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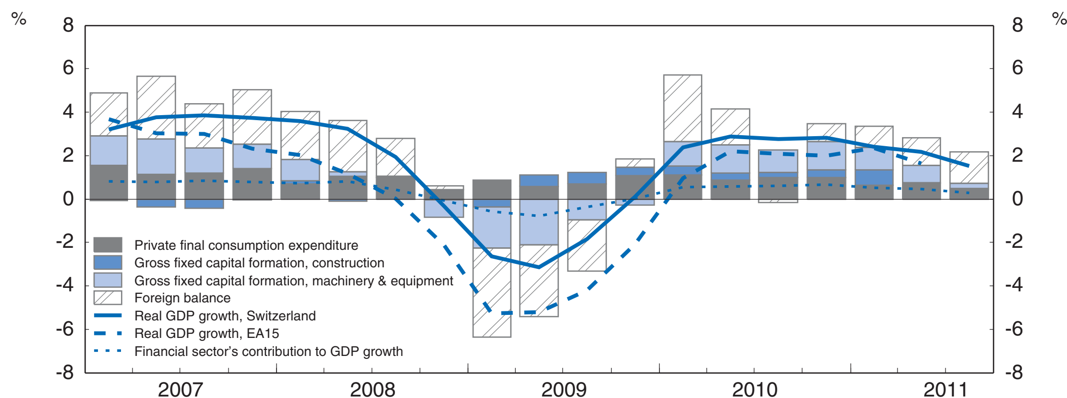
Assessment and recommendations

The economic recovery has been broadly balanced but risks to the outlook have increased

Switzerland emerged relatively early from a recession that had been less deep than in the euro area. The recovery continued in the first half of 2011, although with slowing momentum (Figure 1). Domestic demand has been boosted by investment, notably in construction. Financial services output has recovered, although at a slower pace than in previous expansions. Substantial employment growth has continued to lower unemployment while absorbing a large inflow of foreign workers (Figure 2, Panel A). While the output gap is now small, consumer price inflation remains low, as exchange rate appreciation damped import prices, notably for imported commodities and oil.

Figure 1. **Real GDP growth and its main contributors**

Year-on-year growth rates and percentage contributions



Source: OECD, *Economic Outlook 90 Database*; SECO.

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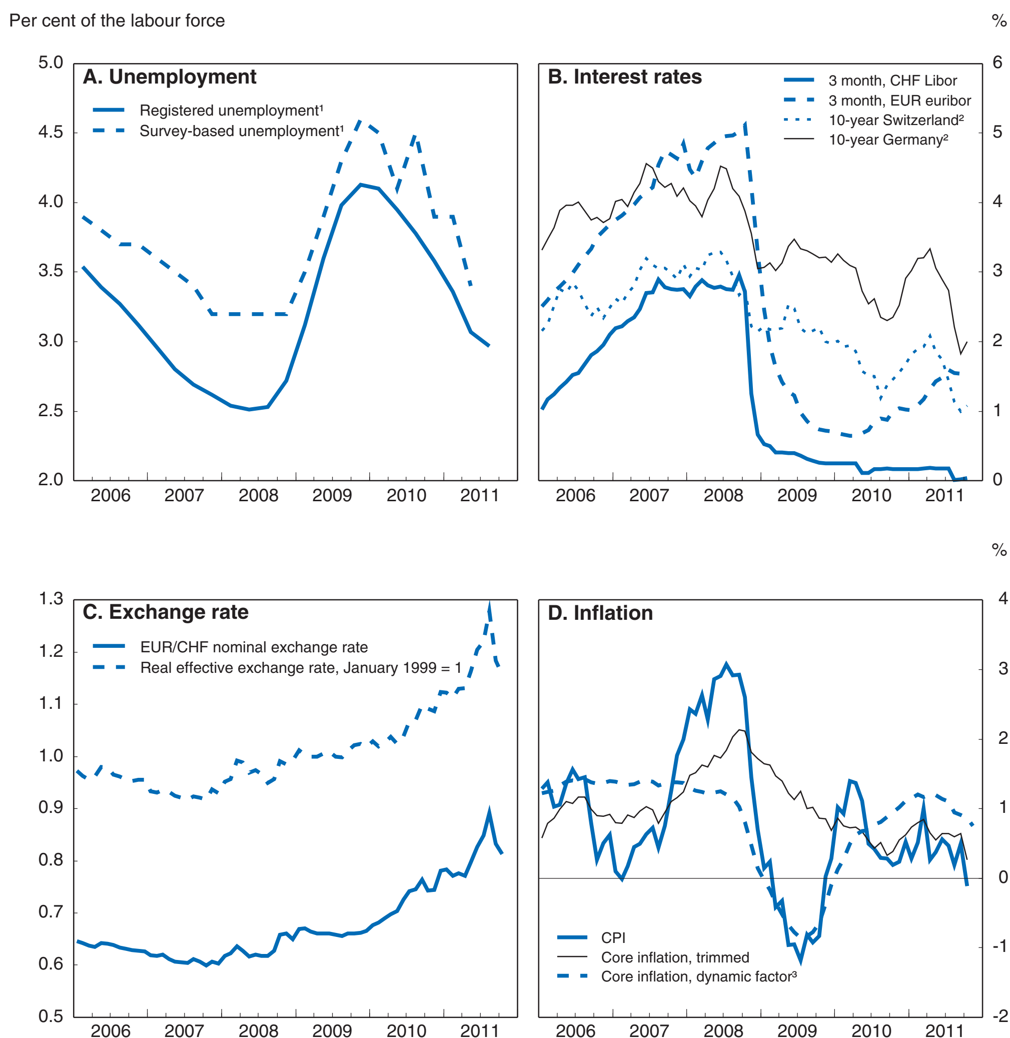
While uncertainty over the near-term outlook is substantial, especially in the context of the euro area debt crisis, economic indicators point to a period of economic stagnation in the near term, especially in manufacturing. This is related to decelerating activity in trading partners, notably Germany, and the appreciation of the Swiss franc. GDP growth may weaken in 2012, widening the output gap, and the unemployment rate is expected to bottom out (Table 1). Inflation is also likely to be low if the Swiss franc remains at its historic highs against major currencies. Nonetheless, according to OECD estimates, potential growth has not diminished as a result of the crisis and amounts to about 2%. It has been supported by a continued large inflow of foreign workers. However, while the

Figure 2. **Macroeconomic indicators**



1. Seasonally adjusted.
2. Sovereign bonds.
3. Dynamic factor inflation (DFI) extracts the inflation trend from a large number of nominal and real macroeconomic variables which allows it to anticipate movements in actual inflation.

Source: OECD, *Main Economic Indicators* and *Economic Outlook 90 Databases*; SNB, *Monthly Statistical Bulletin*, November 2011.

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aggregate productivity gap with respect to best-performing OECD countries has stopped widening in recent years, it remains substantial and reflects weak performance in some sectors not open to international competition. Despite progress over the past 15 years, there is hence scope for further reform of product market regulation, notably in services markets, including in network industries, as highlighted in earlier *Economic Surveys* and *Going for Growth*.

