THE FUTURE OF SWISS BANKING

Cembra Money Bank

Jahrestagung in Davos

8. APRIL 2014

Dr Thomas Borer

Overview: Our view on the future of Swiss banking

1. Regulatory reform has not ended - banks still need to implement and make strategic changes

2. Wealth Management will remain attractive but urgently requires legal certainty on cross-border tax issues

3. Switzerland's attractiveness as a location for asset management should be strengthened

4. Capital-intense investment banking is not sustainable– we need a ***change*** in investment banking, rather than ***no*** investment banking

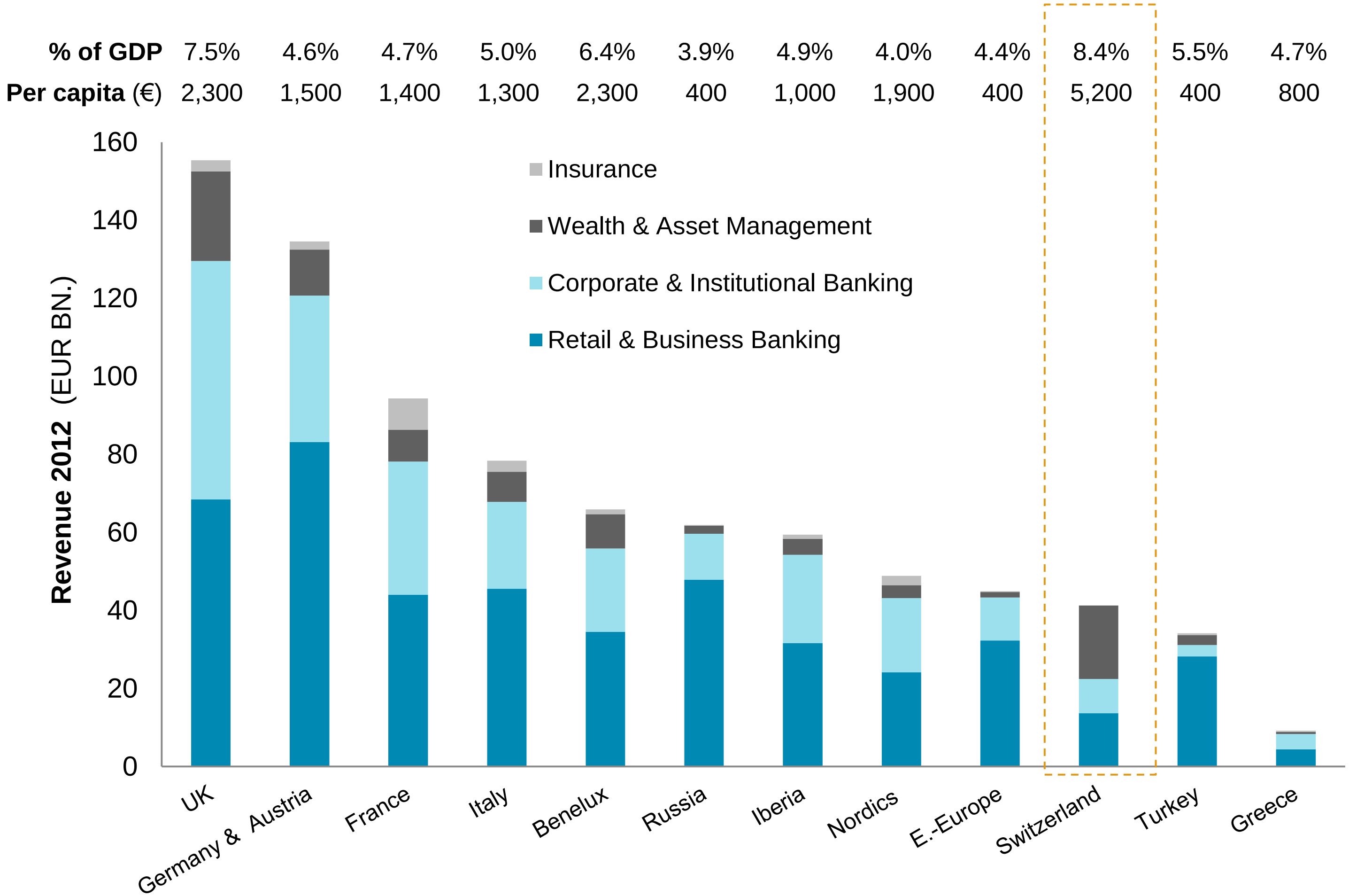
5. Swiss retail banking is highly attractive, but new competition will change the landscape

6. Winners in Retail and Wealth will fully embed digital technologies into their business models to enable convenience, client proximity and reduced costs

1 Special Role of Swiss Banking

The Swiss financial sector has a distinctly different structure than the industry in other European Markets

Bank revenue by segment and region, 2012 (EUR BN.)



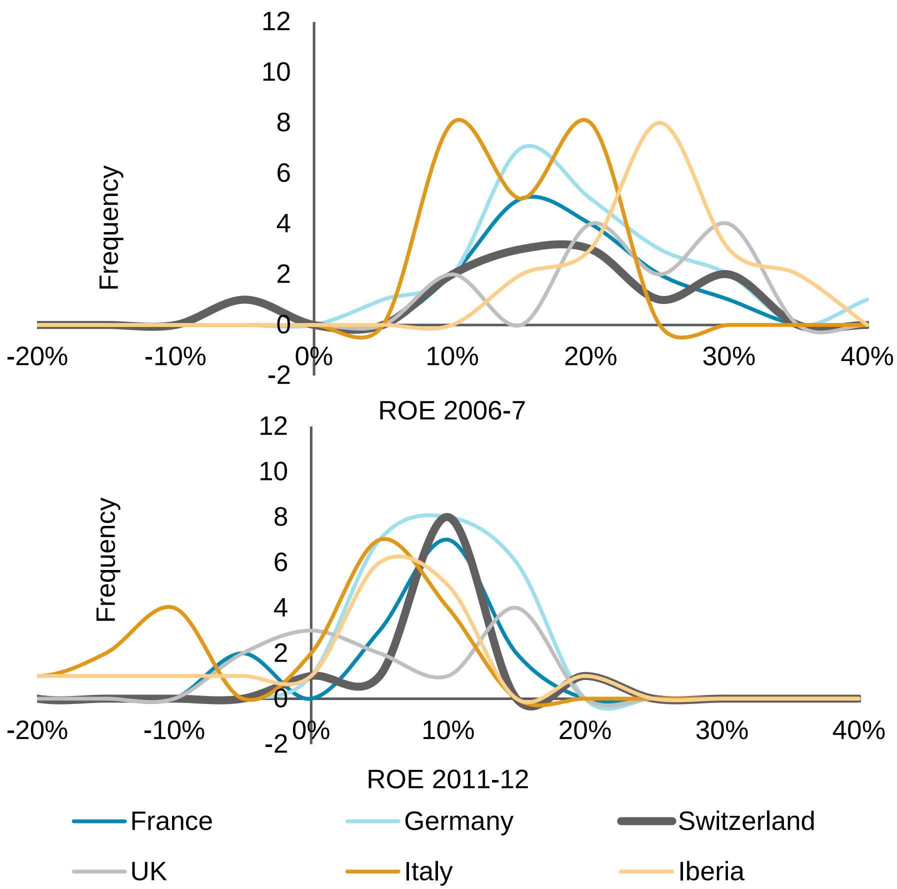
Comments

- The financial sector in Switzerland is disproportionally large relative to other European countries, both in terms of share of GDP and revenue per capita
- The sector is also structurally different from the ones in other countries
  - Asset & Wealth Management accounts for almost 50% of revenues
  - The share of business generated with large corporate and institutional clients is relatively small

Source: International Monetary Fund (IMF), Eurostat, Central Intelligence Agency (CIA) fact book, Oliver Wyman Analysis

The profitability of European financial services companies has shrunk after the crisis, while Switzerland maintains a relatively strong position

Distribution of Return on Equity (ROE)[1] by country



Comments

- The average returns of the industry has deteriorated considerably after the financial crisis
- At the same time the distribution of returns has narrowed
  – In 2006 / 07 returns shows a very high dispersion around the mean
  – In 2012 / 13 returns narrowed significantly around the (now lower) mean
- The Swiss financial sector is positioned well in the pan-European peer set due to
  1. Relatively strong and stable economic situation in Switzerland
  2. Large share of the Asset & Wealth Management segment with low return volatility

Source: Bankscope published by Bureau van Dijk, Company reports, Oliver Wyman analysis
1. ROE is calculated as net income / average common equity

2 Regulatory reform has not ended - banks still need to implement strategic changes

Regulations that are relevant for Switzerland can be grouped into the following four areas

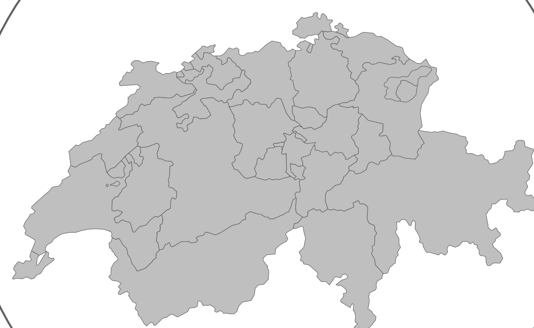
Overview of the relevant areas of regulations

