# Fritz Zurbrügg: Presentation of the Swiss National Bank's Financial Stability Report

Introductory remarks by Mr Fritz Zurbrügg, Member of the Governing Board of the Swiss National Bank, at the media news conference of the Swiss National Bank, Berne, 16 June 2016.

*   *   *

In my remarks, I will start by looking at the key points addressed in the *Financial Stability Report*, which was published today. I will then finish with a review of the launch of the new banknote series, which commenced in April.

**Big banks: Capital situation further improved – SNB welcomes regulatory reforms**

Let me begin with the situation of the Swiss big banks. Over the past year, they each improved their capital situation further, as regards both risk-weighted capital ratios and leverage ratios. Both big banks are already almost fully compliant with the requirements of the current Swiss 'too big to fail' regulations (TBTF1), which will apply in full from the beginning of 2019. The Swiss National Bank acknowledges the progress made in this area.

These regulations were revised over the course of the last year. The revised regulations (TBTF2) envisage a significant increase in requirements on the loss-absorbing capacity of the big banks and will come into effect in a little over two weeks from now. With a phase-in period until end-2019, the requirements will be gradually increased to the definitive level.

Both big banks are already fully compliant with the revised requirements that come into effect on 1 July. However, to meet the requirements applicable from the beginning of 2020 – i.e. after the phase-in period – action will need to be taken. This is particularly the case as regards meeting the leverage ratio requirements, but also as regards gone-concern instruments. The latter are used to recapitalise a bank in the event of imminent insolvency without recourse to government support. This is achieved by writing off designated debt instruments or converting them into equity.

In addition to the reforms at national level, reforms are also underway on the Basel Committee on Banking Supervision's international capital framework. It is likely that risk-weighted assets will increase as a result of these international reforms. This expected increase has, as far as possible, been factored into the calibration of the revised Swiss 'too big to fail' regulations.

All of these reforms – especially the higher leverage ratio requirements – will result in a further strengthening of the Swiss big banks' resilience. In light of the fact that, in an international comparison, these two institutions are particularly large relative to the economy, this strengthening is necessary for two reasons. First, the big banks' loss potential relative to their capitalisation is substantial. Given their significance to the Swiss economy, it is important that the big banks remain adequately capitalised, even in the event of such losses occurring. Second, while leverage ratios at both Swiss big banks have improved by international standards, they are still below the average for large globally active banks.

The SNB welcomes and supports these reforms. We will continue to be actively involved in the finalisation of the international reforms. The combined package of national and international reforms represents a decisive step in the process of resolving the 'too big to fail' issue in Switzerland.

**Domestically focused banks: adequate resilience, despite substantial increase in mortgage exposure**

This brings me to the domestically focused banks.

For these banks, whose activity centres on Swiss lending and deposit-taking business, I would like to highlight three developments.

First, these banks' risk exposure to the Swiss mortgage and residential real estate markets rose markedly in 2015, with their mortgage lending volume growing at a similarly robust pace as in the previous year. In addition, they further increased their affordability risk and interest rate risk exposure from maturity transformation, against a background of slightly higher imbalances on the mortgage and residential real estate markets.

Second, in 2015, these banks' interest rate margins stabilised at a low level, after having fallen steadily and significantly since the start of the low interest rate period at end-2008. This stabilisation is remarkable, given that pressure on interest rate margins continued last year. Swiss money and capital market rates fell once again in 2015. At the same time, the interest paid by banks on customer deposits remained largely unchanged. Thus, the difference between these two interest rates – the liability margin – narrowed further. The reduction of the liability margin was offset by an increase in the asset margin, and by taking on greater interest rate risk.

Third, domestically focused banks were able to maintain their level of resilience compared to the previous year, despite the increased risk exposure. Overall, their capitalisation is well above regulatory minimum requirements, and is also adequate according to SNB stress tests. The currently available capital surpluses at most banks would be sufficient to cover the losses projected in these stress tests. Given the level of prevailing risks, this is positive.

However, the risks to financial stability could increase further. As we saw in 2015, even a lower momentum on the Swiss mortgage and residential real estate markets can cause imbalances on these markets to increase. This can happen, for instance, when combined with comparatively weaker developments in fundamentals such as GDP growth.

Moreover, in a sustained period of low interest rates, real estate prices will remain subject to upward pressure. Another rise in prices or decline in yields could occur particularly in the residential investment property segment. This would increase the risk of a substantial correction in the event of an interest rate rise, which would put pressure both on leveraged investors and on the banks who finance their investments.

At the same time, in an environment of persistently low interest rates, the pressure on interest rate margins would continue. Such pressure creates powerful incentives for banks to take on more risks. The focus here is on maturity transformation and affordability risk in mortgage lending. In the short term, this may allow banks to increase their profitability, but the flip side is that this also makes them more vulnerable to interest rate shocks and corrections on the mortgage and residential real estate markets.

Domestically focused banks would be particularly exposed to a major interest rate shock. As we explain in our *Financial Stability Report*, in the event of a normalisation of interest rates, banks would initially benefit from the restoration of the liability margin. However, a major interest rate shock would cause net interest income to fall significantly at many banks, potentially resulting in losses. The greater a bank's maturity transformation is, the higher these losses will be.

Even if the current low interest rate period were to continue and interest rates were only to rise very gradually, the possibility of a major interest rate shock should not be ruled out. Experience has shown that interest rate corrections can sometimes be sudden and sharp. It should also be borne in mind that interest rates on the money and capital markets are currently more than 300 basis points lower than at the beginning of 2008. In other words, even if interest rates were to return to levels previously considered normal, this would still constitute a major correction.

In view of the fact that risks to financial stability could increase further over the short to medium term, the capital surpluses of domestically focused banks are of particular significance. When defining their appetite for risk and their capital plans, the banks should continue to ensure that they are also able to absorb the losses associated with highly unfavourable but possible scenarios in the future. Even under scenarios of this kind, they should be able to perform their core functions for the Swiss economy – in particular, the supply of credit.

The SNB will continue to monitor the situation on the Swiss mortgage and real estate markets closely, paying particular attention to developments in the residential investment property segment as well as to banks' risk-taking in mortgage lending. As hitherto, the SNB will regularly reassess the need to adjust the countercyclical capital buffer.

**New banknote series: successful launch**

I would like to finish my presentation today with a few words on the new 50-franc note, which was released on 12 April 2016 as the first denomination in the ninth banknote series.

From the SNB's perspective, the launch of the new banknote series was an all-round success.

First, the changeover at bank counters and ATMs went as planned. According to our information, the general public also encountered no major problems when withdrawing or paying in money at cash machines.

Second, reactions to the new banknote were predominantly positive among the public and experts alike. Using a nationwide information campaign, we were able to inform the public about the new 50-franc note's design and security features in a very short time. This campaign helped members of the public across the country to familiarise themselves quickly with the new banknote. When new banknote series are issued, the demand for information is always greatest at the launch of the first denomination.

Third, the return rate of the old 50-franc notes is within the expected range. We anticipate that, six months after the launch date, around two-thirds of the old notes in circulation will have been exchange