Table 1. **Short-term economic projections**

	2008	2009	2010	2011	2012	2013
	Current prices CHF billion	Percentage changes, volume (2000 prices)				
GDP at market prices	545.0	–1.9	2.7	1.8	0.8	1.9
Private consumption	308.7	1.4	1.7	1.1	1.3	1.3
Government consumption	59.3	3.3	0.8	1.3	1.5	1.6
Gross fixed capital formation	115.2	–4.9	7.5	4.2	2.9	4.2
Final domestic demand	483.2	0.1	2.9	1.9	1.7	2.0
Stockbuilding[1]	0.2	0.4	–1.2	–1.2	0.2	0.0
Total domestic demand	483.4	0.6	1.5	0.6	1.9	2.1
Exports of goods and services	307.3	–8.6	8.4	3.9	0.4	5.7
Imports of goods and services	245.6	–5.5	7.3	2.0	2.7	7.0
Net exports[1]	61.7	–2.4	1.3	1.3	–0.9	0.0
Memorandum items						
GDP deflator	_	0.2	0.1	0.8	0.2	0.3
Consumer price index	_	–0.5	0.7	0.4	0.0	0.3
Private consumption deflator	_	–0.5	0.7	0.6	0.2	0.3
Unemployment rate	_	4.3	4.5	4.0	4.3	4.0
General government financial balance[2]	_	1.0	0.6	0.8	0.5	0.6
Government debt[2]	_	43.7	42.6	42.0	41.2	40.7
Current account balance[2]	_	11.4	15.6	13.4	12.6	12.8

Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see OECD Economic Outlook Sources and Methods (*www.oecd.org/eco/sources-and-methods*).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.
2. As a percentage of GDP.

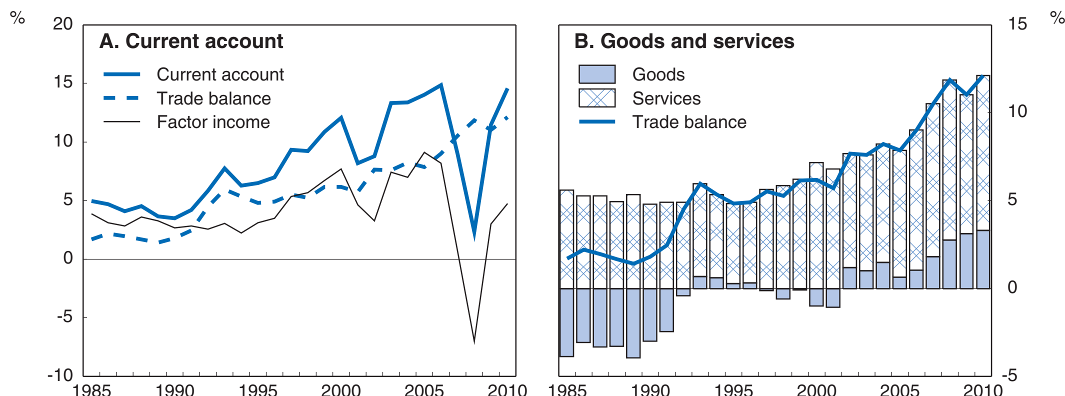
Source: OECD Economic Outlook 90 Database.

The strong appreciation of the Swiss franc is threatening the export sector

The trade-weighted real exchange rate appreciated to record levels as the Swiss franc benefited from capital inflows in the context of turbulence in some euro area debt markets (Figure 2, Panel C). The speed of the appreciation accelerated in 2011 and the real effective exchange rate, calculated by the Bank for International Settlements, was almost 40% above its long-term average in August. With an export share of 50% of GDP, the likely overvaluation of the exchange rate relative to fundamentals and the rapid speed of appreciation impose particularly heavy costs on sectors producing tradable goods and services. The current account surplus returned to its level observed prior to the crisis (Figure 3) in 2010, which is, however, not inconsistent with exchange rate overvaluation. Switzerland has a large current account surplus which is largely due to structural factors not related to the real exchange rate. The recovery in global financial markets boosted investment income, including profits from the foreign affiliates of the large Swiss banking and insurance institutions, as well as revenues from financial services exports. Exports of merchandise trading services, including the trading of raw materials, have expanded on a large scale in recent years. These services exports are little sensitive to exchange rate movements. Deteriorating price competitiveness in goods exports was more than compensated by strong global demand for Swiss goods and services, notably from emerging East Asian economies to which, according to OECD estimates, Switzerland has closer trade ties than most European OECD economies. Exports to emerging Asia have contributed more than a third to overall Swiss export growth since 2009. The specialisation of exports on goods and services which are research-intensive and patent-protected (such

Figure 3. **Current account and main components**

As a percentage of GDP



Source: *SNB, Monthly Statistical Bulletin*, November 2011.

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as pharmaceuticals) as well on luxury market segments may have contributed to this strong demand growth.

During the summer of 2011, exchange rate appreciation accelerated at an unprecedented pace, as the CHF-euro exchange rate fell from CHF 1.23 per euro at the beginning of July to less than CHF 1.05 per euro in August 2011, before stabilizing at around 1.2 following the change in monetary policy (see below). The negative effects of real exchange rate appreciation are subject to substantial lags. Surveys indicate that most firms have so far accommodated the appreciation by lowering margins and therefore have not reduced the volume of production. But exports have begun to fall. Export-oriented small and medium-sized businesses are particularly vulnerable because they depend on domestically priced inputs to a larger extent than large firms. In view of the sunk cost characteristics of investment in production facilities and firm-specific human capital, there is a risk that even temporary large exchange rate appreciation can have permanent effects on production supplied by these businesses, possibly resulting in large welfare losses.

Some concerns are emerging that a housing market bubble may start building up

Activity in domestically-oriented sectors has benefited from unusually low short and long-term interest rates (Figure 2, Panel B), reflecting notably the confidence financial investors place in the Swiss economy. Low interest rates have boosted domestic mortgage lending, which has already been growing vigorously for several years. The response of domestic demand growth to these developments has been moderate, in part because housing investment is inelastic to changes in prices. House prices appear to have accelerated and strong mortgage lending is increasing financial risks for banks and indebted households, which would be aggravated if interest rates were to rise sharply. In the assessment of the Swiss National Bank (SNB), house prices exceed fundamental valuations only in some local areas so far, although continued price increases could signal a housing bubble. Indeed, both outstandingly low interest rates and robust income growth generate a propitious setting for asset price bubbles to develop. Financial risks arising from the build-up of a house price bubble could be exacerbated by gross household

indebtedness that is among the highest in the OECD area, even though household financial wealth is also sizeable, reflecting, in part, the large funded component in the pension system. A housing bubble in the domestic housing market could increase risks faced by the domestically oriented, smaller, banks. This could add to the potential risks resulting from the large size of the two large, internationally oriented banks.

Monetary policy needs to remain expansionary

Core inflation measures have remained between zero and 1%. In view of the recent and massive exchange rate appreciation, and the deterioration of the global economic outlook, the output gap is expected to widen, keeping inflationary pressures low. According to the SNB's conditional inflation forecast, which is based on the assumption of a policy rate of zero percent, inflation will remain close to or fall below zero until 2013 and will increase to 1% by 2014. Monetary stimulus will therefore need to remain expansionary for some time, unless the scenario underlying the inflation projections changes, for example through a reversal of recent exchange rate developments. Since interest rates may therefore remain unusually low and liquidity abundant it is important that macro-prudential measures are taken in parallel to avoid excessive mortgage lending (see below).

To counter a rapid and massive appreciation of the Swiss franc in the summer of 2011, which seems to be largely driven by a search for safe havens by investors, the SNB lowered the upper limit of the target band for its policy rate – the 3-month Swiss franc LIBOR – from 0.75 to 0.25% on 3 August 2011. The SNB has also embarked on an unprecedented liquidity expansion through repurchase and foreign exchange swap transactions with the aim to weaken the Swiss franc. On 6 September, the SNB introduced a floor to the CHF/euro exchange rate of 1.20 CHF/euro and announced it stands ready to purchase unlimited amounts of foreign exchange to enforce the exchange rate ceiling. The SNB argued that the overvaluation of the Swiss franc poses an acute threat to the Swiss economy and that, without the lower limit, there would have been the risk of a deflationary development, which could have entailed mutually reinforcing declines in activity and prices. Even with the exchange rate above 1.20 CHF/euro there will be a period with negative inflation in 2012 according to the SNB's inflation forecast published in September. The SNB should weigh the benefits from this intervention against its potential risks. In view of the speed and the size of the appreciation, the intervention by the SNB was appropriate to fulfil its mandate to maintain price stability. A number of other countries have also recently taken unilateral action, ranging from currency intervention to measures to influence capital inflows. While these measures were introduced to achieve legitimate domestic policy objectives, were such practices to become more generalised they could collectively have negative spillover effects on trade and global capital allocation.