BANK LENDING

- Basel 3
- CRD IV
- Dodd-Frank
- MiFID II
- Shadow banking

TAX

- Article 26 OECD
- FATCA
- Bilateral tax agreements



WEALTH MANAGEMENT

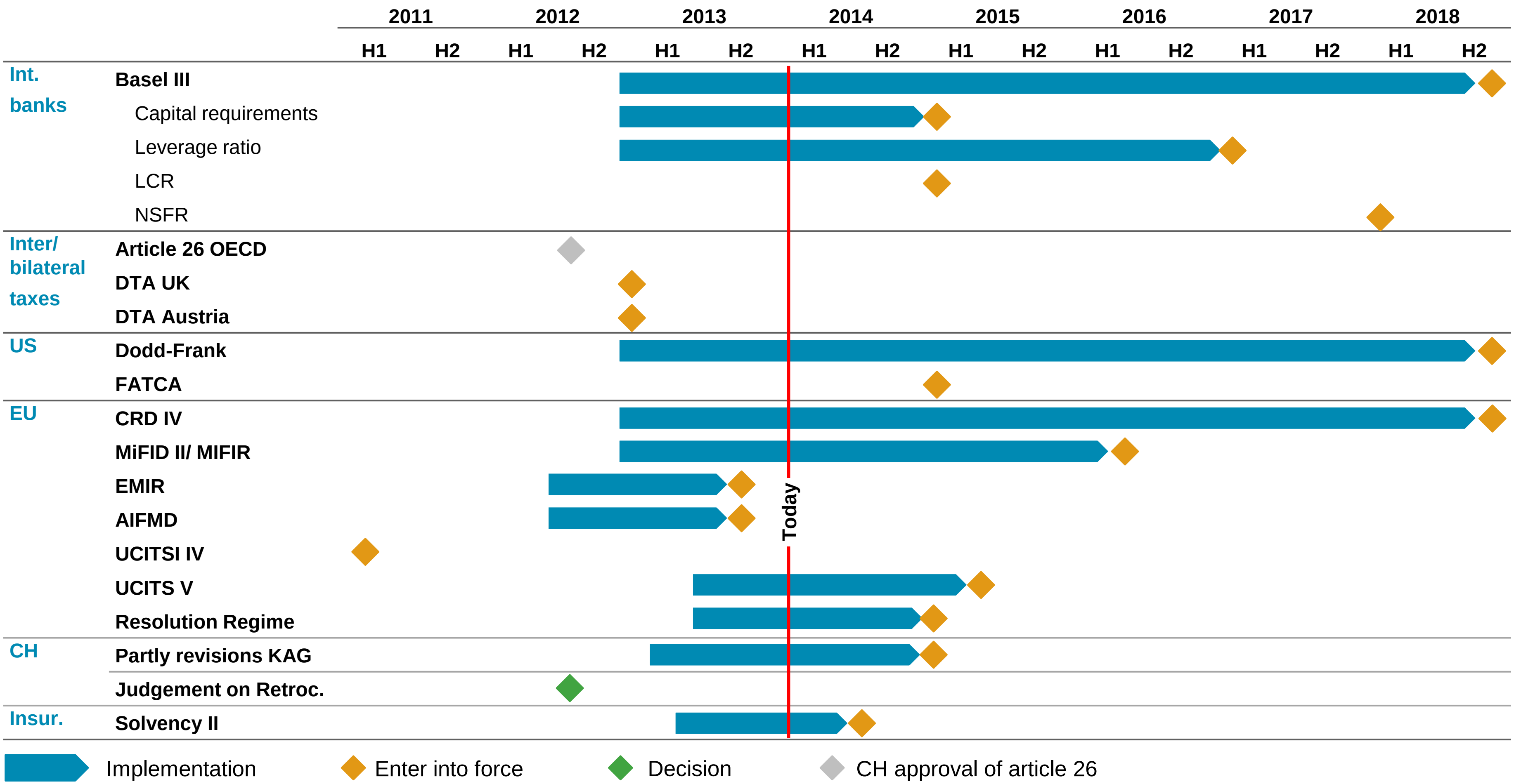
- AIFMD
- UCITS V
- MiFID II
- Revision of KAG
- Judgement on retrocessions

INFRASTRUCTURE

- EMIR
- MiFID II/MiFIR
- Dodd-Frank
- Revision of KAG

Apart from tax, most regulations are already outlined, but detailing and implementation is just beginning

Timeline[1]



1. Timelines based on estimates, changes are possible

We see challenges in linking the measures to the latest regulations with the overall strategy

Banks must adapt their business- and operating models to the changed drivers

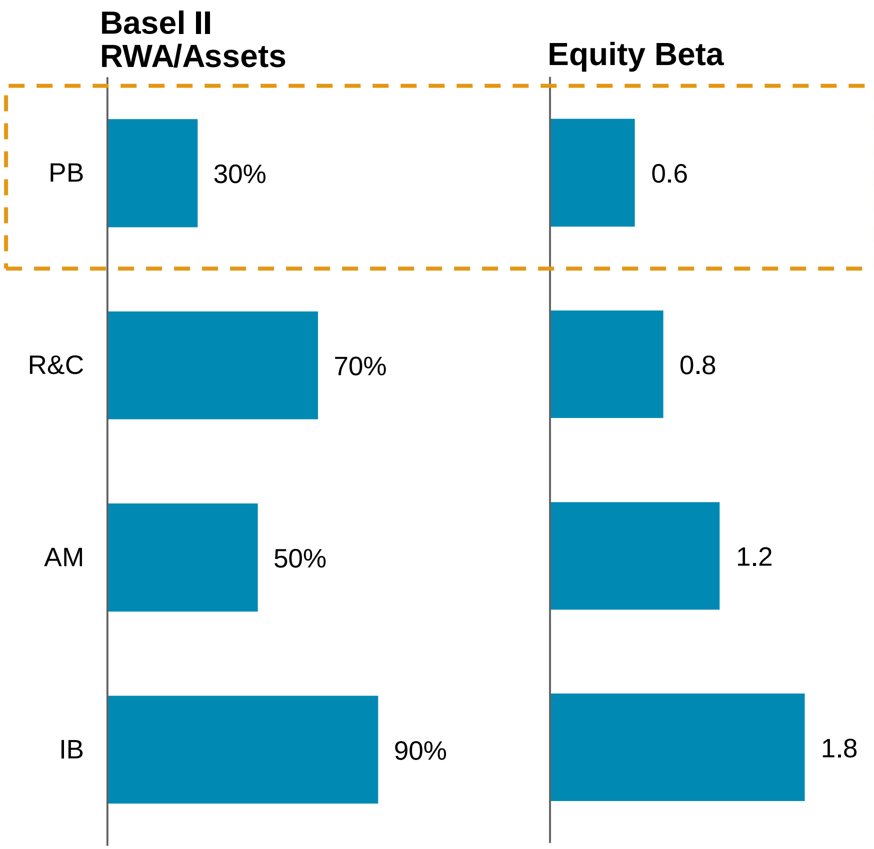
Business model	**Products**	• Restructuring in production regarding capital / balance-sheet usage etc. • New thoughts to insourcing vs. outsourcing • Fundamental adjustments to pricing structures (e.g. B/S usage, retrocessions) • Development of capital market flow products towards volume-based products / platforms
	Geographies	• Geographical repositioning: focus on fewer markets • Fragmentation of global markets – protectionism / overregulation
Operating model	**Customer service**	• Changes in interactions with customers, increased responsibility for customers, customers demanding „higher standards“
	Structure	• Increased requirements on governance (increased reach of national regulations and significant tightening)
	Financial resources	• New „insufficient resources“ (e.g. SWISS TBTF leverage exposure, NSF. Etc.)
	Cost	• Higher cost induced by regulations require increased operating efficiency

UNSTABLE EUROZONE | NEW REGULATIONS | CHANGES IN SUPERVISIONS | DISINTERMEDIATION AND NEW CAPITAL INVESTORS | CHANGES IN CUSTOMER DEMAND

