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Report prepared for the City of London Corporation
by The University of Kent Centre for Swiss Politics
April 2013

Switzerland's Approach to EU Engagement:
A Financial Services Perspective

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Switzerland's Approach to EU Engagement: A Financial Services Perspective is published by the City of London. The author of this report is the Centre for Swiss Politics, University of Kent.

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Executive Summary

This report examines Switzerland's past and present political engagement with the EU, and how this operates for one of its key industries, the financial services sector. The report will help to inform debate around how the UK engages with the EU, by considering the experiences of Switzerland as a European country outside the EU, with a significant financial services industry. Key points to note are:

A complex approach to engagement

The Swiss approach is complex, consisting of a set of disparate sector-specific bilateral agreements developed over time, including on Schengen but excluding financial services, together with much informal Europeanisation, including autonomous adoption of EU law.

Reliance on London for access to European capital markets

Despite there being no comprehensive services accord, the Swiss financial sector has, so far, benefitted from largely unfettered access to the EU market, often through its presence in London. New EU regulations could change this. Tighter regulations would mean third countries constantly having to amend their parallel legislation, in line with any changes in Single Market legislation, in order to maintain equivalence over the course of time.

A means of moving closer to the EU

Switzerland's bilateral approach has been a means of moving closer to the EU rather than maintaining distance – and around 40% of Swiss legislation derives from EU rules.

Access to EU markets

Maintaining Switzerland's level of access to the Single Market requires continual closeness to the EU. A Free Trade agreement is not sufficient, especially for the financial sector. Maintaining access to European capital markets necessitates formal agreements and parallel legislation to that of the EU.

Overall

The Swiss approach is an exception, developed over time, rather than a formal model, and is a means of closer engagement with the EU. Forgoing complete access to the Single Market has had implications for the Swiss financial services sector, namely through the associated necessity of establishing operations in London, and has reduced Switzerland's ability to engage in EU policy making.

1 Introduction

There has been much debate recently around the UK's relationship with the EU and the extent of its engagement in political and fiscal union. One approach to informing these discussions has been to consider the experiences of other European countries operating outside of the EU, for example Switzerland and Norway.

Recent papers have looked, for example, at the benefits and costs to trade for Switzerland and Norway[1], and at the benefits and drawbacks of their overall approach[2] and applied these in a UK context. This report looks in more detail at a specific sector – financial services – to gain a better understanding of how the Swiss approach operates for this sector, and what the UK can learn from this.

The report examines the present Swiss relationship with the European Union, its bilateral sectoral agreements and the impact of the political and legal framework on the operation of Switzerland's financial services industry. There follows an assessment of the advantages and disadvantages of the EU-Switzerland relationship and a reflection on the lessons which could be drawn from it for the UK, albeit recognising that there are many other differences between the UK and Switzerland.

While Switzerland's EU engagement is often referred to as a 'model', the reality is more complex and problematic. In fact the Swiss situation is a one-off, and the Swiss have always been negotiating to draw closer to the EU, not to distance themselves. So the reflections on what we can learn from the Swiss approach, also suggest that this approach could not be easily applied to other Member States.

2 The actual framework of Swiss engagement with the EU

The details of Switzerland's actual relationship are not always well known. In fact, over the past 60 years, Switzerland has created a multifaceted framework of relations, based on selective formal agreements – including Schengen but excluding financial services – and much informal integration. The result is far from a finished product and remains the subject of internal debate.

2.1 Bilateral agreements

Swiss relations with the EU go back to agreements signed in the 1950s. Although developed after the 1972 Free Trade Agreement with a flurry of technical agreements, they proved unsatisfactory, given the pace of Community integration. Hence Switzerland entered the negotiations which led to the 1991 signing of the European Economic Area [EEA] agreement. But EEA membership was narrowly defeated at a referendum in December 1992.

