Differentiated Regulation Supports the Competitiveness of Private Banks

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Ladies and Gentlemen,

The financial and banking crisis of 2008 remains etched in all of our memories. It also drove global financial centres to make a clean sweep of the past and start afresh. Of the many paradigm shifts that followed the crisis, the tightening of national and international regulations have proved among the most challenging for financial institutions worldwide, forcing them to radically change their culture and the way they do business. Ten years on, financial centres face an increasingly complex web of regulations. With the exception of US financial institutions, which enjoy lenient treatment at the hands of their own government even though they were the primary trigger of the crisis, most banks have seen the cost of regulatory compliance more than double. Swiss private banks are no exception. Despite satisfactory results in 2017, to remain dynamic and competitive they must now find new ways forward.

Differentiated regulation

Tellingly, Anglo-Saxon observers have coined a new nickname for over-regulation: namely "gold-plating". This metaphor perfectly encapsulates the stifling grip that this regulatory corset imposes on banks. It also suggests that regulators, in a reversal of the medieval alchemists' quest to turn lead into gold, have achieved the exploit of turning gold into lead. For small and mid-sized banks specialising in wealth management, the regulatory noose is particularly tight, and they are hit hard by the imposition of international standards originally designed to regulate systemically important banks. Complying with all the applicable rules – the utility of which is not always easy to discern – requires a disproportionate effort on the part of smaller institutions.

This past autumn, FINMA itself admitted that regulations should be loosened for small banks. Noting that the diversity of the banking sector is an asset for the Swiss economy and that small institutions foster competition and innovation, Mark Branson declared an intention to better apply the principle of proportionality more thoroughly, to encourage continued growth and development in the sector. He suggested several measures aimed at lightening the regulatory burden for small banks, especially those managing less than 20 billion francs in assets. He outlined three lines of action: making regulations less complex for small institutions, removing some requirements for those with a low risk profile, and, lastly, reducing the frequency of prudential audits so as to lower the associated costs.

At first glance, this appears to be a step in the right direction, one that private banks wholeheartedly welcome. However, special attention should be given to ensuring that the stated intention results in tangible outcomes. Moreover, FINMA could apply the principle of proportionality even more broadly.

Indeed, by defining regulatory categories in purely quantitative terms, on the basis of balance sheet totals, assets under management, preferential deposits, and minimum capital ratios, FINMA stops halfway to the finish line. The current approach fails to take advantage of the financial watchdog's considerable latitude to apply the rules in a differentiated manner depending on the bank's business model and the real risk it presents. That said, a number of category 3 banks with a low risk profile, including Pictet, Lombard Odier, Julius Baer and Vontobel, are likely to benefit from the planned regulatory relief.

There are several other areas where FINMA could implement a differentiated regulatory approach that accounts for banks' actual activities.

- Requirements such as stress tests and annual capital planning, which are designed to assess the resilience of small banks in the event of a sudden or serious economic crisis, should be eliminated for banks that maintain excellent liquidity and capital ratios. At the very least, the frequency with which such institutions are required to report data should be reduced.
- Reporting of interest rate risk, counterparty risk, and securities transaction risk should be simplified.
- Lastly, banks must provide a range of financial information to both the FINMA and the SNB. The two institutions should coordinate their requirements more closely to eliminate unnecessary and costly duplication.

In addition to the above recommendations, it bears repeating that wealth management banks depend largely on foreign clients, and are therefore an important export industry. That is yet another reason for the FINMA to actively support our global competitiveness by implementing an effective, light-handed, and proportionate regulatory regime that does not impede our development.

The further explanations published by FINMA on 7 December 2017 regarding the principle of proportionality, in connection with the revised circular on disclosure for banks, show that the regulatory authority is capable of giving category 3 banks more leeway. We welcome this flexibility and encourage the FINMA to continue moving in this direction.

Another argument in favour of a more reasonable approach is that excessive regulation, by imposing a heavier burden on smaller institutions, leads to consolidation in the banking sector. This trend in turn diminishes the diversity of the Swiss financial centre, removing an essential ingredient of its dynamism and competitiveness.

The Paradise Papers

While banks wait for the fog to clear, they are doing their best to apply a multitude of rules and standards to the letter. In this context, it seems highly unfair to criticise banks for their alleged bad behaviour. The vilification of clients for using legal entities is similarly unjustified. Why, you might ask? Simply because these entities are perfectly legal and meet a legitimate need for confidentiality, whether for family or business purposes.

The international media, which often confuse morality with legality, fail to acknowledge that reality. The recognition that not everything that is legal is moral should not lead one to conclude that all practices viewed as unethical are necessarily criminal. It is not banks' responsibility to treat everything that society considers immoral as if it were illegal. Banks are bound to comply with the applicable laws and regulations, and if the rules no longer achieve their desired end, it is up to legislators to change them.

It is important to remember that the Panama Papers and Paradise Papers "scandals" are based on stolen data, and are thus the outcome of actions that were clearly illegal, though some may consider them "moral". The question that begs to be answered is: who stole the data, and for what purpose? It may well be revealed that the instigators of those bogus scandals are the very same who are now calling loudly and insistently for every aspect of the economy to be comprehensively gold-plated. Their true aim is not to restore world trade to a state of moral purity, as they would have us believe – unfortunately with some success – but rather to take advantage of their competitors' weakened position. Unless we are careful, the consequences of the drama currently playing out on the world stage will soon be felt by every one of us in this room today. If our country no longer offers the conditions that enable businesses to thrive, economic activities will inevitably move abroad.

The importance of small banks

Accordingly, when translating international rules into Swiss law, our authorities should take care not to apply them more strictly or quickly than rival financial centres. Our negotiators, meanwhile, should take full advantage of the adoption of international standards by the Swiss financial centre to secure tangible benefits in exchange, such as access to markets, a crucial prerequisite of our export readiness and international competitiveness.

To illustrate this point, allow me to use the members of the Association of Swiss Private Banks as an example and try to evaluate the loss to the Swiss economy resulting from their growth beyond our borders. For the purpose of this press conference, we estimated their contribution in terms of job creation and tax revenue. Without tangible data, it is difficult to gain a clear picture of what this contribution represents in economic terms, but the following figures speak for themselves.

Between 2007 and 2017, ASPB members grew their workforce from 5815 to 8109 employees. Of the 2294 jobs created during that period, 1438 are based abroad and 857 in Switzerland. To put it another way, our members have more than doubled their staff numbers abroad, versus 19% at home.

Extrapolating from these numbers, I tried to estimate the cost to Switzerland in terms of lost jobs. Assuming that the 1438 employees hired abroad since 2008 earn on average 180,000 francs per year, the potential loss to the Swiss economy totals 250 million francs in earnings and 100 million francs in forgone tax revenue. Given that Swiss private banks account for only 5% of jobs in banking nationally, I leave it to you to deduce the total shortfall for the banking sector as a whole.

What should be clear by now is that over-regulation is an issue not only for banks, but also for the Swiss economy more broadly. We must therefore resist the siren's call, keep a cool head, and ensure that regulations establish a clear distinction between banks that are systemically important and all the others, thus safeguarding the diversity, fairness, and competitiveness of our financial centre. Thank you for your attention.