Banking & Finance Switzerland

The banks in Switzerland are in solid shape, despite the challenging national and international environment. The banks in Switzerland faced numerous challenges in 2017. On the one hand, the continued low and negative interest rate environment and strong competition led to significant pressure on margins. Regulations relating to capital requirements and tax transparency are driving up costs. Further to this, digitalisation had a strong influence on the general banking climate and accelerated structural change in the sector. It is still unclear how conditions will change for the Swiss banks as a result of the UK’s decision to leave the EU (Brexit). The fact that most banks are reporting attractive earnings despite this difficult environment speaks to the ability of the Swiss banks to withstand crises as well as to their adaptability.

Pursuant to the current Global Financial Centres Index (GFCI) ranking, published in March 2017, both Zurich and Geneva rank among the leading global financial centres, in 11th and 20th place respectively.

Switzerland’s financial sector continues to be an important contributor to the Swiss economy. According to key figures published by the Swiss State Secretariat for International Financial Matters in October 2017, the Swiss financial sector’s share in Switzerland’s gross domestic product (GDP) in the year 2016 was 4.6% and the Swiss financial sector’s nominal added value (Wertschöpfung) was about CHF30 billion (as compared to CHF34.6 billion in 2011).

According to the Swiss banking barometer 2017 (published by the Swiss bankers association in August 2017), at the end of 2016, the banks in Switzerland managed total assets of CHF6.65 trillion. Compared to the previous year, domestic customer assets rose by CHF119 billion (+3.6%), while foreign customer assets fell by CHF36 billion (-1.1%). Overall, this corresponds to an increase in the assets managed in Switzerland of CHF83 billion (+1.3%). The share of foreign assets under management is slightly below 50%. With a market share around 25%, the Swiss banking sector remains the global market leader for cross-border private banking.

Aggregate annual profit amounted to CHF7.9 billion (in 2015 it was CHF15.8 billion, although this number included a high extraordinary income generated by a large bank due to a group-internal divestiture), and aggregate net income was CHF62.5 billion (-3.2%). The banks paid CHF2.3 billion in taxes (+3.2%).

Lending by the banks in Switzerland to companies and private individuals is intact. The domestic credit volume was CHF1.1 trillion, which represents a 2.9% rise compared to the previous year. At 2.7% in 2016, domestic mortgage lending rose slightly more than in the previous year (+2.6%). This is likely due in part to the measures introduced by the banks in the mortgage lending segment, including the amendments made to self-regulation.

The Swiss banking system is based on the model of the "universal bank", which means that a licensed bank may provide all banking
services, such as credit business, deposit and custody business, asset management and investment advice, payment transactions, securities transactions, underwriting business or financial analysis.

Rising regulatory costs, pressure on margins and investments in technological developments are, however, accelerating structural change in the sector, which is also reflected in the key performance indicators. For the 2016/2017 reporting period, the number of banks in Switzerland decreased. At the end of 2016, a total of 261 financial institutions were licensed as banks, compared with 266 in 2015.

The Swiss banking sector continues to be exposed to and shaped by the wave of global regulation that followed the financial crisis. Both national and international efforts aim to provide the financial system with greater stability and to reduce the risks for customers and governments. Swiss financial market regulation has followed the trend towards regulatory convergence.

The regulatory frameworks that are particularly relevant for Switzerland's banking sector can be divided into four groups: banking regulation, consumer protection, tax and anti-money laundering, and financial market infrastructure. In the past few years, Swiss banking regulation in particular has seen major developments. FINMA transposed the Basel III capital and liquidity requirements into Swiss law relatively quickly by amending the Swiss capital adequacy ordinance (CAO) and issuing a variety of circulars with implementing provisions, in part far exceeding the minimum requirements set out by Basel III, which was often referred to as the "Swiss finish". Switzerland closely follows developments at the Basel Committee on Banking Supervision, with the CAO being amended in order to provide for a leverage ratio of 3% for all banks (entering into force in January 2018) and revised risk distribution provisions (entering into force in 2019).

In recent years, Switzerland has been a forerunner with regard to specific regulation of systemically relevant banks, such as Credit Suisse, UBS, Zürcher Kantonalbank, Raiffeisen Group and Postfinance. The so-called too-big-to-fail (TBTF) package comprises measures such as stronger capitalisation, stricter liquidity requirements, improved risk diversification and organisational measures that guarantee systemically important functions for the economy such as payment transactions, even in the case of the threat of insolvency. The result of this TBTF regulation is a differentiated regulatory landscape in Switzerland, with significantly higher supervisory requirements for the systemically relevant banks that are reassessed in regular intervals.

