

NAVIGATING THE FINANCIAL CRISIS IN HELVETIC WATERS: AN ANALYSIS OF THE BANKING SECTOR (2007-09)

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Abstract

As has been argued throughout this paper, the different way in which banks have been affected by the crisis is closely linked to their distinct business model. Consequently, the characteristic structure of the balance sheet in big banks and ethical banks is correlated with their divergent dynamic during the crisis. While the financial turmoil has left the business approach of ethical banks unchanged, as evidenced in the striking stability of their balance sheet from 2007 to 2009, the pattern shown by big banks has substantially changed over this same period. These developments would tend to suggest the need to reform the business model of big banks. There is no clear empirical evidence that a banking system with a large number of small institutions would be any more stable than the system as it currently stands. Besides, financing certain big projects would always require the existence of large international banks. Both types of financial institutions are in fact complementary. How to regulate the banking and financial sector is thus a complex and multifaceted issue. One cannot impose the same requirements on big international-oriented banks and small domestic banks. As this paper has tried to demonstrate, both have a distinct business model.

Keywords: banking, crisis, business model

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I. Introduction

Even if the worst appears to be over, the global economy is still experiencing the effects of the strongest recession since the Great Depression of the 1930s. Beginning with a simple housing bubble in the United States, which peaked in 2006 and finally collapsed in 2007, the crisis then expanded from the housing to the financial market through mortgage-based securities, which enabled institutions and investors around the world to invest in the US. It was thus through such financial innovations, marketed around the world, that a local mortgage crisis has finally become the most widespread financial crisis to date. Almost all industrialized nations and a number of developing countries have been affected in one way or another. In short: it is the most globalized financial crisis ever seen.²³

Global contagion at breakneck speed and deep impact on the real economy worldwide does not mean, however, that all countries have undergone this episode in the same way. Even among industrialized nations the situation varies. In this paper we shall

focus on one single country and one specific sector: the Swiss banking industry. The reasons for this choice will be explained in more detail later on, but two of the main motives can be mentioned straight away: the significance of the Swiss financial centre and the noteworthy diversification of its banking sector in a rather small country. Our hope is that the analysis of how Swiss banks dealt with the crisis will contribute to a more accurate understanding of the overall phenomenon.

Most importantly, the 2007-09 financial crisis is not just different according to the country or the sector under consideration. It also differs within the same economic branch. In our case, it would be illusory to think that all Swiss banks have been affected by the crisis in a similar way. Consequently, the present paper will begin by giving a general overview on how the Swiss banking industry as a whole has undergone the process. Thereafter, we shall focus the analysis on two specific kinds of banks: *big banks*, which according to the typology proposed by the Swiss National Bank are just two in number: UBS and Credit Suisse²⁴; and *ethical banks*, which according to the characterization given below are just three: Freie Gemeinschaftsbank, WIR Bank, and Alternative Bank ABS. We shall thus be working

23 Among the multiple works dealing with the financial crisis, see for example M. Aglietta and S. Rigot (2009). On the particular case of developing countries, see P. Hugon and P. Salama (2009).

24 See Swiss National Bank (2009b, pp. 20-23).

not just with some few examples taken at random but with the whole sample of banks belonging to these two categories.

The overall hypothesis which we want to test can be summarized as follows: big banks and ethical banks represent two distinct business models; each of them has gone through the crisis differently; and these two facts are closely related. In other words: it is precisely because of their distinct business models that each type of bank presents a dissimilar performance during the financial crisis. If this hypothesis is confirmed, we may be presented here with some elements for reflection on how to regulate the financial institutions.

II. Structure and significance of the Swiss banking sector

The Swiss financial centre is of major international importance and makes a substantial contribution to the domestic economy.²⁵ The banking industry is by and large its most important sector. At the end of 2008, its total assets amounted to CHF 4,361 billion. This is over eight times the size of the Swiss annual GDP and it is the biggest ratio among the G10 countries. Measured in absolute terms the US has the largest banking sector, but the total assets of all its banks only equate to one year's GDP. The Swiss banking sector is thus far more significant in comparative terms (see table 1).

Despite the modest geographical extent of the country and a significant concentration of the banking sector (table 1), Switzerland accounts for one of the most diversified banking industries in the world. Well known as a world leader in cross-border private banking, with a market share of 28 %, and third in the world in terms of global assets under management, Swiss banks are also pioneering in many other areas. By the end of 2008, there were 327 banks and 3,161 branches in Switzerland. Based on a number of different characteristics such as business focus, geographical scope of activities and legal status, the Swiss National Bank (SNB) classifies this wide range of financial institutions into eight bank categories and a number of other subcategories (see table 2).

Two bank categories draw our attention here. The first is the so-called "big banks". As can be seen in table 2, they represent more than 60 % of total assets. They are also the most internationally-oriented type of bank, operating globally through a network of branches and subsidiaries around the world. In principle, big banks cover all types of business, from simple savings to the most sophisticated activities of investment banking (capital market transactions, securities trading, money market transactions, financial engineering, etc). This category consists of only two banks: UBS and Credit Suisse (CS). Our

analysis will focus on these because of their size, geographical scope, financial activities, economic importance, and also because they are the ones that best represent the traditional universal banks.

We shall compare these "big banks" with the so-called "ethical banks". Unlike big banks, the geographical scope of ethical banks is rather limited and their business activities are far less diversified. In general, they refuse to participate in the speculative operations of the financial market because they consider that this economic logic is responsible for many international crises, social inequalities, and ecological problems. Consequently, the main activities of ethical banks are concentrated on savings collection and credit distribution. They focus on the original credit business of banks, but apply not only an analysis based on financial performance but also a social and/or environmental screening to the projects they finance. Particular attention is thus given to ecological housing, organic agriculture, renewable energies, and small and medium-size companies.²⁶

25 Swiss Bankers' Association (2009).

26 For a more detailed characterization of ethical banks, see F. Relano (2008).

Table 1. Size and concentration of the banking sector (international comparison)

	Size of the banking sector (ratio of total assets to annual GDP)	Concentration (assets of the largest three banks as a percentage of total assets)
Belgium	6.3	89
Canada	1.8	58
France	3.3	75
Germany	3.4	41
Italy	1.6	75
Japan	1.9	52
Netherlands	5.3	93
Sweden	3.3	82
Switzerland	8.2	76
United Kingdom	4.3	72
United States	0.9	46

Sources: IMF's and SNB's annual reports.

