4. Are Financial Centers on the Brink of a Revolution?

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The Swiss financial center has overcome numerous challenges and global shifts in the past. Now, it is faced with another defining global trend: digitalization. Some observers are even going so far as to speak of a digital revolution. Financial institutions will have to realign their business models. The Swiss financial center is excellently positioned to seize the opportunities offered by these technological developments and retain its leading edge among the international financial centers. SIX – as the operator of the Swiss financial market infrastructure – will play a decisive role in this process.

The Swiss financial center is indisputably one of the top financial centers worldwide. There are CHF 6,600 billion in assets under management in Switzerland, of which a good 51.1% originate from abroad. This is equivalent to a market share of 25% of the global, cross-border asset management business, putting Switzerland in pole position worldwide in this area. There are 275 banks in Switzerland. They differ greatly in terms of size, business model, regional focus and ownership structure. For a country with few natural resources such as Switzerland, this success cannot be taken for granted. The typical Swiss attributes that have driven this success - expertise, security, stability, reliability - have helped Swiss banking establish itself as a global brand over the last 150 years. The Swiss financial center is characterized by its stability. The dependability of the political and legal system in Switzerland coupled with the reliability of its institutions and its currency make Switzerland a “safe haven” for people and companies throughout the world. It goes without saying that the Swiss financial center has had to fight hard for this leading position in the past, and - if it wants to hold on to it - will have to continue to do so in the future. Its competitors are waiting in the wings, and international competitive pressure is skyrocketing. At the same time, margins in the international business are falling, and regulation costs are spiralling. This is compounded by the fact that client needs are changing constantly, placing new demands on the financial markets. In its history, the Swiss financial center has been repeatedly confronted with extremely difficult and profound challenges. These have been prompted not only by competition or changing client needs, but increasingly also by global crises, the shock waves of which have also been felt in Switzerland - including the bursting of the Internet bubble in the 1990s or the extreme turbulence surrounding the subprime financial crisis just a few years ago, to name but a few. Crises like these regularly led to consolidation within the market or a reworking of existing business models.

Digitalization is Changing the Financial Industry

Today, the financial centers around the world are on the verge of another paradigm shift. And this time, it is not a crisis that is driving it, but rather a technological trend; or - depending on the way you look at it - a revolution: digitalization. Terms such as FinTech or distributed ledger technology (blockchain), full end-to-end automation, etc. are dominating discussions and articles on the financial industry. Digitalization is becoming a major preoccupation for financial institutions around the world, even though it is as yet unclear the direction the trend will evolve in. It is also a matter of conjecture which business models will prove a commercial success. One thing is certain, however: Digitalization brings with it a raft of advantages not only for financial providers, but also for clients, focussing on mobility, simple comparability, accessibility, the continual availability of services or the automation of processes. A good example is the growing expectation that we should be able to use banking services in real time from any corner of the world. Everything is “going mobile”, and customers want to be able to access data and services at any time and from anywhere. In many developing countries, mobile communication has made banking accessible for the first time. The increasingly dominant position of the Internet is paving the way for the biggest change of all: small providers are able to create investment solutions (e.g. apps) that extend far beyond a bank’s offering or combine the services offered by multiple providers in a streamlined package - all for a comparatively small outlay. Apps such as these are fundamentally changing the way we access financial services. Technological developments will call into question proven business models or even cancel them out completely. It is not only the client relationship that will have to reinvent itself. Processes and value chains will also change, as evidenced, for example, by blockchain technology, which establishes a completely new method of handling encryption, digital signatures, open systems and transaction functions. The possible applications are practically unlimited, hence why cryptocurrencies such as Bitcoin are based on blockchain technology. This technology also has the potential to change the business models of financial intermediaries. In concrete terms, it is entirely conceivable that this could make classical clearing houses redundant - without anyone really batting an eyelid. The digitalization of the financial markets will enable new players to enter the fold. Classical financial institutions risk being squeezed out of established markets or will at least have to accept massive dents in their market shares. It is not only small startups but also huge and powerful international technology groups that will be vying for their customers and encroaching on their home turf. This is a new development and one that will present major challenges for banks all around the world. The most recent example is the area of cashless payments. Numerous companies such as credit card firms, technology groups, financial institutions and countless smaller providers - including some from outside the industry - have been posturing for predominance in this market for some time now.