Fiscal policy should remain prudent

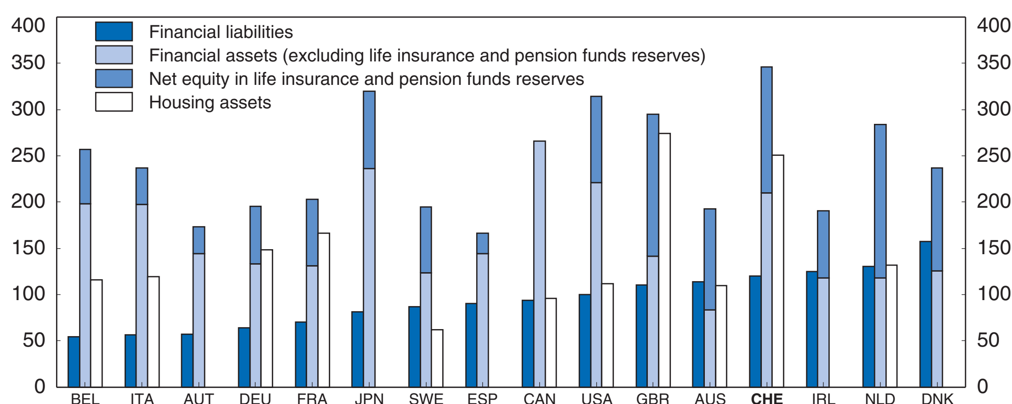
Prudent budgetary policies, a relatively mild recession during the global economic and financial crisis and a rapid recovery have kept the general government balance in surplus in 2010. Federal fiscal policy remains consistent with meeting the requirements of the debt-brake rule, which requires balanced budgets over the cycle. Relatively robust economic growth so far, sustained by domestic demand, may result in overestimating structural revenue growth. However, in view of the deteriorating economic outlook, the automatic stabilisers should be allowed to operate, even though this might result in a modest deterioration of budget outcomes.

Incentives for households to leverage their wealth should be reduced

Net wealth and net financial wealth are high, in part reflecting assets in pension funds, but gross debt of Swiss household is also high (Figure 4). The personal income tax system generates incentives for households to leverage their wealth. All interest on household debt is tax deductible, subject to a ceiling defined by capital income received and an additional 50 000 CHF per year (equivalent to two thirds of average disposable income). Incentives to leverage wealth are reinforced by the tax advantages on the returns of an important part of household wealth, including capital gains on stock holdings and pension fund assets. While data are limited, they suggest that taxation of imputed returns on owner-occupied housing raises little revenue in part because of difficulties in aligning imputed rents with market developments. Available tax data indicate that revenues from the taxation of imputed rents are negative as expenditures deducted by tax-payers appear to exceed imputed rents. Finally, early withdrawals of savings held in pension funds are taxed at a fifth of the full tax rate under certain conditions, and such withdrawals can be used to repay mortgages.

Figure 4. **Household assets and liabilities in high-income OECD countries, 2009**[1]

As a percentage of GDP



1. Non-consolidated excepted for Australia, for which only consolidated data are available.

Source: OECD, *National Accounts Database 2011*.

StatLink http://dx.doi.org/10.1787/888932560778

By giving incentives to household indebtedness, the Swiss tax regime can potentially aggravate any future period of financial instability. It also has undesirable redistributional effects, as the deductibility of interest payments mostly benefits wealthy households and distorts household financial decisions, generating deadweight costs as a result of excessive financial intermediation for the sole purpose of minimizing tax payments. The tax deductibility of interest expenses of households from personal income tax should be phased out although it should be kept for interest on mortgages for housing that is let. Once (and only once) the tax deductibility of interest expenses of households is abolished, taxation of imputed rents of owner-occupied housing should also be removed to ensure a consistent taxation of costs and benefits of owner-occupied housing. This combination would reduce administrative and tax compliance costs. Early withdrawals of pension fund assets should be taxed in full. These steps would also widen the base of personal income taxation and could therefore make room for lower labour tax rates, thereby increasing work incentives.

Changes in the tax structure could strengthen potential activity

The Swiss tax system is heavily geared towards the taxation of household income, which is more harmful to economic activity than taxation of consumption. By contrast, taxation of consumption of goods and services is low, including VAT and environmental taxes. Real estate taxes also make a minor contribution to tax revenues. Substituting taxation of goods and services for the taxation of personal income would be growth-enhancing. Several goods and services are fully exempt from VAT, creating significant distortions for activity, especially in upstream markets. As in other OECD countries, banking services are exempt from VAT and the government is evaluating the elimination of the tax on securities transactions. The base of the VAT should be widened, especially by removing exemptions. An increase in the standard VAT rate of 8% should also be considered. Options to apply the VAT to financial services should be explored in order to equalise the tax treatment of this sector with respect to other sectors. Higher environmental taxation is necessary to address both global and local externalities (see below). Personal income taxes should be reduced. Such a shift in the taxation would be likely to redistribute real disposable income from low income households to high income households, especially in view of the fact that low income households pay no or little federal income tax over a wide range of income. However, Swiss households pay lump sum contributions to compulsory health insurance on a per-capita basis. These contributions are also paid by low income households, although federal and cantonal governments pay transfers to lower the burden of these contributions for such households. The withdrawal of these transfers raises effective marginal taxes. These transfers could be withdrawn more gradually as income rises. Such a step would cushion the negative impact of an increase in the VAT on lower-income earners. Most working women work part-time. One factor is costly childcare, which holds back full-time female labour participation. There is scope for subsidizing the supply of childcare facilities more generously and effectively, as argued in several past *Economic Surveys*. Funding for childcare facilities should be increased and provided through a national voucher scheme to pay for services in accredited facilities. Such subsidies could be targeted to households on modest incomes. The provision of more generous subsidies for children from deprived socio-economic would maximize the educational benefits of childcare facilities.

Powers to set personal income tax rates are assigned to all three government levels (federal, cantonal and municipal). While tax competition among cantons and municipalities appears to have contributed to more efficient provision of public services, competition among cantons and among municipalities with respect to personal income tax rates has some negative side effects. Tax rates on low income earners are relatively high in poor cantons, as the mobility decisions of high-income households, who favour low-tax cantons, have tended to undermine their tax bases. Giving more room for real estate taxes to generate revenues for municipalities would allow the tax burden to shift from personal income taxation to the taxation of real estate, which is less harmful for economic activity. Such a shift could limit some of the harmful effects of tax competition that result from the selection effects of the dispersion of personal income tax rates across cantons and municipalities, as it would allow local governments to tax a relatively immobile tax base. Real estate taxes may also be particularly suited to funding municipalities because of the stability of revenues and the relatively close correspondence of such revenues with both spending needs and provision of local public services, which is capitalised in real estate prices. The scope for local governments to raise a higher share of

revenues from the taxation of real estate should be raised. Real estate is included in the general tax on net wealth. In addition, several cantons apply specific taxes to real estate. However, the revenues from these specific taxes are limited by the constitution to the level of expenditure on public infrastructure development in residential areas. This limitation should be removed. Cantons should consider assigning real estate tax raising powers to municipalities in full. Municipalities' income tax surcharges could be limited nation-wide.

Cross-border issues in taxation need to be addressed

Cantons use low lump-sum taxes to attract high-income individuals moving to Switzerland from abroad. These individuals can apply for lump sum taxation provided they do not engage in economic activity in Switzerland. At the federal government level, their tax liability is assessed by applying the personal income tax on the quintuple of the rental payment or the imputed rent for the Swiss residence. They may reduce the tax base in other OECD economies. The lump sum tax regime for non-economically active individuals should be abolished and these individuals should be subjected to the standard taxation of personal income and wealth. Such a step would also be consistent with the abolition of taxation of imputed rents more generally.