For internationally active systemically relevant banks, Switzerland has already implemented the total loss-absorbing capacity (TLAC) requirements of the Financial Stability Board (FSB) as of July 2016, subject to phase-in and grandfathering provisions until January 1, 2020. Under the revised regime, systemically important banks operating internationally (G-SIBs) will be subject to two different minimum requirements for loss-absorbing capacity: G-SIBs must hold sufficient regulatory capital that absorbs current operating losses to ensure continuity of service (going concern requirement) and they must issue sufficient loss-absorbing debt instruments to
fund restructuring without recourse to public resources (gone concern requirement). The going concern requirement applicable in 2020 for a G-SIB consists of a base requirement of 12.86% of RWA and a 4.5% of leverage exposure; and a surcharge, which reflects the G-SIB’s systemic importance. For the two Swiss G-SIBs, Credit Suisse and UBS, this currently translates into a going concern requirement of 14.3% of RWA, of which the minimum CET1 component is 10%, and 5% of leverage exposure, of which the minimum CET1 component is 3.5%. The gone concern requirement of a Swiss G-SIB is equal to its total going concern requirement, that is in 2020, a base requirement of 12.86% of RWA and 4.5% of leverage exposure, plus any surcharges applicable to the relevant G-SIB, but not including any countercyclical buffers. The gone concern requirement should primarily be fulfilled with eligible bail-in debt instruments that are designed to absorb losses after the write-down or conversion into equity of regulatory capital of a G-SIB in a restructuring scenario, but before the write-down or conversion into equity of other senior obligations of the G-SIB. In addition to bail-in debt instruments, the gone concern requirement may further be fulfilled with other capital instruments, including CET1, Additional Tier 1 capital instruments or Tier 2 capital instruments. In addition, the Swiss department of finance has been instructed to prepare an amendment of the CAO introducing a gone concern requirement for domestically active systemically relevant banks (Zürcher Kantonalbank, Raiffeisen Group, Postfinance), currently expected to amount to 40% of their going concern requirement.

Furthermore, Switzerland has eased certain restrictions for financial technology firms in line with the Swiss authorities’ commitment to foster innovation in the financial sector. Following an amendment to the banking ordinance, firms are allowed to accept funds for settlement purposes for a period of up to 60 days (the previous practice was seven days) and the acceptance of public funds up to CHF1 million is no longer classified as operating on a commercial basis and thus in principle exempt from authorisation, allowing firms to try out a business model before they are finally required to obtain authorisation if they grow larger.

The regulatory changes relating to financial services are driven by the desire to align Swiss investor protection to international standards, such as MiFiD II, as well as to preserve market access for the cross-border securities business, in particular with the EU. Against this background, the Swiss federal government launched several legislative initiatives. On January 1, 2016, the Swiss Federal Financial Market Infrastructure Act (FMIA, FinfraG) entered into force and introduced, inter alia, regulations applicable to the OTC derivatives market. On November 4, 2015, the Swiss Federal Council presented a draft for a new Swiss Federal Financial Services Act (FFSA, FIDLEG), which, if adopted by the Swiss Parliament, would regulate the provision of financial services generally and the prospectus requirements for public offerings of securities. It also presented a draft for a new Swiss Federal Financial Institutions Act (FFIA, FINIG), which would, inter alia, subject independent asset managers to licensing requirements and prudential supervision for the first time in Switzerland. Both the FFSA and the FFIA are currently being discussed in the Swiss parliament and will, if
approved by the Swiss parliament in the Summer Session of 2018, enter into force in 2019 or, more likely, 2020.

In relation to tax and money laundering, Swiss banks that participated in the "Programme for Non-Prosecution Agreements Non-Target Letters for Swiss Banks" that was jointly issued in 2013 by the US Department of Justice and the Swiss government to settle issues in connection with a potential involvement in tax offences of US persons, continued to provide information to the US DOJ under the cooperation clauses contained in the NDAs that they concluded with the US DOJ. Other non-US regulators and authorities have initiated or continue their enforcement actions against certain Swiss banks as well. In addition, the US DOJ continued to follow the leads and insights gained during the Swiss Bank Programme and sought to target individual institutions, both banks and non-banks, that it suspected to have links to non-compliant (non-taxed or undeclared) client assets.

In addition, since January 2016, aggravated tax misdemeanour has been defined as a new predicate offence to money laundering. Aggravated tax misdemeanour is defined as tax fraud relating to direct taxes such as income tax and profit tax, provided the tax evaded in any tax period exceeds CHF300,000. Measuring the relevance of the introduction of the new tax-related predicate offence is difficult, but according to the Money Laundering Reporting Office Switzerland (MROS), of the 2909 reports made to MROS in 2016, only 34 related to the predicate offence of aggravated tax misdemeanour. It remains to be seen whether the tax-related predicate offence will lead to more reports in 2017.

The automatic exchange of information (AEOI) with countries abroad for information regarding taxable persons became the new international standard for the resolution of the tax issues. The US took a first unilateral step in this direction with its Foreign Account Tax Compliance Act (FATCA), which came into effect in July 2014. Switzerland signed an intergovernmental agreement with the US in 2013. As of January 1, 2017, Switzerland has implemented the AEOI with other countries in accordance with the global OECD standard. Bilateral agreements, as well as an agreement with the EU, have been signed with a number of OECD and non-OECD countries and further agreements are currently being negotiated. Switzerland will exchange information with the respective countries as of January 1, 2018.

Furthermore, FINMA, as well as its US and UK counterparts that supervise the foreign operations of the large Swiss banks, have zoomed in on compliance issues related to market conduct, imposing hefty profit disgorgements and fines. Moreover, in connection with proceedings against Swiss banks, FINMA is increasingly opening separate enforcement actions against responsible members of management.