



Finance

Swiss banking: a damaged brand

by [Peter Nathania](#), [Ludo Van der Heyden](#), [Salvatore Cantale](#) Published 19 May 2023 in [Finance](#) • 10 min read

How did Credit Suisse get into such a sorry mess, and what steps can Swiss banks take now to win back trust?

The Credit Suisse (CS) crisis has highlighted a major vulnerability that the Swiss government and business authorities have not addressed over the last two decades: the transition to a new banking and economic model away from one anchored in a unique product, bank secrecy. The latter made Swiss banking easy and the nation rich for many decades. Given current geopolitical trends towards transparency and a Swiss tradition of neutrality, this transition deserves greater attention. Its answer is of importance, and not just for the Swiss.

How Switzerland got here

Bank secrecy is deeply rooted in Swiss society. It continues to this day for Swiss nationals and residents and is not in question domestically. The only issue that merits debate concerns the extension of bank secrecy to non-residents. Historically, that extension turned Switzerland into a bank vault not accessible to foreign authorities. It naturally pitted Swiss authorities against foreign governments that were denied, in many cases, their own legitimate tax revenues through opaque capital outflows to Switzerland.

Switzerland thus attracted swarms of tax evaders from all over the world, unfortunately also including dictators or gangsters such as Meyer Lansky, the “Mob’s Accountant”. Eager to avoid Al Capone’s fate, Lansky transferred the monies earned from his growing casino empire to a Swiss bank account. He later bought a Swiss bank, which further secured his transfers.

World War I had first triggered major capital flight to Switzerland. When European governments increased taxes to pay for the war, and to recover from it, this further fueled the flow. The French would bank in Geneva, Germans in Basel and Zürich, and Italians in Lugano.

The 1929 stock-market crisis led to renewed pressures to catch tax evaders. The French government of Édouard Herriot was particularly insistent, and Nazi authorities eager for Jewish assets joined them in pressuring Swiss authorities. The latter countered with the Banking Law of 1934, which turned the violation of Swiss banking secrecy into a criminal federal offence, and not just a civil one. Sanctions for leaking client data were increased from three to five years in 2015, longer sanctions falling upon those profiting from the leakage.

The 2008 Global Financial Crisis (GFC) reignited the attacks from foreign governments. These resulted in Swiss authorities signing the 2003 EU Savings Directive, which forces governments to provide other governments with information on interest paid on accounts held by foreigners. In February 2013, Switzerland also signed the FATCA agreement (the US Foreign Account Tax Compliance Act) with over 100 countries, including the US. The agreement aims to greatly reduce tax fraud for participating countries through undeclared bank accounts in Switzerland and in other onshore or offshore banking centers. The implementation of FATCA forced banks to report foreign non-resident accounts. Swiss fraudsters had to agree to

reporting to their governments, and pay taxes, or set sail for less transparent harbors.



Bank secrecy is deeply rooted in Swiss society

The GFC revealed another vulnerability: the normally conservative Swiss bankers and regulators had been unable to avoid UBS being caught in the crisis in a major way. The Swiss National Bank had to allow UBS to transfer \$60bn worth of toxic assets from its balance sheet, the worst write-off among European banks. The Swiss government also injected circa \$4bn of cash into UBS. On the other side of Paradeplatz, CS raised close to \$9bn from the Qatari Investment Authority, avoiding the need for a governmental bailout. After these exceptional measures, the Swiss Government stated that it “was confident that this package of measures will contribute to the lasting strength of the Swiss financial system.”

The need to frame the future role of banking in the Swiss financial and economic models

The major issue behind the current drama in Swiss banking is that it is now clear that the measures taken following the GFC did not “provide lasting strength” to the Swiss financial system. Notwithstanding the government’s claims, the latter did not happen, and certainly not in a manner that led to a durable solution for its two systemic banks.

UBS, with a major equity infusion from the government, was forced to review its practices and reduced its huge investment-banking exposure as a result, something CS was not forced to do. CS's vulnerabilities were therefore not addressed at the time, and regularly resurfaced. Remarkably, following the dismissal of CEO Brady Dougan in 2015, none of CS's three leaders (Chair, Vice-Chair, and CEO) were expert bankers. It is surprising that Swiss regulatory authorities allowed the appointment of a CEO from the insurance industry, while the CS Chair, a lawyer, could remain in place, and all this while bad news from the bank continued. CS never successfully addressed its poor credit and compliance practices, nor the lavish compensation packages awarded to its senior leadership.

