Reserve management and the use of ratings at the Swiss National Bank

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I could say that we are also a shareholder organisation, but shareholder pressure in the case of the Swiss National Bank is very specific and is not very intense. So, yes, our point of view is quite different.

I will first talk about our reserve management perspective. I will say a few words about the use of ratings in monetary policy thereafter.

Of course the reserve management of the Swiss National Bank has been relatively exciting of late. But this has been because of what Stan Fisher termed on Sunday the acceleration of our balance sheet. In terms of the topic of this workshop, things are somewhat less exciting, maybe I would even say relatively boring. And this has two reasons. First, when we talk about sovereigns, we have a very limited risk budget. But this is not where we take risks. The second observation, of course, is that liquidity is an even more dominant criterion for us than credit risk.

So let me say a few words about our investment policy. At the moment, we have a foreign currency reserve portfolio of something like CHF 430 billion, which is something like 70% of GDP, up by about CHF 170 billion in the past year. As a central bank, we invest, as you would imagine, very conservatively. We are not a sovereign wealth fund. We are not in that sense comparable to Norway. We consider ourselves to have a relatively progressive policy in the sense that we hold not only sovereigns but our share of equities is 12% at the moment, which by central bank standards is relatively high. Our share of bonds is consequently at 88%, because we are not in alternative investments. Corporate bonds represent about 5% of our assets, meaning that sovereigns and supra-sovereigns are 83% at the moment.

And on that part of our portfolio, this 83%, I would say that we play it safe. This is not where we take the risk. Safe or very safe or very limited credit risk means that, in terms of ratings, more than 90%, I think it's 96%, of our holdings are AAA or AA, and we have no investment below BBB. On this part of our investment, ratings are really a communication tool, and we use them as indicative. We play it safe, that is the dominant criterion. How we communicate that is by using this ratings terminology.

Now as I said, we have a very limited risk budget. The other point is that liquidity is paramount. This has always been the case because as a traditional central bank, we have reserves in order to be able to use them in stressed times. So the emphasis was always on highly liquid sovereigns, which means almost by definition high credit quality.

Today, of course, liquidity has another perspective. For us, with our size, we must be able to get in, and we must be able to get out, relatively easily. We have tried very hard in the last few months to keep the impact of our re-allocation of

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reserves to a minimum, and I think we've achieved that despite rumours to the contrary, but markets have often been moved by rumours. So liquidity is crucial, simply in order to be able to invest the reserves that we've acquired at a very rapid pace. For us, the name of the game is to diversify, to minimise concentration risks, to limit our absolute risk exposure, across all sovereigns that are highly rated or relatively safe. Here market size is important but also tax treatment, administrative impediments, and legal risks that we would not want to take.

So given that background, credit risk assessment at the Swiss National Bank is not really at the forefront. We don't heavily distinguish between AAA and AA, and we are not going to take a huge amount of risk below that level. We have a small risk management unit which uses internal judgment, supported by ratings and other analysis. But we do not build our own models and we would not think of doubling the size of our risk management unit in order to analyse sovereign risk in greater depth. So the Bank of Canada's move, for instance, is not something we would imagine contemplating.

We communicate, as I've said, in terms of ratings. We use them in a way that is absolutely not mechanical. In fact, on the investment side, we have a relative opacity that allows us to use a considerable amount of discretion. So a rating change, for instance, would simply be a flag that might justify an internal note on whether we should think about the problem or not. A downgrade does not usually lead to a mechanical trigger, even when get below the BBB rate at which state we are no longer comfortable. We can afford to wait. We can hold to maturity, and we have every reason to avoid procyclical behaviour and reputational effects.

Now, from that perspective, what is the impact of the disappearance of a risk-free asset or the absence of a risk-free asset? Well, in many senses for us it is not really relevant. And we would argue that ratings are more appropriately termed risk rankings than ratings per se. Of course, we would feel more comfortable if the universe of risk-free assets were broader. We do have a problem with the growth of our reserves, with the problem of restricted opportunity, and it is a challenge for us to find markets where we can comfortably invest, given our risk appetite. But the notion of a risk-free asset per se is not something that worries us in any way.

Finally, I would like to turn, given this very boring description of our practice on the investment side, to talk a little bit about our use of ratings on the monetary policy side, because in many ways it's more significant, and it is more difficult to communicate. We use ratings to define our acceptable collateral basket, the SNB General Collateral basket. And here, obviously, opacity is not the name of the game. We have to be absolutely clear, with a stated and clearly communicated policy, so that here we do not have the same margin for discretion, although we do have some leeway that I will mention in a moment.

In order to understand what we do, I have to give you a few elements of our collateral policy. We use a collateral basket that we would like to define as tough in terms of its credit risk requirement. On the other hand, and this is the quid pro quo, we have a very open international policy. In fact, the majority of the collateral assets acceptable in our basket consists of non-Swiss franc-denominated securities. So we have a very international basket. On the other hand, we insist on very tough requirements. On top of those, we have a fully automated trading system, which at the moment and by design does not accommodate haircuts. We have no haircut on our collateral basket. On the other hand, we do have twice-daily margin calls.

Finally, the SNB definition of acceptable collateral has been adopted by the market itself. So more than 95%, in fact, I think it's close to 99%, of the interbank market in Switzerland uses SNB-acceptable collateral. So this puts us in quite a special position, and in this context we have decided to go to a fully rules-based approach. For foreign currency denominated securities our definition of high-quality assets is stated as no lower than a composite rating of AA–. So here we do put a lot of emphasis on the rating. And we stick to this, that is, we apply no discretion on the weaker side. We have applied some discretion some times on the tougher side, but no discretion on the weaker side.

We insist on a rules-based approach, and I would say it has worked perfectly well. Our repo market has worked extremely well during the crisis. And our approach minimises the signalling effect. We would have clearly in this context a significant signalling effect if we were to use our own internal rating in order to define our GC basket.

Basically, what we are saying is that our policy has some very good characteristics but, even so, we cannot avoid occasional difficulties. This was the case, for instance, in December 2011, when Irish titles, private and sovereign, were excluded from our GC basket because of the sovereign's downgrade. We did have a few phone calls to make, and we did receive a few phone calls but, of course, we would have had many more phone calls if early on we had been forced to make our own decision to exclude Irish titles from our basket, or if we had said for political reasons that we are going to refrain from doing that, and then suddenly the interbank market would not have been following us and would have taken a divergent route. So we believe that our approach keeps these challenges to a minimum, but it does have this component of what could be seen by some as a very high reliance on ratings from rating agencies.

Thank you.