Table 2. Bank categories in Switzerland (2008)

	Number of banks	Total Assets in CHF billion	Proportion of total assets
Big banks	2	1,885	61,2 %
Cantonal banks	24	389	12,6 %
Foreign banks	154	355	11,5 %
Raiffeisen banks	1	132	4,3 %
Asset management banks	48	131	4,3 %
Regional/savings banks	75	90	2,9 %
Private bankers	14	41	1,3 %
Other banks	9	57	1,9 %
Total	327	3,080	100 %

Source: Swiss National Bank (SBN)

According to the SNB categorization, ethical banks form part of the "other banks" group. More precisely, the subsection entitled "other banking institutions" includes the following entities (see table 3):

Table 3. Other banking institutions (2008)

Company name	Year of formation	Equity capital*	Reserves*	Balance sheet total*
Bank Coop	1927	337 500	331 165	13 338 462
Freie Gemeinschaftsbank	1984	7 786	2 632	197 284
WIR Bank	1934	17 680	224 379	3 390 280
Bank-now	2006	30 000	155 907	2 540 980
Cornèr Banca	1952	12 000	402 000	3 824 591
Alternative Bank ABS	1989	42 725	4 725	841 573
InCore Bank	2006	10 000	40 460	183 076
Migros Bank	1958	700 000	478 000	30 998 019
VZ Depotbank	2006	30 000	585	736 437

*in CHF thousands. Source: SNB

Just by looking at these figures, it can be easily seen that this subcategory is extremely heterogeneous as far as the size and age of banks is

concerned. Their respective business activities are also quite different. Next to institutions specialized in securities trading (e.g. VZ Depotbank) or in mortgage

business (e.g. Migros Bank), the SNB put the three Swiss institutions which fulfill the afore-mentioned characterization of ethical banks: Freie Gemeinschaftsbank, WIR bank, and Alternative bank ABS.

We have chosen to compare these two categories (big banks and ethical banks) because both represent a different business model. Obviously, the main activities and geographical scope of other institutions like cantonal banks, for example, are also different from that of big banks. Yet, one cannot really say that their banking models are genuinely distinct. Cantonal banks are certainly focused on the savings and mortgage business, but they are also present, to a lesser extent, in all other financial activities. This is not the case of ethical banks, the only ones really at variance with the mainstream logic of maximizing financial profits. Once a minimum of necessary economic surpluses are obtained by ethical banks, the social or environmental added value of the projects they finance are just as important. So unlike other financial institutions, which just pretend to be “green” and responsible without renouncing the maximization of financial return for their shareholders, only the functioning of ethical banks is really based on a triple bottom line analysis. Their distinct philosophy can be summarized in one word: optimization, as opposed to maximization of profits.

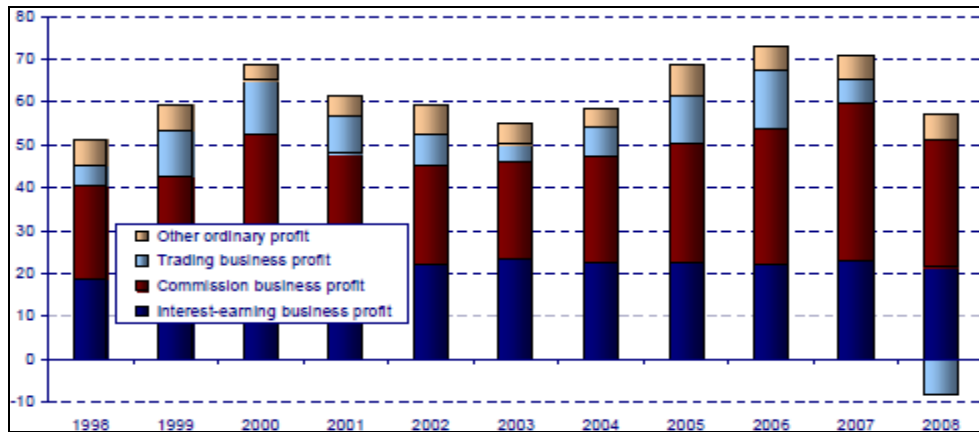
Before seeing in detail the particular case of big banks and ethical banks, let us begin by giving an overview on how the financial crisis affected the Swiss banking sector in general.

III. The financial crisis in the Swiss banking sector

Like many other industrialized countries, Switzerland went into recession in the latter part of 2008. Under these circumstances, it is not surprising to observe that the level of stress in the banking sector deteriorated. In terms of profitability, Swiss banks declined by 31 % in 2008, which is the biggest fall since the introduction of SNB bank profit statistics over 20 years ago.²⁸ This can be attributed to the negative results from trading, a business that has become increasingly important for banks over recent decades. The extent to which their profits correlate with stock-market trends is noteworthy. Big banks, particularly active in this field, are thus particularly concerned. Nevertheless, market conditions for the commission and services business also deteriorated significantly throughout 2008, with falls of 19% and 7% respectively (see figure 1). There are signs of recovery in 2009, but the prospects for the short and medium term are uncertain. Even if, as expected, the world and the Swiss economy were to gradually recover as of 2010, profitability for all bank categories is likely to remain relatively low by historical standards over the next few years. In the event of a deep and long-lasting recession, significant losses for the banking sector as a whole are to be expected.