3 Wealth Management will remain attractive but urgently requires legal certainty on cross-border tax issues

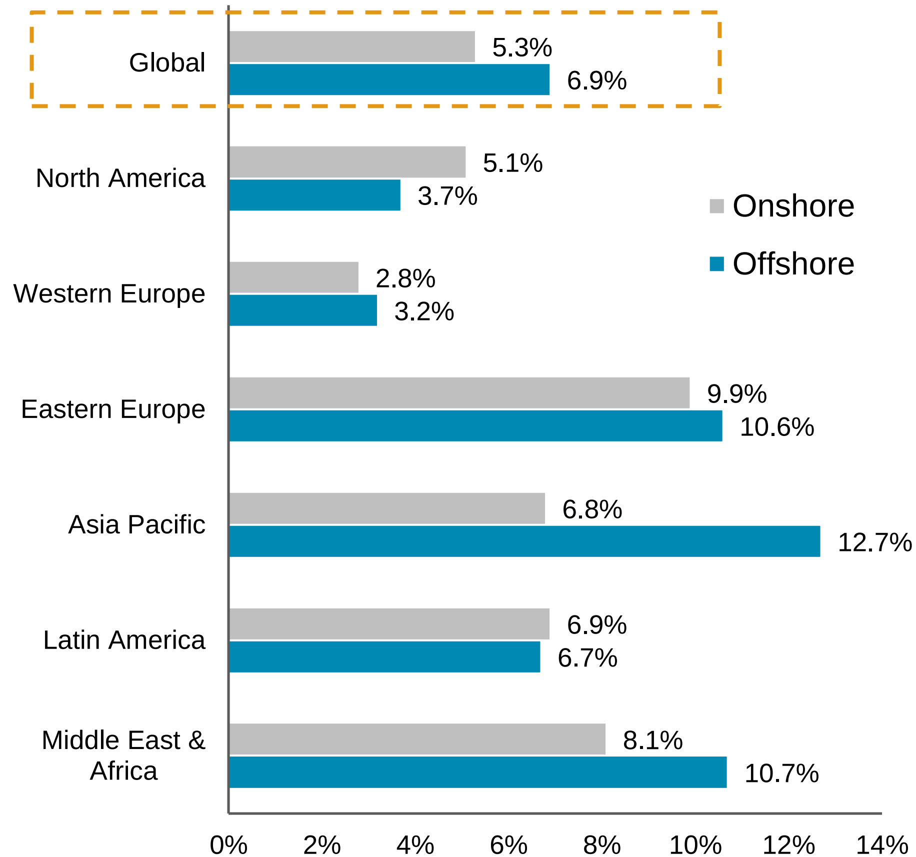
Wealth management is more attractive than other banking activities: Less capital-intensive, higher risk-adjusted returns plus growth

Wealth management is less capital-intense…



…and is growing globally

Growth rates (CAGR) 2011 – 2015



Source: Oliver Wyman analysis

We are currently in a historical phase in which a new legislative framework is being developed for cross-border private banking

> *We are prepared to take coordinated steps against countries that do not comply to the international standards, ensuring transparency in taxation*
>
> – G20 declaration for strengthening the financial system, 2009

Prior to 2008

- First attempts to coordinate the international tax laws (e.g. EU guidelines on taxation of interest income) were without significant effect, mainly driven by blockades from Austria, Belgium, Luxembourg and Switzerland

2008

- Various scandals e.g. UBS and LGT
- Financial crisis

2009

- OECD publishes a list of non-conforming countries
- G20 summit in London threatens non-conforming countries with possible sanctions

Today

- Most countries agree that the old system does not accomplish the desired effects and that a new system is needed instead

In addition, Conduct Risk is increasing – following the letter of the law is no longer enough – banks need to comply with the spirit of regulations

"*(FINMA states) that the applicable law does not provide sufficient protection for customers*"

– FINMA, Point of view, Feb. 2012[1]

Impacts

- Customer protection **affects all important markets (e.g. USA, UK, Germany, CH)**
- No longer sufficient to comply to the letter of laws/regulations. **Institutions must comply with the spirit and intent of regulations**
- Customer protection **affects all activities of banking** – all employees, all products, all services
- Customer protection will **change the approach to advisory in private banking**
  - Simpler products
  - More information for customers
  - Significant increase of the **intensity in advisory**
- **High penalties** have already been imposed due to insufficient customer protection

Customer protection affects all areas of financial services – especially retail banking and wealth management

1. FINMA, „Regulierung der Produktion und des Vertriebs von Finanzprodukten" 24. Februar 2012

Despite a rather difficult period of transformation, the outlook remains positive

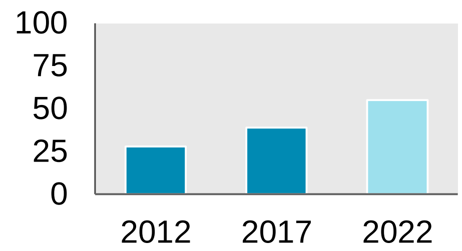
Revenues will only slowly catch up

- Margin gains will be limited because of
  - low interest levels
  - risk-averse investors
- Return to more attractive levels (however limited) from 2016/2017 onwards
- Assets under management (AUM) will increase

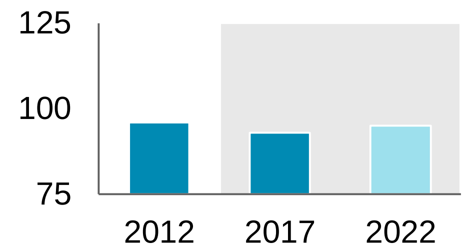
In mid-term, cost will be high

- Ratio of expenses and earning will increase due to investments in compliance and infrastructure
- New PB-models, especially for the 1-5M CHF customer segment, will become necessary (investments)
- Economies of scale is important and will excel consolidations

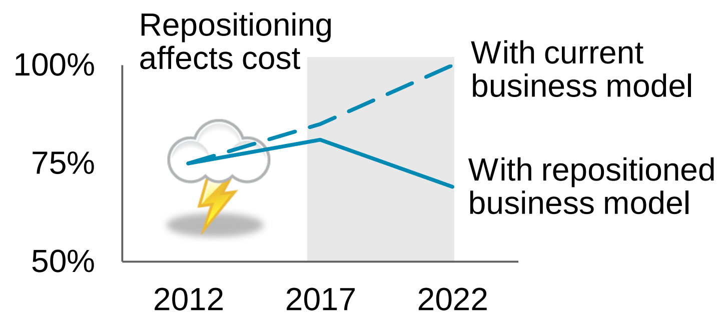
AUM
($ tn)



Gross-margin
(in bps of AUM)



Ratio of expenses to earnings
(%)



Period of upswing

Source: Oliver Wyman analysis

4 Switzerland's attractiveness as a location for asset management should be strengthened

In Switzerland, asset management presents itself as an attractive business area and as a strong second pillar in addition to private banking

Advantages of asset management

LOW SYSTEMIC RISK

- Even catastrophic downturns (e.g. LTCM) did not trigger heavy macroeconomic events

LOW CAPITAL REQUIREMENTS

- Capital requirements are relatively low according to Basel III

CONSISTENT WITH DEMOGRAPHIC CHANGES

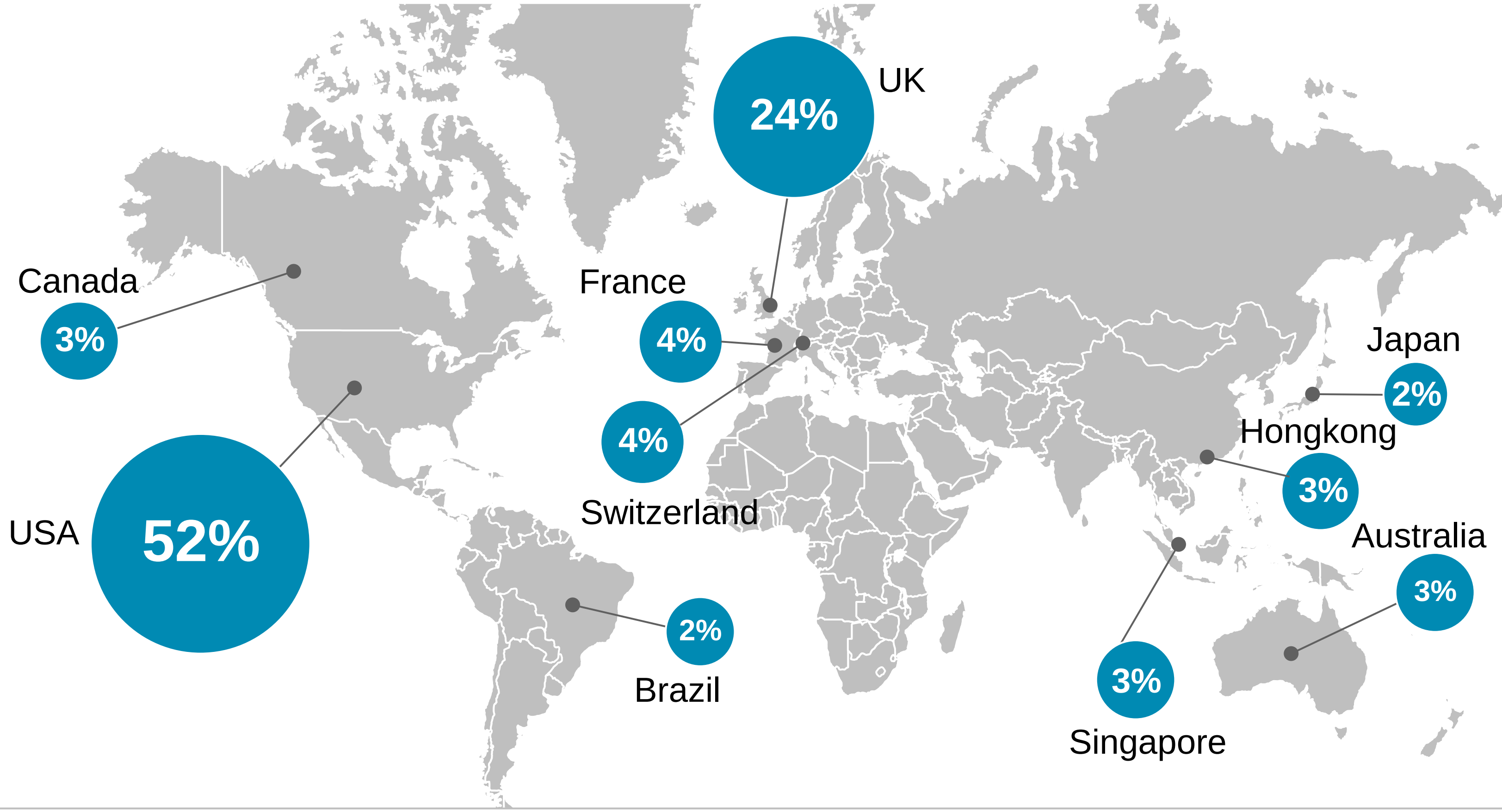
- Aging population worldwide – pension plans will gain importance

