

Leading Research

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The Future of Swiss Offshore Private Banking

*Assessing the Impact of the New "Abgeltungssteuer-
Abkommen" (Withholding Tax Agreements) for
Switzerland's Private Banking Industry*



Executive Summary

- Switzerland's new withholding tax agreements with Germany and the UK will further accelerate its transition to "white money" (taxed money) private banking
- Short term, the implementation of these agreements will have a significant negative impact:
 - Asset outflow of as much as 47 billion Swiss francs (CHF)—about 2.3 percent of total offshore assets under management (AuM) held in Switzerland—due to withdrawals and tax payments from the accounts of clients with domicile in Germany and the UK
 - A total loss in private banking industry revenues of more than 1 billion CHF—about 4.4 percent of total industry revenues—due to outflow and margin reductions on remaining assets
 - Large one-off implementation costs, mainly for IT and regulatory compliance as well as for one-off cleanup efforts
- Medium to long term, these agreements offer a great opportunity for Switzerland and its private banks:
 - Clear positioning as a fully compliant offshore hub for "white money" with client privacy as a key competitive differentiator
 - A unique multi-shoring value proposition
 - Simplification in cross-border private banking, and new strategic options to penetrate some of the largest wealth management markets in Europe
- To adopt these new tax agreements, Swiss private banks need to take some short-term actions:
 - Lower the cost base in response to the diminishing revenue pool
 - Ensure operational readiness with respect to IT, processes, compliance, and capabilities of front-office personnel
 - Adopt a short-term action plan to compensate for expected asset outflow
- In parallel, Swiss private banks need to amend their business models to seize the opportunity:
 - Define which strategic segments to play in, based on where they have a "right to win"; evaluate new business opportunities
 - Make choices about markets and adjust footprint, as only a few markets offer sufficient scale for compliant cross-border banking
 - Refine the advisory model and make quantum leaps regarding onshore/offshore value propositions and offerings; relationship managers (RMs) will need significant retraining and development

Source: Booz & Company analysis

Together with Swiss private banking opinion leaders, Booz & Company has formed a perspective on the future of Swiss offshore private banking in light of the new tax agreements

Methodology			Number of Interviewees
<ul style="list-style-type: none"> Interviews with senior executives from all leading Swiss wealth management institutions and relevant stakeholders for the Swiss private banking market Supplementary interviews with further industry representatives, university faculty, and Booz & Company wealth management experts Supporting desktop research (analysis of market and company data, industry reports, press articles) and financial modelling 	Universal Banks	<ul style="list-style-type: none"> Senior private banking executives responsible for onshore and offshore markets 	6
	“Pure Play” Private Banks	<ul style="list-style-type: none"> Board members and senior private banking executives 	14
	Regulator/Industry Association	<ul style="list-style-type: none"> Senior private banking representatives 	4
	Research/Universities	<ul style="list-style-type: none"> Senior private banking experts and leading researchers 	3
	Other Wealth Management Experts	<ul style="list-style-type: none"> Several wealth management senior opinion leaders 	8
			Total: 35

Source: Booz & Company analysis

The new tax treaties will solve legacy issues with Swiss offshore bank accounts for clients and affected banks