Major Challenges for Financial Institutions

Technological developments are in themselves nothing new, and financial institutions have long had to align themselves to emerging trends. What makes digitalization so radical, however, is the extremely rapid pace of development of these new technologies, the globalization of trends and providers, and the potentially pervasive influence on existing business models. Digitalization could revolutionize the financial industry not only in Switzerland, but around the globe. To remain competitive going forward, the Swiss financial center must be able to identify trends at an early stage and respond to these with agile and innovative solutions. In general, financial institutions will need to be receptive to developments and open to alternative business models. Today, it is almost impossible for individual institutions to keep track of the multitude of new ideas that are launched worldwide each and every day. This is compounded by the fact that many of these ideas will fall by the wayside, increasing the default rate and thus also the investment risk. In addition, established companies in particular should be wary of getting caught up in experiments that do not mesh with their current quality commitments. Innovation can harbor massive risks. Weighing up the opportunities and risks posed by digitalization will present a major dilemma for many financial institutions. It is also a dilemma with no clear answer: Should they embark on the technological transformation alone in the hope of differentiating themselves through new features, or should financial institutions within core areas of the banking industry band together so they can react quickly and efficiently to emerging trends? Cooperation agreements and partnerships could be the most promising strategy for Switzerland, especially for smaller financial service providers. Swiss financial institutions are in a strong position to benefit from digitalization. Banks in Switzerland have always been forward-looking in their business approach. They have developed the expertise needed to embrace new technologies and align themselves to new trends. Swiss banks are today already the global leaders in online banking, for example. There are very few countries where such a large number of institutions – including SMEs – are able to offer such a broad range of online services. In the face of all this digitalization, one thing in the financial industry will remain constant: trust. The banking business is built on close personal relationships and trust between clients and their bank. This is Switzerland's core competence and will not change. Furthermore, the chances are very good that Swiss banks will be able to take on a leading role in these changes.

SIX is the Driver of Digitalization in the Swiss Financial Center

As the operator of the financial market infrastructure in Switzerland, SIX ensures that the entire value chain for financial trading functions securely, efficiently and in compliance with the law. SIX operates the stock exchange platform with Swiss Exchange as well as the entire post-trade business with Securities Services, including clearing and settlement on both the ask and bid side. In addition, SIX Financial Information provides clients worldwide with up-to-date stock market data, and SIX Payment Services is responsible for processing card-based payment transactions. SIX includes approximately 140 national and international banks in Switzerland and ensures that the Swiss financial center and the Swiss economy as a whole can rely on stable and seamless systems at all times. SIX is the technology company of the Swiss financial center and ranks among the global leaders in the area of financial market infrastructure. With that in mind, technological developments - or indeed revolutions - play a defining role and are even crucial to its survival. Not only will new technologies create new business models; they will also break up existing value chains, not least in the area of financial market infrastructure, and place new demands on systems. Digital technologies will lead to the increased automation of procedures and processes, with the obvious aim of having less manual interaction in the client-bank relationship, resulting in massive efficiency gains and reducing costs. It is also likely that, going forward, interactions between clients and banks will shift increasingly to electronic channels, not least because the most recent generation has grown up with the Internet and is accustomed to using it in their day-to-day lives. This confronts providers with broad sales networks with some fundamental questions. It is probably only a matter of time before value chains are fragmented and activities begin to be outsourced. This will result in an increased standardization of products. SIX will seize this challenge as opportunity to branch out into new business activities that serve the interests of the financial center. One concrete example of this is the central hub being developed by SIX that could significantly shorten the client onboarding process at banks and also enable clients to be identified automatically and their data streams managed centrally. Thanks to the new technologies available, systems such as these will become reality in the near future and have the potential to significantly simplify client-bank relationships. Processing speeds in the field of stock exchange trading are another example. Today, transactions are processed two or three days after the trade. In the not-too-distant future, however, this could happen immediately, in real time. This would require significant changes to processes, to security precautions, and last but not least to risk weightings. It is imperative that SIX, as the technological backbone of the financial center, demonstrates innovation and agility when devising its new business models so that it can react flexibly and confidently to the new realities of digitalization. This may sound unusual at first for a financial market infrastructure that is geared primarily to stability and reliability. But, as indicated above, it is absolutely essential not only for SIX as a company, but also for the Swiss financial center as a whole. Against this backdrop, SIX has made it a strategic priority to strengthen innovation, working in tight collaboration with trailblazing international startups from the FinTech scene. SIX has also set up a FinTech Incubator in Zurich for the Swiss financial center. The Incubator has three core functions:

1. to identify trends in the FinTech sector when they start happening (no easy task given the flurry and pace of international developments);
2. to give employees at SIX the opportunity to contribute their ideas and develop new business models away from the hustle and bustle of day-to-day business;
3. to foster a dialogue with startups (something that would be extremely difficult without a fixed structure).

Conclusion: Digitalization is an Opportunity for the Swiss Financial Center

Switzerland is home to the leading market player in international asset management, has a wealth of exceptionally trained and internationally experienced staff in all areas of the financial industry, and boasts top-tier training centers. In SIX, the country also has an excellent technology company that first and foremost perceives digitalization as an opportunity and provides financial service providers with targeted support to help them implement their own digitalization strategies. The Swiss financial center is therefore ideally equipped to take advantage of the digital revolution and to retain its position as one of the leading financial centers worldwide - even ten years down the line.

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