SYNERGIES WITH PRIVATE BANKING

- Private banking and asset management can share a wide range of infrastructures

Switzerland is considered a good but not yet a prime location among alternative fund managers

Important locations for alternative fund managers



Switzerland does not seem to be favourable as a prime location for funds – less than 0.5% of all hedge funds are located in Switzerland

Source: Eurekahedge, Oliver Wyman analysis

Establishing a prime location and to take on a leading role seems viable but requires coordinated efforts of various parties

Strategies of SBA and SFA

1. Establish asset management as brand
2. Develop and apply standards for asset management
3. Ensure adequate supervision
4. Improve market entry
5. Promote proper structures for asset management
6. Establish optimal tax environment (incl. other duties and charges) for investors
7. Further develop infrastructure in a targeted manner
8. Offer specific trainings

- Strengthening Switzerland's position as prime location for asset managers is key – it is less relevant to establish Switzerland as a location for funds
- The strengthening is not a task to be performed solely by the Swiss asset management industry. It also requires concentrated and coordinated initiatives by
  - FINMA
  - SIF/SECO/EDA
  - ESTV
  - Policymakers

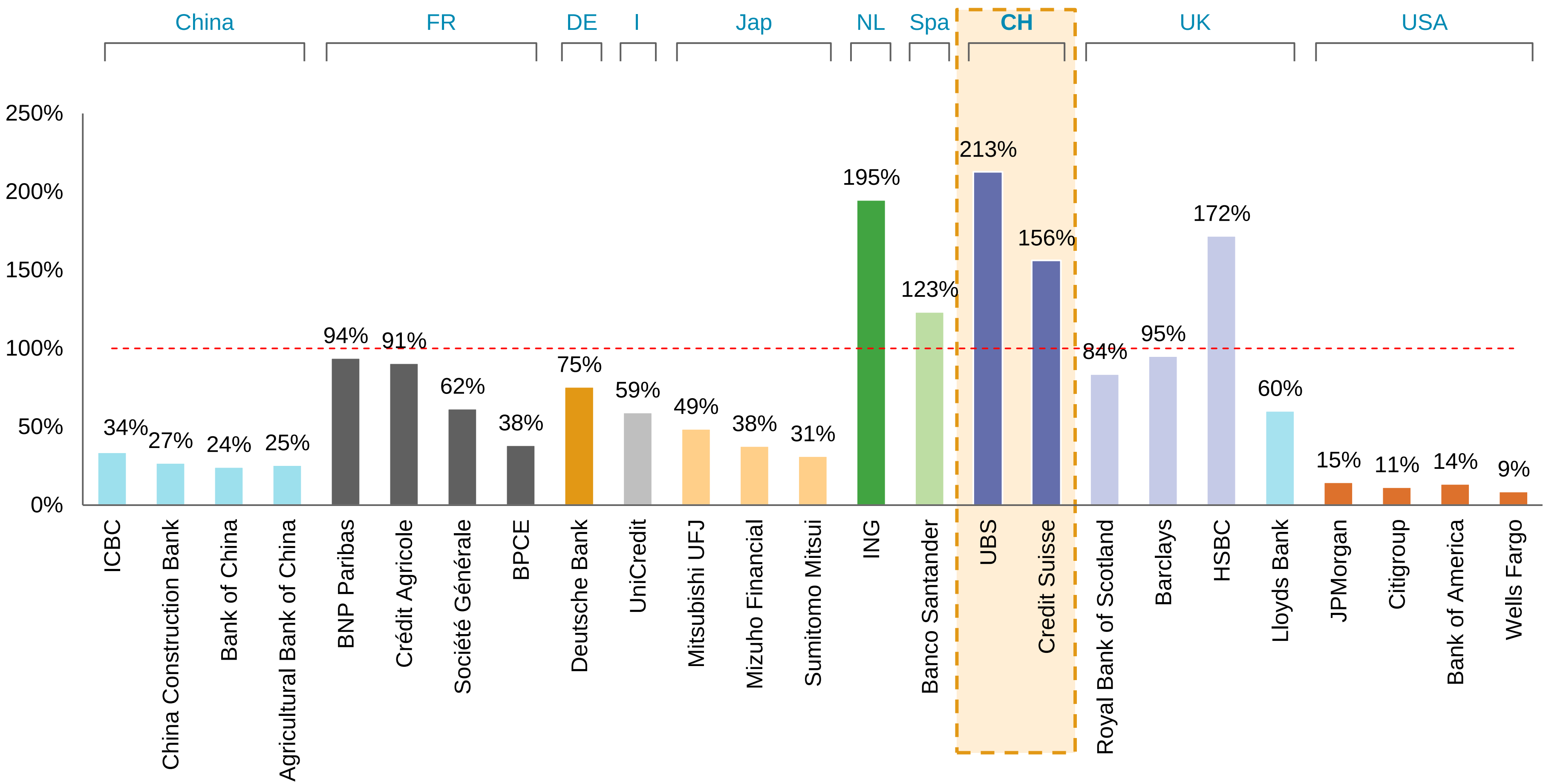
BLUE = Requires a wide range of support/coordination

Source: Swiss Banking, Swiss Fund Association «Grundlagenpapier Asset Management in der Schweiz»

5 We need a ***change*** in investment banking, rather than ***no*** investment banking

We should all be aware – Switzerland is too small for its banks

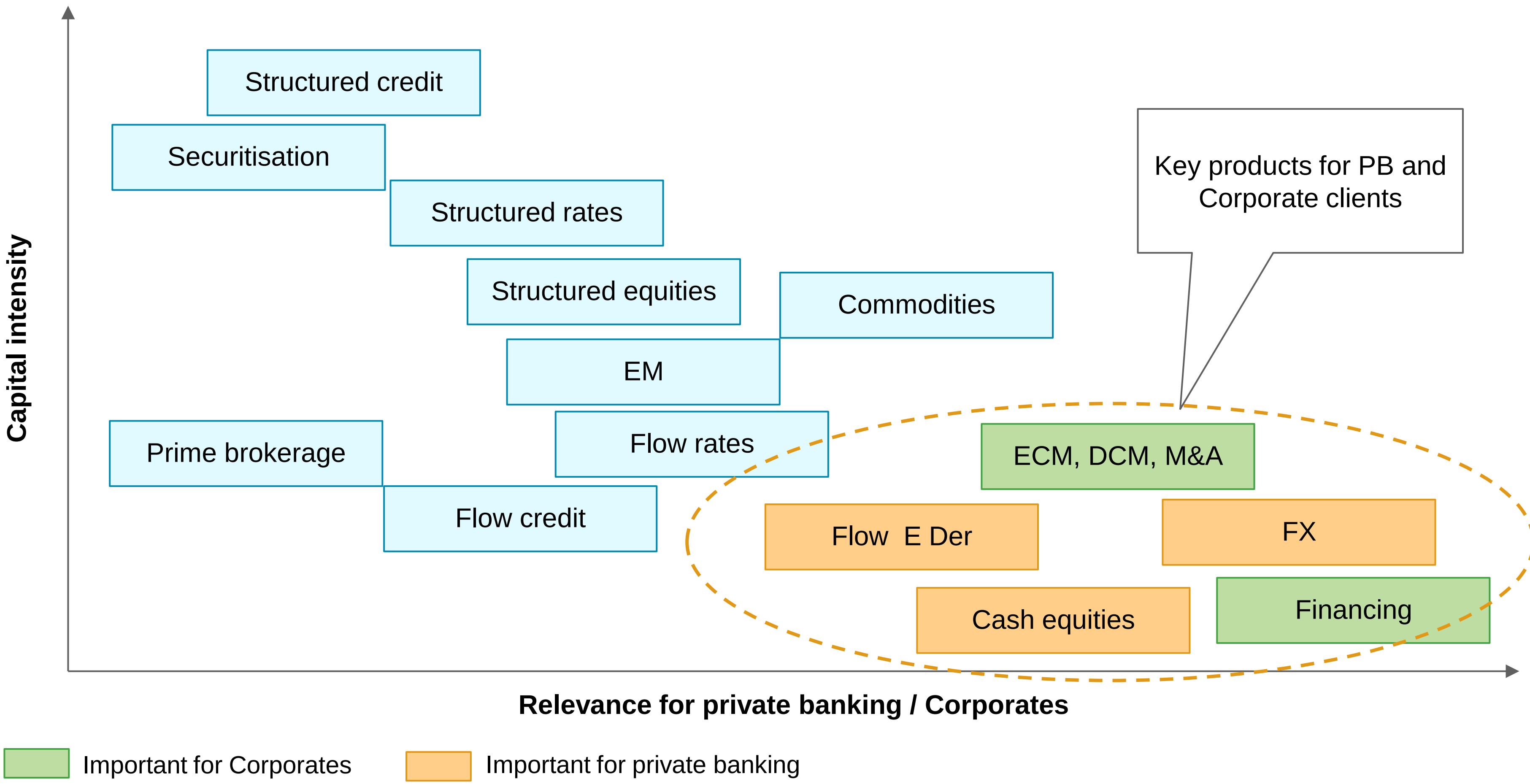
Top 25 globally active banks by assets in 2012: ratio of total assets to GDP of home country