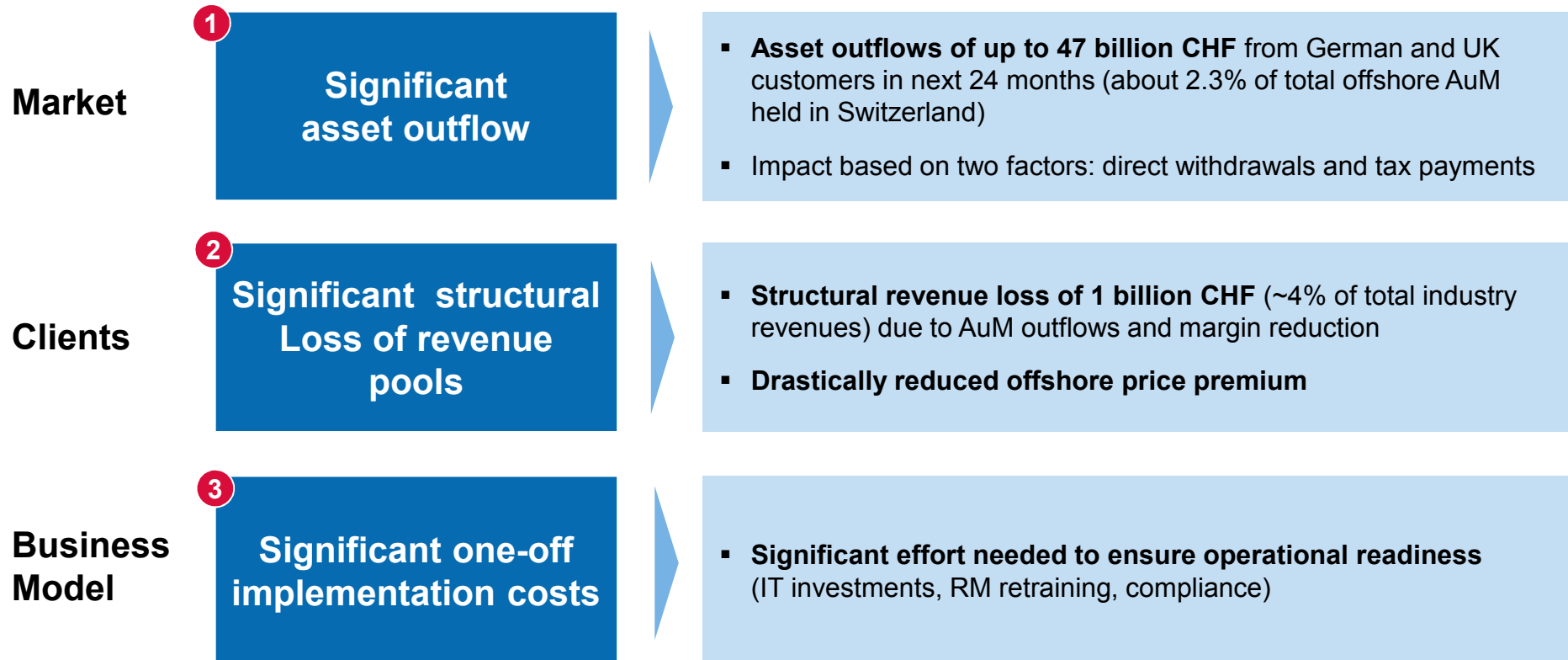
Key Components of New Withholding Tax Agreements

- Switzerland has agreed to new tax agreements with the UK and Germany;* similar agreements are expected with other European countries
- Clients with domicile in Germany or the UK have two options to make their legacy offshore assets tax-compliant:
 - Self-declaration of accounts to their local tax authorities (the only way to truly legalize legacy assets)
 - Anonymous payment of a one-off tax (at a rate of between 19 and 34 percent)
- All clients will pay a withholding tax on their offshore assets in line with their domestic capital gains taxation
- Swiss banks will make up-front payments to show their commitment to compliance with the new tax agreements—payments will be offset by clients' future tax payments
- Swiss banks will get improved and easier access to local markets, simplifying cross-border business (though details are yet to be defined)
- There will be no automatic information exchange, and clients' privacy will be preserved
- Full implementation is scheduled for May 2013

* Final ratification by both countries' parliaments is still pending.
Source: Booz & Company analysis

Short term, the implementation of the new tax agreements will cause Swiss private banks to lose 47 billion CHF in AuM and more than 1 billion CHF in revenues

Substantial Short-Term Negative Impact on the Private Banking Industry



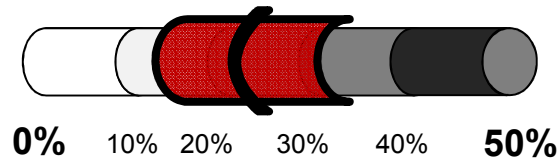
Source: Booz & Company analysis

Study participants expect asset outflow of 25 to 30 percent on all non-declared assets

Key Findings/Comments from Interviewees

Question:

What % of asset outflow do you expect on non-declared assets?



- All study participants expect significant asset outflow from currently non-declared asset holdings in Switzerland
- Outflow will be based on two main factors:
 - Asset withdrawals (prior to May 2013)
 - Payment of regularization tax
- Asset withdrawals are expected to gradually increase over the next 18 months until early 2013
- Significant share (30%) of affluent clients will close their accounts and withdraw money in cash (and subsequently spend or invest it elsewhere)
- Young clients (e.g., those with inherited non-declared assets) will predominantly try to declare and fully regulate their assets; older customers will predominantly choose the anonymous regulation

