

## **Niklaus Blattner: A look behind the scenes of system oversight**

Introductory remarks by Mr Niklaus Blattner, Vice-Chairman of the Governing Board of the Swiss National Bank, at the end-of-year media news conference, Zurich, 16 December 2004.

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It is the task of the Swiss National Bank (SNB) to contribute to the stability of the financial system. Implementation rests on three pillars: macroprudential oversight of the banking sector (Financial Stability Report), oversight of systemically important payment and securities settlement systems (system oversight) and crisis management measures. This is what I talked about at the last press conference. Today, I would like to give you a look behind the scenes of system oversight. Then I will turn to the regulatory environment, which we are also obliged to critically monitor and shape.

### **System oversight: a look behind the scenes**

In the last few months, we had to define which payment and securities settlement systems are systemically important. Only these systems have to comply with the minimum requirements stipulated in the National Bank Ordinance. To be classed as systemically important, it is not sufficient that a system is significant to the national economy, ie we do not merely consider the number and volume of transactions settled through a system. Rather, we focus on whether the failure of a system jeopardises the economy's supply of liquidity. This is the case particularly if participants in a flawed payment or securities settlement system have no other alternatives. The fewer alternatives available, the more serious the liquidity bottlenecks and counterparty risks. An additional aspect relates to the network. It comes into play when a system is the connecting link between other systems, such as in the case of the central counterparty SIS x-clear, which links the trading platform virt-x and the securities settlement system SECOM. The failure of such a connecting link can significantly affect operations at the upstream and downstream systems, even if the link itself is only of minor direct relevance to the market participants.

Our analyses led to the conclusion that the following systems should be classified as systemically important: the interbank payment system Swiss Interbank Clearing (SIC), the securities settlement system SECOM, the central counterparty SIS x-clear and the multi-currency payment system Continuous Linked Settlement (CLS). PostFinance is not classed as systemically important. This may be surprising given the economic significance of postal payment transactions, but it is a direct result of the existence of alternatives, ie bank payment transactions, which are instantly available should the postal payment system experience any serious problems.

Of the systemically important systems, CLS has been exempted from the minimum requirements as it is already adequately overseen by the Federal Reserve Bank of New York and because the exchange of information between the New York Fed and the National Bank runs smoothly. By strictly avoiding duplications, we can reduce the burden of oversight, ie the density of regulation, also in the case of SECOM and SIS x-clear. The operators of these systems are supervised as banks by the Swiss Federal Banking Commission (SFBC). Cooperation between the SFBC and the SNB is facilitated as the provisions in the Banking Act and the requirements stipulated by the National Bank Ordinance are partly similar, and both authorities wish to minimise the regulatory burden. This is also in the interest of the systems that are subject to oversight. I should add that not only the SFBC, but all of the evaluated systems have the opportunity to comment on our classification. The classification will be finalised at the beginning of next year.

### **Basel II: a never-ending story?**

The National Bank is involved in the implementation of the recommendations on the international convergence of capital measurement and capital standards, known as Basel II. The National Bank does not only provide a member to serve on the Basel Committee on Banking Supervision. As an authority committed to system stability, it also shares the responsibility of adequately implementing the Committee's recommendations.

The SFBC's fundamental hypotheses are undisputed, namely that the current provisions are in need of reform and that the recommendations of the Basel Committee are to be implemented with

moderation, while at the same time any dilution of the capital adequacy requirements aimed at reducing the insolvency risks has to be avoided. We are confident that the parties directly involved, ie the SFBC and the banks, will again succeed in agreeing, within the given time frame, on pragmatic and acceptable solutions.

With a view to the future, I should note that the current reform will further increase the complexity of the capital adequacy requirements. Although the potential of capital adequacy regulation has not yet been exhausted, other possibilities should also be investigated in the future. Complementing the capital adequacy approach with improved liquidity management of the banks seems to be a particularly promising measure. Shortcomings in liquidity management may give rise to problems that cannot be resolved by adequate capitalisation. It is not surprising that such considerations are made primarily by central banks. After all, liquidity concerns are typical for central banks. On the macro level, maintaining the supply of liquidity is a monetary policy task. On the micro level, however, it is the task of each bank to bring its solvency into line with the risks. This requires that the liquidity risks be correctly assessed and managed, and that assets, which can if necessary be used as collateral, be made available. The central banks and supervisory authorities of the G-10 countries should, therefore, increasingly focus their attention on minimising liquidity risks. This is of particular relevance to banks that are systemically important and internationally active.

### **Integrated financial market oversight: what now?**

In the meantime, the Federal Council decided on the further procedure regarding the Federal Act on Financial Market Oversight (FINMA Act). The Federal Department of Finance will prepare a statement by the end of next year and submit it to the Federal Council. The statement shall comprise the first two parts of the report by the Zimmerli Expert Commission (on the creation of integrated financial market oversight and sanctions). The third part of the project (examination of expanded prudential oversight) will be dealt with at a later point in time.

The Federal Council has taken various concerns of the National Bank into account. As regards the division of tasks between the supervisory board and the management board in particular, the Federal Council has moved closer to the view held by the National Bank, which believes it important that the power of disposition remains with the management board. As a non-professional body, the supervisory board is inevitably faced with conflicts of interest, which could prove an obstacle to individual dispositions. However, the experience and know-how of the supervisory board can be fully exploited with regard to the deliberation of questions of principle, budget and important staff issues. Furthermore, we support increased budgetary autonomy of the Federal Financial Market Oversight Authority (FINMA), as we are convinced that a financial centre that is as complex and significant as the Swiss financial centre requires an authority with a supervisory and management board whose powers are equal to those of the corresponding bodies of banks and insurance companies.

The National Bank backs the project regarding the FINMA Act. We continue to view the integration of financial market oversight as a means to improve oversight rather than as an end in itself. Should it emerge in the course of work - either with regard to sanctions or prudential oversight - that the planned reform is becoming so cumbersome that it jeopardises the present level of banking supervision, we reserve the right to reassess the project.

### **Conclusion**

My explanations clearly reflected the National Bank's wish to adopt a moderate stance with regard to public interventions. We are pleased that the Federal Council requests through the FINMA Act that the regulation consequences of new projects be assessed. The ongoing reform of capital adequacy requirements is driven by international standards (Basel II). It is the responsibility of the SFBC and the banks to find correct and acceptable solutions. Everything beyond this must be prepared by the G-10 bodies. The call for moderation directly affects the National Bank with regard to the oversight of payment and securities settlement systems. We contribute to minimising the regulatory burden by interpreting the term "systemically important" in line with the law, by closely cooperating with the SFBC and by taking into account the activities of foreign oversight authorities. We will continue on this path in the future, too.