Swiss private and government authorities are running the risk of letting things get out of control by not offering a new economic model for Swiss banking, as they had all promised following UBS's bailout and CS's equity recapitalization. The preceding years further offered multiple signals, both public (market announcements, feedback from the stock market, management changes) and private (legal settlements, supervisory reviews). Vulnerabilities were apparent; yet no focus was given to reduce them.

The precedent here is clear and offered by Britain, an example all could follow at the time. The UK never presented a viable replacement for its economic model post GFC, while its banking and financial sectors imploded, leaving the country saddled with major debt and many disenfranchised. National discontent and UK dialogue ultimately devolved into populist and ideological discussions around "Brexit or Bremain", leaving the key question on Britain's future economic model unaddressed. Ultimately Britain exited from the EU, which further closed options in the absence of any clear vision of the country's future.



“Switzerland risks now paying significantly for the failure of banking authorities and supervisors to effectively manage its preparedness and intervene earlier”

The CS tragedy pointedly questions the role of Swiss banking for the nation’s financial sector and economy. Financial markets, as well as Swiss citizens, dislike ambiguity. At a minimum, the country ought to signal that it is cognizant of the fact and committed to confront the question head-on.

The need to deal with crisis in an authoritative way

Switzerland risks now paying significantly for the failure of banking authorities and supervisors to effectively manage its preparedness and intervene earlier. Recent events heightened its vulnerabilities, despite the importance of the Swiss banking

model to its domestic financial and economic sectors, as well as to the global financial system. The CS crisis thus questions the viability of the Swiss economic model.

Two of the main principles of crisis management are the overarching importance of correctly framing any crisis and its roots, and the need to act rather than react. In crisis, inaction is worse than reaction; it is imprudent. Slowness often leads to a worsening of the crisis. What may be initially presented and perceived as prudence and strength often turns into inaction and hesitation, and ultimately becomes weakness. The common saying “manage the crisis, otherwise the crisis manages you” captures this chain of events well.

Blame is one sign of such a state of affairs. Swiss Financial Market Authorities (FINMA) came out in 2021 with a report indicating that the capitalization of Postfinance – one of the four remaining big Swiss banks with Raiffeisen, Zürcher Kantonalbank (ZKB), and UBS – was insufficient to face current risk levels. Postfinance was quick to point out that Finma data was outdated. The Federal Administrative Court recently sided with Finma. As a result of the CS downfall, Finma is now being sued by international investors and borrowers. Finma itself has just come out saying that it needs additional means for sanctioning banks and their errant managers. Interestingly, boards of directors, who are legally responsible for their organizations, seem to still not be in the front of the firing line. Yet, legislators are now discussing a cap on bankers’ bonuses, underlining the distrust of authorities in banking boards.

The Chairman of the Saudi National Bank (SNB), CS’s biggest shareholder, happily joined the list of those being blamed, when he said that the “SNB would absolutely not invest further money into CS, for many reasons outside the simplest reasons, which are regulatory and statutory.” Instead of being proactive and engaging with its shareholders, and particularly the SNB, ahead of these events regarding their views, CS was surprised by such non-committal comments, and eventually blamed SNB CS for triggering the demise of the bank. The SNB Chairman has since stepped down, but the damage was done.

The Swiss authorities waited too long. They had decided not to do for CS what they had done for UBS during the GFC. No rationale for the final solution was given, only that a “commercial” solution was sought, and that no other solution existed. Yet,

Black Rock was interested in repeating an earlier transformational move, when it bought BGI, Barclays's investment arm, in 2009. The Swiss Government did not welcome the Black Rock offer, even when this option would have maintained the two big bank system, allowing the Government to take control of the Swiss operations of CS – even if temporarily through a “bridge bank” so as to ultimately offer a healthy and competitive bank to the market. The solution could have stemmed a precipitated exit of another CHF35 billions of CS deposits, a further slide of the CS share price, and a further exit of CS talent out of the bank.



