EY Banking Barometer 2020

In the Grip of Monetary Policy

EY

Building a better working world

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Editorial

Low interest rates, low volatility and high uncertainty: such is the environment currently facing Swiss banks, in a nutshell. This brings with it a number of challenges, as margins in the lending business come under ever greater pressure and banks are having to grant ever more loans to stabilize their interest income. Banks are increasingly being confronted with disappearing margins in the commission business as well. Expansive monetary policy and negative interest rates have resulted in various asset classes being overvalued and risks being undervalued. In addition, uncertainties stoked by trade tensions, geopolitical developments and emerging concerns about the economy are feeding doubts on the part of investors and bank customers – with corresponding adverse repercussions on banks' earnings.

Alongside this very challenging environment – which so far has seen banks prove themselves to be relatively resilient – banks are having to contend with a swelling tide of structural change in the financial industry. This is manifesting itself not only in new market players such as technology firms and platforms disrupting banks' traditional value chains, but also in shifting patterns of customer behaviour.

How are Swiss banks responding to these challenges? How do they assess their short-term and long-term outlook? Should private customers prepare themselves for banks to start applying negative interest rates to their account deposits? What will be banks' strategic focus in the year ahead? These questions aside, this year we also surveyed banks about our focal topic "sustainable investing." Do banks think this is just hype? Do banks believe they can make a decisive contribution to combating climate change? How firmly is the topic of sustainability already integrated into their existing advisory processes?

The EY Banking Barometer 2020 goes in search of answers to these and other questions. We hope you enjoy reading this publication and look forward to a lively discussion with you.

Patrick Schwaller

Managing Partner
Audit Financial Services

Olaf Toepfer

Partner
Leader Banking & Capital Markets

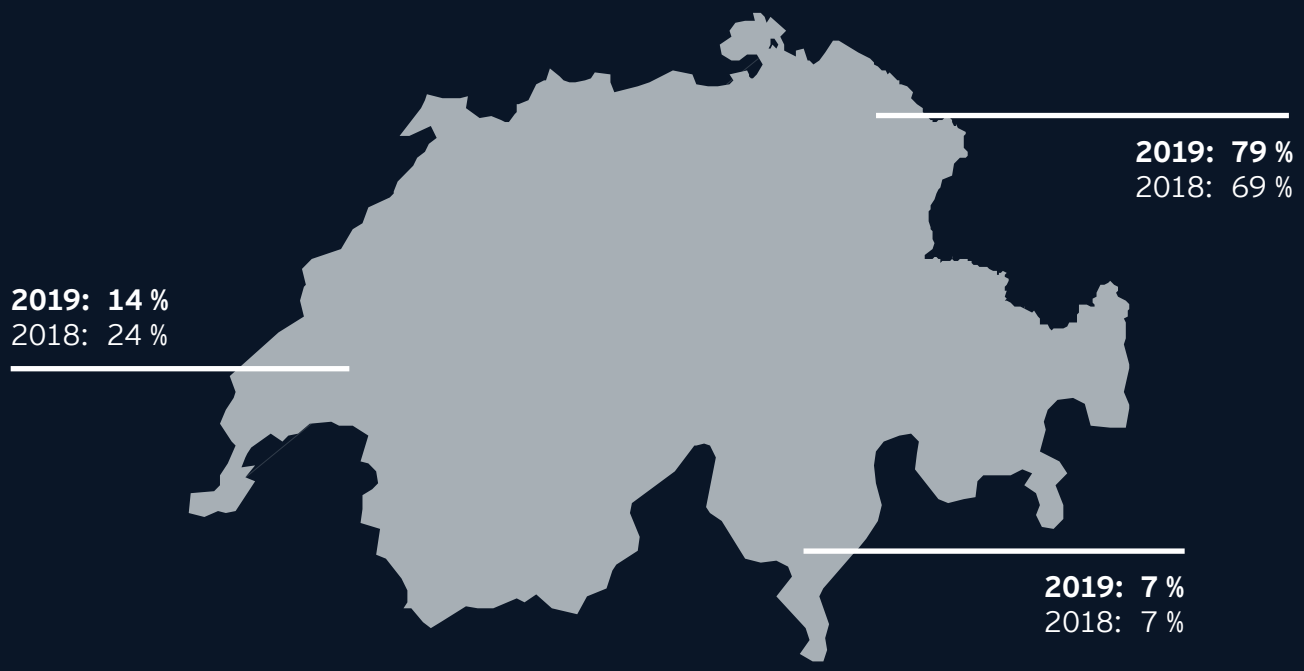
Timo D'Ambrosio

Senior Manager
Audit Financial Services

1 Study design

Study design

- Survey by EY in November 2019
- Survey of 100 banks in Switzerland[1]
- 10th edition since 2010



Breakdown of survey sample

Type of bank	2019	2018
Private banks[2]	**28 %**	**33 %**
Banks under foreign control	**17 %**	**28 %**
Regional banks	**38 %**	**18 %**
Cantonal banks	**17 %**	**21 %**

Bank size by customer assets	2019	2018
Under 5 billion francs	**69 %**	**46 %**
Between 5 and 1 billion francs	**7 %**	14 %
Between 10 and 50 billion francs	**17 %**	**26 %**
Over 50 billion francs	**7 %**	14 %

[1] The questions were also put to the two big banks in Switzerland and included in the general evaluations but not the evaluations by type of bank

[2] Including investment banks

2 Key messages

1 Low interest rates, low volatility, high uncertainty

Low interest rates, low volatility and high uncertainty: such is the environment currently facing Swiss banks, in a nutshell. This brings with it a number of challenges, as margins in the lending business come under ever greater pressure and banks are having to issue more and more loans in order to stabilize their interest income. In the commission business as well, banks are increasingly having to contend with disappearing margins, while geopolitical uncertainties and emerging concerns about the economy are depressing activity on the part of investors and bank customers.

Expansive monetary policy and negative interest rates have resulted in various asset classes being overvalued, and risks being undervalued. Given the low interest rate environment coupled with low risk premiums and low volatility, banks are generating lower revenue than they used to in the past. It is of particular cause for concern here that consistent, disciplined risk management is currently not being satisfactorily rewarded, while inadequate risk management is not having any major adverse consequences.

Against this backdrop, there is the danger that banks have forgotten how to manage credit risks and handle potential credit defaults across the breadth of their financing business, and a degree of comfort has set in.

2 Gloomy business outlook – negative interest rates for small savers as well?

In the all-important interest margin business, banks rely on a normal yield curve that exhibits significant differences between short-term and long-term interest rates. Contrary to the expectations of most banking institutions outlined in last year's survey, any normalization in monetary policy has faded into the distance. Banks will find themselves confronted with negative interest rates and exceptionally flat yield curves for some time to come, which is placing an even tighter squeeze on interest margins and is clouding the business outlook for the banking community. When looking to the short and medium-term future, around one third of banks (previous year: 22% and 16%, respectively) expect their operating results to decline. This scepticism diminishes only negligibly when viewed further out, with a total of 27% of banks (previous year: 13%) forecasting declining revenues in the long term. In the case of the cantonal and regional banks, which are focused primarily on the lending business, this crisis of confidence is even more pronounced.

This picture is supported by the fact that considerably more banks than the previous year – 47% of cantonal banks and 70% of regional banks – anticipate rising impairments in the SME lending business in the medium to long run. Only in the short term are banks still relaxed about the future. This trend is being driven primarily by the economic concerns that have bubbled up in recent months. Banks remain relatively relaxed concerning the situation on the real estate lending markets, however, with only just over one quarter (28%) expecting impairments to increase in the medium term.

The pressure on margins in the interest income business is forcing banks increasingly to pass on negative interest rates to their customers. Whereas in 2015 70% of the banks surveyed categorically ruled out passing on negative interest rates, the figure is now only 21%. In addition, more than one half of banks (55%) – up significantly on last year's figure of 33% – say they would like to lower the threshold from which they would like to apply negative interest rates to customer deposits. The question begs itself for how long banks can spare small savers from the effects of these negative interest rates.

3 | Traditional business models are being pushed to their limits – stronger customer focus is needed

It is undoubtedly too early to usher in the end of the traditional business models. Swiss banks have proven themselves to be relatively resilient in recent years in the face of a challenging market environment. However, it cannot be denied that the ongoing expansive monetary policy adopted by the central banks and the associated low or negative interest environment pose a tremendous challenge for banks and raise fundamental questions concerning their business models – especially for cantonal and regional banks, which are focused heavily on the domestic market and the interest margin business. This insight now also seems to have taken hold among most banks, with a total of 83% of those surveyed expressing the opinion that in the future banks will have to tap into new sources of income if they do not want to lose their earning power.

But how can they do this? The majority of banks (60%) agree that the greatest lever for profitable income growth is improved customer focus. However, only one quarter of banks believe that the key to boosting profitable income lies in product-centric measures such as bundling different services (19%). This assessment suggests that in the future banks will align their activities more closely to customer needs or customer demands and away from the product range they offer. This business model is strongly reminiscent of the kind adopted by large technology firms, which by setting up (networked) platforms have created new ecosystems for their customers.

4 | Before the focus switches to new business models, in the short term belts will be tightened another couple of notches

But before banks can set about rethinking and realigning their business models, in the short term it seems they will be turning their attention to measures to improve cost efficiency. Indeed, 39% of banks (previous year: 32%) say the topic of costs will be their top priority over the next twelve months – the highest figure in the last three years. This is also reflected in banks' responses when asked about remuneration in the banking sector going forward, with almost three-quarters of the organizations surveyed (71%) expecting remuneration in the financial industry to trend downwards in the future.

Banks are increasingly cognisant that a fundamental structural change has begun in the Swiss financial services segment; 88% are now convinced of this fact. The structural change is also manifesting itself in the fact that banks have never perceived the threat from competitors from outside the sector as highly as this year, with a total of 79% of the banks surveyed perceiving their market position as under threat from these new providers. This notwithstanding, the majority of banks (61%) think that they will ultimately emerge victorious from the wave of digitalization.

5 | The topic of sustainability at the banks has so far only played a bigger role in investment – not in lending

The topic of sustainable investing has shifted increasingly into the focus of investors and customers in recent years. There is fundamental consensus among banks that this topic is not just hype, and a definite trend toward sustainable investing will manifest itself over the long term (81%). What is more, more than one half of banks (55%) are of the opinion that they can make a decisive contribution to fighting climate change. It comes as no surprise, therefore, that 70% of banks intend to expand their offering of sustainable investments going forward, not least in order to benefit from growing customer demand. While these survey findings suggest that banks have woken up to the topic of sustainable investing, it is evident that this insight has not been integrated across the board into their advisory and investment processes or reporting setups. Accordingly, the topic of sustainability is a mandatory component of the advisory process at less than one third of banks (30%), and just 9% of banks say they update their customers on sustainability topics (ESG scores) as part of regular reporting. In the case of loan financing by banks, the topic of "sustainability" has no significance as of yet. Only a minority (19%) of the banks surveyed say that they take ESG factors into account in their lending, and only 25% say that they will take account of these criteria in the future.

The topic of sustainability will challenge the financial service industry to its core in the foreseeable future. All organizations at all levels will need to address the topic and quickly build up the expertise they need. During this phase of transformation, those organizations that take the lead will reap the benefits ahead of the curve.

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Low interest rates, low volatility and high uncertainty: such is the environment currently facing Swiss banks, in a nutshell. This constitutes a very challenging environment for banks overall.

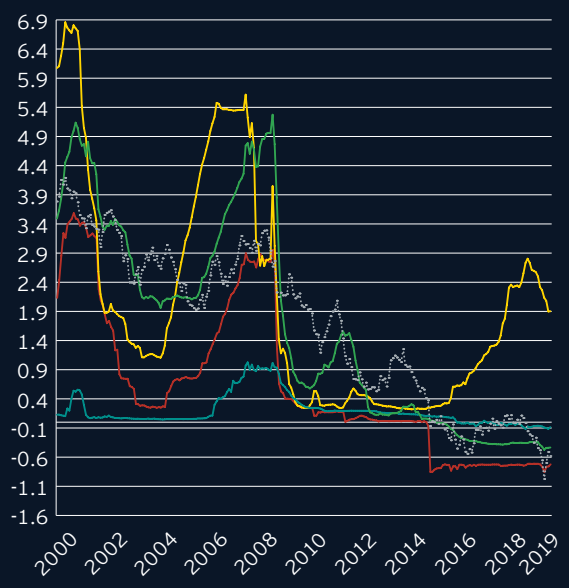
Patrick Schwaller
Managing Partner
Audit Financial Services

3 Market environment for banks

Monetary policy is keeping the markets on edge

Interest rates

in %



- LIBOR EUR 3M
- LIBOR USD 3M
- LIBOR JPY 3M
- LIBOR CHF 3M
- CHF 10 y Swiss Bonds

Stock markets

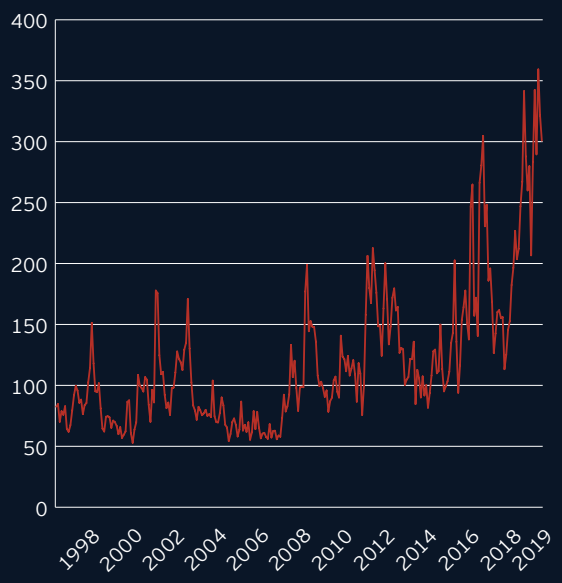
Indexed, 1.1.2000 = 100

- MSCI WORLD
- MSCI SWITZERLAND
- MSCI USA
- MSCI EUROPE

Source:SNB, MSCI

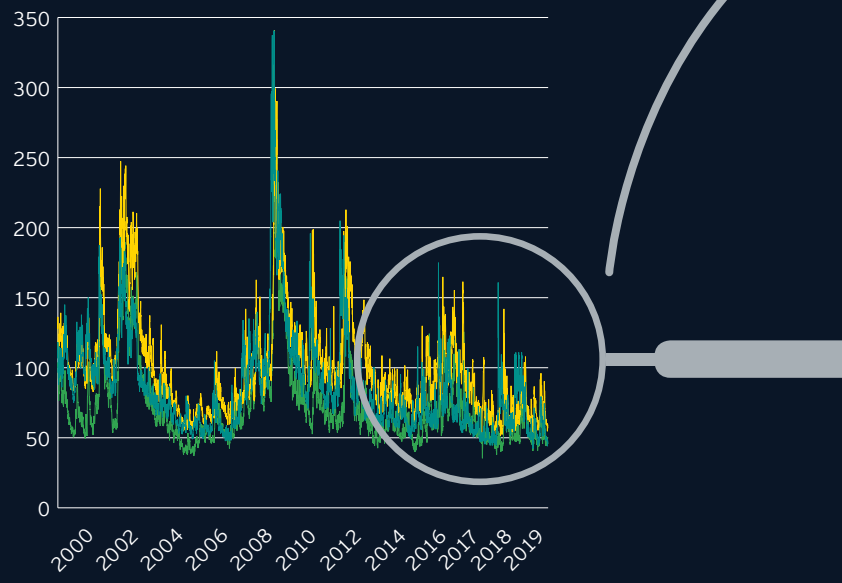
More than ten years have passed since the outbreak of the last financial and economic crisis and the financial system was bailed out by the community of states and the central banks. Yet there is still no normalization in sight. In fact, quite the opposite: the unwanted consequences of the rescue measures are becoming clearer and clearer with each passing year. Interest rates have been at absolute lows for several years now, and in many countries they have even been negative for some time. The real estate and securities markets, meanwhile, know only one direction: up. During the financial crisis, the ultra-expansive monetary policy pursued by the central banks had its intended effect and brought the financial system back from the brink of collapse. The unwanted, long-term consequences of the policy of cheap money can, however, no longer be ignored: inflated asset prices, record levels of national and corporate debt, growing threat to retirement provision, increased risk exposure when investing due to a lack of investment alternatives, misallocation of capital in unproductive economic sectors, to name but a few. Capital has lost its price. Saving no longer reaps any rewards, and loan financing is available practically free of charge for purchases of all kinds. The important controlling and allocation function played by interest rates has been rendered disabled for some time now, as evidenced among other things by the historically low volatility on the financial markets. It is almost as if not only capital, but also risks no longer have a price.

Economic Policy Uncertainty Index



Volatility

Indexed, 1.1.2000 = 100



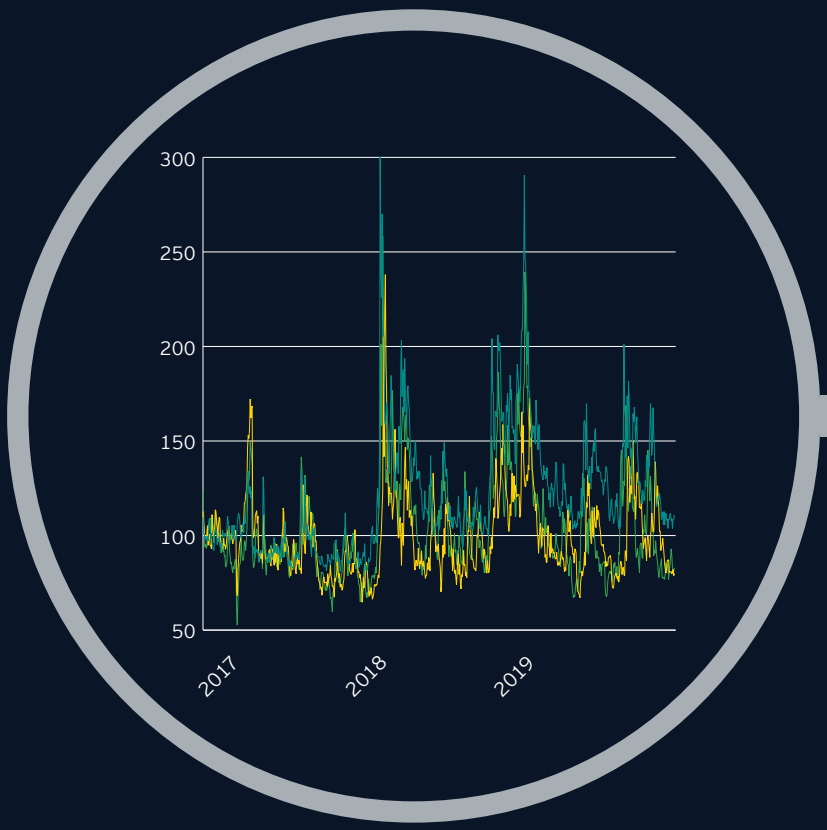
VSMI ®
EURO STOXX 50® Volatility (VSTOXX®)
Cboe Volatility Index® (VIX®)

Source: Davis, Steven J. (Policyuncertainty.com), SIX, STOXX, Cboe

The consequences of the ultra-expansive monetary policy can also be seen in the rising levels of national debt of the world's major economies, with global debt up by more than USD 100 trillion or approximately 70% since the beginning of 2007 to USD 250 trillion. The emerging economies paint an even more sobering picture (up 267%). Yet even in the industrialized nations debt has been accelerating at a dizzying pace. In the face of these developments, if and when interest levels eventually do normalize, this could have serious ramifications for some highly indebted regions and countries, possibly leaving many of them unable to afford the higher interest payments that become due.

At the end of 2018 the stage seemed to be set for the Fed to take advantage of the favourable economic environment and initiate a normalization of monetary policy. Since then the tide has turned once more. Both the Fed and the ECB reacted to initial signs of economic cooling in 2019 with renewed rate cuts. The ECB also felt compelled to launch a new package of measures to stimulate inflation. With the growth dynamics of the global economy having continually weakened in recent months and economic growth forecasts – especially for Europe and the emerging economies – becoming more and more pessimistic, any normalization in monetary policy still seems a long way off, contrary to the expectations of most banks as reported in last year's survey. The central banks have squandered the opportunity to normalize monetary policy and going forward there is barely any scope for further monetary policy initiatives to respond in any meaningful way to the next economic slowdown, the first signs of which are already emerging in some economic sectors.

The market environment for banks is being shaped not only by elevated trade tensions, but also by geopolitical uncertainties. Even though the two sides in the USA-China trade dispute have moved closer of late, the situation remains precarious and harbours unpredictable medium and long-term risks for the glob-



VSMI ®
EURO STOXX 50® Volatility (VSTOXX®)
Cboe Volatility Index® (VIX®)

Source: SIX, STOXX, Cboe

al economy. What is more, the repercussions of the impending Brexit remain unclear, and tensions in the Gulf region have escalated demonstrably in the past few months.

While Swiss banks have managed to post relatively stable business results in recent years and have proven themselves to be resilient in a difficult market environment, it cannot be denied that the margins in the traditional banking business continue to be squeezed and are falling in multi-year comparison. This is affecting not only the lending and interest margin business, but also the second pillar of the Swiss banking industry: the commission and service income business.

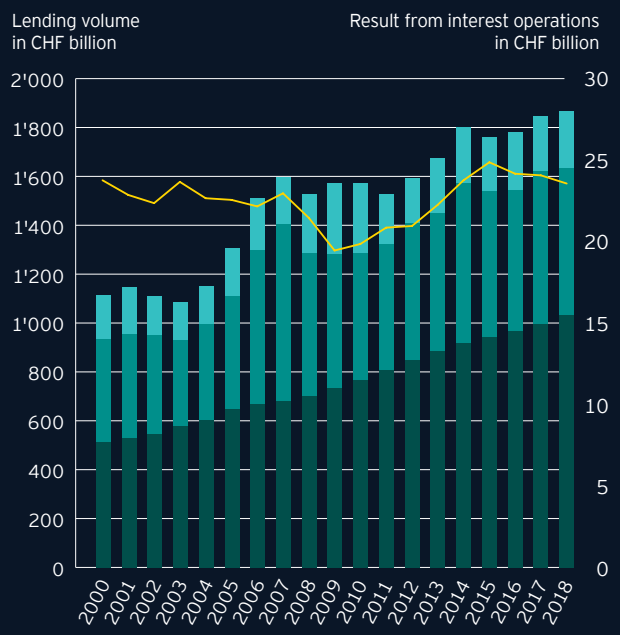
Interest income has been kept largely stable since 2000 and amounted to CHF 23.5 billion in 2018. However, this has only been possible by simultaneously expanding volumes for the balance sheet items of mortgage receivables, amounts due from customers and financial investments by 68%. This has caused Interest margins to contract considerably.[1] It can be concluded overall that while banks are still making as much money in the interest margin business as they were back in 2000, they are having to grant more and more loans in order to achieve the same result.

The performance of the commission and service income business paints an even less rosy picture. While securities holdings have increased by just under 60% since 2000 to CHF 5,849 billion, income from commission and service fee activities has declined by CHF 6.9 billion or 24% to CHF 22.0 billion. There are multiple reasons for the erosion of margins in the commission and service income business. On the one hand, more and more players are entering the market (also from outside the industry) who are enticing customers with more favourable conditions. On the other, the period under review saw the increased tax regularization of assets held at Swiss banks. This has especially affected the previously very high-margin securities holdings of foreign private customers, which have decreased significantly since 2000 by CHF 484 billion or 49% from CHF 997 billion to just CHF 513 billion.

[1] While in 2007 this was still 1.80%, it has since fallen to 1.17% (Source: SNB)

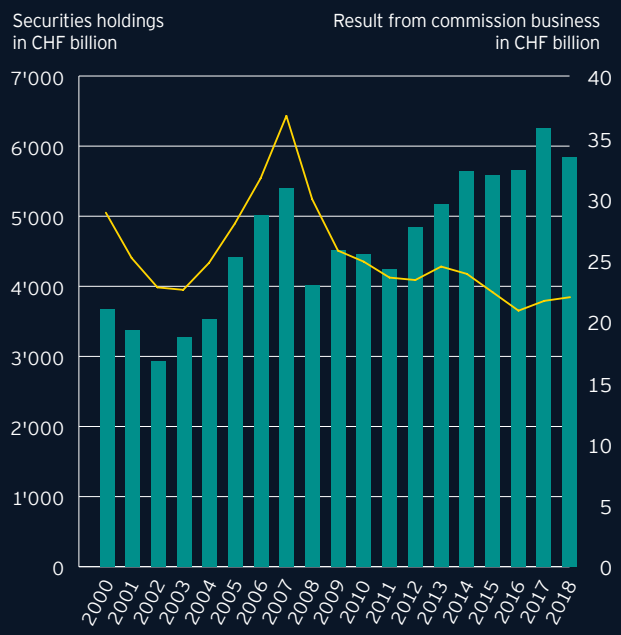
Interest rates and lending volume

in CHF billion



Result from commission business

in CHF billion



Source: SNB

It can be said in summary that Swiss banks are having to operate in an increasingly challenging environment: one of low interest rates, low volatility and high uncertainty.

- In the traditional banking business, what banks need is a normal yield curve with positive interest rates in order to generate an interest margin from the lending and deposit business. When the yield curve is flatter and interest rates are negative, compounded with a lack of acceptance to pass on negative interest rates and apply these to customer deposits on a broad basis, it is impossible to make a profit from the interest income business in the long run.
- It is an intrinsic part of a bank's business model to assume and manage risks, which is compensated in return through corresponding risk premiums, to name just one example. The expansive monetary policy has, however, resulted in a tendency to underestimate risks, as evidenced by today's historically low risk premiums and very low market volatility. Given these low risk premiums and low volatility, banks are earning less. What gives particular cause for concern is that consistent, disciplined risk management is currently not being satisfactorily rewarded, while inadequate risk management is not having any major adverse consequences, since the prevailing ultra-expansive monetary policy seems to be eliminating many of the inherent risks – or is at least papering over the cracks.
- The uncertainties stoked by increased trade tensions, geopolitical developments and emerging concerns about the economy are feeding doubts on the part of investors and bank customers. Security appears to be the top priority, and in such an environment Swiss banks generally benefit from increased inflows of new money. Nevertheless, banks can only earn something from this extra customer money that is coming in if it is managed and invested. Additional savings deposits, by contrast, are not generating any income for banks given the current interest rate environment and are being actively avoided by more and more institutions.

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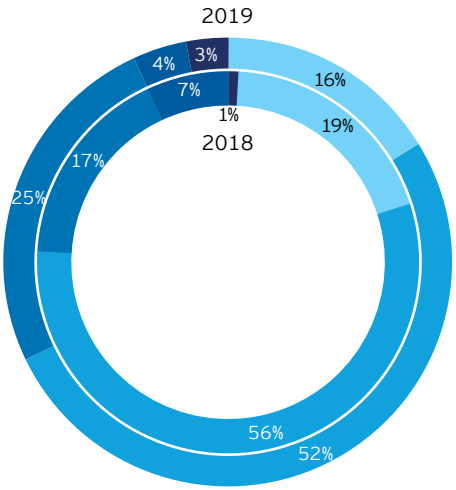
When asked about their outlook for the future, Swiss banks seems to be suffering from a notable crisis of confidence – especially retail banks.

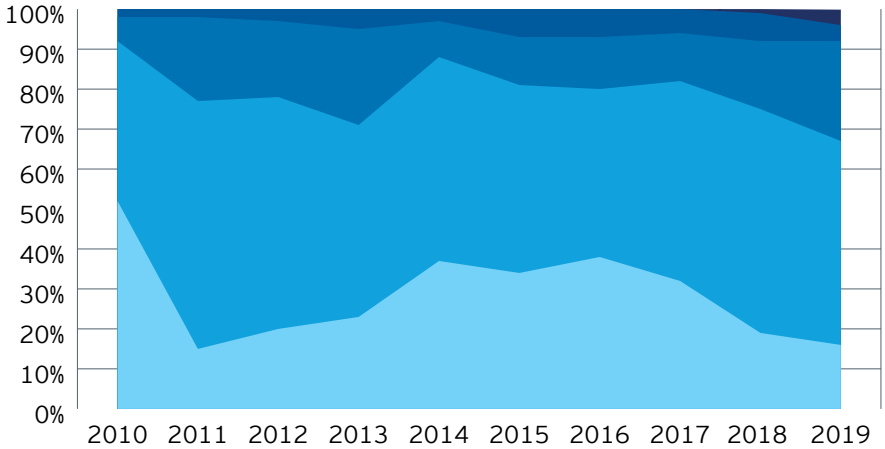
Olaf Toepfer
Partner
Leader Banking & Capital Markets

4 Operating business development

Banks are experiencing more and more headwind

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





- Positive (increase in operating income of over 10%)
- Somewhat positive (increase in operating income of up to 10%)
- Somewhat negative (decrease in operating income of up to 10%)
- Negative (decrease in operating income of 10% to 25%)
- Very negative (decrease in operating income of over 25%)

Since this study began, Swiss banks have never been so dissatisfied with business performance than they were last year. In spite of this, overall satisfaction is still at a relatively high level. As many as one third of banks (32%) rate current business performance as negative (previous year: 25%), while 3% of the banks surveyed rate the course of business as very negative (decline in operating income of more than 25%).

