Accountability report

On 24 March 2014, the Governing Board of the Swiss National Bank (SNB) submitted its accountability report for 2013 to the Federal Assembly in accordance with art. 7 para. 2 of the National Bank Act (NBA). The report provides information about how the SNB has fulfilled its mandate pursuant to art. 5 NBA – in particular as regards its conduct of monetary policy and its contribution to the stability of the financial system. It is submitted to the Federal Council and the General Meeting of Shareholders for information purposes.

SUMMARY

Monetary policy

The SNB pursues a monetary policy serving the interests of the country as a whole. It must ensure price stability, while taking due account of economic developments. The SNB's monetary policy strategy consists of the following elements: a definition of price stability, a medium-term conditional inflation forecast, and a target range for a benchmark interest rate – the three-month Libor (London Interbank Offered Rate). In addition, since 6 September 2011, a minimum exchange rate of CHF 1.20 against the euro has applied.

In 2013, global economic growth remained weak and strongly affected by downside risks. Persistent uncertainty, the restrictive fiscal policy in many countries and the continued strain imposed by structural problems had a dampening impact. During the course of the year, there were increasing signs of a modest recovery in Europe. A contributory factor here was the alleviation of the European financial and government debt crisis. In the US, economic growth firmed, and in Japan the economy picked up noticeably. In many emerging economies, economic growth remained subdued, partly as a result of restrained demand from the advanced economies.

The economy in Switzerland progressed relatively favourably compared to the international situation. At 2.0%, real GDP recorded higher growth in 2013 than in the previous year, while unemployment stabilised at 3.2% in the second half of the year. The main growth drivers were domestic consumption and residential construction, which benefited from positive income developments, immigration and favourable financing conditions. Export industries, by contrast, continued to suffer from the weak global economy and the high value of the Swiss franc.

The downward pressure on prices persisted, although it was less pronounced than in 2012. On average for the year, consumer prices fell by 0.2% in 2013, following a decline of 0.7% in the previous year.

In view of the slight decrease in consumer prices and the, as yet, uneven economic recovery, an appreciation of the Swiss franc would have posed a renewed threat to price stability in Switzerland. In an environment of short-term interest rates close to zero, the minimum exchange rate ensured that monetary conditions were appropriate for the Swiss economy. For this reason, in its quarterly monetary policy assessments, the SNB confirmed its intention to enforce the minimum exchange rate against the euro, set in September 2011, with the utmost determination.

Implementation of monetary policy

The SNB continued to direct its monetary policy instruments towards enforcing the minimum exchange rate. The Swiss franc traded above CHF 1.20 for the entire year, largely as a result of the easing of tensions on financial markets. Consequently, unlike in 2012, the SNB was not required to enforce the minimum exchange rate through foreign currency purchases.

The extensive purchases of foreign currency in 2012 meant that the money market was amply supplied with Swiss franc liquidity in 2013, so the SNB did not conduct any liquidity-providing open market operations. The target range for the three-month Libor was unchanged at 0.0–0.25%. Interest rates remained low; rates at the very short-term end were mostly below zero. The SNB was involved at both international and national level in the efforts to reform benchmark interest rates.

The SNB decided that, as of May 2014, it would conduct its monetary policy operations via a trading platform operated by SIX Group, instead of via the Eurex platform as hitherto. This will ensure that trading, securities settlement and payment processing on the money market are supplied by a single operator.

Cash supply and distribution

In 2013, banknote circulation averaged CHF 59.7 billion, considerably above the previous year's figure. The strong demand for large-denomination notes is partly due to the low level of interest rates, which vastly reduces the cost of holding banknotes. At the beginning of October, the SNB informed the public that, since autumn 2012, a small number of Swiss 1000-franc banknotes were in circulation which had not been issued by the National Bank. These notes had been abstracted during the production process at Orell Füssli Security Printing Ltd.

After the work on the new banknote series had suffered a number of delays, the SNB reassessed the situation in 2012 and introduced a variety of measures. In 2013, work on the new banknote series progressed further. The SNB will announce the issue date as soon as production of the first banknote denomination, the 50-franc note, has been completed. The current banknote series continues to have a high security standard.