1 Trading Places: Is EU membership still the best option for UK trade Open Europe (2012)
2 Outsiders on the inside: Swiss and Norwegian lessons for the UK Centre for European Reform (2012)

The government was then forced to fall back on bilateral sectoral agreements. The first batch, covering free movement of persons, technical barriers to trade, public procurement, agriculture, research, civil aviation and overland transport, took nearly ten years to come into effect. A second package was agreed in 2004, covering processed agricultural goods, Europol, environment, fraud controls, MEDIA, pensions, statistics, taxation of savings and, especially, Schengen and Dublin.

As time went on these Bilaterals became a value in their own right in the public mind, and not a stopgap. Since then a few other deals have been signed covering Eurojust (2008), education (2010), Fund regulations (2011) and the European Defence Agency (2012), together with a 2011 increase in the withholding tax rates. The Bilaterals have also been extended to new EU member states that have, additionally, benefited from Swiss stabilisation and cohesion payments. All told there are now at least 120 technical accords, managed by 27 joint committees.

2.2 Europeanisation

The limitations of these formal agreements encouraged Switzerland to embark on a continuing process of informal Europeanisation to keep the country close to the EU where necessary. This involves the autonomous adoption of EU norms, transport arrangements and some domestic policy adjustments.

Thus, since 1988 Switzerland has checked all draft Bills relating to economic activity for their compatibility with EU laws. In fact around 40% of Swiss legislation derives from EU rules - ironically more than twice as much as in the British context - and has, for example, led to the adoption of similar provisions on air traffic, commercial law and intellectual property measures.

Switzerland has also decided to adjust domestic policies to fit with European requirements in areas as diverse as the financing of Alpine base rail tunnels and wage and welfare provisions to cope with free movement of labour.

2.3 Continuation and controversy

This process of adaptation to the EU is unfinished. Despite the virtual standstill in recent years the Swiss want to develop their bilateral relations into food and product safety, cooperation between competition authorities, GALILEO, electricity and REACH. In June 2012 the government presented proposals for meeting the Union's desire for institutional provisions involving automatic acceptance of changes in relevant EU legislation, jurisdiction equivalent to that of the ECJ and more uniform implementation.

However, the Council decision of 21 December 2012 made it clear that, while the EU is willing to carry on talking because the Swiss had moved in its direction, it could not accept their actual proposals. For the EU, the bilateral road has come to an end. It also reiterated its unease about Swiss cantonal tax arrangements and interference with free movement of persons. Nonetheless, the statement was welcomed by Berne which still believes bilateral deals possible.

Unsurprisingly relations with the EU remain a matter of continuing domestic debate, with some talking of joining the EEA or negotiating an Association agreement and others of blocking, not just of moves towards membership, but also any new bilateral arrangements.

3 The place of financial services within Swiss-EU relations

Although the Swiss financial sector is proportionally larger than its British counterpart, it has not featured prominently in formal Swiss-EU relations. Two phases must be distinguished in its evolution: until 2006, when it became clear that the Swiss would not be joining the Union, there was something of a policy vacuum in Brussels on Switzerland. Thereafter things have become increasingly difficult for the Swiss finance industry.

3.1 Formal agreements

Perhaps surprisingly, there is no bilateral service agreement, although the second package of bilateral agreements assumed that there would be one. But negotiations failed in 2003 mainly because of Swiss reservations, including banks' insistence on secrecy.

There are only three formal service accords: a little used 1989 non-life insurance agreement; annexes to the free movement of persons agreement; and the 2004 withholding tax agreement which has led to the signing of so called 'Rubiks' withholding tax treaties with the UK, Germany and Austria (and also planned with France, Greece and Italy). This leaves Switzerland much in the same situation as states dependent on the General Agreement on Trade in Services [GATS] when accessing the EU market.

3.2 Structures and strategies

Although Swiss firms have sometimes found that freedom of movement for capital is narrowly interpreted in the Union where third countries are concerned, large Swiss firms have come to terms with this, operating through subsidiaries in London and elsewhere. Though extremely cumbersome this does give them full access to the EU market. But unlike for EU-based financial industry, cross-border service delivery is merely tolerated where it is observed, not established by right, and room for interpretation remains.

