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The Swiss cantonal banks

The profitability challenge

Switzerland's cantonal banks are burdened by history and cantonal structures. They are now running against the clock to stay in the market.

They were originally set up to help the economic development of the cantons and to give local people access to loans. They are now involved in universal banking just like the large commercial institutes. They have become gradually more like the big banks

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but are still limited by cantonal boundaries. But in exchange for this they enjoy a state guarantee, which instils public confidence. Today they provide one bank workplace out of six, possess the densest branch network in the country and account for one-fifth of the balance-sheet totals of all Swiss banks. But they do not make up a homogenous group since, as the Federal Council noted in its report on their legal status, "they are a symbol of cantonal sovereignty".

That was their main strength as long as banking was a monopoly, impervious to competition. But when it was deregulated and faced with the advance in information and computer technology, cantonal and even national boundaries became too narrow. The cantonal banks were then squeezed in a way which Swiss politics, history and economic structures had not prepared them for.

The deterioration in Switzerland's economy since 1991 has led to a sharp rise in their provision requirements. At the same time competition in the retail banking market, in which they used to have a secure position, has been weighing on their margins. Nowadays, the Swiss banking sector is saturated and has stopped growing, and cantonal economic frameworks are no longer healthy. Most cantonal banks have little spread in their sources of income, and their financial base is often inadequate, something which the state guarantee served to conceal in the past.

Today, the soundest among the cantonal banks are those which have spread their activities into portfolio management, trading and brokerage. For the others net interest margins have often set alarm bells ringing, and it has sometimes been too late to effect a rescue without substantial intervention by the state as shareholder. This is what happened at the beginning of the 1990s in Berne. The cantonal government all at once had to bail out its cantonal bank, which was on the verge of collapse, with several hundred million francs. The Soleure Cantonal Bank did not have such luck; in 1995 it was sold to Swiss Bank Corporation. This year it is the turn of the Appenzell Outer Rhodes Cantonal Bank to be sold – to Union Bank of Switzerland. In all these cases financial obligations stemming from unsound commitments were not covered. Each such incident raises the question of whether the cantonal banks can continue going it alone.

But the conflicting ideas of cantonal sovereignty and privatisation are rarely discussed in practical terms. The merger of the two Geneva state banks in 1994, followed by those of Vaud this year, have led cantonal governments, in their role as shareholders, to consider whether problematic financial institutes whose main purpose is no longer the same as it was a century ago should be propped up. The Federal Council's recent report on the subject put the ball firmly back in the cantons' court. The Federal Cartel Commission for its part has been asking if distortion of competition is being caused by the state guarantee. But it is all these phenomena together which will finally be too much for the cantonal banks. The weight of the past, shocks from market realities and political stalemate: they all combine to drain profitability. That is the real challenge facing them.

With balance sheets often requiring new structures, frequently loaded down with bad loans and confined to their narrow cantonal boundaries, the cantonal banks are no longer able to generate sufficient profits to "pay the price" of their state guarantee. At present cantonal banks need a minimum profitability rate of something between 6% and 9% on their capital resources. But it is here that the Federal Banking Commission – whose task is to protect savings deposits – has dealt yet another blow by raising its provision requirements in terms of resources to cover bad banking risks. It is true that the latter does not have full legal power over these banks, and in many ways they are outside its control. But its recommendations do have the ring of gospel, and this enables it to wield an influence which is effective if discreet.

The new requirements for capital resource provisions, particularly those concerning mortgage loans, are increasing pressure on the profitability of the cantonal banks. So they have been thinking in terms of holding structures in order to bring about rapid improvement by rationalising costs and boosting income. They would like to concentrate their banking services, set up a single financial force capable of aggressive action and enable the cantons to work together while keeping their official status. This would transform today's 24 institutes into a single Swiss Cantonal Bank Ltd. with 24 subsidiaries.

But this project, which some hope to implement by the end of the century, is opposed by the more profitable among the cantonal banks who do not want to give up their advantages. It is the race for profitability, however, which will in the end separate these two groups. It will not in fact be the shareholders, chained by the shackles of cantonal sovereignty, which will decide, but rather the imperatives of the financial markets. ■

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