Cashless payment transactions

In 2013, the Swiss Interbank Clearing (SIC) system, the most important system for cashless payments in Swiss francs, settled a daily average of approximately 1.7 million transactions amounting to CHF 127 billion. This is a year-on-year increase of 2.8% in the number of transactions or 5.8% in the value of transactions. The SNB steers SIC, while SIX Interbank Clearing Ltd, a subsidiary of SIX Group, operates the system. SIX is a joint undertaking of the Swiss banks, and covers key parts of the Swiss financial market infrastructure, the Swiss value chain. The SNB needs an efficient and secure financial market infrastructure in order to fulfil its statutory mandate. It therefore welcomes the increase in SIX's strategic orientation to the Swiss value chain.

Asset management

At the end of 2013, the SNB's assets totalled CHF 490 billion, the bulk of which (CHF 477 billion) was held in currency reserves, i.e. gold and foreign currency investments. The gold price and exchange rates were the most important risk factors. In 2013, valuation losses on gold led currency reserves to decline by CHF 8 billion. The size of the currency reserves placed greater demands on currency reserve management. The majority of foreign currency investments continued to be in the form of government bonds or holdings at central banks; the bulk of these are in highly liquid bonds issued by core euro area countries and the US.

In 2013, the SNB increased the share of equities in its foreign currency investments from 12% to 16%. It expanded its equity portfolio to cover equities of small-cap companies, as well as equities from advanced economies that had previously not been included. Equity holdings are managed passively and according to a set of rules based on a combination of equity indices in various currencies. The SNB does not invest in equities of mid-cap or large-cap banks, in order to preclude potential conflicts of interest. In addition, in 2013 the SNB decided not to invest in equities from companies which produce internationally banned weapons, seriously violate fundamental human rights, or systematically cause severe environmental damage.

At the beginning of July, the SNB opened a branch office in Singapore. The step was taken in view of the sharp expansion in foreign currency investments and the growing importance of Asian financial markets.

Financial system stability

Acting on the proposal of the SNB, on 13 February 2013 the Federal Council activated the sectoral countercyclical capital buffer (CCB) for mortgage loans financing residential real estate in Switzerland. In so doing, it reacted to the persistent imbalances on the mortgage and real estate markets. Banks were obliged, with effect from 30 September 2013, to hold additional capital amounting to 1% of their risk-weighted positions backed by mortgage loans. On 22 January 2014, the Federal Council, at the proposal of the SNB, increased the CCB from 1% to 2% of the associated positions.

The Banking Act gives the SNB the authority to designate banks and bank functions as systemically important, following consultation with the Swiss Financial Market Supervisory Authority (FINMA). In 2013, the SNB conducted clarification work in this regard on Zürcher Kantonalbank. In November 2013, it designated Zürcher Kantonalbank as a financial group of systemic importance in accordance with the Banking Act.

The SNB was also involved in the integration of the Basel III liquidity standards into Swiss legislation, i.e. into the Liquidity Ordinance. In addition, it carried out a comprehensive review of the provisions on the oversight of financial market infrastructures (FMIs) in the National Bank Ordinance (NBO). The revised NBO entered into force on 1 July 2013. It contains a number of new or increased minimum requirements for operators of systemically important FMIs, thereby strengthening the resilience of FMIs and bringing the regulations into line with international standards.

In November 2013, the SNB sold the stabilisation fund set up in autumn 2008 to take over illiquid assets from UBS. A prerequisite for the sale to UBS was the full repayment, in August, of the SNB loan by the stabilisation fund. UBS paid a purchase price of CHF 3.8 billion, corresponding to the SNB's contractual share in the stabilisation fund equity as at end-September 2013. The proceeds of the sale were invested in foreign currency. With the total reduction of risks and the transfer of the stabilisation fund to UBS, the SNB was able to bring an exceptional and challenging undertaking to a successful conclusion. In addition to the sale proceeds, the SNB earned USD 1.6 billion in interest income over the duration of the loan to the stabilisation fund. In a difficult period, the stabilisation fund made a significant contribution to the strengthening of the Swiss financial system.