²⁸ Most of the data contained in this sub-section is based in A. Körber, U. Müller, M. Schriber, and T. Stocker (2009).

Figure 1. Profits performance by banking activity, in CHF bn.

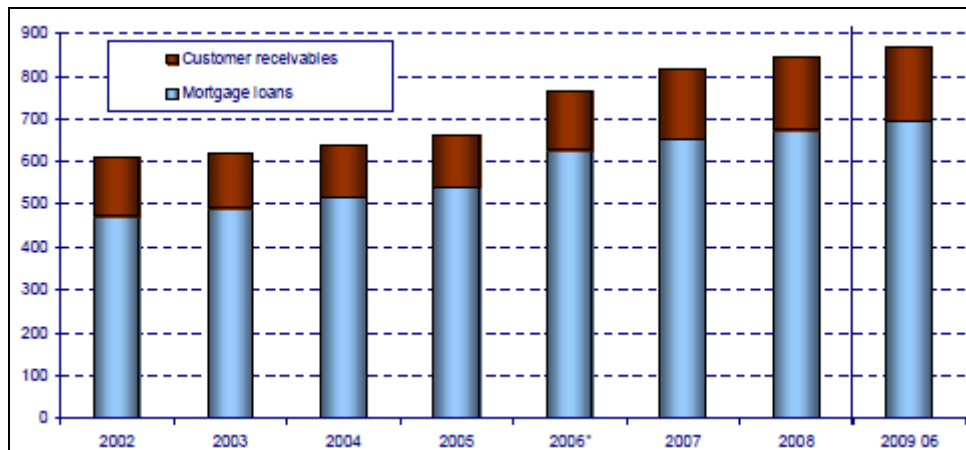


Source: SNB.

In contrast, the economic downturn did not have comparable destructive consequences as far as the credit business is concerned. Unlike other industrialized countries, the available data does not indicate the existence of a credit crunch in Switzerland in 2008. Quite the opposite, the lending activities of banks rose by 3.2 % at the end of the year. If compared with the previous period, this represents a slightly weaker growth in credit demand, but it is still an extremely solid performance given the economic environment (see fig. 2). Mortgage lending,

which accounts for 80 % of total credit volume, increased 3.6 % in 2008, whereas other customer credit receivables grew only by 1.6 %. Cantonal banks were the most active in this domain, developing their credit volume by 4.4 %. This all seems to indicate that this robust credit demand, which is based mainly on private households, is set to continue in 2009. An important factor which supports this tendency is the low interest rates in most credit segments.

Figure 2. Trend of loans in Switzerland by type, CHF bn

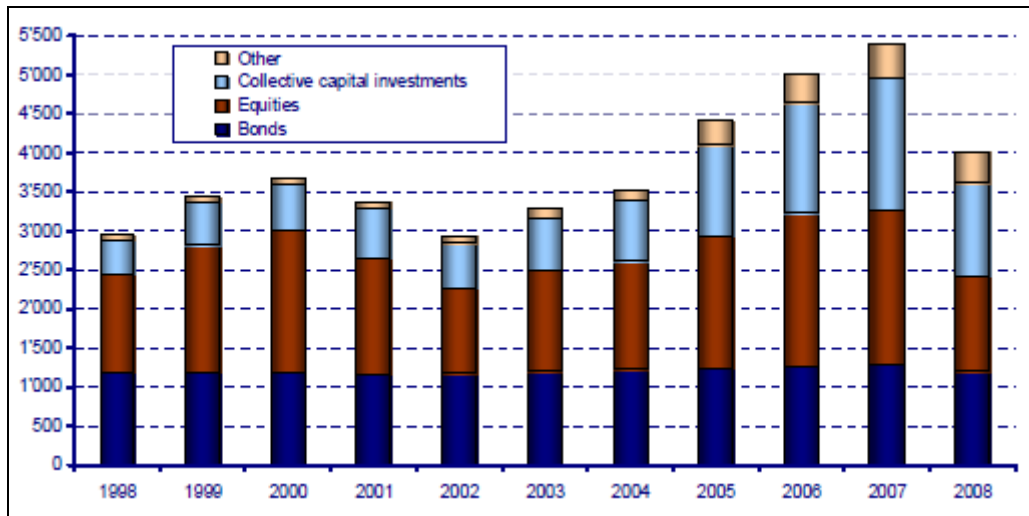


Source: SNB

The situation does not look as positive when it comes to assets under management (see fig. 3). Measured by the yardstick of the security portfolios held in client custody accounts, this type of business fell in 2008 by a quarter (25.7 %). Equity holdings and collective capital investments (investment funds) posted the biggest losses (38.4 % and 29 %, respectively) because of poor stocks and funds performances. The increased risk aversion caused

bond holdings to decline less (7 %). And yet, the banks in Switzerland as a whole were still managing customer assets amounting to CHF 4.0 trillion at the end of 2008. The future performance of assets depends heavily on the performance of the international financial markets. Assuming that the recent positive trend on stock-markets will continue for some time, managed assets in Switzerland will probably be higher by the end of 2009.

Figure 3. Trends in customer security deposits, by type, in CHF bn.



Source : SNB

Summing up, it can certainly be said that the financial crisis has deeply impacted the performance of Swiss banks. It is true that some parts of the business have been more affected than others, but the overall picture does not seem good. Nevertheless, it would be misleading to conclude that all banks have been concerned in a similar manner. As we will now see, this has not at all been the case.

