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**Group of experts on the further
development of the financial market
strategy**

Final report

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1 Introduction

1.1 Mandate and procedure

The Federal Council decided on 4 September 2013 to appoint a broad-based group of experts for the further development of the financial market strategy.

The group of experts, isolated from daily business, was instructed by the Federal Council to conduct a current-state analysis of the underlying framework of the Swiss financial centre and, on this basis, draft a set of proposals for the further development of the financial market strategy. The interests of the economy as a whole were to be taken into account. The brief of the group of experts stressed that they should address not only potential means of strengthening the domestic framework but also measures to maintain and improve market access abroad. The deadline for completion of the mandate was end-2014.

The group of experts comprised representatives from private enterprise and the Federal Administration, including regulatory bodies and academia. The private and public sectors were each represented by eight experts. All members were appointed by name and no deputies were provided, except for representation of the big banks; see Chapter 8 for the list of members.

The group of experts convened five times. Four subgroups were appointed for the extensive groundwork to be covered in the following areas (further details given below): (i) the regulatory process and implementation of regulations, (ii) foreign market access, (iii) economic risks, and (iv) the domestic tax environment. As a rule, each subgroup was chaired jointly by a representative from the public and private sectors; the only exception was the subgroup on economic risks, led by the Chairman of the group of experts. The subgroups were tasked with drafting documents and furnishing a decision-making basis for the group of experts; the group of experts retained authority for decisions and validating documents. The experts could be represented and/or assisted by subject specialists within the subgroups.

As the group of experts did not directly include any financial infrastructure providers, SIX Group was invited to a consultation as part of the group's third meeting.

The object of their work was to produce a comprehensive report that would furnish the Federal Council with a set of recommendations by the specified deadline. The group of experts considered three subject areas to be of such urgency that it submitted its recommendations to the Federal Council even before this deadline. The first of these concerned foreign market access, for which the group presented its main proposals as early as March 2014; this coincided with a press release. Secondly, in a statement in May 2014, the group of experts announced its explicit support for the Federal Council's plans to implement the automatic exchange of information in tax matters. Thirdly, in June 2014 the Federal Council was given recommendations on the conversion of withholding tax into a paying agent tax, whereupon the group of experts was directly included by the Federal Council in the formulation of a draft consultation paper.

1.2 Scope of the strategic work

Given the broad nature of the brief given to the group of experts, it is important to delimit the work entailed. This applies in respect of the addressees of the strategy and the content itself.

1.2.1 The underlying framework – not strategies for financial firms

The strategic priorities to be drawn up refer explicitly to the Swiss economic policy framework. This tasks the state and thereby economic policy with defining the underlying legislative and regulatory conditions; it does not mean influencing the corporate strategies of individual firms.

Responsibility for strategic decisions taken by private companies must ultimately lie with their owners, who must then also bear the consequences in the event of losses. This responsibility should not and cannot be removed by the state. Hence, "financial market strategy" does not mean that strategic decisions are to be made on behalf of individual organisations, financial groups or financial businesses: it is about setting strategic directions for economic policy, i.e. the framework in which the financial markets operate.

Therefore, no recommendations are explicitly directed at the financial industry and its policy. State bodies are not responsible for deciding whether the future of the Swiss financial centre or of individual banks lies in a specific field, such as asset management or industrial banking. Such decisions therefore do not fall within the remit of this group of experts appointed by the Federal Council. These are business decisions to be taken by individual financial institutions. However, the group's mandate does include identifying possible regulatory impediments that could jeopardise a Swiss financial institution's expansion in certain banking businesses on an international comparison. The goal of the financial market strategy is thus to ensure a framework that will enable Swiss financial institutions to operate successfully in present and future profitable banking businesses, in Switzerland and abroad, and so create and maintain sustainable employment. Consequently, the brief of the group of experts cannot include recommendations as to the Swiss financial sector's future size or composition. Their brief explicitly mentions that the interests of the entire economy should be taken into consideration; specifically, this means addressing in detail the particular risks inherent to the financial sector in respect of system stability.

The primary addressees of the recommendations set out in this report are the legislative and regulatory bodies as a whole. Certain recommendations may also be directed at industry organisations. However, no recommendations are addressed to the financial institutions themselves.

1.2.2 Financial market policy – not general economic policy

Another boundary is formed by which aspects of economic policy to focus on in this strategy work. The success of Swiss financial institutions – indeed, of all Swiss businesses – depends on the formulation of general economic policy at all regulatory levels. The work of this group of experts, however, is purposely limited to those aspects of economic policy concerning only or at least primarily financial institutions. For example, the Corporation Tax Reform III package is not covered here in any depth, whereas the possible conversion from the withholding tax to a paying agent tax is. While both of these are important, the reform of corporation tax concerns the development of the general economic policy framework and is not specific to the financial sector.

It should nonetheless be stressed that such non-specific economic policy framework conditions are in many cases just as important to the competitiveness of the Swiss financial centre as financial market regulation per se. A flexible labour market, a stable currency and robust state finances are among the key factors to the international success of Swiss financial services providers over the years. Preserving and building on Switzerland's advantages as a business location are thus also of great importance to the financial sector and should be taken into account when viewing competitiveness as a whole. As the objective here is not to formulate a comprehensive economic policy strategy for Switzerland, we will focus in the rest of this report on those areas concerning financial market policy in the narrower sense and make specific recommendations only in that respect.

Notwithstanding the above, the key elements of general economic policy of particular importance for the financial sector are outlined in the following box:

Key elements of Switzerland's general economic policy of relevance to the financial sector

Stability

Trust in a predictable and stability-oriented economic policy. Factors of particular significance for the financial sector are: (i) Switzerland's own currency with an autonomous, stability-oriented monetary policy, (ii) relatively moderate, stable government debt underpinned by the stabilising effect of the debt brake on fiscal policy, and (iii) a consensus-based political system, preventing rash changes to the framework conditions. (Less positive aspects: Certain innovations in exercising the right of initiative).

Economic openness

Strong international integration of the Swiss economy, supported by a liberal foreign trade policy at a multilateral and bilateral level. (Less positive aspects: Uncertainty surrounding the future of the bilateral agreements following approval of the initiative against mass immigration).

Efficient labour market regulations and state activity

On an international comparison, high quality of state activity in the broadest sense. Of particular note here is the (i) liberal labour market regulation, (ii) a moderate tax level, (iii) the federal structure of fiscal policy based on the principle of subsidiarity, (iv) an extensive infrastructure, and (v) the moderate administrative burden.

High level of education and research

High level of education with a strong practical approach, combined with internationally competitive research. Of particular note are (i) the practical approach taken by the dual vocational training system, (ii) the high density of internationally renowned third-level institutions, (iii) leading positions in research quality.

1.3 Structure of the report

The remainder of this report is structured as follows. Chapter 2 starts out with a review of previous strategy work in financial market policy. It goes on to present the latest international changes in framework conditions, which provide the impetus for further development of the strategy. The conclusion is that the new challenges call for reform in four specific areas. Chapters 3 to 6 are then dedicated to each of these four areas of reform.

Chapters 3 to 5 look at how the framework conditions could be adapted to enhance the competitiveness of Swiss financial services providers. This begins in Chapter 3 with possible adjustments to the regulatory process in response to the rapidly changing framework conditions. Chapter 4 assesses a number of approaches to preserving or improving access to the leading international markets. Chapter 5 analyses the possibilities for adjusting the taxation of banks and insurance companies.

Chapter 6 discusses ways of maintaining and reinforcing the systemic stability of the Swiss financial sector with regard to the numerous risks that have come to light during the financial crisis or were triggered by this crisis. A detailed analysis of the effectiveness of the TBTF regulation for big banks, on an international comparison, lays the foundation for the review of the effectiveness of the TBTF regime, as required under Art. 52 of the Banking Act by February 2015. It also analyses various aspects of systemic stability outside of the big banks sector, such as deposit protection or tax incentives for borrowing. Based on these studies, Chapters 3 to 6 propose recommendations for adapting the financial market strategy. Chapter 7 summarises these recommendations in an overview table.

2 Scenario

2.1 Previous financial market strategy

2.1.1 Strategy work prior to the financial crisis

Since the appointment of the interdepartmental "groupe de réflexion" in 2000, the Confederation has explicitly worked on developing more comprehensive strategic concepts for financial market policy. Initial work in this field resulted in the guidelines for the financial centre policy, published by the FDF in 2003. In that document, the focus of strategic considerations was already on the three objectives of competitiveness, stability and the integrity of the financial centre. As with the "Guidelines for Financial Market Regulation" issued by the FDF in 2005, these initial studies also concentrated on the general regulatory directions but did not put forward any concrete proposals for taking measures. Around the same time, the private sector was also working on a strategy for financial market policy, leading to a joint publication by the leading associations of a "Swiss Financial Centre Masterplan" in 2007. At the start of 2008, the FDF established a formal "Financial Centre Dialogue" in which public authorities and private companies were to jointly propose strategic ideas for reinforcing the future financial centre. This work was interrupted in autumn 2008 when the evolving financial crisis came to a head; from then on, the focus was exclusively on dealing with the crisis.

2.1.2 The 2009 financial market strategy ("Graber Postulate Report")

In spring 2009, the Federal Council appointed a joint working group with representatives from the public and private sectors, tasked with drafting a report on the future financial market policy. This was prompted by a postulate raised by Member of the Council of States Konrad Graber, calling for a report that would combine previous work in this direction with the additional challenges that appeared with the financial crisis and, on this basis, set the foundation for a broad-based strategy.

At the end of 2009, the Federal Council ratified the ensuing report, "Strategic directions for Switzerland's financial market policy". In addition to an analysis, the report contained a catalogue of 25 relatively concrete measures in the most important areas of financial market policy. Essentially, this report was thus the Federal Council's first explicit and comprehensive measures-oriented strategy in this field and, to a certain extent, formed a framework for the work done in subsequent years. One particularly significant follow-up to this work concerned the issue of "too big to fail" (TBTF). The TBTF Commission, comprised of both public and private-sector representatives, formulated the draft legislation for the amendment of the banking law in this area.

2.1.3 The 2012 update to the strategy

At the end of 2012, the Federal Council passed an update to this financial market strategy. This "*Report on Switzerland's financial market policy*" discussed the extent to which the measures announced in 2009 had been implemented. Its main objective, however, was to determine, from a strategic point of view, how to align banking secrecy with the tax compliance of foreign assets under management, in light of the steadily growing pressure exerted on Switzerland. The report explained the principles of the "clean money strategy", which sought to uphold banking secrecy regarding tax matters through a combination of source tax agreements and new due diligence requirements. This report also led to further studies by the Financial Centre Forum on enhancing certain framework conditions in the areas of asset management, insurance and pension provision as well as the capital market.

2.1.4 The first report on the "Further development of the financial market strategy" in 2013

At the end of 2012, the FDF tasked a group of experts – comprised of representatives from public authorities and academia – with the formulation of proposals for the further development of the existing financial market strategy. This work rapidly concentrated on the question of how to respond to the growing opposition to international withholding tax agreements and the issue of EU market access being jeopardised by regulatory developments. In mid-2013, the Federal Council approved publication of the group of experts' report "Regulatory challenges in cross-border Swiss asset management and strategic options". At the same time, it followed the group's recommendation to adapt the strategy and to support the concept of automatic exchange of information (AEOI) in tax matters rather than international withholding tax agreements. Another significant element of the adapted strategy is that Switzerland now actively participates in the development of an international standard on AEOI. Switzerland is particularly keen to ensure that the principle of speciality, data protection and reciprocity are given appropriate weight in the new standard and that the beneficial owners of all legal forms (including trusts) are covered by AEOI.

Given the rapid developments in the international context – and despite their very wide brief – this group of experts concentrated on a small number of issues concerning only the cross-border asset management business. Consequently, the broader work on the further development of the financial market strategy was conducted by another group of experts appointed in autumn 2013 – which also included the private sector – as summarised in this report.

2.2 The latest global changes in the framework conditions

The ongoing financial crisis and the various responses in terms of economic policy have produced vast changes in the framework conditions for the financial sector. The financial market strategy passed by the Federal Council in 2009 was clearly already shaped by the initial waves of this storm. Since then, however, it has become clear that the ensuing hurricane, with varying degrees of intensity, has changed the most important framework conditions to such an extent that the strategy needs to be reassessed. Below is a brief outline of the most important of these recent changes, from which we deduce in the next section those areas in need of reform; in turn, these have determined the organisation of this group of experts' work and thus the structure of the remainder of the report:

- **New wave of regulation in response to the financial crisis**

The financial crisis in its various manifestations made it drastically clear that certain key elements of financial market regulation were not producing the desired effect. Therefore, to avoid such setbacks in the future, or at least to stem their impact, most countries have introduced far-reaching regulatory changes in recent years. This includes regulations to increase systemic stability but also regulations to improve the effectiveness and extent of customer protection. Regarding impact, at least, there is a discernible trend towards additional and, in particular, more complex regulation and less of an attempt to revamp the existing situation with the same level of regulation.¹

Part of this wave of regulation is internationally coordinated, e.g. with the FSB. However, many regulatory initiatives contain particular national references, meaning that financial institutions

¹ The incumbent Chief Economist of the Bank of England illustrated this trend towards increased regulatory complexity with some fitting examples in a speech. See Andrew Haldane (2012): The Dog and the Frisbee, Speech given at the Jackson Hole symposium in 2012. For example, taking the Basel I agreement as a very basic indicator, this was only 30 pages long; however, Basel II came in at 347 pages and Basel III was 616 pages long.

operating internationally now face an increasingly complex set of different regulatory requirements, which increases the cost of compliance. Also, the swift implementation of many current regulatory projects raises the risk of ending up with unnecessarily inefficient regulations. On top of this are the national regulations that have extraterritorial effect, such as FATCA.

- **International market access increasingly threatened**

Closely related to the growing wave of regulation is the recently observed increase in market access barriers for foreign financial services providers. The mere fact that so many regulations differ at a national level creates a non-tariff trade barrier in respect of the rising implementation costs. Also, given the severity of the crisis, there is a certain trend towards regulation that seeks primarily to protect domestic financial institutions from the contagion effects of international turbulence. Such national ring-fencing also has a protectionist effect. Strict domiciliary requirements against third-country providers, as originally planned with MiFID II in the EU, have a particularly strong impact in terms of market partitioning. In extreme cases, such regulations can bring the exchange of financial services between countries to a complete halt.

- **More intensive global measures to strengthen financial stability**

Most countries have stepped up their efforts considerably in recent years to strengthen financial stability. Not so long ago, Switzerland was the only seriously affected country to have fully implemented TBTF legislation; many more countries have now followed suit. There is a strong general consensus that legislation in this area needs to be beefed up, and the FSB is introducing the corresponding global standards, to be implemented relatively quickly. It is now widely accepted that the orderly winding-up of a systemically important global bank poses major regulatory challenges, requiring new measures at both a national and international level.

A key contributory factor to this international awareness is the recognition that the global economic situation and its developments entail further special risks for the financial sector. Such risks include, for example, the persistently high debt levels (of private individuals, governments and financial institutions), unresolved governance problems within the euro zone, the global liquidity flood, and huge current account imbalances. As global banks are inevitably exposed to these risks, the need to boost their resistance to crisis through suitable regulatory measures is considered a matter of urgency.

- **Pressure to adapt in tax matters**

Depleting government coffers worldwide have also contributed in no small measure to raising the international profile of tax policy adjustments. The most direct trend – and of most relevance for Switzerland – is the de facto zero tolerance for tax avoidance or evasion. The clearest sign in this respect is the internationally accepted consensus for the automatic exchange of information (AEOI) in tax matters.

However, the need to adjust also stems from the internationally growing competition among financial centres for the best framework conditions for financial services providers. The tax environment, which ultimately is determined nationally, plays an important role in this respect. As a result, Switzerland's tax disadvantages, which have been known for many years now, are taking a greater toll on the situation. The focus here is on specific features such as the withholding tax, which currently compromises the development of a Swiss capital market, and the remaining stamp duty.

- **Non-regulatory changes of relevance to business models**

The above global changes to framework conditions have created enormous pressure to review the business models that exist in the financial sector. This will accelerate structural change in

the Swiss financial sector. A number of market developments have caused the repercussions of changes to the framework conditions to be felt even more strongly.

Of particular note is the rapidly increasing digitalisation of the financial sector, which calls the existing business models into question, quite fundamentally in some cases. Major adjustments are also happening in the business environment for private banking, of particular importance for Switzerland. For instance, the once clear boundaries between private banking and asset management are becoming somewhat fuzzier, raising the risk of new competition for Swiss asset managers but also an opportunity to reach a new and vast client base. Another major opportunity – which also comes with pressure to adjust – is the sharp rise in private wealth, particularly in Asian markets.

2.3 Four basic areas of reform

The further development of the existing financial market strategy must concentrate on responding to the above changes in the framework conditions. According to the scope outlined in 1.2, the focus should be on regulatory aspects and not on the need for financial institutions to adapt their business models. The remainder of the report thus refers to only the first four of the above changes to regulatory challenges in the narrower sense. These dictate the four basic areas of reform, each of which was to be studied by a separate subgroup appointed within the group of experts. For each area of reform, we briefly outline the main issues to be addressed within the subgroup's remit.

2.3.1 Regulatory process

The main question here was how to maximise transparency and efficiency in the regulatory process and implementation of regulations, given the sustained pressure to adapt the legislative framework in the financial sector.

Specifically, the issue is whether and, if applicable, at what level and when those concerned by a new regulation could be included in the regulatory process and implementation of the regulation. This should not unnecessarily delay an expedient regulation and its implementation but should instead improve its efficiency and transparency through rapid implementation.

