VHV BCG

**Vereinigung Schweizerischer Handels-
und Verwaltungsbanken**

**Association de Banques Suisses
Commerciales et de Gestion**

**Associazione di Banche Svizzere
Commerciali e di Gestione**

**Association of Swiss Commercial
and Investment Banks**

Impacts of Anti-Money Laundering Regulation on the Competitiveness of the Swiss Financial Industry

Results of a study of the Swiss Banking Institute

Zusammenfassung

Die Vereinigung Schweizerischer Handels- und Verwaltungsbanken hat das Swiss Banking Institute der Universität Zürich beauftragt, den Einfluss der Bestimmungen zur Geldwäschereiprävention auf die Wettbewerbsposition der Banken in der Schweiz zu untersuchen.

Die Studie zeigt, dass die schweizerischen Geldwäschereipräventionsvorschriften als sehr wirkungsvoll angesehen werden. Verglichen mit den Bestimmungen ausländischer Finanzplätze legen sie den Banken jedoch auch die höchste Bürde auf. Für die Banken in der Schweiz resultiert daraus ein nicht zu vernachlässigender Wettbewerbsnachteil gegenüber ausländischer Konkurrenz. Die verschiedenen Präventionsmassnahmen belasten zudem wegen geringerer Skaleneffekte kleinere Marktteilnehmer stärker als grössere.

Sommaire

L'Association de Banques Suisses Commerciales et de Gestion a chargé le Swiss Banking Institute de l'Université de Zurich de consacrer une étude à l'impact des mesures contre le blanchiment de capitaux à la compétitivité des banques en Suisse.

Il ressort de cette étude que les mesures suisses pour la prévention du blanchiment des capitaux sont considérées comme très efficace. En comparaison des places financières étrangères telles que la Grand Bretagne, Singapour, l'Allemagne et les Etats Unis, les banques en Suisse subissent une charge nettement plus grande. Il en résulte un handicap compétitif non négligeable. En raison des effets d'échelle, la prévention du blanchiment représente une charge plus importante pour les petits opérateurs que pour les grands.

Abstract

The Association of Swiss Commercial and Investment Banks commissioned the Swiss Banking Institute to conduct a study on the impact of the Swiss and foreign Anti-Money Laundering (AML) regulation on the competitive position of the banking sector in Switzerland.

The results show that the Swiss AML ordinance is considered as very effective and serves its purpose. Compared with the AML regulation of foreign financial centers, the Swiss rules are regarded as particularly burdensome. This imposes a significant competitive disadvantage on banks in Switzerland. Due to economies of scale, smaller banks have higher charges than bigger in the area of AML.

The results of the study were presented at the general assembly on 28 April 2005 by professor Hans Geiger and Oliver Wünsch. The study is available on: http://www.sfcw.ch/aml.

1. Introduction

The Association of Swiss Commercial and Investment Banks (VHV) commissioned the Swiss Banking Institute to conduct a study on the impact of the Swiss and foreign Anti-Money Laundering (AML) regulation on the competitive position of banks with private banking business in Switzerland.

In an earlier study of the Swiss Banking Institute, Anti-Money Laundering was already identified as both the single most important and expensive area of banking regulation. While previous AML studies concentrated on the legislative framework, the current project aims to analyze the actual implementation issues and impact of AML regulation on the private banking business.

The study is performed in two phases. The first phase concentrates on the Swiss AML ordinance and was conducted with banks with significant business in Switzerland. In an upcoming step, the analysis will be extended to include foreign financial centers. This document presents the findings of the first Swiss phase.

The results of the study were presented at the annual meeting of the Association of Swiss Commercial and Investment Banks on 28 April 2005.

2. Key Findings

1. The Swiss Anti-Money Laundering ordinance is considered as very effective.
2. The Swiss AML regulation is broadly seen as most burdensome, compared with the AML rules in the United Kingdom, US, Germany, Luxembourg and Singapore.
3. The involvement of banks in Switzerland in the Swiss AML legislation process is regarded as insufficient. Foreign banks in Switzerland agree on this point even more than Swiss bank.
4. Banks in Switzerland identify the Swiss government and authorities as well as international committees and regulatory bodies as the two most important drivers for the Swiss AML regulation.
5. Nearly all banks regard a bank’s reputation in respect to Anti-Money Laundering matters as important or very important for their efforts to recruit client advisors.
6. Client advisors spend 15% of their working time for AML related matters. A considerable part of this effort is related to existing business relationships, i.e. to transaction monitoring and keeping “Know your Customer” information up to date.
7. 52% of the banks make use of their “Know your Customer” information for Client Relationship management, thereby employing synergy effects between data gathered for regulatory purposes and marketing activities.
8. Swiss AML rules do not scare away legitimate money.
9. As Swiss banks are obliged to apply Swiss rules even for their business abroad, they see a competitive disadvantage compared to their local competitors at foreign financial centers.
10. Banks face significant economies of scale in their AML units.