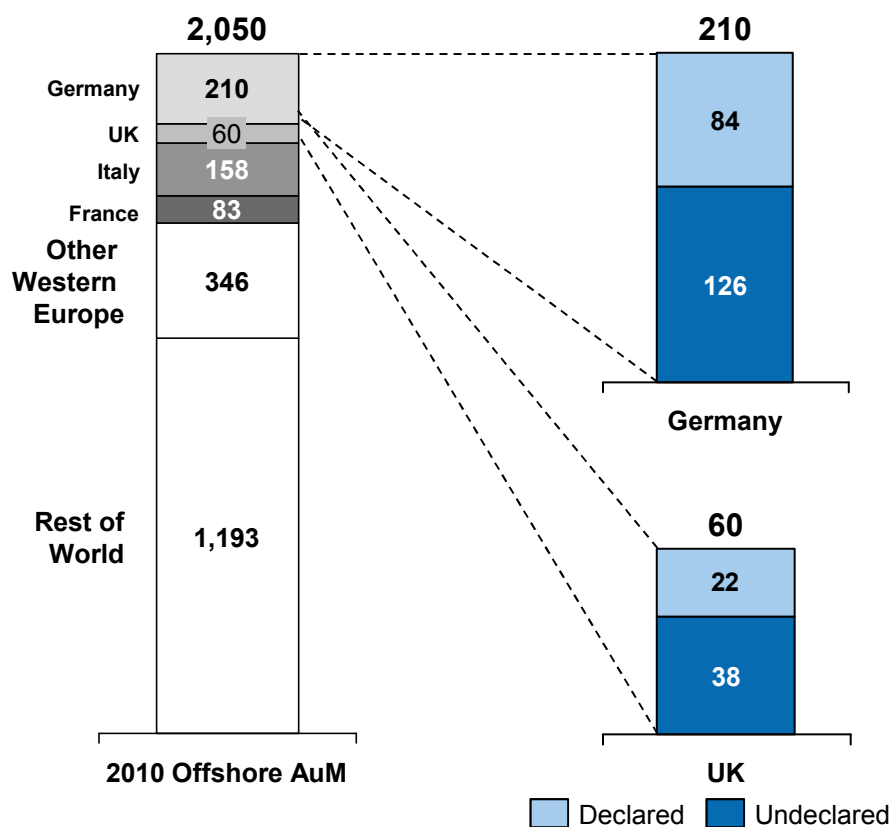
Range of responses

Median

Source: Booz & Company analysis

At the end of 2010, offshore assets of about 850 billion CHF from western European countries were deposited in Switzerland

Offshore AuM in Switzerland (December 2010)
(in CHF billion)



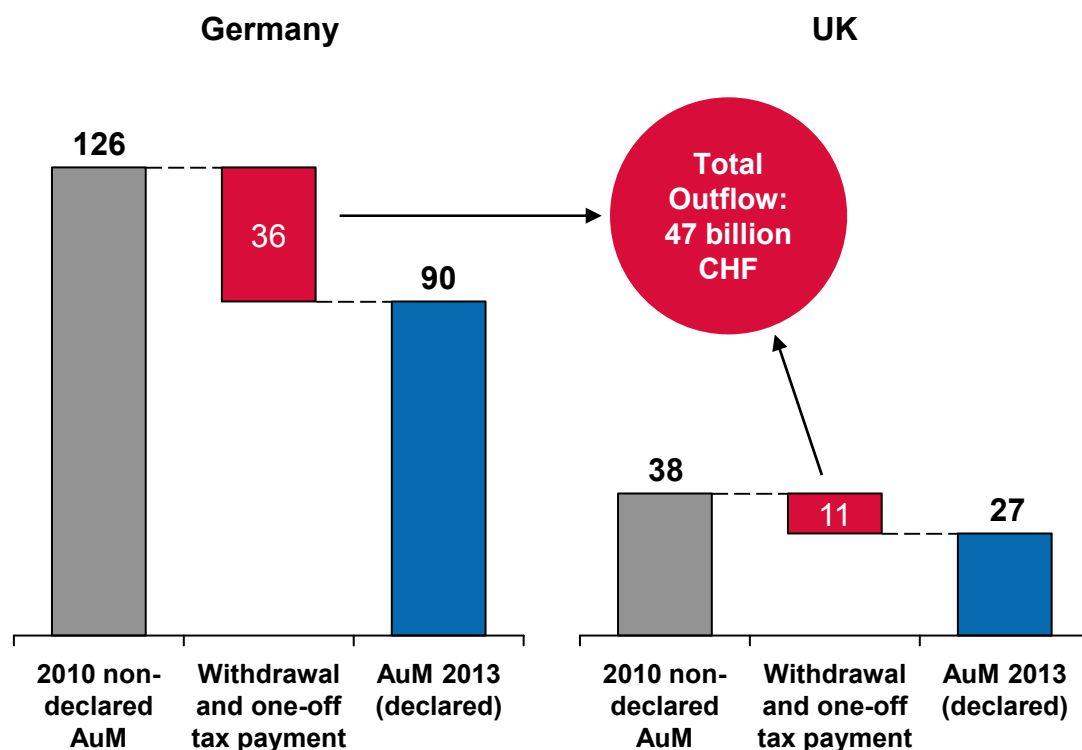
Key Findings

- Offshore accounts in Switzerland amounted to 2,050 billion CHF AuM at the end of 2010
- About 850 billion CHF of those offshore assets belong to western Europeans
- Germany accounts for 210 billion CHF, about 10 percent of the total offshore AuM; about 126 billion (60%) of that is assumed to be undeclared
- The UK accounts for 60 billion CHF in offshore assets; about 38 billion (63%) of that is assumed to be undeclared