Source: www.gfmag.com, Oxford Economics, Bankscope

The answer is to re-focus on areas which are less capital intensive, for example Private Banking and Corporates

Investment banking-products: capital intensity vs. relevance for private banking and Corporates

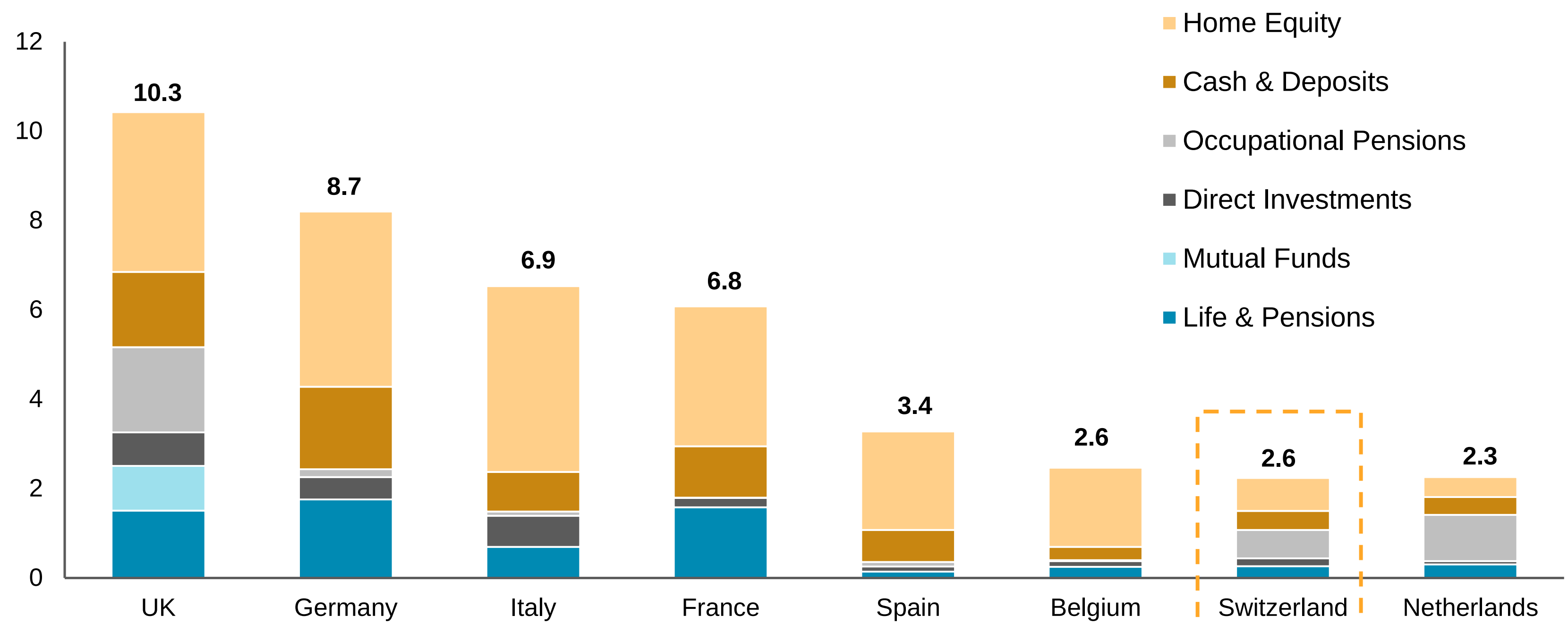


Source: Oliver Wyman analysis

6 Swiss retail and consumer banking is highly attractive. But new competition will change the landscape!

The strong retail business in Switzerland is, among other reasons, driven by the large volume of private financial assets

Total Personal Financial Assets (PFA)
2012, EUR TN



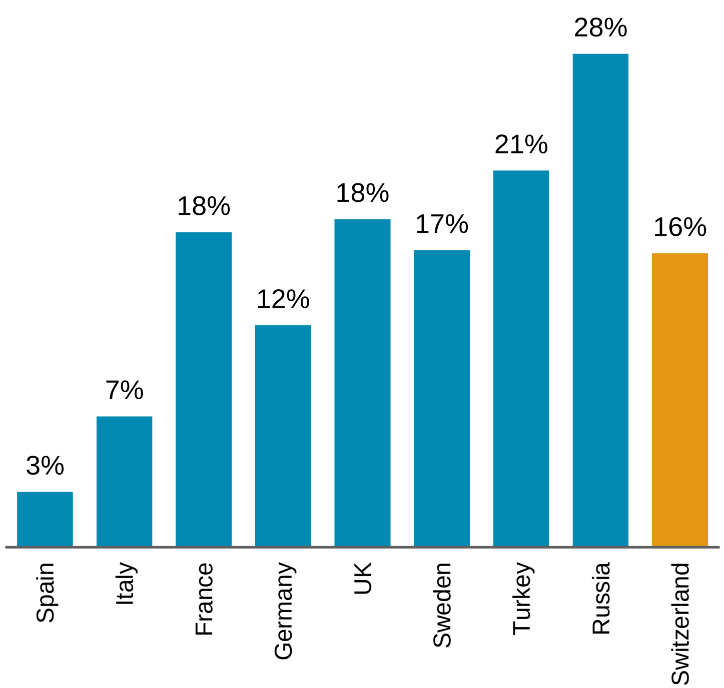
	UK	Germany	Italy	France	Spain	Belgium	Switzerland	Netherlands
PFA[1] (EUR) per capita (EUR 000s.)	164	107	113	107	74	236	**324**	139
PFA as multiple of 2012 GDP	5.4x	3.3x	4.4x	3.3x	3.2x	6.9x	**5.2x**	3.9x

Source: Oliver Wyman Datenbank, Lipper, Assogestioni

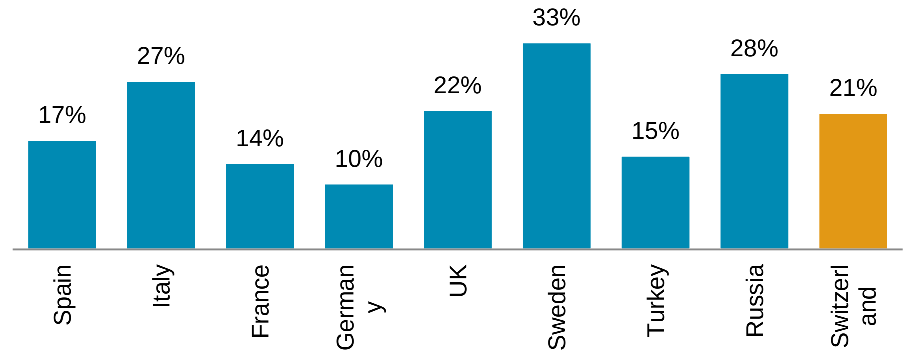
1. PFA: Personal Financial Assets

Swiss retail banking remains profitable, especially in individual banking and compared with peers in neighbouring countries

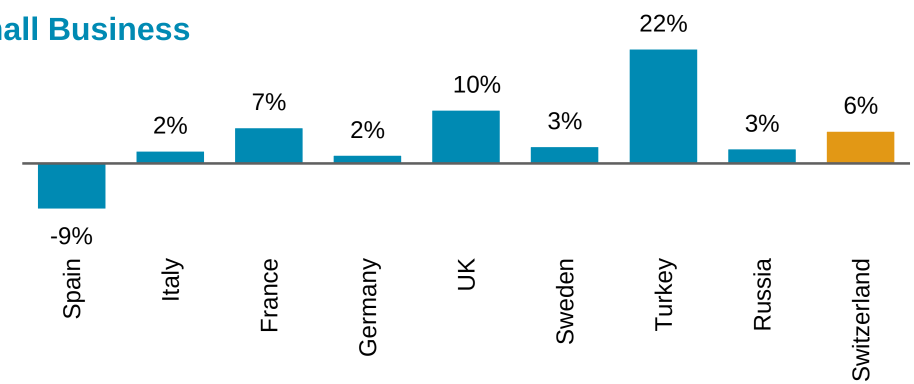
2012 Return on Equity (ROE) post tax %
By country