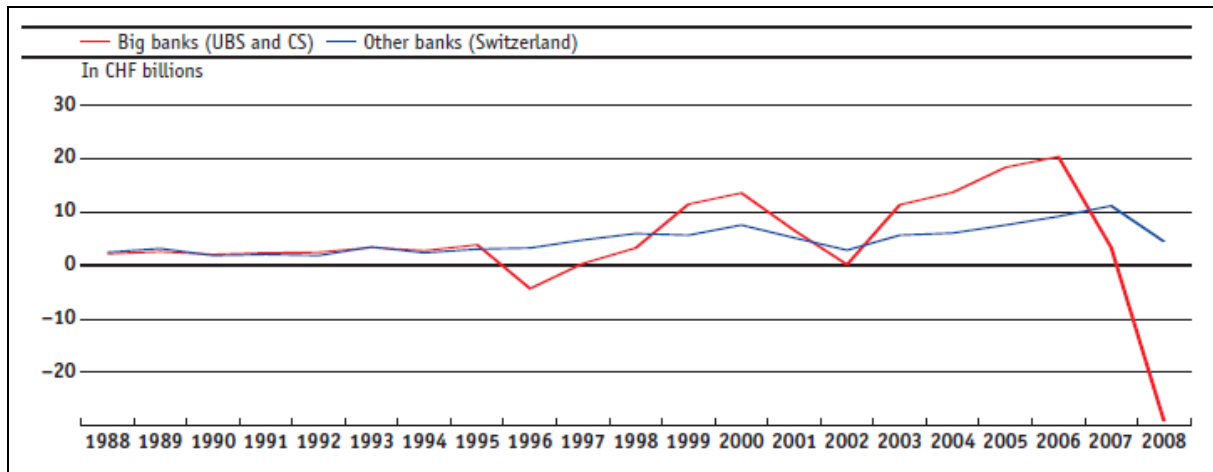
IV. Variations on profitability performance by banking group

The first domain which illustrates the dissimilar impact of the crisis on the different banking groups is that of profit performance. As far as big banks are concerned, it should be noted that their size and structure gives them in principle some noteworthy advantages, including economies of scale and better opportunities for risk diversification. In practice, however, it is not entirely so. Despite their integrated business model, the performance of big banks depends to a large extent on their trading activities at international level. This fact has particularly exposed UBS and Credit Suisse to the turbulences of the recent financial crisis. In 2008, both experienced the largest loss on record, amounting to CHF 29 billion. Seen in perspective, it is interesting to note that only two years earlier (2006) the aggregate profit of big banks registered another historical record, this time in positive terms, amounting to CHF 20 billion (see graph 1)²⁹. In contrast, banks with a domestic business focus, such as cantonal, regional and Raiffeisen banks, have been only moderately affected by the deteriorating economic and financial conditions. As can be seen in graph 1, non-big banks recorded a net profit of CHF 8 billion. This means a drop of 32 % on profits recorded in 2007, but unlike

big banks they remained profitable. The results for ethical banks were better still. In sharp contrast with big banks and domestic-oriented banks, they are the only financial institutions that ended 2008 with real increasing profits of 6 %.

²⁹ The data contained in this subsection is largely based in Swiss National Bank (2009a).

Graph 1. Net profits of Swiss banks

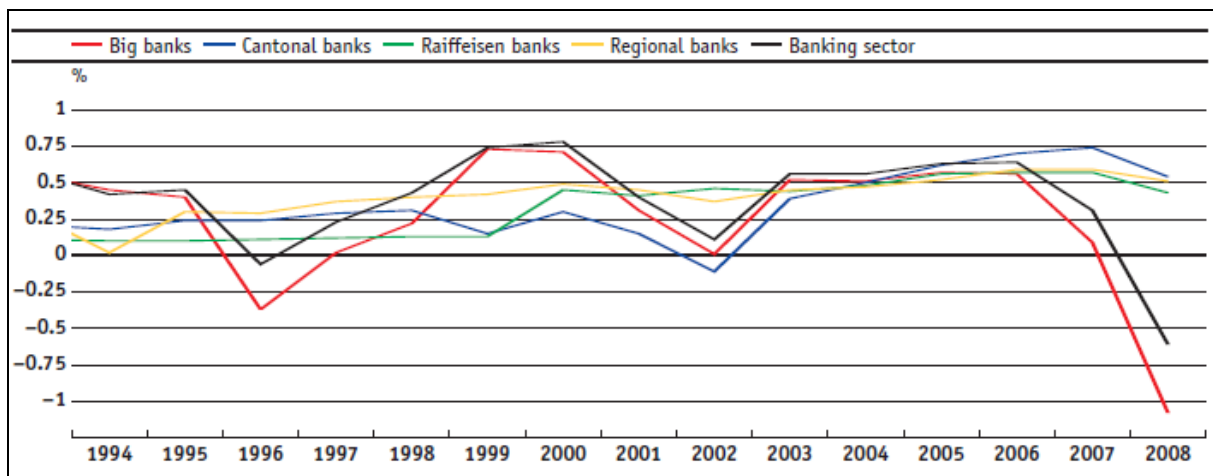


Source: SNB and FINMA

Not surprisingly, the different types of banks registered also dissimilar results in terms of return on assets (RoA). Whereas big bank profitability fell from 0.1 % in 2007 to -1 % in 2008, RoA in other bank categories remained relatively stable. In the long run it can even be said that RoA in domestic-oriented banks remained significantly above the 20-year

historical average (see graph 2). This fact highlights once more the limited impact that the crisis had on the profitability of this bank category. Still better, ethical banks are the only ones recording a positive increase of 0.3 % of RoA in 2008.