Switzerland has made progress in improving international co-operation in combating tax evasion, notably by revising its tax treaties with partner countries so as to incorporate fully the OECD standard on the exchange of information between tax administrations. Nonetheless, the peer review of Switzerland conducted by the Global Forum on Transparency and Exchange of Information for Tax Purposes has identified areas which need to be improved further in Switzerland. Notably, Switzerland should undertake the necessary measures to ensure that appropriate mechanisms are in place to identify the owners of bearer shares in all instances. It should also ensure that the identification requirements of the given taxpayer or the holder of the information in the revised double tax agreements as well as its interpretation thereof are in line with the standard for the effective exchange of information. The country has already introduced bills to address several recommendations made in the peer review report, in particular those dealing with the aforementioned identification requirements.

Box 1. **Three key recommendations on improving the tax system**

- To reduce incentives to leverage, tax deductibility of interest expenses of households from personal income tax should be eliminated (except for interest on mortgages for housing that is let).
- To enhance growth, the tax burden should be shifted away from labour towards less distortive taxes such as consumption taxes. To that aim, the personal income tax should be reduced while the base of the VAT should be widened and an increase in the standard VAT rate considered.
- To further improve potential growth and avoid negative side effects of tax competition, limitations on local governments' ability to raise real estate taxes should be eliminated, allowing higher real estate tax revenues to partly substitute personal income tax revenues at the local level.

Reform of regulation of the large, internationally active banks is essential to limit potential financial risks

While the two largest banks (Big-2) have downsized their balance sheets from a combined total of nearly seven times GDP in 2007 to 426%, they remain exceptionally large in international comparison (Table 2). Direct exposure to euro area crisis countries is low, but the Big-2 remain very highly leveraged, resulting in potential risks for taxpayers and the economy should losses recur. Current regulation allowed the Big-2 to maintain loss-absorbing capital levels below 2% of total assets on average at the end of 2010, even in the context of persistent global financial turmoil, although capital relative to risk-weighted assets is higher than in many internationally active banks. The past financial crisis has revealed that financial difficulties in one big bank can have potentially far-reaching consequences for the economy and could be very costly for tax payers.

Table 2. **Banks' total assets in per cent of GDP**

		2007	2010
Euro area	Credit institutions	317	338
	MFIs	330	350
Switzerland	All banks	669	505
	Top 2 banks[1]	693	426
United Kingdom	MFIs	486	542
	Top 2 banks[1]	117	165
Denmark	Banks	232	240
	Top 2 banks[1]	261	259
Netherlands	MFIs	379	382
	Top 2 banks[1]	274	268
Ireland	Credit institutions	706	759
	Top 2 banks[1]	194	203

1. Data include foreign subsidiaries' assets.
Source: SNB; ECB; National Central Banks; OECD *Economic Outlook 90 Database*; Eurostat and Bankscope.

The government has presented draft legislation with proposals to reduce the potential need for large scale public rescue operations, on the basis of the recommendations of an expert commission. The draft legislation was approved by parliament in September 2011 with minor modifications. The new legislation foresees tighter capital requirements, which are expected to require capital to amount to about 19% of risk-weighted assets in the Big-2, and a leverage ratio requirement which is currently estimated to reach around 5%. However, these measures, once approved, will be implemented over a transition period of several years, in line with the Basel III process. The low capacity of the Big-2 to absorb losses requires prompt corrective action, especially in the context of ongoing financial instability. The regulator should require the Big-2 to hold more loss-absorbing capital relative to total assets in the near term.

The capital levels foreseen in the new legislation include a basic requirement, a buffer component banks have to build up and retain when profitable as well as a progressive component which varies in line with the banks' balance sheet size and their market shares in domestic lending markets. The progressive component, in particular, is well suited for reducing moral hazard and associated risks among large banks, and counteracting incentives for banks to grow bigger so as to benefit from implicit government guarantees. Close to half of the required capital can consist of contingent convertible bonds (CoCos, see

below), the remainder being common equity. Common equity, the valuation of assets and their risk weights are defined in line with Basel III.

The reform package makes substantial progress in reducing financial risks. A leverage ratio of about 5% for the Big-2 is however still modest in view of the risks involved from losses of a similar or larger order of magnitude. While most of the Big-2's assets are foreign, they account for close to 30% of domestic lending. Recent theoretical and empirical research indicates that higher capital requirements do not generate substantial social costs in terms of lower credit volumes, while providing significant benefits not only for financial stability but also lending quality, as they reduce moral hazard from implicit government loan guarantees. The need for substantial tightening of capital requirements is reinforced by the absence of an internationally co-ordinated resolution mechanism which could help avoid the rescue of a failing bank by the government (see also below). It is crucial that, at the least, the proposed capital requirements for the Big-2 are implemented in full. A stricter leverage ratio requirement should be introduced.

The reform also foresees requiring the banks to develop minimum contingent procedures to enable them to keep systemically important activities afloat, while closing down others, when their capital falls below critical thresholds. However, these requirements have yet to be spelled out. The reform package foresees that banks which improve their capacity to be unwound orderly beyond the minimum requirements to maintain systemically important functions can get a rebate on the capital requirements. Systemically important activities to be protected have yet to be defined, but will in any case relate to domestic financial markets only. In view of the global scope of the Big-2's activities and the close financial and reputational links between the components of banking groups, credible resolution plans will require an internationally co-ordinated approach at the group level. It is important that reductions in capital requirements are only granted if credible internationally co-ordinated resolution mechanisms at the group level are presented by the Big-2 and that they are discussed in the multilateral supervisory colleges, as intended by FINMA.

Contingent convertible bonds (CoCos) can contribute close to half of the new capital requirements. Their conversion into paid-in capital will be triggered when the regulatory accounting value of common equity relative to risk-weighted assets drops below predefined thresholds. Additionally, these CoCos include a non-viability clause which can be triggered by FINMA if there is a threat of insolvency according to FINMA's assessment. There is a risk that regulatory accounting values may reflect the true financial situation of banks only with a considerable delay, especially if most assets, such as loans, are not subject to mark-to-market valuation rules. Risk weights are determined by the banks' own models and have in the past proven inadequate, while regulatory forbearance contributed to lack of corrective action. Book valuations are subject to some managerial discretion and management is required to defend incumbent stockholders' interests, which may incline management to avoid conversion. For these reasons, it is important that book values of the banks concerned are assessed independently, especially with respect to the banks' own risk assessments. While the non-viability assessment provides another safeguard against late conversion, it is subject to FINMA's discretion and may generate the potential risk of regulatory forbearance. On the other hand, triggers based on market valuations of the Big-2 alone risk fostering speculation to push market valuations down to the trigger value, which could destabilize the market. The accounting triggers for the contingent convertible bonds (CoCos) should be complemented by market indicators: when the stock price of one (or

both) of the Big-2 banks that issue the CoCos drops sharply, the authorities should monitor the viability of the bank and if necessary activate the non-viability clause triggering conversion.

The reform stipulates two different thresholds for the conversion of CoCos into common equity. Two thirds of the CoCos the Big-2 can issue to meet capital requirements may be subject to a conversion trigger of 5%, while the conversion of the remaining third is to be triggered at 7% of common equity relative to risk-weighted assets. The lower trigger is set just above the minimum common equity that banks will be required to hold at all times, set at 4½ per cent of risk-weighted assets. A belated conversion would entail more significant risks for the CoCos subject to the lower conversion trigger, reinforcing the need for the banks to hold substantial common equity buffers.

Regulators should ensure that the Swiss financial system is prepared for a simultaneous trigger of CoCos issued by the Big-2. In particular, it would be dangerous for the Swiss financial system if the buyers of CoCos are concentrated within a few Swiss financial institutions. To this end, it is useful to limit exposures of all Swiss financial intermediaries to the Big-2. Such limits are already in place for the banks. The two largest Swiss insurance groups' balance sheets sum to more than 100% of GDP. Significant exposures to the Big-2 could exacerbate any financial risks in the Big-2. For insurance companies specific provisions on risk concentration *vis-à-vis* the Big-2 should be considered.

