of numerous new regulatory requirements has consumed a lot of resources in recent years, and banks have had to channel a lot of money into certain divisions, especially risk management and compliance. These topics were in the spotlight for many years. In the recent past banks have increasingly begun to address the adverse margin trend and the costs of regulation.

For the foreseeable future, banks now want to gear their strategic focus increasingly to the topics of innovation and growth. Alongside investments in new sales channels and digitization, partnerships with non-banks are also shifting into the spotlight.

Advancing digitization is also giving rise to new risks. It is therefore hardly surprising that banks rank cyber security as priority no. 1 for the coming months. Banks need to find an answer to the numerous cyber attacks that have come to light in recent months, and how to deal with this new threat and which measures offer appropriate protection.

Banks recognize the extent of digitization

Swiss banks are increasingly recognizing the potential of digitization, with 52% of the banks surveyed now expecting technological development to have a fundamental impact on strategies, business models and business processes. This is a veritable shift in opinion, since before that only one quarter of banks shared this view, the majority perceiving digitization as an additional sales channel which would complement their existing offering. Just one third expressed this opinion in this year’s survey.

Digitization is the strongest driver of long-term structural change. This assessment on the part of banks suggests that digitization is no longer just a trend, but instead is becoming a reality. Banks are reacting to this by setting up digital think-tanks, so-called innovation hubs where new solutions are tested and developed. The vast majority of the banks surveyed also anticipate using robots or virtual assistants in the future. The potential for robots is considered to be especially high in the areas of analysis and decision-making (e.g. investment recommendations, credit decisions) and in the middle/back office. For this to happen, banks first need to make further progress in standardizing and industrializing business processes.

Structural change is advancing - but scepticism is spreading

There is broad consensus among banks that the Swiss financial industry is in the grips of a fundamental structural change. However, scepticism with regard to this question is increasing. This is surprising given the wide range of new challenges facing banks. Digitization is forcing banks to fundamentally rethink their business models, with more and more competitors from outside the sector encroaching on banks’ traditional turf and new technologies shaking up established internal processes. Around two-thirds of banks have started to recognize increasing competition from outside the sector, compared with only one third just a few years ago.

Banks’ differing perceptions of the situation clearly indicate the uncertainty regarding the topic of structural change. This is difficult to grasp, and the implications for existing business models still difficult to quantify. Banks have trouble identifying the concrete implications for them. They are in general agreement when it comes to the question of which business area will be the most heavily affected by the structural change. Banks agree this will be payments. The emergence of various mobile payment systems has accelerated the pace of development, making the process of structural transformation in this sector more and more visible and tangible.

Accordingly, the lion’s share of banks are also of the current opinion that Swiss banks will no longer be able to operate payments at a profit in the long run. It is not possible to predict with any degree of certainty what the repercussions of giving up payments will be for banks: payments serve as an interface to customers and are thus an important link in the chain for a wide range of lucrative business transactions. It therefore plays an important role in the traditional banking business, not least for the deposit business - a very important source of income for banks.
Is there a new wave of optimism for banks?

Swiss banks are looking to the near future with relative confidence. Only a small minority of 18% (previous year: 32%) expect declining operating results for the next six to twelve months. This is the lowest value since the start of study. The vast majority of banks are riding a new wave of optimism, and making innovation and growth plans for the future. While this finding may seem surprising at first glance in view of the numerous challenges facing the industry, there are also plenty of good reasons for this optimism. Many banks have demonstrated a relatively high level of resilience to the challenges they have faced in recent years, which has given them a new sense of self-confidence. The banking industry is also of the opinion that the wave of regulations has peaked and normalization will follow accompanied by an improvement in framework conditions.

It would also seem that some of the geopolitical risk factors that were at play just a year ago (change of power in the USA, uncertainty surrounding the outcome of many European elections, Brexit, etc.) have subsided - at least in terms of their perception. Moreover, it is reasonable to assume that the economic recovery underway in many parts of the world and the money supply injected by central banks have not quite run their course. This points to a positive economic scenario in the short term, which should also benefit Swiss banks.

With that in mind, most Swiss banks are convinced that their business will perform well in the coming months. Many banks say that they are not planning any major job cuts in the short term, and instead want to shift their focus back to the topics of growth and innovation, and even perceive opportunities to increase returns for their shareholders again. These are all veritably good signs for the near future. In view of the fundamental challenges ahead, it remains to be seen whether this optimism will translate into a longer-term perspective.
Contacts

Patrick Schwaller
Managing Partner
Audit Financial Services
Maagplatz 1
8005 Zürich
Telephone: +41 58 286 69 30
patrick.schwaller@ch.ey.com

Olaf Toepfer
Partner
Head Banking & Capital Markets
Maagplatz 1
8005 Zürich
Telephone: +41 58 286 44 71
olaf.toepfer@ch.ey.com

Bruno Patusi
Partner
Head Wealth and Asset Management
Maagplatz 1
8005 Zürich
Telephone: +41 58 286 46 90
bruno.patusi@ch.ey.com

Stéphane Muller
Partner
Head Financial Services Suisse Latine
Route de Chancy 59
1213 Genève
Telephone: +41 58 286 55 95
stephane.muller@ch.ey.com
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