2.3.2 International market access

This concerns plausible measures to secure or expand access to the markets of Switzerland's main trading partners.

With a view to maintaining and promoting the value added of international financial activity in Switzerland, the need for additional measures to preserve or improve market access (cross-border and with a local presence) should be examined. In this context, the subgroup should also evaluate the extent to which the Swiss financial centre and its regulation should adopt more of a global orientation in the future and gear itself to the EU/EEA market and whether this raises any conflicts of interest.

2.3.3 Tax environment

The main adjustments regarding the tax compliance of foreign assets were previously formulated in the recommendations of the first group of experts. Of key importance in the remaining work are the possible changes to the specific features of the Swiss tax system that impede development of the financial sector.

The study asks whether and in what areas the tax treatment of financial transactions under Swiss tax law poses serious disadvantages on an international comparison. Specifically this concerns the tax obstacles in relation to withholding tax and stamp duty. The financial consequences for the state budget and further implications of a potential overhaul should be

examined in particular. At the same time, the possible implications of strategic tax-policy decisions in Switzerland and abroad should also be analysed.

2.3.4 Economic risks

The main point here is the effectiveness of the TBTF regime and the possible need for action, especially as the group of experts was tasked with the work with a view to evaluating the TBTF legislation in accordance with the banking law. Other potential risks to financial stability must also be taken into account.

Specifically, previous measures to contain the economic and systemic risks within the TBTF package are reviewed and any need for action is identified. Furthermore, the Swiss TBTF system is assessed with respect to international standards and the concrete measures taken by Switzerland are compared with the implementation of TBTF measures in some of the leading foreign jurisdictions. This section also examines whether and to what extent topics such as depositor protection, financial market infrastructures, insurance companies, shadow banks and tax-related debt incentives raise relevant questions for Swiss financial market stability and whether there is a need to take action.

3 Efficient organisation of regulatory processes

3.1 A comprehensive regulatory process

3.1.1 Introduction

Formally speaking, a regulatory process may be triggered by either the Federal Assembly (Article 160 Cst.) or the Federal Council (Article 181 Cst.). The onus is thus on the Federal Council to formulate and determine the strategies for the financial market and its regulation. In practice, this process is often initiated in response to political developments as a result of parliamentary motions, but may also be initiated by the Federal Administration or by market participants themselves. International legal developments and obligations under international law also increasingly act as triggers for legislative initiatives, with international standards having an ever greater impact on national legislation. In addition, expectations are growing within the relevant standard-setting organisations or bodies that Switzerland will (also) implement these standards. In its report in response to the Graber postulate (09.3209) of 16 December 2009 ("Strategic directions for Switzerland's financial market policy"²), the Federal Council found that regulatory measures in other key financial markets, particularly in the US and EU, were increasingly – and more rapidly – having an impact on Switzerland, and that Switzerland's systematic early recognition mechanism needed to be strengthened accordingly.

Based on the constitutional mandate of Article 94 (2) and (3) Cst.³ to defend the interests of the economy as a whole and create favourable framework conditions for private enterprise, the Federal Council set out the objectives and principles of financial market policy.⁴ These are also drawn upon in the regulatory process as the basis for efficient and effective regulation.

3.1.2 Adjustments needed

The regulatory process itself is governed as regards consultation by the Consultation Procedure Act⁵ and as regards the legislative procedure in Parliament by the Parliament Act⁶. In contrast, the monitoring of market behaviour and regulatory trends prior to the regulatory process in the narrower sense is not currently subject to any standardised or formal processes.

The early phases of the regulatory process (in the broader sense) are not legally structured. The available constitutional basis, laws and regulation principles to be applied throughout the entire regulatory process are thus addressed and implemented with insufficient consistency in the early planning and subsequent implementation phase, and also in the actual legislative procedure. A regulatory impact assessment thus typically kicks in at too late a stage. Preparatory conceptual work is neglected, potentially resulting in regulation being issued at the "wrong" norm level. The problem of time pressure in the regulatory process, which is often due to the accelerated momentum of international regulatory initiatives and the resulting need for regulatory adjustments, only allows for corrections to be made to a limited extent.

In the context of financial market regulation, there should therefore be a greater awareness of the fact that the regulatory process constitutes an ongoing and comprehensive procedure, beginning already with observation of the financial markets and the regulatory developments and trends (regulatory process in the broader sense). Already during this conceptual phase, in-depth norm concepts (including determination of the correct norm level and avoidance of excessively open delegation norms; if need be, a decision for the appropriate form of self-

² Report in response to the Graber postulate (09.3209) of 16 December 2009: Strategic directions for Switzerland's financial market policy (Graber Postulate Report), p. 61

³ SR 101

⁴ Cf. Report on Switzerland's financial market policy (Federal Council Report), p. 17 et seq.

⁵ SR 172.06; CPA

⁶ SR 171.10; ParlA

regulation) should be formulated and the Federal Council's regulatory principles should be considered.⁷

Implementation of the regulation should then be encompassed in this comprehensive understanding of the regulatory process. Implementation of the regulation refers to execution of the regulation, such as in the form of ordinances, circulars or memos from the supervisory body and the (recognised) self-regulation.⁸ However, implementation of a regulation does not include the concrete implementation of a specific regulation by the target entities of regulatory standards.

3.1.3 Recommendations

(1) Existing regulatory principles should be consistently applied and implemented throughout the regulatory process (in the wider sense of the term).

The understanding of the regulatory process must be expanded to a comprehensive regulatory process (in the wider sense of the term) that also covers the monitoring of market behaviour and of regulatory trends in the international environment, the decision on this basis regarding the need for regulation in the first place, and the actual legislative procedure within the meaning of the Consultation Procedure Act and the Parliament Act. The regulatory impact assessment, including the impact analysis, must also accompany the entire regulatory process in the wider sense. The comprehensive regulatory process thus also includes the implementation of regulation, during which the principles for execution of the laws and ordinances should be evaluated by the authorities.

(2) The review of compatibility with these principles should be conducted as part of the assessment of the need for regulation – for every regulatory project.

The general regulatory principles and the specific principles for financial market regulation should be observed in all phases of the regulatory process in the wider sense of the term. A test of compatibility with these principles should prevent unnecessary regulatory processes from even being started. When testing the need for regulation, the objectives of financial market policy – i.e. investor protection, protection of the financial system, and competitiveness – should be taken into account.

The regulatory process should therefore only be initiated once a clear need for regulation has been identified and with a view to meeting the objectives of financial market policy, i.e.

1. on the basis of indicators (e.g. events of particular significance, regulation by international bodies) and
2. based on the principles of financial market policy
3. a need for regulation is identified which
4. is necessary if the objectives of financial market policy are to be achieved.

(3) A complete norm concept should be drawn up for every regulatory project.

A complete norm concept should be developed by the authorities as early as the conceptual phase. To this end, expertise from both within and outside of the Federal Administration should be drawn upon. The Federal Office of Justice should be instructed to carry out preventative risk monitoring.

The hierarchy of norms and principles of legislative delegation should be observed. The key content of regulation, the fundamental decisions and the limits of delegation must be enshrined in formal law. In the interests of legal security and acceptance, the legislative basis should be formulated such that the implementing authority has clear guidelines when it comes to applying

⁷ Cf. Federal Council's report, p. 17 et seq.

⁸ See also the diagram at the end of Annex 1

the law. At the same time, however, the principle-based approach should essentially be retained.

Based on its specific mandate, the input of the Federal Office of Justice (FOJ) with respect to preventative legal monitoring should be sought by the Federal Administration at an early stage, i.e. before the actual issuance of decisions of general principle. In particular, the selected solution approaches (e.g. in the area of self-regulation) should be reviewed. Transparency must be ensured in the drafting process at an early stage, for example if it has not (yet) been possible to arrive at conclusive answers at the legislative level. Review or evaluation clauses (such as in the case of the TBTF regulation) or – to a lesser extent – "sunset" clauses⁹ may represent feasible approaches to a solution in specific cases. The repercussions of such mechanisms for other edicts need to be reviewed, however. In addition, sufficient introductory and transitional provisions/deadlines must be prescribed.

3.2 Institutionalised dialogue and the role of the Financial Centre Forum

3.2.1 Introduction

The involvement of market participants in financial market regulation¹⁰ is already enshrined at a constitutional level (Article 147 Cst.). This principle of participatory financial market regulation is implemented by law for the consultation procedure and within the context of the implementation of the regulation (Financial Market Supervision Act¹¹). FINMA and the Federal Department of Finance (FDF) have thus further defined this principle in guidelines and directives.

Internationally, too, a participatory financial market regulation is recommended. In its recommendations on regulatory policy and governance, the OECD Council recommends to "adopt an integrated approach, which considers policies, institutions and tools as a whole, at all levels of government and across sectors, including the role of the legislature in ensuring the quality of laws."¹²

Switzerland's Financial Centre Forum, which is chaired by the State Secretariat for International Financial Matters (SIF), currently involves the SNB, FINMA, the SBA, SIX, the SIA, the SFAMA, and now independent asset managers too. The Financial Centre Forum is responsible at a strategic level for fulfilling "early recognition functions" in particular and may also call upon other interest groups, depending on the subject field and need. The task of the Financial Centre Forum is to ensure the involvement of affected market participants when designing parameters and implementing financial market policy measures by means of institutional collaboration between the authorities and the private sector, thereby achieving needs-oriented and differentiated solutions.¹³

Intensive regulatory activity in the EU and the US in recent years has forced the Swiss financial centre to adjust its financial market regulation in order to secure market access and preserve its competitiveness. For reasons of competitiveness, certain market sectors are at times reliant on Swiss legislation being adjusted in line with international developments in a way that creates equivalency. In other words, the regulatory process in Switzerland can no longer be managed and understood at a (purely) national level. Also of considerable significance from this point of

⁹ Sunset clause: The legislation has only a fixed period of validity unless its continued validity is agreed within a set timeframe.

¹⁰ Depending on the extent to which regulatory initiatives affect them, non-financial companies may also be included in this process, e.g. in their capacity as issuers.

¹¹ SR 956.1; FINMASA

¹² OECD Recommendation 2012, Section I.2., p. 6

¹³ Cf. Federal Council's report, p. 24

view is the inclusion of market participants for a broad-based and accepted financial market regulation.

3.2.2 Adjustments needed

For practical implementation of participatory financial market regulation, there is a need for a systematic mechanism whereby market participants can also be involved in the early phases of the regulatory process outside of formal consultation. Significant time pressure can lead to situations in which regulatory planning – as well as the formulation of regulatory drafts – takes place only within the Federal Administration, without the appropriate involvement of affected parties at an early stage. Although Switzerland can at least draw on the experience and knowledge of the authorities when faced with the momentum of international legal developments, the specialist knowledge of market participants at a practical level is lost in such situations. It should be noted that, due to their network and the corresponding ease with which they can obtain information, market participants can make an important contribution to the early recognition of a need for regulation. If a need for action is detected in good time, the regulatory process will be initiated at an early stage and the time pressure can be reduced. As part of this dialogue with market participants and experts, to be structured and expanded, the Federal Council should continuously develop its basic strategy for financial market regulation.

It is important to bear in mind that the consistent and institutionalised involvement of affected market participants in the various phases of regulatory planning and in the implementation of regulatory projects also gives rise to certain responsibilities for market participants themselves. Their contribution throughout the regulatory process should be commercially and politically "neutral" in keeping with regulatory principles. "The economic policy of the Confederation (and the cantons) should preserve the interests of the Swiss economy as a whole...".¹⁴ Whereas the formal consultation procedure is envisaged as a mechanism through which particular interests can be flagged up, market participants must ensure that their vested interests do not obstruct the regulatory process or lead to any disadvantages for individual market participants (or market segments) in earlier phases of their involvement in the regulatory process. Well organised associations of market participants should not gain any advantages over smaller interest groups. As part of its mandate, the Financial Centre Forum must take care to ensure that the interests of the overall Swiss economy are pursued.

3.2.3 Recommendations

(4) The institutionalised dialogue between the authorities, market participants, and the world of academia should be expanded as well as specifically strengthened where the early recognition of regulatory developments phase is concerned. Offensive (i.e. proactive) communication and early project outlines will have the effect of strengthening this dialogue. The authorities, the world of academia and, at an earlier stage, market participants must all play their part in ensuring a constructive and objectivised dialogue.

The early recognition of regulatory developments both in Switzerland and abroad can be significantly optimised through an ongoing, institutionalised dialogue between authorities, market participants, the world of academia and, where appropriate, representatives of parliament. This dialogue should comprise a rolling form of regulatory planning with the involvement of market participants and academia, involving the setting of priorities that take into account the globalised environment. The authorities must structure this dialogue transparently and organise it in a way that ensures the appropriate representation of all involved parties. They pursue a transparent and offensive communication policy via the financial market strategy and planning of the Federal Council and the positioning of Switzerland in international bodies.

¹⁴ Cf. Federal Council's report, p. 17

On the other hand, the involvement of market participants must not lead to paralysis or to any one-sided influence on the planning or process of regulation (i.e. the danger of "regulatory capture"), but should remain aligned with the public interest. If Switzerland is to end up with regulation that is in keeping with its regulatory principles, market participants must be in a position – particularly at the early recognition stage – to avoid conflicts of interests, or must at least disclose such conflicts. The early involvement of market participants should also not lead to a situation in which better-organised entities obtain an advantage and influence regulation in a way that is favourable to them. The interests that are specific to a market participant should not be raised until the consultation stage.

(5) The Financial Centre Forum should act as the coordinating party in the dialogue on questions of financial market regulation. Its mandate will need to be clarified accordingly. Finally, the composition of the Forum should be adjusted so that all involved market participants are appropriately represented.

In future, the Financial Centre Forum should act as the point of coordination for the dialogue on regulatory issues between the authorities and market participants. Subsidiary working groups should be formed to draw up findings and recommendations on behalf of the Financial Centre Forum, whereby the composition of these subgroups may vary according to the issue being tackled. The expanded institutionalised dialogue at the early recognition stage should be coordinated with the mandate of the Financial Centre Forum.¹⁵ The findings that emerge from this dialogue need to be utilised and managed, while the organisation and the mandate of the Financial Centre Forum should be specified with this in mind. The composition of the Forum should be adjusted so that all involved market participants are appropriately represented.

Switzerland's financial market policy and the associated intention of the Federal Council should be communicated such that it is perceived as consistent and credible outside Switzerland. For its part, the FDF should involve the private sector and collaborate with the Federal Department of Foreign Affairs (DFA) – in particular Swiss representative offices abroad and Presence Switzerland – in drawing up and implementing appropriate communication strategies and concepts.¹⁶

3.3 The role and structure of the impact analysis and the regulatory impact assessment (RIA)

3.3.1 Introduction

Whereas an impact analysis has to evaluate the costs and benefits for individual market participants and the financial market as a whole at every phase of the regulatory process, the RIA also covers a comprehensive evaluation of the need to act, alternative regulations, and the expediency of implementation. The results of the impact analysis are set out in the RIA and summarised transparently in the dispatch.

The obligation to conduct an impact analysis and draw up an RIA in the legislation process is derived from the Federal Constitution¹⁷ and the Parliament Act¹⁸. According to the recommendations of the OECD¹⁹, ex post evaluations should determine the need for regulation, how to deliver the intended policy objectives in the most effective and efficient way,

¹⁵ Cf. Report on the Graber postulate: Point 7, p. 60 et seq.

¹⁶ Cf. Federal Council's report, p. 24

¹⁷ See Art. 5 (2) and Art. 170 Cst.

¹⁸ See Art. 141 (2) ParlA

¹⁹ RIA Handbook (<http://www.seco.admin.ch/themen/00374/00459/00465/04053/index.html?lang=de>).

and consider alternatives to regulatory solutions. FINMA regulation applies the regulation principles as per Article 7 FINMASA, which also consider the cost impact on involved parties.

The legislative guidelines of the FOJ require that an impact analysis be made as early as the concept stage, and should have an influence on the shape of legislation as the draft develops. The execution of an impact analysis may therefore prove necessary at any point in the entire regulatory process in a wider sense.

However, there is no specific point in time that is ideal for the RIA in every respect. For as long as no preliminary draft of the proposed legal provisions exists in the early phase of the legislation process, there is still great uncertainty over the precise structuring of legislation, and therefore over the potential repercussions of the measures to be taken. Once formulated drafts and commentaries on the legislative provisions are available, an analysis of repercussions is easier to undertake. By this stage, however, the alternative options that it would be appropriate to explore are often much more limited. Moreover, the tasks involved in carrying out an RIA are becoming more challenging and more comprehensive, not least due to regulatory developments abroad. The implementation of normative guidelines with respect to the RIA therefore relies on market participants making relevant impact analysis information available and contributing as a "sounding board" for provisional results. One of the greatest challenges facing impact analyses is thus also the procurement and evaluation of relevant data. Ideally data should be obtained empirically, be of high quality (validity, reliability, accuracy), be taken from neutral and independent sources (no distortion by interested parties), have a high degree of meaningfulness in its application, and require low resources for its capture. In addition, an RIA must be objective and balanced.

3.3.2 Adjustments needed

Particularly in connection with more recent regulation projects, the industry regretted the fact that the RIA is conducted so late in the regulatory process and rather superficially. In the industry's view, there seems to be a lack of genuine interaction between impact analysis and the selection of regulatory instruments. It is likewise unhappy about the lack of involvement of market participants capable of evaluating the impact of various measures from the industry perspective.