Macroprudential considerations need to be incorporated effectively in prudential regulation

To strengthen macro-prudential regulation, co-ordination between the government, the financial market regulator (FINMA) and the SNB was improved in 2010 and 2011, including through the regular exchange of information and co-ordinated crisis prevention. FINMA and the SNB can jointly define projects of common interest, in which they consult each other but they are not generally required to do so. The current financial crisis showed that the supervision of individual banks needs to incorporate explicitly developments in domestic and international financial systems to assess risks fully. The authorities are considering options how to strenghten macroprudential oversight and the government has announced the introduction of macroprudential tools for the mortgage market. In view of its macroeconomic expertise and its responsibility to contribute to the stability of the financial system, a leading role of the SNB in ensuring that system-wide risks and macroeconomic developments are adequately reflected in prudential regulation would be desirable. The role of the SNB in microprudential regulation should be strengthened to ensure that system-wide risks are taken into account in such regulation. For example the SNB could be mandated to propose measures to incorporate system-wide risks in regulation. FINMA could be required to either comply or explain, while retaining its ultimate regulatory competence.

Neither FINMA nor the SNB have powers to impose cyclically-dependent buffers across all banks, or temporary rules to prevent excessive lending growth, for example in the mortgage market. Implementation of Basel-III rules will result in the introduction of a counter-cyclical buffer starting in 2016, which may be too late for preventive action in the domestic mortgage market. Therefore, the Swiss authorities are considering introducing such a buffer already in 2012. The SNB should be given powers to introduce macroprudential instruments. These could be, for instance, time-variant counter-cyclical

capital buffers or measures to curb excessive lending growth, such as limits on the loan-to-value ratio or the debt service-to-income ratio.

There is a need to strengthen system-wide oversight over mortgage lending, especially in view of persistently low interest rates. Such oversight is critical in a country hosting a major international financial centre. For example, no statistics are available on average loan-to-value ratios and their frequency distribution in new mortgages. Current legislation does not give sufficient powers to the SNB to require commercial banks to provide all the necessary information, for example, to ensure that data can be aggregated across banks. Some indicators suggest that house price rises have accelerated recently, with signs of prices rising above fundamental values in parts of the country. Some gaps in available data hamper the monitoring of financial risks. The SNB should be enabled to collect all the necessary data for effective oversight over the domestic mortgage market. The authorities are reviewing the improvements needed in data availability to strengthen macroprudential oversight.

Some reform of the regulatory framework for the small banks active in domestic lending markets would help reduce potential risks further

Cantonal banks, which are mostly owned by cantonal governments, have recently been particularly active in mortgage lending. While their individual balance sheets are relatively small, they are on aggregate important players in the domestic lending market. The widespread guarantees of cantonal banks by cantonal governments, which lower their funding costs, may help them gain market shares, especially in the current context of diminishing interest margins, and may encourage them to take on excessive risks. These risks are potentially heightened by the dependence of these banks on revenues from mortgage lending and the concentration of cantonal banks in their respective local markets, some of which have overheated. Explicit government guarantees to the cantonal banks should be eliminated.

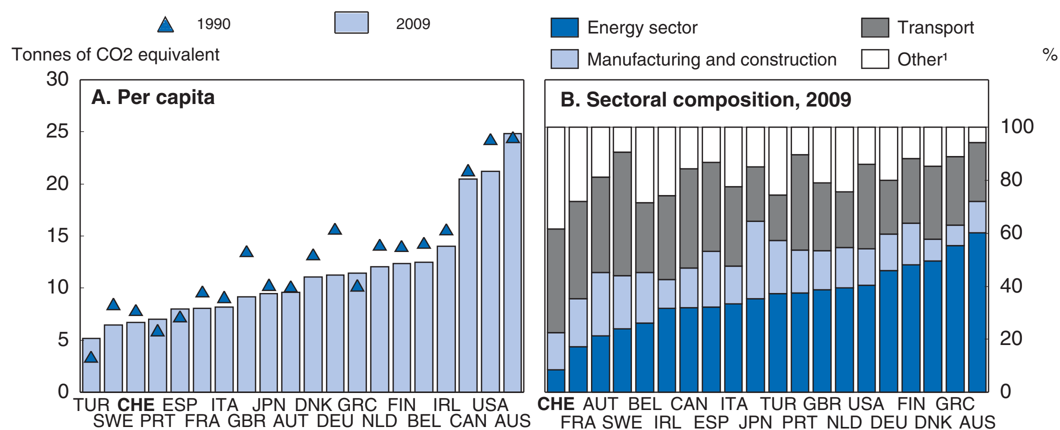
Box 2. **Three key recommendations on reducing risks in the financial system**

- A stricter leverage ratio requirement, above the foreseen level of around 5%, should be introduced. Preferably, common equity should contribute a larger share to the capital requirement.
- Credible and internationally co-ordinated resolution mechanisms at the group level should be in place for the Big-2 before any reductions in capital requirements are granted.
- To avoid imbalances building up, macroprudential tools should be introduced, such as measures to slow credit growth. The SNB should be enabled to collect all the necessary data to oversee the mortgage market.

Meeting greenhouse gas emission reduction targets requires more cost-effective policies

Switzerland is characterised by a low level of greenhouse gas emissions per capita (GhG) as compared to other countries which reflects the strong reliance on energy sources emitting small amounts of greenhouse gases and an industrial structure with a negligible weight of heavy industries (Figure 5, Panel A). Greenhouse gas emissions have remained

Figure 5. **Total per capita greenhouse gas emissions and percentage contributions to greenhouse gas emissions by sector**



1. "Other" cover emissions from fuel combustion in the following sectors: commercial/institutional; residential; agriculture, forestry and fishing.

Source: UNFCCC Database.

StatLink http://dx.doi.org/10.1787/888932560797

almost the same since 1990 (Figure 5, Panel A), as emission reductions in the residential and industrial sector were offset by increases from the transport sector. Estimates suggest that Switzerland may not meet its 2012 Kyoto target of an 8% cut of greenhouse gas emissions below the 1990 level on average between 2008 and 2012. However, efforts to ensure compliance are under preparation. Meeting the 2020 target of a 20% emission reduction below the 1990 level will necessitate more cost effective policies so as to minimize losses in welfare and activity that may otherwise arise. This is particularly important as Switzerland is characterised by relatively high estimated marginal abatement costs.

Rendering the current policy mix more cost-effective would require addressing three general issues. *First*, efficiency could be increased by aiming at a uniform implicit carbon price within and across broad sectors. *Second*, prioritising quasi-voluntary measures before recourse to more effective market-based instruments, such as taxes or emission trading, may not produce the desired incentive effect for emission reduction and may reduce the political acceptance of a price on all greenhouse gas emissions. *Third,* the frequent use of revenues from taxes and levies for earmarked projects may reduce their effectiveness and waste resources.

The implicit carbon price in road transport is low

Road transport is the sector with the highest CO_2 emissions in Switzerland (Figure 5, Panel B) and CO_2 emissions from road transport have been continuously increasing, notably due to increased passenger road transport. CO_2 emissions are higher in congested traffic, as fuel consumption is up to two or three times as high in stop-and-go traffic as compared to fluid traffic. Congestion has increased eight-fold over the past 15 years, up to 15 000 hours in 2010. Addressing problems resulting from increased road transport, in particular congestion, would have a double dividend as they generate other important external costs for the society.