The Swiss have also been able to treat the three jurisdictions to which they are subjected as a single 'College' of Regulators, involving FINMA (the Swiss Financial Markets authority), the FSA (now the PRA and FCA) and the SEC. Banks have also encouraged the Swiss government to enact policies which have generally proved beneficial for financial services, notably the preservation of cantonal insurance and other monopolies, and the negotiation of the 'Rubiks' treaties. However, Zurich insurers are now complaining that premature and heavy handed Swiss application of EU rules is threatening their competitiveness while private bankers are calling for new deals with France and other countries to avoid a loss of clients.

3.3 Impact

So far, the Swiss financial sector has performed well, in part thanks to EU goodwill. This has meant no completed WTO cases, and acceptance of Swiss firms providing services through London and sometimes, residually, directly into the EU despite the lack of a legal right to do so. Nevertheless, lack of legal remedies and de facto asymmetry in front of the ECJ can occasionally cause problems.

Large enterprises are relatively happy with the status quo, but some wealth managers and small firms have found operating in EU markets increasingly difficult. Switzerland thus lacks the full market access enjoyed by EEA-based financial bodies.

3.4 A changing scene

The prevailing situation now seems under threat, as the Swiss financial sector faces tougher EU rules on third country operations. These can be discriminatory. MiFID II is seen as creating new barriers for Swiss firms by forcing more of them to open (larger) subsidiaries in the EEA and to obtain authorisation from an EEA Member State in order to gain an 'EU passport'.

Hence, once the new EU legislation is fully in force and the four new supervisory agencies operational (the European Banking Agency, the European Securities and Markets Authority, the European Insurance and Occupational Pensions Authority and the European Systemic Risk Board), the problem for Swiss-based financial institutions will be two fold. First, to access the EU market, an equivalence certificate is needed. To obtain this, the Swiss authorities must demonstrate that not only are they able to supervise their own, but that they can also control EU-based businesses. Second, there are at least 20 different equivalence requirements in place, due to the (sub) sector-specific approach of EU regulation. Both factors make obtaining equivalence a burdensome process.

Hence, the financial industry in particular will be faced with a choice of fully adapting to EU standards, once they are in place, or simply being shut out of the EU market. The 'letterbox' provision in AIFMD, according to which hedge funds have to locate significant management functions in the EU, might have similarly far-reaching consequences. If Swiss firms can no longer provide cross-border services into the EU, this could be very damaging in terms of job losses, decreasing tax revenue and prestige. For example, unofficial estimates from the Swiss banking sector speak of up to 29,000 jobs that could be lost in this way.

3.5 The tax and bank secrecy dimensions

The sector is also much involved in the tax negotiations which have run in parallel with recent developments. Because the EU sees Switzerland as a major player in this area, it is concerned about cantonal tax rates, concessions to foreign businesses and the 'Rubiks' deals. The EU wants Switzerland to adopt its 1997 Code of Conduct for Business Taxation, leading the government to consult on a negotiating mandate.

Switzerland is also under pressure from other quarters: the US, the OECD, the IMF and the Financial Stability Board. This has encouraged the Swiss government to draft a White Money strategy as an alternative to the automatic exchange of bank client information; but Luxembourg's negotiation on FATCA might again reinforce the EU's insistence on automatic information exchange.

4 The Swiss approach assessed

Contrary to prevailing perceptions, the Swiss approach is not a way of staying aloof from the EU. Rather, over the years the Swiss have sought to ensure that they are not compromising access to the EU market. It has been said that the country needed to be fit for membership in order to avoid becoming a member.

4.1 The nature of Swiss relationships

The Swiss approach is still under construction rather than being a finished product. It is a complicated series of pragmatic responses introduced, over time, to secure the country's interests. From the EU point of view, it is less a bilateral framework than a series of sectoral means of engaging Switzerland in the multilateral market system.