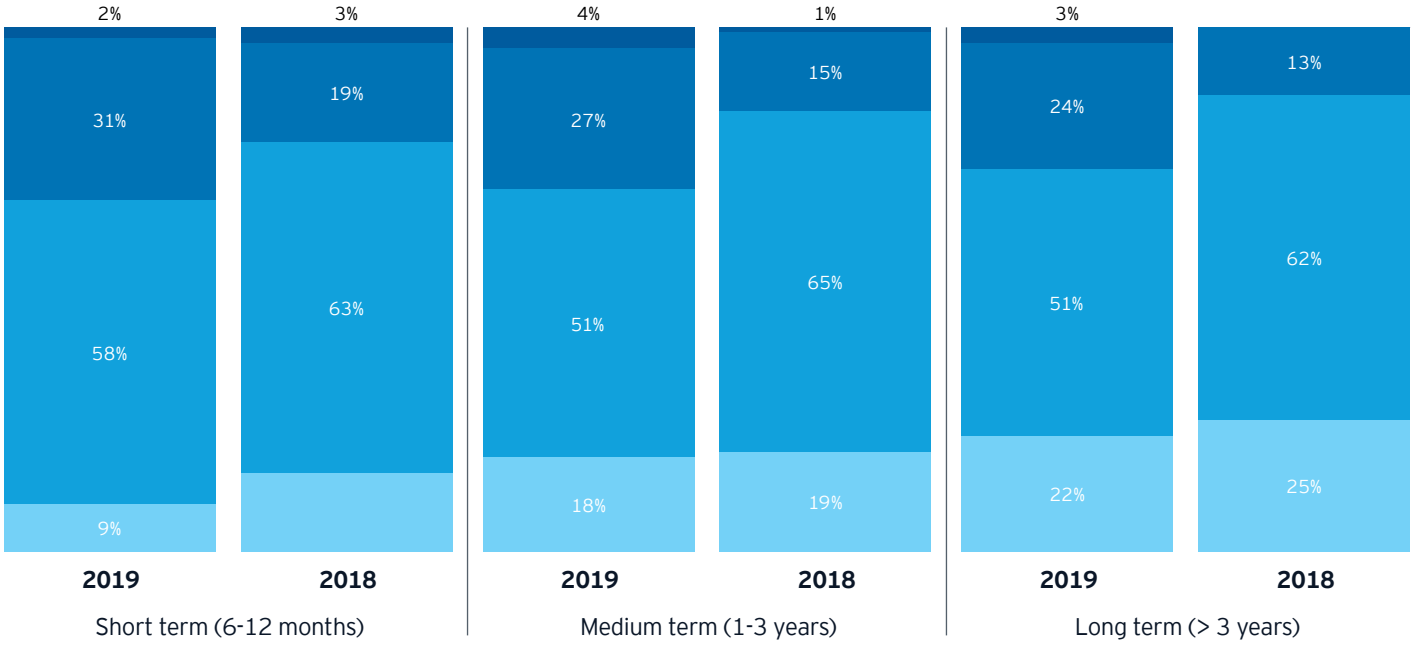
This development can primarily be explained by interest rate trends, with the average interest rate granted for new ten-year fixed mortgages contracting from an already low 1.63% at the end of 2018 to an even lower level of around 1.26% at the end of November 2019, according to SNB data. This value was even lower in August 2019, at 1.19%. Since banks have been unable to expand their mortgage volumes as much as they have done in the past due to saturation trends in the market and prevailing regulatory provisions[2], this development has left its mark on banks' income statements. Added to this, many older fixed mortgages held with banks – which it had been possible to conclude at higher interest conditions – are currently reaching their term.[3] New mortgages, by contrast, have lower interest rates, which is squeezing the interest margin even further.

[2] In the first ten months of 2019, banks were able to increase their mortgage volume by 2.7%, compared with the average annual growth rate during the period from 2000 to 2018 of 4.4%.

[3] For example, the interest rate for new ten-year fixed mortgages was 3.7% at the end of 2007, according to SNB data.

Gloomy outlook for the future

«What kind of development do you expect in your organization's operating business?»



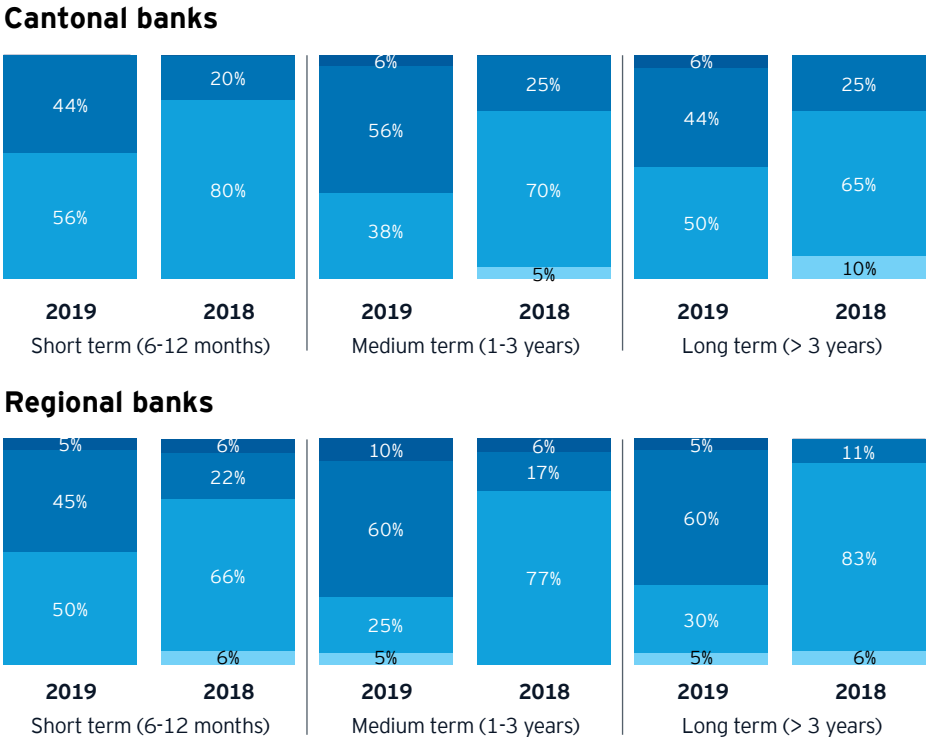
Scepticism concerning future business performance at Swiss banks is growing. Whilst last year banks were largely optimistic for all planning horizons (short, medium and long term), this year has seen a significant shift in mood. Accordingly, around one third of banks expect their operating income to decrease in the short to medium term, up 11 percentage points to 33% in the short term, and 15 percentage points to 31% in medium term (previous year (22% and 16%, respectively). This scepticism diminishes only negligibly when viewed further out, with a total of 27% of banks (previous year: 13%) forecasting declining revenues in the long term.

The results of the survey show that banks assess their business outlook much more negatively than they did a year ago. The reasons for this downturn in mood are clear: concerns about the economy increased worldwide last year. The burgeoning hope toward the end of last year of a paradigm shift in the monetary policy pursued by the major central banks, and in turn of a pivot in interest rates in the not-too-distant future, has vanished into thin air. What is more, geopolitical risks have escalated appreciably. The simmering trade dispute between the USA and China harbours unforeseeable consequences, the repercussions of the impending Brexit remain uncertain, and new fuel has been added to the tensions in the Gulf region in the past few months. All in all, it can be said that Swiss banks are having to contend with a difficult environment hampered by low interest rates, low volatility and high uncertainty – with no discernible end in sight.

Alongside these macroeconomic and geopolitical challenges, banks need to respond with an ever-greater sense of urgency to the structural change under way in the financial industry.

Negative interest rates are killing the mood at retail banks

«What kind of development do you expect in your organization's operating business?»



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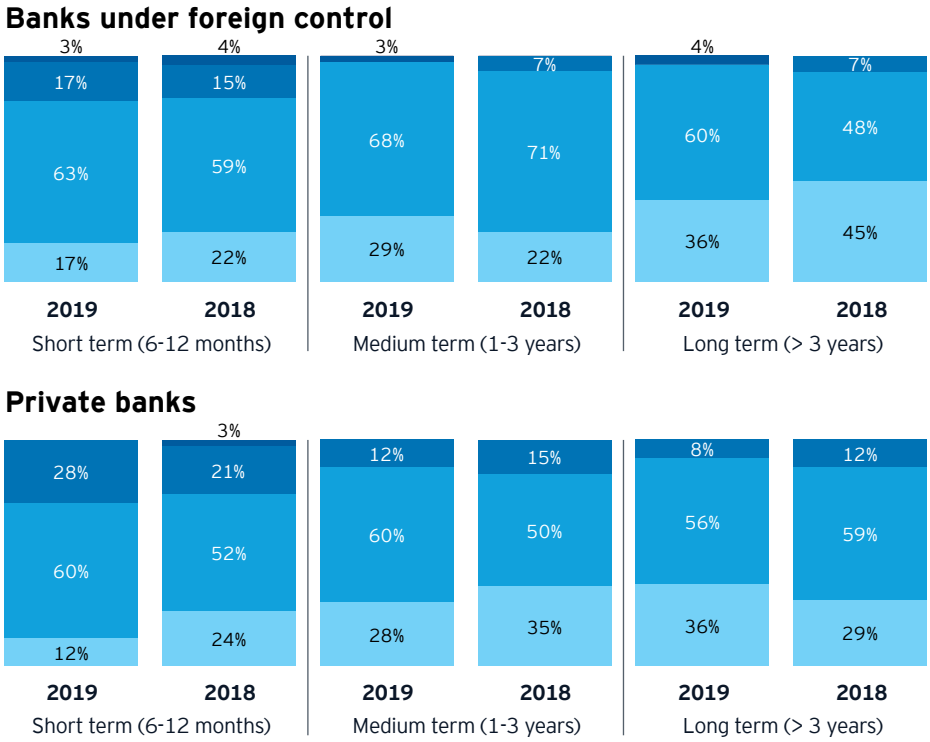
The individual banking groups already exhibited a very disparate view last year of their prospects for the future. Whereas there was healthy optimism among foreign and private banks operating primarily in the asset management business, when it came to the regional and cantonal banks, the mood was a lot more sceptical. These two camps grew even further apart this year, with the cantonal and regional banks suffering a massive crisis of confidence. Their outlook has clouded considerably for all planning horizons, but especially over the medium term. Fewer and fewer regional banks are positive about the future: only 50% in the short term (previous year: 72%, down 22 percentage points), 30% in the medium term (previous year: 77%, down 47 percentage points) and 35% in the long term (previous year: 89%, down 54 percentage points). The picture is similar among cantonal banks, where – depending on the planning horizon – only between 38% and 56% of the banks surveyed are looking to the future with optimism. The declines versus the previous year range between 24 percentage points (short term) and 37 percentage points (medium term).

Private banks and foreign banks, by contrast, are similarly optimistic as they were a year ago. In the medium to long term, only isolated banks expect their operating results to fall (3% and 4%, respectively, for foreign banks and 12% or 8%, respectively, for private banks). Accordingly, the medium and long-term outlook of this banking group has brightened further compared to last year, while the short-term outlook has deteriorated slightly.

What is the reason for these wildly differing assessments concerning their future prospects? Among the cantonal and regional banks, the overriding concern seems to be that there is no end in sight to the prevailing low interest rate environment, which is pushing the business models of these banks to their limits. Foreign and private banks, meanwhile, have already undergone a far-reaching transformation in recent years as they have restructured their cross-border asset management in line with new tax laws, and feel well equipped for the future given their negligible dependence on the interest margin business.



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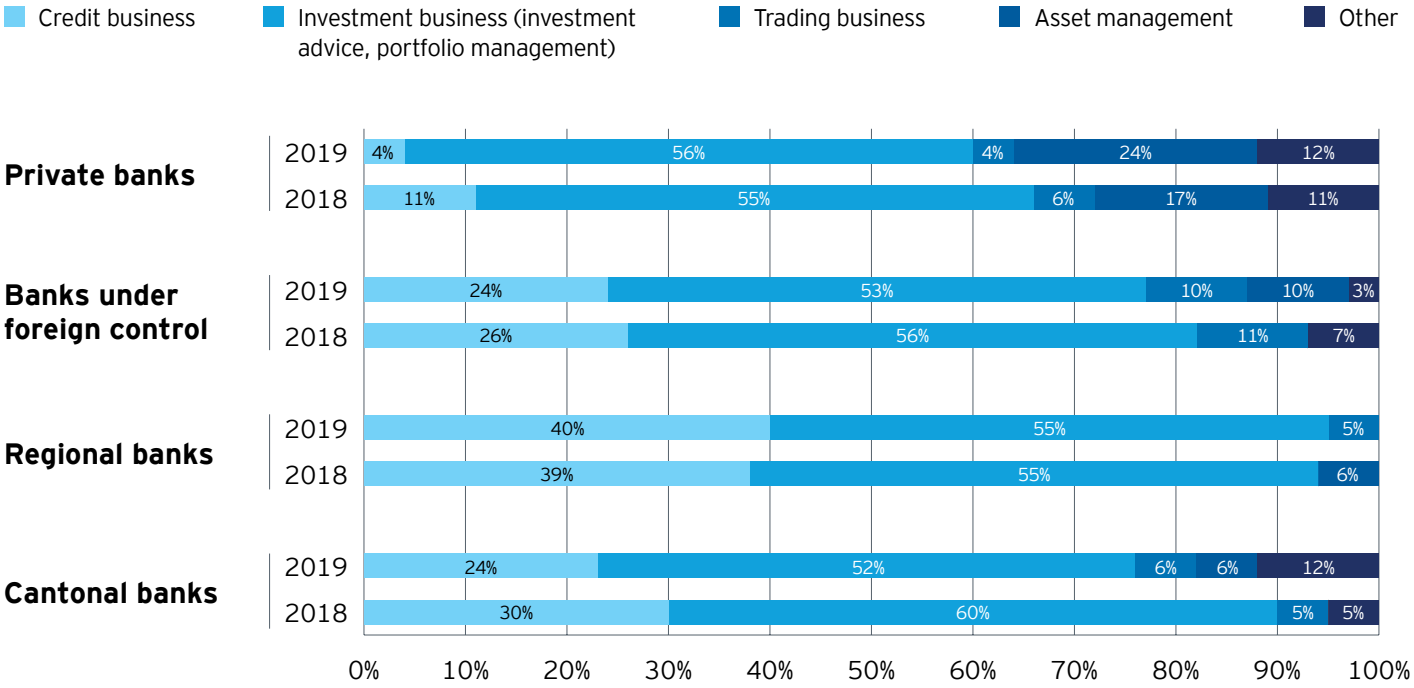
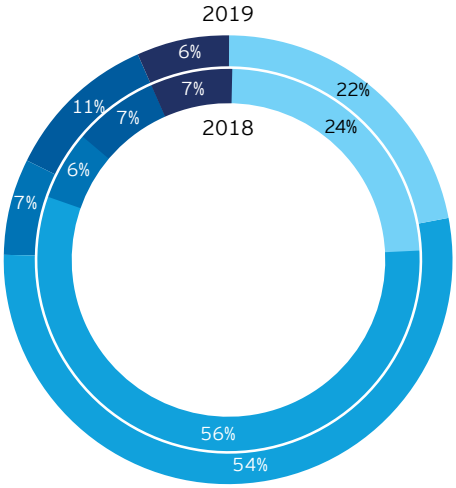
Investment business still top priority

«In which business segment do you expect the biggest growth potential for your organization?»





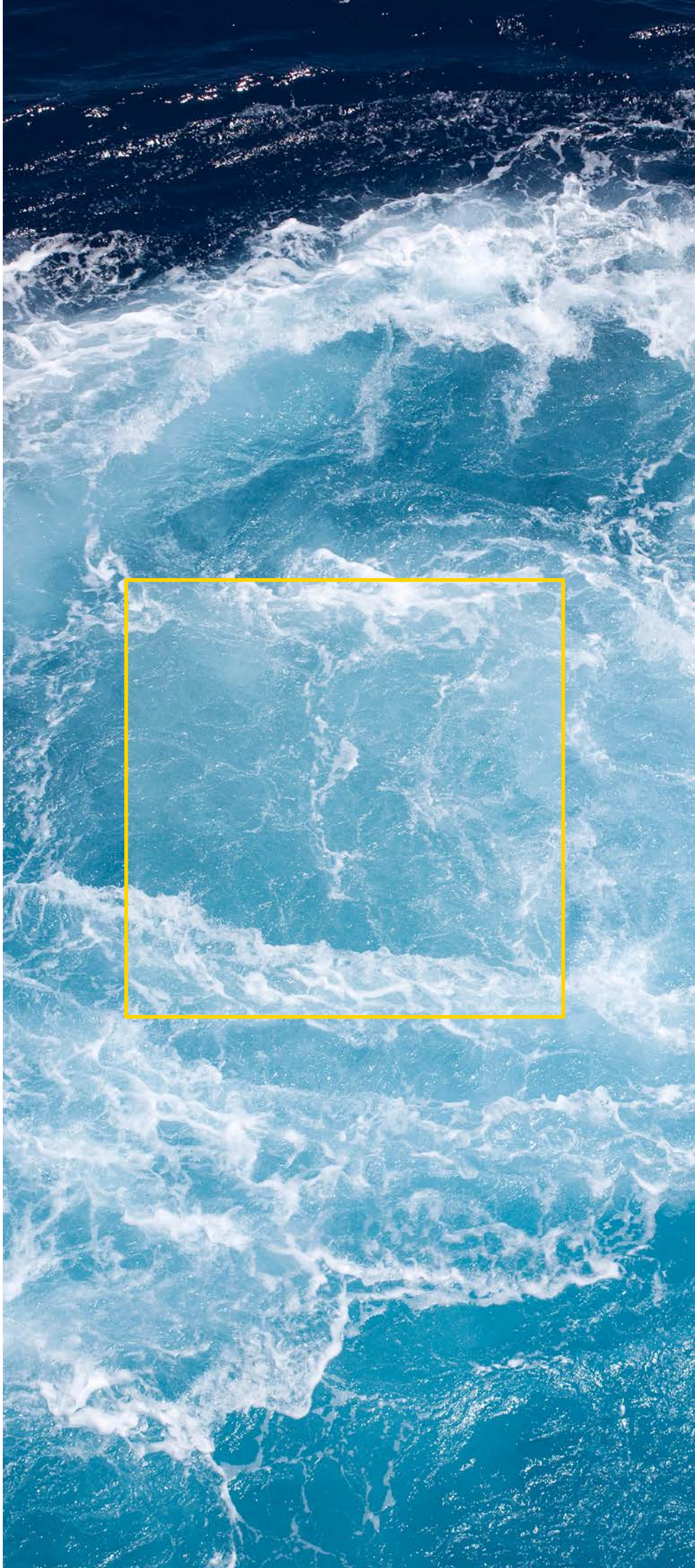
As in the previous year, the majority of banks – 54% – perceive their greatest potential for growth to be in the investment business (investment advice and portfolio management; previous year: 56%). 11% of banks are turning to asset management to generate growth (previous year: 7%, up 4 percentage points). The lending business, by contrast, seems to be declining in importance, with just 22% of banks (previous year: 24%) saying that the lending business is the greatest driver of growth. Among the cantonal banks in particular (24%), a shift can be observed away from the lending business as the primary growth driver (previous year: 30%, down 6 percentage points).

This result hardly comes as a surprise: the lending business has lost a lot of its appeal in recent years, as low interest rates continue to squeeze the interest margin and the market is pushed to the point of saturation on the back of the preceding massive increase in volumes. This is forcing many banks to ramp up their focus on the investment business as can already be seen in banks' 2018 operating results. While income from commission and service fee activities was up slightly by 1.2% to CHF 22.0 billion, income from interest rates fell by 1.8% to CHF 23.5 billion. The interest income business is still the major source of income for Swiss banks; however, its lead over the commission and service income business has contracted to now just CHF 1.5 billion.

It is difficult to predict how successful this shifted focus on the investment business will be. The growth potential of the investment business in the Swiss market is structurally limited and the combined growth ambitions of all banks likely outstrip the effective potential of the Swiss domestic market. A glance at the volumes of foreign assets under management at Swiss banks for private customers shows that these have almost halved (49%) so far this millennium, down from CHF 997 billion

in 2000 to CHF 513 billion at the end of 2018. Adjusted for (positive) exchange rate developments[4], this decline would likely be even more dramatic. It is also assumed that new technologies and business models will further exacerbate the competitive situation.

[4] For example, the MSCI World stock market index increased almost three-fold during the same period.



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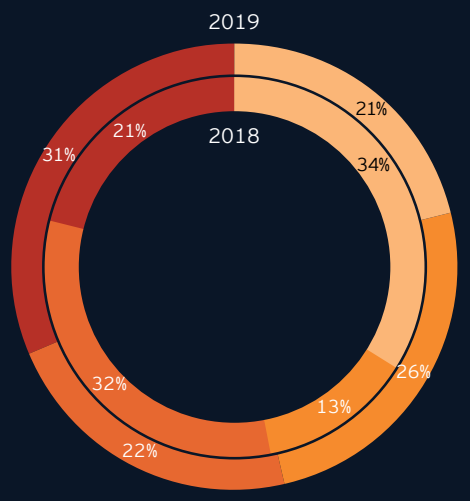
Negative interest rates are already a reality for wealthy private customers – how long can banks continue to protect small savers from negative interest rates?

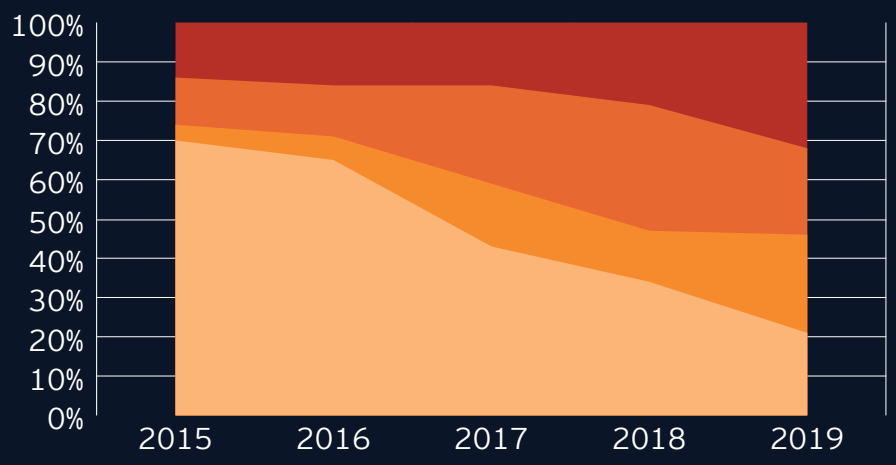
Patrick Schwaller
Managing Partner
Audit Financial Services

5 Negative interest rates

It is becoming the norm to pass on negative interest rates...

«Does your organization intend to introduce negative interest rates in the private customer business?»





- No, under no circumstances
- Yes, but only for balances in excess of CHF 100,000
- Yes, but only for balances in excess of CHF 1 million
- Yes, but only if the SNB increases the negative interest rate further (e.g., to -1.5%)

The share of Swiss banks that can envision passing on negative interest rates to private customers increases with each year that the low interest rate environment persists. Whereas in 2015 70% of the banks surveyed categorically ruled out passing on negative interest rates, the figure is now only 21%. This constitutes a further year-on-year decline of 13 percentage points (previous year: 34%).

The customer segment of so-called affluents – that is, customers with net assets totalling over CHF 100,000 – has been especially hard hit by this development, as a glance at the responses of the private banks reveals. Indeed, the share of private banks that could envision passing on negative interest rates for affluents has risen markedly from 24% last year to 56% today. 24% of private banks, slightly more than the previous year, categorically rule out passing on negative interest rates to private customers (previous year: 18%).

This year's survey shows that the persistent unsatisfactory interest rate situation is now also forcing regional banks to rethink their stance on this matter, with just 67% of regional banks categorically ruling out passing on negative interest rates last year, compared with just 20% now. The picture is similar at the cantonal banks, where as recently as last year one quarter categorically excluded taking such a step; this year, this figure declined by a further 7 percentage points to just 18%.

...but how long will small savers be spared?

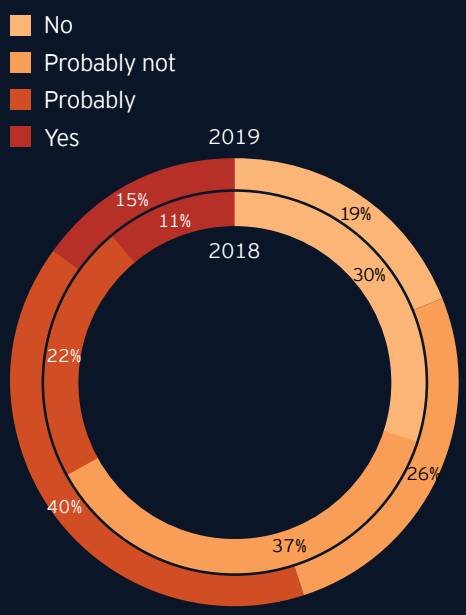
«Does your organization intend to reduce the minimum balance for passing on negative interest rates to your customers?»

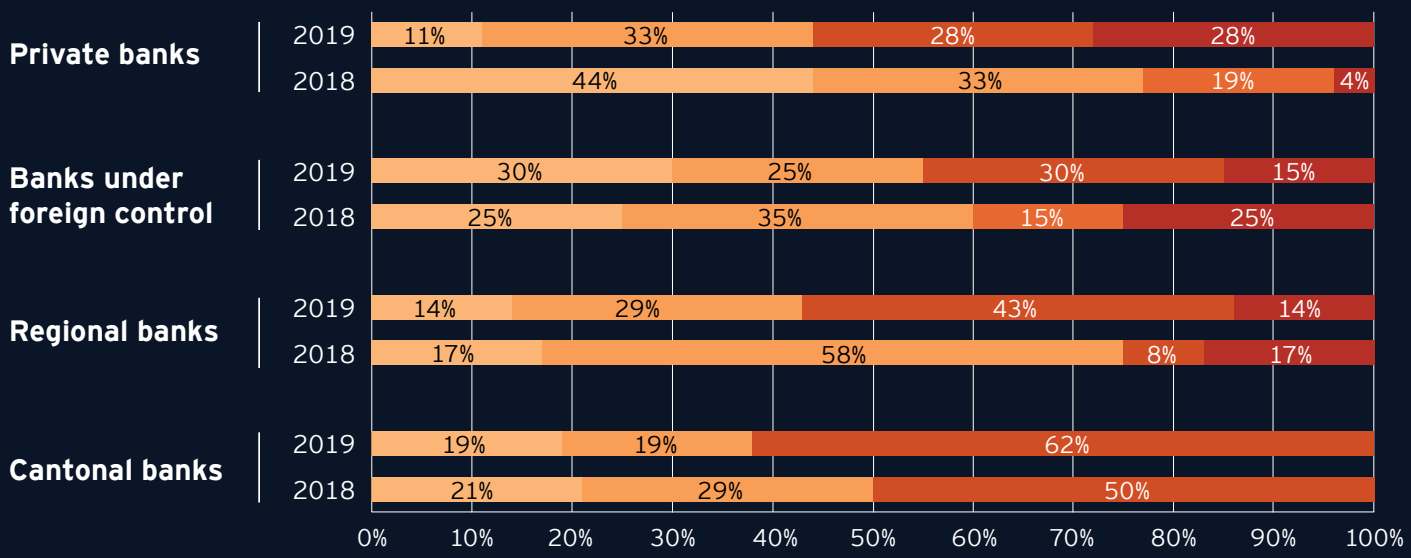
Effective November 1, 2019, the SNB increased the allowances in excess of which banks have to pay negative interest on the monies deposited in their coffers, mitigating somewhat the pressure on banks caused by the negative interest rate environment. In spite of this positive measure for banks, this year more than one half of banks (55%) – a considerable increase of 22 percentage points on last year's figure of 33% – say they would like to lower the threshold from which they would like to apply negative interest rates to customer deposits.

For a long time, the idea of charging negative interest on customer deposits was taboo. But with each year that low interest rates persist, the pressure on banks to pass on negative interest rates to customers increases. A look at the SNB's operating figures confirms this picture: in each of the past two years, banks had to pay around CHF 2.0 billion to the SNB in negative interest rates – equivalent to almost one fifth of bank's cumulative annual profits.[5]

Until now, only corporate customers and very wealthy private customers have been asked to dip into their pockets to offset this shortfall. However if, with each year that passes, banks want to reduce the threshold more and more, it would seem only a matter of time until the first (less wealthy) private customers have to pay negative interest, especially if aside from their cash savings they do have any other products that are profitable for the bank.

[5] Calculated on a simplified basis as "SNB income from negative interest rates" divided by the cumulative income of Swiss banks for 2018.



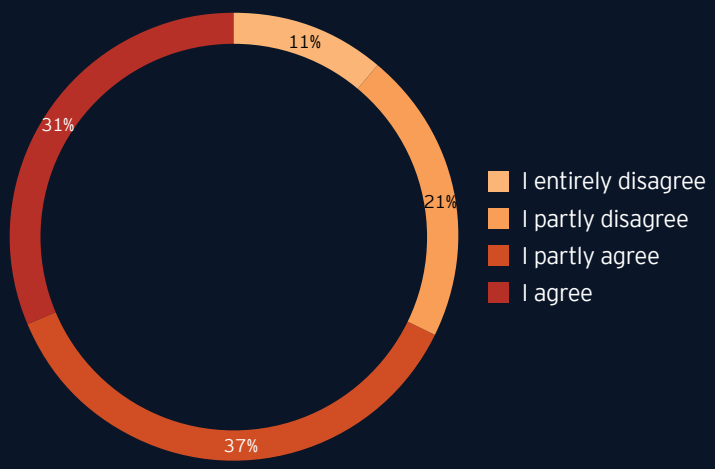


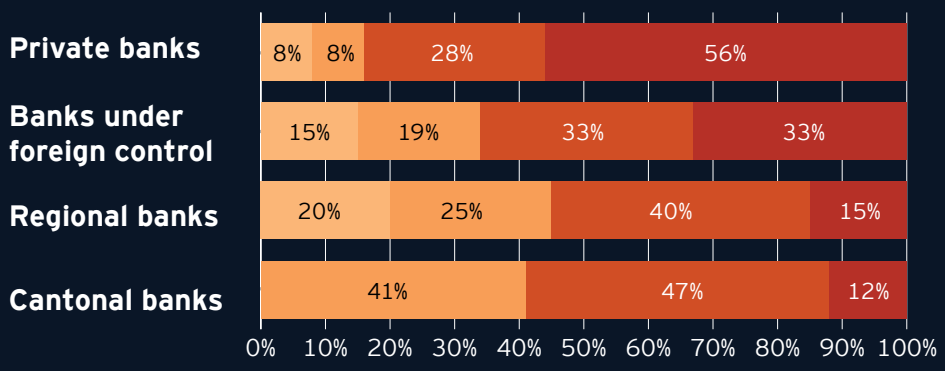
Pure savings customers no longer welcome

«Do you agree with the following statement? Given the current interest rate environment, having relationships with pure savings customers is less interesting / attractive for our bank.»

The negative interest rate environment that has prevailed for several years now means that customer relationships with pure savings customers can no longer be maintained at a profit. It is hardly surprising, therefore, that as many as two thirds of the banks surveyed (68%) are not very well disposed toward savings customers at the present time. This is especially true at private banks (84%). But at the majority of cantonal banks (59%) and regional banks (55%) as well, savings customers – in particular, opportunistic savings customers – are no longer being welcomed with open arms. The adverse effects of negative interest rates are making their presence felt here: banks are starting to ask themselves how they can avoid attracting additional, purely opportunistic deposit business and what kind of incentives they can offer to encourage existing savings customers to expand and develop their business relationship.

Swiss banks are looking for ways out of the difficulties caused by the currently low interest rates. The primary initiatives are to introduce new fees for account management, issuing payment cards or executing foreign currency transactions. According to this study, however, this will likely just be a temporary band-aid (see p. xy for more information). Another strategy to boost revenue is to persuade customers to invest more of the assets "parked" in savings accounts in funds or securities. Against the backdrop of increasing uncertainties on the investment markets, implementing this seemingly straightforward strategy will be no easy task, however. What is more, this strategy harbours suitability risks if banks fail to carry out a detailed and extensive suitability and adequacy test for their customers in advance.