As part of the clarification of the need for regulation, the decision as to whether such a need for action exists should be based on overarching economic cost/benefit considerations. After a decision in favour of regulation has been made, the ensuing regulatory process should be supported by an impact analysis that evolves in parallel with legislation. In other words, impact analysis considerations should be continuously drawn on as the legislative draft develops. The ongoing process of impact analysis with a view to drawing up an RIA must involve an overall economic perspective and should set out the corresponding costs and benefits. The economic consequences for market participants and the competitiveness of the Swiss financial centre should be explained, and a comparison made with the results of regulation implemented in rival financial centres. Moreover, the impact analysis should also draw on the evaluation of existing regulations (review clauses). In this context, a review should be undertaken as to whether the objectives set were actually achieved.

3.3.3 Recommendations

(6) The impact analysis/RIA should be consistently implemented throughout the regulatory process, in a form suited to the phase in question. The results should be presented and communicated transparently.

Whether and how these financial market policy objectives could be achieved with the proposed tools should be studied as part of the impact analysis. The risks associated with a regulatory adjustment and the corresponding costs and benefits need to be analysed. The regulatory

authorities should seek to ensure that the regulation has maximum effectiveness and differentiation.

It is recommended that analyses should be commenced in the early phases of the legislative process (elaboration of project outline, report) with a view to carrying out the RIA and should then continue the analysis in greater depth in the course of the legislative process. The initial results from these analyses should be set out in the explanatory report during the consultation period, thereby ensuring that these are already available as part of the consultation documentation during the interdepartmental discussion phase. The results of the concluding phase of the RIA should be set out transparently in the dispatch or in the formal application to the Federal Council.

Just like any analysis, an RIA will benefit from both interaction and critical reflection. It therefore makes sense to involve a number of different authorities and industry representatives when drawing up an RIA. The outsourcing of the drafting of the RIA (e.g. to a university) may be the only way forward if there is little specialist knowledge of the subject, if great resistance to regulation can be expected, or if the administration lacks the necessary resources. However, in such scenarios, the independence of the commission experts should be ensured to the greatest degree possible. Moreover, the language used in the RIA must remain comprehensible for a non-specialist (or less specialist) audience.

It should be noted, however, that the performance of impact analyses and the RIA are subject to the principle of proportionality. Moreover, it is important to bear in mind that this work requires the provision of adequate resources by the authorities as part of an ongoing regulatory process.

3.4 Implementation of regulation

3.4.1 Introduction

The implementation of regulation begins after the edicts have entered into force in general-abstract form. This phase of the regulatory process therefore faces the question of which principles the executing authority should apply when implementing federal acts and ordinances, and how the affected market participants will put these into practice.

There are different courses of action available to an authority in the fulfilment of its tasks. These will depend on whether a legal or material outcome is intended, whereby different procedural rights will apply. Regulatory administrative actions that take the form of legal acts are intended to bring about a direct legal consequence (e.g. edicts, decrees). "Material acts" are administrative acts that are aimed at producing a specific "physical" result and may have indirect legal effects.

Also in the implementation of regulation, the regulatory principles and the FINMA Guidelines as well as the generally valid principles of administrative law (e.g. the sparing use of legislation) should be followed consistently. The feasibility should already be factored into considerations during the regulatory planning stage. Clear transitional provisions should be drawn up that give the affected parties sufficient time to adjust their internal processes, systems, and regulations, and if necessary inform their clients. The impact analysis should then be conducted with regard to the effectiveness and efficiency of the regulation in the context of implementation. The continuation of institutionalised dialogue between authorities, market participants and academia also forms part of this phase of the regulatory process.

Moreover, the basic principles of administrative law enshrined in the Federal Constitution are binding for all activities of the state, and therefore also apply to the activities of the enforcing

authorities. This includes the principles of legality, public interest and proportionality,²⁰ equality of rights²¹ and the principle of good faith.²²

The Federal Financial Market Supervisory Organisation (FINMA) is responsible for supervision as per the financial market laws.²³ FINMA must take the measures and issue the decrees required to implement the financial market laws.²⁴ It must inform the public about its supervisory activity and practice.²⁵ In accordance with the regulatory principles under supervisory law, the regulation must be made through "ordinances where this is prescribed in financial market legislation" and "circulars on the application of financial market legislation".²⁶ These regulatory principles must be set out in guidelines.^{27 28} The implementation of regulation in the narrower sense is promoted by FINMA through information, training and FAQs.²⁹ FINMA's guidelines also prescribe an impact analysis for regulations passed by FINMA.³⁰

3.4.2 Adjustments needed

FINMA executes financial market regulation by applying statutory provisions in individual cases. In its circulars it then explains its administrative practice to the entities subject to legislation. Circulars do not have the character of legislative edicts, which impose obligations on supervised entities in a directly binding and general-abstract way, confer rights, or establish responsibilities.³¹ Moreover, FINMA communicates its position on important topics or questions in the form of working papers or position papers, or through the medium of Frequently Asked Questions (FAQs).

Although communications do not give rise to legal consequences and are not legally binding for the target entities, they have an indirect legal impact insofar as they make it clear to the affected parties what decision FINMA would arrive at, e.g. in response to applications. Communications of this kind should therefore remain strictly in line with the legislative mandate. The communication activity of an enforcement authority should never replace the process of legislation. However, transparent communication in the implementation of regulation increases the legal security for the supervised entity.

3.4.3 Recommendations

(7) The executing authority should periodically review its communication concept that explains the function of the various forms of communication in a transparent manner. Market participants should be involved in this process where possible.

Communications from the executing authority that are not legally binding (working papers, position papers, FAQs) should be designated as such and used with restraint due to their effect in practice. FINMA may thereby neither replace nor supplement the established legislative process. The boundaries of authority as delegated by the legislator may not be exceeded. Institutionalised dialogue must also be conducted in planning regulator implementation. FINMA published guidelines on communication 30 October 2014.³² Based on initial experience with

²⁰ Art. 5 Cst.

²¹ Art. 8 Cst.

²² Art. 5 (3) and Art. 9 Cst.

²³ Art. 6 FINMASA

²⁴ Art. 56 FINMASA

²⁵ Art. 22 (1) FINMASA

²⁶ Art. 7 (1) FINMASA

²⁷ Art. 7 item 5 FINMASA

²⁸ See <http://www.finma.ch/d/regulierung/gesetze/Documents/leitlinien-finanzmarktregulierung-20130703-d.pdf>

²⁹ FINMA Guidelines, sentence 16

³⁰ FINMA Guidelines, sentence 17

³¹ Cf. FINMASA dispatch, BBI 2006 2861

³² Cf. <http://www.finma.ch/d/aktuell/Seiten/mm-leitlinien-enforcement-kommunikation-20141030.aspx>

the new communication concept, this should be subject to an evaluation. Where possible the market participants should be involved.

4 Preserving and improving market access

Access for Swiss financial services providers to foreign markets is crucial for upholding the competitiveness of the Swiss financial centre. Switzerland should be able to safeguard its position as one of the world's leading financial centres and consolidate that position in the future. The further development of the domestic market and that of international business are both of equal significance. On the one hand, the domestic framework conditions need to be enhanced; on the other hand, Swiss financial intermediaries rely on good conditions to access foreign markets. The latter is of particular importance when providing services from Switzerland to retail clients having their permanent or temporary residence in another country. Also of importance is international business in the commercial client segment or investment banking and in asset management for institutional clients. Access to international markets is a priority for the financial market infrastructure too, as this sector generates in certain business areas a substantial portion of its revenue abroad, mainly in the EU or with EU clients – locally and also from Switzerland. The objective of making market access as free as possible is also strongly supported by insurance companies, which generally run their business by way of a local presence on site.

The basis for the group of experts' deliberations and their recommendations regarding market access was formulated and prepared by the subgroup dedicated to this topic. Throughout 2014, the subgroup examined current and future challenges concerning market access for the Swiss financial centre as well as Switzerland's scope for action in this respect. This work was supplemented by a detailed discussion on possible improvements in marketing the Swiss financial centre as a support measure.

The group of experts assumes that the Swiss financial sector will find it considerably more difficult in the future to secure cross-border access to foreign markets, especially for banks and asset managers operating primarily in the retail customer business, but also for the financial market infrastructure. Even a complete closure of certain markets to providers operating from Switzerland may be conceivable as a result of other countries' (supervisory) legal requirements. The speed at which such a deterioration of the situation could occur and the business areas worst hit in this case cannot be determined with any certainty at present. Despite such uncertainty, however, a trend can be observed and indicates a need to take action.

The group of experts has thus come to the conclusion that, if the Swiss authorities fail to take extensive measures beyond previous incursions into financial market policy, we can expect to see a deterioration in market access conditions for the provision of financial services to clients resident abroad. Heightened and at times quite substantial difficulties with market access – together with other factors such as the transition to the automatic exchange of information (AEOI) in tax matters – accelerate the need for a thorough review of the business model of Swiss financial services providers and may influence investment decisions to Switzerland's detriment, leaving a large number of jobs at stake in the financial sector and beyond. A partial or complete loss of access to the EU/EEA and other major markets in key business areas would thus have far-reaching consequences for the economy as a whole.

Preserving market access requires political agreement with the partner authorities of the EU and other key countries of importance for the Swiss financial industry. Unilateral action alone is not enough to preserve or improve market access. There is also a need to limit the potential for discrimination, following the referendum on restricting the free movement of persons (acceptance of the popular initiative "Against Mass Immigration" on 9 February 2014).

The group of experts therefore considers it crucial that Switzerland should make active and immediate use of its scope for action in respect of market access. It favours a solution that pursues the different options simultaneously, allowing for the different timeframes for their realisation.

It should be noted that the recommendations formulated by the group of experts do not circumvent the Swiss political opinion-forming and regulatory processes and do not anticipate any such changes in direction at a national level. The issues to be weighed up in these processes include appraisals of the need for regulation and the economic impacts (i.e. cost/benefit considerations, taking account of the extent to which the various stakeholders in the financial centre and the economy are affected). Such trade-offs will ultimately determine whether the options outlined below are deemed desirable from an overall point of view.

4.1 Structure of the relationship with major partner countries and alignment with international standards

4.1.1 Introduction

Switzerland may sign inter-governmental agreements with other countries as it implements its financial market policy in relation to other countries, e.g. to preserve and improve market access. This is ultimately with a view to improving the current situation for Switzerland through a reconciliation of interests between the negotiating partners. Only in recent years has Switzerland begun to seek contractual adjustments or specifications of market access conditions, especially in cross-border business, for Swiss financial services providers. This can and should also increase the legal security. This is typically undertaken in the context of regulating overall relations in the financial sector, including tax aspects, with the relevant country. A standalone agreement to improve market access is already in place with Germany. Market access agreements that specify the legal requirements for Swiss providers have also been signed with Austria and the UK as part of the withholding tax agreements. However, individual EU member states are free to conclude such inter-governmental agreements with third countries, like Switzerland, as long as the EU has not assumed exclusive responsibility in this area.

Preconditions for Switzerland's partner countries to grant Swiss firms market access or even simply to abstain from setting barriers are generally a level of customer protection comparable to that under their national law and conformity with internationally recognised standards (e.g. for anti-money laundering regulations) in the financial sector and in tax cooperation. The increasing importance of such international standards has emerged from the global orientation and extensive interconnection of financial markets. To guarantee or promote conformity and implementation in the individual states, the international institutions and committees such as the FSB, the IMF or the OECD have introduced various instruments, ranging from country reports/reviews to blacklists. While standards are not legally binding, given their status as "soft law", they are instrumental in determining the national financial market regulation. Depending on the political significance of a standard, non-conformity may pose substantial reputational risks to a country, or more specifically its companies, and result in costly, undesired obstacles to market access.

4.1.2 Adjustments needed

The signing of inter-governmental agreements with selected countries in and beyond Europe, including emerging markets, is an effective means of securing market access for financial services within the meaning of reciprocal market opening. Negotiations with interested partner countries of Switzerland on the transition to AEOI may offer a framework to promote this.

With respect to EU member states, the introduction of harmonised EU market access rules has drastically lowered the importance of national access rules for Swiss financial services providers. In the revision of the MiFID guidelines (MiFID II), however, the EU did not impose harmonisation for retail clients – which encompasses the entire private banking business – by way of a general requirement to establish a branch for third-country firms. Market access in this segment will continue to be regulated by the EU member states. This scenario offers Switzerland the possibility of entering into bilateral market-access agreements with EU

member states without the requirement to establish a branch; such agreements could preserve or improve market access for financial intermediaries in the retail business within the EU. Nonetheless, the actual scope for action with such bilateral agreements cannot be determined conclusively as it depends on national market-access requirements, and few countries today have liberal access opportunities by law. Should a member state introduce the requirement for a branch, the EU-wide harmonised requirements also apply to that branch's retail business. Moreover, the feasibility of such agreements depends on the countries' willingness to enter into negotiations. In this respect, the bilateral relationship with individual negotiation parties could also be compromised by the question of free movement of persons with the EU.

The financial crisis triggered a host of international regulatory activities to strengthen systemic stability and depositor protection that also affect and increasingly hamper cross-border financial business. Implementation of the G20's financial regulatory reform has led to an increase in the speed and intensity of regulation in all relevant financial centres. The rise in internationally aligned requirements is accompanied by a de facto reduction in individual countries' scope for action. The globally oriented financial industry is nonetheless well served with globally unified rules, e.g. in the form of international standards, as these harmonise the regulatory requirements and ensure a level playing field for all providers.

As a leading global financial centre, Switzerland must actively participate in the formulation of international standards for the financial industry. This requires a consistent representation of Swiss interests in the main standard-setters' committees and also includes maintaining a high level of shared rules of procedure. Switzerland already makes a substantial contribution on international committees to the drafting, elaboration and monitoring the observance of the relevant standards (e.g. recently in the IOSCO Task Force on Cross-Border Regulation). Participating in international committees enables Switzerland to influence their decision-making and to present its relevant experience at home and the corresponding impacts. This also raises opportunities to form alliances and gain international acceptance for Swiss regulations.

4.1.3 Recommendation

Switzerland is seeking to negotiate agreements with selected major partner countries with the goal of preserving and improving market access for Swiss providers at a bilateral level. It is a credible negotiating partner by aligning its regulation to international standards and actively participating in the international initiatives and processes in financial market regulation, e.g. as a member of the Financial Stability Board and the various standard setters.

Agreements on market access with key partner countries should follow the principle of reciprocity regarding direct access to the market in question, based on equivalent regulation and supervision. Regarding customer and investor protection, the provisions in the provider's country of origin should be recognised as equivalent and thus sufficient for market access. The goal is to obtain agreements that create economic prospects. Priority is given to the most important European countries for Swiss-based financial business. However, there is also growth potential for the Swiss financial industry in emerging markets, which may be developed through inter-governmental agreements. The issue of market access should be introduced, for example, in the context of talks on the introduction of AEOI with the partner countries. Given the trend towards greater protection of domestic markets, such bilateral agreements will probably not be easy to achieve.

Pursuing the objective of bilateral agreements calls for detailed, up-to-date knowledge of financial-market law and the relevant provisions under supervisory law in the partner countries. Such country-specific know-how, which should mainly refer to Switzerland's key neighbours as well as the US and the leading emerging markets, needs to be scaled up within the relevant authorities.

Switzerland's regulation and supervision should be aligned with internationally recognised and widely used international standards in finance as a means of underpinning Switzerland's position in negotiations with other countries and ensuring a level playing field in international competition. This seems particularly relevant in relation to meeting due diligence obligations, including anti-money laundering efforts, systemic stability and cooperation with the supervisory bodies. Switzerland should therefore optimise and intensify its opportunities to exert influence on the further development of regulatory standards.

Effective participation in the relevant multilateral processes requires not only technical knowledge and a strong set of arguments but also constant, long-term commitment. Knowledge of the functioning of the various committees and increased efforts to cultivate relationships are important factors in making Switzerland's concerns heard. Given the importance of this approach in representing Swiss interests, the competent authorities must further build their capacity in this respect.

4.2 Equivalency approach to financial market regulation in the EU/EEA

4.2.1 Introduction

As is the case with many jurisdictions, the EU also initiated an extensive reform of financial market regulation in the wake of the financial crisis. One of the European Commission's objectives in undertaking this work is to harmonise the national market-access conditions, highly fragmented in some cases. To a certain extent, access by third-country firms to the EU/EEA market in areas in which harmonised market-access rules are created (e.g. under MiFID II/MiFIR in business with professional clients, but not in serving retail clients) depends on whether that provider's home country has a regulatory and supervisory framework deemed to be equivalent to that of the EU. This curtails Switzerland's scope for action in respect of bilateral agreements with individual EU member states, bringing it under pressure to enshrine equivalent standards in national law in certain areas. If Switzerland were to lose access to the EU financial market in such important areas, this would likely have far-reaching consequences on its competitiveness as a financial centre or on individual groups of financial services providers. Conversely, this approach also offers Switzerland certain advantages by allowing third-country firms to enjoy the same conditions of competition. A third country such as Switzerland may also apply for recognition of equivalency specifically in those areas offering high added value and earnings potential in cross-border business. As a rule, however, the equivalency approach allows only limited and incomplete access to the EU market (i.e. not the same as for the individual EU member states). Also, while the autonomous creation of equivalency is a prerequisite for improved market access, this alone is not sufficient without the corresponding steps being taken by the opposite party. In any case, not all tests of equivalency are in association with market access. It is true that, with the equivalency approach, Switzerland retains autonomy of action in the decision as to whether it wishes to align Swiss legislation with the EU counterpart. In essence, however, it has no real influence on how EU regulation will be shaped and whether the EU or individual member states will actually grant improved access on the basis of its autonomous alignment.