3. Method

The Swiss Banking Institute conducted a questionnaire-based survey among:
- all members of the Association of Swiss Commercial and Investment Banks (VHV);
- all members of the Swiss Private Bankers Association;
- members of the Association of Foreign Banks in Switzerland with private banking activities;
- the two Swiss big banks; and
- selected cantonal banks.

The questionnaire was circulated in February and March 2005. 35% of the banks invited took part in the survey. The 54 answers received (37 from Swiss banks, 16 from foreign banks in Switzerland) give a representative sample of the groups of banks and include players of all relevant sizes.

4. Findings and interpretation

4.1 Swiss AML regulation very effective

The Swiss Anti-Money Laundering ordinance is considered as very effective in preventing money laundering. All respondents, Swiss as well as foreign banks in Switzerland, share this common view. Independently of the discussion about adequacy of the regulatory environment, this shows that the rules serve their purpose.

4.2 Swiss AML regulation places high burden on banks

Yet, compared with the AML rules in the United Kingdom, Singapore, Germany, Luxembourg and USA, the Swiss AML ordinance is seen as the most burdensome in terms of implementation costs and effort. This is a shared opinion among Swiss and foreign banks. Considering the opinion about the other financial centers, Swiss and foreign banks do not agree on the same view. Especially the perception of the UK and German AML regulation differs significantly from Swiss and foreign banks.

It has to be noted that some banks, especially big, foreign players, partly consider their home country rules as stricter than the Swiss AML framework. In addition, most of them have company internal directives, which they assess as the strictest compared with any other relevant legislation.

The following table depicts the regulation burden rankings by Swiss and foreign banks:

Rank	Country (Swiss banks)	Country (foreign banks)
1	Switzerland	Switzerland
2	Germany	United Kingdom
3	Luxemburg	Luxemburg
4	Singapore	Singapore
5	United States	Germany
6	United Kingdom	United States

1: most burdensome; 6: least burdensome

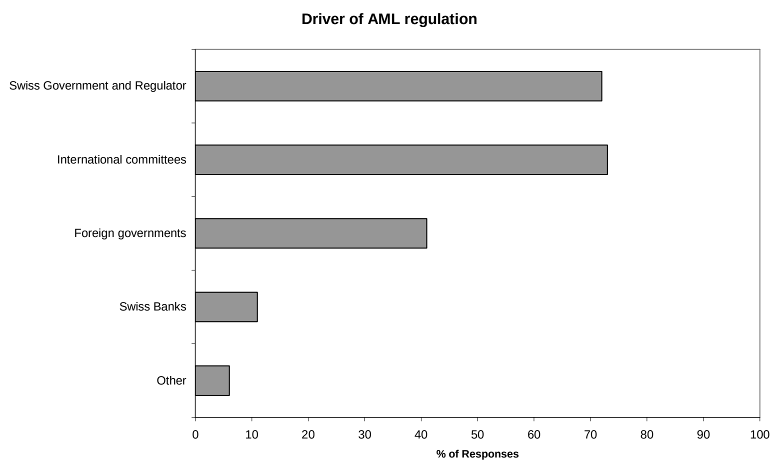
4.3 Industry involvement in the regulation process insufficient

While the banks rate the relationship with the Swiss regulator (Swiss Federal Banking Commission) and associated authorities as good, they are not satisfied with their influencing capabilities during the development process of AML regulation. Especially foreign banks in Switzerland, albeit also pointing out a good and constructive relationship with the regulating bodies, regard their involvement and consultation during the legislation process as insufficient. Small and medium-sized banks face the same representation of their concerns in the legislation process as large industry players.