Graph 2. Return on assets (RoA)

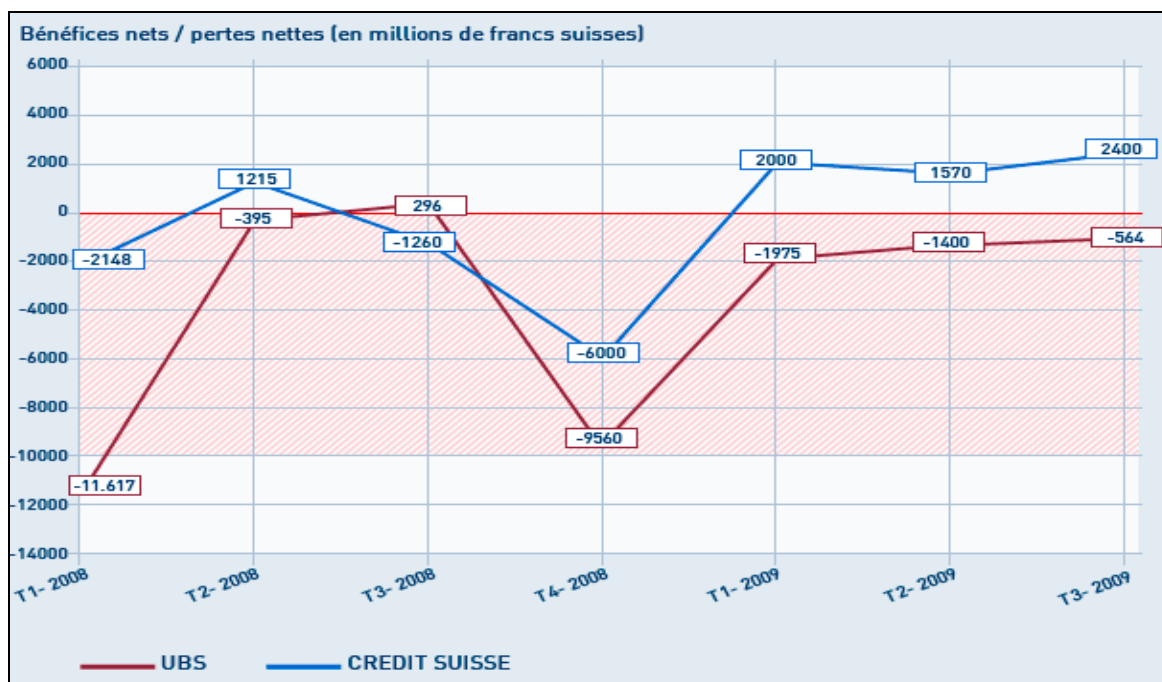


Source: FINMA and SNB

Big banks losses were mostly driven by a substantial fall in trading income, amounting to CHF 37 billion in 2008, i.e. an impressive decline of 1033 %. The market's confidence in big banks was eroded in particular after the collapse of Lehman Brothers (15 September 2008). Share prices plummeted, ratings were downgraded and thus big banks' liquidity situation deteriorated seriously. In line with the shortfalls of other financial institutions throughout the world, UBS announces gross losses amounting to

USD 44.2 billion by September 2008. The bank incurs an annual net loss of about CHF 4.4 billion for 2007 and CHF 11.9 billion in the first half of 2008. Credit Suisse stays profitable in 2007, but suffers a loss of CHF 0.9 billion in the first half of 2008 (see graph 3). In contrast, Swiss banks with domestic business focus prove not to be substantially exposed to the US real estate market and thus are scarcely affected by the financial turmoil at this point.

Graph 3. Net benefits/losses of UBS and CS, in CHF millions



Source: Bloomberg

Government involvement with bank rescues took place soon after the Lehman Brothers bankruptcy. In the case of Switzerland, UBS's vulnerability to the turbulent market environment leads to a joint package of support measures by the SNB and FINMA in October 2008. These measures made it possible for UBS to transfer a portfolio of illiquid assets of up to USD 60 billion from its balance sheet to a fund controlled by the SNB, combined with a capital injection by the Swiss government of CHF 6 billion. Credit Suisse also took measures to strengthen its resilience to shocks, but unlike UBS they managed to do so without financial support from the public sector. As a result of all this, the big banks' capital situation improved slightly in 2008, despite massive losses which by the end of the year amounted to CHF 21.3 billion for UBS and CHF 8.2 billion for Credit Suisse.

In the first quarter of 2009 big banks began to improve their situation, even if UBS still disclosed net losses. Globally, they continued to be exposed to decreasing credit quality abroad, notably in the US. Moreover, their capital situation and their leverage could compromise their resilience if a longer-lasting recession than was forecast at the time were to become a reality. The financial crisis has thus noticeably weakened the situation of big banks. It has also highlighted the existence of major gaps in the regulatory framework. In line with the efforts made at an international level, an initial set of concrete measures have been recently drawn up in Switzerland. They consist firstly of imposing higher capital requirements on the two big banks and introducing limits to their leverage capacity.

Secondly, more robust liquidity requirements for the big banks are going to be put in place. Finally, the Swiss financial authorities also wish to strengthen the depositor protection from CHF 30,000 to CHF 100,000. The Swiss law has already been amended to this effect, but in order to prevent a procyclical impact, the other measures will not come into force until 2013 at the earliest. Big banks will thus have enough time to recover from the crisis before applying the new requirements.

Interestingly, this regulatory framework is exclusively designed for big banks. The other financial institutions, with a more domestic business focus, are not explicitly mentioned. This is because, unlike big banks, they have not been badly affected by the crisis. While their average profitability shrank moderately in 2008, it still remains above the long-term average. Ethical banks, in particular, have been even able to improve their performance in some respects during the period of financial turmoil. There thus seems to be an increasing difference in the way that the different types of banks withstand the financial crisis. These divergences will also be apparent if we now move to the traditional credit business.