The implicit carbon price from road transport is very low, underscoring even more the large potential for emission reductions at low overall costs in the road transport sector. Swiss excise duties on transport fuel consumption are not high enough to create sufficient incentives to reduce emissions from car use. Estimates suggest that the revenues from fuel tax may not even be high enough to cover other transport-related costs. While high on diesel, the level of the excise duty on unleaded gasoline, which is used by the majority of cars, is low in international comparison. Moreover, commuting costs are tax-deductible. While the Swiss heavy vehicle fee (HVF) is an effective and flexible policy instrument, it is restricted to freight transport, which accounts for only 10% of total road transport. As part of Switzerland's efforts to tackle climate change, the Swiss Parliament has recently adopted legislation for more stringent emission performance standards for new passenger cars, in line with EU regulation. Also the energy efficiency label for cars is welcome as it helps to enhance the awareness of environmental costs linked to transport fuel consumption. However, the standards and the label are only likely to be fully effective if combined with price based measures.

In order to address CO_2 emissions from road transport, a CO_2 levy on transport fuels should be introduced. This levy would best be combined with a variable congestion charge that would be higher in congested geographical areas and periods of peak demand. In contrast to an overall flat rate levy, congestion pricing induces an efficient use of roads by redistributing demand for car use in time and space. Furthermore, since it would internalise a large part of the external effects from car use, the respective CO_2 levy would be lower than would otherwise be necessary. The most flexible and effective congestion charge system would consist of an electronic pricing scheme using satellite navigation. Even in such a system, confidentiality can be ensured without changing the institutional setting. Introducing a congestion charge early on could ensure that CO_2 emissions from road transport are dealt with soon. A congestion charge should be embedded in a broader mobility pricing framework that the government is planning to introduce in the longer run.

The policy mix in the residential sector can be made more cost effective

Despite the potential for reduced energy consumption from energy-saving renovation and reduced greenhouse gas emissions, there seems to be little incentive to renovate older buildings. About 85% of all dwellings are more than 30 years old while only 10% of dwellings have been constructed within the past 10 years. Moreover, only about 1% of the dwellings are renovated per year. One important reason for this are high investment costs relative to potential savings and lack of information on available technology and the savings it generates. The structure of the housing market also contributes, as two thirds of Swiss households live in rental dwellings, combined with rent regulation that makes it uncertain for home-owners whether they can pass on energy-saving investment into higher rents. To encourage energy-saving investment, a CO_2 levy on fossil heating and process fuels came into force in 2008 and the rental law was amended to make it easier for owners to pass on the costs from energy-saving investments. In 2010, the government launched a buildings programme which consists of financial incentives to individual renovation projects, financed by one third of the CO_2 levy's revenues.

There is scope to make this policy mix more cost effective. *First*, even with the 2008 amendment to the rental law, it may remain uncertain for owners whether their renovations will ultimately be judged as energy-saving, which would allow owners to pass on costs from energy-saving renovations to higher rents. The definition of energy-saving

renovations should be based on clearly defined criteria, *e.g.,* potential gains in energy efficiency achievable through the renovation. Moreover, if owners can only pass on the costs to the rent, leaving all of the return of the investment to the tenants, owners may still have an insufficient incentive to undertake energy-saving investment. If the extent to which rents can be raised was linked to potential energy efficiency, beyond cost recovery, owners would have a stronger incentive to undertake energy-saving renovations. A complementary tool would be to make provision of information on energy efficiency of dwellings compulsory.

Second, the use of the CO_2 levy in the residential sector should be revised. The level of the CO_2 levy is substantially lower than an estimated efficient uniform CO_2 tax and may hence not induce a sufficient incentive for energy-saving renovations. Moreover, while the buildings programme addresses some informational barriers on the side of the households, a significant risk of deadweight losses remains while achieving relatively modest emission reductions on top of those achievable through the levy. This risk arises especially since the subsidies in the buildings programme apply to all energy saving renovations, and are not targeted at renovations of rented dwellings. Once rent regulation is improved as suggested above, and a higher level of the CO_2 levy is eventually put in place, the financial incentives in the framework of the buildings programme would become redundant and should hence be gradually phased out. During the phase-out, subsidies should be made more restrictive, for instance by linking subsidy allocation to potential gains in energy efficiency.

Linking the Swiss and the EU emission trading system will help, but steps are required in the transition to the new system

In Switzerland, the industrial sector contributes only about 10% of total greenhouse gas emissions (Figure 5, Panel B) and has managed to largely decouple emissions from production. The current policy mix to reduce CO_2 emissions in the industrial sector goes in principle in the right direction as it involves market-based instruments to a large extent. The CO_2 levy on fossil heating and process fuels also applies to the industrial sector. Firms that are exempted from the CO_2 levy for competitiveness reasons can participate in the recently established Swiss emission trading system, and in March 2011, Switzerland and the EU started negotiations with a view to linking their emission trading systems. The government is committed to its efforts to link the Swiss system (Swiss ETS) with the EU emission trading system (EU ETS) as this would allow Swiss firms to trade in a much larger and efficient system, and it has the potential to provide Switzerland with a more cost-effective way to reduce emissions.

There do not appear to be precise criteria as to the definition of loss in competitiveness or the level of energy intensity needed to justify an exemption from the CO_2 levy on fossil fuels. Firms can be exempted from the levy if they establish an agreement with the regulator to meet a bilaterally negotiated emission target. This setting risks that CO_2 emissions are not priced, reducing the efficiency of the CO_2 levy. The overall impact of the CO_2 levy on firms' competitiveness is small, reducing the need for exemptions from the levy for competitiveness reasons. Swiss firms should be obliged to either pay the levy or participate in the emission trading system. For instance, firms in sectors covered by the EU ETS could participate in the emission trading system, while for firms in sectors not covered by the EU ETS, exemptions from the tax should be phased out.

The government's plan to set up a list of criteria to be met by firms requesting exemption from the levy is a first step in the right direction.

The Swiss ETS is a baseline-credit system. Firms can choose whether they want to participate or not and emission allowances are allocated to the companies free of charge, in accordance with the bilaterally negotiated targets. On top of distorted emission reduction incentives that result from bilaterally negotiated targets, this design also entails adverse selection in that only those firms participate that would have reduced their emissions in any case. For instance, giving emission permits for free is likely to reduce the incentives of firms to cut emissions and hence to participate in permit trading, because firms who made large cuts in emissions risk being granted fewer emission permits in the future. Within the ETS, emission targets should be set in the sense of binding emission caps for the industry as a whole. Beyond improved incentives, this step would also move the Swiss ETS closer towards a cap-and-trade system which will be required for the linking with the EU ETS anyway. Emission permits should also be auctioned, at least up to the limit foreseen in EU rules. Steps in this direction are planned in the draft revision of the CO_2 Act.

The Climate Cent Foundation, a voluntary initiative by the Swiss oil industry, uses the revenues from a small levy on imported fuels to finance domestic and international emission reduction projects, notably projects in the framework of the UN clean development mechanisms (CDM). The financing of such projects has the potential to reduce emissions at very low cost, compensate for carbon leakage, and boost the transfer of cleaner technologies to developing countries. However, verifying that the international projects produce emission reductions on top of those which would have resulted anyway is difficult. There is scope for Switzerland to work towards improved environmental integrity of the international emission reduction projects Moreover, owing to its obligation to contribute to emission reductions within Switzerland, the Climate Cent Foundation has a position of a dominant player and can set emissions allowance prices inhibiting competition in the Swiss ETS. The Climate Cent Foundation should not be allowed to distort the emission trading market. The right to collect the climate cent should be replaced by a CO_2 levy on transport fuels as recommended above.

Box 3. **Three key recommendations on reducing greenhouse gas emissions**

- In order to address strongly increasing CO_2 emissions from road transport, a CO_2 levy on transport fuels should be introduced. This would best be combined with the introduction of a time- and area-dependent congestion charge.
- To boost energy-saving renovation in the building sector, rental regulation should be further improved. The definition of energy-saving renovations and the extent to which rents can be raised should be based on clear criteria, *e.g.*, potential gains in energy efficiency achievable through the renovation.
- The ongoing efforts by the government to link the Swiss system with the EU emission trading system (ETS) are strongly encouraged. Several steps would have to be made to make the climate policy mix in the industrial sector more cost effective in the transition towards this linking.