4.4 Swiss and foreign governments driver of AML regulation

The lack of awareness of industry concerns is staggering, especially as 38% believe that the Swiss government and regulatory bodies themselves are one of the main drivers of the AML regulation. Foreign banks in Switzerland weight the influence of the Swiss bodies as slightly higher than the pressure from abroad.

However, it has to be acknowledged that 40% of the banks interviewed also consider international committees and regulatory bodies such as FATF and BIS to be the drivers of AML regulation. In addition, 20% see a significant influence of foreign governments, either directly or indirectly through international bodies, on the Swiss AML ordinance. Sometimes it is asserted that Swiss banks are driving AML regulation themselves. Yet, only 10% of the respondents agree with this opinion.



4.5 International Coordination of Regulation sound

About 60% of the respondents regard the coordination between the Swiss and European regulators (both pan European institutions as the European Union as well as regulators of individual European countries) as good. The same is true for the relationship between the Swiss regulator and its US counterparts. In contrast, there is a common opinion that the coordination between Switzerland and Singapore in the area of AML regulation is not sufficient.

4.6 Relationship between Regulators and Industry good

The responsiveness of the Swiss regulator is appreciated, but the assessment of this issue differs between Swiss and foreign banks. While Swiss banks say that the British, Singapore and Luxembourg supervisory bodies are more open to concerns of the industry than the Swiss authorities, foreign banks rate the awareness of the British regulator to the opinions of the industry as poorer and regard the responsiveness of the Swiss regulator as best. As a common opinion of all Swiss banks, the German regulator is regarded as least responsive compared to its counterparts.

As a tendency, all banks judge the relationship with their lead regulators as slightly inferior compared with other foreign supervisors.

The rating of the relationship quality between banks and the regulatory bodies is independent of the bank size. Therefore, small and medium-sized banks in Switzerland face the same conditions in dealing with the regulators.

4.7 Organization of AML activities

25% of the foreign banks have created an independent AML unit represented at the executive board. While this arrangement ensures maximum independence of treatment of AML matters from operational activities, only one Swiss bank has decided to establish an autonomous AML unit.

As for Swiss banks, 50% of the respondents have located the Anti-Money Laundering unit of their company within the compliance department. 20% have placed it at the legal unit, another 20% at the risk unit, with 10% choosing different arrangements.

4.8 Communication of AML matters low

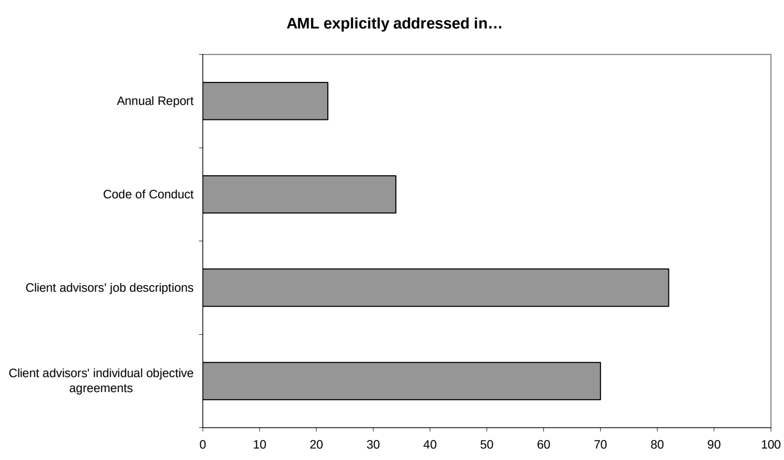
Despite the high overall effort of Money Laundering prevention for their business, the bank's active communication of this position is low. 22% of the respondents address the issue of AML in their annual report.

4.9 AML shapes Relationship between Banks and Client Advisors

The relationship between a client advisor and the employing bank is influenced by Anti-Money Laundering matters. 75% of the banks consider their reputation in regard to money laundering prevention as very important for their efforts to recruit client advisors.

While 80% of the banks include AML specific topics in the job descriptions of their advisory personnel, 70% put these matters into the individual objective agreements of their client advisors, thereby eliminating potential conflicts of goals.

Besides job descriptions and objective agreements, bank employees are also bound by the company's code of conduct. Whereas 44% of the foreign banks mention the prevention of money laundering in the code of conduct, only 30% of the Swiss banks decided to do so.