4.2.2 Adjustments needed

Even if the EU's application of the equivalency approach for Swiss financial services providers does not actually guarantee access to the EU/EEA market, it is a reality and should play a role in Switzerland's efforts to improve market access wherever this serves to preserve access or there are good prospects of improving access. In order to preserve market opportunities for the Swiss financial centre abroad and avoid reputational risks while still exploiting the scope for action at a national level, Switzerland is obliged to consider in its regulatory process both the development of internationally recognised standards as well as the legal developments of its main trading partners, specifically the EU.

The equivalency requirements imposed on third countries in respect of regulation and supervision imply that Switzerland should obtain market access if it fulfils the corresponding requirements unilaterally set by the EU. Here too, however, there is no entitlement to recognition of equivalency. Moreover, equivalency is not uniformly defined; it is not a certainty and, depending on the regulation, may range between a legal alignment that is true to the letter and a results-based examination. From Switzerland's viewpoint, this absence of clarity can result in significant legal uncertainties. What's more, there is no guarantee that equivalency, once acquired, will remain valid in the future. In view of the continuous further development of financial market regulation in the EU, an even more restrictive structure of the current or new third-country regimes cannot be ruled out.

It is the European Commission and not the European supervisory bodies that decides on recognition of equivalency of a third country's financial market regulation and supervision. With increasing harmonisation of EU market-access rules for third-country providers, such questions are becoming more prevalent in the political context of relations between Switzerland and the EU as a whole.

4.2.3 Recommendation

Switzerland strives to achieve regulation and supervision that is equivalent in substance to that of the EU/EEA in areas in which this is desirable from the Swiss point of view to maintain market access, while exploiting its scope for action at a national level. It seeks dialogue with the EU to examine ways that acknowledge the Swiss approach and make the procedure for recognition of equivalency of the corresponding Swiss legislation more transparent, fast and predictable.

Equivalency, within the meaning of Swiss regulation and supervision recognised as equivalent to EU rules, should be a priority objective in national reform projects where this is necessary for recognition of equivalency under the relevant third-country regime in EU law and desirable from the Swiss point of view. Such an overall assessment should also estimate the need for regulation and the impact of regulation from an economic viewpoint. Switzerland should make consistent use of its national scope for shaping regulation where this is deemed appropriate. In such areas, the regulation should be aligned in particular with international financial standards and the legal developments in important partner countries so as to secure its international acceptance with a view to market access.

At the same time, and in connection with its equivalency approach, Switzerland should seek dialogue with the European Commission to achieve improvements in the process for recognising equivalency in the case of Switzerland. It should be ensured that a rapid, impartial examination and recognition of the equivalency of Swiss regulation and supervision is conducted by the European Commission, i.e. first or at least in the first group of third countries. An understanding with the EU should be sought to safeguard the predictability of the process and improve the legal security for all those involved. As a minimum, equivalency with other third countries should be requested within the context of these recognition processes. Furthermore, in areas in which alignment of Swiss law is sought, involvement in the work of the EU supervisory authorities regarding equivalency-relevant EU regulations should be at an early stage. Switzerland's concerns related to the EU-internal process should also be raised in the context of talks on the introduction of AEOI with the EU.

If the equivalency approach is to be implemented credibly, this requires an ongoing comparison of the Swiss legal situation and reform plans in the financial sector with the relevant legal developments at EU level, particularly concerning the EU's third-country regime, and other important non-EU countries (i.e. third countries from the EU's point of view, such as the US). The specialist know-how required in this respect should be further built up by the competent authorities.

4.3 Option of a sectoral agreement with the EU on financial services

4.3.1 Introduction

This option focuses on an international agreement between Switzerland and the EU to improve market access that would be restricted to the financial sector. Such a sectoral financial services agreement (FSA) would cover both freedom of establishment (discrimination-free establishment of local branches) and the provision of services (cross-border service provision). An FSA would require substantial adjustments to Swiss law in accordance with the EU acquis and would take a relatively lengthy period of time to be realised.

An FSA would fundamentally improve and secure long-term access to the EU financial services market and legal security concerning this market for Swiss providers. In concrete terms, following the signing of an FSA concerning the relevant EU acquis in the financial market area, Switzerland would be on an equal footing as EFTA-EEA states with regard to market access and would no longer be classified as a third country. This would help to retain and possibly also create value added and employment in Switzerland and, at the same time, strengthen Switzerland's economic relationships with its most important European trade partners in general. This market access is uncertain today and could deteriorate at any time. In some areas it depends on a positive equivalency decision from the EU, although the possibility of such decisions also being influenced by political considerations cannot be ruled out.

The provisional study of the economic impact of an FSA indicates that the reciprocal market opening for the EU in association with an FSA would likely have a positive impact on the Swiss economy ("free trade effect"). The impact of stronger legal security was also assessed as being positive. In contrast, adoption of the EU acquis, also in association with an FSA, should be regarded as a cost factor. This may entail direct or indirect costs both in the financial sector as well as for other sectors and affected parties (e.g. non-financial firms, the public sector, social security funds, the general population). Unless under a statutory exemption, an FSA in the field of occupational pensions, for example, would lead to substantial adaptations (the currently predominant form of "enveloped" solutions would be rendered impossible). The complex legal and economic questions on the impact of an FSA cannot yet be conclusively answered and would have to be further discussed in talks with the EU. The outcome of an evaluation of the consequences of an FSA would depend heavily on how the current EU market access develops and whether – as part of negotiations in certain areas – exceptions could be made, and to what degree Switzerland would be asked to adopt elements of the EU's horizontal acquis, as well as possibly other associated measures.

4.3.2 Adjustments needed

In the context of an FSA, Switzerland would have to adopt the relevant sectoral EU acquis in the financial market area (institutional regulations pertaining to banks, financial conglomerates, financial market infrastructure and insurers as well as product/service-related regulations) and possibly also parts of the horizontal, cross-sector EU legislation. Adoption of the sectoral acquis would take place dynamically, i.e. the corresponding adjustments to the EU acquis covered by the agreement would be implemented by Switzerland while at the same time preserving its own national legislative process. On the other hand, Switzerland would also have the possibility of participating in the drafting of new EU law in the financial services area as an observer without voting rights. If need be, regulations on the basis of reciprocal recognition of equivalency and exceptions could result from negotiations. In the area of the horizontal EU acquis, equivalency could possibly be asserted by the Swiss side. The transitional provisions and deadlines for enforcement of an FSA would be subject to negotiation.

Switzerland could continue to enter into bilateral agreements in the financial sector with third countries (non-EEA states) but would still be bound by the EU law adopted through the FSA and any third-country provisions therein. With respect to non-EEA countries, Switzerland would

still have regulatory scope for action, and thus an opportunity for differentiation, in those areas where EU law also leaves its individual member states such scope.

4.3.3 Recommendation

Switzerland seeks dialogue with the EU to further clarify the formal and material aspects of a possible agreement on financial services. It submits a request to this effect to the European Commission for exploratory talks on such a sectoral agreement.

Switzerland should further explore the possibility of a sectoral financial services agreement with the EU as a medium-to-long-term option for action. Such a contractual agreement would allow Swiss financial services full access to the EU/EEA market and thus also long-term legal security for cross-border business. In turn, Switzerland would be expected to adopt the relevant EU acquis in the financial market area and probably also parts of the horizontal cross-sector EU acquis. The precondition for concluding such an agreement would most likely be a consensus on an institutional agreement and most probably also a solution with the EU on the issues regarding freedom of movement of persons.

To obtain greater clarification of the technical feasibility and possible structure of any such financial services agreement with the EU, Switzerland should seek exploratory talks with the European Commission; a request to this end should be submitted to the European Commission. This matter of concern to Switzerland should also be raised in the context of talks on the introduction of AEOI with the EU. The findings from the proposed talks may support the opinion-forming process in Switzerland and improve the knowledge base for any further decisions at a political level. The decision on how to proceed, with a view to a possible sectoral agreement, should be evaluated in the political process in Switzerland, i.e. also from an economic standpoint.

In order to pursue the possibility of a financial services agreement with the EU, detailed knowledge of the EU acquis and its relationship to Swiss law would be necessary. This know-how should be further built up within the competent authorities.

4.4 Strong international positioning of the Swiss financial centre as a support measure

4.4.1 Introduction

Switzerland as a financial centre has repeatedly been associated in the past with undeclared funds or dictators' assets, despite the efforts made by the sector and the authorities. In contrast, there seems to be sparse public reporting and thus very little awareness abroad of the measures actually taken by Switzerland, particularly regarding anti-money laundering efforts or in connection with the freezing, confiscation or restitution of dictators' assets, but also concerning the advantages of the Swiss financial centre (infrastructure, human capital, legal security, currency stability, regulatory framework, etc.) and the sector's overall performance. The transition to AEOI offers an opportunity to highlight these measures and the advantages of the Swiss financial centre and to bring a lasting change to people's perception for the better.

4.4.2 Adjustments needed

A coordinated approach by the industry, with common instruments, may provide additional, effective support to the authorities' efforts to facilitate access to foreign markets. To help boost demand for high-quality financial services from Switzerland, representatives of the Swiss financial centre based abroad should make a more prominent effort to inform about the advantages of the Swiss financial centre as a whole as well as its regulation and supervision. Such communication should be consistent, facts-based and uniform. Nonetheless, the strength

of the framework conditions in Switzerland remains a precondition for credible communication and a sustainable improvement in Switzerland's reputation.

Apart from aspects of communication, there is also potential for improvement in the organisation and coordination of marketing activities. A comparison of the marketing activities of the leading global financial centres in other countries, based on a survey at the Swiss representations in those countries, shows that no uniform approach is taken to the marketing of financial centres. The comparison covered primarily the organisation and financing of those responsible for marketing, the relationship between the bodies responsible for marketing and strategy, and the distribution of roles between the private and public sectors. The marketing strategies differ from country to country, based on historical and structural circumstances. The survey also revealed that, from an organisational standpoint, a distinction can be made between a sector-neutral approach (i.e. basically applicable to any sector) and a sector-specific model. Whereas the sector-neutral approach entails several players operating simultaneously and in parallel, the sector-specific model has a single player, usually an agency, coordinating a uniform and coherent effort. Thus, the financial centres of London, Luxembourg and Singapore have an agency or authority for a thematically and geographically focused marketing approach. It was also noted that intensive consultation and cooperation between all players, and particularly between the strategic bodies responsible for the financial centre and the offices responsible for marketing, is a key factor in an effective marketing campaign.

In Switzerland, many different players from the private and public sectors are currently active by various means in the marketing of the Swiss financial centre; this situation is not always conducive to an effective and uniform image. A more aligned and coordinated image of the financial centre as a unit should be sought. The onus for introducing measures for improved coordination and organisation of marketing activities lies primarily with the sector itself.

4.4.3 Recommendation

Switzerland is improving its positioning abroad as a financial centre through the effective coordination of the state and financial sector, a uniform appearance and active communication on Switzerland's transition to the automatic exchange of information (AEOI) in tax matters. The financial sector should examine which organisational measures would be appropriate to ensure more effective marketing and present its proposals in this respect.

A more offensive marketing campaign abroad by the Swiss financial centre may provide additional support to Switzerland's efforts to gain and maintain market share. Measures in this area should primarily be taken or initiated by the sector itself. The sector should thus examine measures that promote and support coordination between all participants and a uniform appearance of the financial centre.

The state should take a leading role in the further development of Switzerland's framework conditions and the strategy for the financial centre, with the involvement of existing consultation committees. It may also lend its support by, for example, opening doors to foreign public authorities. Switzerland should examine a case-specific, closer integration of the private sector in Switzerland's official relationships with foreign partners (e.g. increased involvement of diplomatic missions, participation of private-sector representatives on the edges of official financial dialogues).

The positive perception of the Swiss financial centre should be enhanced by way of active communication against the backdrop of Switzerland's transition to AEOI. Such communication should underscore the advantages of the Swiss financial centre as an overall client solution, comprising traditional values and strengths (legal security, currency stability, infrastructure, cultural affinity, etc.) as well as the aspect of data protection.

A comparison of marketing activities by the leading global financial centres in other countries has revealed huge organisational differences between them. The sector should examine these models with the goal of achieving the coordination and organisational improvements appropriate to Swiss circumstances. Aspects to be considered should include, for example, the creation of a privately funded coordination body and/or an agency that ensures the sector has a unified appearance and makes a focused lobbying effort abroad in parallel with Switzerland's strategic objectives.

5 Improving the tax environment

5.1 Facilitating the capital market by restructuring the withholding tax

5.1.1 Introduction

Swiss capital market poorly developed for debt paper

Compared internationally, Switzerland's market has been developing less dynamically for some time as Swiss groups have primarily been issuing bonds abroad over the last 20 years. The figures speak for themselves: the volume of outstanding debt securities issued on the Swiss capital market rose between 1993 and 2003 by only 2.0% p.a. on average and then by 3.4% p.a. between 2003 and 2013.³³ Meanwhile, the volume of outstanding foreign bonds of Swiss groups³⁴ increased by an average of 22.4% p.a. between 1993 and 2003 and still by 9.4% p.a. from 2003 to 2013. Such growth rates were even higher than those on the global international capital markets, which expanded during the same periods by 17% and 8.9% respectively.

The reason for this increase is that foreign bonds of a Swiss group guaranteed by the Swiss parent company are not classified as domestic issuance as long as the proceeds from the issuance are not repatriated into Switzerland. Consequently, these bonds are not subject to withholding tax, making them more attractive to investors than domestic bonds, the interest on which is subject to withholding tax. The domestic debt securities market is therefore mainly limited to bonds issued by Swiss public bodies and private-sector companies that invest the proceeds in Switzerland.

Role of withholding tax with respect to the different interest groups

Interests of the financial centre

The key interest of the Swiss financial centre is to enable capital to be raised and issued at competitive tax conditions in Switzerland. To date, issuance has largely been made abroad, also in the case of domestic debtors or guarantors. In this regard, there is also the interest of placing capital for Swiss companies (securities underwriting). Particular problems are raised by the issuance of bail-in bonds from Switzerland and the future handling of CoCos (contingent convertible bonds) and write-down bonds. These matters need to be urgently addressed. The new bail-in bonds conceived by the Financial Stability Board (FSB) are expected to be passed in the near future.³⁵ It can be assumed that the concept of bail-in bonds by FINMA or the Financial Stability Board will require a very high domestic issuance volume, for which – according to representatives of the financial centre – there is not a sufficiently large market for bonds subject to withholding tax.

The impact of replacing the debtor principle by a paying agent principle could be fundamentally positive for the Swiss financial centre as, according to estimates by the financial sector, banks in Switzerland could provide various financing services for domestic and foreign clients that were not possible to date on account of the withholding tax. There should also be an attractive tax framework for private banking. In relation to withholding tax and the possible conversion to the paying agent principle, the financial centre also has an interest in minimising the bureaucracy involved, mitigating the settlement risk as much as possible and ensuring appropriate remuneration for the functions assumed under the paying agent principle.

³³ Source: Bank for International Settlements, BIS Debt Securities Statistics

³⁴ Bonds issued abroad by Swiss group companies or foreign subsidiaries guaranteed by the Swiss parent company

³⁵ At the G20 summit in Brisbane on 15/16 November 2014, the FSB published its proposal for a qualitative and quantitative minimum standard on total loss absorbing capacity (TLAC) (see also the report of the "Economic risks" subgroup in Annex 4).

Interests of the business location

Switzerland as a business location has an interest in being able to raise capital at competitive tax conditions within the country. This concerns financing on the market, e.g. by issuing bonds, as well as intragroup financing activities. Apart from issuance in Switzerland, Swiss industrial firms are also, according to SwissHoldings, primarily interested in scaling down or eliminating the financing structures required abroad and concentrating these in Switzerland. However, the possibility of bonds being issued by Swiss groups abroad should not be curtailed. Another interest lies in mitigating the legal risks associated with foreign issues. Based on the case law of the Federal Supreme Court, there is, according to SwissHoldings, a threat of the permissibility of foreign issues being further complicated. Switzerland as a business location has an interest in eliminating this risk. As such, it also has a strong interest in minimising the bureaucracy involved and the settlement risk in association with withholding tax.

Interests of the tax authorities

The interests of the tax authorities differ according to whether investors are domiciled in Switzerland or abroad.

Regarding persons domiciled in Switzerland, the withholding tax serves to guarantee the payment of income and wealth tax. For tax-compliant persons, the withholding tax is then fully reimbursed upon application or offset against their income and wealth tax. For non-tax-compliant persons, however, the withholding tax is understood as their definitive tax burden.

A further distinction is made for persons domiciled abroad:

- For persons from countries that have a double taxation agreement (DTA states), the tax authorities' interests lie in obtaining a final taxation where this is permissible under the DTA (known as residual tax, e.g. 15% on dividends for persons domiciled in Germany). As the residual tax is offset against the tax owed by the investor in his country of domicile, the location poses less of a problem as long as the investor is tax-compliant and there is complete reimbursement/offsetting in the country of domicile. Frequently, however, there is no such complete elimination of the tax burden (e.g. collective investment schemes). In the case of non-tax-compliant investors, the residual tax always results in higher taxes.
- For persons domiciled in a country without a double taxation agreement (e.g. Brazil), there is an interest with regard to Swiss DTA policy to levy a tax that at least equals the residual tax of a DTA state. This would be an argument in favour of levying a residual tax. The existing withholding tax thus also to a certain extent fulfils a guarantee function in respect of foreign tax authorities, although this will become obsolete by the time an AEOI is introduced for the partner country. However, a tax that is not taken into account by the country of domicile always results in higher taxes and may therefore dissuade investors from investing in Switzerland. This would be an argument against levying a residual tax.
- The significance of the residual tax differs greatly according to the financial instrument. For example, the residual tax is particularly fruitful for Swiss income on participation rights but far less so for Swiss bonds because of the substitution possibilities for international investors.