V. Differences as regards the financing of the real economy

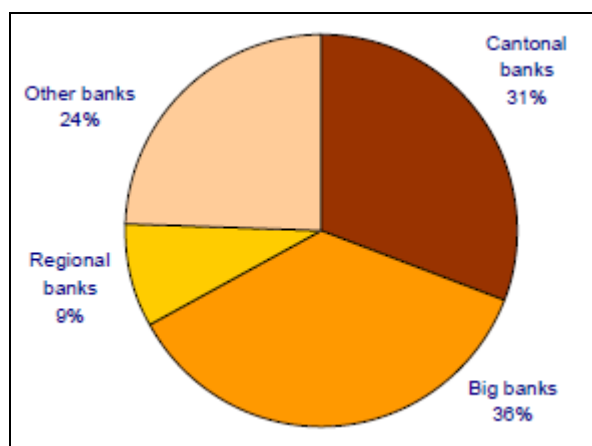
It has already been said that despite the economic slump Switzerland has not suffered a credit crunch. In 2008, it actually grew by 3.2 %. Compared with previous years, this result denotes a slightly weaker growth in credit demand, but given the clouds in the

economic horizon it still stands as an extremely solid performance. Differences have to be made, however, according to the various types of banks.

Interestingly, the overwhelming dominance of the two big banks in terms of the total balance sheet does not occur in the sphere of the credit business. Whereas the two largest banks account for

76 % of total assets in Switzerland, their combined market share in the domestic credit market is only 36 %. Cantonal banks, with scarcely 9 % of total assets, closely follow big banks in the credit market with a share of 31 % (see fig. 4). This does not mean, however, that big banks and domestic-oriented banks have had similar results in this domain.

Figure 4. Breakdown of lending by banking group (2008)



Source: SNB

During the crisis, the total lending volume of big banks has barely increased by 0.4 %. The loss of confidence in these institutions in a context of financial turmoil has led also to a weaker demand for credit. The consequent loss of market share has gone to other financial institutions with a more domestic business focus. Cantonal and regional banks are

among those that have benefited most, with an increase of 4.4 % and 4.1 % respectively in their credit volume. Nevertheless, it is again ethical banks that record the most significant increase in credit volume, with a positive change of 6.3 % from 2007 to 2008 (see table 4). This is fairly consistent with their values and their business model.

Table 4. Credit volumes in ethical banks

	Total lending 2007 (bn CHF)	Total lending 2008 (bn CHF)	Percentage of change
ABS Bank	593	649	9.4 %
Freie Gemeinschaftsbank	134	141	5.2 %
WIR Bank	846	874	3.3 %
	1753 (WIR)*	1870 (WIR)*	6.7 %
Total	3326	3534	6.3 %

* 1 WIR = 1 CHF

Source: Annual reports 2007 and 2008.

In fact, this is not the only domain in which ethical banks have taken clear advantage of the special climate generated by the financial and economic crisis. Additionally, one of the most outstanding developments is that they have been able to attract new clients away from big banks because of their lack of confidence in these institutions. By the end of 2008, the volume of clients' assets in the BAS Bank had increased by 9.4 %, reaching CHF 767 million. This was mainly due to the 1230 new clients that had joined the bank during that period, meaning an increase of 6 % if compared with 2007.³⁰ In the

case of the WIR Bank and the Freie Gemeinschaftsbank the growth in the volume of clients' assets during 2008 is still more spectacular, at 11.7 % and 12 % respectively.³¹ With all these new clients, ethical banks have been able to build up their liquidity reserves without public aid, thus withstanding the financial turmoil in a different manner to that of big banks.

The overall picture thus shows that ethical banks have had better results than other financial institutions in all domains during the crisis. The

30 «Communiqué de presse du 19 mars 2009», www.bas.ch

31 See respectively, Banque WIR (2009, p. 22); Freie Gemeinschaftsbank (2009, p. 21).

performance of domestic-oriented banks is also quite remarkable, particularly when compared with that of big banks. The fact that both ethical and domestic-oriented banks are mainly focused on the savings and mortgage business within the Swiss market, has largely preserved them from the financial turbulences at international level. Since there are no signs of a real estate or credit bubble in Switzerland, the local lending business in which they are particularly active continues to be strong. It should be noted, however, that domestic-oriented banks are also present, to a lesser extent, in all other financial activities. The cantonal banks of Bern and Luzern, for example, have been directly involved in the selling of mortgage-based securities originally marketed by Lehman Brothers. So for the sake of maximizing profits, cantonal banks do occasionally participate in speculative operations of the international financial market (see table 8). Consequently, their banking strategy does not appear to be intrinsically different from that of UBS or Credit Suisse. Only financial institutions such as the Alternative Bank ABS, Freie Gemeinschaftsbank, or WIR bank offer a really

distinct banking approach. As we are going to see in the next section, this is also linked to their singular performance during the crisis.

VI. An alternative banking model

The remarkable way in which ethical banks have gone through the crisis is not just the result of a management strategy specially put in place for this period of financial turbulence. There is a more deep-rooted explanation which concerns their distinctive business model. This is the hypothesis which is going to be explored in this section by comparing big banks and ethical banks in terms of the structure of their balance sheet and its evolution over time during the period of financial turmoil.

A fairly simple way to make clear that big banks and ethical banks have indeed a distinct business model is to analyze the structure of their respective balance sheet. In that sense, we propose to summarize the multiple items of this accounting document in four main sections (table 5):

Table 5. General description of a balance sheet in four blocks

ASSETS	LIABILITIES
Interbank operations	Interbank operations
Client transactions (loans)	Client transactions (deposits)
Financial transactions	Financial transactions
Reserves	Equity

Once we have this common analytic grid, it suffices to apply it to the different financial

institutions. For the case of big banks, the results for the years 2007 and 2008 are the following:

Table 6. Credit Suisse

ASSETS	2007	2008	LIABILITIES	2007	2008
Interbank operations	24 %	31 %	Interbank operations	30 %	26 %
Client transactions	17 %	20 %	Client transactions	26 %	25 %
Financial transactions	47 %	35 %	Financial transactions	40 %	36 %
Reserves	12 %	14 %	Equity	4 %	13 %

Source: Annual Reports, 2007, 2008

Table 7. UBS

ASSETS	2007	2008	LIABILITIES	2007	2008
Interbank operations	19 %	22 %	Interbank operations	21 %	12 %
Client transactions	15 %	17 %	Client transactions	28 %	38 %
Financial transactions	52 %	48 %	Financial transactions	48 %	47 %
Reserves	14 %	13 %	Equity	3 %	3 %

Source: Annual reports, 2007, 2008.