ANNEX A1

Progress in structural reforms

This table reviews action taken on recommendations from previous *Surveys*. Recommendations that are new in this *Survey* are listed at the end of the relevant chapter.

Recommendations in previous Surveys	Action taken since September 2009
A. Competition	
Apply the prohibition principle to all hard-core cartels. Raise ComCo's resources and ensure its independence by excluding members that represent economic interests.	The Federal Council will submit a revision of the Federal Act on Cartels to the Parliament in 2012 establishing a new independent competition authority and ban certain forms of vertical and hard core horizontal agreements if they are not justified by efficiency reasons. The SIEC test (Significant Impediment of Effective Competition) shall be introduced for merger control. ComCo has been endowed with additional personnel in 2011.
Consider introducing criminal sanctions to punish people responsible for anti competitive behaviour.	Reform proposals to introduce administrative and criminal sanctions against private persons were submitted to public consultation.
Reform the bankruptcy law to reduce the prescription period and facilitate the use of the concordat procedure.	A proposed reform of the concordat procedure which would facilitate the financial reorganization of companies is being discussed in Parliament.
Strengthen the independence of sector regulators.	Legislation should enter into force in the second half of 2012 making the postal regulator (PostCom) independent from the Federal Council and endowing it with the power to impose fines. The government plans to make the electricity market regulator independent from the Federal Office of Energy in 2012.
Privatise remaining government-ownership in potentially competitive market segments of network industries.	None.
Harmonise procurement rules across cantons, lower threshold values for public tendering, improve the accountability of procurement actions and benchmark public procurement costs at lower levels of government.	A revised ordinance has simplified procedures. Procurement statistics have been improved and prices are being benchmarked.
In the electricity sector, introduce ownership separation between generation and transmission, strengthen the powers of the regulator, introduce price caps and benchmark regulation, use regulatory accounting rules for the determination of network access prices.	The strengthening of the separation of the Swiss transmission system operator Swiss grid from other activities as well as *ex ante* benchmark regulation of access prices are under consideration.
In telecommunications, apply *ex ante* regulation to access conditions to the local loop and to interconnection charges.	*Ex ante* regulation is being discussed in Parliament.
In railways, make tendering of regional passenger services compulsory, ensure non-discriminatory access to rolling stock and allow competitors to propose investment projects. Base investment decisions on an independent cost-benefit assessment.	Parliament is considering introducing tendering of regional passenger transport services, although not on a compulsory basis, as well as rules on the provision of the incumbent's rolling stock for services tendered to competitors. Co-ordination regarding investment projects among the infrastructure operating companies, transport companies and the authorities have been introduced, but not in freight.
In postal services, eliminate restrictive personnel rules and administrative privileges applying to the incumbent. Abolish sector-specific regulation regarding the fixing of pay and working conditions.	Differences in rules and regulations have been eliminated, except for universal services obligations.

Recommendations in previous Surveys	Action taken since September 2009
In agriculture, remove impediments to structural change in land law. Reduce protection against imports. Eliminate collusive actions among producers. Lower subsidies and shift them towards direct income support.	Expenditures for market support have been further reduced and shifted towards direct payments. Payments for the dairy sector were abolished and customs duties on processed cereals for human consumption reduced.
B. Labour market	
Improve the integration of foreign workers. Harmonise the rules on the lengths of residency for naturalisation.	A study on the integration of EU-citizens has been published in 2011 and a thematic review by the OECD is underway. Draft legislation which aims to grant Swiss citizenship after 8 instead of 12 years of residency and to limit the power of the local authorities in setting the duration of residency is being discussed in Parliament.
Lower the maximum duration of unemployment benefits.	The maximum duration of unemployment benefits has been lowered for workers with short contribution records and a special rule for regions with particular unemployment problems has been abolished.
Provide students from non-EU countries graduating in Switzerland more time to find a job in Switzerland.	Legislation from January 2011 stipulates that foreign nationals with a Swiss university degree may be admitted if their work is of high academic or economic interest. They shall be temporarily admitted for a period of six months following completion of their education or training in Switzerland in order to find suitable work.
C. Education	
All cantonal governments should introduce compulsory, free schooling from the age of 4, set common educational objectives for this phase, and offer full-day attendance.	The HarmoS-Concordat came into effect in August 2009. 15 cantons (representing 76% of the entire population) have ratified the Concordat. It introduces compulsory education from the age of 4, common educational objectives, and the obligation to offer day-schools.
Introduce a national voucher scheme and a national system of accreditation of facilities to support childcare provision for children below the age of 4.	The Conference of Cantonal Directors of Social Affairs has published recommendations for quality standards. The Confederation subsidizes innovative projects like vouchers at cantonal and local levels.
Strengthen the capacity of early childhood education and childcare facilities to support children with specific education needs. Promote access of the foreign population to early childcare services.	Support of children up to 6 years with specific needs is being integrated into the public education system.
Investigate regularly the impact of differences in education policy, spending and resources across cantons and determine best practice. Evaluate regularly education outcomes, as foreseen in HarmoS concordat.	National education standards for compulsory education in key competencies were adopted in June 2011 by the Swiss Conference of Cantonal Ministers of Education.
Strengthen accountability of schools for education outcomes. Conduct regular external testing over the school career at all schools, and benchmark the results against the newly defined competency objectives.	Regular evaluation of the achievement of the national education standards (see above) is planned within the national education monitoring. The evaluation will be based on sample classes.
Introduce management staff, responsible for objective setting, improving education practice, evaluating and helping to develop teaching skills. Require head teachers in all cantons to acquire school management skills.	Almost all schools have a school head, responsible for managing a school. Common standards for the skill needs of school heads (continuing education) were adopted by all cantons.
Reinforce school autonomy with respect to defining teaching content and materials.	None.
All cantons should participate in the review of the placement of children with learning difficulties or disabilities in separate schools and classes as foreseen in the concordat.	The Intercantonal Agreement on Special Needs Education came into effect. All 12 cantons which ratified the concordat to date will adhere to the policy of preferring the integration of children with special education needs in regular classes over separation. Federal legislation will apply these rules to the remaining 14 cantons.
Postpone first tracking to the age of 13 in all cantons and raise mobility across school tracks subsequently.	All cantons with first tracking at age 11 or 12 will extend duration of primary education so as to postpone first tracking to the age of 13.
Review whether the current mix of vocational and education training and academic education for young people is right for the needs of the labour market.	None, except an analysis of the private and social returns from education in the Swiss Education Report 2010.
Improve the system for recognising immigrants' qualifications, and implement plans to validate skills acquired through experience. Further improve the supply of language teaching for immigrants.	The process for the validation of formal, informal and non-formal skills to obtain a Federal vocational education and training diploma has been defined for more than 30 professions. In the future, more professions will be included in line with demand. Cantons boost language teaching for immigrants with funds from the Federal Office for Migration.