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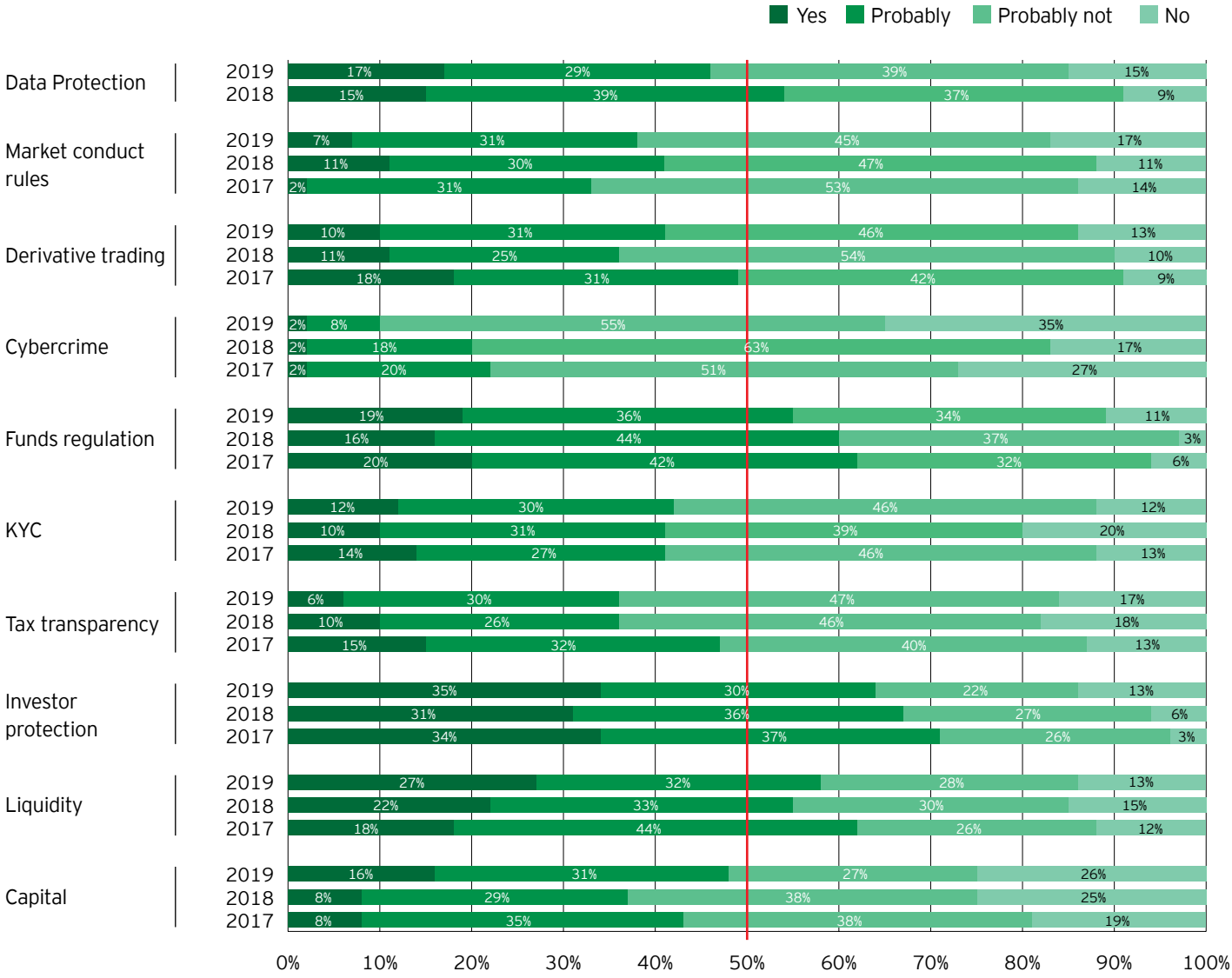
It is somewhat ironic that the regulatory measures introduced by the central banks to manage the last financial crisis have been identified as the likely cause for a possible next crisis.

Patrick Schwaller
Managing Partner
Audit Financial Services

6 Financial market regulation

Balanced regulation – more scepticism concerning equity capital regulations

«In which of the following areas have Swiss regulations potentially gone too far and therefore resulted in negative impacts?»



More than ten years ago, the outbreak of the financial and economic crisis sent devastating shockwaves throughout the global economy and world of finance. In response to the financial crisis, regulators worldwide and in Switzerland tightened the regulatory reins. There were three main objectives: more capital, more liquidity and contingency plans for systemically relevant banks.

Implementing these new regulations generated substantial costs for banks. In spite of these financially undesirable spillover effects, banks fundamentally acknowledged the sense and purpose of the new regulations. Nevertheless, the survey reveals rising scepticism on the part of banks versus the previous year concerning key areas of regulation such as "Capital" (up 10 percentage points), "Liquidity" (up 4 percentage points) and "Derivatives trading" (up 5 percentage points).

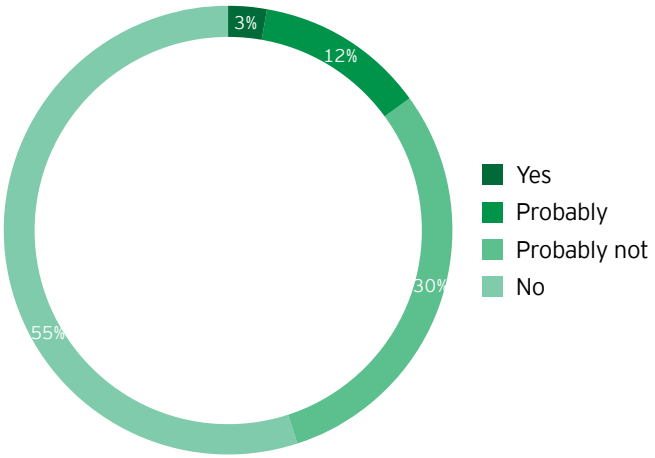
The Swiss authorities stepped up the capital regulations for systemically relevant banks another notch in November 2019 when they adopted the final capital rules. Switzerland now has one of the most stringent capital regimes in the

world, something the country's major international banks in particular think puts them at a decisive disadvantage to their foreign competitors, since procuring additional risk capital such as bail-in bonds generates high additional costs. Swiss big banks have to hold more capital and have higher capital costs than their global peers.

On the other hand, a contrary trend can be observed on the topic of "Data protection": whereas last year more than one half of banks (54%) said they thought there was a tendency toward over-regulation in this area, this year this figure was just 46%. This is a pattern frequently seen when new regulations are introduced. In the initial analysis and implementation phase (including also investments in new IT systems), compliance costs are comparatively high and criticism of the regulatory project in question is correspondingly strong. Once this initial phase is complete, costs gradually start to fall again, which usually results in broader acceptance of the regulation at the companies affected.

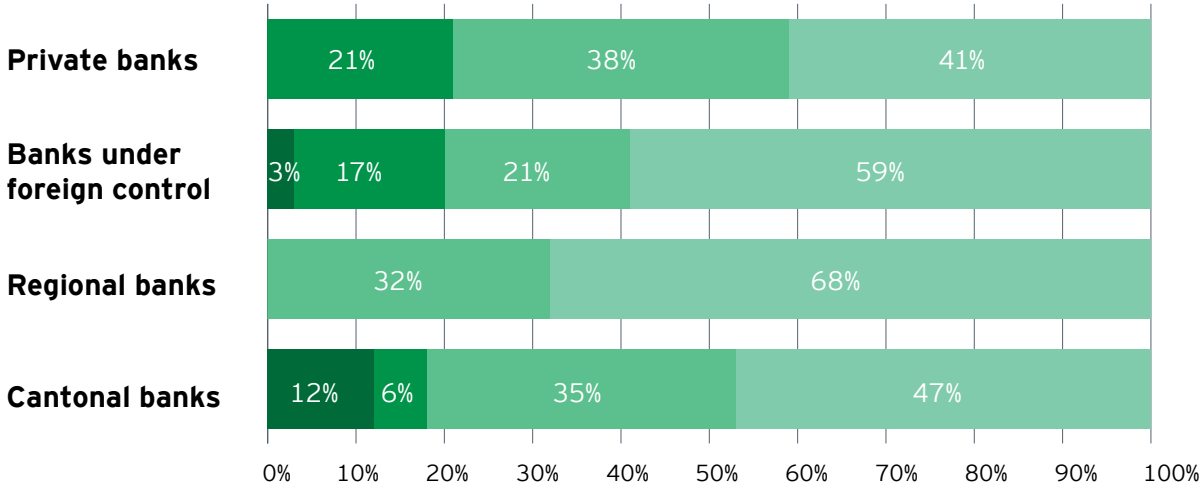
Banks appear unfazed in spite of the Federal Supreme Court ruling in respect of administrative assistance with France

«Are you concerned that the Federal Supreme Court's decision of July 2019 could have negative effects on your bank and its business model?»



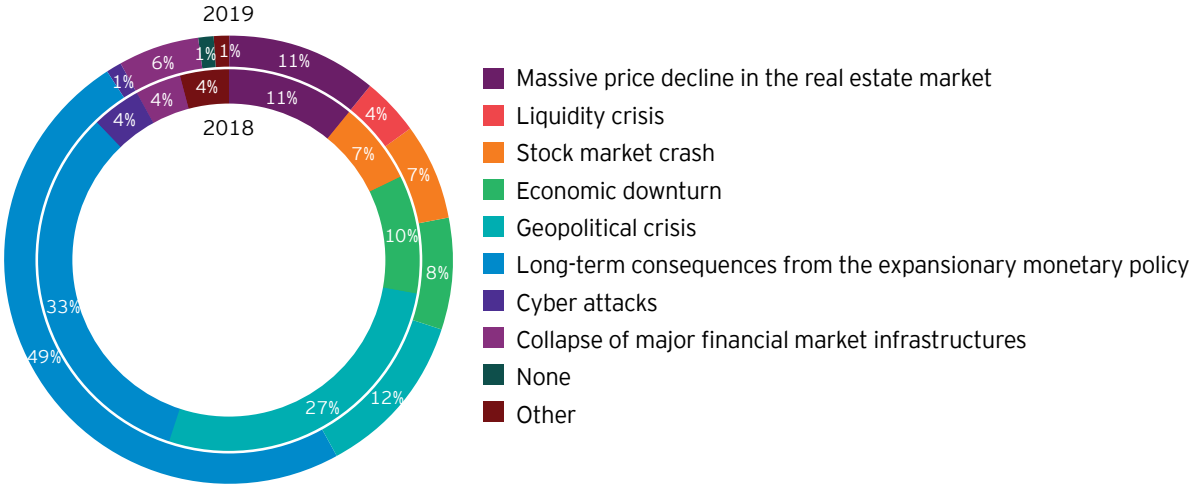
The Federal Supreme Court ruled in July 2019 that the Swiss Federal Tax Administration must provide, through administrative assistance channels, the names and further information concerning over 40,000 French banking customers to the French tax authorities. This overturned the lower-court ruling by the Federal Administrative Court, which had deemed the French request for administrative assistance an illegitimate fishing expedition. The decision by the Federal Supreme Court was perceived by many people as a judgment against the Swiss financial centre that could pave the way for more and more unsubstantiated requests for information. In addition, multiple observers perceived the danger that the data surrendered could be used for ends other than the tax purposes intended and thus could undermine the "principle of speciality." In view of these circumstances, the Swiss Bankers Association acknowledged the ruling "with great scepticism."

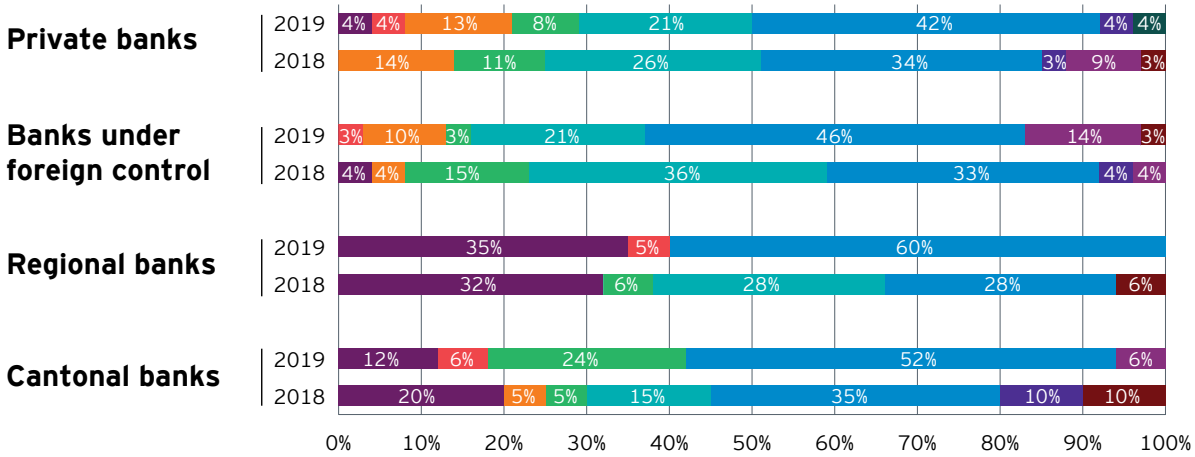
It may come as a surprise, therefore, that only 15% of the banks surveyed fear that the Federal Supreme Court ruling on providing customer data to the French tax authorities will have negative repercussions for their bank. What comes as no surprise, however, is that private banks, which are more firmly anchored in cross-border banking, are more concerned than cantonal and regional banks, which are focused on the domestic market. Accordingly, 21% of private banks perceive negative repercussions for their bank, while as far as the regional banks are concerned, not one single bank thinks it will be affected by this Federal Supreme Court ruling.



Monetary policy proving the major cause for concern

«What do you see as the greatest danger that may cause a next financial crisis?»





For some time now, an increasing number of not only economists and market players, but also leaders of industry, have been warning about the potentially disastrous consequences of the sustained ultra-expansive monetary policy being pursued by the central banks. The inflation in asset prices, skyrocketing levels of debt, a lack of structural pressure in some areas of the economy and the widening wealth gap are some of the most frequently cited warning signals. Given these circumstances, it is hardly surprising that almost one half of Swiss banks (49%) believe the greatest risk for a possible ensuing financial crisis lies in the ultra-expansive monetary policy. This is a significant increase in comparison to the previous year, up 16 percentage points. It is somewhat ironic that the regulatory measures introduced to manage the last financial crisis have been identified as the likely cause for a possible next crisis.

Concerns about the consequences of the current monetary policy seem to be overriding the other risk areas, with just 12% of banks naming geopolitical uncertainties as the greatest risk. With the trade dispute between the USA and China, on the one hand, and Europe, on the other, still far from resolved, and tensions in the Gulf region bubbling up again, this figure is lower than might have been expected. Banks' assessment of the dangers posed by the real estate market has remained virtually unchanged versus last year. Slightly more than one tenth (11%) of the banks surveyed perceive the greatest risk in a collapse in prices on the real estate markets, while 8% put the ramifications of an economic downturn at the top of the list of potential dangers.

“

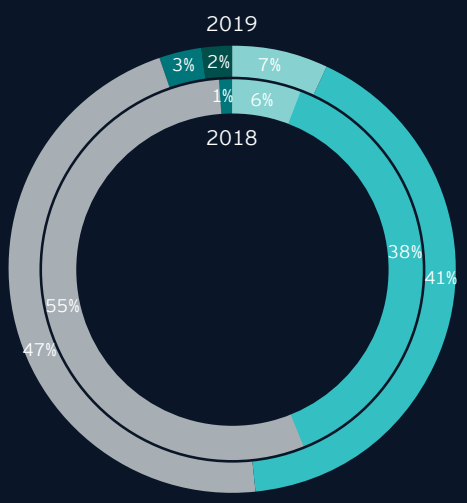
The scenarios for economic performance continue to deteriorate. Yet banks remain cautiously optimistic. If banks want to come out on top of the next economic downturn, they need to initiate the right steps in risk management sooner rather than later.

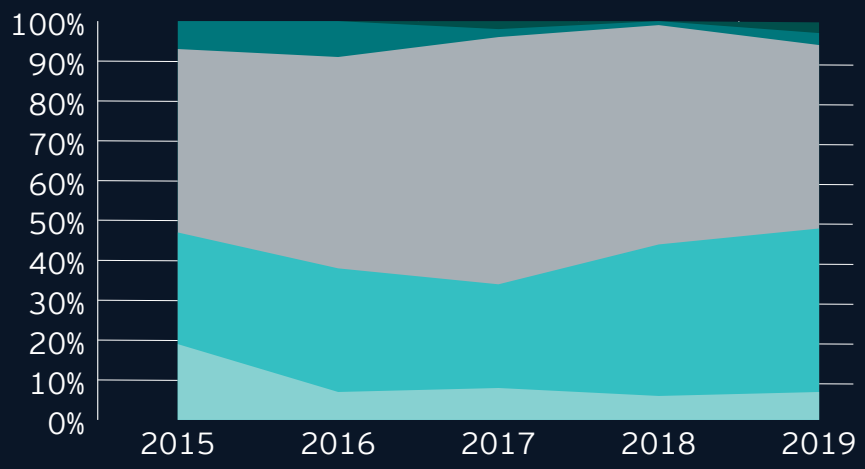
Olaf Topefer
Partner
Leader Banking & Capital Markets

7 Lending business

Is housing financing showing signs of saturation?

«How do you expect the lending policy of Swiss banks in the residential property segment to develop in the next 6 to 12 months?»





- Become more restrictive
- Become somewhat more restrictive
- Remain unchanged
- Become somewhat more expansionary
- Become more expansionary

Swiss banks have massively expanded their mortgage lending business in recent years, and over the course of 2018 broke the symbolic barrier of CHF 1,000 billion in mortgages lent for the first time. This trend was driven primarily by the Raiffeisen banks and the cantonal banks, which have expanded their mortgage lending volumes by a staggering 203% and 105%, respectively, since 2000.

In the last two years, however, the appetite for new residential property financing has waned slightly. While 47% of banks (previous year: 55%) intend to continue the lending policy they have adopted in recent years, 48% of banks currently anticipate pursuing a more restrictive lending policy for residential property financing going forward (previous year: 44%). The reasons for this more cautious approach are the gradual saturation that is setting in on the real estate market coupled with stricter regulatory conditions governing the financing of investment properties.

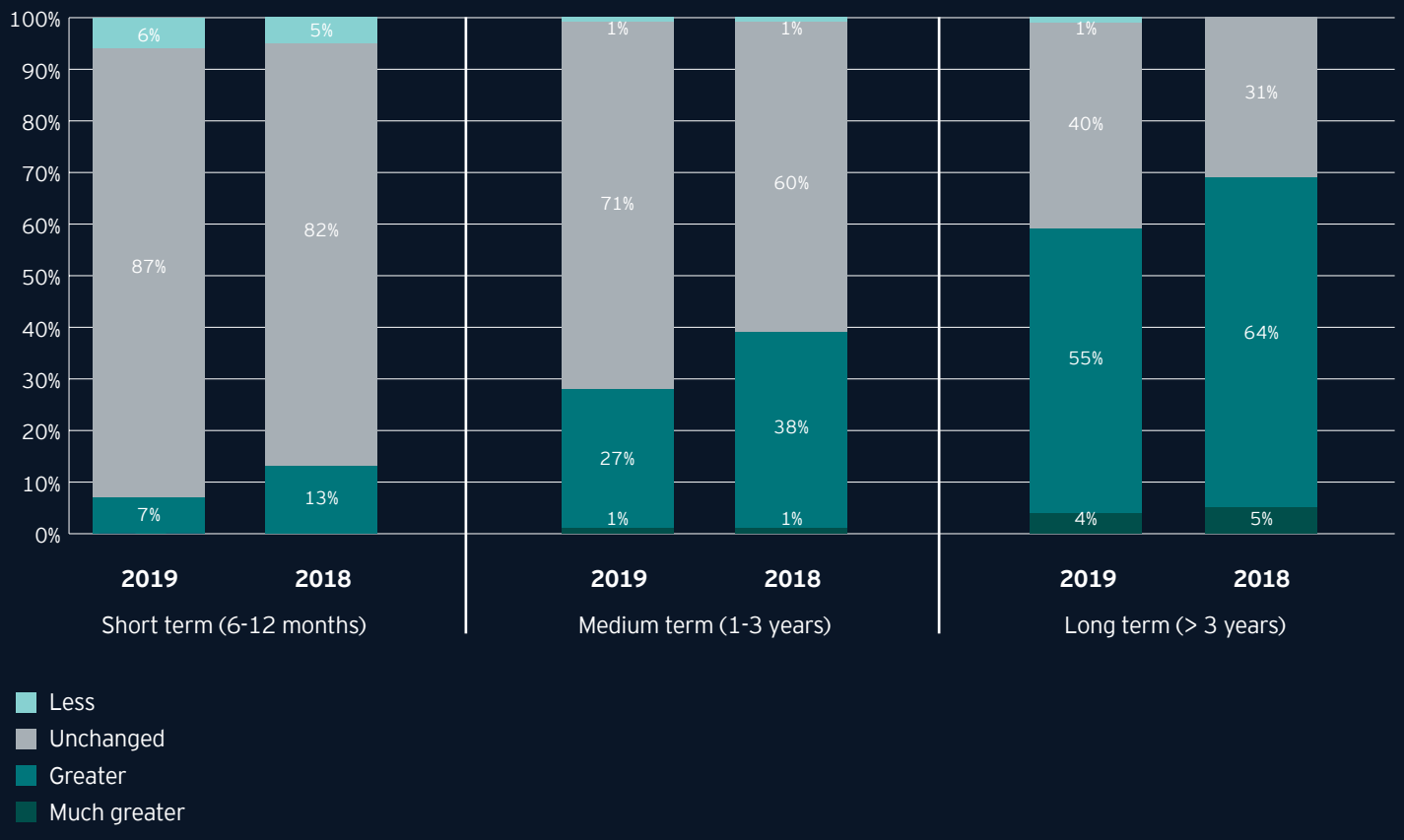
The share of banks that want to adopt a more expansionary lending policy in the future is still very low at 5%, albeit up slightly on the previous year's figure of 1%.

No credit defaults expected in the medium term

«What level of risk provisioning (impairment losses and provisions) do you expect you will need to cover your housing financing business in the short / medium / long term?»

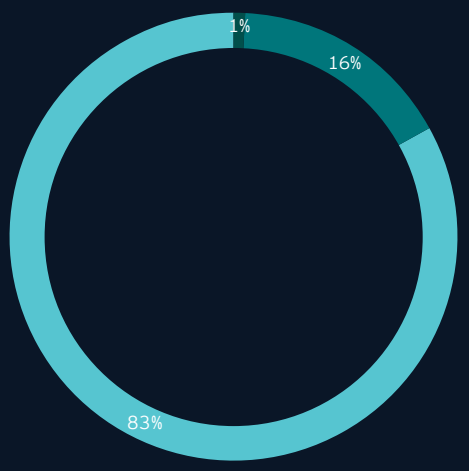
The vast majority of Swiss banks are completely unconcerned about the level of risk provisions needed to cover housing financing. In the short term, just 7% of the banks surveyed anticipate a rising need for impairment allowances, another 6 percentage points less than in the previous year. This brighter outlook on the part of banks is even more pronounced in the medium term, with only 28% (previous year: 39%, down 11 percentage points) expecting a greater risk provisioning requirement. This extremely positive assessment is also gradually starting to trickle through into banks' long-term outlook: only slightly more than one half of banks (59%) think that impairment losses will increase in the long term, once again a sizeable decrease on last year's result (previous year: 69%, down 10 percentage points).

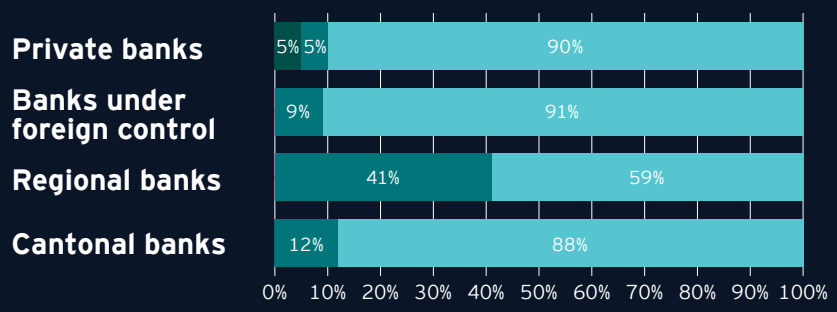
Where is this added confidence coming from? The greatest risk to the upwards trend of real estate prices is a marked rise in interest rates, which in all likelihood would lead to lower prices. However, such an interest rate hike has been pushed to the back burner in recent months in the wake of the Fed's about-face on monetary policy. Toward the end of last year, the successive interest rate increases by the US Fed were interpreted as a sign that the ultra-expansive monetary policy would soon be coming to an end. As 2019 progressed, however, these hopes went up in smoke, and instead the Fed made three preventive rate cuts of 25 basis points each. Another variable that could pose a substantial risk for the real estate market would be a severe economic downturn. Rising vacancies – especially on the market for office properties – coupled with increasing unemployment could develop into a serious problem for banks. Yet even though economic momentum in Switzerland lost some of its steam last year, the majority of economists assess the risk of a broad-based and far-reaching recession as small for the time being. These trends have obviously led Swiss banks to believe that they are once again increasingly on the safe side.



Mortgages with negative interest rates remain taboo

«Looking from today's perspective, it seems realistic that our organization will offer mortgage loans with negative interest rates in the future.»





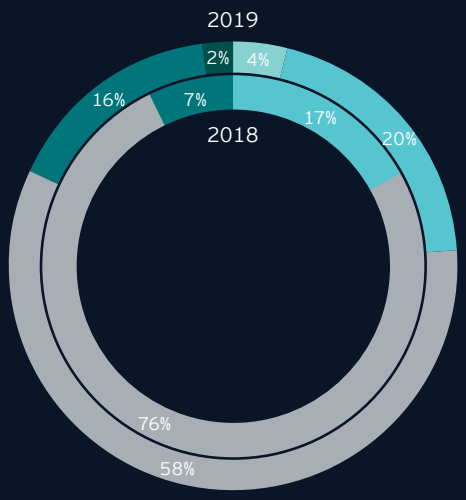
- Yes
- Yes, but only in individual cases for Private Banking or for institutional customers
- No

It sounds like a dream come true for borrowers: take out debt and be given extra money on top. This scenario, which until just a few years ago would have seemed completely absurd, is already reality in at least a few European countries. For example, Jyske Bank, Denmark's third-largest bank, this year granted the first mortgage worldwide with a negative interest rate. In addition, in November 2019, the state-owned development bank Kreditanstalt für Wiederaufbau (KfW), based in Germany, announced at an event that the following year it would like to start issuing promotional loans with negative interest rates. In an initial phase, this credit offering will be geared exclusively to banks and companies, but later will be extended to private customers as well. Here in Switzerland, a survey of cantonal banks published by Tamedia caused a stir when two cantonal banks revealed that under certain circumstances or in isolated cases they were issuing negative-rate mortgages to (institutional/commercial) large customers.

Faced with this development, the question begs itself as to whether going forward Switzerland will see negative-rate mortgages on a broader nationwide front. Swiss banks currently have a very clear stance on this matter: 83% of the organizations surveyed say it is unrealistic that they will issue mortgages with negative interest. Nonetheless, 16% state they would consider it in individual cases for private banking customers or institutional customers. Only one bank expects to offer negative-rate mortgages in the future.

Banks remain active in SME financing

«How do you expect the lending policy of Swiss banks in the SME segment to develop in the next 6 to 12 months?»



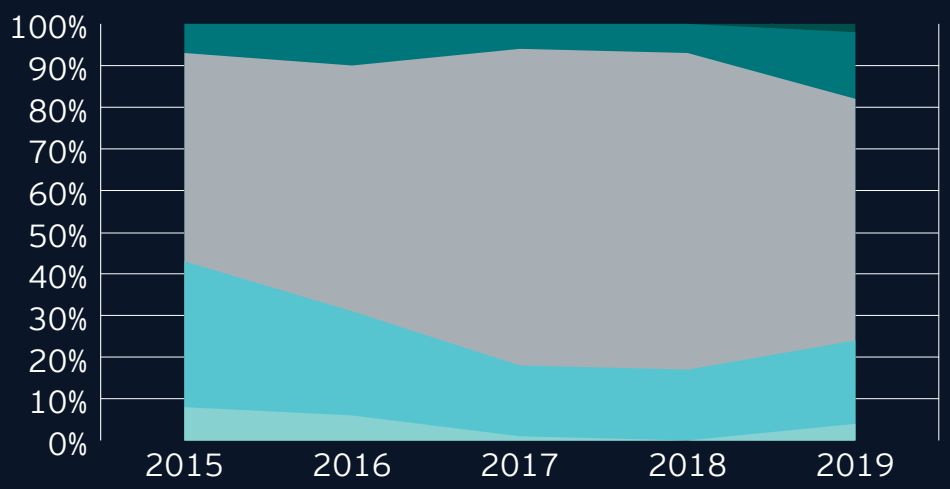
- Become more restrictive
- Become somewhat more restrictive
- Remain unchanged
- Become somewhat more expansionary
- Become more expansionary

Swiss banks upped their offered limits for business loans to SMEs in 2018 by 4.6% to CHF 441.3 billion.[6] The extent to which credit limits had been utilized by companies remained virtually unchanged at end-2018 at 70.3% (previous year: 70.6%).[7] This shows that Swiss banks play an important role in SME financing in Switzerland and the lending market for SMEs is functioning well.

It is unlikely that anything will change regarding this picture in the year ahead. While the share of Swiss banks that want to withdraw from SME financing going forward has increased slightly, up from 17% last year to 24% this year, the vast majority of banks still plan to leave their lending policy unchanged (58%) or even to expand it (18%). This means Swiss SMEs will not have to contend with any bottlenecks in the availability of borrowed capital in the future.