Switzerland has put big banking into a single basket, denominated UBS

Instead, the Federal Finance Minister's statement “that there was no other solution” was not a great message to send to markets. Instead of picking the best amongst several options, the message communicated that authorities had no other contingencies or plans and, were in a rush and forced by events. This not only spoke of a lack of surveillance and supervisory preparedness vis-à-vis CS, but implies a lack of readiness on other issues, including a systemic crisis that could impact the Sovereign. The past perception that slowness to respond was driven by prudence is now perceived as prolonged inaction and, ultimately, unpreparedness.

The fate of UBS, and as we argue Switzerland, was left to a news conference in which the Chairman of UBS was unable to present a cogent and coherent plan or timetable for de-risking the new UBS group, further contributing to the overall uncertainty.

The Road Ahead

“Too Big to Fail” in Switzerland has now become “Too Big to Rescue.” Switzerland has put big banking into a single basket, denominated UBS. This is an enormous concentration, UBS’s assets now representing 2 times the GDP of the country. This exposes the country to existential risk like never before. A swift plan of action to defuse the risks currently concentrated in the UBS group is now required. So is a revision of the Swiss banking supervisory regime, with one “too big to fail and to rescue” bank. And, as argued earlier, Switzerland’s financial and banking models need to be recast.

Prior to the finalization of the international treaties that ended Switzerland’s banking secrecy, the Swiss authorities were given over 10 years of notice that they needed a new economic model. The mono-line national banking strategy, held up by two global banks acting as its pillars, has ended. So has the exploration of US investment banking – a game that proved too Anglo Saxon and too remote from the core competencies of UBS and CS. Exploration is now ongoing, but of a different kind. Finma has opened an investigation into the Credit Suisse top brass, while the Attorney General has opened an investigation into UBS’s state-backed takeover of CS.

Recovery is typically a long process. Strength, safety, stability, and security need to be restored, and as soon as possible. Confidence in the country’s institutions will return with credible and strong reforms, emanating from a thorough re-examination of its banking sector and a reassessment of its supervisory regime.

CS, once a pillar of modern Switzerland, has, after a long journey to America and the world, ended up damaging the Swiss brand, known the world over for stability, professionalism, and prudence. Swiss banking must start emanating the values demonstrated so ably by Swiss watch manufacturers and chemists, and more recently, by its micro- and biotech sectors.

The world will be watching and asking whether Switzerland will remain what it always was: a country engaged in the world, but neutral, upholding the Swiss Franc (CHF) and its banking system as a beacon of solidity, with independence from the US Dollar, the Euro, and the Renminbi. Or, whether it will cave into US and Euro pressures to join their fiscal indiscipline and its consequences.

The worst would be for Switzerland to do so inadvertently, the result of an inability to resolve the current troubles affecting its banking sector.

Authors



Peter Nathaniel

IMD Executive in Residence and former member of the Executive Committee of The Royal Bank of Scotland Group

Peter Nathaniel provides strategic, risk management, and restructuring advice to major financial institutions, central banks, governments, and other international multi-lateral organizations from around the world. He has over 30 years' experience and is frequently called on by organizations for his expertise as a leading professional in corporate/debt restructuring, risk-management and corporate governance, and is a frequent speaker on these topics at events. He also provides one-on-one professional coaching and mentorship to key executives and leaders.



Ludo Van der Heyden

IMD Distinguished Scholar & INSEAD Chaired Professor Emeritus in Corporate Governance

Ludo Van der Heyden became a Distinguished Scholar at IMD in September 2022, where, together with Professor Salvatore Cantale and Executive in Residence Peter Nathaniel, he supports IMD's developmental activities and programs in the banking sector. He has been Professor of Technology and Operations Management at INSEAD since 1988 and the INSEAD Chaired Professor in Corporate Governance

since October 2010 and has been Professor Emeritus since September 2018.



Salvatore Cantale

Professor of Finance at IMD

Salvatore Cantale is Professor of Finance at IMD. His major research and consulting interests are in value creation, valuation, and the way in which corporations structure liabilities and choose financing options. Additionally, he is interested in the relation between finance and leadership, and in the leadership role of the finance function. He directs the Finance for Boards program and co-directs Driving Sustainability from the Boardroom.