International monetary cooperation

The SNB participates in international monetary cooperation through its representation in international bodies, working in collaboration with the Confederation in some areas. This involves, in particular, the International Monetary Fund (IMF), the Bank for International Settlements (BIS), the Financial Stability Board (FSB) and the Organisation for Economic Co-operation and Development (OECD). Given the continuing financial and sovereign debt crisis, IMF lending to members in economic difficulties remained at a high level in 2013. In order to cover the IMF's greater funding requirements, the member countries agreed in early 2012 to an exceptional, temporary increase of IMF resources through bilateral borrowing. In April 2012, Switzerland pledged a contribution of up to USD 10 billion. To this purpose, the two chambers of parliament approved an increase of the credit facility for monetary assistance from CHF 2.5 billion to CHF 10 billion in March 2013. Subsequently, no bilateral loan agreement with the IMF has been entered into.

Within the framework of the Article IV consultations, the IMF regularly reviews the economic policy of its member countries and issues recommendations. In May 2013, the IMF Executive Board concluded the annual Article IV consultation with Switzerland. It confirmed that Switzerland pursues a stability-oriented economic policy and that it has a sound economic basis. It considered a resurgence of the euro crisis as the main risk and recommended that the SNB maintain its minimum exchange rate of CHF 1.20 per euro as long as the economic recovery is not clearly assured and price stability is not threatened. The IMF also conducted a comprehensive evaluation of Switzerland's financial sector in 2013 as part of the Financial Sector Assessment Program (FSAP). The results will be published in spring 2014.

Banking services for the Confederation

The SNB provides the Swiss Confederation with banking services in the areas of payment transactions, liquidity management, the issue of money market debt register claims and bonds, and the custody of securities. In 2013, on behalf of and for the account of the Confederation, the SNB issued money market debt register claims amounting to CHF 42.0 billion and bonds amounting to CHF 6.0 billion. It also carried out roughly 84,000 payments in Swiss francs and approximately 25,000 payments in foreign currencies on behalf of the Confederation.

Statistics

The SNB compiles statistical data on banks and financial markets, the balance of payments, direct investment, the international investment position and the Swiss financial accounts. In so doing, it works with the relevant federal government bodies, FINMA, authorities from other countries and international organisations. In 2013, the revision of the surveys in connection with financial flows was completed. Henceforth, more details on the breakdown of financial flows by country will be collected. Also in 2013, preparatory work was undertaken to publish the balance of payments using the methodological basis of the latest IMF balance of payments standards. In addition, the Federal Council came out in favour of Switzerland participating in the IMF's new, extended statistical standard SDDS Plus. The new standard aims to close the data gaps that were revealed during the financial crisis.

1 Monetary policy

1.1 MANDATE AND MONETARY POLICY STRATEGY

Constitutional and legal mandate

Article 99 of the Federal Constitution entrusts the Swiss National Bank (SNB), as an independent central bank, with the conduct of monetary policy in the interests of the country as a whole. The mandate is explained in detail in the National Bank Act (art. 5 para. 1 NBA), which requires the SNB to ensure price stability and, in so doing, to take due account of economic developments.

Significance of price stability

Price stability is an important condition for growth and prosperity. Inflation (a sustained increase in the price level) and deflation (a sustained decrease in the price level) both hamper economic development. By leading to misallocations of labour and capital, they complicate decision-making by consumers and producers. They also result in income and wealth redistributions and put the economically weak at a disadvantage.

By seeking to keep prices stable, the SNB helps to create an environment in which the economy can exploit its production potential. The aim of the National Bank's monetary policy is to ensure price stability in the medium and long term. Short-term price fluctuations, however, cannot be counteracted by monetary policy.

Influencing the interest rate environment

The SNB ensures price stability by using its monetary policy operations to influence the interest rate environment and align it with the prevailing economic situation. Low interest rates promote the supply of money and credit to the economy, thereby increasing the demand for goods and services. In addition, they often lead to a weakening in the currency, which boosts export demand. The resulting shortage of production capacity causes the price level to rise. Conversely, high interest rates lead to a shortage in the supply of money and credit, often combined with currency appreciation, thereby holding back aggregate demand. The utilisation of production capacity falls, and the upward pressure on prices weakens.

Since Switzerland is strongly integrated in the global economy, the exchange rate has a substantial influence on production and the price level. Thus, interest rates and exchange rates jointly shape monetary conditions in the economy.

Minimum exchange rate as unconventional measure

If, as in the last few years, short-term interest rates are close to zero and monetary conditions become tighter, the option of further interest rate cuts is no longer available as a monetary policy instrument. Under such circumstances, the SNB can turn to unconventional measures to combat a tightening of monetary conditions. One example is the setting of a floor for the exchange rate, as was the case when the SNB introduced the minimum exchange rate of CHF 1.20 per euro on 6 September 2011.