Note: Offshore AuM include cash deposits, fiduciary investments, and securities accounts of foreign private customers at Swiss banks.
Source: Swiss National Bank; analyst reports; Booz & Company analysis

In summary, we expect about 47 billion CHF in asset outflow from German and UK client accounts (based on end-of-2010 numbers)

Outflow of Non-Declared Assets
(in CHF billion; German and UK offshore clients)



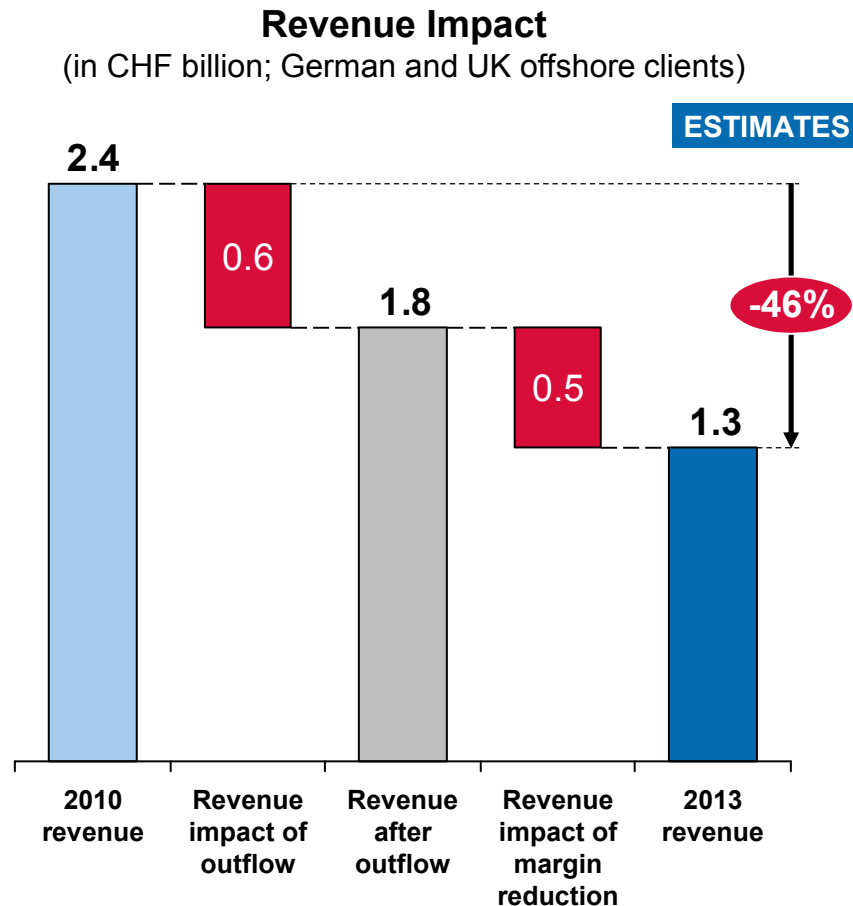
Key Findings/Comments from Interviewees

- We expect a total outflow of 47 billion CHF from non-declared offshore AuM (i.e., about 2.3 percent of the total offshore assets currently held in Switzerland)
- Outflows will result from client withdrawals – predominantly by affluent clients – and payment of regularization taxes
- Tax payment volume to the UK will highly depend on the share of UK clients using the Liechtenstein disclosure facility (implemented in 2009) for regulation
- Note: AuM reductions from foreign exchange market (FX) effects and equity market changes in 2011 have not been included. The FX effect through October 2011 results in an additional AuM reduction of about 10 billion CHF

Note: Calculation does not take into account any (non-declared) AuM inflow between 2010 and 2013 and any market effects since end of 2010.
Source: Swiss National Bank; analyst reports; Booz & Company analysis

2 Steep decline of revenue pools

As a consequence, we expect a structural revenue loss of more than 1 bn CHF for Swiss banks due to these withholding tax agreements



Key Findings/Comments from Interviewees

- Expected outflow of 47 billion CHF will result in direct revenue (and profit) impact of 600 million CHF
- Furthermore, clients with regularized assets will gradually push for conditions in line with their onshore price point. As a result, we assume that offshore margins will move downward over time to 80 bps, implying additional profit loss of about 500 million CHF
- Overall, we expect a revenue loss of about 1.1 billion CHF for the Swiss private banking industry from the new tax agreements with Germany and the UK (about 4 percent of 2010 total private banking revenue in Switzerland)
- This comes on top of the current cyclical market downturn with a low-interest environment and extremely low client trading activity

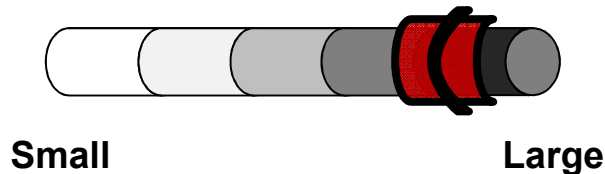
Note: Calculation does not take into account any AuM inflow.
Source: Swiss National Bank; analyst reports; Booz & Company analysis

One-off implementation costs will be significant and could result in short-term losses for smaller players

Key Findings/Comments from Interviewees

Question:

What one-off implementation cost do you expect for your bank?