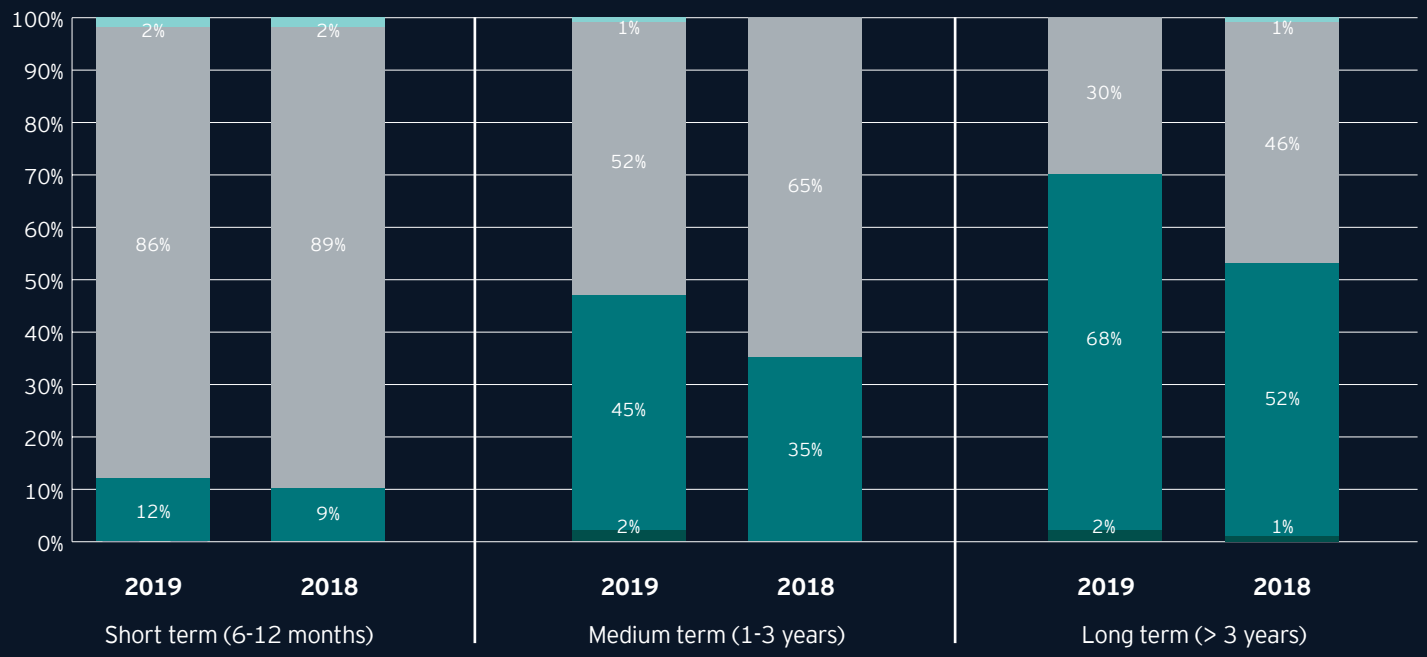
[6] Source: SNB

[7] Source: Own calculations based on SNB data



There is a risk of impairments in the long term for SME financing

«What level of risk provisioning (impairment losses and provisions) do you expect you will need to cover your SME lending business in the short / medium / long term?»



- Less
- Unchanged
- Greater
- Much greater

Although the latest economic reports still forecast moderate GDP growth in Switzerland, many economists are starting to become more pessimistic in their economic outlook. Significant risks would arise in particular from the deteriorating international situation (escalation of the trade conflict, growing tensions in the Gulf region). In addition, there is the risk of a self-accelerating downturn if the mood deteriorates at the end of the economic cycle, first among companies and then among individuals. Given these somewhat gloomier economic prospects, the likelihood is increasing that writedowns may be needed for SME financing in the long run. In the short term at least, banks remain unconcerned about any impairments for SME financing, with only 12% (previous year: 9%, up 3 percentage points) expecting greater short-term risk provisions from their corporate financing business. This picture deteriorates appreciably in the medium to long-term, however, and banks seem to be taking the economic risks associated with this seriously: one half of all banks (47%) already expect rising impairments in the medium term (previous year: 35%, up 12 percentage points); in the long term, this share rises to as much as 70% (previous year: 53%, up 17 percentage points).

Banks are under no illusion that we are probably at the end of the credit cycle and that the period without any significant credit defaults cannot last forever. In recent years, however, banks have only had to put their capabilities in the area of credit risk management to the test in isolated cases since the expansive monetary policy and the low/negative interest rate regime pursued by the central banks have seemingly eliminated many of the inherent risks – or have at least papered over the cracks. More precisely, it is to be hoped that the banks have not forgotten how to manage credit risks and handle potential credit defaults across the breadth of their financing business.

“

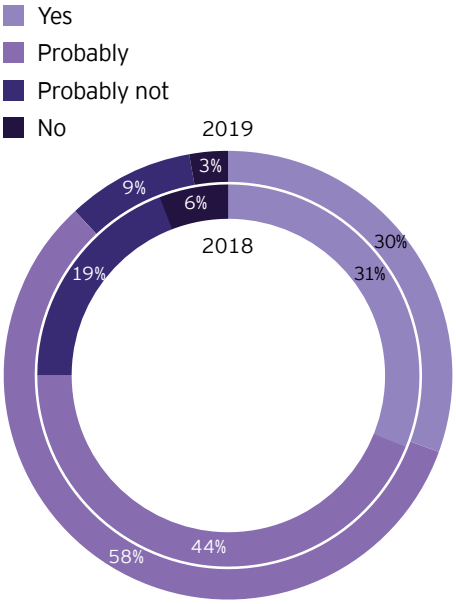
Today’s FinTechs are not changing how value is created in banking. However, banks that manage to put customers at the heart of their activities will be the ones that prevail in the long term.

Olaf Toepfer
Partner
Leader Banking & Capital Markets

8 Structural change and FinTech

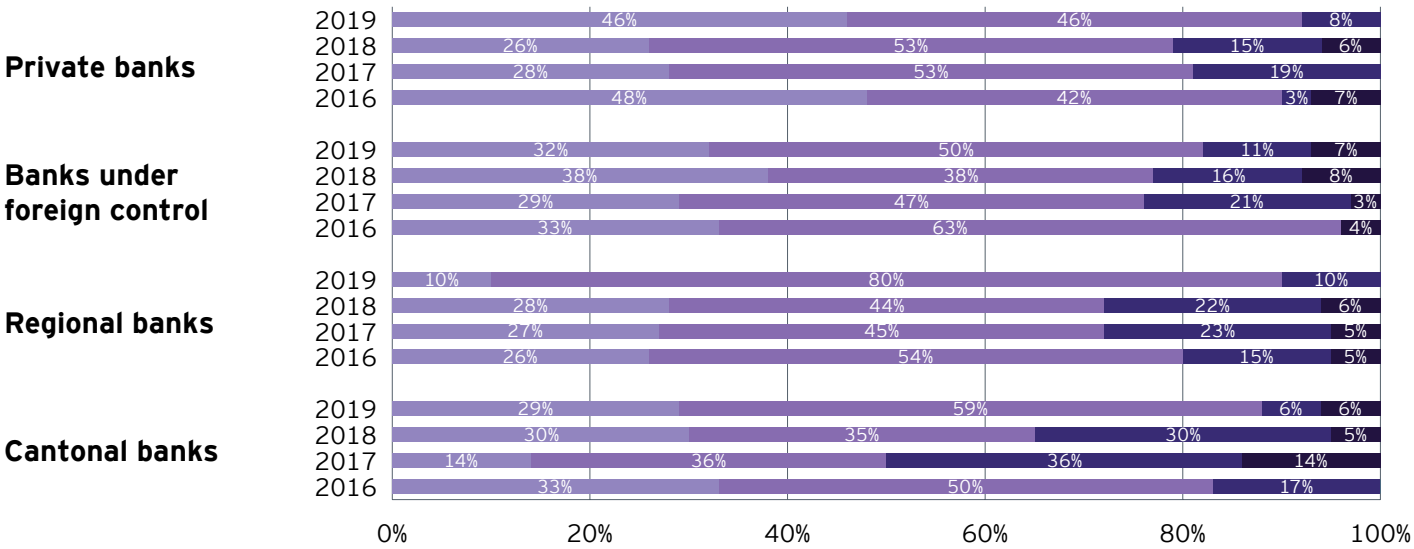
Banks are increasingly convinced that a structural change is under way

«In your opinion, is a fundamental structural change (sustained transformation of the value chain) already taking place in the Swiss financial services industry?»



The conviction that a fundamental structural change has begun in the Swiss financial industry strengthened again this year. Whereas two years ago 73% were of this opinion, this year the figure was 88%. The most significant change in perception can be seen at the cantonal banks, where in 2017 one half of cantonal banks were convinced of a structural change, compared with 88% in this year's survey.

Indeed, trends are emerging in the market which did not exist a few years ago and could trigger structural changes. Neobanks and marketplaces are frequently cited as an example here, although the ramped-up collaboration between established banking institutions and technology groups abroad (e.g. Google and Citi in the USA) is perhaps even more relevant. Even if neobanks do not pose any serious threat to established banks' core business at the present time, they are already encroaching on their traditional domains and in particular putting their margins under pressure. The first established organizations have begun responding to the "freemium" model adopted by neobanks and have cut their prices for standard retail services (e.g. card and account fees). Concerning the customer experience and user-friendliness offered to customers, neobanks are also setting new standards and are raising the expectations of bank customers. These developments mean that traditional institutions will have to step up investments in their sales channels and introduce more innovative offerings just to meet these rising expectations. It is highly unlikely, however, that customers will be willing to pay more for this improved customer experience.



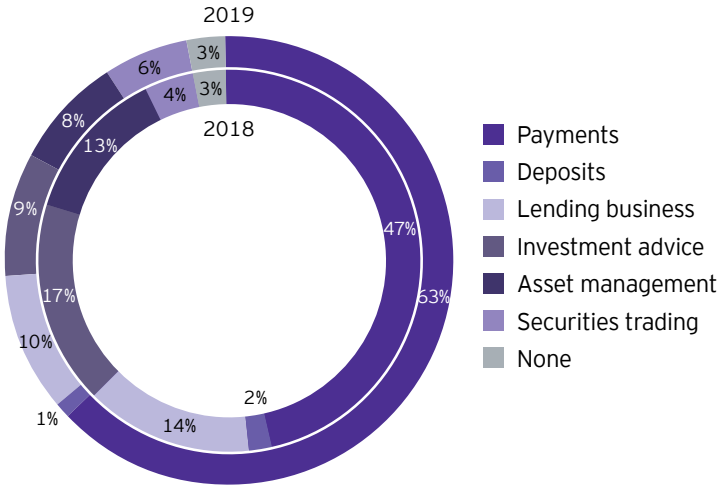
Payments a gateway?

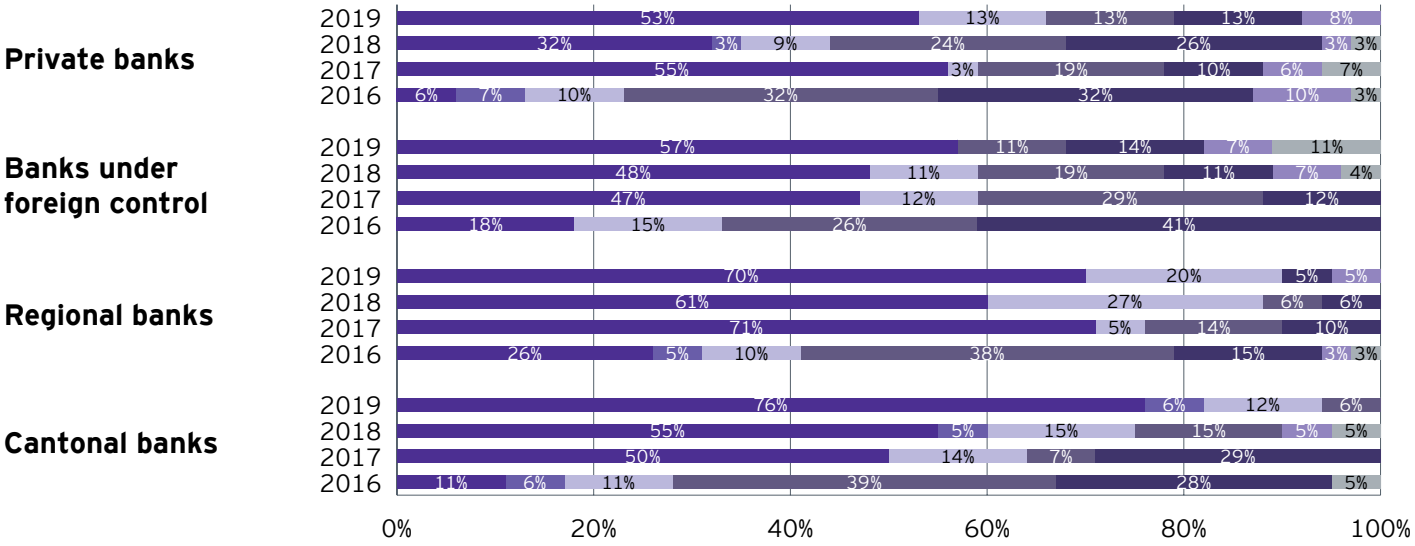
«In your opinion, which of the following business areas is most affected by structural change?»

A majority of 63% (previous year: 47%) of the banks surveyed are of the opinion that payments are most severely affected by structural change. This realization has continued to take hold in recent years.

The finding is hardly surprising, with more and more market players – including some from other industries – now offering customers alternative methods to execute their payments. One example which is currently not available in Switzerland is the Apple Card, a credit card from Apple and Goldman Sachs. The fact that an investment bank is interested in retail banking and has founded a digital retail bank is something worth noting, and its collaboration with Apple demonstrates its ambitions in this customer segment. Indeed, while there is not a great deal of potential in the payments segment to boost added value, it does offer the opportunity to occupy and develop the interface to customers. With this in mind, the area of payments, with its direct interface to customers and transaction data, holds great strategic relevance for the industry.

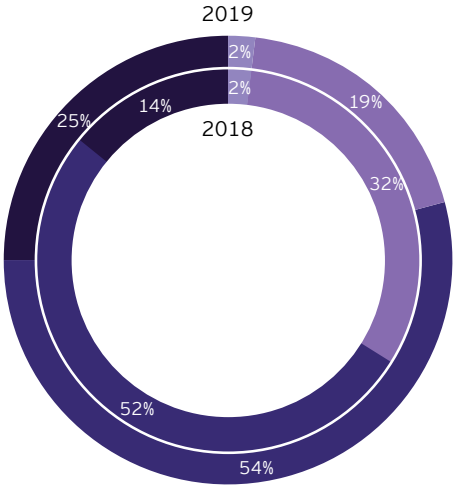
Interestingly, banks believe that their lending business is less severely impacted by structural change, with just 10% (previous year: 14%) identifying it as the most affected business area. A counterargument to this is that price transparency in the lending business has improved significantly, and the margins on lending to private customers have narrowed by a few basis points each year. This trend is particularly important for the cantonal and regional banks, since the lion's share of their ability to create value stems from the interest margin business.

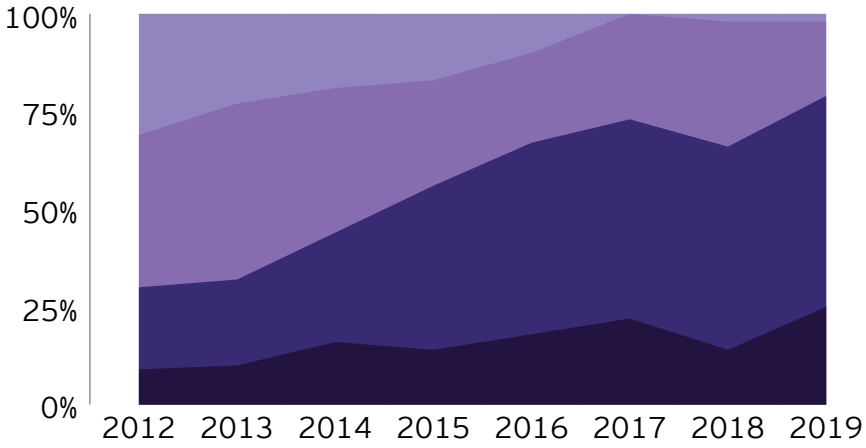




Competition is increasing from outside the sector

To what extent do you agree with the following statement? «Competitors from outside the sector (non-banks, FinTech, BigTech) are threatening the market position of banks.»





- I entirely disagree
- I partly disagree
- I partly agree
- I agree

The infiltration of providers from outside the industry into banks' traditional domains can no longer be ignored. When on the lookout for cheap mortgage financing, customers are increasingly being courted by offerings from insurance companies or pension funds, and barely a day passes where there isn't a report in the media about some new FinTech or other. It is therefore hardly surprising that banks have never perceived the threat from competitors from outside the sector to be as high as they did this year, with 79% of the banks surveyed overall (previous year: 66%) saying they feel their position in the market is under threat from non-industry providers.

Until just recently, in conversations with bank representatives, it was not uncommon to hear that the extraordinarily high entry barriers in the banking sector would prohibit non-banks from gaining a foothold in banks' core business areas. These barriers to entry are still there, yet competitors from outside the industry have become a reality that needs to be taken seriously. This applies in particular to isolated, clearly delineated sections of the value chain in banking.

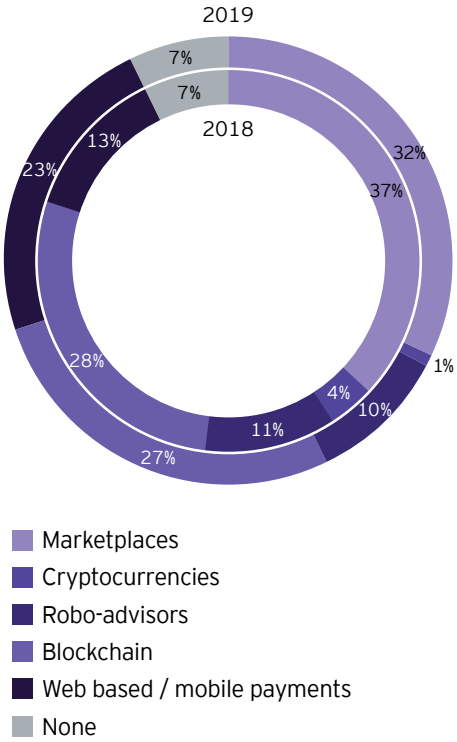
Depending on the business model, the dangers lurk elsewhere

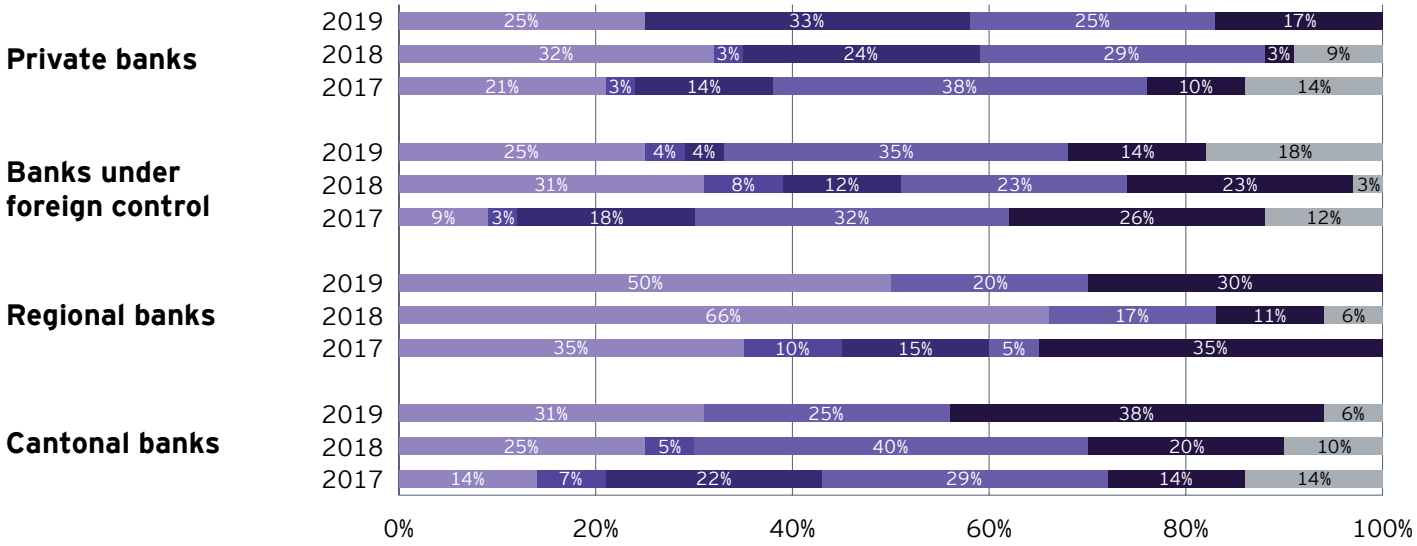
«Which of the following evolving technologies / businesses represents the biggest potential threat for well-established financial institutions?»

Swiss banks perceive the greatest danger for established financial institutions in three key developments: marketplaces/ platforms (32%), blockchain (27%) and mobile payment systems (23%). Here, banks believe that the threat posed by mobile payment systems has increased (previous year: 13%, up 10 percentage points), while that posed by marketplaces/ platforms has slightly decreased (previous year: 37%, down 5 percentage points). The assessment of the potential risk of blockchain technology, by contrast, has remained virtually unchanged (previous year: 28%, down 1 percentage point). Only 18% of banks perceive the greatest potential threat in other developments such as roboadvisors (10%).

Something that comes as less of a surprise is how wildly bank's responses differ when asked which direction a threat could come from. Regional banks see marketplaces and exchange platforms as the greatest threat for their business (50%), while cantonal banks put mobile payment systems at the top of their list (38%). The picture is different again at private banks: although the assets under management by roboadvisors in Switzerland are still modest and in recent months a wide range of initiatives were halted, respect for system-supported investments has increased yet further and one third of private banks think they pose the greatest threat for their organization (previous year: 24%).

This survey result reveals, on the one hand, the high degree of uncertainty when assessing potential threats, with banks with a very similar business model (e.g. cantonal banks and regional banks) perceiving the dangers as coming from different directions. While, on the other, it shows that a range of different developments are accorded a high factor of risk: marketplaces and platforms for brokering loans and mortgages, blockchain technology for tokenizing assets, and system-supported investments in private banking and wealth management.

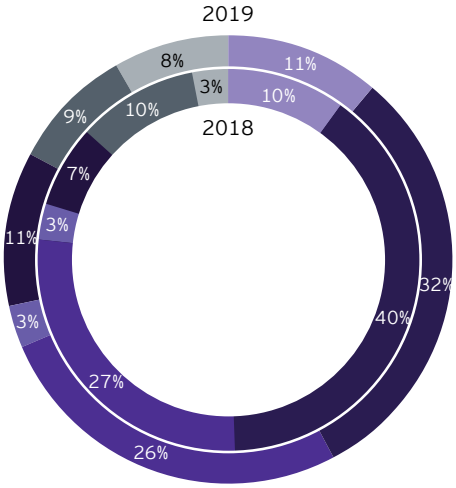




Customer proximity and consulting quality are decisive

«In your opinion, which factor will be decisive in order to ensure customer loyalty in the future?»

Like last year, banks are of the opinion that proximity to customers (32%, previous year: 40 percent) and high quality of advisory services (26%, previous year: 27%) are the decisive factors for ensuring customer loyalty.

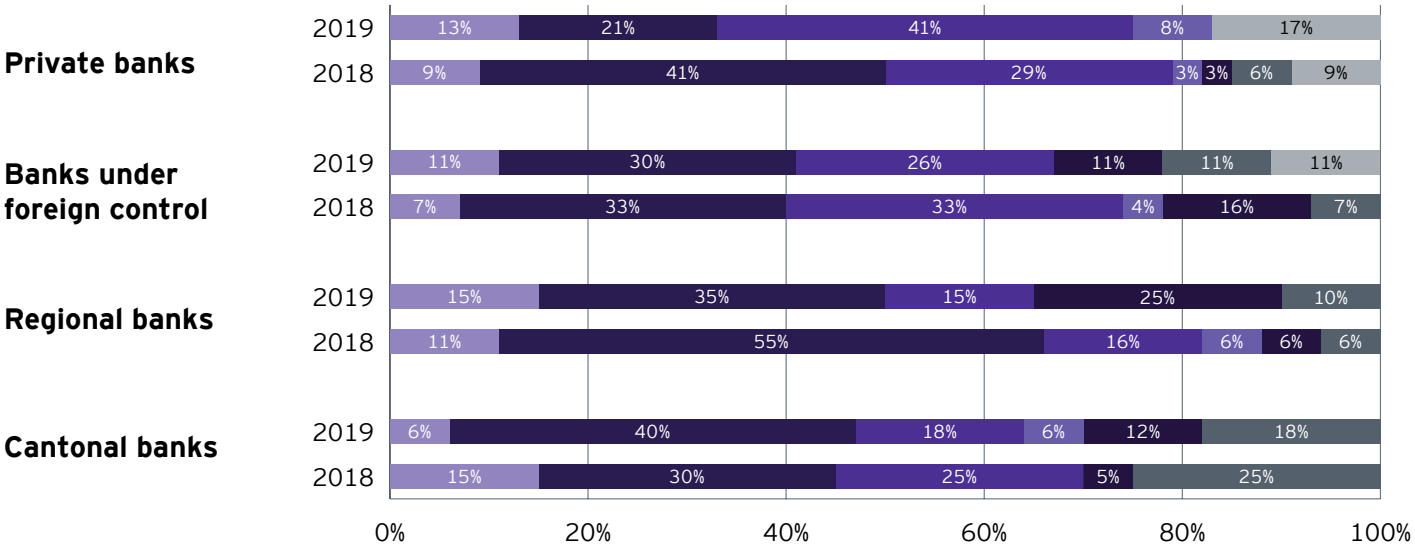


- Security / stability of the bank
- Proximity to the client
- High quality of advisory services
- Excellent online offerings
- Good value for money relation
- Reputation of the bank
- Innovation

In retail banking, it has become increasingly challenging in view of prevailing trends to stay close to customers through the entire lifecycle and to build up strong customer loyalty. Customers expect to be able to conduct straightforward banking transactions from home or while on the move; only seldom do they want or need to speak to an advisor in a branch. Physical branches and personal contact, meanwhile, are still very important for less digitally savvy customers or when dealing with financial issues connected to major life events such as commencing studies, buying or selling a home, or taking retirement.

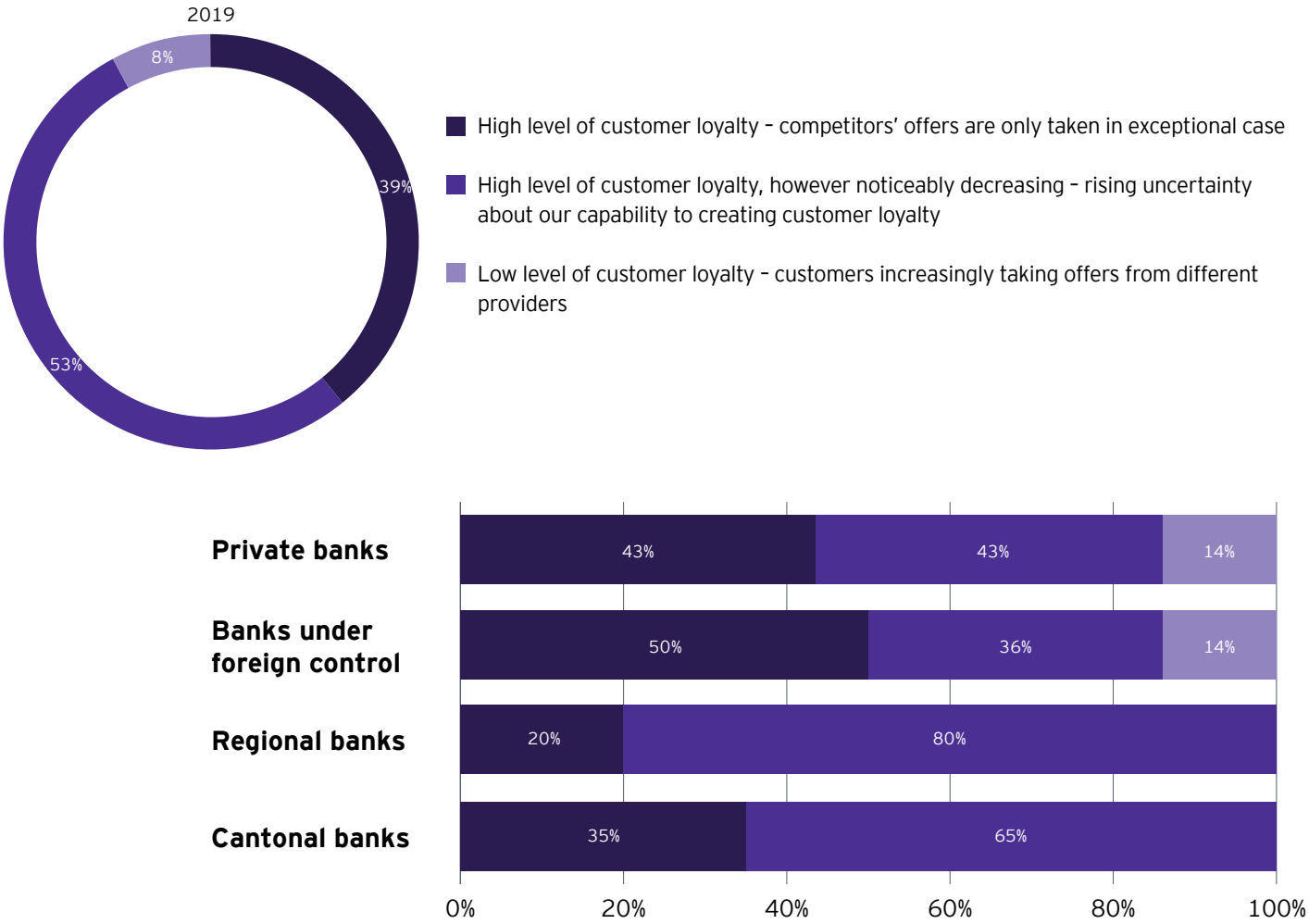
Will primary banking relationships that allow banks to foster high customer loyalty even exist in the future? Over the years, the banking relationships of private customers have become more and more fragmented. Bank customers already use the products and services of a variety of organizations depending on the offering that best suits their needs for the operation in question. When making payments abroad, they use the services offered by neobanks to save money on foreign currency transaction fees; they maintain their savings account with the bank that pays the highest rate of interest; they take out their mortgage with the provider that offers the best interest rate; and they get their pension advice from a different institution yet again. Retaining customers is one of the most pressing challenges facing Swiss banks.

Customer loyalty is decreasing markedly, and increasingly it is being dissociated from customer satisfaction. For example, a customer may be thoroughly satisfied with their home bank, but nonetheless they are willing to try out products from new market players (see Section 12 for more information). Since customer loyalty will become more and more critical in the future, banks need to consider how they can build this up on a systematic and methodical basis.