4.10 Major AML work by Client Advisors

Anti-Money Laundering prevention has a significant impact on a client advisor's daily work. About 15% of the total working time of a client advisor is dedicated to Anti-Money Laundering efforts. This is independent of the size of the bank. We reason that the effort for these tasks is mainly dependent on the number of customers without any economies of scale.

The time used for the due diligence process by the client advisor while establishing a new client relationship is 2.5 hours on average. Hence, a considerable part of the client advisors' AML efforts is related to existing relationships, e.g. transaction monitoring and keeping client dossiers up to date. The amount of advisors' AML work is independent of the size of a bank.

20% of the banks have specialized staff to assist the advisors in AML matters placed in the client advising divisions.

4.11 Heterogeneous customer base

We expected that a bank's client base is not homogenous in regard to AML related efforts and issues. It was assumed that a concentration is related to the client profile and domicile. 65% of the Swiss banks support this view. In that case, the concentration is reflected in an adapted organizational structure as well as more intense education of client advisors and related staff. In contrast, only a small minority of foreign banks recognizes a concentration of AML efforts on specific groups of customers.

4.12 Usage of "Know your Client" information outside AML matters

In order to fulfill the Client Due Diligence rules, a bank is required to build up a substantial pool of information about its clients. Yet, this data is not only useful to identify doubtful money, but can also be valuable in generating and improving business with existing clients. 52% of the banks surveyed have realized this potential by exploiting synergies between their Client Relationship Management and Due Diligence systems.

There is, however, a lack of standardization of the IT systems and data pools used for assisting Client Due Diligence processes. 66% of the banks use custom developed software for this purpose. In the area of transaction monitoring software, the situation is similar.

4.13 AML Regulation as Important Competitive Factor

AML regulation does not only have impact on illegitimate money. Since legitimate customers are also subject to certain procedures like "Client Due Diligence" and clarifications of doubtful transactions, it has an impact on legitimate business as well. Although the majority regards the negative impact as low, the opinions vary between the respondents.

As all Swiss banks have to apply Swiss AML rules even for their business outside Switzerland, Swiss AML regulation affects the competitive situation abroad. For their business in Singapore, Germany and the United Kingdom, Swiss banks see a slight competitive disadvantage to their local competitors, although the answers show no distinct opinion. The same is true in the US. There, larger Swiss players rate their situation as better than smaller banks. In Luxembourg, Swiss banks assess their AML related competitive position as equal to domestic banks.

Disadvantages arise out of three facts: First, Swiss banks face higher compliance costs. 33% of the respondents stress this issue. Some banks also point out that Swiss rules bar them from offering certain services. Finally, 30% of the Swiss banks with international operations argue that the clients are not appreciative of the efforts and processes caused by Swiss AML rules.

The banks regard the positive effect of AML regulation for marketing purposes as negligible, although some respondents stress the importance of AML efforts for the Swiss financial center as whole.

4.14 Significant Economies of Scale at the Banks' AML Unit

Banks face substantial costs in applying the Anti-Money Laundering ordinance in their daily operations. The costs can be split up into direct costs, which arise from the fact that resources are directly used for development and implementation of AML rules and processes within a bank. In addition, there are indirect costs, such as the opportunity costs due to lost or waived business.

Within a bank, direct costs are mainly generated in the client advising divisions through AML related work of advisors, in a specialized AML unit and in the internal audit department.

The analysis shows that for banks with 500 employees or less, there is no correlation between the headcount of the AML unit and the size of the bank. Thus, small banks face the same absolute personnel costs in their AML unit as medium-sized banks. It can be concluded that the same is true for other, non-personnel related costs at the AML units. The reason for this may be the high proportion of upfront work at the AML offices, like setting up directives and AML processes. The effort in this area is independent of the actual business volume and is mainly determined by the regulatory framework. This is the same for all banks, regardless of their size. For banks with 500 employees and more, a dependency between AML related headcount and bank size can be identified. We reason that this is mainly driven by client specific efforts, like case investigation, reporting, etc.

The results confirm a competitive advantage of medium-sized to large banks over small competitors.

5. Outlook

In order to get further information about the competitive position of banks in Switzerland and abroad, we aim to extend the study to foreign financial centers. It is planned to conduct the survey in the United Kingdom, Germany, Luxembourg, Singapore and the US. For that, we are currently seeking for the participation and support of local academic institutions.

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