Under the prevailing debtor principle, non-tax-compliant domestic investors can easily substitute domestic bonds subject to withholding tax with equivalent bonds that do not attract any source tax. The guarantee function is thereby lost to a large extent, and the potential for tax revenues from unreclaimed withholding tax is low.

5.1.2 Adjustments needed

Measures in relation to the capital market must be directed towards, on the one hand, achieving competitive tax framework conditions for all products and, on the other hand, closing the loopholes in securing revenues from foreign sources for Swiss investors under the prevailing withholding tax law.

Against this backdrop, the group of experts recommends embedding the change in system from the debtor to paying agent principle into an overall strategy and a general approach to tax policy. Whether or not the paying agent principle can fulfil the objectives will depend to a large extent on how it is structured. Given the highly complex correlations, a single rule in the arrangements for the paying agent principle could have negative repercussions for Switzerland as a business location. Cost-benefit analyses should therefore be carried out as the basis for alternative forms of implementation.

The group of experts emphasizes the following objectives in this reform:

- 1 the strength of the capital market for debt capital;
- 2 a timely solution for bail-in bonds and the extension of the exception to date for CoCos and write-down bonds;
- 3 defending the tax-specific interests of the Confederation, cantons and municipalities.

Based on the impacts of a general or partial conversion to the paying agent principle in relation to withholding tax and in recognition of the associated opportunities and risks, the group of experts have focused on the following parameters.

1. *Conversion to the paying agent principle with the exception of income from domestic equity investments:* The proposed solution is a complete conversion to the paying agent principle. With the conversion to the paying agent principle, withholding tax becomes payable also on foreign investments held with Swiss paying agents.

The only exception to this conversion to the paying agent principle is income from domestic equity, which could keep the debtor principle. The reasons for this exception are:

- Companies in Switzerland are not subject to paying agent obligations in association with the withholding tax.
- The additional benefit from the liability of dividends under the paying agent principle for the domestic equity capital market is significantly lower than for the domestic debt capital market.

Moreover, the financial risks for the tax authorities can be kept low because the current substantial tax revenues generated by withholding tax on the income from domestic participation rights remains unchanged.

Regarding a partial system change, a special comment should be made on the treatment of the distribution and reinvestment of income from *domestic collective investment schemes*. Several variants are conceivable in this regard:

- a) Preservation of the debtor principle;
- b) Complete conversion to the paying agent principle;
- c) Partial conversion to the paying agent principle while maintaining the debtor principle for forwarded income from participation rights.

2. *Tax collection limited to domestic natural persons:* Tax collection on income under the paying agent principle is limited to domestic natural persons as the beneficial owners, for which the guarantee function must take effect. As already the case today with the final source taxes in relation to Austria and the UK and the future AEOI internationally, Swiss paying agents see through certain structures such as domiciliary companies, trusts and insurance wrappers by way of the know-your-customer rules, which are already in use as part of anti-money-laundering regulations. In principle, accounts and securities portfolios held with foreign banks do not fall within the scope of application of the paying agent concept for withholding tax.

3. *Study of the introduction of voluntary disclosure:* Domestic natural persons could be given a voting right and thus vote on whether their income is to be subject to withholding tax under the paying agent principle or instead the income is to be disclosed to the tax authorities. While such a disclosure option is not mandatory for realisation of the project, it would avoid the unattractive tax deduction for tax-compliant Swiss investors at their request. As withholding tax will continue to be levied according to the debtor principle on income from (directly held) participation rights, there is by definition no possibility of voluntary disclosure on such income.

4. *No residual tax on interest income:* No residual tax is levied internationally on the domestic income from debt capital, including interest on bank assets. Income from (directly held) participation rights remains liable to 35% withholding tax, with offsetting of the residual tax by the country of domicile in accordance with the DTA. The reason behind there being no residual tax on interest is, on the one hand, the fear that the Swiss capital market would otherwise not be attractive enough for debt capital and, on the other hand, the fact that the loss in revenues by waiving the residual tax on interest is relatively low.

The FTA sees in a complete waiving of residual tax on debt capital income a considerable risk of tax evasion if the future international AEOI system were to reveal substantial loopholes in geographical or material terms. Therefore, a network of AEOI agreements should be sought internationally that comprises the countries with the most important market participants.

5. *Alignment of the switchover from the debtor principle to the paying agent principle with the introduction of AEOI internationally:* Swiss taxpayers could be tempted to deposit undeclared assets with foreign banks/paying agents and thereby circumvent the tax guarantee mechanism envisaged under the paying agent principle. The planned introduction of AEOI internationally will prevent any such incentives to use foreign paying agents for this purpose. Implementation of the switchover from the debtor principle to the paying agent principle must therefore be aligned with the introduction of AEOI internationally.

6. *Abolition of self-limitation in mutual administrative assistance in tax matters:* The Swiss tax authorities should be allowed to make use of notifications received from abroad. The existing self-limitation in mutual administrative assistance in tax matters should be abolished as a prerequisite for the paying agent concept.

7. *Abolition of the existing practice on foreign bonds guaranteed in Switzerland:* Given that both domestic and foreign bonds are subject to withholding tax under the paying agent principle, no residual tax should be levied on interest, and AEOI is envisaged internationally, the distinction between domestic and foreign bonds loses its significance for withholding tax. Consequently, the current practice of guaranteeing foreign bonds in Switzerland may be abolished and not replaced. Moreover, bonds guaranteed by Swiss-based parent companies that are raised by a subsidiary abroad are not attributed to the domestic guarantor. This creates advantages for groups operating in Switzerland.

8. *Temporary exception for bail-in bonds until enactment of the revision:* For bail-in bonds, a temporary exception – until enactment of the other provisions of the revised withholding tax law – is envisaged as part of the overall paying agent proposal, similar to the prevailing rule to be extended for CoCos and write-down bonds, which includes an exemption from withholding

tax. This exception as part of the proposal on the partial switchover to the paying agent principle for withholding tax should come into effect earlier in the form of a transitional provision.

9. *Transitional period for paying agents:* Paying agents should be given a period of two years in order to allow them sufficient time to implement the paying agent principle. The proposed legislation should then come into effect on the following 1 January.

10. *Transitional period for CoCos and bail-in bonds:* For CoCos, whose exemption from withholding tax is limited under current law until end-2016, and for the urgent issue of bail-in bonds, appropriate transitional provisions should be made without formally separating these from the business.

5.1.3 Recommendation

In its parliamentary dispatch on the withholding tax, the Federal Council should request implementation of a complete switchover to the paying agent principle with exceptions for domestic equity income, taking the following parameters: For domestic bank clients, a source tax should still be levied in Switzerland as a guarantee mechanism. Where possible, a residual tax should be avoided. For the reform, the paying agents must be given sufficient time for switching over. The possibility of compensation for the costs incurred through the tax-deduction procedure by the paying agent should be studied. The Federal Council should align the switchover to the paying agent principle with the planned introduction of AEOI internationally. As a transitional provision of this reform project, product-specific tax exemptions should be envisaged for officially regulated products such as bail-in bonds, CoCos or write-down bonds.³⁶

The recommendation in relation to the capital market must, on the one hand, seek to achieve competitive tax framework conditions for all products and, on the other hand, strive to close the loopholes in securing revenues from foreign sources for Swiss investors under the prevailing withholding tax law. Foreign investors today acquire very few bonds from Swiss debtors as the withholding tax charged cannot be fully reimbursed to them, or only with a degree of bureaucracy; consequently, there are practically no large Swiss companies issuing bonds in Switzerland. The conversion to the paying agent principle would eliminate this false incentive and thus make a decisive contribution to developing a competitive Swiss capital market. A source tax for domestic bank customers as a guarantee mechanism in Switzerland could take the form of a tax under the debtor or paying agent principle, although a disclosure option should be examined. Tax-compliant persons and institutional investors would have no incentive to switch their paying agent abroad if they had the disclosure option available to them in Switzerland.

A relatively large problem to date regarding the proposed reform was that possible alternatives abroad could have negated the guarantee function of the withholding tax. This problem will be significantly reduced through the introduction of AEOI internationally, as the Swiss tax authorities receive reports on the investments of Swiss residents abroad on the basis of reciprocity and can thus ensure correct taxation. This significantly lowers the incentive to avoid taxation by way of accounts with foreign banks or paying agents. Implementation of the switchover from the debtor principle to the paying agent principle must therefore be aligned with the introduction of AEOI internationally. This regulation makes no other changes to Swiss banking secrecy within Switzerland; the Swiss tax authorities have, as before, no access to information about accounts held by Swiss residents with banks in Switzerland.

³⁶ The representative of the Swiss Union of Crafts and Small and Medium-Sized Enterprises advocates tax exemption for officially regulated products and is against the rest of the recommendation.

The future role of bail-in bonds for the TBTF regulation is another key driver for the reform. Only if these are issued in Switzerland can they play their role in the winding-up of a Swiss big bank. To ensure that this concept can be realised in time, a temporary exemption from withholding tax should be envisaged in the project in the form of a transitional rule for bail-in bonds, to remain in effect until enactment of the reform discussed here.

5.2 Financial transaction tax and transfer stamp taxes

5.2.1 Introduction

With respect to the taxation of securities transactions, Switzerland is increasingly confronted with foreign taxation regimes with extraterritorial effects. Already in 2012 and 2013, respectively, France and Italy introduced their own financial transaction taxes on acquisitions of shares; in the case of Italy, the tax also affects derivatives of Italian shares. Currently, 11 EU member states are now planning to introduce a common financial transaction tax (EU FTT) within the framework of "enhanced cooperation". There is no agreement yet among member states regarding the details of the planned EU FTT. Introduction will probably be step-by-step and at the beginning of 2016 at the earliest.

Given the extraterritorial effects of this taxation regime, Switzerland is directly impacted. Both the French and the Italian transaction tax are based on the issuance principle. The tax is therefore due as soon as a French or Italian security is traded, irrespective of the residence of the contracting parties³⁷.

In the case of the planned EU FTT, it is still uncertain whether the establishment principle will supplement the issuance principle, as provided in the original draft. This establishment principle would additionally entail that the tax would be levied if a financial intermediary is involved that is "established" in an FTT state (where "established" is interpreted very broadly, so that a party is already considered "established" if a branch, permanent address, or usual residence exists in an FTT state).

As a consequence of the extraterritorial effect of the FTT regime, Swiss financial institutions have a tax withholding obligation for the participating countries. On the one hand, this means multiple taxation might occur for transactions on which both a foreign FTT and the Swiss transfer stamp tax is due. On the other hand, conflicts may arise between Swiss and foreign legal provisions.

Already today, banks are experiencing such a legal conflict: To pay the tax on transactions involving Italian securities, the banks require an exemption from the Federal Council in respect of the provision in Article 271 SCC.³⁸ Several banks have requested such an exemption. However, based on a weighting and balancing of all affected interests, especially the economic interests of the affected banks and the economic and political interests of Switzerland, the Federal Council denied these applications in February 2014. The affected Swiss banks submitted a request for reconsideration. They see themselves in legal conflict because on the one hand, they have to respect the decision of the Federal Council to this effect, and on the other hand, they have to comply with the FINMA rules which include compliance with Italian law.

As a consequence of the extraterritorial effect of the FTT regime, Swiss insurers likewise have a tax withholding obligation for the participating countries. In regard to their investments,

³⁷ In the case of the French and Italian FTT, the tax affects equity instruments issued by a company domiciled in the respective country, and in the case of Italy also derivatives whose underlying securities are shares subject to the Italian FTT.

³⁸ Unlike in the case of the French FTT, the Italian FTT makes the client subject to the tax, not the bank, which makes such an exemption necessary.

insurers are affected by the threat of multiple taxation in the case of transactions for which both a foreign FTT and the Swiss transfer stamp tax is due. Especially when using derivatives to hedge risks, the transactions may trigger a (multiple) FTT, entailing additional costs for the insurers – and ultimately for policyholders.

5.2.2 Need for action

If fighting extraterritorial effects of the financial transaction tax (FTT) were successful in international bodies, the financial centre and its clients would be protected from the extraterritorial additional taxation, so that the Swiss financial centre would incur no competitive disadvantage. Multiple taxation that would interfere with financial intermediation could be prevented, and clients would also remain protected from multiple taxation. The financial centre would avoid additional tax payment costs. Competition through access to the Swiss tax base by foreign treasuries would be prevented.

If the FTT should be introduced within individual EU countries with extraterritorial effect, an excessively high tax burden for clients might still be avoided that would otherwise negatively impact the competitiveness of the financial centre. This would be autonomously achievable by way of unilateral measures relating to the transfer stamp tax. Harmonisation with the foreign FTT system would presumably not prevent certain transactions covered by the FTT from relocating to FTT-free financial centres. The conclusion of double taxation agreements would likely turn out to be protracted. Multiple taxation that would interfere with financial intermediation could in principle be avoided by way of all the mentioned strategies. Clients would remain protected from multiple taxation. Major or minor revenue losses would likely be the result, the magnitude of which cannot currently be gauged.

5.2.3 Recommendation

At the international level, the Federal Council should oppose the extraterritorial effect of any future financial transaction tax and use bilateral measures (conclusion of agreements with the partner countries concerned) or unilateral measures (relating to the transfer stamp tax or harmonisation with foreign FTT systems) to avoid double taxation effects.

With regard to the financial transaction tax, Switzerland should oppose extraterritorial measures and safeguard Switzerland's interests. If the financial transaction tax should be introduced within individual EU countries with extraterritorial effect, Switzerland would have to develop a strategy for how to avoid the possibility of double taxation in the event of a collision between the financial transaction tax and the transfer stamp tax. As soon as it is clear how the financial transaction tax is designed, Switzerland should examine whether agreements should be sought to avoid double taxation in this domain. Double taxation agreements offer greater legal certainty in regard to adjustments of internal law in partner countries. In parallel, it should be examined immediately whether the existing nexuses for the stamp duties on securities sales, but also on non-life insurance, should be adjusted and modified in such a way that double taxation arising from foreign stamp duties/FTTs can effectively be avoided, or whether a harmonisation with the foreign FTT systems might be a possibility.

5.3 Taxation of group companies in Switzerland

5.3.1 Introduction

As part of the further development of TBTF rules, systemically important banks in various countries have increasingly been induced to divide up their corporate structure into smaller, ring-fenced, resolvable entities. This will lead to a higher number of companies and accordingly a higher number of taxable entities in Switzerland as well.

From a business perspective, it can make sense to consolidate companies within a single country for tax purposes – such as Switzerland – and to pay taxes on the "consolidated" result of the operating activities within Switzerland (not "consolidated" on a worldwide basis). This will be referred to as group profit taxation. The consolidation may refer to individual elements (e.g. intercantonal allocation of taxes on the basis of results across all legal entities, treatment of certain or all activities of one group company as a permanent establishment of the others) or, *de lege ferenda*, group profit taxation of Swiss activities.

Not least of all, the consolidation allows more rapid offsetting of profits and losses within the group. This is already possible today in many countries in very different ways (e.g. UK, US, and various EU countries). Switzerland also already uses group taxation for the value added tax.

With respect to the value added tax, legal subjects with a domicile or permanent establishment in Switzerland that are linked with each other under the uniform management of a single legal subject can become members of a VAT group. Legal subjects include legal persons, general and limited partnerships, and natural persons. A VAT group may also include legal subjects that do not operate a business. The VAT group encompasses only the group companies domiciled in Switzerland as well as all permanent establishments in Switzerland of a group company domiciled abroad. If the higher-level company is domiciled abroad, only the group companies and permanent establishments located in Switzerland can be included in a VAT group.³⁹

5.3.2 Need for action

From the perspective of the banks, the introduction of group profit taxation for operating activities in Switzerland would, depending on the design (e.g. introduction of a minimum tax), lead to more stable and predictable tax payments of corporate groups in Switzerland and allow the corporate groups to exploit losses more quickly. From the perspective of the FTA, group profit taxation cannot be introduced in the short term, however, but it should be considered as an option in the medium to long term.

With respect to the profit tax, the introduction of group profit taxation for operating activities in Switzerland would permit more rapid offsetting of losses with profits within the corporate group and eliminate multiple taxation by the capital tax. In this way, the average effective tax burden would be reduced, thus increasing the appeal of Switzerland for corporate relocations. The more rapid offsetting of losses with respect to the profit tax would also reduce the marginal effective tax burden, which would tend to have a positive effect on investment activity and growth.

The introduction of group profit taxation would, however, make allocation of taxes between cantons considerably more complicated and thus increase the enforcement costs of taxation. Group taxation would entail greater tax neutrality in regard to the structuring of a corporate group and should therefore be considered positive under the aspect of horizontal tax equity. Revenue losses would occur, the magnitude of which cannot currently be estimated.

5.3.3 Recommendation

The Federal Council should mandate the Federal Department of Finance to consider group taxation of Swiss activities for the profit tax.

Group taxation of Swiss activities, as has already been implemented successfully in regard to the value added tax, should be considered *de lege ferenda* for the profit tax. For investments within the tax group, the investment deduction would be eliminated, and parent companies would not be able to claim a deduction for their investments in other companies of the legal

³⁹ See VAT Info No 3. Group Taxation, accessed 13.11.2014

entities consolidated within the Swiss tax group, because any operating loss of these other companies would already have been included in the profit and loss calculation of the tax group. The banks assert that under current law, the legally provided leeway for tax consolidation should be exploited in a sensible way. To the extent sensible, intercantonal allocation of taxes on the basis of results across all legal entities should be used. Certain or all activities of one Swiss group company should be considered a permanent establishment of the other group companies.