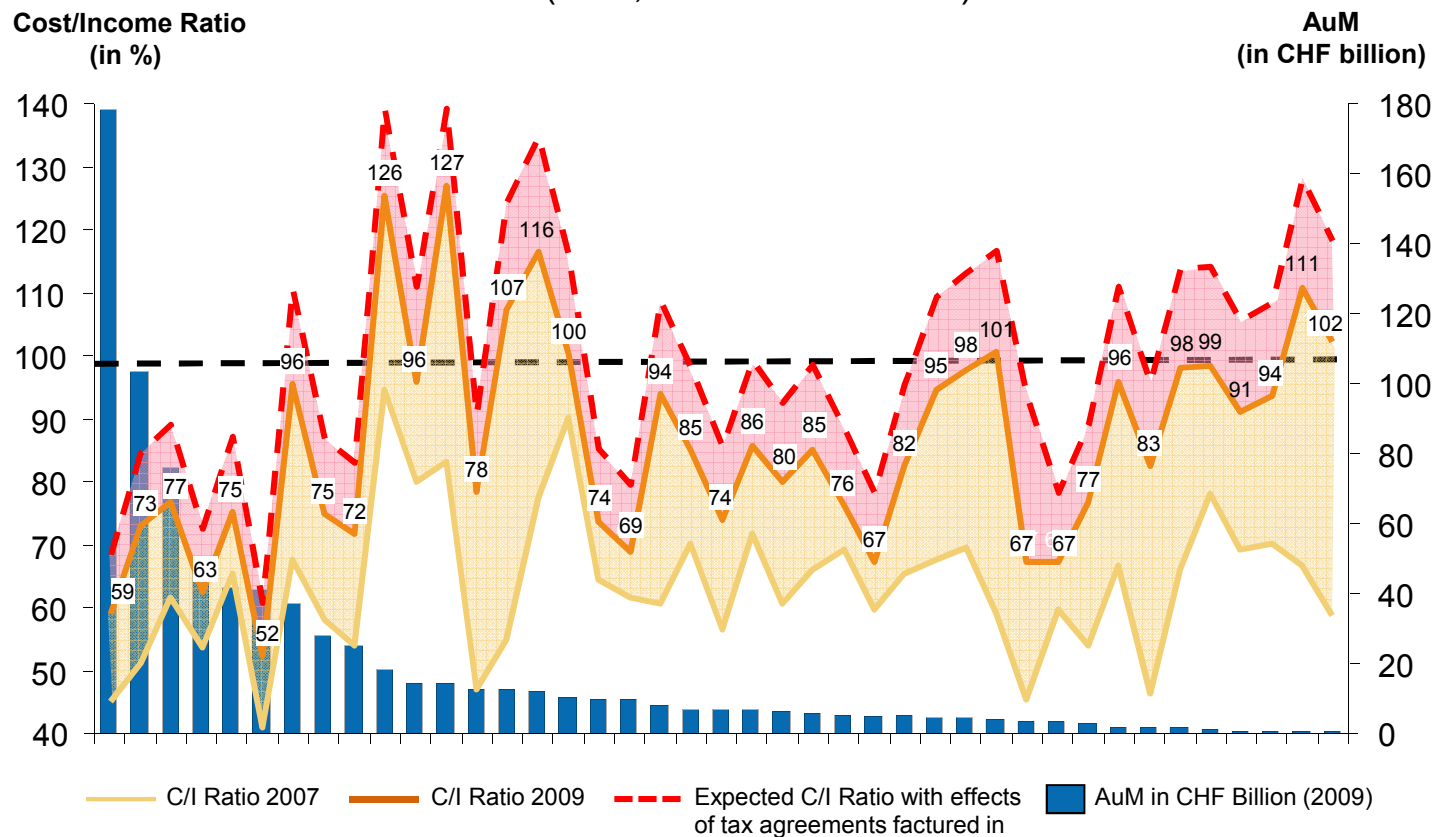


- All participants expect significant one-off implementation costs for the new withholding tax
- Even small banks expect costs that may reach double-digit million Swiss francs
- Some Swiss private bankers advocate a cross-bank solution to be developed by infrastructure providers or software houses; however, several banks are intending to instead pursue their own IT solution
- Apart from IT-related investments, additional one-off costs are expected for RM training and the development of leading-edge, fully compliant product and service offerings for all target markets
- Required one-off IT costs for compliance combined with additional regulatory requirements (e.g., MiFID, MiFID II, FATCA) will push cost/income ratios of many smaller banks beyond 100 percent in the short term