Moreover, the approach is much more than a free trade agreement even if it lacks a services component. Switzerland has had to adopt a version of the Cassis de Dijon principle as well as going down the bilateral road to make good both the insufficiencies of the FTA and the gaps arising from self-exclusion from the EEA. So the approach is a strategy for drawing nearer to the EU and not the reverse, as the trajectory of the last 20 years shows.

4.2 Opinion in the EU and in Switzerland

Far from having been imposed on the Union, the present framework owes a good deal to EU tolerance. It also requires a great deal of Swiss adjustment to EU legislation. Indeed many of the country's borrowings are a matter of cutting and pasting, even in areas where it was not specifically required, notably in competition law.

It is certainly true that the bilateral approach enjoys domestic legitimacy overall in Switzerland, as evidenced by referendums and opinion polls. However, bilateralism is queried not only in Brussels but also domestically. Europhiles point to its weaknesses while the radical right Swiss People's Party (SVP) attacks it as a 'creeping membership' approach which is taking Europeanisation too far.

4.3 Advantages

Nonetheless the approach seems to preserve sovereignty, allowing Switzerland freedom both to decide what relations it will have with the EU and carry out its own trade and currency relations with the rest of the world. Equally it enjoys full freedom of movement of goods and people while being spared the costs and constraints of the CAP and other policies. So it has not had to reform its post, railways and telecommunications.

Switzerland can also rapidly adjust EU rules in areas where it has decided to shadow the EU. So far it has maintained a low VAT rate while avoiding automatic exchange of financial information. Swiss-based financial services, finally, have so far been offered in the EU through subsidiaries, but with the major share of added value generated and supervision exercised at home.

4.4 Disadvantages

Conversely, while there is nominal autonomy, the system provides Switzerland with virtually no political influence. Moreover, as the bilateral accords are based on EU law as it was at the time of negotiation, they cannot be easily adjusted to changes in EU policy, made without Swiss input. Indeed the Swiss do not always know what new rules are coming, which can be costly for the country's businesses. The government often has to use bilateral talks with member states in order to learn about EU policy intentions. Furthermore, the management of the various agreements is cumbersome and bureaucratic.

Financially, the Swiss are required to make cohesion and research payments which have not always been popular domestically. Close relations with the EU also expose internal Swiss fiscal arrangements to constant sniping. Being economically close and politically distant also leads to continuing domestic tensions. Finally, given EU resistance to going further down the unreformed bilateral road, it is questionable whether the approach is sustainable. Indeed, some Swiss observers believe that bilateral deals were only agreed because the Union was hoping to encourage Swiss membership.

4.5 Outlook

Faced with EU regulation that specifically targets the financial market and largely excludes third-country based industries, the Swiss will have to choose between four options. The first, withdrawing from all deals and accepting that Switzerland would have no privileged access to the EU market, is a 'nuclear option' unlikely to appeal to business interests. The second, joining the EEA, is technically possible and might not change the status quo all that much but because it would both go back on the 1992 decision and represent a visible loss of sovereignty it is politically unacceptable to most Swiss. Even though some politicians are now canvassing the idea, having to copy and paste most EU legislation would clash with Swiss democratic ideals.

The third option, seeking full membership of the EU, is even more politically explosive, and the government has clearly and consistently ruled it out for several years despite claims that it is surreptiously preparing a referendum on entry. It has ruled entry out because of public hostility, despite the fact that it could give the country the influence it presently so obviously lacks. The only option left is the fourth one: continuing the status quo and autonomously adopting only as much regulation as necessary while accepting that the country will have to manage without any influence over the rules which significantly affect domestic policy. However, even here insecurity as to whether, when and in what form EU agencies and/or Member States will accept equivalence remains, and pros and cons of the four options will have to be reconsidered.

5 The challenges of Switzerland's approach to EU engagement

Switzerland's relationship with the EU has required it to balance closeness to the EU through continuous adaptation, while accepting a diminution of influence over adopted policy and regulation. It has required extensive and lengthy negotiations with Brussels on bilateral sector agreements, and new relations with other international partners together with structural changes at home.