5.4 Other areas without recommendations

5.4.1 Automatic exchange of information (AEOI)

The Group of Experts welcomes the position of the Federal Council regarding introduction of the new global standard for automatic exchange of information in tax matters with partner countries as well as the adoption of the definitive negotiating mandate in this regard on 8 October 2014.

5.4.2 Concerns of the insurance industry

With regard to the insurance industry, a congruent system of taxation of insurance products should be achieved upon establishment, during the term, and upon payment of the insurance product. From the perspective of the Swiss Insurance Association, the principles of taxation of pension products embedded in the Swiss three-pillars system should be further developed in an appropriate manner in these areas. In particular, the stamp duties on life insurance premiums in Pillar 3b and the income tax treatment of annuity payments are up for discussion. If an over-taxation of annuities is eliminated, the FTA believes that the elimination of the privileged taxation of lump sums in flexible pension provision and Pillar 2 should be discussed as well. The demographic and macroeconomic changes must be taken into account appropriately. However, no common recommendation for action could be found on this point.

In contrast, the FTA has already been mandated by the Federal Council to examine the transition to the risk location principle⁴⁰ in the area of property insurance. Additionally, it is currently working on an administrative report on the income tax consequences of pension insurance policies, in order to show how an appropriate taxation of annuity payments might look in the future. Both dossiers respond to a concern of the Insurance Association.

5.4.3 Value added tax and exports of financial services

Insurance services and most banking services are exempt from the value added tax. The reasons for this tax exemption include the desire to avoid double taxation with the stamp duty (insurance sector) and the transfer stamp tax (banking sector) and also the lack of an appropriate assessment basis for individual services, without which deduction of the input tax is hardly possible. For this reason, current law also rules out the voluntary taxation of services in the insurance and banking sectors. The tax exemption and the lack of a possibility of voluntary taxation lead to a "hidden tax" totalling about CHF 760 million in the insurance sector⁴¹ and about CHF 1,005 million in the banking sector.⁴² This makes banking and insurance services more expensive than are rendered to recipients abroad. If, analogous to the rule in the EU, the VAT input tax deduction were permitted in connection with banking services rendered to recipients abroad (merely an option for services rendered abroad), an estimated third of the hidden tax would be eliminated. This lost revenue would probably have to be

⁴⁰ In the EU area, the power of taxation for insurance taxes (the international term for "stamp duty") is allocated to the state where the risk is located ("risk location principle").

⁴¹ Based on 2005 FTA figures, recalculated to current tax rates

⁴² Based on 2005 FTA figures, recalculated to current tax rates

compensated within the VAT. However, no recommendation for action could be formulated in this regard.

5.4.4 Capital tax

The Tax Harmonisation Act requires the cantons to levy a capital tax. It also gives cantons the possibility to offset the profit tax against the capital tax. The cantonal legislature determines the tax rate. Companies subject to a cantonal tax status in regard to the profit tax benefit from a reduced capital tax rate.

For the purpose of strengthening the appeal of the business location, a reduction of tax burdens should be considered. In particular, adjustments to the cantonal capital tax are up for discussion. For instance, an investment deduction or offsetting within the corporate group for the capital tax could be introduced. Due to the regulatory changes, the Swiss banks are adjusting their structures and are establishing new legal companies (e.g. holding companies) for this purpose. In this way, multiple taxation might be avoided in respect of the capital tax. Since, as part of the Business Tax Reform III, the introduction of an investment deduction and offsetting within the corporate group are being considered, there is currently no need for action in this area.

5.4.5 Avoidance of withholding tax risks in the case of transfer pricing adjustments

Multinational corporations usually have many group-internal flows of services which, according to the arm's length principle, should be compensated. Because of the new regulatory requirements intended to improve the resolvability⁴³ of banking groups, the group-internal flows of services will increase even further due to the creation of separate entities. Quite similarly to insurance companies, the banks are facing special challenges. According to their business activities, the individual group companies have different maturities for their financial assets and liabilities, even if matching is achieved across the group as a whole. The different interest rates on the different maturities must be compensated across the group as a whole, which is difficult especially if a premium over risk-free investments must be paid for raising funds through long-term liabilities. Another problem consists in the correct distribution of risk premiums for CoCos and similar instruments. There is no internationally recognised distribution key for these costs. Due to the lack of clear international tax allocation rules and the high degree of complexity, allocation conflicts cannot regularly be eliminated in advance with the tax authorities. If a Swiss company renders a service in kind to a foreign group company, where that service does not meet the arm's length principle, and if the Swiss company receives compensation for the service that is too low, then the tax authority will – in addition to profit tax offsetting – also levy a withholding tax of 35%. Since the foreign group company is generally not able to request full reimbursement of the withholding tax (basic withholding tax under the DTA), the tax burden will as a rule be higher from the perspective of the group, even if the foreign tax authority carries out a corresponding tax adjustment in the domiciliary state of the foreign affiliate.

The problem of withholding tax risks in the case of transfer pricing adjustments is of the utmost importance to the capital market in Switzerland. Switzerland should therefore address the transfer pricing problems it faces. The FTA will hold detailed discussions with the sectors affected by withholding tax risks in the case of transfer pricing adjustments in order to identify and consider possible solutions, taking account of the international developments. Given this, there is currently no further need for action.

⁴³See also section 3.5.1.

6 Safeguarding systemic stability

The utmost importance is attached to the stability of the financial market in Switzerland, which is home to financial institutions that are large both compared internationally and with the size of the country. Financial market stability may, for instance, be endangered by a distressed systemically important bank. But other stability risks must also be taken into account that do not emanate from systemically important banks.

For this reason, the present chapter firstly discusses the Swiss "too big to fail" legislation. It examines how the Swiss TBTF policy mix compares with the international standards and the measures adopted in other important financial centres. Building on this, the need for action is presented from the perspective of the Group of Experts in order to further strengthen Swiss TBTF measures and further reduce the implicit government guarantee.

Secondly, three other areas are discussed which, from the perspective of the Group of Experts, also call for action in regard to systemic stability: the deposit insurance scheme, the tax incentives for indebtedness especially of private persons, and crisis planning for non-systemically important banks. In order to prevent bank runs by clients, depositor protection systems play an important role. Likewise, excessive debt of private persons may constitute an inherent risk to systemic stability. The stability of the Swiss financial system could moreover be further strengthened if selected banks that are not systemically important were to elaborate crisis plans with appropriate measures.

Additionally, other potential risks to financial market stability were examined. These are merely summarised in the final subchapter, since no need for action was identified in the individual areas beyond work already in progress. These topics include shadow banks, the insurance sector, and OTC derivatives and financial market infrastructures.

6.1 TBTF in the big bank sector

6.1.1 Introduction

The most recent global financial and economic crisis showed that the distress or failure of a systemically important financial institution (SIFI) may – due to its size, market significance, or interconnectedness – result in considerable upheaval in the financial system and negative consequences for the overall economy. The affected government or governments cannot and therefore will not let a systemically important financial institution fail in the event of a crisis if the continuation of systemically important functions is not ensured: The financial institution is "too big to fail" and therefore enjoys an implicit government guarantee.

Without countermeasures, the threat of default of an SIFI thus leaves the state authorities no other option than to rescue it with public funds in order to prevent financial instability and harmful upheavals in the national economy. The most important goal of a TBTF policy is therefore to prevent certain financial institutions from being so important to the functioning of the overall system that they cannot fail and therefore the government would have to employ taxpayer money to rescue such financial institutions.

The various measures to minimise the TBTF problem can be distinguished as prudential measures, organisational measures, and measures in the event of a crisis. Some of the measures have more of a preventive effect and are intended to prevent insolvency. Others have more of a curative effect and are intended to minimise the negative consequences of insolvency and at the same time ensure the continuation of the systemically important functions in the event of insolvency, in order to protect the state from the absolute necessity to rescue the entire bank simply to ensure these functions.

As a response to the TBTF problem in Switzerland, the Banking Act has been revised and expanded to include specific provisions on the regulation of systemically important banks. The amendments entered into force on 1 March 2012.⁴⁴ The adopted measures are based on the recommendations of the TBTF Expert Commission of 30 September 2010.⁴⁵ Due to the complexity of the TBTF problem, ultimately only a combination of measures can have an effective impact. The focus was therefore on strengthening capital adequacy, stricter liquidity requirements, better risk diversification, and organisational measures. Most of the relevant implementing provisions have been in force since January 2013.

The question thus arises to what extent the adopted measures have been able to reduce the TBTF problem in Switzerland and whether there is additional need for action. According to Article 52 of the Banking Act, the Federal Council must, within three years of entry into force of Sections 5 and 6 – i.e. by the end of February 2015 – and afterwards every two years, show in a report to Parliament whether there is any need for action in regard to the TBTF regime at the level of laws and ordinances. The report on TBTF Policy in the Big Bank Sector (see Annex 2) is intended as a foundation for this review, and the present chapter summarises the most important points.⁴⁶

6.1.2 Need for action

On the basis of the considerations in Annex 4 an overall assessment will be undertaken to evaluate the need for action.

Should the Swiss approach be given good marks on an international comparison?

Overall, the Swiss approach should be given good marks compared with the approaches of other countries. No reorientation of the regulatory model is therefore necessary (for instance in the direction of strict requirements such as a system of separated banks, prohibitions of certain transactions, or size limitations).

The assessment should consider that both the size of the Swiss banking sector relative to GDP as well as market concentration are high compared to other countries. From the Swiss perspective, the TBTF problem is therefore an especially great challenge and justifies measures that exceed the international average. Against this backdrop, the Swiss approach played a pioneering role in terms of the prudential measures (capital adequacy, liquidity, risk distribution), the timetable, and the amount. Meanwhile, comparable and in some cases higher requirements now also exist in other G-SIB jurisdictions.

The organisational measures in Switzerland have a liberal and subsidiary design compared with other jurisdictions, and they refrain from imposing strict organisational requirements. The measures in the event of a crisis are in line with international trends (recovery and resolution plans; bail-in strategy).

Conclusion: The Swiss approach should be given good marks compared with other countries, and no fundamental reorientation of the regulatory model is necessary.

Are the big banks implementing the legislative requirements?

In regard to both the risk-weighted capital requirements and the leverage ratio, implementation has been swift so far, so that both big banks exceed the requirements currently set out by

⁴⁴ For additional information, see, e.g. the Dispatch on Amendment of the Banking Act (strengthening of stability in the financial sector; too big to fail) of 20 April 2011.

⁴⁵ See Final Report of the Expert Commission on the Limitation of Risks to the National Economy by Major Companies (September 2010).

⁴⁶ Based on these insights, the reports requested by Parliament in the meantime (postulates 11.4185 and 14.3002) in connection with the system of separated banks can likewise be answered.

law.⁴⁷ In regard to the requirements applicable at the end of the transition period (2019), the banks have not yet reached the target values (leverage ratio and RWA ratio).

Substantial efforts have been undertaken in regard to emergency planning. Implementation has not progressed sufficiently far, however, for Switzerland to be able to guarantee the continuation of systemically important functions in the event of a crisis. To achieve this, considerable further efforts will be necessary. Both big banks have announced and initiated necessary organisational measures for this purpose and are undertaking to implement the required Swiss emergency plan by way of an *ex ante* separation. According to the big banks' plans, the *ex ante* separation will take until least 2015 or mid-2016. After these points in time, the banks' plans indicate that continuing dependencies on the residual bank – for instance in the form of financial linkages such as initial guarantees, in order to avoid cancellation rights of existing creditors – will not adversely affect emergency planning as required by the law even after the *ex ante* separation for a transition period of several years.

The same finding is true of measures that promote the recoverability and resolvability of the entire systemically important bank and that go beyond continuation of the systemically important functions. Currently, an orderly resolution of the major Swiss banks would not be possible, which is why further progress by the banks in this area is crucial. Measures promoting the recoverability and resolvability of the entire systemically important bank are components of the big banks' reorganisation projects. Implementation of these measures is being harmonised with FINMA and, according to the banks' plans, will still take several years.

Conclusion: In regard to prudential measures, implementation is generally on course. The target values for the capital ratios are likely to be reached already before the legislative deadline at the beginning of 2019. The emergency planning required by Swiss law and the Banking Ordinance as well as generally the improvement of resolvability have not yet been implemented, however. The big banks have initiated steps for the reorganisations necessary for this purpose. If all the planned measures concerning Swiss emergency planning and resolvability were fully realised, then the current legal minimum requirements would presumably be met.

Does the legislative approach taken by Switzerland solve the TBTF problem?

IMF estimates and the S&P rating bonus lend themselves to the conclusion that implicit government guarantees for Swiss banks continue to be assumed – but reduced compared with 2009. Additionally, various developments and insights since introduction of the TBTF legislation have made clear that even full implementation of the total package will not solve the TBTF problem. Supplementary measures are therefore necessary.

Prudential measures

Since the balance sheet size of the banks has declined less than the corresponding risk-weighted positions, and the two major Swiss banks have low RWA/total asset ratios compared with other countries, the question arises whether bank-internal risk models are adequately estimating the risks. If this were not the case, the crisis resistance of the banks would be too low. In light of the major significance of RWA capital ratios to the Swiss approach, adequate calculation of the RWAs is a precondition for the requirements to have full effect.

The easements in regard to capital requirements that must be granted to the banks so that the requirements at the group level are not too high due to consolidation effects (Article 125 CAO) have led to the lowest possible risk-weighted capital requirements permitted by law at the level of the individual institution, namely 14% plus the countercyclical buffer, and preferred treatment of investment stakes. Because other jurisdictions are meanwhile enforcing capital

⁴⁷ The law provides for a phased introduction of the requirements over several years. This is intended to prevent a negative impact on the availability of credit.

requirements for subsidiaries, the easements mean that important parent banks from a Swiss perspective have only barely sufficient capitalisation. The parent banks now contain the core of the two banking groups with their systemically important functions.

Organisational measures

The greatest challenge currently lies in the implementability of the Swiss emergency plans. Because the Swiss approach does not require direct organisational measures, implementability of the emergency plan plays a special role: Only an implementable emergency plan ensuring continuation of the systemically important functions can reduce the *de facto* absolute necessity for governments to rescue banks in the event of a crisis. The legislation grants the banks leeway to decide whether to base their emergency plan on an *ex post* or an *ex ante* separation of the systemically important parts. In Switzerland, *ex post* separation of the systemically important functions has turned out to be problematic, however. The big banks have meanwhile clearly stated that they want to achieve the legally required immediate implementability by separating the systemically important functions into a separate legal subject. Should an SPE bail-in not work or is insufficient, preconditions for the continuation of the systemically important functions have to be developed – including full implementation of the *ex ante* separation, the operational and accordingly financial disentanglement from the rest of the banking group, and capital and liquidity that are appropriate to the entity in question during every phase.

The international experiences and regulatory discussions show that a single-point-of-entry resolution strategy requires the subordination of loss-absorbing capital – structurally, legally, or contractually – as well as a minimum disentanglement of the organisational entities *ex ante* in order for a restructuring to be possible when needed. In the US, for instance, the big banks are now set up as bank holding companies.

Measures in the event of a crisis

It is also uncertain whether sufficient liability reserves are available in the event of a crisis for an orderly resolution of the residual bank as well. In the Swiss TBTF regime, one of the roles of the progressive component is that of a liability reserve. The amount of the progressive component is likely to be too low for this function, however. In part, this has to do with the different objectives of the progressive component (incentive mechanism for the reduction of balance sheet sizes and market shares as well as improvement of global resolvability; ensuring sufficient means for recovery and resolution). In this connection, bail-in is currently being examined as a means to obtain capital for recovery. Bail-in provides for the mandatory participation of certain bond creditors. What is crucial in this regard is that at the time of an imminent insolvency, there are sufficient liabilities available for recovery. Legal certainty and enforceability are crucial in this regard. With respect to the range of legal instruments available as crisis measures, recent international surveys have confirmed weaknesses in the Swiss defensive measures.

Conclusion: According to today's estimation, even a full implementation of the TBTF legislation does not fully solve the problem. Additional measures to strengthen the overall Swiss package are necessary to increase the robustness of the big banks and to make recovery or orderly resolution possible without costs to taxpayers.

6.1.3 Recommendations

The international comparative analysis has confirmed that the Swiss regulatory model is in principle suitable to reduce the TBTF problem. However, it has also shown that certain adjustments within this model are necessary to truly eliminate the implicit government guarantee for the long term – which represents the core of the TBTF problem. The Group of Experts proposes making changes already today in the three areas where measures are necessary (prudential measures, organisational measures, and measures in the event of a

crisis) and continuing to periodically review the effectiveness of the overall package in the coming years.

Prudential measures

1. Review of the method for calculating RWAs and possibly improvement measures

With the assistance of the National Bank, FINMA is currently investigating whether and to what extent the RWAs based on the bank-internal model approaches differ from those of the model-independent standard approach. If this investigation does not find any significant and unexplained differences, the confidence of the market in the model approach would be strengthened. If, however, any significant differences cannot be explained, corrective measures would have to be considered and implemented. Feasible, for example, would be the introduction of an RWA floor or of multipliers. Higher transparency requirements might also make sense.

2. Recalibration of capital requirements

Not taking into account the progressive component – which constitutes the liability reserve for the event of a crisis – the requirement under the Swiss approach for the going concern leverage ratio for big banks is 3.12%.⁴⁸

This is barely more than the international minimum standard for all (i.e. including non-systemically important) banks (3%) and significantly lower than the future corresponding requirements in the United States for systemically important banks (5-6%)⁴⁹.