Let us first look at client transactions. In normal conditions, universal banks like Credit Suisse or UBS should show a dominance of credit granting on the assets side. Contrary to this, table 6 and table 7 show that, under the period under consideration, the

value of client transactions on the liabilities side is higher than on the assets side. This means that savings for UBS and Credit Suisse are more important than loan distribution. The explanation for this unexpected result is that both banks have been

heavily affected by the crisis. Therefore, they will spontaneously reduce the volume of loans and use savings collection as a means for reabsorbing the losses and reconstituting their capital base (reserves and equity capital). In the particular case of Credit Suisse, this objective has been attained without major difficulties. Table 6 shows that both reserves and equity increase significantly (from 12 % to 14 % and from 4 % to 13 % respectively). Consequently, the gap between deposits and loans in the client transactions is also reduced, going from 9 % in 2007 (26 % – 17 %) to 5 % in 2008 (25 % - 20 %). The picture is not so positive in the case of UBS, which is unable to increase its level of reserves and equity. Consequently, it is not surprising to find that their gap between loans and deposits continues to increase in the period under consideration, passing from 13 % in 2007 to 21 % in 2008. In other words: the crisis has substantially affected the intrinsic nature of Credit Suisse and UBS, which are normally considered universal banks with credit granting as their main activity, which now look exceptionally like savings banks.

The second element worth mentioning is the very high percentages devoted to financial transactions, which in some cases approximate and even surpass 50 % of the total activities. This fact

clearly illustrates that the core of the business for big banks is no longer savings collection and project financing through loans, but operations in the global financial market. Even if, due to the crisis, the percentage of financial transactions is decreasing in both cases, it is still very prominent. So much so that, rather than universal banking institutions, UBS and Credit Suisse look more like investment banks. To confirm this point, it should be noted that the value of the off balance sheet in the two years under consideration represents about 20 times the amount of total assets in the case of UBS and 34 times in the case of Credit Suisse. Once more, this clearly illustrates that the major source of profitability for big banks comes from the speculative operations made on the financial market.

Before turning to the analysis of ethical banks, it should be noted that domestic-oriented banks are somehow in an intermediate position. As can be seen in table 8, cantonal banks make a more modest use of the financial market and favour credit granting. Yet, they can still be considered as functioning within the same logic as universal banks. A more radical change in the business model, not just in quantitative terms but also in the qualitative rationale, is noticeable in the balance sheet of ethical banks (see tables 9-11).

Table 8. Cantonal banks

ASSETS	2008	2009	LIABILITIES	2008	2009
Interbank operations	16 %	12 %	Interbank operations	9 %	12 %
Client transactions	72 %	72 %	Client transactions	60 %	63 %
Financial transactions	7 %	10 %	Financial transactions	17 %	15 %
Reserves	5 %	8 %	Equity	14 %	10 %

Source: annual reports 2008, 2009.

Beginning with client transactions, assets and liabilities in the case of ethical banks are more or less on a par. There is a moderate prevalence of credit activities in the case of ABS and WIR banks (tables 9 and 11), and a slight ascendancy of savings in the Freie Gemeinschaftsbank (table 10). Taken in an aggregate form, the traditional credit business prevails and this is barely surprising. Ethical banks

are small institutions with few branches in a limited regional scope. Therefore, they do not have the same infrastructure as savings banks for deposit collection. Furthermore, their main goal is credit distribution, applying a triple bottom line analysis to the loans they grant. Symptomatically, this intrinsic nature of ethical banks has not been noticeably affected by the crisis.

Table 9. ABS

ASSETS	2007	2008	LIABILITIES	2007	2008
Interbank operations	13 %	14 %	Interbank operations	20 %	22 %
Client transactions	77 %	77 %	Client transactions	70 %	70 %
Financial transactions	0 %	0 %	Financial transactions	0 %	0 %
Reserves	10 %	9 %	Equity	10 %	8 %

Source: annual reports 2007, 2008.

Table 10. Freie Gemeinschaftsbank

ASSETS	2007	2008	LIABILITIES	2007	2008
Interbank operations	12 %	14 %	Interbank operations	10 %	12 %
Client transactions	75 %	72 %	Client transactions	76 %	75 %
Financial transactions	0%	0 %	Financial transactions	0%	0 %
Reserves	13 %	14 %	Equity	14 %	13 %

Source: annual reports 2007, 2008.

Table 11. WIR

ASSETS	2007	2008	LIABILITIES	2007	2008
Interbank operations	2 %	3 %	Interbank operations	15 %	16 %
Client transactions (among which WIR)	82% (27%)	81 % (26 %)	Client transactions (among which WIR)	71 % (25%)	72 % (23 %)
Financial transactions	15 %	15 %	Financial transactions	0 %	0 %
Reserves	1 %	1 %	Equity	14 %	12 %

Source: annual reports 2007, 2008.