Monetary policy strategy

In its monetary policy strategy, the SNB sets out the manner in which it intends to fulfil its statutory mandate. The strategy consists of the following three elements: a definition of price stability, a conditional inflation forecast over the subsequent three years, and a target range for the reference interest rate – the three-month Swiss franc Libor (London Interbank Offered Rate). Since September 2011, the minimum exchange rate against the euro has also applied.

Definition of price stability

The SNB equates price stability with a rise in the national consumer price index of less than 2% per annum. Deflation – in other words, a protracted decline in the price level – is also regarded as a breach of the objective of price stability. With this definition of price stability, the SNB takes into account the fact that it cannot precisely steer inflation and that the consumer price index tends to slightly overstate inflation.

Conditional inflation forecast

The inflation forecast published quarterly by the SNB serves as the main indicator for the monetary policy decision and is a key element in communication. In focusing its monetary policy on an inflation forecast for the next three years, the National Bank adopts a forward-looking stance and gives the public an indication of its long-term monetary policy intentions. Besides the inflation forecast, the SNB takes into consideration a large number of indicators of domestic and international economic and monetary developments and of financial stability for its monetary policy decisions.

The SNB's inflation forecast is based on the assumption that the reference interest rate communicated at the time of publishing will remain unchanged over the next three years. It is therefore a conditional forecast and shows how the SNB expects consumer prices to move in the event that the interest rate does not change. It cannot be compared with forecasts by commercial banks or research institutions, as these generally factor in anticipated interest rate movements.

Target range for three-month Libor

The SNB implements its monetary policy by fixing a target range for its reference interest rate, the three-month Swiss franc Libor. The target range usually extends over 1 percentage point. As a rule, the SNB holds the Libor in the middle of the range. With interest rates reduced to almost zero in the wake of the financial crisis, the Libor target range was gradually narrowed. Since August 2011, a target range of 0.0–0.25% has applied.

Integrity of the Libor

Libor interest rates correspond to the trimmed mean of current interest rates at major international banks operating in London. To date, they have been administered by the British Bankers' Association in London. Since February 2014, the stock exchange operator Intercontinental Exchange (ICE) has, as the new administrator, been responsible for setting Libor rates. This change was effected in connection with Libor manipulations that were discovered in summer 2012. Even though the Libor plays only a subordinate role as an operational target in the current interest rate environment, the SNB must be able to rely on the integrity of its reference rate. It is therefore involved in national and international efforts to restore the integrity of benchmark interest rates. International activities are being coordinated by the Financial Stability Board (cf. chapter 6.7). At national level, the SNB and the Swiss Financial Market Supervisory Authority (FINMA) are talking to financial market participants about ensuring a more robust construction of the benchmark interest rates which are fixed in Switzerland (cf. chapter 2.2).

Minimum exchange rate against euro

On 6 September 2011, the SNB introduced the minimum exchange rate against the euro as an additional operational objective, and the target range for the three-month Libor became less prominent. The minimum exchange rate allowed the SNB to maintain an appropriate monetary policy stance, even in an environment of extremely low interest rates, and thereby ensure price stability.

The minimum rate was introduced under exceptional circumstances, in which short-term interest rates could not be lowered any further. The appreciation of the Swiss franc at the time presented a risk to the Swiss economy and carried the threat of a deflationary development. For the SNB, the minimum exchange rate remains an important tool with which to prevent an undesirable tightening of monetary conditions, should the upward pressure on the Swiss franc increase again. The minimum exchange rate is at a level where the value of the Swiss franc remains high.

1.2 INTERNATIONAL ECONOMIC DEVELOPMENTS

Weak growth in global economy

In 2013, global economic growth remained weak, as expected, and downside risks prevailed. Persistent uncertainty, the restrictive fiscal policy in many advanced economies and the continued strain imposed by structural problems had a dampening impact. In most regions, international trade barely increased for the second year in succession. During the course of 2013, there were increasing signs of a modest recovery in Europe. A major contributory factor here was the alleviation of the European financial and government debt crisis, which had driven the slide into recession in 2012. In the US, economic growth firmed, and in Japan the economy picked up noticeably. In many emerging economies, which suffered from restrained demand in the advanced economies, economic growth remained subdued.