Against this backdrop, the capital requirements should be adjusted in accordance with the following three principles:⁵⁰

- Switzerland should be one of the countries with the highest going concern capital requirements for G-SIBs. This should be true both of risk-weighted capital requirements and of the leverage ratio.
- The increases necessary to ensure this first principle should be carried out while taking account of any measures adopted in accordance with recommendations 1 and 6.
- The leverage ratio should in the normal case continue to be conceived of as a safety net when determining the capital requirements.

3. Adjustments to capital quality

According to the international standard, the leverage ratio is calculated based on core capital (Tier 1). In the Swiss TBTF regime, however, the going concern capital requirements not only include the basic requirements, but also the entire capital buffer, which in part may be met using high-trigger CoCos. The Swiss government allows banks to combine Basel Tier 1 and Tier 2 instruments with high and low-trigger CoCos, respectively. The banks have made use of this. For this reason, the Swiss leverage ratio requirements cannot simply be compared with the requirements based on the Basel standard. In order to make the Swiss approach more easily comparable with the international standards, the part that may be met using high-trigger

⁴⁸ The going concern capital requirements include basic requirements and the entire capital buffer.

⁴⁹ These are the eight bank holding companies (BHCs) with more than USD 700 billion consolidated total assets or more than USD 10 trillion in assets under custody.

⁵⁰ Minority position: "The big banks generally agree with the principles for recalibrating the capital requirements, but they believe the following qualifications are necessary: Fulfilment of the third principle should not lead to an increase in risk-weighted capital requirements. It should also be noted that an international comparison of the leverage ratio should be undertaken only on a comparable basis, and the recalibration must take account of the sum of all upcoming measures to tighten regulations."

CoCos should also at least have a capital quality of Tier 1. For these adjustments, appropriate transitional provisions (e.g. grandfathering) should be provided.

4. *Adjustment of Article 125 CAO for systemically important individual institutions*

In order to ensure that adequate capitalisation of those entities performing systemically important functions is guaranteed at all times, Article 125 CAO should be amended so that it does not apply especially to the *ex ante* separated Swiss bank forming the basis for emergency planning. Independently of the foreign requirements governing other entities, the Swiss bank established for emergency planning should meet the capital requirements envisaged at the group level without any easements.

Organisational measures

5. *Determination of by what date the Swiss emergency plan and improved global resolvability must be implemented*

The TBTF law has defined a fixed deadline for the required capital adequacy (at the latest by the beginning of 2019). In contrast, there is no clear timetable or publicly communicated final deadline for implementation of the emergency plan and thus for the continuation of the systemically important functions and the measures ensuring improved resolvability. Thus, several years might pass before measures become effective in these two areas that are intended to reduce the financial and operational linkages. This should be corrected by defining a binding and publicly communicated target date. When defining the timetable, it should be taken into account on the one hand that every year in which the recovery and resolution plans are not yet implementable increases the risk that government assistance would again become necessary in the case of a serious shock. On the other hand, it must be conceded that organisational measures by the big banks do take a certain amount of time to implement.

When designing the measures, it must be taken into account that only a certain internal operational and financial *ex ante* disentanglement can guarantee the resolvability of a bank by providing the possibility to separate out individual entities in the event of a crisis.

FINMA should monitor strict implementation of the emergency plans and regularly inform the authorities of the status of planning and implementation of the Swiss emergency plans and the work undertaken in the Crisis Management Colleges on the global resolution plans.

Measures in the event of a crisis

6. *Supplementation of the TBTF regime with binding TLAC requirements so that sufficient liabilities are available to make recovery or orderly resolution possible*

The amount of these additional requirements should be based at least on the parameters set out in the FSB proposal published for consultation on 10 November 2014 and should be complete by the end of 2015. Should the FSB be unable to agree on a standard during the process after the Brisbane summit, Switzerland will nevertheless adopt regulations. Due to the key importance of this measure for the elimination of the TBTF problem, this is indeed justified. It must also be assumed that countries such as the US and the UK will in any event also adopt requirements. In the Swiss TBTF regime, one of the roles of the progressive component is to serve as such a liability reserve.⁵¹ The amount of the progressive component as it is currently designed is likely to be too low for this function, however, especially considering that it can fall to 1%. The TLAC concept is in principle compatible with the Swiss capital requirements for systemically important banks. The TBTF rules anticipated the TLAC concept already to some extent by creating contractual "resolution capital" upon introduction of the progressive

⁵¹ In addition to the incentive to reduce the balance sheet total and market share as well as the incentive to improve resolvability.

component and the low-trigger CoCos. The work on defining the binding TLAC requirements should be continued swiftly with the involvement of the parties concerned.

In order for the bail-in strategy to be successful and for losses in fact to be borne by creditors in the event of a crisis, the Group of Experts believes two additional flanking measures – one legal and one tax-related – are necessary:

7. Legal adjustments to strengthen measures in the event of a crisis

In order to manage a crisis successfully, legal certainty and enforceability are crucial. Only then can it be ensured that resolution plans function in practice. The most recent international assessments also indicate that the Swiss legal instruments relating to crisis measures contain certain weaknesses. For instance, the only explicit mention of the reduction of claims in legislation is in connection with the conversion from borrowed capital to equity capital (Article 31(3) of the Banking Act). According to the wording of the Banking Act, a bail-in would be possible only as a last resort, which contradicts the preferred resolution strategy.

8. Adjustments to the withholding tax to increase the appeal of bail-in bonds issued in Switzerland.

An important precondition for the improved enforceability of a bail-in by FINMA is the issuance of such instruments in Switzerland. Adjustments to the tax environment are helpful in this regard. The tax preconditions for the issuance of bail-in bonds in Switzerland should be improved. Only an attractive Swiss capital market would be able to make the issuance of appropriate volumes at competitive prices possible. As a key flanking measure, the conversion of the Swiss withholding tax into a paying agent tax should be envisaged and – depending on the duration of the reform – a time-limited exemption of bail-in bonds from the withholding tax should be considered as a transitional measure (see recommendations of the Group of Experts on taxation).

Periodic review of the effectiveness of the overall package

At this time, it cannot yet be assessed whether a fully implemented Swiss TBTF regime, including the changes recommended here, will be sufficient to eliminate the implicit absolute necessity for the government to rescue TBTF institutions and the associated implicit subsidies to big banks. To do so, it must first be seen how the big banks implement the announced and initiated reorganisation projects and the additional measures detailed in the section above. The Group of Experts therefore recommends a regular review of effectiveness.

9. In the two-year rhythm provided by law (Article 52 of the Banking Act), the effectiveness of the regime should be reviewed, and additional measures should be taken on this basis where necessary.

FINMA should regularly assess the progress made in the preparation and implementation of the emergency plans and global resolvability in accordance with the Banking Ordinance and also take account of the criteria established by the Financial Stability Board. On the basis of indicators and analyses, the authorities should review to what extent emergency plans and an orderly resolution of the banks as a whole can be implemented in a credible manner and whether an implicit government guarantee still exists.

If the reviews show that indicators continue to point to an implicit government guarantee and that major obstacles to securing resolvability remain, additional measures must be taken – e.g. higher capital requirements and/or higher requirements with regard to the emergency plan and resolvability.

6.2 Deposit insurance scheme

6.2.1 Introduction

The legal protection of depositors has existed to the current extent since 2008 and covers all deposits at a Swiss bank or Swiss securities dealer that are in the name of the depositor, amounting to up to CHF 100,000 per depositor and institution (including medium-term notes in the name of the bearer that are deposited at the issuing bank). The protection is three-tiered and governed by various legal provisions:

1. Preferential deposits are paid out immediately from the available liquidity of the insolvent bank (Article 37b(1) of the Banking Act); in the ideal scenario, creditors can be satisfied with payments from these assets alone. The bank is required to permanently maintain receivables covered domestically or other assets located in Switzerland in the amount of 125% of their preferential deposits (Protection of Assets; Article 37a(6) of the Banking Act); these assets do not have to be liquid but, depending on their composition, they must be able to provide a likewise specified amount of liquidity directly or indirectly.⁵²
2. If the assets are not sufficient for an immediate payout, the deposit insurance scheme is triggered for insured deposits.⁵³ Insured deposits are the preferential deposits without deposits in employee benefits foundations, to the extent the deposits are booked in Switzerland (Article 37h(1) of the Banking Act). The insured deposits amounted to about CHF 340 billion at the end of 2009 and about CHF 430 billion at the end of 2013.
3. The remaining deposits that are insured but not covered – including those not booked in Switzerland – are privileged in bankruptcy and are considered claims in the 2nd bankruptcy class (Article 37a(1) of the Banking Act).⁵⁴

The three-tiered structure of depositor protection is unique compared to other countries. The first tier offers a certain level of protection. This was demonstrated in the financial crisis,⁵⁵ even though it remains to be seen what the situation will be in the next crisis. If, however, it would become necessary to trigger the deposit insurance scheme – especially in the case of contagion – then neither a systemic crisis nor the default of one of the largest banks could be managed. In light of upcoming developments, the second tier was not supplemented or redesigned as planned in 2011. At the time, the proposal circulated for consultations was unable to secure a majority, especially given that it envisaged a deposit insurance fund financed *ex ante* under public law, an increase of the system cap, and a second comprehensive insurance tier financed by the Confederation (advance or guarantee).

⁵² At all banks together, the preferential deposits were about CHF 399 billion at the end of 2009 and about CHF 498 billion at the end of 2013 (the significant increase in recent years is in part due to the banking licence for PostFinance, and in part due to the reintroduction of the privileging of numbered and pseudonym accounts). Liquidity as of mid-2014 consisted of high quality liquid assets (HQLAs) in the amount of CHF 385 billion (positions in Swiss francs) and CHF 681 billion (positions in the single currency; Article 14(2) of the Liquidity Ordinance in the version in force from 1 January 2015 requires fulfilment of the quantitative requirements both for positions in Swiss francs and for positions across all currencies, i.e. the single currency).

⁵³ This scheme is based on self-regulation and resulted in the establishment in 2005 of the Swiss Banks' and Securities Dealers' Depositor Protection Association (esisuisse), which is registered in the Commercial Register.

⁵⁴ Uninsured deposits (especially those exceeding the maximum amount of CHF 100,000 per depositor and bank) are in the 3rd bankruptcy class.

⁵⁵ The bankrupt **Banque Privée Espirito Santo SA** also had sufficient means and liquid assets to fully reimburse the preferential deposits of clients (see FINMA press release of 19 September 2014).

6.2.2 Need for action

In January 2013, the Basel Committee on Banking Supervision published quantitative standards for liquidity under Basel III and also clarified the relationship between deposit insurance schemes and liquidity: the more secure the deposit insurance scheme, the lower the liquidity requirement – and vice-versa. A prefunded deposit insurance scheme that is independent of the banks, has the ability to make prompt payouts, and has a high level of public awareness qualifies for a lower "run-off rate", so that a reciprocal relationship between liquidity requirements and the deposit insurance scheme exists. In concrete terms, the run-off rate according to the Liquidity Ordinance could be reduced from 5% (as provided so far⁵⁶) to 3% as long as the following conditions are met:

- The deposit insurance scheme is based on a system of prefunding via the periodic collection of levies on banks with insured deposits, and the scheme has adequate means of ensuring ready access to additional funding in the event of a large call on its reserves, e.g. an explicit and legally binding guarantee from the government, or a standing authority to borrow from the government.
- The institution providing the deposit insurance has formal legal powers to fulfil its mandate and is operationally independent, transparent, and accountable.
- As a rule, access to insured deposits is available to depositors within at most seven business days after the deposit insurance scheme is triggered.
- There is high public awareness of the deposit insurance scheme.⁵⁷

In the reports it published on the country assessment of Switzerland at the end of May 2014 as part of its Financial Sector Assessment Program, the IMF recommended improving certain aspects of the existing deposit insurance scheme. On the basis of the IMF recommendations, a parliamentary interpellation was submitted in June 2014 and considered by the Council of States in September 2014.⁵⁸

The developments in recent years justify taking up the question again of supplementing or redesigning the deposit insurance scheme (i.e. the second tier of depositor protection) and exploring possibilities in this regard. Moreover – unlike in 2008 – there is currently no time pressure.

6.2.3 Recommendations

Recommendations for implementation:

The understanding and awareness of the entire depositor protection system should be improved, specifically in relation to clients and at the international level.

The three-tiered structure of depositor protection should be communicated more clearly to the relevant international organisations and bodies, so that all tiers are appraised especially in the context of comparisons in country assessments. In the appropriate form, the institutions should draw affected clients' attention to protection. Similarly to foreign countries, clients in Switzerland could be informed by the bank of the protection system when contracts are concluded, and relevant indications could be included on account statements. Finally, it should

⁵⁶ See Annex 2 point 1.1.1 of the Liquidity Ordinance in the version in force from 1 January 2015.

⁵⁷ See paras. 75-78 of the paper "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" of the Basel Committee on Banking Supervision, January 2013.

⁵⁸ Interpellation 14.3572, Bischof Pirmin, "Savings deposit insurance of CHF 100,000. Where are the weaknesses? How to remedy them?"

be considered whether depositors – as envisaged in the EU – should be informed more effectively by way of a standardised information sheet, among other means.

The organisation of esisuisse as the provider of the deposit insurance scheme should be improved as part of a revision of the articles of association.

According to the international standard, the institution providing the deposit insurance scheme must have formal legal powers to fulfil its mandate and be operationally independent, transparent, and accountable. The governance and independence of esisuisse must be improved accordingly. In particular, an adjustment of the composition of the Board of Directors is necessary. The Board of Directors currently consists primarily of individuals working for larger banks. Work in this regard has already been taken up as part of the revision of the articles of association. Attention should also be paid to accurate formulation of the legal powers of esisuisse.

For payouts from the deposit insurance scheme, the goal should be to reduce the payout deadline from currently 20 working days to ideally 7 working days.⁵⁹

The payout deadline – including for the transmission of the relevant data – must be kept as short as possible. For data transmission between FINMA, its agents, and esisuisse, the law and the legal foundations recognised by FINMA as self-regulation do not contain a deadline, however. Here, the required preconditions (also in terms of infrastructure) must be created to ensure a smooth payout. In order to achieve a lower run-off rate in accordance with the quantitative standards for liquidity under Basel III, a payout deadline of at most 7 business days is required internationally.⁶⁰ This goal of a shorter payout period, also suggested by the IMF, should be implemented in Switzerland.

Recommendations for consideration:⁶¹

It should be considered whether the funding model of the deposit insurance scheme can be improved over the status quo by instituting (at least partial) prefunding, especially by supplementing it with the deposit of securities or the introduction of a fund with ex ante funding.

In order to improve the safety net if the prudential requirements (including the protection of assets) fail, an improvement of funding both by supplementing the deposit insurance scheme with the deposit of securities and by introducing a fund with (partial) *ex ante* funding for the deposit insurance scheme should be considered. The appropriate offices, the framework conditions, and the consequences and their cost and benefit must be examined in detail as part of a comprehensive analysis. In this regard, it should be ensured, firstly, that the securities in question are allowable as required liquidity and, secondly, that the deposit insurance scheme can subsequently benefit from the a lower run-off rate (3% instead of 5%). When estimating the costs, it should be considered in particular whether and to what extent provisions must be established for levies required for *ex ante* solutions, and how unnecessary cost implications can be avoided through the design of the system.

Costs and benefits of an increase to the system cap should be considered.

⁵⁹ Unlike some legal orders, the Banking Act refers to "working days" as opposed to "business days".

⁶⁰ In the EU, the maximum repayment deadline is to be reduced starting in 2019 from currently 20 working days to 7 working days by January 2024.

⁶¹ In the view of the representative of the big banks in the working group, there is currently no need for a fundamental change in the system.

Irrespective of the type of funding, an increase of the system cap should be considered. In particular, the additional costs to banks must be balanced against the additional stability of the system gained by a higher cap (number of institutions additionally covered, etc.⁶²).

6.3 Crisis planning for non-systemically important banks

6.3.1 Introduction

In order to prevent crises, the crisis resistance of banks can be increased on a preventive basis. Another option is to reduce the consequential losses of a default by way of preventive crisis planning. Experience from past crises shows that the impact of the financial difficulties of a bank can be buffered using appropriate preparatory measures. This insight has also been implemented by the Swiss TBTF regime.

6.3.2 Need for action

The importance of adequate crisis preparation goes beyond systemically important banks. The stability of the Swiss financial system could be further strengthened if certain banks that are not systemically important were to develop crisis plans with appropriate measures. As part of a risk-based approach, the level of detail of these crisis plans would be based on the size, complexity, and interconnectedness of the banks in question. For smaller institutions, simplified requirements should apply. In particular, the resolution authorities would have to define the level of detail of the plans individually for each institution. Currently, FINMA does not have the legal power to demand work from the banks in this regard.

6.3.3 Recommendation

The power to demand or establish crisis preparations and plans from certain banks, even if they are not systemically important, could make a further contribution to the stability of the Swiss financial system. It should therefore be examined whether a legislative basis should be created with powers to that effect, and which financial institutions would be covered.

6.4 Tax incentives to incur debt as a stability risk

6.4.1 Introduction

The Swiss tax system favours borrowed capital over equity capital and thus creates debt incentives. This distortion occurs especially in the taxation of natural persons, but to a certain extent also in the taxation of companies. Since borrowed capital as a rule is provided by financial institutions, these tax incentives to accumulate debt may be problematic with a view to the stability of the financial system. Especially in regard to the taxation of natural persons who occupy their own residential real estate, there are substantial tax incentives in Switzerland to prefer borrowed capital (i.e. debt) over equity capital. These incentives of the tax system should be considered critically to the extent they induce private households to choose higher levels of indebtedness than they would be willing to sustain in a world without taxes. This distortion in favour of indebtedness may make them more vulnerable to crises and external shocks. It should be considered that these obligations are counterbalanced by considerable assets. However, assets and mortgage debt are distributed differently.