Individuals



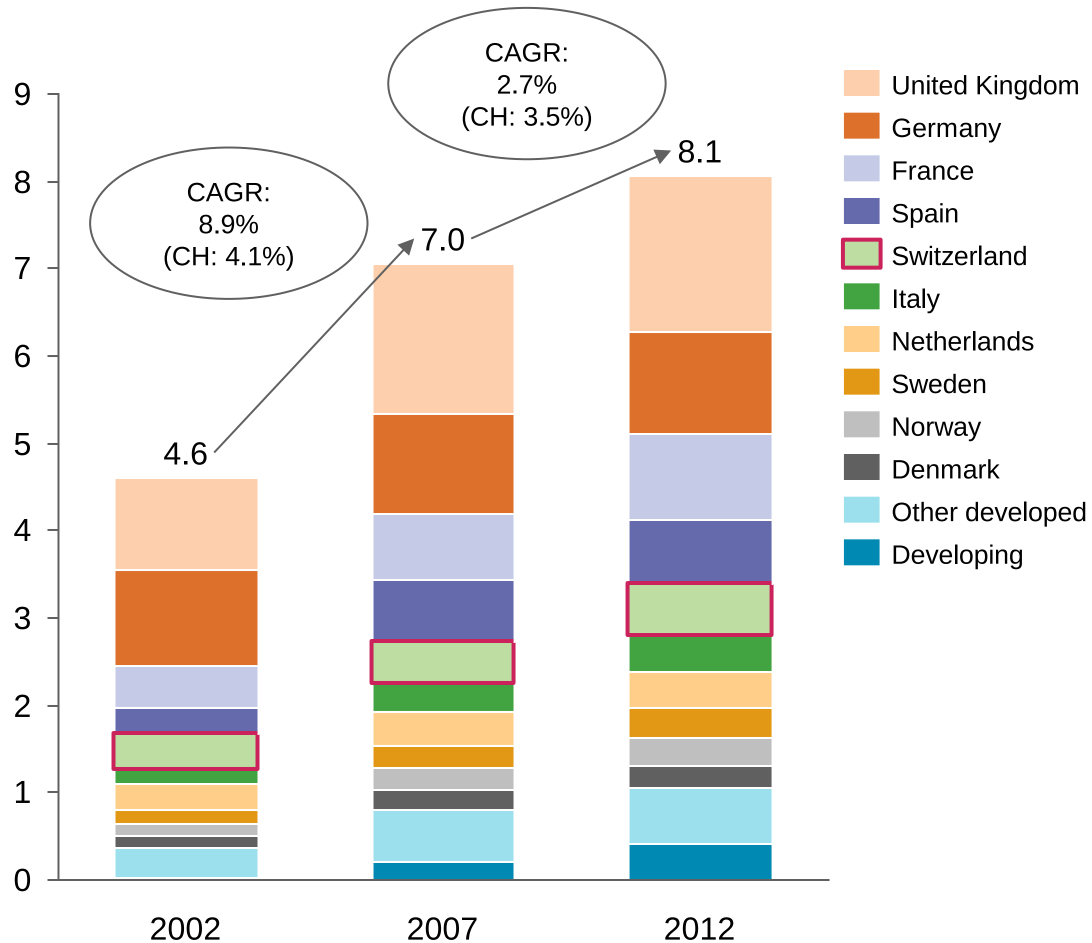
Small Business



Note: RoEs normalised with capital calculated as a percentage of RWAs, represented by the average of the Top 5 banks Core Tier 1 ratio in each country.
ROE figures include regulatory provisions whose 2012 increase has varied significantly across European countries.
ALM margin has been included in the total ROE calculation but not at segment level.
UK figures excluding PPI redress.
Source: Oliver Wyman analysis

Since beginning of the financial crisis in 2007 the growth of new retail loan volume has slowed down across Europe

European[1] retail credit evolution,
2002-12, in EUR TN.



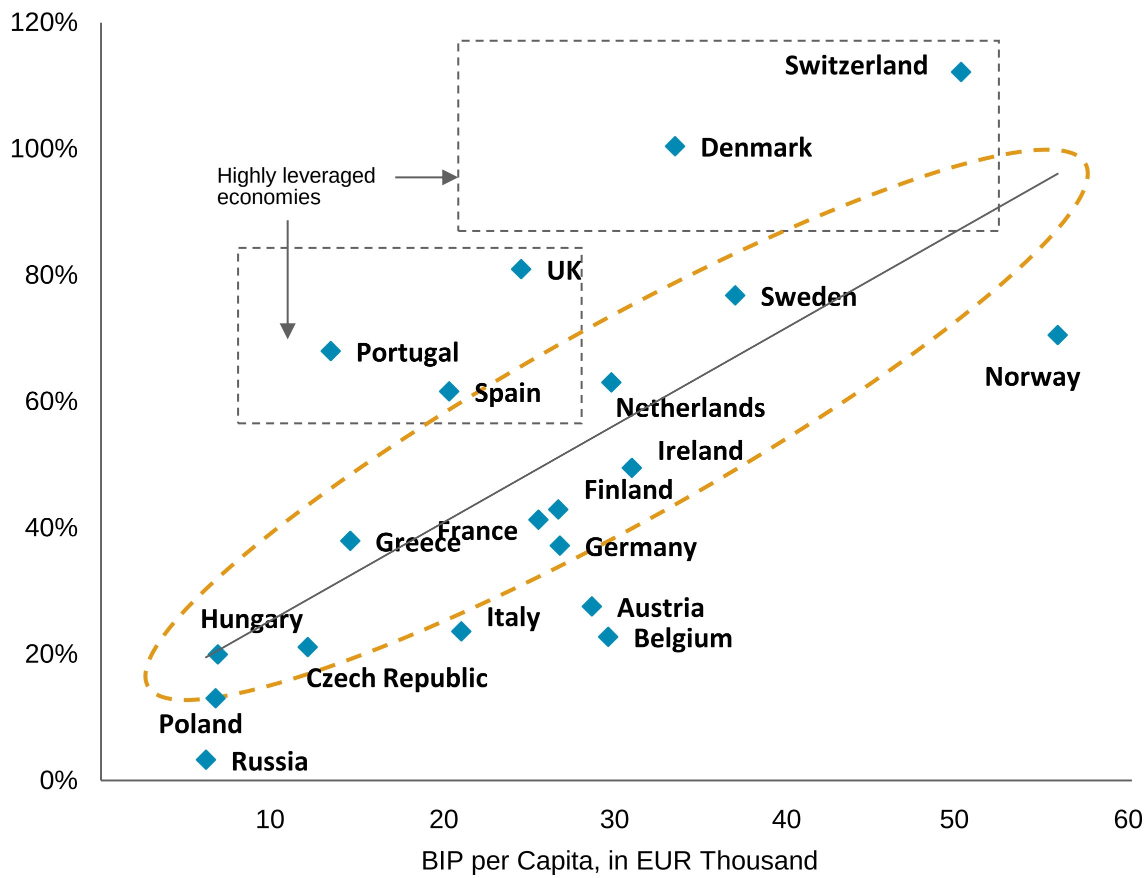
Comments

- The net new loan volume growth has slowed down considerably across all European countries over the last five years
- The developing markets in Europe e.g. Russia, Turkey) realised higher growth rates than the mature markets, but are significantly below the very high rates realised before the crises (up to 50% p.a.)
- The growth in the mature markets is primarily driven by mortgages, consumer finance is flat

Sources: EMF, ECB, Oxford Economics, EIU, OW analysis
1: 21 sample countries - Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland, Turkey, United Kingdom

Market fundamentals suggest that consumer credit growth will likely exceed GDP growth in the medium / long term

Outstanding credit balance as a % of GDP
2011 (includes mortgages)



Source: IMF, ECB, Oxford economics, Statistics Norway, Statistics Sweden, Oliver Wyman analysis

Fundamental considerations

- Fundamentals show consumer credit typically grows faster than GDP
- As income per capita increases we typically observe that:
  - The proportion of the population that is ‘credit worthy’ increases
  - Credit markets deepen, leading to increased availability of credit
  - A smaller proportion of income is spent on essential items (food, housing, healthcare, etc.) and an increasing proportion is used to service debt
  - House prices increase with development of mortgage markets

Changes in distribution and customer behaviour as well as a changing competition landscape are on retail banks' agendas

	Retail banking agenda	Expected changes over the next five years
I	Changes in the structure of distribution channels in general and role of the branch network in particular	• Holistic view of branch restructuring needs • Better in-branch customer experience
II	Commitment to digital	• Better usage of customer data and information • Real-time decisioning and linked processes • Increase investments in digital capabilities
III	Sharpen customer segmentation and proposition delivery	• Product design, distribution, servicing and segment definitions particularly for Affluent and Small Businesses
IV	Take on the cost base	• Improved efficiency in operations and infrastructure • Renewed core processes and costs
V	Changing competition landscape	• More new entrants from non-financial services companies are expected to
VI	Prepare today for interest rate rises tomorrow	• Scenarios for future change in macro environment