Banks enjoy high customer loyalty

«How do you assess customer loyalty for your organization?»



Banks are fundamentally convinced that they enjoy strong customer loyalty (92%). However, over one half (53%) believe that this trend is declining; cantonal banks (65%) and regional banks (80%), in particular, are uncertain about their ability to retain customers.

This result is hardly surprising as the structural change initially seems to be making its presence felt in retail banking. The offerings of neobanks and platforms are focused primarily on products and services that appeal to retail customers and wealthy individuals: payments, account maintenance, credit cards, consumer loans, initial investments in passively managed funds, mortgages. Customers are enticed to the respective platform with specific value propositions (such as "best deal" or "convenience") and in many cases are won over by the cutting-edge experience.

In the years ahead, we do not anticipate any disruptive shifts in the end-customer business in Switzerland in terms of banking volumes owing to the emergence of new providers. Switzerland lacks the potential to systematically transfer customer relationships from existing business (so-called feeder strategy) which in other regions has led to the upscaling of neobanks. The question begs itself, however: Could next-generation neobanks break into the core business of established institutions on the back of the proven decline in customer loyalty?

Banks need new sources of income

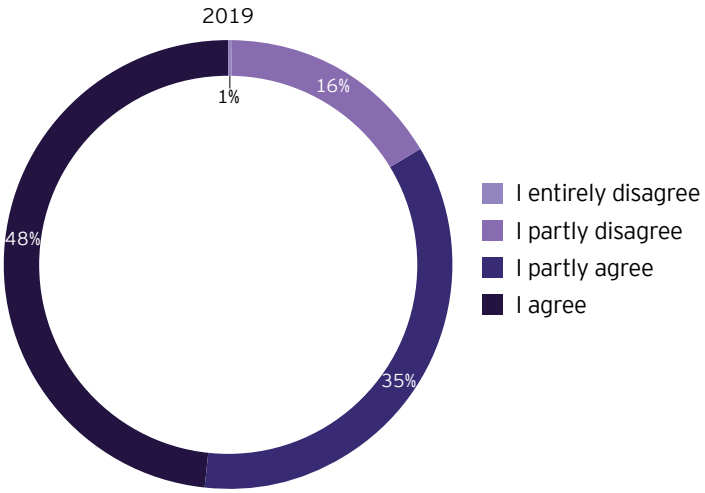
Do you agree with the following statement? «To avoid losing their profitability in the future, banks must develop new sources of income.»

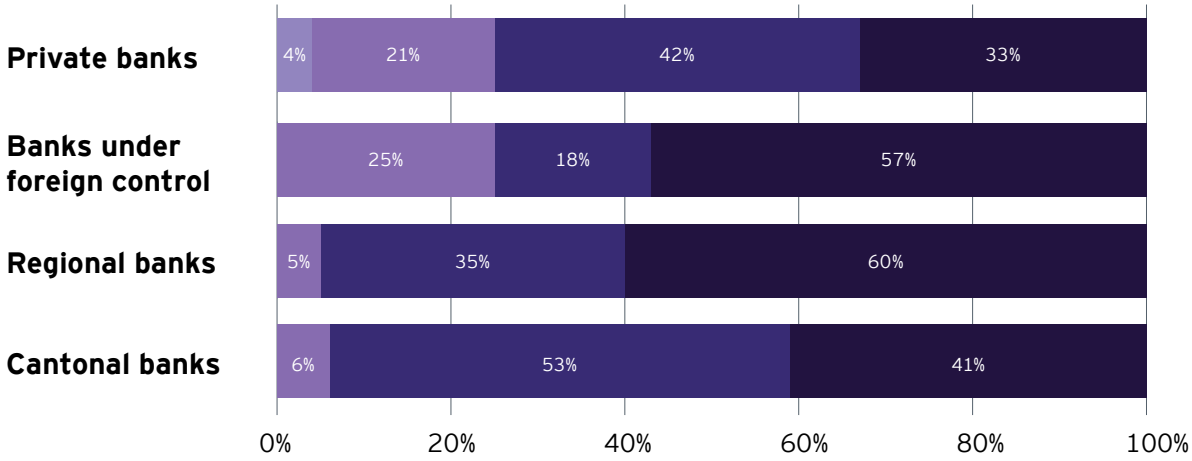
Do banks need new sources of income in the future so they do not lose their earning power? A total of 83% of the banks surveyed are of the opinion that this is the case, with almost one half of all banks (48%) saying they "entirely agree" with this statement and a further third saying they "partially agree" (35%).

Among the cantonal and regional banks, which are geared primarily to the domestic market and the interest margin business, the survey findings even give rise to the impression that these banks have doubts about the future viability of their current business model. Only 5% or 6%, respectively, believe that it will not be imperative for them to tap into new sources of income in order to safeguard their earnings power.

This situation begs the question as to which new avenues banks will need to explore in order to tap into new business areas and revenue streams. Will they be able to do this under their own steam or will they increasingly seek out partnerships with young, innovative FinTechs or technology companies? Banks have plenty of interesting options to choose from to harness this additional source of income. These range from product and service innovations (e.g. growing real estate brokerage and management, expanding generation management, managing electronic data) to upgrading the business model for retail and mass affluents (e.g. digital banking platforms).

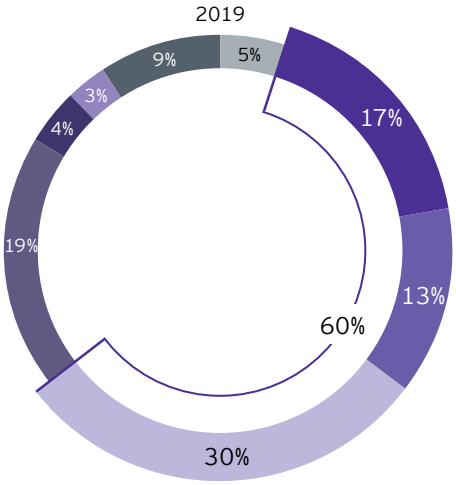
The interesting thing is, although banks are largely in agreement that their future business success depends heavily on the outcome of their search for alternative revenue streams, until now they have taken only a few initiatives to achieve this goal. Indeed, when evaluating their priorities for the coming 6 to 12 months, this year cost issues are once again in the foreground (see p. 53 to 55 for more information).





Is customer focus a lever for income growth?

«Which are the two major levers for profitable earnings growth in your organization?» (two answers possible)

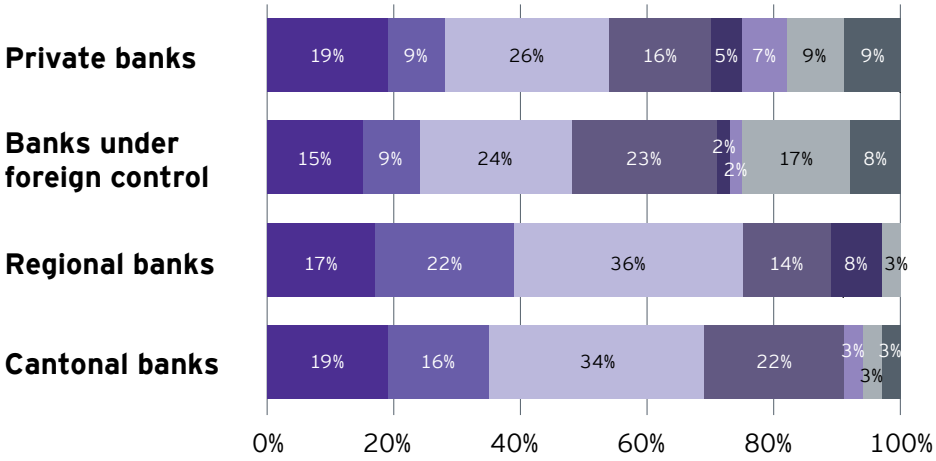


- Improving customer experience (especially at digital points of contact)
- Increasing conversion rates in sales through a better understanding of customers' needs
- Streamlining activities related to customer acquisition, development and retention
- Improving the range of products and services by pooling various services
- Increasing fees
- Developing sustainable investment solutions
- Acquiring additional account managers
- Acquiring other providers (inorganic growth)

Opinions regarding the most important lever for profitable income growth differ widely. If the possible answers are separated into categories, however, the picture is clear: improving the Customer experience (17%), increasing the conversion rate through better Customer understanding (13%) and the Systematization of customer acquisition, development and retention (30%) can be grouped together in a single category as a customer-centric lever. The majority of the banks surveyed (60%) consider improved customer focus to be the best lever for profitable income growth. Regional banks (75%) and cantonal banks (69%), in particular, want to place a stronger emphasis on customer interests going forward. Only one quarter of banks perceive product-centric measures such as bundling various services (19%), increasing charges (4%) or developing sustainable investment solutions (3%) as the key to profitable income growth.

The importance of customer understanding will likely grow as the process of structural change progresses. This hypothesis is supported by the fact that companies in other industries that had aligned their value proposition to understanding the wants and needs of their customers have performed above the average. While it is true that what works for other industries will not necessarily work for the financial services industry, these insights can be readily transferred to the banking sector.

At the present time, understanding what makes customers tick and drives their decisions – in other words, "customer understanding" – has not evolved as strongly as in other industries, despite the fact that this will likely be a crucial factor for implementing systematization in customer development. The majority of banks (54%) perceive the greatest potential for growth for their organization in the investment business (see Section 4); in this regard, customer understanding seems to be of decisive importance to boost effectiveness in sales.

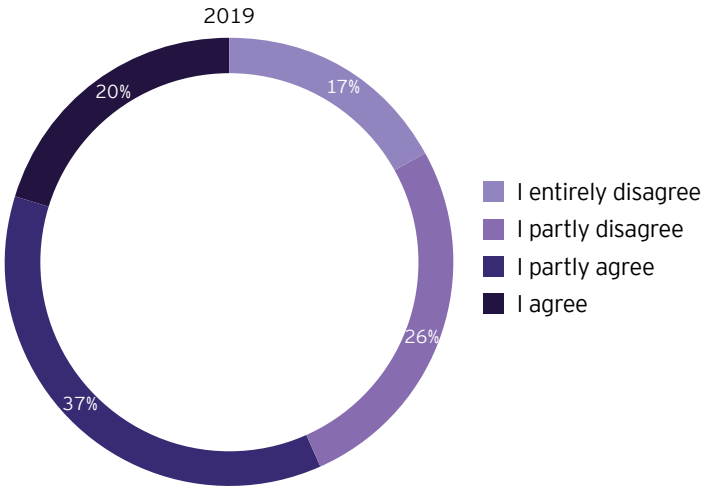


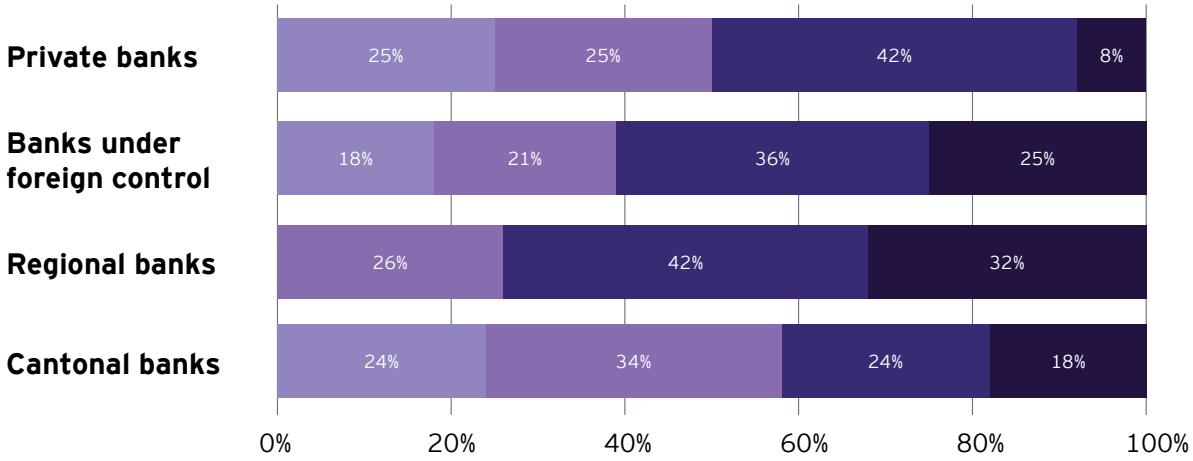
Cryptocurrencies – risk or opportunity?

Do you agree with the following statement? «The risks related to cryptocurrencies far outweigh the opportunities.»

It is still too early to derive a clear picture of the risks and opportunities associated with cryptocurrencies at banks. More than half of the banks surveyed (57%) assess the risks as greater than the opportunities, although there is no uniform picture across each type of bank. While almost three quarters of regional banks (74%) and two thirds of banks under foreign control (61%) think that the risks outweigh the opportunities, 58% of cantonal banks and one half of private banks are of the opposite opinion.

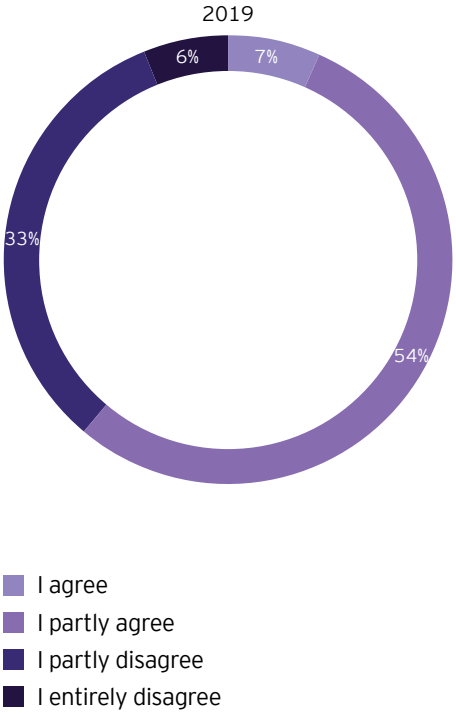
Even though some clearly dominant cryptocurrencies have emerged, the future role of cryptocurrencies in general both in and outside the banking industry is still far from clear. This is due to the fact that until now the use of cryptocurrencies has been very limited, and while promising applications have been identified, so far they have not been capitalized upon. Until clear models for the future become discernible where cryptocurrencies play a decisive role, the lion's share of banks (63%) are waiting for the industry to consolidate and are fine-tuning their own risk assessment before defining a proprietary strategy for dealing with cryptocurrencies.





Digitalization: Banks see themselves as victors

Do you agree with the following statement? «In the long term, well-established banks will emerge as winners from the wave of digitalization in the financial sector.»

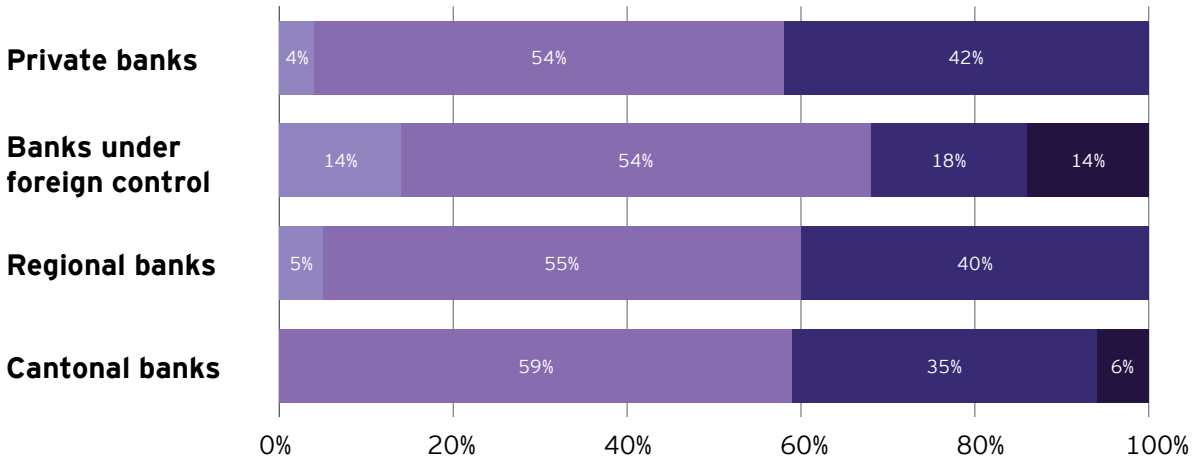


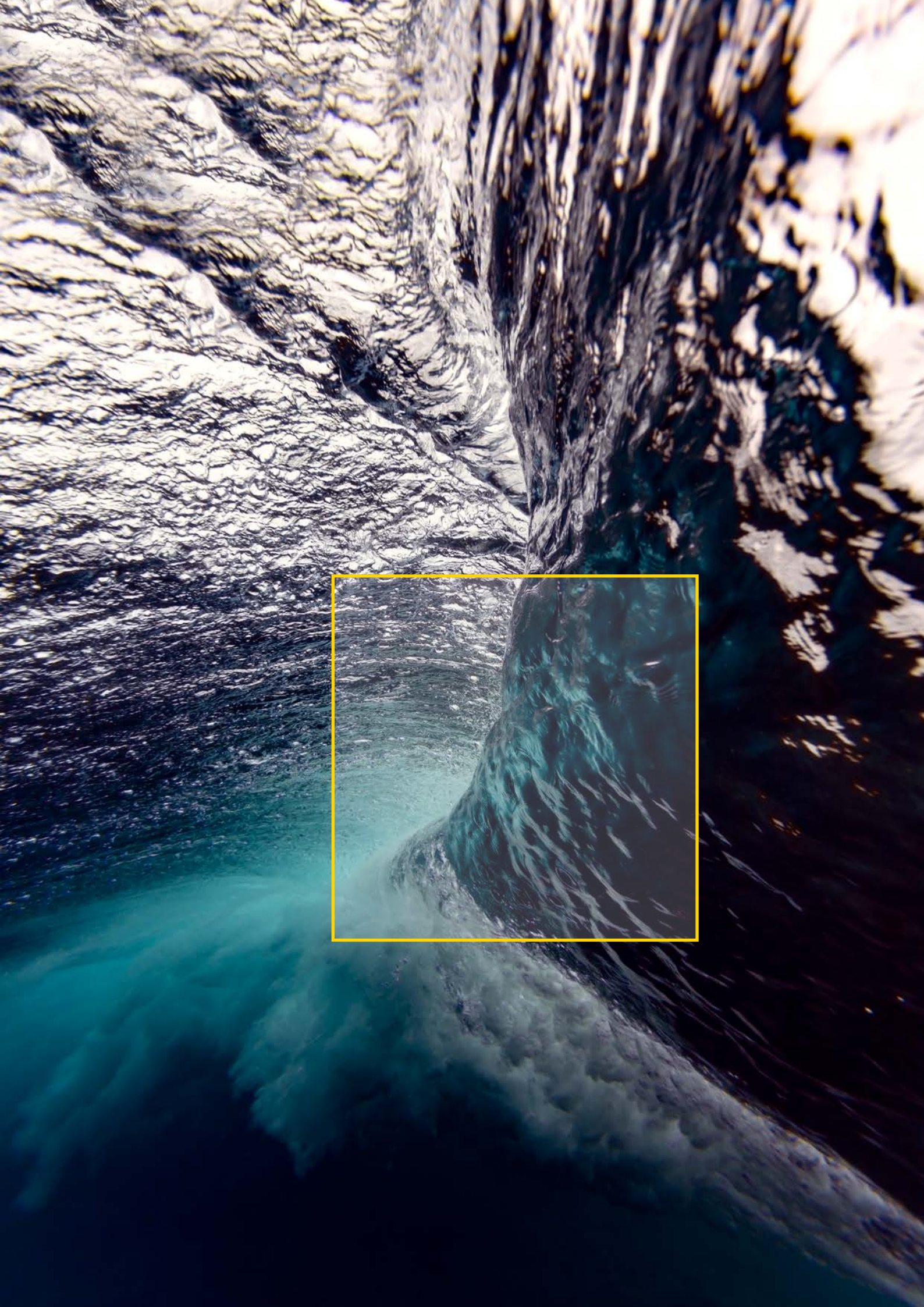
The megatrend of digitalization has infiltrated almost all aspects of our lives and the economy over the past two decades. Entire industries such as retail, the media or tourism have been practically turned on their head, while many companies that were previously global leaders in their field have since been relegated to the side lines. Even if such massive upheavals in the financial industry cannot be predicted due to various factors (regulation, rigidity in the behaviour of bank customers, importance of wealth preservation), almost all banks (88%) acknowledge that a structural change is under way in the Swiss financial industry (see page. 41). The majority of banks (61%) are optimistic about this change and are convinced that the established institutions will emerge as winners of this development in the long run. This conviction is evident across all banking groups.

Digitalization poses a major challenge for traditional banks, since the new technologies allow new providers from outside the sector to penetrate the market, intensifying the competition. This tends to lead to falling prices for financial services, with commensurate consequences for banks' earning power. Banks also have a number of opportunities available to them, however. As indicated by a SNB survey published in August 2019, banks predominantly perceive digitalization as an opportunity, especially to reduce costs.[8] This can be achieved, for example, by closing branches, automating processes or decommissioning IT applications.

Nevertheless, banks will not be able to make the most of the opportunities undoubtedly offered by digitalization by focusing on cost saving measures alone. If banks want to emerge as true winners of the wave of digitalization, they will not be able to avoid having to rethink their business models from the perspective of the customer – and to do this with creativity.

[8] SNB: Survey on Digitalisation and Fintech at Swiss Banks 2019

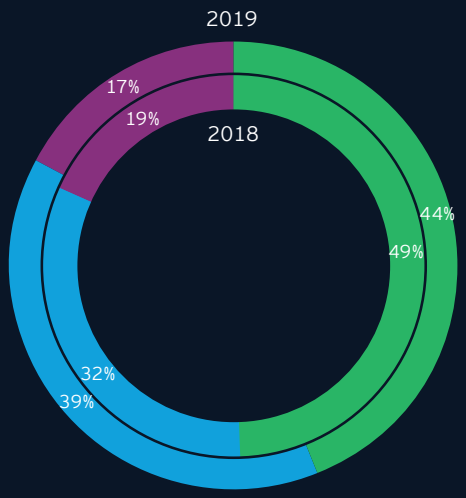




9 Priorities 2020

Innovation is important, but focus on costs is more urgent

«Which of the following topics do you expect will dominate the financial services industry over the next 6 to 12 months»

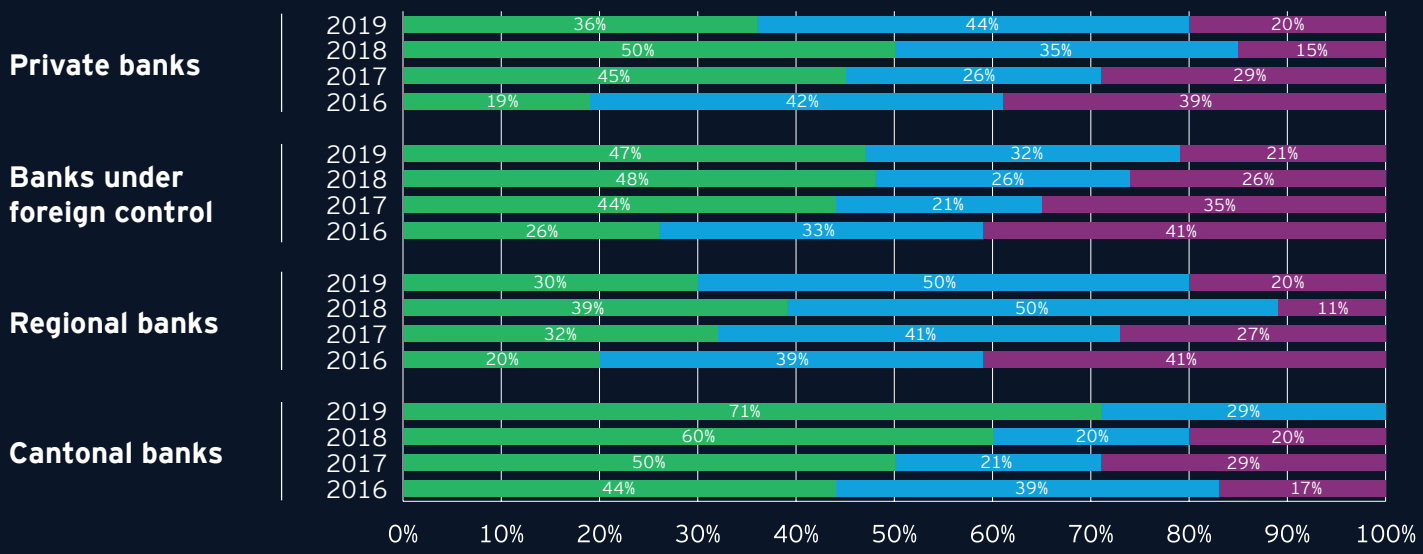


- Income growth and innovation
- Cost reduction and efficiency gains
- Risk, compliance and regulation

The chief priority for the coming 6 to 12 months, cited by 44% of banks (previous year: 49%, down 5 percentage points), remains Growth and innovation. Aside from this, 39% (previous year: 32%, up 7 percentage points) consider Cost efficiency to be the priority. This is the highest figure in the last three years. The Regulatory agenda remains the top priority for 17% percent of banks, almost unchanged on the previous year at 19%.

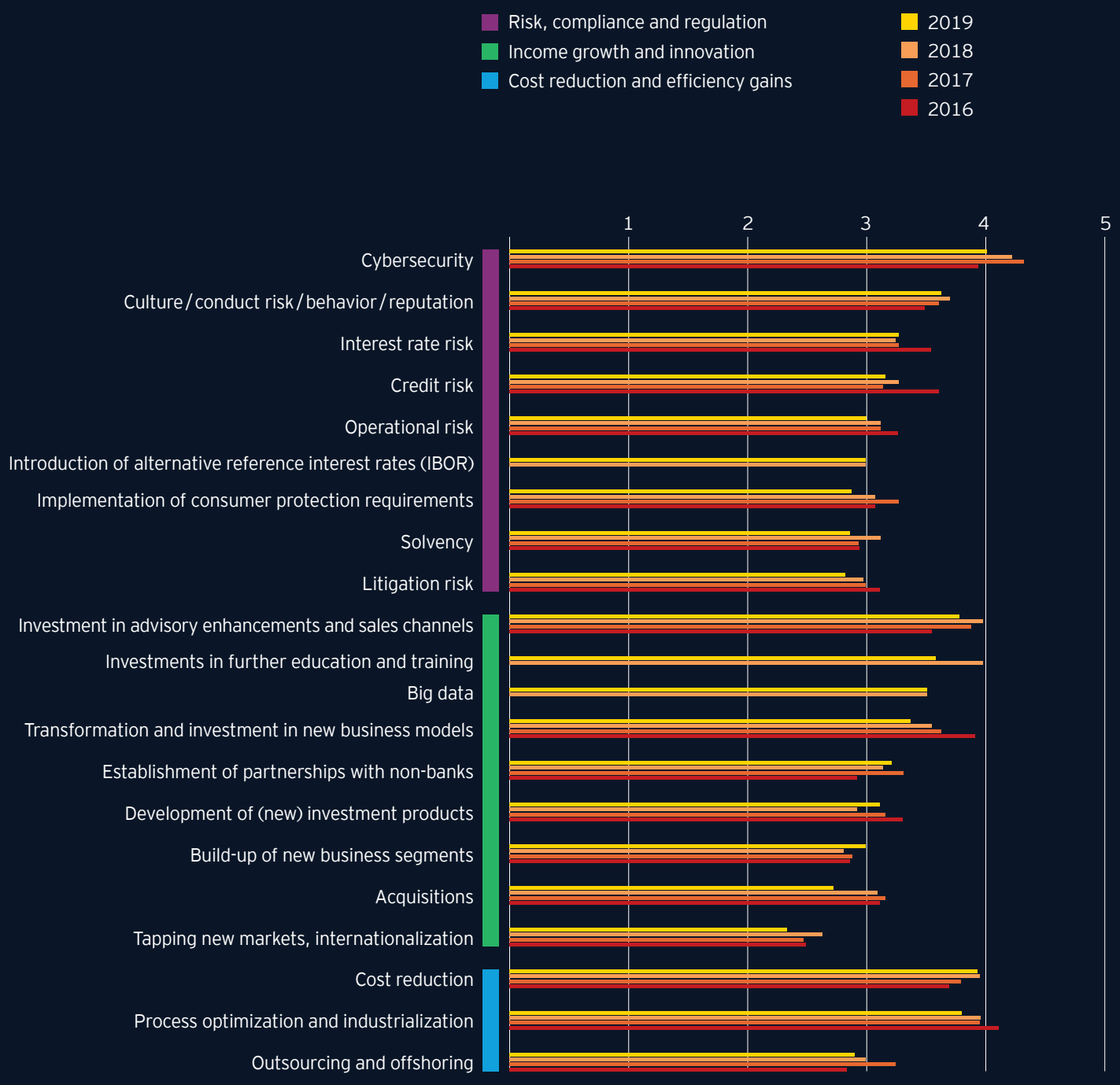
With practically all banks of the opinion that they need to tap into new sources of income (see p. 47 for more information), these survey results show that banks view income growth as their primary objective. Since this cannot be achieved as a matter of course in the current environment, however, in the short term they are placing increased emphasis on reducing costs in order to enhance profitability.

There is no uniform picture within the individual banking groups overall. The cantonal banks are for the most part focusing on the topic of Income growth & innovation (71%). By contrast, cost saving measures do not figure on their radar as strongly as among other banking groups (29%), and regulatory issues are not cited as a priority by a single organization. The regional banks perceive the situation somewhat differently: for 50%, Cost saving measures are at the top of the list, followed by Income growth & innovation (30%). Among private banks and banks under foreign control, the picture is predominantly the same as for the overall market.



Cyber security remains the primary preoccupation

«Which of the following topics and activities do you expect to be of the most importance for the financial industry over the next 6 to 12 months?»