6.4.2 Need for action

In principle, financing decisions are every individual's personal responsibility. As a general rule, adequate equity capital resources and financing ensure that losses can be absorbed and that no insolvency or over-indebtedness occurs. A certain level of borrowing, however, leads to

⁶² Currently, the system is not able to manage a systemic crisis or a default of one of the (according to the IMF: 10) largest banks.

high interest and principal payments that must be made even in economically difficult times. There is always also the risk that borrowed capital becomes difficult to renew, or that the conditions for renewal are worse for the borrower, due to tight economic circumstances of the borrower, the creditor, or the economy as a whole.

In the case of high leveraging or debt, the dependency on external lenders therefore increases and, consequently, the susceptibility and vulnerability to shocks, crises, or economic fluctuations. Such a shock may be systemic – e.g. due to a rise in interest rates or a general economic slowdown – or idiosyncratic, as might happen to natural persons if they lose their job or go through a divorce.

Because of the higher vulnerability due to tax distortions favouring debt, risks may arise for the stability of the financial system (depending on the concentration of loans on the balance sheets of banks). If borrowers are no longer able in a crisis to service their debt at the loan-granting banks (i.e. the lenders), this would lead to losses that might endanger the stability of individual financial institutions or the financial system as a whole.

These debt incentives are especially pronounced in Switzerland for the financing of residential property. The high mortgage debt in Switzerland compared with other countries, in terms of residential real estate loans as a share of GDP, is now nearly 120%. Important reasons for this are likely the tax incentives to incur debt and the disincentives to pay off mortgage loans. Along with maintenance and administrative costs, debt interest is – in conformity with the logic of the tax system – considered an expense deductible from the imputed rental value, which in turn is considered "income in kind". Because debt interest is tax deductible from income, while capital gains on private assets are tax-exempt, tax incentives are created to keep gross debt high. On grounds of tax optimisation, many Swiss households therefore do not pay off their mortgage in whole or in part or do so only indirectly. This means the basic capital of households remains exposed to market risks (e.g. a major increase in interest rates), which in the event of a shock may lead to accumulation of payment difficulties for mortgage borrowers or price erosion on the real estate market, which in turn might endanger banks and the financial system as a whole. Moreover, historical experience shows that more than two thirds of the systemic banking crises were preceded by price collapses for real estate.⁶³

6.4.3 Recommendation

The tax system should follow the principle of not creating debt incentives (i.e. financing through borrowed capital instead of equity capital). It is recommended to examine how strong the debt incentives in the Swiss tax system are as well as the resulting risks to financial stability. A special focus should be on the comparatively high mortgage debt of households in Switzerland. Based on this, measures should be developed and evaluated for better ways to comply with the principle of tax neutrality in the financing structure.⁶⁴

6.5 Stability issues without additional need for action

6.5.1 Shadow banks

Shadow banking is broadly defined as "credit intermediation involving entities and activities outside the regular banking system" (e.g. money market funds).⁶⁵ Shadow banking activities can have a positive impact on the financial system in terms of innovation, efficiency, and diversification as a complement to the traditional banking sector. However, shadow banks can also be vulnerable to runs and increase contagion risk, as has been illustrated in the recent

⁶³ See, e.g. Oscar Jorda, Moritz Schularick and Alan Taylor (2014): The Great Mortgaging: Housing Finance, Crises and Business Cycles, NBER Working Paper No. 20501, September 2014.

⁶⁴ The representative of the Swiss Union of Crafts and SMEs opposed this.

⁶⁵ According to the FSB Global Shadow Banking Monitoring Report 2014, p. 1. Available at http://www.financialstabilityboard.org/publications/r_141030.pdf

financial crisis. Of particular concern are shadow banking activities that present bank-like risks, such as providing maturity and/or liquidity transformation, taking leverage and transferring credit risk.

The major conclusion of the recent country case study by the Swiss National Bank in collaboration with the Federal Department of Finance and the Swiss Financial Market Supervisory Authority (FINMA)⁶⁶ for Switzerland is that the estimated size of the shadow banking activities exhibiting bank-like risks is considerably smaller than the rough FSB estimates.⁶⁷ Building on a detailed analysis, it estimates the size of the Swiss shadow banking sector to be CHF 481 bn (81% of GDP), or more than three times smaller than previous estimates. This amount can still be considered as conservative, since all bond funds and all other investment funds are included in this measure of the shadow banking sector even though not all of these funds are likely to exhibit bank-like risks.

Overall, the risks to financial stability from the Swiss shadow banking sector are considered to be low for several reasons. First, compared to the banking sector, even the conservatively estimated size of the shadow banking sector is considerably – by more than five times – smaller. Second, the identified shadow banking assets are assessed to carry low to moderate bank-like systemic risks. Third, the extent of the interconnectedness between Swiss shadow banks and banks in Switzerland is considered to be low. Finally, shadow banking entities are often subject to regulation already today. In Switzerland, 60% of shadow banking assets stem from bond funds and other investment funds, which are well regulated⁶⁸ and supervised by FINMA. In this context and in terms of risks to financial stability and thus the national economy, there is currently no priority need for action concerning shadow banks.

6.5.2 Systemic importance in the Swiss insurance sector

In 2013, the insurance sector contributed 4.7% to GDP in Switzerland and is an important pillar of the Swiss financial centre.⁶⁹ Because of this importance and the national economic function of insurances, there is accordingly also extensive supervision and regulation of the insurance sector and sufficient incentive to examine this sector for systemic risks. Already in 2010, the TBTF Expert Commission looked at the issue of systemic importance in the insurance sector and concluded that there are no insurance companies systemically important to Switzerland.⁷⁰ The Commission's conclusions referred to the home market and thus took a national perspective.

In the meantime, the work on systemic risks in the insurance sector has been advanced internationally. For the first time in July 2013, the Financial Stability Board (FSB) designated nine insurance companies as global systemically important (G-SII – Global Systemically Important Insurers) on behalf of the G20 and in consultation with the International Association of Insurance Supervisors (IAIS) and the competent national supervisory authorities. Additional regulatory measures to contain the risks emanating from G-SIIs were published. Various investigations on the topic of systemic risks in the insurance sector have been carried out in recent years.⁷¹ A consensus emerged: Systemic risks in the insurance sector are primarily

⁶⁶ The study is part of a broader project on shadow banking in Switzerland being conducted jointly by the three institutions.

⁶⁷ According to the most recent FSB report on shadow banking, the Swiss OFI sector corresponds, relative to GDP, to the third largest OFI sector worldwide.

⁶⁸ The Collective Investment Schemes Act (CISA) has been recently revised.

⁶⁹ SIF, Key figures Swiss Financial Centre 2014, April 2014.

⁷⁰ Expert Commission on the Limitation of Risks to the National Economy by Major Companies or TBTF Expert Commission. Final report of the Commission:
<http://www.sif.admin.ch/dokumentation/TBTF>

⁷¹ FINMA WP 6/2010
https://www.finma.ch/e/finma/publikationen/Documents/wp_juni2010_systemische-risiken-im-versicherungssektor_20101004_e.pdf, Geneva Association, Systemic Risk in Insurance,
https://www.genevaassociation.org/media/99228/ga2010-systemic_risk_in_insurance.pdf.

located in the non-traditional insurance business and in the non-insurance and capital market business of insurers, while there are hardly any in the traditional insurance business. Due to the possible loss potential, attention must always also be paid to the interconnectedness of insurers.

From the domestic viewpoint, there continue to be no systemically important insurers in Switzerland on the basis of the definition of the FSB and the TBTF Expert Commission. Neither size, interconnectedness, nor a lack of substitutability indicate that there is a *de facto* government guarantee. In determining their credit ratings, the rating agencies continue to assume that insurers do not have a too-big-to-fail status; Standard & Poor's even continues to pursue its approach of distinguishing between banks and insurers when assigning ratings. The international developments also change nothing about the lack of systemic importance in the national insurance sector. But Switzerland also assumes an important responsibility for global financial stability, especially if a Swiss institution should someday be designated as a G-SII by the FSB. Such a global designation would, however, have no immediate impact on the status of this company from a national perspective, as long as the internationally important insurers continue to remain small to medium-size actors in the national market and operate only little business in the non-traditional, non-insurance (NTNI) segment. In this context, there is currently no priority need for action in the insurance sector in light of the risks to financial stability in Switzerland.

6.5.3 OTC derivatives and financial market infrastructures

Efficient financial markets depend on smoothly functioning financial market infrastructures by means of which market participants can trade, invoice, and settle financial instruments. These financial market infrastructures include stock exchanges and other markets, central counterparties (CCPs), central securities depositories, payment systems, and trade repositories. Financial market infrastructures often have a monopoly-like status and are strongly interconnected internationally. Their failure thus entails significant risks for the stability of the financial system. The financial crisis has also shown that the lack of transparency and insufficient collateralisation on the markets for over-the-counter (OTC) derivatives due to their strong international links and the major trading volumes and default risks may endanger the stability of the entire financial system.

The existing Swiss regulation of the OTC derivatives market has gaps compared with the internationally recognised requirements and currently is not subject to any provisions under supervisory law that take account of the G20 obligations and the FSB recommendations for trading in OTC derivatives. With the Financial Market Infrastructure Act (FMIA), Switzerland is already reacting to the existing regulatory gaps. For additional considerations on this topic, see Annex 5.

7 Overview of the recommendations

The table summarises the additional measures and adjustments to the previous financial market strategy that the group of experts recommends. Those cases addressed in the report where the group of experts recommends a continuation of ongoing or initiated reforms are not listed.

Objectives	Measures	Brief explanations	
Efficient organisation of regulatory processes	Clear and transparent principles for all phases of the regulatory process	Application of existing regulatory principles to the entire regulatory process, including the early phases of regulatory projects. Performance of a review of compatibility with the principles as part of the assessment of the need for regulation for every regulatory project. Preparation of a complete norm concept for each regulatory project.	
	Enhancement of the existing institutionalised dialogue between authorities and the financial sector and clearly defined role of the Financial Centre Forum	The institutionalised dialogue between the authorities, market participants, and the world of academia should be expanded as well as specifically strengthened where the early recognition of regulatory developments phase is concerned. Offensive (i.e. proactive) communication and the early preparation of project outlines will have the effect of strengthening this dialogue. The authorities, the world of academia and, at an earlier stage, market participants must all play their part in ensuring a constructive and objectivised dialogue. The Financial Centre Forum should act as the coordinating party in the dialogue on financial market regulation issues. Its mandate will need to be clarified accordingly. Its composition should be adjusted so that all involved market participants are appropriately represented.	
	Continuous impact analysis and regulatory impact assessment (RIA) in the entire regulatory process	The impact analysis/RIA should be consistently implemented throughout the regulatory process, in a form suited to the phase in question. The results should be presented and communicated transparently. The regulatory authorities should strive to deliver regulation that is highly effective and differentiated.	
	Periodic review of the communication concept for the enforcement of regulations	The executing authority should periodically review its communication concept that explains the function of the various forms of communication in a transparent manner. Market participants should be involved in this process where possible.	
	Preserving and improving market access	Striving for formal market access agreements with major partner countries and alignment with international standards	Switzerland is seeking to negotiate agreements with selected major partner countries with the aim of preserving and improving market access for Swiss providers at a bilateral level. It is a credible negotiation party by aligning its regulation to international standards and actively participating in the international initiatives and processes in financial market regulation, e.g. as a member of

Objectives	Measures	Brief explanations
		the Financial Stability Board and the various standard setters.
	Equivalency approach to financial market regulation in the EU/EEA	Switzerland is striving to achieve regulation and supervision that is equivalent in substance to that of the EU/EEA in areas in which this is desirable from the Swiss point of view to maintain market access, while exploiting its scope for action at a national level. It seeks dialogue with the EU to examine ways that acknowledge the Swiss approach and make the procedure for recognition of equivalency of the corresponding Swiss legislation more transparent, fast and predictable.
	Discussions to clarify the EU's market access requirements in the financial services area	Switzerland is seeking dialogue with the EU to further clarify the formal and material aspects of a possible agreement on financial services. It will submit a request to this effect to the European Commission for exploratory talks on such a sectoral agreement.
	Uniform image and targeted communication to improve the positioning of the financial centre	Switzerland is improving its positioning abroad as a financial centre through the effective coordination of the state and financial sector, a uniform appearance and active communication on Switzerland's transition to the automatic exchange of information (AEOI) in tax matters. The financial sector should examine which measures would be appropriate to ensure more effective marketing and present its proposals in this respect.
Improving the tax environment	Facilitating the development of a dynamic Swiss capital market by restructuring withholding tax	In its parliamentary dispatch on the withholding tax, the Federal Council should request implementation of a complete switchover to the paying agent principle with exceptions for domestic equity income, taking the following parameters: for domestic bank clients, a source tax should still be levied in Switzerland as a guarantee mechanism. Where possible, a residual tax should be avoided. For the reform, the paying agents must be given sufficient time for switching over. The possibility of compensation for the costs incurred through the tax-deduction procedure by the paying agent should be studied. The Federal Council should align the switchover to the paying agent principle with the planned introduction of AEOI internationally. As a transitional provision of this reform project, product-specific tax exemptions should be envisaged for officially regulated products such as bail-in bonds, CoCos or write-down bonds.
	Strategy for dealing with international financial transaction taxes and their relationship with transfer stamp taxes	At the international level, the Federal Council should oppose the extraterritorial effect of any future financial transaction tax and use bilateral measures (conclusion of agreements with the partner countries concerned) or unilateral measures (relating to the transfer stamp tax or harmonisation with foreign FTT systems) to avoid double taxation effects.

Objectives	Measures	Brief explanations
	Review of group taxation of group companies in Switzerland	The Federal Council should mandate the Federal Department of Finance to consider group taxation of Swiss activities for profit tax.
Safeguarding systemic stability	Strengthening of the Swiss TBTF regime	Review of the RWA calculation method and possibly improvement measures.
		Recalibration of capital requirements.
		Adjustments to capital quality.
		Amendment of Article 125 CAO for systemically important individual institutions.
		Determination of a date by which the Swiss emergency plan and the improved global resolvability should be implemented.
		Supplementation of the TBTF regime with binding TLAC requirements so that sufficient liabilities are available to make recovery or orderly resolution possible.
		Legal adjustments to strengthen the toolkit for a crisis scenario.
		Adjustments to withholding tax to increase the appeal of bail-in bonds issued in Switzerland.
		The effectiveness of the regime should be reviewed at two-yearly intervals as envisaged by legislation (Art. 52 BankA), and additional measures should be taken on this basis where necessary.
	Improvements in the existing deposit insurance scheme	The understanding and awareness of the entire depositor protection system should be improved, specifically in relation to clients and at the international level.
		The organisation of esisuisse as the provider of the deposit insurance scheme should be improved as part of the revision of the articles of association.
		For payouts from the deposit insurance scheme, the goal should be to reduce the payout deadline from currently 20 working days to ideally 7 working days.
	Review of more extensive adjustments to the deposit insurance scheme	It should be considered whether the funding model of the deposit insurance scheme can be improved over the status quo by instituting (at least partial) prefunding, especially by supplementing it with the deposit of securities or the introduction of a fund with ex ante funding.
The costs and benefits of increasing the system cap should be considered.		
Review of the introduction of crisis planning for certain non-systemically important banks	The power to demand or establish crisis preparations and plans from certain banks, even if they are not systemically important, could make a further contribution to the stability of the Swiss financial system. It should therefore be examined whether a legislative basis should be created with	

Objectives	Measures	Brief explanations
		powers to that effect, and which financial institutions would be covered.
	Examination of the systemic risks due to tax-related debt incentives, particularly in the case of private mortgages	The tax system should follow the principle of not creating debt incentives (i.e. financing through borrowed capital instead of equity capital). It is recommended to examine how strong the debt incentives in the Swiss tax system are as well as the resulting risks to financial stability. A special focus should be on the comparatively high mortgage debt of Swiss households by international standards. Based on this, measures for better ways of complying with the principle of tax neutrality in the financing structure should be developed.

8 Members of the group of experts

Chairman

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Representative of academia

Susan EMMENEGGER, Professor, University of Bern

Representatives of the private sector

Patrick ODIER, Chairman of the Swiss Bankers Association and Managing Partner of Lombard Odier & Cie

Urs ROHNER, Chairman of the Board of Directors of Credit Suisse Group AG; deputy: Axel WEBER, Chairman of the Board of Directors of UBS AG

Beat OBERLIN, Chairman of the Executive Board of Basellandschaftliche Kantonalbank

Urs BERGER, Chairman of the Swiss Insurance Association and Chairman of the Board of Directors of Schweizerische Mobiliar Holding AG

Martin SENN, CEO of Zurich Insurance Group Ltd.

Martin NEESE, Chairman of Forum SRO

Michel DEMARE, Chairman of SwissHoldings

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Representatives of the authorities

Jean-Pierre DANTHINE, Vice Chairman of the Governing Board of the Swiss National Bank

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Annexes

- Annex 1 Regulatory process and regulatory implementation
- Annex 2 Situation analysis and potential areas of action in market access
- Annex 3 Tax environment for financial transactions
- Annex 4 Review of the Swiss TBTF regime by international standards
- Annex 5 Systemic stability in areas not affected by the Swiss TBTF regime