Case Studies provided on next slides

Case study: Klarna (Sweden)
Leading facilitator of e-commerce in Northern Europe

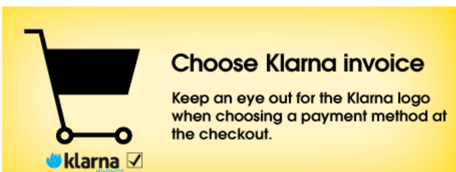
Proposition

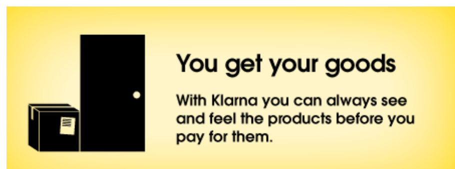
- Mission: make e-commerce safer and simpler for consumers and businesses
- When you purchase online with Klarna, you buy now and pay later
- From a merchant perspective, Klarna helps increase sales conversions, and takes on the risk (both credit and fraud) and the administrative burden
- Klarna makes money from both sides of the transaction: consumer finance and merchant factoring

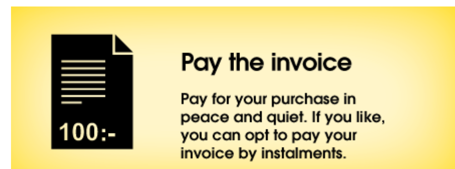
Company information

- 5 million customers, 700,000 customers with a Klarna account
- 12,000 merchants offer Klarna as a payment option
- Operates in 6 European countries: SW (where 20% of all e-commerce is operated by Klarna), NO, FI, DK, DE, NL
- Founded 2005 under the name Kreditor, now >600 employees
- Holds a European banking licence
- Acquired Israel-based fraud detection boutique Analyzd in May 2011
- Major investors: Investment AB Öresund, Sequoia Capital, DST, General Atlantic ($166 MM venture funding to date)

How it works







	Choose Klarna invoice	You get your goods	Pay the invoice
Customer benefits	• Customer choose Klarna at check out instead of paying by card, using a few personal identification details • No disclosure of sensitive payment details e.g.. credit card numbers • Do not pay until goods are received	• Customer receives goods from store • Customer receives invoice from Klarna	• Customer either pays invoice in full or can elect to pay in instalments (with interest) • Fees charged for late payment
Merchant benefits	• Merchant enjoys greater sales volume as customers have greater confidence in process and option to delay payment	• Merchant takes no credit or fraud risk from online payments – this all resides with Klarna	• Klarna simplifies the administration process e.g. invoicing and debt collection

Bank disrupters will continue to find fertile ground to attack traditional retail banking revenue pools

Potential bank disrupters – new entrants

Competition type	Examples	Comments
Online/digital-only	SWISSQUOTE BANKING. SELF-MADE.; AXA BANQUE; ING DIRECT	• Online-only banks with significant market shares in many countries, but with very little importance in Switzerland
Non-traditional service providers	PayPal; zopa; KICKSTARTER	• Successful, although small, in single-product offering • Expansion into other products likely to be only ever be ancillary to main offering
Car manufacturers	BMW; Audi; PEUGEOT; Ford	• Relatively stable and limited market presence to support sales: limited footprint (especially in city centres) from which to establish branch structure
Retailers	TESCO Bank; ICA banken; Carrefour Banque; FINANCIERA El Corte Inglés	• Financial services targeted at existing consumers base to support principal retail offerings: another element of becoming a “one-stop-shop” for customer needs • No relevance for Swiss market yet
Brand-led offerings/ new entrants/ carve-outs	Virgin money; METRO BANK; IKANO BANK; TSB	• More appetite to grow beyond existing customer base • No relevance for Swiss market yet

Source: Oliver Wyman Banking report “The shape of things to come”, October 2013

Attackers in the SME segment are mostly Start-ups or IT firms leveraging their analytical capabilities and client-centricity to offer value add to their customers

Bank attackers in the SME online/mobile space – Examples

Offering	Established FS players (non-banks)	New FS players/ FS start-ups	IT companies/ IT service providers	Crowd funding/ peer-to-peer platforms
1 Account services /Cash Mgt./St. Investments		CashFlows, fidor BANK, kyriba	SUNGARD, WALLSTREET SYSTEMS, kyriba, GTreasury	Treasury and Cash Management solutions
2 Transaction Banking/ Payment Solutions	V.me by Visa, WESTERN UNION, MasterPass	The Currency Cloud, iZettle, sofort überweisung.de, Square, DWOLLA, Skrill, Expensify	ACI payment systems, Google wallet, FUNDtech, FIS, PayPal, POLARIS, ARIBA An SAP Company	Battle for future online/ mobile payment method
3 Financing/Trade Export Finance (TEF)		Klarna, OB10, MarketInvoice, OnDeck	osmo, amazon	zopa, ezbob, wonga for business, smava Direkt Kredit, Funding Circle, SEEDMATCH CROWDFUNDING
4 Risk Management/ Hedging		hedge mantra	Hedge Trackers, 360T TRADING NETWORKS, FXall What's Your Edge?	Social/P2P as alternative lending
Other (e.g. accounting services, e-invoicing, …)		mint	SAP, intuit, sage, KashFlow Accounting Software, ClearBooks Online Accounting Software	Accounting solutions

- Majority of the New Entrants focusing on one specific customer demand, to address in a targeted way the new customer expectations
- Banks are fast becoming only one of many financial service providers
- Key success factor going forward, understanding of the relevant New Entrants set and separate myth from reality

Source: Oliver Wyman analysis

Most of these bank attackers are already prepared to expand their service offerings for SMEs

Bank attackers observed trends

Success Factors

Information access	Ease of access	Value add
Capability 'to combine various data sources (invoices, Accounting data, …) to gain insights	Simple, customized and convenient Customer interface	Providing value add transaction or advisory service

As-is product offering cluster		New product offering cluster
Account services/Cash Mgt./ St. Investments	• Analysis of the cash handling pattern to be used for advisory, such as new overdraft agreements, optimised supplier management, optimisation of the cash/credit mgt., … • Accounting services to help customer to build up required accounting capabilities, e.g. B/S and P&L management	Advisory and Financing/ TEF
Transaction Banking/ Payment Solutions	• Linking of real time payments insights into liquidity and risk management solutions or customer product offering (CRM) • Advisory related to payments behaviour (when, bank account usage) or supplier management (e.g. by comparison with similar clients)	Risk Management Customer Mgt
Financing/Trade Export Finance (TEF)	• Advisory in alternative lending sourcing such as crowd funding asset financing • Expansion of crowd funding platforms into classical lending products • Advisory in trade partner selection, raw material management or hedging strategies	Risk Mgt Cash Mgt/Payments
Risk Management/Hedging	• Liquidity management optimisation • Pro-active risk advice related to financing / investments and cash management	Liquidity Mgt

Banks @ risks to remain as utility provider (such as Telcos) while other service providers manage the relationship (becoming more and more full service relationship managers) and provide value add services

Case study: EZBOB (UK): Microfinance
Start-up online provider of short term loans to small businesses

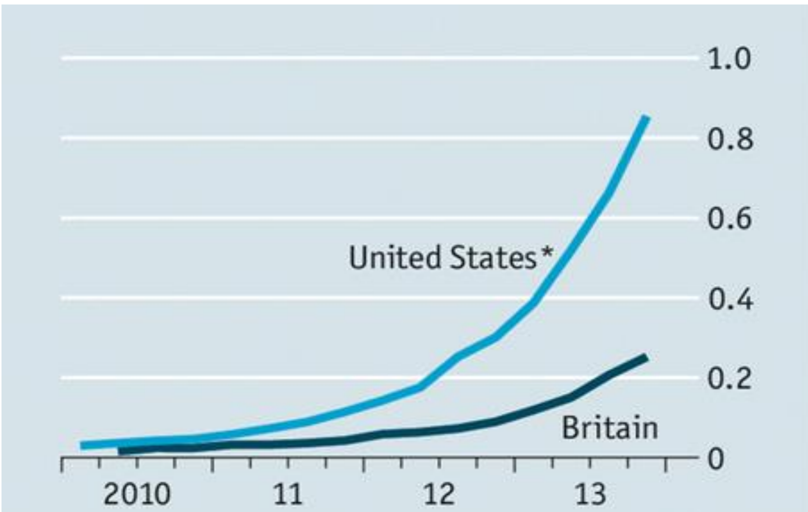
Company information and proposition

- UK start-up founded September 2012
- Provides short-term funding for small online retailers with turnover >£10,000
- Borrowers link their online shops (e.g. Amazon Marketplace, eBay) and payment accounts (e.g. Paypal) to their EZBOB account
- Credit worthiness assessed using these cost and revenue data