The structural configuration of the ethical banks' balance sheet differs far more radically in terms of their financial activities. As we have seen, this type of activity is essential for big banks and not negligible for cantonal banks. On the contrary, ethical banks are completely absent from this kind of activity. Only the WIR bank shows some noticeable participation in the financial market, but for very different reasons than big banks. As the annual reports of the WIR bank make clear, their operations in the financial market concern exclusively assets with a fixed interest rate to be held up to maturity.³² So, unlike big banks, these financial transactions are not of a speculative nature but are made on a medium or long-term perspective for the functioning needs of liquidity. The existence of WIR money, a parallel currency accepted by the Swiss National Bank, can also help to explain these financial transactions, which by all means remain modest (15 % of total assets) and quite exceptional. The other two ethical banks, ABS and Freie Gemeinschaftsbank, are more radical in their banking approach. As tables 8 and 9 show, they completely refuse to participate in the global financial market, thus emphasizing that they are not conducting their business in the same way as other banks do. One of the founding statements of the Alternative bank ABS will perfectly illustrate this point:

“The Alternative Bank ABS puts its ethical principles before profit maximization and sees its activity as an alternative to the dominant economic logic, which is the main factor responsible for the worsening of ecological problems and the increase of social and economic inequalities.”³³

If we now focus on interbank operations, it is surprising that the crisis and the general loss of confidence between financial institutions is not

clearly reflected in the percentage of capital flows between banks. There are two possible reasons for this seeming paradox. One must first keep in mind that the percentage in a given activity might remain constant despite a decreasing volume of transactions if all other sectors decline correspondingly, as has been the case during the crisis. Most importantly, it should also be taken into account that the interbank business consists of two main types of operations: transactions between banks and transactions between each of the banks and the central bank. During the crisis, there is an evident decrease in the former type of operation and, in order to counteract the lack of confidence, a considerable intensification of the latter. This dynamic particularly applies to the case of big banks. If we cannot see a clear trend in the percentages of their interbank operations it is because the plunge of bank receivables is counterbalanced by the substantial cash injections made by the Swiss National Bank, namely in the case of UBS.

There is finally the issue of capital base (reserves, equity). In order to analyze the robustness of the different bank categories to financial shocks, the most appropriate indicator to be taken into account is the capitalization ratio. In this regard, let us first make clear that, like any other enterprise, financial institutions can use their earnings to absorb eventual losses. Our preceding arguments prove that big banks have made recourse to public funding to cover their losses. We are now going to deepen the analysis with a discussion about the capital-to-assets ratio in the different types of banks (see table 12).

32 Banque WIR (2008, p. 42).

33 M. König and A. Wespe (2006, pp. 47-48).

Table 12. Risk-weighted capital ratio

	Regional Banks	Raiffeisen Banks	Ethical Banks	Big Banks
2007	13.7 %	18.7 %	12 %	10.7 %
2008	14.5 %	18.8 %	14 %	12.6 %

Source: SNB and Annual Reports 2007 and 2008.

Several comments can be made on these figures. If we initially focus on the case of big banks, one notices immediately that the magnitude of this ratio has improved during 2008 as a result of public cash injections, but it still remains weaker than that of smaller institutions. There are several possible reasons for this fact. First of all, it is important to remember that the smaller the bank, the more reduced the loss of profitability. This is fairly consistent with our discussion on banking profit. Second, the loss of clients from big banks has induced a decrease of their liquidity. Third, the participation of big banks on the international market has increased their market risk and constrained these institutions to reconstitute provisions for improving their risk-weighted capital ratio. In the case of domestic-oriented and ethical banks the situation is quite different. In fact, for them the contrary argument applies: their losses have been insignificant, they have gained clients, and they continue to concentrate their activities on the real economy of the domestic market. Their level of capitalization is thus more significant, particularly in the case of regional and Raiffeisen banks, namely because their size and infrastructure enable them to raise more funds. Their capacity for loss absorption if the economic environment were to worsen once again is thus much higher than that of big banks. In addition, it has already been said that ethical and domestic-oriented banks are the financial institutions that have best endured the crisis. Therefore, they were not in real need of increasing their capitalization ratio. And yet, they have generally decided to reinforce it to reinsure their clients of their global stability. As table 13 shows, ethical banks are particularly noteworthy in this regard, with an increment of 2 % during 2008. These institutions have thus followed the recommendations of the Swiss National Bank despite the fact that they were not obliged to do so from the point of view of the present-day regulatory framework. In the end, it is interesting to note that the capital situation has generally improved in the Swiss banking industry after the crisis, even if this was done for different reasons and through different means according to the several types of banks under consideration. Once more, this fact reflects how differently the two distinct banking models have been able to cope with the financial turmoil.

VII. Conclusions

The 2007-09 financial crisis has had a considerable impact on the Swiss banking industry. Taking into account the major banking indicators, the overall level of stress has risen considerably during this period. But such an overall assessment conceals dissimilar situations. Whereas the performance of big banks has been severely hit in almost all domains, thus triggering the bad results of the whole Swiss banking industry, other financial institutions with a more domestic focus have survived the crisis reasonably well. In still sharpest contrast, ethical banks present contemporaneously a very favorable picture.

As has been argued throughout this paper, the different way in which banks have been affected by the crisis is closely linked to their distinct business model. Consequently, the characteristic structure of the balance sheet in big banks and ethical banks is correlated with their divergent dynamic during the crisis. While the financial turmoil has left the business approach of ethical banks unchanged, as evidenced in the striking stability of their balance sheet from 2007 to 2009, the pattern shown by big banks has substantially changed over this same period.

These developments would tend to suggest the need to reform the business model of big banks. Should we infer from this that a ready-made solution for improving the functional effectiveness and stability of the financial system would be to implant small ethical banks around the world? Certainly not. There is no clear empirical evidence that a banking system with a large number of small institutions would be any more stable than the system as it currently stands. Besides, financing certain big projects would always require the existence of large international banks. Both types of financial institutions are in fact complementary. How to regulate the banking and financial sector is thus a complex and multifaceted issue. One cannot impose the same requirements on big international-oriented banks and small domestic banks. As this paper has tried to demonstrate, both have a distinct business model. Therefore, they do not need the same type of supervision and regulation. Finally, it should also be kept in mind that greater systemic stability generally involves higher regulatory costs, thereby creating an optimization problem. The question of how to figure out this optimal point is still an open one which requires more empirical evidence. By analyzing in

detail how two distinct banking models in the Swiss context have come through the crisis, the present paper hopes to contribute to a more general but necessary reflection at a global level.

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