Ranking	2019	2018	2017	2016
Cybersecurity	1	1	1	2
Cost reduction	2	5	4	4
Process optimization and industrialization	3	4	2	1
Investment in advisory enhancements and sales channels	4	2	3	6
Culture / conduct risk / behavior / reputation	5	6	6	8
Investments in further education and training	6	3	-	-
Big data	7	8	-	-
Transformation and investment in new business models	8	7	5	3
Interest rate risk	9	10	8	7
Establishment of partnerships with non-banks	10	11	7	15
Credit risk	11	9	13	5
Development of (new) investment products	12	19	11	9
Operational risk	13	13	14	10
Introduction of alternative reference interest rates (IBOR)	14	17	-	-
Build-up of new business segments	15	20	17	16
Outsourcing and offshoring	16	16	10	17
Implementation of consumer protection requirements	17	15	9	13
Solvency	18	12	16	14
Litigation risk	19	18	15	12
Acquisitions	20	14	12	11
Tapping new markets, internationalization	21	21	18	18

- Risk, compliance and regulation
- Income growth and innovation
- Cost reduction and efficiency gains

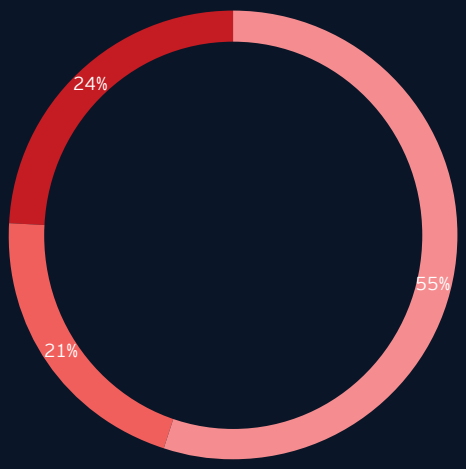
The focus on cost considerations is also evident in banks' responses when asked about their specific focal topics for the coming 6 to 12 months, with two topics from the area of Cost reduction and efficiency gains among the top three topics, specifically Cost reduction and Process optimizations and industrialization. This has pushed the two topics Investments in advisory and sales channels and Investments in further education out of the top three, although as in the past three years the number one spot again goes to the topic Cyber security. This means a topic from the area Risk and regulation is still at the top of the list of priorities.

The realization that banks need to tap into new sources of income in order to secure their long-term profitability is taking its time to trickle through into their selection of priorities. Even though the topics Development of new investment products and Build-up of new business segments have climbed seven and five places to rank 12 and rank 15, respectively, banks' overall selection of priorities for the coming year makes it pretty clear that they are less willing to deal with a possible transformation of their business model.

These survey results can be interpreted to mean that banks are fundamentally happy to address topics relating to innovation and growth and have committed themselves to these causes because they accord them high importance. When it comes to concrete measures, however, cost issues take priority since these have a greater urgency and seem inevitable.

IT expenditure and IT investments over time

«Please indicate the percentage of your respective annual IT costs and IT investments that are attributable to:»

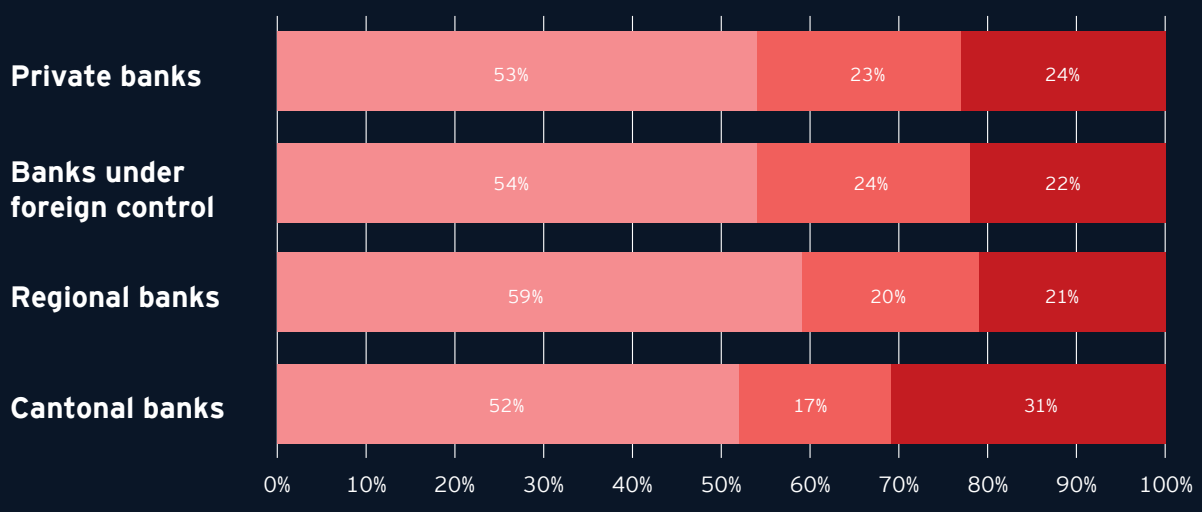


- Daily business / operations («run the bank»)
- Changes («change the bank») due to regulatory or legal requirements
- Changes («change the bank»), freely initiated by the bank (e.g., investments for revenue growth and / or cost reduction)

On average, just over half (55%) of annual IT expenditure or IT investments are channelled into bank's ongoing operations ("run the bank"). In multi-year comparison, the percentage share of IT expenditure in ongoing operations has trended downward, which should leave more funds left over for upgrades to the IT landscape ("change the bank").

In order to increase competitiveness, however, the funds that are most important are those that are "free" for banks to use to make changes to their IT landscape as they see fit (i.e. they are not earmarked for legal or regulatory requirements). This share averages 24% of the overall IT budget within a range of 21% to 31%, depending on the banking group. This proportion tends to increase in a long-term comparison, which in the today's highly competitive environment is a trend in the right direction. Those funds in the IT budget which have not already been earmarked for a specific purpose are primarily used to automate business processes offering corresponding cost-saving potential or to modernize and further digitalize the IT landscape to create added value for customers through new services while simultaneously optimizing costs.

It remains to be seen how much IT costs for ongoing operations can be reduced going forward. That is because as the process of automation and digitalization continues, ongoing costs for safeguarding IT security tend to increase. We will therefore likely see a shift in costs to cyber security, meaning that costs for ongoing operations will not necessarily decrease, but rather they will be constituted differently. The increased outsourcing of IT and security will play a role here.



“

The values of future generations such as the meaningfulness of work or social justice are readily compatible with the financial industry. However, banks will have to use all their powers of persuasion if they want to get the younger generations on their side.

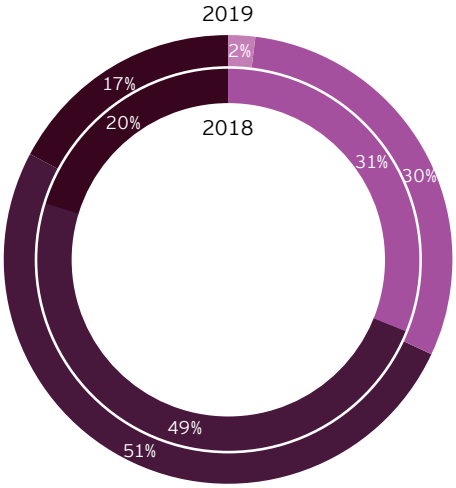
Timo D’Ambrosio
Senior Manager
Audit Financial Services

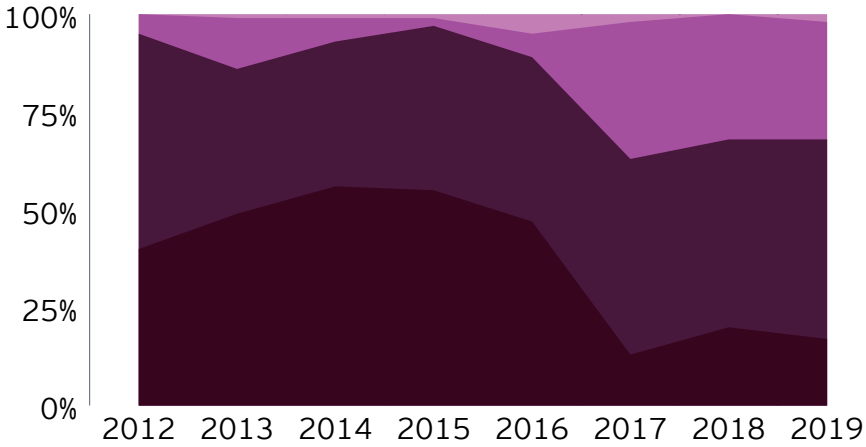
10 Outlook

Banking in 7 to 10 years

Regulation is here to stay

Do you agree with the following statement?
«There will be substantially more regulation in the Swiss banking sector.»





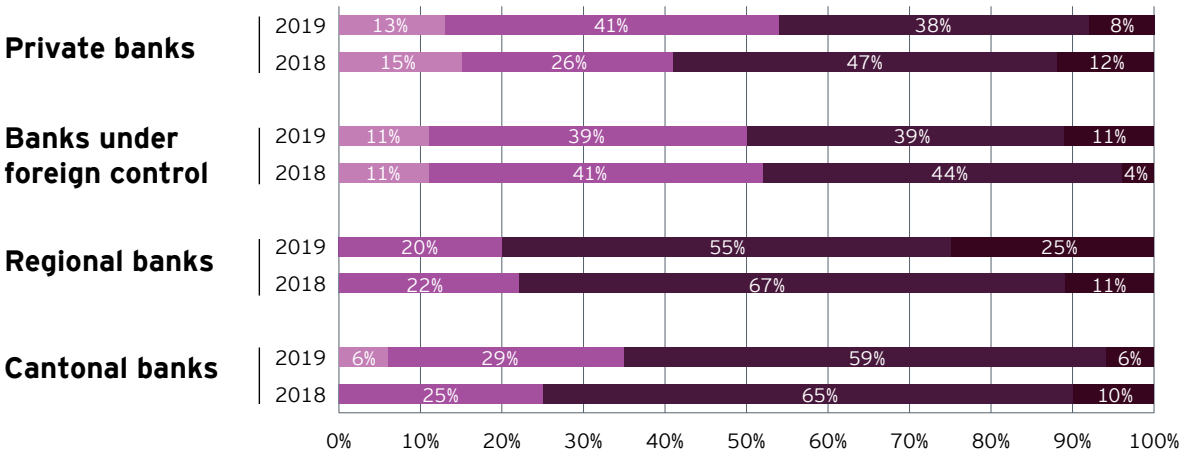
- I entirely disagree
- I partly disagree
- I partly agree
- I agree

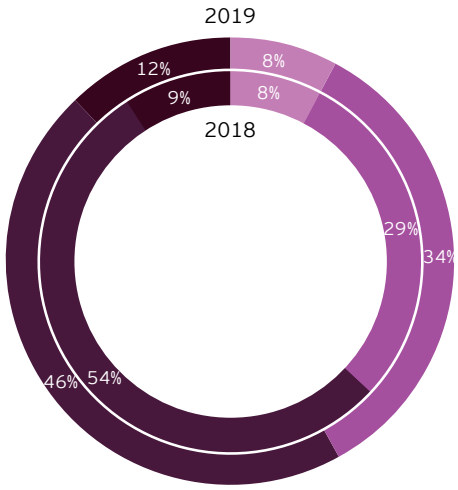
In the wake of the financial crisis, banks have had to implement a wave of new regulations at both the international and national levels. The scope and complexity of the implemented regulatory projects have been considerable at times. Significantly higher capital and liquidity requirements, tighter rules in derivatives trading and new, close-meshed investor protection regulations are only some of the key measures concerned. Many of the most striking weaknesses that existed prior to the outbreak of the financial crisis have now been addressed, and the banks now possess greater stability and crisis-resilience than they did in pre-crisis times.

Even though the volume and scope of regulations has increased markedly since the financial crisis, the vast majority of Swiss banks (68%) do not expect regulatory requirements to ease in the future. This may be due to the fact that financial market regulation is reactionary and the causes of the last financial crisis are only addressed when new risks and dangers start to materialize on the financial markets, which in turn then require new regulations. While the implementation of ever-more extensive and detailed regulatory rulebooks is initially associated with additional costs for banks, it should be noted that banks also benefit from this tight-knit network of regulations in that it creates additional barriers to entry for new market players.

Banks are starting to believe more strongly in their own resilience

Do you agree with the following statement?
«The value add of Swiss banks will be higher in 7 to 10 years.»





- I agree
- I partly agree
- I partly disagree
- I entirely disagree

In 2018, Swiss banks generated gross added value of around CHF 32.8 billion, representing 4.9% of the total gross added value of Switzerland (previous year: 4.8%).[9] This is a considerable decline in comparison with the relative share of 8.6% at the start of the millennium.

However, when assessing the banking industry's ability to create value overall, it should be considered that banks are strongly interconnected with other industries in economic terms. In 2018, the additional added value initiated with other "supply industries" was CHF 13.4 billion[10]. If this figure is taken into account, the effective value creation of the banking industry in a broader sense corresponds to around 6.9% (previous year: 7.3%).

In spite of their improved operating performance in 2018, the long-term outlook for Swiss banks remains rife with challenges. There is no end in sight to the negative interest rate period; the erosion of margins has taken hold not only in the interest income business, but also in the commission and service income business; technological change and digitalization are striking at the core of banks' traditional business models; new competitors are encroaching on various business areas that used to be the exclusive arena of banks; and the network of regulations is more tight and dense than in almost any other sector.

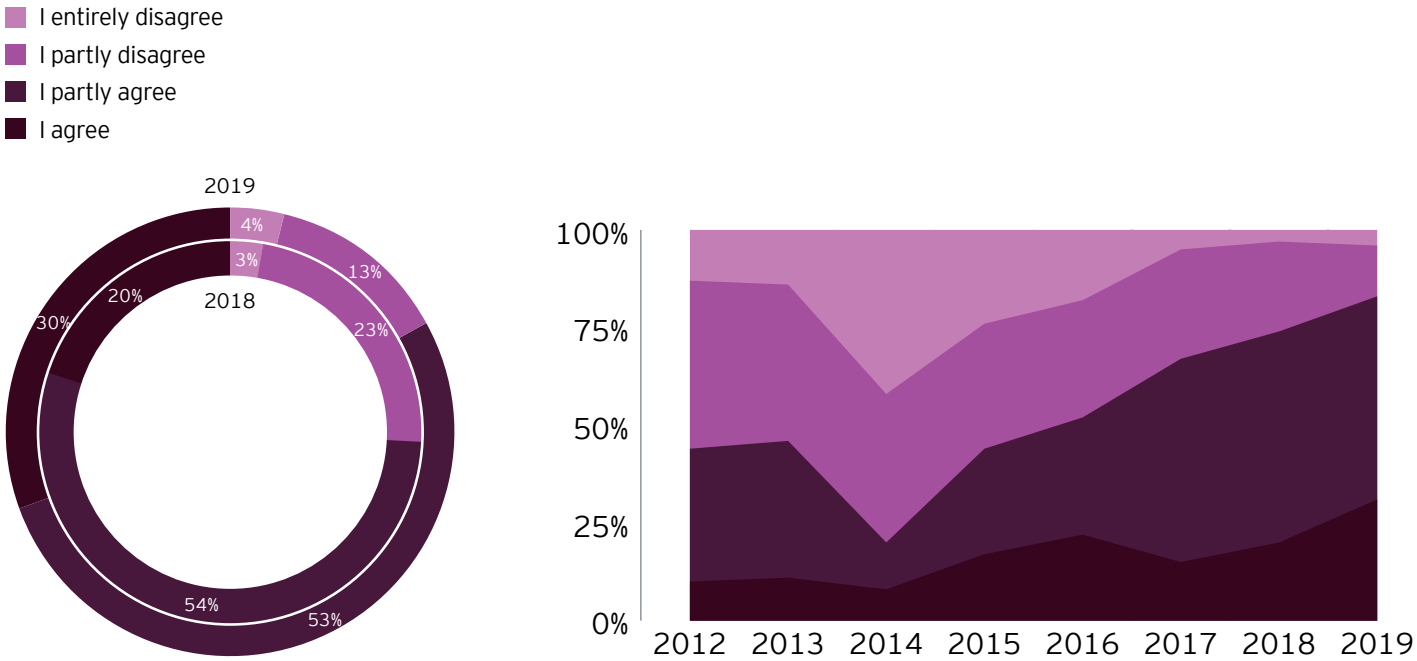
Nevertheless, Swiss banks are once again starting to exhibit more optimism concerning their ability to create value going forward. Of the banks surveyed, 42% believe that their added value will increase in the future. This is a year-on-year increase of 5 percentage points (previous year: 37%). Accordingly, banks' belief in their own resilience seems to be holding strong and even strengthening in some cases.

[9] Source: SECO

[10] BAK Economics AG: The economic importance of the Swiss financial sector – 2019 results, p. 6.

No fee increases in the long term in spite of the low interest rate environment?

Do you agree with the following statement?
«The price of banking services will fall.»



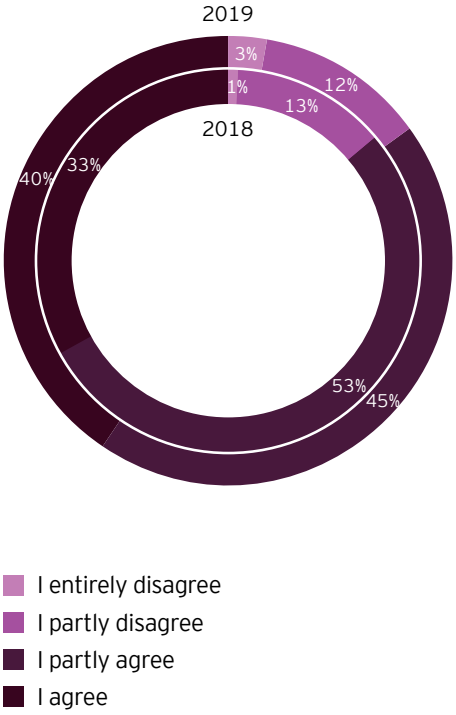
Many banks have increased their fees for banking services in recent months in response to declining income from the interest rate business. This has primarily affected fees for account management, issuing payment cards, executing foreign currency transactions or withdrawing cash at bank counters. This measure is only intended to offer short-term relief, however. And while it will go some of the way to mitigating the adverse effects of the negative interest rate environment, in the long run barely any of the banks surveyed forecast rising prices for banking services. Quite the contrary: a total of 83% of banks (previous year: 74%) expect the prices for banking services to fall. This is the highest value since this survey began, and reflects the growing belief among banks that this trend will continue going forward, with one third of banks (30%) already fully convinced that a price collapse is on the horizon for banking services.

The reasons for this are clear: competitors from outside the industry are increasingly pushing their way into the traditional domain of banks and attracting customers with low-cost services. In addition, customers are increasingly on the lookout for digital solutions, and they don't want to pay over the odds for these.

This trend encapsulates the dilemma currently facing banks: if, on the one hand, there is no more money to be made in the interest margin business because interest rates are so low and, on the other, there is no room to raise the prices for other banking services, how can banks safeguard their profitability in the long term? It seems only logical against this backdrop that almost all Swiss banks (83%) are convinced they need to harness new sources of income in the long run (see p. 47 for more information). Another potential way out of this unfortunate predicament would be to increase the activity of existing customers by improving the customer experience and customer understanding (see p. 48 for more information), combined with the effective and sustainable extraction of value.

Battle for talent rages on

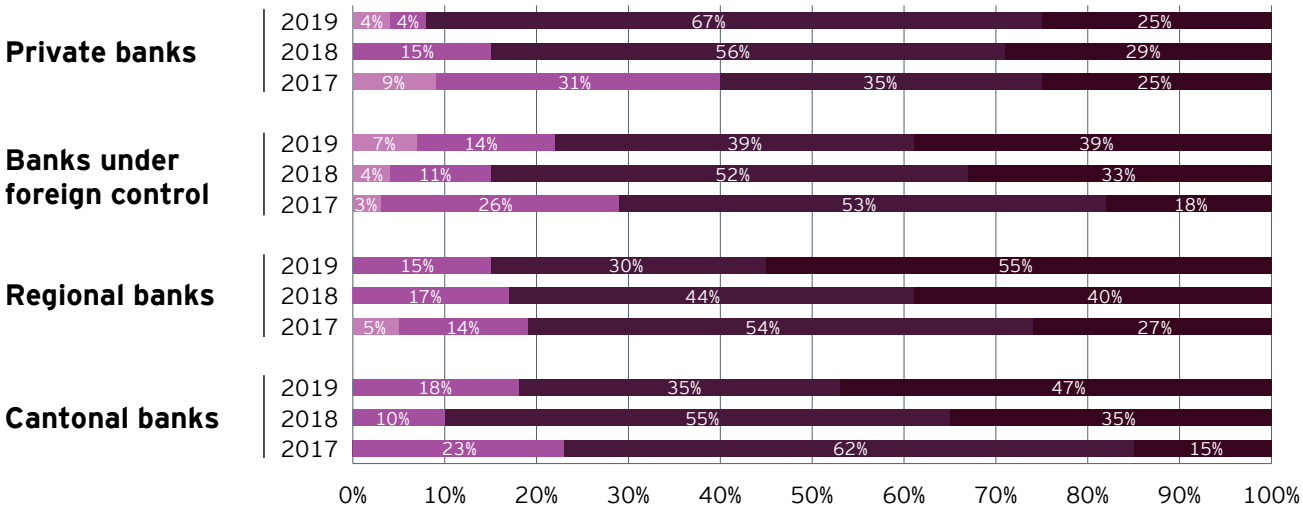
Do you agree with the following statement? «Talent recruitment will become increasingly difficult.»



85% of all banks – on a par with the previous year (86%) – forecast that it will become increasingly difficult going forward for banks to recruit talent. It is noteworthy that the share of banks that entirely agree with this opinion is up sharply from 33% to 40%.

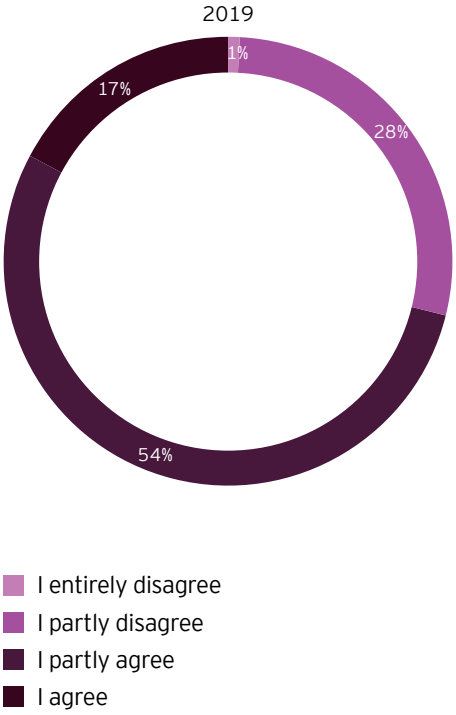
It is becoming increasingly clear that new technologies and digitalization are shaking up professional profiles in the banking sector. Take, for example, the need for tech-savvy professionals, which has risen steadily over the past few years and shows no signs of abating. This trend is placing tremendous demands on banks' internal training and continuing education programmes.

Banks face particular challenges in recruiting young talents and junior staff, since the appeal of banks on the labour market has diminished in recent years. There are multiple reasons for this: Firstly, the financial crisis has eroded confidence and damaged the reputation of the entire financial industry. Banks are no longer at the top of jobseekers' lists of the most attractive employers, having been replaced by BigTechs such as Google or Apple. Secondly, the ongoing job cuts – driven by the wave of consolidation in the industry and the rapid downsizing of branch networks – has undermined job security in the banking sector in recent years. And thirdly, banks, just like all employers, are having to find new ways to meet the changing needs of young people in terms of what they want from the world of work. Future generations seem to be giving special consideration to aspects such as the meaningfulness of work, social justice, sustainability and work-life balance. While these values are readily compatible with the financial industry, banks will have to use all their powers of persuasion if they want to get the younger generations on their side.



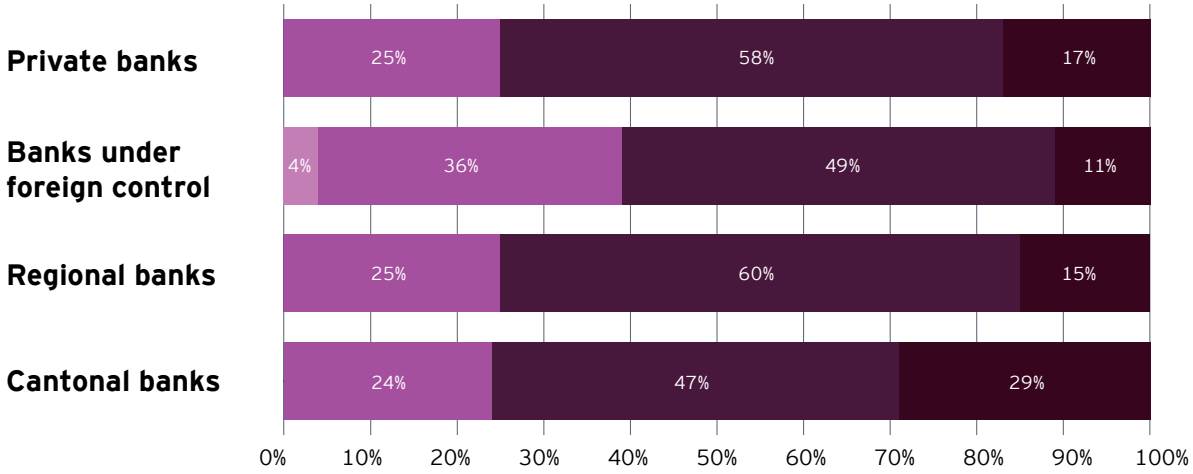
Banks wants to tighten their belts when it comes to remuneration

Do you agree with the following statement?
«In the medium to long term, remuneration in the financial sector will decrease significantly.»



Eroding margins in the core business, stagnating revenue, a prolonged period of severely underperforming stock prices – there are plenty of good reasons why remuneration in the banking sector is on the decline. Banks evidently share this opinion, with almost three-quarters of the organizations surveyed (71%) expecting remuneration in the financial sector to trend downwards in the medium to long term.

This forecast is supported by banks' responses when asked to name specific priorities for the next 6 to 12 months, where this year the topic of cost reduction takes second place (previous year: fifth place). This is because personnel costs are generally the highest cost item in the financial industry.



“

The ground-up integration of ESG considerations into advisory and investment processes requires a far-reaching transformation process that will impact almost all areas of the banking business.

Mark Veser
Senior Manager
Sustainability Leader

11 Sustain-ability

Focus: Sustainability

The topic of sustainability, often referred to as ESG (Environment, Social, Governance), has continued to gain in importance in the international banking environment in recent years. This is essentially attributable to three drivers, which are outlined below.

- Firstly, in the past few years there has been rapidly rising expectation on the part of the general public that companies need to make a contribution to addressing societal challenges such as climate change or to meeting the UN Sustainable Development Goals. This can be observed in developments such as the 'climate strike' and the growing political influence of green parties in various European countries. Banks are increasingly being expected to make an effective contribution through their services and products. This includes not only offering sustainable investment products, but also avoiding problematic debt funding. Banks have already established the first international reporting standards in this area[11].

- Demand for products and services that meet these requirements has risen across all asset classes and geographical regions in recent years. According to the Global Sustainable Investment Alliance, the share of sustainable investments in the total volume of assets under management is up sharply, with almost one half of global sustainable investments originating from Europe[12]. A market study by Swiss Sustainable Finance reported an increase in sustainable investments of over 80% in Switzerland in 2018[13]. Institutional investors, in particular, expect banks to demonstrate corresponding expertise and product offerings. This is supported by the findings of a global study by EY, which revealed that 97% of all institutional investors factor non-financial information into their investment decisions[14].

- In parallel with this, discussions are swirling about the regulatory requirements for banks – especially in the EU – concerning the incorporation of ESG within the context of investment and advisory processes, risk management and the disclosure of non-financial targets. In the EU, this includes, for example, the development of a taxonomy that should be considered sustainable economic activity and, based on this, sustainable investing, or the amendment of regulations such as MiFID II, UCITS and AIFMD or the directive on non-financial reporting, which requires the disclosure of relevant ESG key figures.

Against this backdrop, this year we again surveyed banks on the topic of "Sustainability."

AThe basic takeaway from the survey is that cantonal and private banks in particular are very receptive to ESG issues. Concerning the cantonal banks, this can be attributed to public expectations, something these institutions are especially sensitive to compared with other banking groups in view of their ownership structure. In the case of private banks, this can be explained by the international nature of their business, their clientèle and the competitive situation this creates.

Regional banks in Switzerland have a tendency to be even more cautious when it comes to the topic of ESG. The business customers of these banks are predominantly local SMEs, which at the present time are probably less keenly aligned with formalized ESG standards than global companies.

We can say, overall, that banks are currently focusing their sustainability activities on the area of investments, while they have yet to make any targeted adjustments to their debt financing policies.

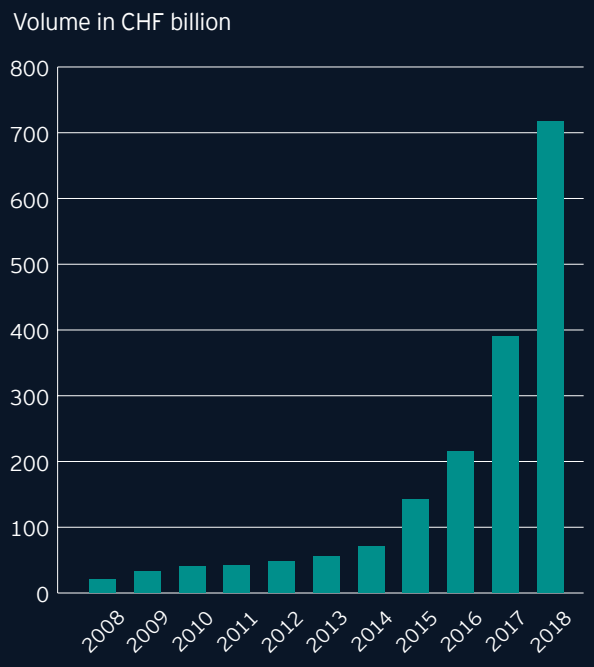
[11] For example, the Principles for Responsible Investments (PRI) or, since fall 2019, the Principles for Responsible Banking, which were launched by 130 banks from nearly 50 countries.

[12] Global Sustainable Investment Alliance (2019). 2018 Global Sustainable Investment Review.

[13] Swiss Sustainable Finance (2019). Swiss Sustainable Investment Market Study 2019.

[14] EY (2018). Does your nonfinancial reporting tell your value creation story?