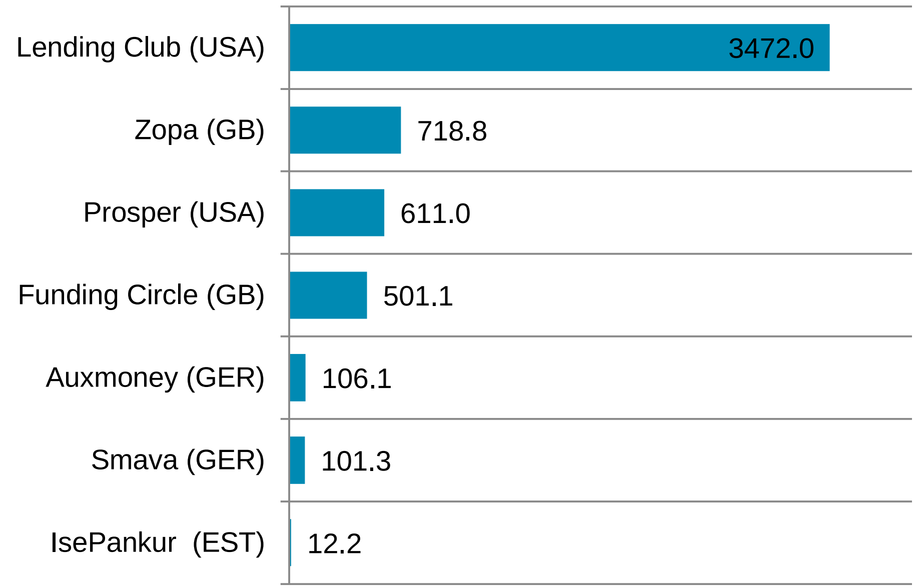
How it works			Client benefits	Business benefits
1		**Sign up** • Small business link online accounts to ezbob (e.g. ebay, amazon, paypal)	• Direct, instant link between sales and credit worthiness	• Detailed cost and revenue breakdown for each borrower
2		**Apply online** • Credit score based on online account sales and payments (and traditional credit report)	• 10 min approval • No paperwork	• Lots of up to date data to assess credit worthiness • Low underwriting costs
3		**Payment** • Up to £40,000 transferred to bank account within 30 mins	• Quick access to funds • 24/7 service	• Low overheads
4		**Repayment** • Maximum 12 month term • Interest rate reduces over loan period	• No hidden fees/charges • No early repayment charges • Loyalty reduces interest rates	• High interest rates (2-7% per month)

Crowd funding and peer-to-peer platforms are becoming more popular
Allowing people to bypass banks

Peer-to-peer lending
2010-13, in USD BN.



Credits awarded so far
in CHF M.



Source: Economist, NZZ-INFOGRAFIK

By offering both borrowers and lenders a better deal, websites that put the two together are challenging retail banks

Case study: Zopa (UK): Peer-to-Peer platform
The world's first and UK's leading peer-to-peer lending company

Company snapshot

- **Overview:** The first P2P lending company to launch in the UK (March 2005). Operates in the UK, Italy and being developed for Japan. Backed by Benchmark Capital and Wellington Partners.
- **Customers:** Zopa has lent over £466 million - over £165 million in the last year. Over 45,000 active savers and 71,000 borrowers. Over £28m in interest earned by savers since Zopa launched
- **Number of employees**: 45

Key financial information

Revenue estimates:
- n/a

Growth estimates:
- n/a

Value proposition

"We reward savers and borrowers who are good with their money by providing lower rate loans and higher interest on savings"

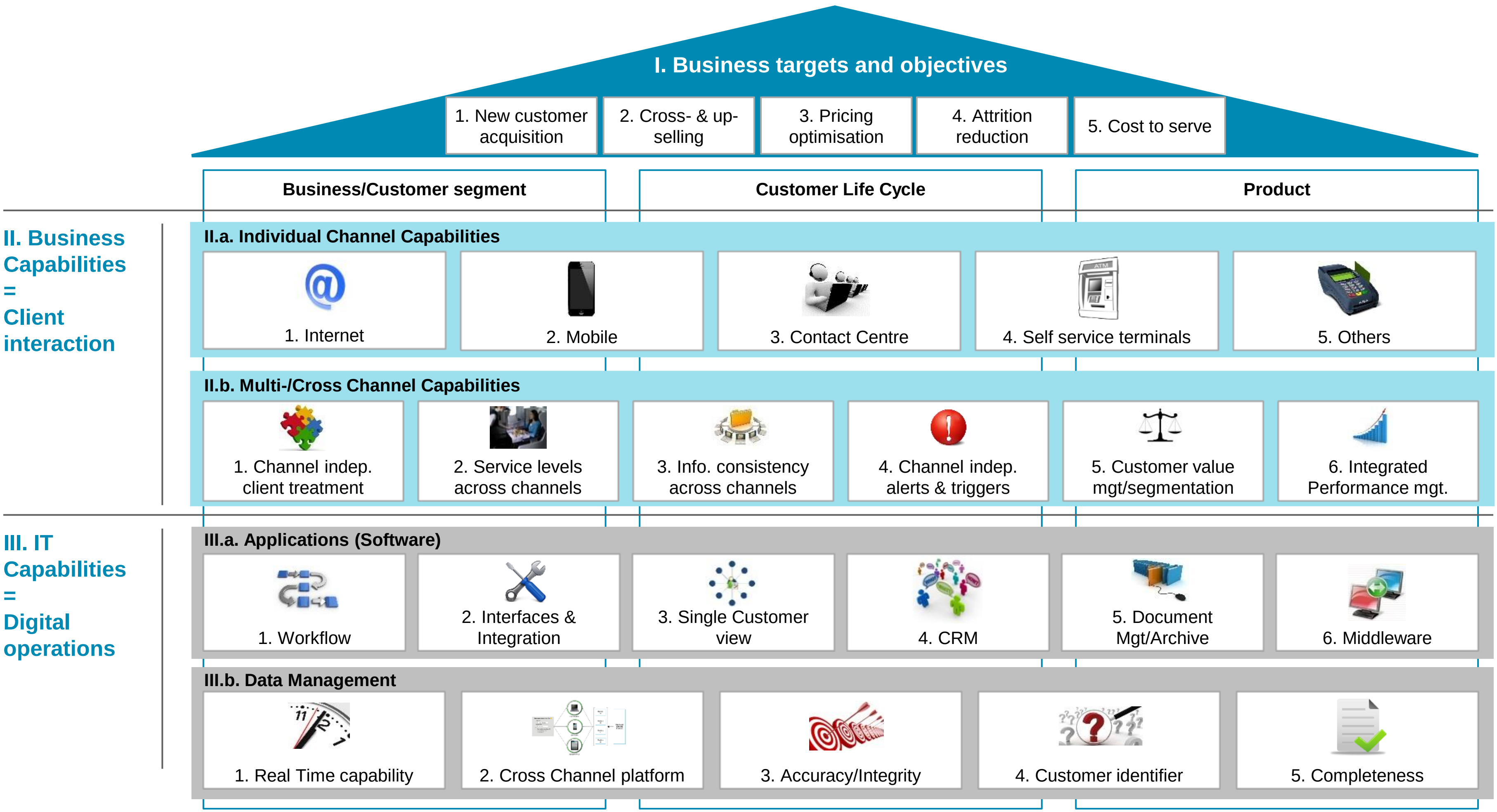
- Safe, quick and easy way to apply for loans
- Zopa guarantees reliability of both borrowers and lenders
- Safeguard feature launched in 2013, which provides lenders with protection in the event that a borrower defaults

Business model

- Both borrowers and lenders are charged fees by Zopa. Borrower fees are currently between zero and £190.. New lenders currently pay an annual fee of 1% of the amount lent, which is deducted monthly from the lender's account. The lender fee was 0.5% for lenders who joined before August 2008. Founder members are exempt from the lender fee.

Committing to digital requires a range of different capabilities and extensive changes in the operating model

Digital Channel capability framework



Note: Assessment of infrastructure capabilities and governance/organisation agreed to be out of scope

Conclusion

Summary

1. The Swiss financial services industry is characterised by a large share of revenues from Asset & Wealth Management activities, followed by Retail and Business Banking
2. Among other reasons due to its structure the Swiss FS industry is able to generate attractive returns compared to other European Countries
3. Also Retail Banking as an individual sector is comparatively profitable
   a) This is primarily driven by the high volume of personal financial assets of Swiss clients
   b) However, the growth in volume of consumer loans has slowed down in Switzerland (and in Europe overall) since inception of the financial crisis – still a solid growth exceeding the BIP growth is to be expected in the longer run
4. The Retail Banking sector exhibits a high degree of innovation
   a) Innovative market entrants with new business models will conquer shares of the revenue pool from established players
   b) Case studies from foreign markets give a flavour of things to come

The future of Swiss banking – Recap and questions

1. Regulatory reform has not ended - banks still need to implement and make strategic changes	How are you keeping up with regulation?
2. Swiss retail banking is highly attractive, but new competition will change the landscape	As a fairly young, growing bank, where do you see opportunities versus incumbents?
3. Winners in Retail and Wealth will fully embed digital technologies into their business models to enable convenience, client proximity and reduced costs	To what extent have you embraced digital technologies?

Questions?