

Swiss-EU negotiations: A dangerous leap into the unknown

Since Friday morning, there is no more stock exchange equivalence between Switzerland and the EU. The risk is that relations between the two sour further, ultimately jeopardising the health of the Swiss economy



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End of stock exchange equivalence

The European Union hasn't renewed the exchange equivalence temporarily granted to Switzerland until the end of June 2019. This means that, from today, banks and financial intermediaries based in the EU can no longer deal shares listed on the Swiss stock exchanges directly in Switzerland. The problem is that these EU-based intermediaries generate more than half of the trade in Swiss equity markets and this will lead to a sharp reduction in volumes traded on the Swiss stock market. To avoid that, the Swiss Federal Department of Finance (FDF) designed new measures to protect the Swiss stock market. It has been decided that EU-based trading venues will no longer have the right to trade in securities of companies headquartered in Switzerland from today. These new measures come into effect today as well.

With these new measures, the goal of Switzerland is to exploit a legal loophole. Indeed, the

European regulation requires obtaining an equivalence only when a "significant" part of the stock market volume of a share is traded on European stock exchanges. Switzerland, therefore, wanted the volume of trade of Swiss equities on European stock exchanges not to be "significant" anymore and to become totally non-existent. If this is the case, the stock exchange equivalence is no longer necessary, according to European regulation. Then, European financial intermediaries can buy and sell shares of Swiss companies on the Swiss Stock Exchange, or on other global stock exchanges but not on European stock exchanges. In practice, it means that shares of Nestlé or Novartis, for example, may be traded via SIX (the Swiss stock exchange) or via the New York or Singapore stock exchanges, but not in Paris, London or Frankfurt.

These protective measures should make it possible to avoid a catastrophe on the Swiss stock market today. There is nevertheless a small detail that could compromise this response strategy. For the plan to work, the European authorities must recognise that trading of Swiss equities on European stock exchanges is no longer "significant". While Switzerland may be quick to point out that trade is becoming almost non-existent, nothing says that the EU will quickly recognise it. And if the procedure is dragged out by the EU, the shortfall for the Swiss stock market could be significant.

At this stage, given the uncertainty surrounding the safeguard measures, it's impossible to estimate the consequences of the non-extension of stock exchange equivalence on trading volumes and on the Swiss stock market. We will have to see how things evolve this week to get an idea of the impact.

How did we get here?

For years, Switzerland and the EU have been negotiating an institutional agreement to replace the patchwork of treaties currently governing relations between the two entities. Because of all the problems with the UK and the Brexit agreement, the EU wanted to speed up the discussions. To exert more pressure on Switzerland, the EU decided in 2017 to link the progress of the agreement to the regulatory recognition of Swiss stock exchanges. The EU wanted to force Switzerland to move. It worked at first. A political agreement was finally reached in November 2018. But this agreement has never been ratified by the Swiss authorities. The reason is that the agreement is relatively unpopular in Switzerland, mainly because of fears that it erodes high local wages. Given that federal elections will be held in October in Switzerland, no political party wants to be perceived as yielding to EU pressure or endangering high salaries, especially as the eurosceptic party is doing well in the polls. By threatening Switzerland, the EU has become more unpopular among the Swiss, which has further contributed to the stalemate.

On the other hand, the EU believes that negotiations have dragged on long enough and it no longer sees other avenues for possible change. As in the case of Brexit, the EU believes this is the best deal possible and that it will not be renegotiated. Consequently, the situation seems completely at an impasse. The risk is that this episode triggers hostilities between the two, leading to an escalation of tensions, which ultimately has an economic impact.

Important consequences

Tensions between Switzerland and the EU aren't good for trade, business investment, or for the funding of scientific research in Switzerland that depends on European funds.

The economic links are very strong between the two, mainly because Switzerland has access to

the European common market and because Switzerland is surrounded on all sides by countries belonging to the EU. Thus, the EU is Switzerland's most important trading partner, with 53% of Swiss exports going to the EU and 71% of Swiss imports coming from the EU. As Switzerland is a small open economy relying heavily on international trade, greater difficulty in trading with neighbouring countries will be a huge problem for Switzerland. There will probably be problems in other areas as well. For example, Switzerland has access to the European electricity market, but the future of this access depends on the ratification of the framework agreement. An escalation of tensions could lead to the exclusion of Switzerland from the European electricity market, threatening the security of supply.

All in all, beyond the purely political aspect of the negotiations, a deterioration of relations between Switzerland and the EU risk jeopardising the health of the Swiss economy.

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