Development of sustainable investments in Switzerland



Source: SSF

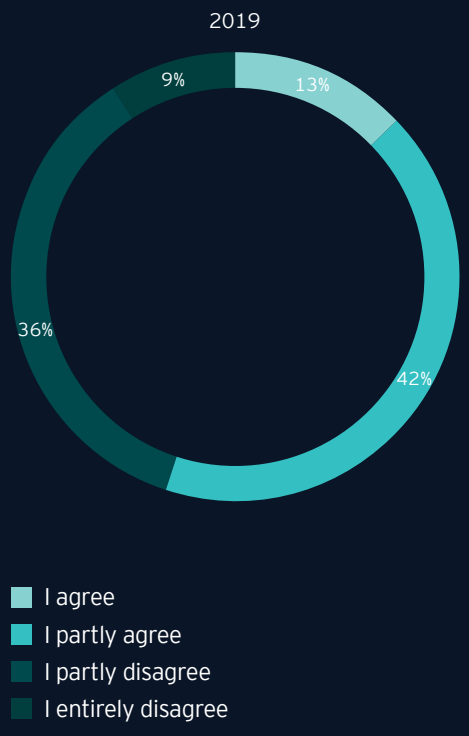
Majority think they can make a contribution to climate protection

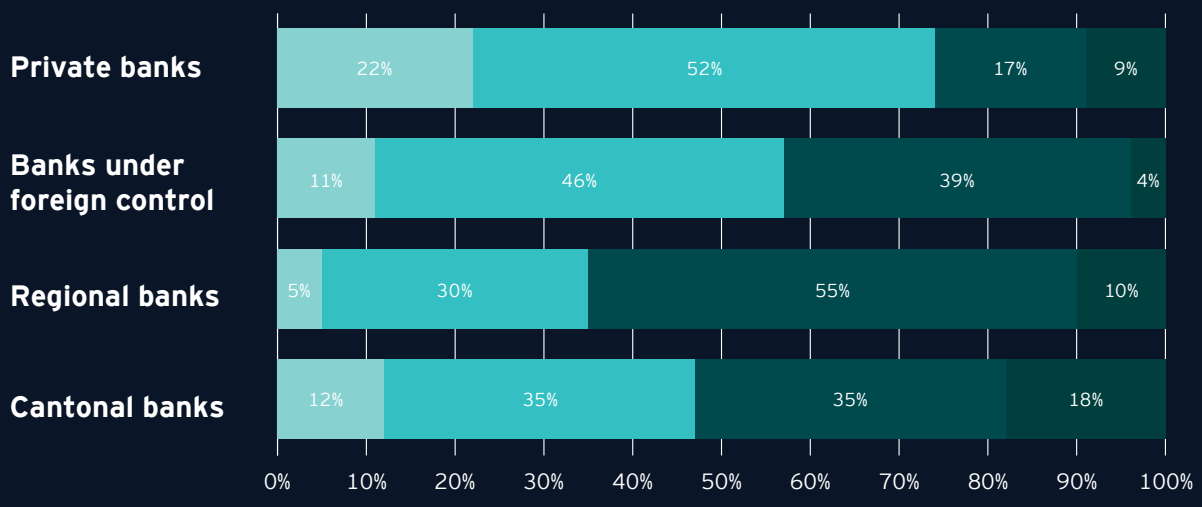
«Banks can make a significant contribution in the fight against climate change.»

A majority of banks (55%) are of the opinion they can make an important contribution to fighting climate change through their activities. This viewpoint is held in particular by private banks (74%) and banks under foreign control (57%); in other words, by institutions that are active mainly in the asset management business. These banks likely recognize the momentum offered by the current discussion with respect to their business model and want to take a more active role.

A significant proportion of the banks surveyed (45%) remain sceptical, however, and do not really think that banks can make an effective contribution to fighting climate change. This pronounced scepticism also reflects the general debate on the role and responsibility of the financial market in actively driving the transformation toward a low-carbon economy.

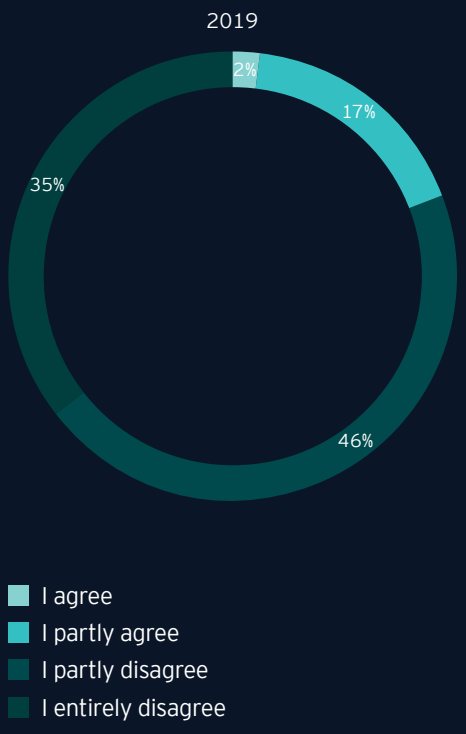
Many people think that the primary responsibility first lies with politics to create the necessary framework for the financial market.





Sustainable investments are not just hype

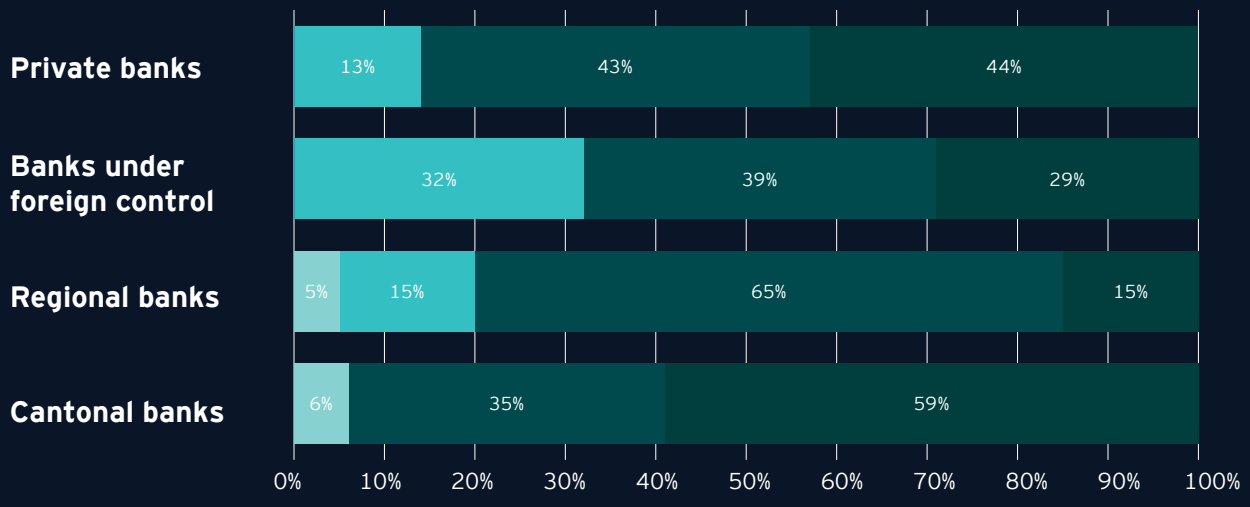
«Sustainable investment is just a temporary trend that will disappear again.»



The lion's share of banks (81%) are convinced that "sustainable investing" will be an enduring topic in the medium term and not just a passing fad. This assessment is supported by the global trend in sustainable investing, which has seen the share of sustainable investments in total assets under management rise markedly in all corners of the globe in recent years[15].

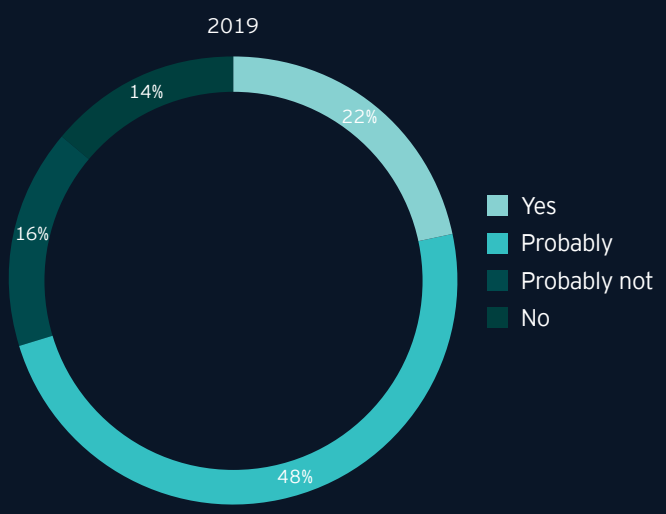
Given that only a handful of organizations have integrated sustainability criteria into their end-to-end investment process, and not just for isolated specific products and themes, banking institutions are faced with an uphill transformation battle in the years ahead. This transformation is being driven by the increased demand for sustainable products, especially from institutional investors, as well as by rising regulatory requirements in the eurozone, which are also having a knock-on effect for Swiss banks – especially those that are active on the European market or manage European customers.

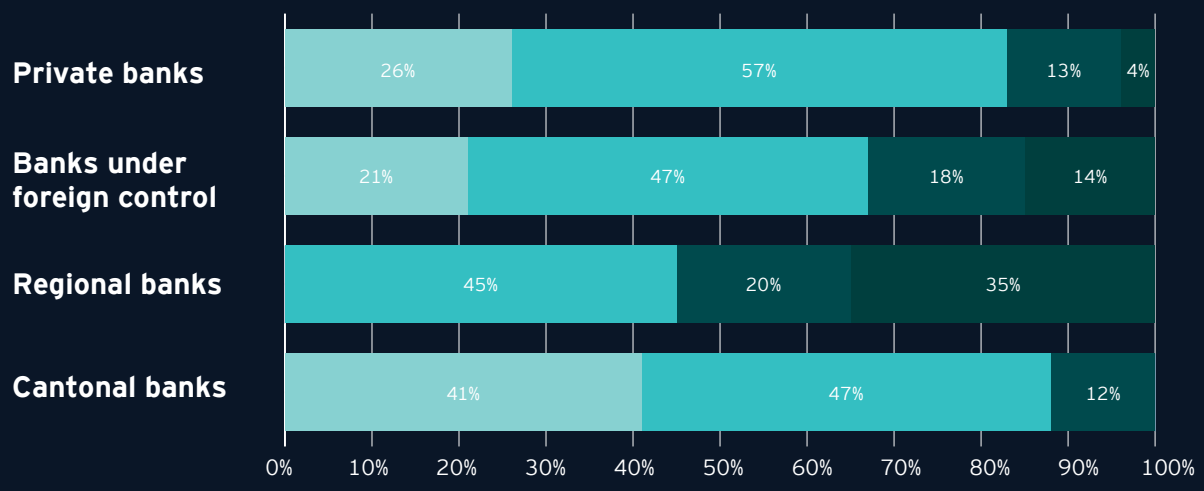
[15] Global Sustainable Investment Alliance (2019). 2018 Global Sustainable Investment Review.



Banks want to expand their sustainable investment offering

«Does your organization have the intention to significantly expand the range of sustainable investment offerings in the future?»



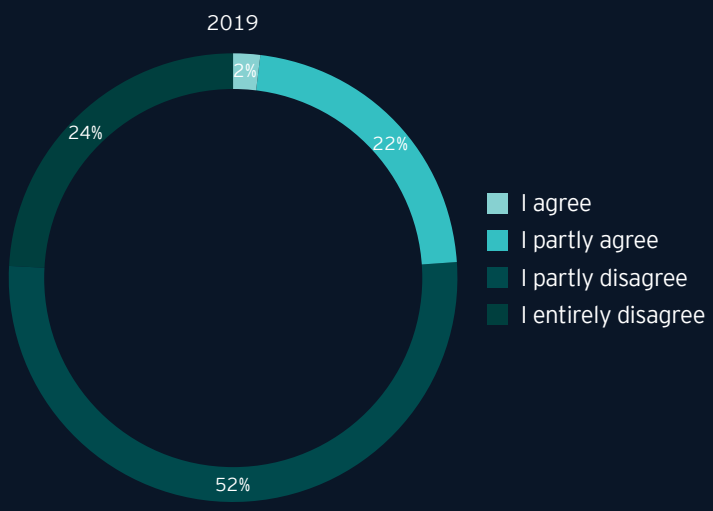


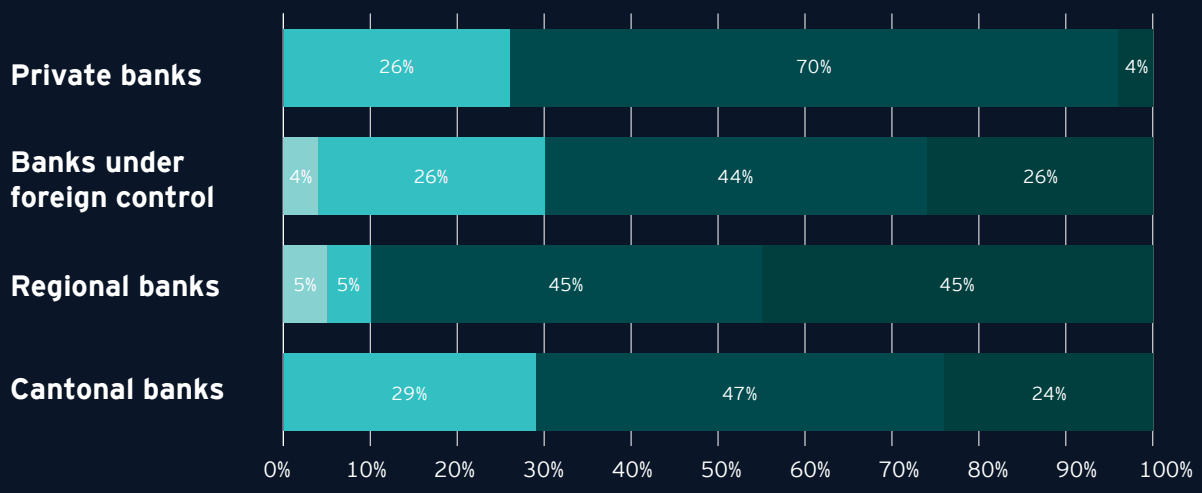
The majority of banks (70%) are responding to the rising demand for sustainable investments and plan to ramp up their offering in this area in the future. Regional banks are an exception here, where the majority (55%) have no plans to expand their sustainable investment offering at the present time.

In order to expand their offering, banks need not only to overcome the product-specific challenges facing them, but also to make adjustments to a wide range of internal bank business processes. This applies in particular to investment processes, risk management and monitoring processes, and reporting. Last but by no means least, the required adjustments will call for relevant data and well-trained staff so that sustainability aspects can be integrated into advisory processes.

Financial performance remains a priority for customers

When investing, our customers assign at least the same importance to sustainability / ESG criteria as to financial factors.





The majority of banks (76%) say that while their customers are interested in sustainability, only in rare cases do they think they would sacrifice financial performance. This clearly demonstrates that "sustainable investing" and, by implication, the "multi-stakeholder value" approach needs to be incorporated alongside the "shareholder value" approach in order to be successful. The key is not to abandon profit-oriented thinking, but rather to find intelligent solutions that lead to financial success without generating conflict.

The issue as a whole therefore should not be understood as a benevolent undertaking. Institutional investors such as pension funds, in particular, need to generate a return in order to provide the benefits they have promised. The markets have increasingly come to the realization that integrating ESG criteria into investment strategies does not have to be at the cost of financial performance; on the contrary, it offers a potential source of added value and can improve a portfolio's overall risk-return profile.

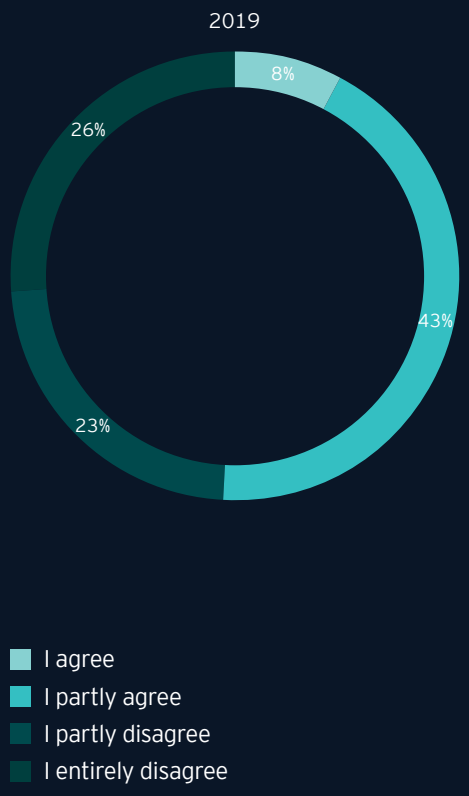
Need for further regulatory requirements unclear

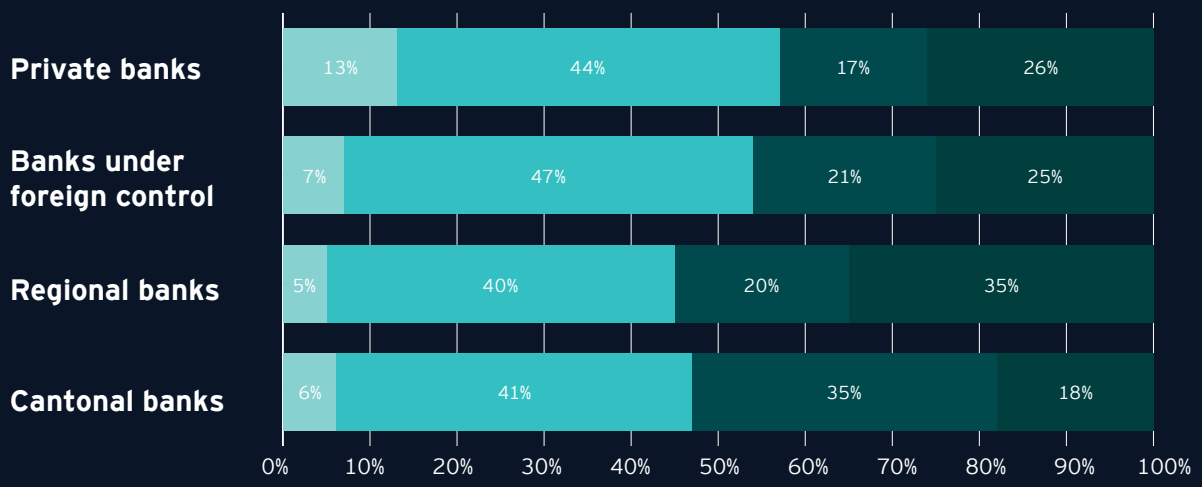
«To exploit the full potential of sustainable investments for climate protection, further regulatory requirements – such as binding standards to create a definition of sustainability – are needed.»

Slightly more than one half of banks (51%) think that more far-reaching regulatory requirements are needed in order to exploit the full potential offered by sustainable investing for climate protection. At the same time, many players in the sector remain cautious when it comes to the impact of additional regulatory requirements in a rapidly growing and innovation-driven market for sustainable products.

It is to be expected that the opinions on this question will not produce a uniform picture in the future either. Political bodies, supervisory authorities and central banks have indicated in no uncertain terms that creating clear framework conditions and uniform standards for a sustainable financial market will remain a focus of regulation, not least in order to address the risk of greenwashing in the advisory or sale of financial products.

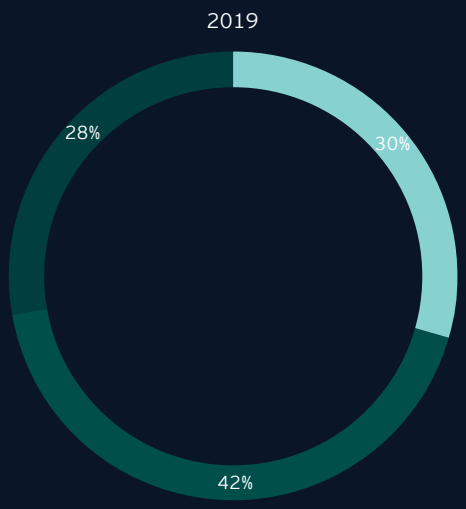
Against the backdrop of the regulatory discussion on sustainable finance, ESG trends have the potential to evolve quickly even without any conclusive legislative mooring and could establish themselves as de facto market standards.





Topic of sustainability has trickled down into investment advisory processes...

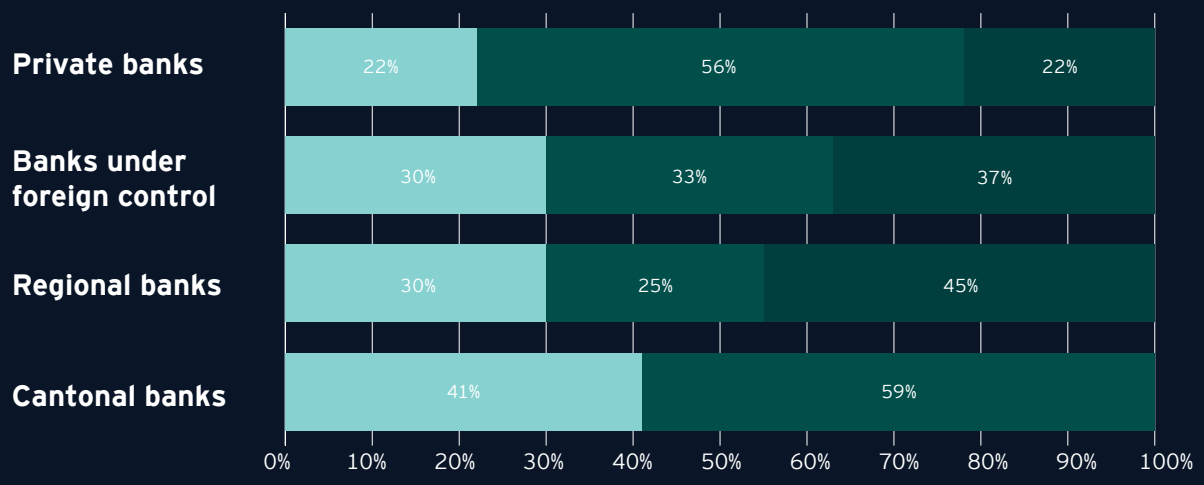
«In our organization, the topic of sustainability is integrated in investment advice or is a mandatory topic in the advisory process.»



- Yes
- No; however, this will be the case in the future.
- No

As many as 30% of banks say they have already integrated the topic of sustainability as a compulsory element of the investment advisory process. This would seem to be quite a high percentage since the complete integration of the full range of formal ESG criteria is extremely complex and comes with its fair share of criticisms. Rather, we assume that these banks have already begun to incorporate the topic of sustainability into the advisory process, but this integration has hardly been systematically implemented and also does not necessarily imply a full offering of sustainability products.

Only a minority (28%) have no plans to empower front-office staff on this topic. This opinion is especially prevalent among regional banks (45%).

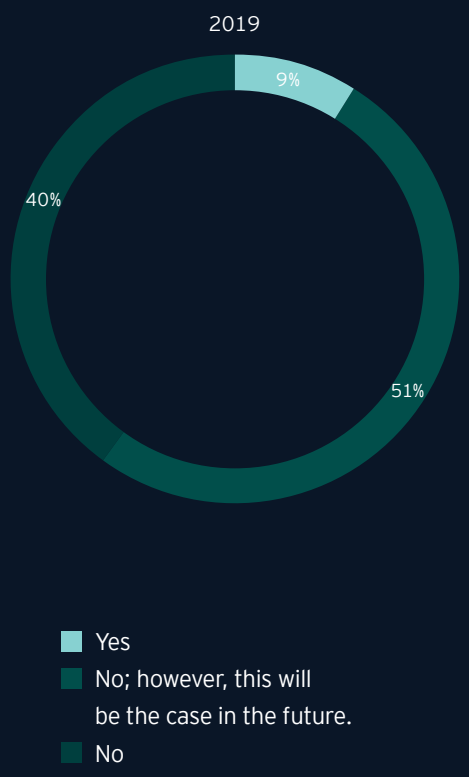


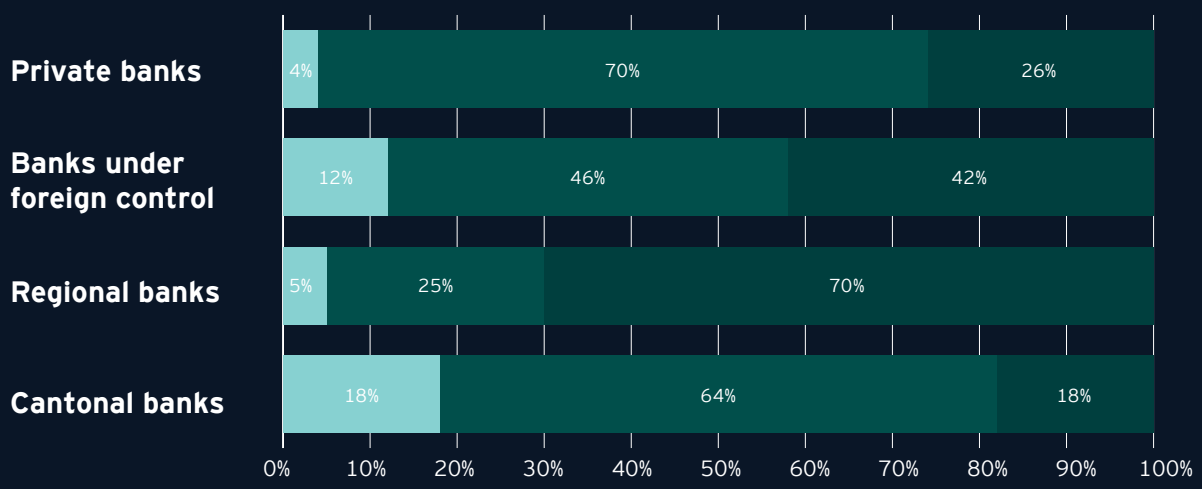
...but not through to reporting to customers

«Within periodic reports, our customers are informed in detail on the sustainability of their investment portfolio (e.g., ESG score).»

Only a minority of just under 10% say they have already rolled out regular reporting on ESG. This shows conflicting priorities where in many areas the topic of sustainability has been integrated into the advisory process, but the accompanying formal requirements for ESG reporting have not yet been met in full. Over one half of the organizations surveyed (51%) plan to incorporate these requirements into reporting in the near future, taking them one step closer to the required bank-wide integration and transformation.

If reporting is provided to customers at regular intervals, it is entirely possible that momentum will increase at an even greater pace than today since this will give rise not only to more questions from customers, but also to greater demand.





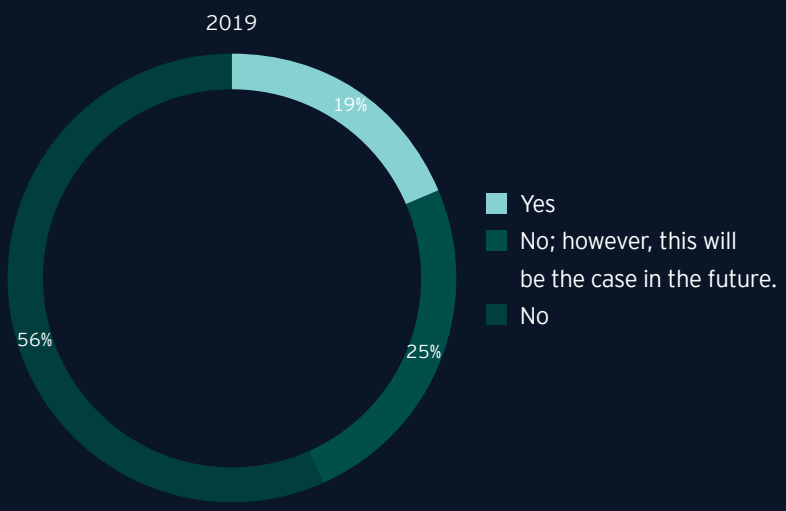
The topic of sustainability does not play a major role in debt financing

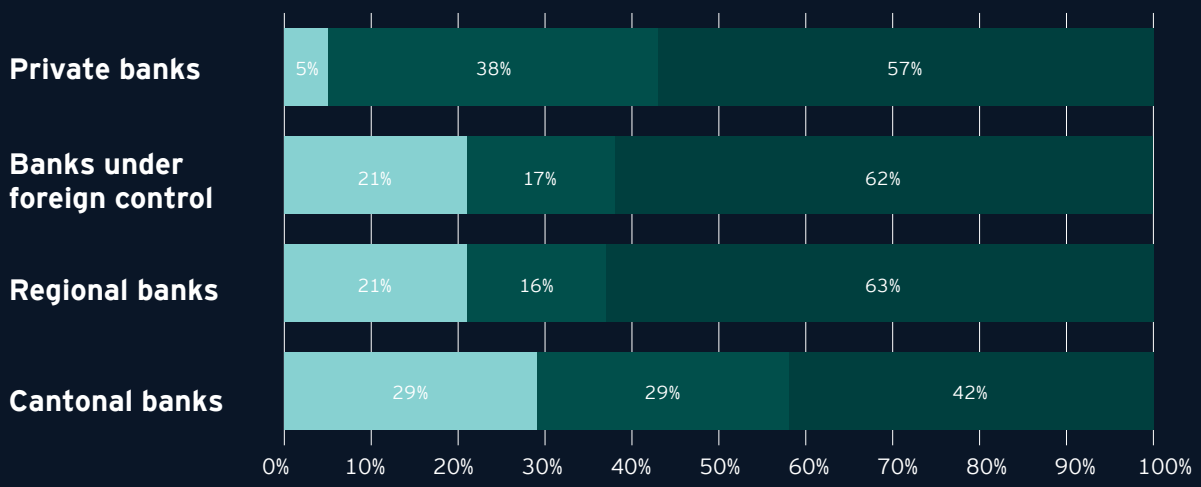
«Our organization considers sustainability/ESG factors in its lending activities to commercial customers.»

When it comes to the question of sustainability, the focus is primarily on investments and investment products. So far as credit financing by banks is concerned, however, the topic of sustainability is of negligible importance – both now and in the future. Only a minority of 19% of the banks surveyed say they take ESG factors into consideration when granting loans, with a further 25% planning to do so in the future. The majority of the banks surveyed do not factor any sustainability criteria into their lending business with commercial customers.

Public debate in the lending business is not yet as far advanced as it is in the investment business, where the question of integrating ESG into the investment process has been on the table for many years now, and market trends are measured according to yardsticks such as the Principles for Responsible Investment (PRI) and are readily available.

The realization that lending has an equal if not even greater influence on sustainability as investing has, however, started to gain currency in recent years. This is reflected not least in the emergence of sector initiatives such as the Principles for Responsible Banking and the dialog initiated on the issue by European regulators, for example in the Action Plan on Sustainable Finance published recently by the European Banking Authority (EBA).



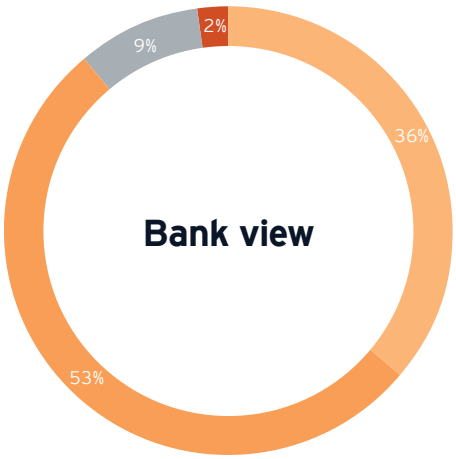


Within the scope of this year's Bank Barometer, we teamed up with the Redesigning Financial Services (RFS) initiative to conduct a survey among 2,000 bank customers. The Bank Barometer reports on only one portion of these survey results; the detailed results are published as part of a dedicated EY publication in the first quarter of 2020.