Source: Booz & Company analysis

As a result, we expect accelerated industry consolidation, especially among smaller foreign banks with dominant offshore holdings

Foreign Banks in Switzerland
(AuM, Cost/Income Ratio)



Key Findings

- Scale matters more than ever
- Cyclical rise in C/I ratios from 2007 to 2009 pushed several banks into loss-making territory
- Structural impact of withholding tax will make more banks unprofitable
- Long-expected consolidation to significantly gain traction in next 24 months

Note: Expected 2012 C/I ratio based on assumed revenue decrease of 10% and cost increase of 4%, based on full-year 2009 numbers.
Source: Verband der Auslandsbanken; Booz & Company analysis

Private banks must recognize that structural change is taking place in the industry, and that fundamental adjustments are unavoidable

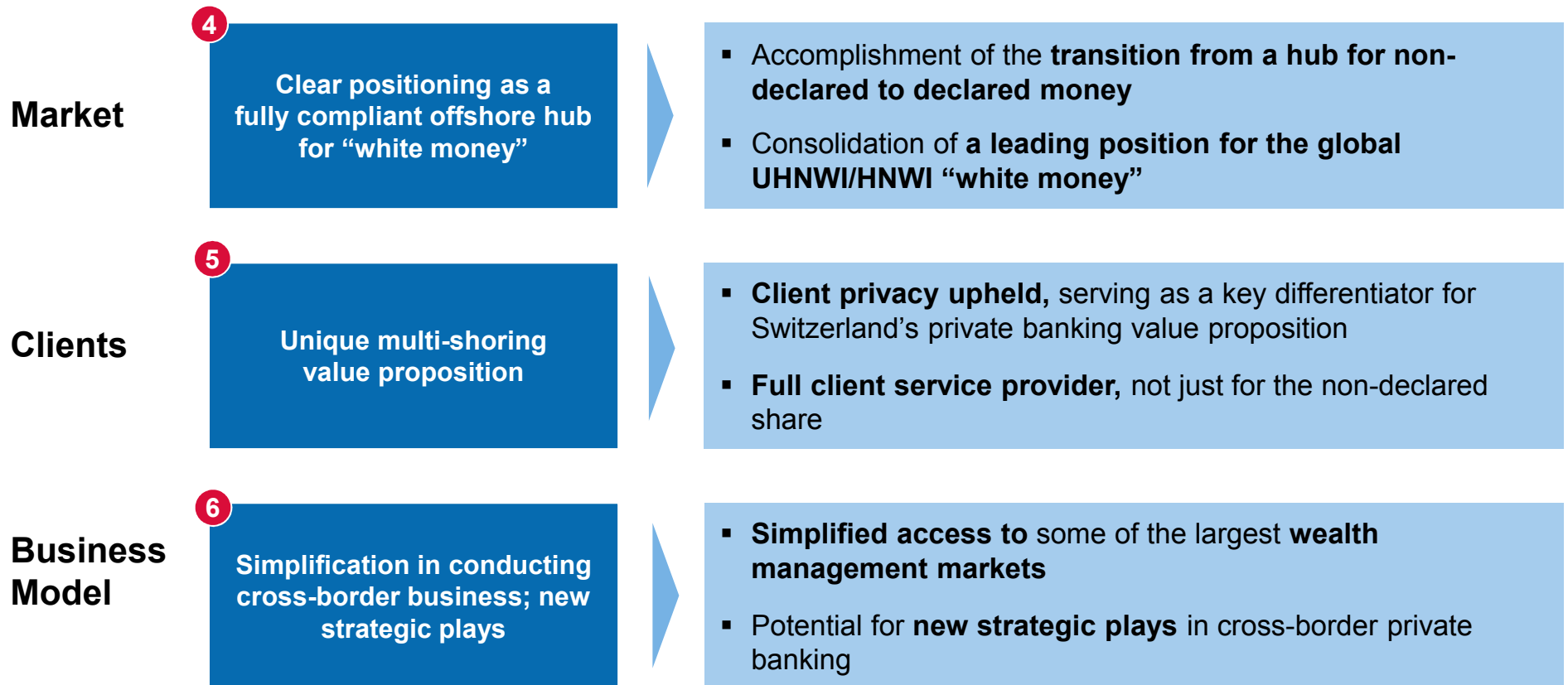
Short-Term Negative Impact—Conclusions

Market	<ul style="list-style-type: none">▪ Expect Switzerland's private banking industry to further consolidate
Clients	<ul style="list-style-type: none">▪ Private banks will have to pursue additional cost reduction measures in recognition that changes in client value pools are structural and not simply a result of the cyclical downturn
Business Model	<ul style="list-style-type: none">▪ Expect breakups of the value chain as many players will not be able to achieve operational readiness alone