Recommendations in previous Surveys	Action taken since September 2009
In higher education, consider a rise in tuition fees while making government-sponsored loans widely available, coupled with income-contingent repayments.	None since the formulation of an inter-cantonal agreement aimed at harmonizing scholarships and loans at national level (the Stipendien-Konkordat). So far, the agreement has been ratified by six out of the twenty-six cantons.
D. Fiscal policy	
Benchmark the cantons' and communes' employment and civil servants' salaries for each area of spending.	None.
Remove stamp duties on issuance of equity and housing market transactions.	Stamp duties on issuance of debt will be abolished by 2012. Removing stamp duties on issuance of equity is being discussed. No action taken as concerns taxing housing market transactions.
Introduce a moderate capital gains tax for private households' holdings of equity stocks.	None.
Reduce the number and breadth of exemptions and reduced rates in the VAT.	Draft legislation to broaden the tax base by abolishing most of today's exemptions and to uniform VAT rates is pending.
E. Health care	
Do away with the mixed hospital funding system, assigning the funding responsibility to insurers.	The Federal Council approved a report on uniform funding of hospital and outpatient services by the compulsory health care insurance.
Require that patients pay the difference in the price of a branded product and lower-priced generic. Eliminate cantonal policies that allow practicing doctors to dispense drugs.	Co-payment for equivalent products with the same active substance is increased from 10 to 20% if prices exceed the average price of drugs in the lowest third of the price range of products containing the same active substance by more than 20%, irrespective if originator or generic drug.
Include diagnostic information in determining risk-compensation payments among health insurers. Improve incentives for insurees to enrol in managed-care programmes. Allow greater freedom for insurers to contract with providers.	The criteria defining the payments to or from the risk compensation fund are extended by information on hospital stay in the preceding year. Introducing information on out-patient treatments is being discussed in Parliament.
F. Old-age and disability insurance programmes	
Consider indexing the retirement age in the first-pillar system to changes in average life expectancy. Deal with lack of sustainability through adjustments to contribution rates, benefits and required years of contributions.	None.
Introduce incentives for prolonging work after the standard retirement age.	Incentives have been raised in the second pillar; no action taken in first pillar.
Allow pension funds to set the conversion rate. Index the minimum interest rate to realised market returns. Reassess the generosity of tax incentives for the occupational schemes.	None.
Reduce the marginal effective tax rates on labour income of disability insurance beneficiaries. Regularly test their work capacities during the first few years of receipt, and randomly thereafter.	A government proposal aims to reduce disincentives to resume work. Beneficiaries are monitored as to their capability to take on work.
G. Regulation of financial intermediaries	
Base prudential standards for financial institutions on their systemic and micro-prudential risks.	Capital adequacy requirements for banks under Basel II (except the Big-2) have been redefined. The new requirements are based on banks' total assets, assets under management, privileged deposits and required equity capital. A capital adequacy target and an intervention threshold have been introduced for the capital ratios.
Ensure that the big two banks' capital adequacy remains among the most stringent of major international banks.	Legislation tightening capital adequacy requirements beyond international norms was approved by Parliament (see Chapter 2).
Establish rules based mechanisms mandating cyclical capital buffers based on indicators of the market cycle and risks.	A countercyclical buffer (CCB) will be introduced in the course of the Basel III implementation. A draft ordinance has been sent to public consultation, which includes also the possibility for an activation of a CCB prior to the Basel III time line.
Raise the leverage ratio of capital to the book-value of Big-2 assets to at least 4% for the consolidated level. Include domestic lending in the assets used to compute the ratio.	Legislation foreseeing a stricter leverage ratio requirement has been approved by parliament (see Chapter 2).
Consider measuring the aggregate exposure of individual insurers to one or more of the Big-2, and ensure that insurance companies have appropriate limits.	None. On an ongoing basis, counterparty exposures of all insurance groups/conglomerates are monitored and exposures to individual asset classes and counterparties limited.

Recommendations in previous Surveys	Action taken since September 2009
Give greater emphasis on macroprudential oversight and include monitoring of all major components of the financial system.	FINMA and SNB have improved regular monitoring and risk assessment. Reporting requirements for insurance companies have been tightened. FINMA has started assessing six key macroeconomic factors on a biannual basis. Co-operation between FINMA and SNB on financial stability matters was improved. The Swiss Federal Department of Finance, FINMA and the SNB have signed a tripartite memorandum of understanding (see Chapter 2). Pension funds remain outside FINMA's remit.
The SNB should lead, together with FINMA, the elaboration of macroprudential standards and make its views public.	In April 2011, the Swiss Federal Department of Finance (FDF) established a joint working group, including high-level representatives from FDF, FINMA and the SNB to assess the current state of macroprudential supervision in Switzerland, including governance issues related to the implementation of macroprudential measures.
Give FINMA the authority for imposing administrative penalties for serious violations of its regulations.	None.
Ensure that FINMA's personnel and other resources are adequate to the authority's responsibilities.	FINMA has recruited senior professionals from the private sector for some of its key positions, and has introduced a technical career path to increase the authority's attractiveness as an employer.
The largest insurance companies should be subject to a close oversight regime similar to that applied to the Big-2.	Within FINMA's redesigned supervisory approach, the large insurance companies have been assigned a lower risk category than that of the Big-2 and are subject to an adapted oversight regime.
Consider periodic rotation of the outside auditors responsible for particular financial institutions, and widen the range of authorized external auditors.	According to FINMA's new supervisory concept, periodic rotations of the lead auditors will be introduced, subject to the respective risk category that is assigned to a bank.
Strengthen FINMA's liquidity regulation and oversight of the largest institutions and extend it in simplified form to other financial institutions over time. Consider including a core liquidity ratio applied to foreign currency denominated assets.	The new regulatory liquidity regime has been implemented. The introduction of a Net Stable Funding Ratio concept following the Basel committee's proposals will be considered. For the other banks, the new Basel liquidity standards will be introduced following the international schedule.
Broaden top-down stress tests of risks to the financial system; include disturbances based on recent market stress and very low probability scenarios.	FINMA plans to extend the scope of stress testing beyond the currently examined two large banks with the aim to cover up to 15 banks. Supervisory expectations on stress testing have been enhanced. For the two large Swiss banks, the soundness and effectiveness of their internal stress testing approach is regularly assessed. To be able to dispose of an independent view, stress test design and scenarios are developed jointly by FINMA and the SNB. FINMA and the SNB have put in place a formal revision process in close collaboration with the two banks. Loss Potential Analysis has been introduced to better identify the large banks' underlying individual loss and cumulative loss in case of a further drastic market deterioration. An analogous approach is being applied to a sample of medium sized banks since the beginning of 2011.
Reform deposit insurance law, introducing some pre-funding and revise the present ceiling on insured deposits as necessary to keep in line with other countries.	The temporary increase of the ceiling on depositor protection from CHF 30 000 to CHF 100 000 per account has become permanent as has the requirement on banks to hold liquid assets in Switzerland to be able to fund deposit withdrawals. The upper limit for payouts under the insurance was increased from CHF 4 billion to CHF 6 billion.
Phase out remaining preferences for cantonal banks, notably the guarantee on their liabilities and fund their mandates explicitly from government sources.	None.
Consider broadening the core colleges of supervisors for the Big-2. Co-operate with foreign counterparts to develop contingency plans so as to deal with future crises.	International co-ordination of resolvability and resolution plans is being developed.
Continue implementing the decision to endorse the OECD standard on transparency and the exchange of information in tax matters as rapidly as possible.	34 treaties have been amended to include the international OECD standard on administrative assistance in tax matters as of July 2011, of which 10 are already in force. The authorities intend to allow the identification of a taxpayer also by other means than the name of the person concerned.

Recommendations in previous Surveys	Action taken since September 2009
H. Housing	
Remove restrictions on the setting of a new rental price when a new tenant moves into a dwelling.	No action considered necessary by the authorities.
Ensure that yearly rent increases for existing tenants can at least compensate for inflation, regardless of contract duration. Allow rent adjustment to market prices for incumbent tenants over longer periods, while protecting them against high increases over short periods.	No action considered necessary by the authorities.
Review construction norms so as to reduce costs. Harmonize regulations set by cantons and local governments. Do not require firms to pay the wages for certain professions prevailing in the canton of the construction project.	A working group to review construction norms is being established, as is a concordat to harmonize certain regulations.
Strengthen enforcement of the Internal Market Act, by allowing private parties to take legal action on the basis of the Act when construction plans in one canton are rejected elsewhere, and by reducing exemptions.	None.
Reduce municipalities' incentives to selectively attract high-income households, *e.g.* by better ensuring that demand for social services is taken into account in intergovernmental transfers received by municipalities. Strengthen their incentives to attract population, *e.g.* by raising the weight of real estate taxation in their budgets.	None.

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