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Introductory remarks by Fritz Zurbrügg

In my remarks today, I will be looking at the current developments in the area of financial stability. I shall look at the big banks first before turning to the domestically focused banks.

Big banks

The financial market situation facing the two big banks has become more volatile since the press conference in June. Given this heightened uncertainty on the markets, the share prices of big banks both in Switzerland and abroad have come under pressure. By contrast, premia for credit default swaps of such banks have remained at a similar level as in June overall.

The SNB's assessment of the situation at the two big banks is essentially unchanged from that at the last press conference. This applies both to resilience and to the orderly resolution of a distressed bank.

As regards resilience, Credit Suisse and UBS are still on track to meet the revised 'too big to fail' requirements on going-concern loss-absorbing capacity. They already meet all final[1] risk-weighted capital requirements. However, as regards the leverage ratio, i.e. the unweighted ratio of capital to assets, further improvement is needed.

The big banks have made significant progress in recent years in the area of resolution. They have steadily expanded their holdings of bail-in instruments. At group level, both institutions are already compliant with the final requirements for gone-concern loss-absorbing capacity. Moreover, Credit Suisse and UBS have taken important organisational steps to improve their resolvability as part of their resolution planning. For instance, they have both set up Swiss

[1] Final requirements refer to the requirements that will apply after expiry of all transitional provisions. In particular, they concern the qualitative requirements for going-concern capital.

subsidiaries that contain their systemically important functions, including, in particular, domestic deposit and lending business.

To ensure an orderly resolution in a crisis, progress is still needed in three areas in particular. First, FINMA, as the competent authority, is currently in the process of drawing up resolution funding plans. These aim to ensure that a bank has sufficient liquidity to implement a resolution without recourse to state support. Second, it must be ensured that big banks' loss-absorbing capacity is adequate, not only at group level, but also on a stand-alone basis at the level of the individual group entities. In this context, the Federal Council has announced that, during the first half of 2019, it will decide on the corresponding requirements for the highest operating unit of the big banks – i.e. the parent entity. Third, Credit Suisse and UBS must further reduce the financial and operational dependencies within the group.

Domestically focused banks

I would now like to turn to the domestically focused banks. Here too, there has been little change since the *Financial Stability Report* was published in June. Mortgage and real estate markets remain the biggest source of risk. I would like to make two observations in this connection.

First, the imbalances on the mortgage and real estate markets persist. Both mortgage lending and prices for single-family homes and privately owned apartments have continued to rise at a moderate rate over recent months. And while prices for residential investment property have not increased any further, the risk of a price correction in this segment is particularly high. The renewed increase in vacancy rates indicates that the robust activity in rental apartment construction may have led to oversupply, exerting downward pressure on rental income and, in turn, on the prices of these properties. At the same time, initial yields on residential investment property, in other words the ratio of rental returns to transaction prices, are at historically low levels. In the event of an interest rate rise, initial yields on investment properties will also have to increase upon a change of ownership. This would place additional pressure on prices.

Second, the risk appetite of domestically focused banks remains high. This is partly due to the fact that interest rate margins of these banks fell further in the first half of 2018. As long as this pressure on margins persists, incentives for domestically focused banks to increase risk-taking will remain substantial. The high risk appetite of the domestically focused banks is, for instance, evident from the fact that mortgage lending growth at these banks continued at a robust 4%, whereas the market as a whole saw growth of around 3%. At the same time, affordability risks, which these banks take on when granting new mortgage loans to finance residential investment properties, have risen once again over the course of the year. Since many of these loans also carry considerable loan-to-value (LTV) risk, they would be particularly vulnerable in the case of a sharp increase in interest rates and a correction in real estate prices.

It is important that banks are in a position to bear the risks they take on. In the SNB's opinion, this requirement is met by most domestically focused banks owing to their good capitalisation level. Capitalisation levels appropriate to the exposures incurred need to be maintained in future, too. This is particularly relevant in view of the previously mentioned granting of mortgages with high affordability risks, which increases the banks' loss potential.

Given the risks I have just described, the SNB continues to take the view that targeted measures in the area of residential investment property lending should be considered. Such measures are currently being examined. In addition, the SNB will continue to monitor developments on the mortgage and real estate markets closely, and regularly reassess the need for an adjustment of the countercyclical capital buffer.