Source: Booz & Company analysis

Long term, the new tax agreements offer a clear opportunity for the Swiss private banking industry

Long-Term Opportunities in Swiss Private Banking



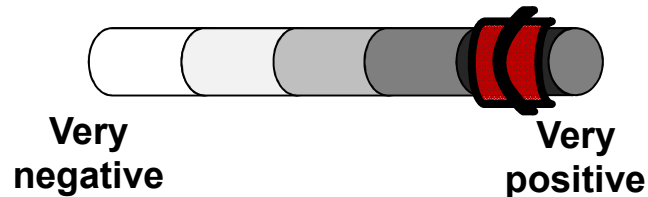
Source: Booz & Company analysis

There is unanimous consensus among all respondents that the new withholding tax agreements are the right step forward

Key Findings/Comments from Interviewees

Question:

Generally speaking, how do you assess the new withholding tax agreements for the Swiss private banking industry?



- New solution is clearly positive for the Swiss financial industry in the long run:
 - Long overdue cleanup of legacy non-declared assets
 - No more risk of criminal charges against Swiss banks and bankers
 - Client anonymity and privacy are secure
- The solution is a strong foundation for future growth of (declared) offshore assets in Switzerland from western European clients



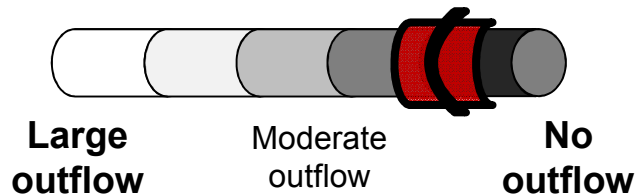
Source: Booz & Company analysis

Respondents regard the risk of losing business to other offshore financial centres (such as Hong Kong and Singapore) to be minor

Key Findings/Comments from Interviewees

Question:

Do you expect significant asset outflow from Switzerland to other offshore financial hubs?



- Swiss private banks will not support clients in shifting assets to other booking centres
- Singapore and, to a minor extent, Hong Kong have clearly stated that they do not want to be regarded as a “last resort” for undeclared western European clients
- Given current market developments, the values and advantages of the Swiss financial market—political and financial stability, strong currency, quality of service, discretion, and trust—are more important than ever
- Switzerland is expected to remain the primary offshore centre for western Europe
- UK customers may circumvent the Swiss/UK tax agreement by using the Liechtenstein disclosure facility, which will probably have more attractive conditions but will require full disclosure to UK tax authorities

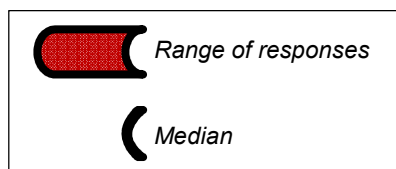
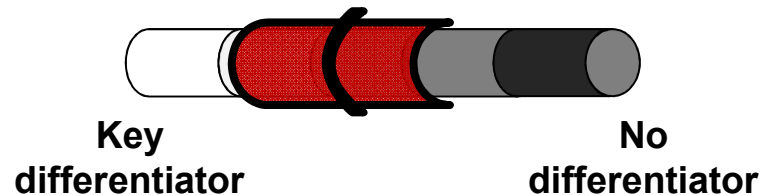
Source: Booz & Company analysis

Client privacy is still seen as a differentiator, but is significantly less important than in the past

Key Findings/Comments from Interviewees

Question:

Will client privacy be a key differentiator for Swiss banking going forward?



- All interviewees stated that they are satisfied that client privacy has been retained as part of the new tax agreements
- Client privacy will remain a key differentiator, especially for clients who do not want their tax authorities to have ubiquitous transparency into their financial situations
- However, the key differentiator for Swiss offshore banking going forward will be the stable environment, independent and transparent legislation, superior service quality, and performance
- Client privacy will have a different perception, no longer the stigma of purely hiding from tax authorities

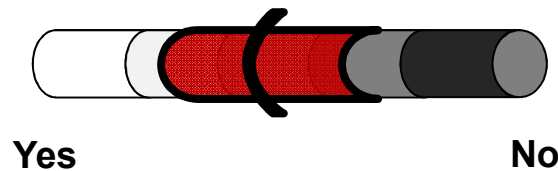
Source: Booz & Company analysis

Study participants expect that easier market access will slightly simplify cross boarder business – but will not fundamentally change the way of working

Key Findings/Comments from Interviewees

Question:

Do you assume significant advantages for easier market access compared to the current situation?