5.1 The need for closeness

The most significant challenge faced by the Swiss is that economic integration with the EU without membership requires close and ongoing co-ordination with EU norms, notably through autonomous adaptation, most recently through the recent Swiss popular vote to create barriers to abusive executive pay which is in line with its own moves to cap bonuses. However, with EU policies which are not resonant with Swiss domestic opinion there is a significant price to pay in terms of policy autonomy and influence.

5.2 The need for continual adaptation

The second lesson is that any initial deal can only be a beginning, since the EU is a moving target. The Swiss government has had to remain adaptive and alert, ensuring that industry, particularly its financial sector, stays in close touch with changes in EU policy, despite not being able to influence policymaking.

This also poses challenges where Switzerland wishes to exert autonomy over policy; voices are now being raised in Brussels about the Swiss use of the emergency brakes clauses in its free movement agreements. Such concerns are likely to be increased by Swiss talk of rejecting at a referendum the extension of free movement to Croatia, something which could have disruptive consequences.

5.3 Going beyond free trade

A third lesson is that a free trade treaty would have been insufficient, making supplementary bilateral agreements necessary to access the Single Market. In the current context, for any country adopting such an approach, agreement on the degree to which national firms would be subject to EU regulation and ECJ jurisdiction would be essential. Any such agreement would also have to cover a sufficiently wide range of sectors, including financial services and would need favourable rules both on doing business via subsidiaries and branches and on cross-border business. Furthermore, appeal to the ECJ would only be possible in areas specified in a formal agreement.

5.4 Explaining and negotiating

Fourthly, the complexity of Switzerland's EU engagement may cause confusion to outsiders, particularly potential trading partners. Switzerland faces an opportunity cost of non-membership in terms of lack of influence over negotiation, in addition to the financial contribution required to maintain access to the Single Market. It also faces uncertainty over the potential for agreeing future sectoral agreements.

Outside tax questions, finance has not played a large part in Swiss-EU relations, partly because the country has been so integrated and partly because finance does not have its own bilateral accord. However, three more challenges emerge in terms of Swiss financial firms' access to the EU financial market. Switzerland does not have a bilateral service agreement with the EU on financial services, and while the Swiss financial services sector has so far performed well as a result of the establishment of wholly owned subsidiaries in London and other EU financial centres, under increasingly stringent third country rules it may have to consider separate deals with neighbouring states. As European-wide financial supervision and regulation are developed, the Swiss government is likely to be required to emulate the EU's approach to maintain market access.

The future form of engagement between Switzerland and the EU is difficult to predict as it will be contingent on attitudes both within Switzerland and the EU, transitory agreements and individual firms' reactions. In the last few years, the EU has rejected ideas of a new sectoral deal with Switzerland, demanding instead an agreement which includes automatic acceptance of the changing acquis, ECJ-like jurisdiction and dispute resolution together with assurances on consistent implementation.

5.5 Internal implications

Finally, continual adaptation of internal structures and policies is required to maintain Switzerland's current relationship with the EU. Equally, only because the Swiss government and its finance sector work together, has it been possible to resist external pressure: so extensive consultation and mutual support are key. Continuing internal contestation is also to be expected.

6 Concluding comments

Swiss relations with the EU are complicated, multifaceted and increasingly uncertain. They are an exception, created out of past Swiss need, policy and politics, developed over time and through a process of negotiation.

Swiss financial services firms face a significant amount of legal insecurity and multiple but 'equivalent' regulatory regimes. They depend on subsidiaries located in London and other European financial services centres to conduct cross-border business with EU member states, unless a formal bilateral agreement including financial services is negotiated (as a stand-alone arrangement or as part of a package deal).

As an approach, Swiss relationships with the EU are not a formal 'model', and the Swiss approach does not lend itself to being readily replicated. Moreover, Switzerland has embarked on a continuing process of informal Europeanisation to keep the country close to the EU where necessary – the approach therefore involves remaining closely connected to the EU rather than keeping a distance.

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