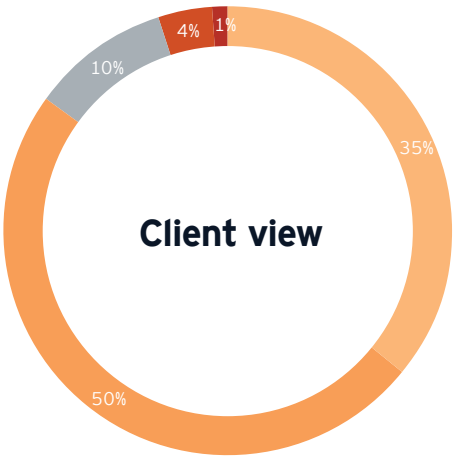
12 Customer survey

Bank customers are satisfied, but...

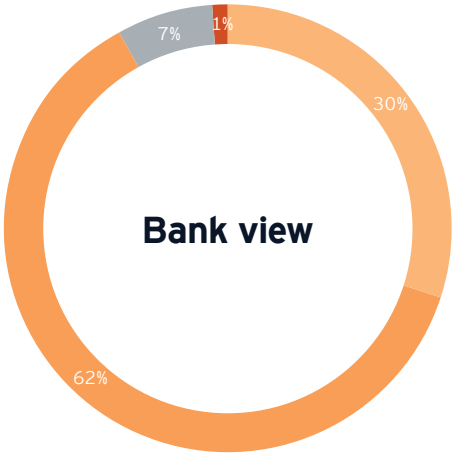
«Our customers are generally satisfied with us as their home bank.»



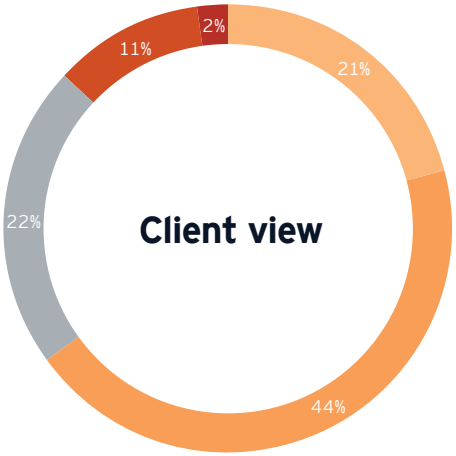
«I am generally satisfied with my home bank.»



«Our customers are convinced that the advice we provide is in their best interests.»



«I am convinced that the advice my home bank provides is in my best interests.»



- I entirely agree
- I agree
- I neither agree nor disagree
- I disagree
- I entirely disagree

89% of the banks surveyed are convinced that customers are generally satisfied with them. Cantonal and regional banks are especially confident when it comes to this question, with not one single bank among those surveyed expressing an opinion to the contrary. Private banks are somewhat more reticent, with almost one quarter (23%) saying that their customers would probably give their bank a neutral report card ("neither nor").

Comparing this with our customer survey, it would seem that banks are justified in their self-confidence: 85% of customers agree with the statement that they are generally satisfied with their home bank. An additional 10% of customers are undecided ("neither nor"), while only 5% say they are dissatisfied with their bank.

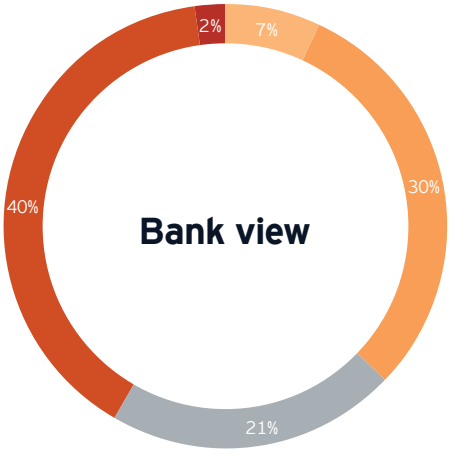
While banks are able to provide a very precise assessment of the general satisfaction of their customers in line with this survey, the question as to whether banks act in the interests of their customers reveals an interesting discrepancy between the perspective of banks and customers on the issue. Almost all of the banks surveyed (92%) assume that their customers are convinced that the advice they provide is in their interests. In actual fact, however, customers' trust in their bank is not quite as strong: only two out of three bank customers (65%) are convinced that banks are always aligned to customer interests. This means that one third of the customers surveyed have doubts concerning this very important issue for banks (i.e. "neither nor" or "(entirely) disagree").

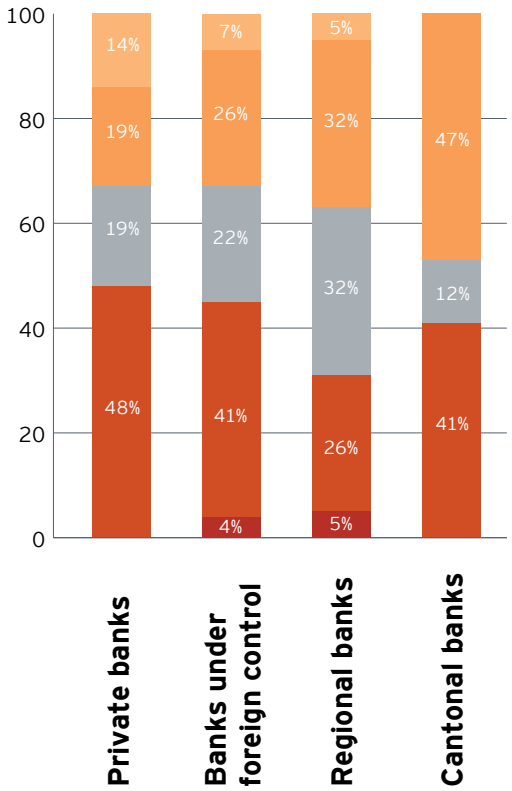
In view of the fact that customer trust is very often cited as the most crucial factor for success in banking, this survey reveals a certain need for action on the part of banks. If banks do not have the underlying trust of their customers, it will be very difficult for them to increase their customer/product penetration and thus to strengthen their earnings base on a sustainable basis.

Swiss legislation has also recognized that there is obvious need for action on the topic of customer trust. With the introduction of FIDLEG, the protection of legitimate expectation related to customers has now been anchored in supervisory regulations. However, customer trust is not created through formal rules and procedures. The decisive factor will be how banks market the added value of consulting and avoid being perceived as mere product vendors.

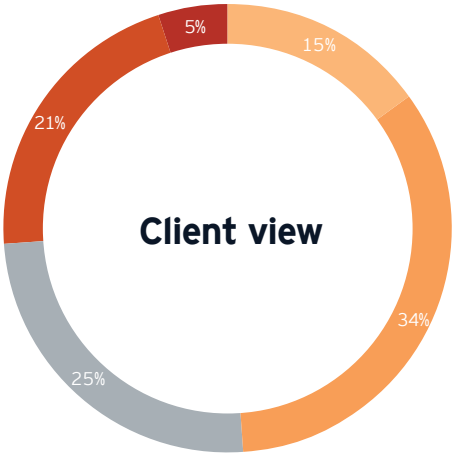
Service and customer protection are more important than bank fees

«The costs of financial services do not play a major role for our customers. Our customers place greater emphasis on reliable service and the protection of their interests.»





«The costs of financial services do not play a major role for me. It is more important for me that I can rely on my bank to protect my interests.»



- I entirely agree
- I agree
- I neither agree nor disagree
- I disagree
- I entirely disagree

Banks have differing assessments of how sensitive their customers are to prices. While 42% of the banks surveyed are of the opinion that price is more important than reliable service and the protection of interests, 37% think the opposite is true. This disparate picture is evident across all banking groups. Interestingly, the share of banks that assume the price charged for financial services plays a secondary role for their customers is higher among cantonal banks (47%) and regional banks (37%) than it is among private banks and banks under foreign control (both at 33%). Given that retail customers in particular are very often characterized as being especially price-sensitive, this finding comes as a real surprise.

It is interesting to note that banks seem to accord too much importance to the topic of price, since only 26% of customers say that, for them, price is their overriding concern when choosing financial services. Indeed, almost one half of customers (49%) give service and the protection of their interests a higher weighting than costs.

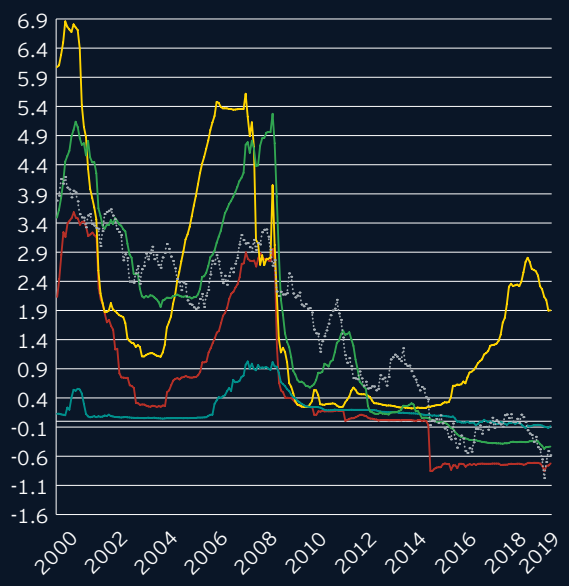
In view of the fact that hardly a single bank anticipates rising fees for financial services in the future (see p. xy for more information), this survey finding can be interpreted as an encouraging sign; it would appear that price is not the only decisive factor for customers, and there is plenty of room to charge higher prices or implement price hikes if this is considered to offer added value on the customer side. Thus, the same rules apply in banking as they do in all other areas of the economy: customers are willing to pay more if they perceive added value in the product or service.

13 Appendix

Market environment

Interest rates

in %



LIBOR EUR 3M
LIBOR JPY 3M
LIBOR USD 3M
LIBOR CHF 3M
CHF 10 y Swiss Bonds

Source: SNB

Stock markets

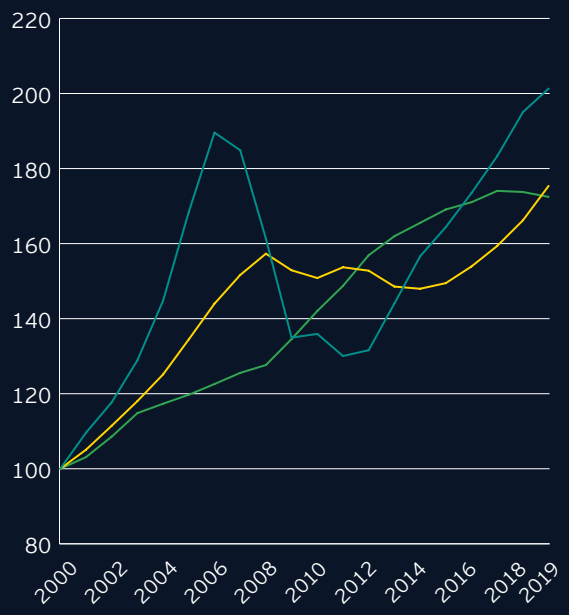
Indexed 1.1.2000 = 100

MSCI WORLD
MSCI USA
MSCI SWITZERLAND
MSCI EUROPE

Source: MSCI

Real estate

Indexed 1.1.2000 = 100

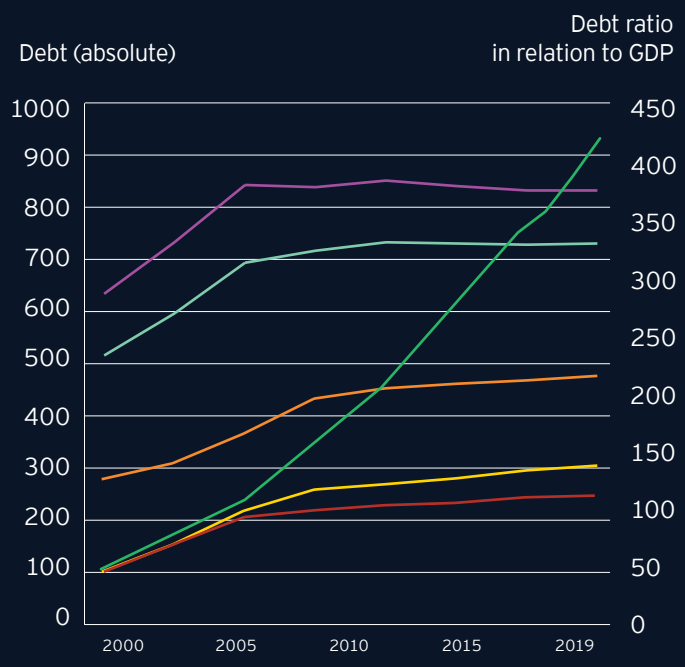


Switzerland
Europe
USA

Source: BIS

Debt ratio

Left axis indexed, 1.1.2000 = 100

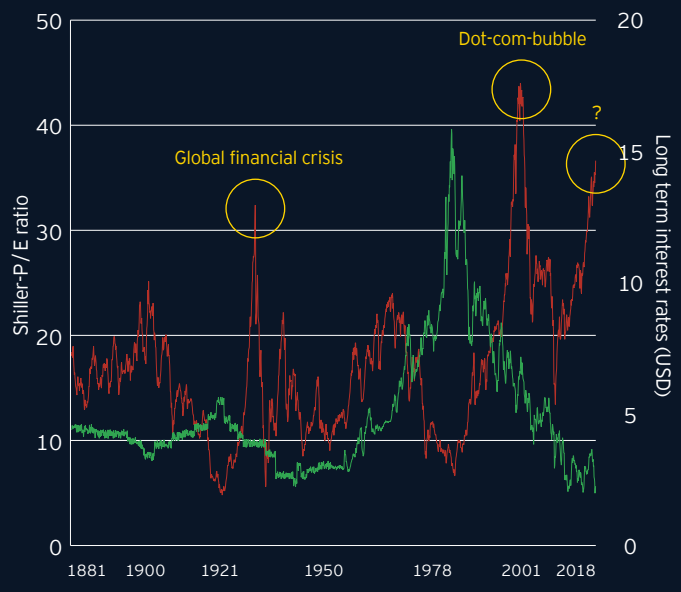


Global (A)
Global (R)
Developed countries (A)
Developed countries (R)
Emerging markets (A)
Emerging markets (R)

Source: IIF

Market environment

Shiller-P/E ratio and interest rates

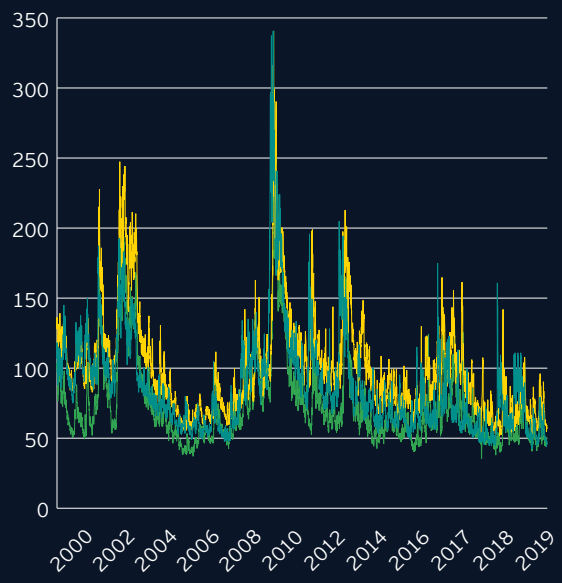


Shiller-P/E Ratio S&P 500
Long term interest rates (USD)

Source: SNB

Volatility

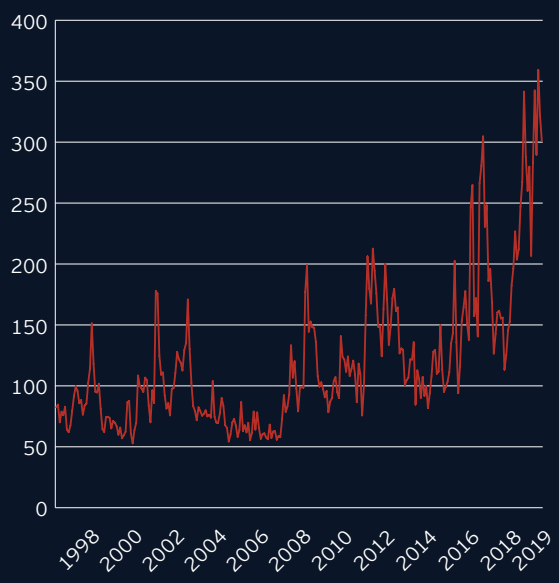
Indexed, 1.1.2000 = 100



VSMI ®
EURO STOXX 50® Volatility (VSTOXX®)
Cboe Volatility Index® (VIX®)

Source: STOXX, Cboe

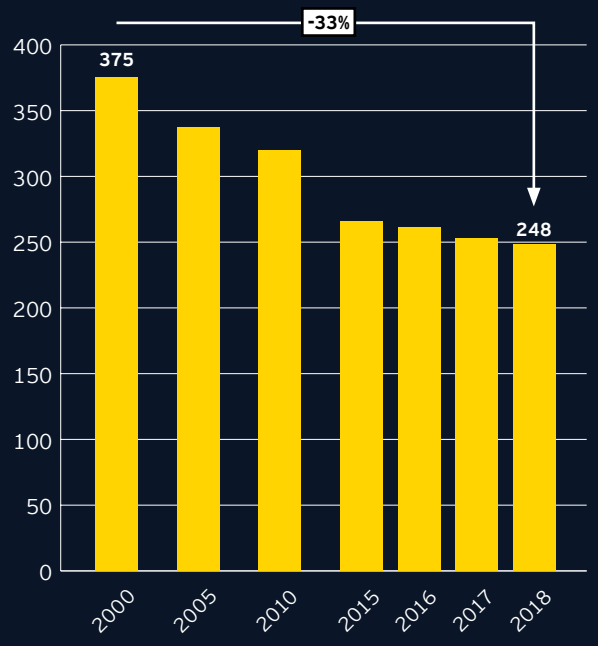
Economic Policy Uncertainty Index



Source: Davis, Steven J. (Policyuncertainty.com)

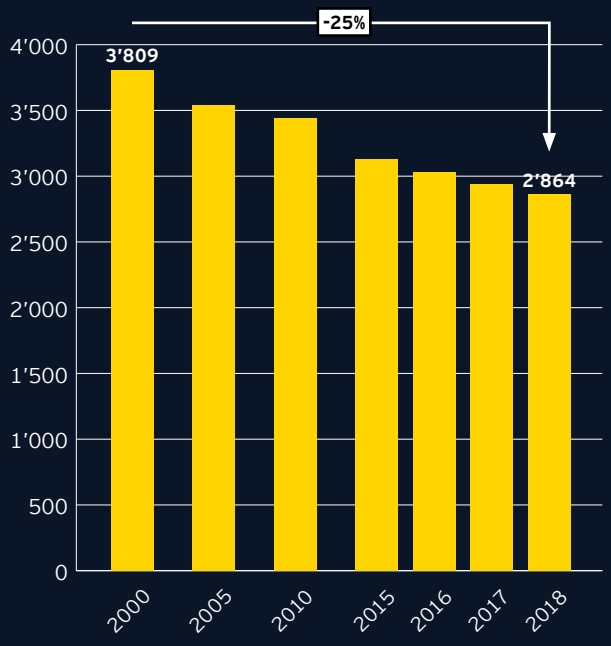
Bank Landscape

Number of banks



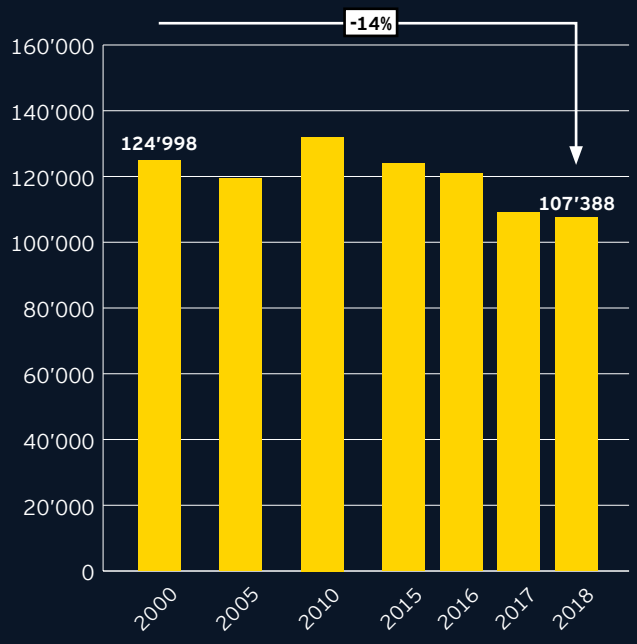
Source: SNB

Number of branches



Source: SNB

Number of employees

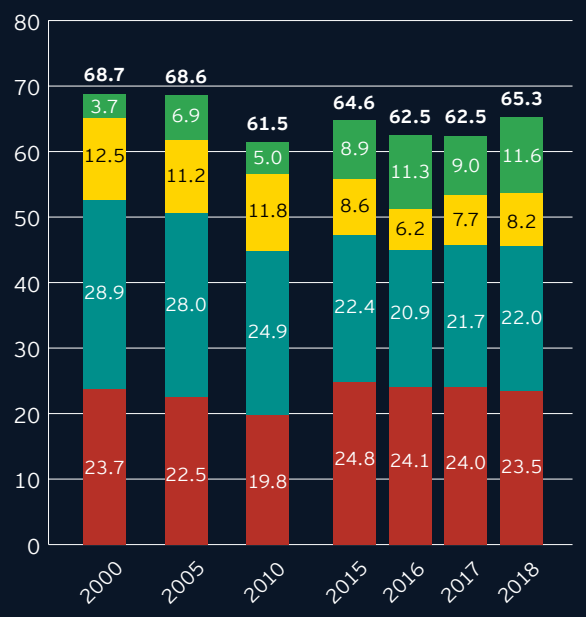


Source: SNB

Value creation and profitability

Results by business area

in CHF billion



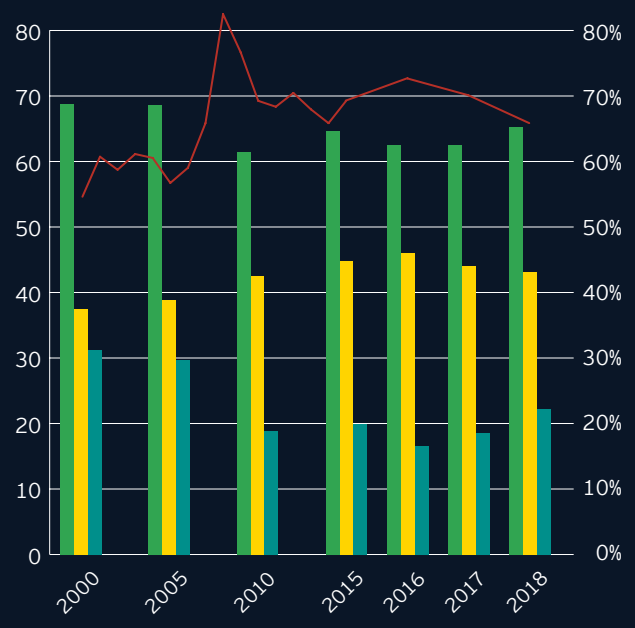
- Other result from ordinary activities
- Result from trading activities and the fair value option
- Result from commission business and services
- Gross result from interest operations

Source: SNB

Result, Expenses, Profit, C/I ratio

in CHF billion

Cost/Income Ratio



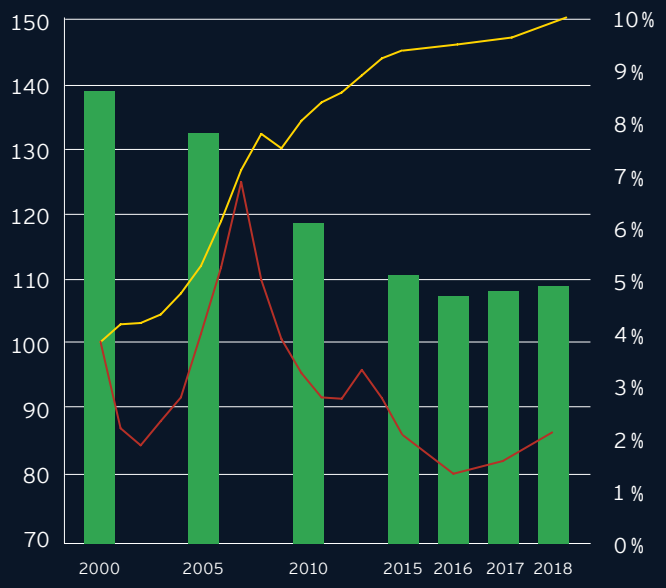
- Operating result
- Operating expenses
- Profit from operating business
- Cost / Income Ratio

Source: SNB

Value creation

Indexed
1.1.2000 = 100

Relative share
of banks



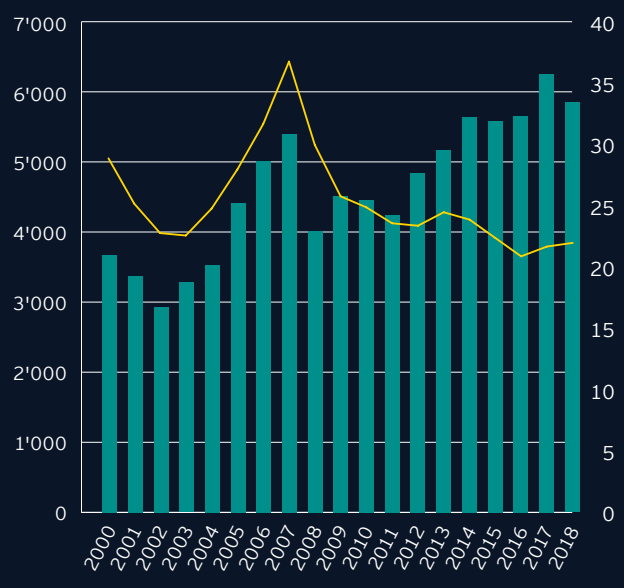
- Economy
- Banks
- Relative share of banks in %

Source: SECO

Result from commission business

Securities holdings
in CHF billion

Result from commission business
in CHF billion



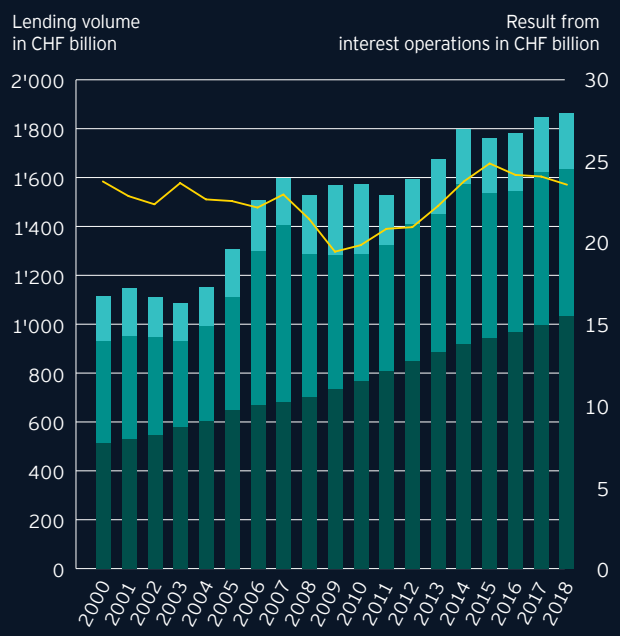
- Securities holdings
- Result from commission business

Source: SNB

Value creation and profitability

Interest rates and lending volume

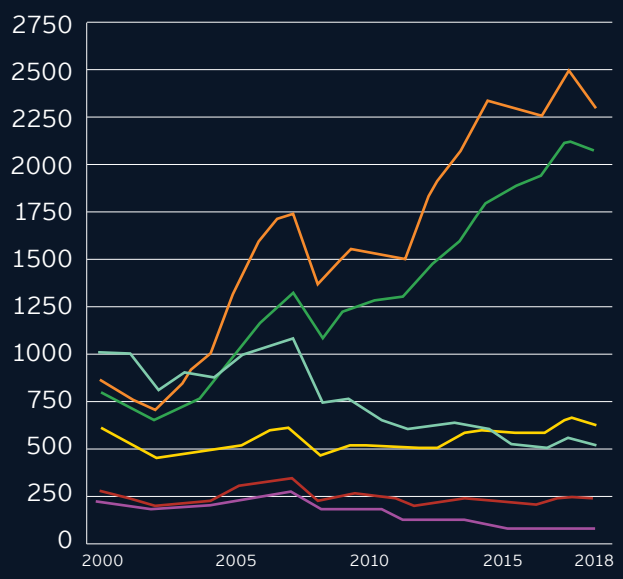
in CHF billion



- Mortgages
- Amounts due from customers
- Financial assets
- Gross result from interest operations

Source: SNB

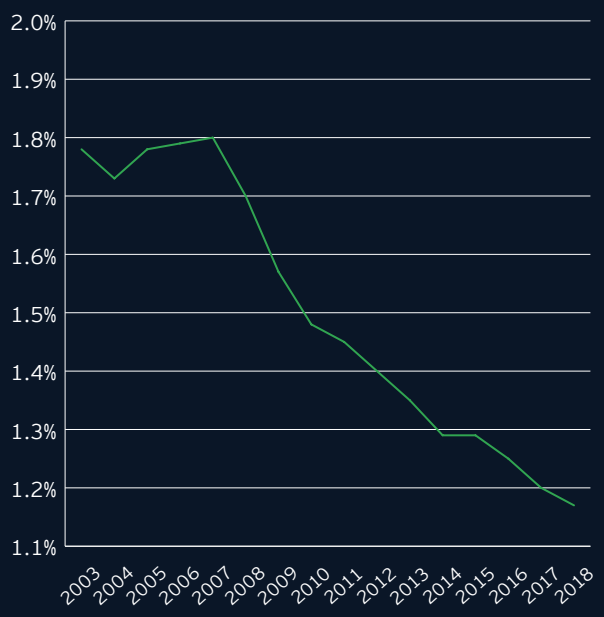
Customer deposits



- Private clients - national
- Commercial clients - national
- Institutional clients – national
- Private clients - foreign
- Commercial clients - foreign
- Institutional clients – foreign

Source: SNB

Interest rate margin of domestically focused banks



Source: SNB; Interest rate margins are approximated as net interest income divided by the sum of mortgage claims, claims against customers and financial claims.

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