- Banks expect some simplification of new client acquisition and an easier and more cost-efficient distribution of Swiss financial products
- However, there are mixed views on how best to capture market share going forward:
 - Some interviewees believe that pure offshore servicing (including client acquisition) of European markets without local onshore presence will not be possible
 - Others state that there will no longer be a need for an onshore license and that a single Swiss booking platform will suffice (although requiring full compliance with local market regulations)
- In particular, foreign banks in Switzerland with strong market presence in Germany and/or the UK could disproportionately profit from the agreement in the future
- Details on the simplified market access rules have not yet been disclosed, so uncertainty remains on the true upside potential of the new tax agreements

 Range of responses

 Median

Source: Booz & Company analysis

Long term, there is a business opportunity for Switzerland's private banking hub; however, many questions still need answering

Long-Term Opportunity—Conclusions

Market

- Clear positioning as the leading offshore private banking hub worldwide for “white money,” once the cleanups are complete

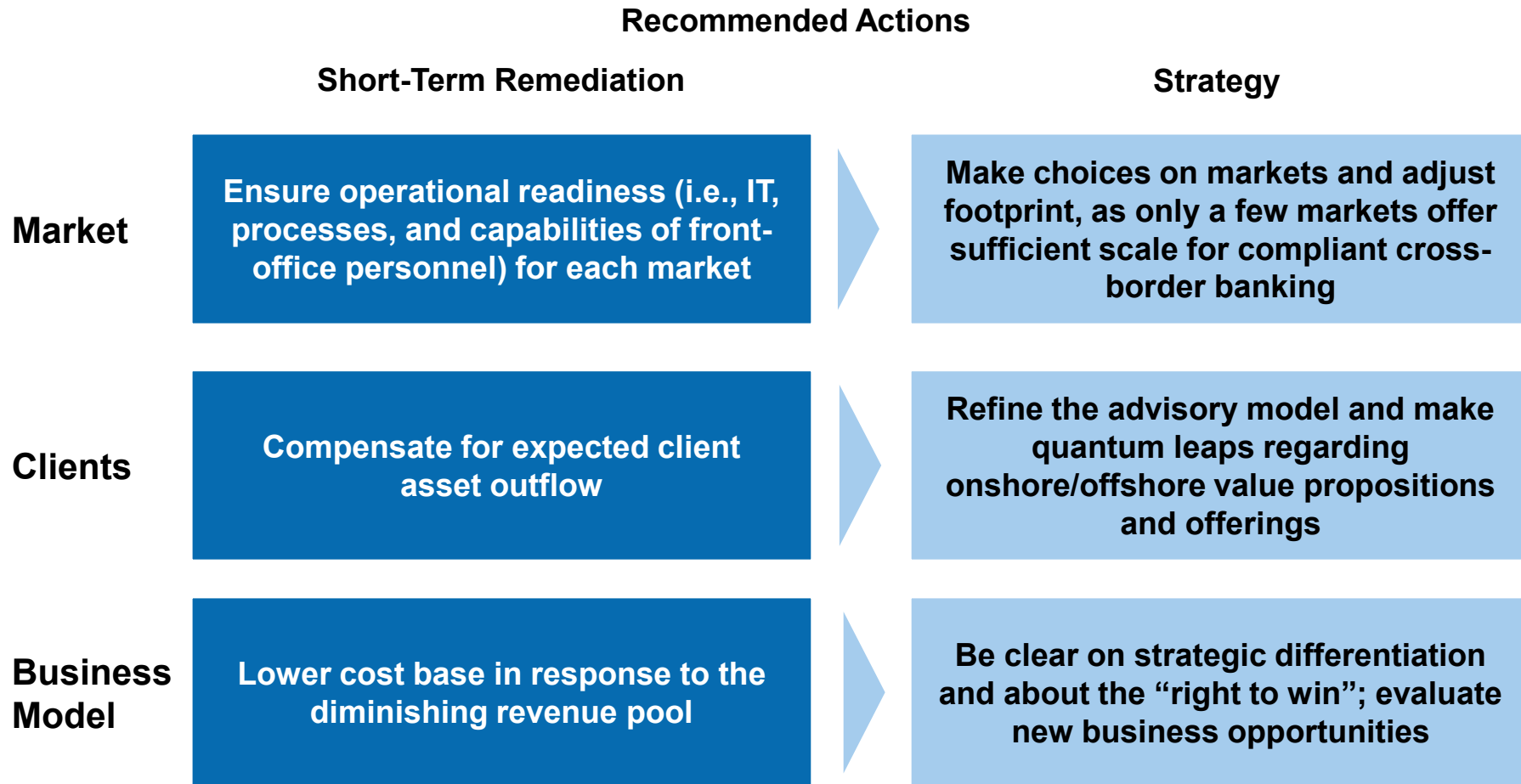
Clients

- Upholding client privacy seen as a welcome differentiator in the marketplace, but not the basis for a sustainable business model

Business Model

- Upside potential for cross-border private banking; however, most contractual details are yet to be defined

Short term, the implementation of the new tax agreements will be painful; long term, it offers significant opportunities



Source: Booz & Company analysis

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