Lower commodity prices

Most commodity prices trended slightly downwards in 2013, as the supply situation improved but global demand remained subdued. The oil price (Brent crude) averaged USD 109, slightly below the 2012 level, and contributed to lower global inflation rates.

European debt crisis receding

The reform programmes initiated in a number of euro area countries, progress in the establishment of a banking union, and, in particular, the purchase programme for short-term government bonds announced by the European Central Bank (ECB) in September 2012 made a major contribution to defusing the European financial and government debt crisis. Risk premia for government bonds of heavily indebted countries over German government bonds declined, and the euro firmed on a trade-weighted basis, after having lost value in previous years.

Recession in euro area gradually overcome

Nevertheless, the economic situation in the euro area remained difficult overall. GDP declined for the second year in succession (by 0.5%). In the second half of the year, business and household confidence picked up gradually along with an improvement in the outlook for exports. Domestic demand also increased again slightly. In addition, the situation was eased by the fact that a number of EU countries were granted more time to achieve their consolidation goals, so that fiscal policy became less restrictive. Developments continued to vary from one country to another. While the German economy was the driving force, economic growth in France remained lacklustre. Also in countries where economic output had previously declined for several quarters in succession, GDP generally rose only marginally over the course of the year. During the course of the year, unemployment in the euro area rose to the highest level since the beginning of the European monetary union (12.1%), and remained relatively unchanged at that level until the end of the year.

Moderate economic growth in the US

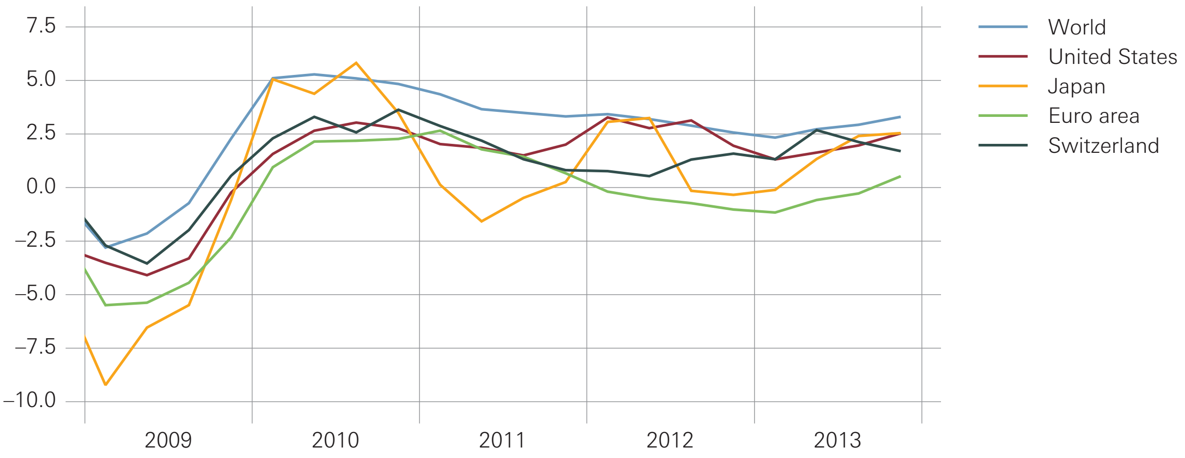
In the US, GDP was up by 1.9% in 2013, a lower increase than in the previous year. Growth was particularly weak in the first half of the year. Momentum in private demand remained low, due in part to the fact that some income tax breaks ceased to apply and social security deductions, which had previously been reduced, were increased again. Government demand declined further as a result of the efforts to consolidate public finances. In autumn, an acrimonious budget dispute in Congress led to a partial government shutdown, dampening GDP growth in the fourth quarter. The utilisation of production capacity was still below average and unemployment remained high at the end of the year, at 6.7%.

Economic recovery in Japan

The Japanese economy improved under the impact of the expansionary monetary and fiscal policies initiated in spring 2013. The yen lost substantial value, which boosted exports and led to significant gains on the Japanese stock exchange. Business and consumer sentiment brightened and private demand grew significantly. Towards the end of the year, economic growth was supported by private consumption expenditure, which was brought forward due to the VAT increase scheduled for April 2014. Averaged over the year, GDP expanded by 1.5%.

GROWTH OF GROSS DOMESTIC PRODUCT

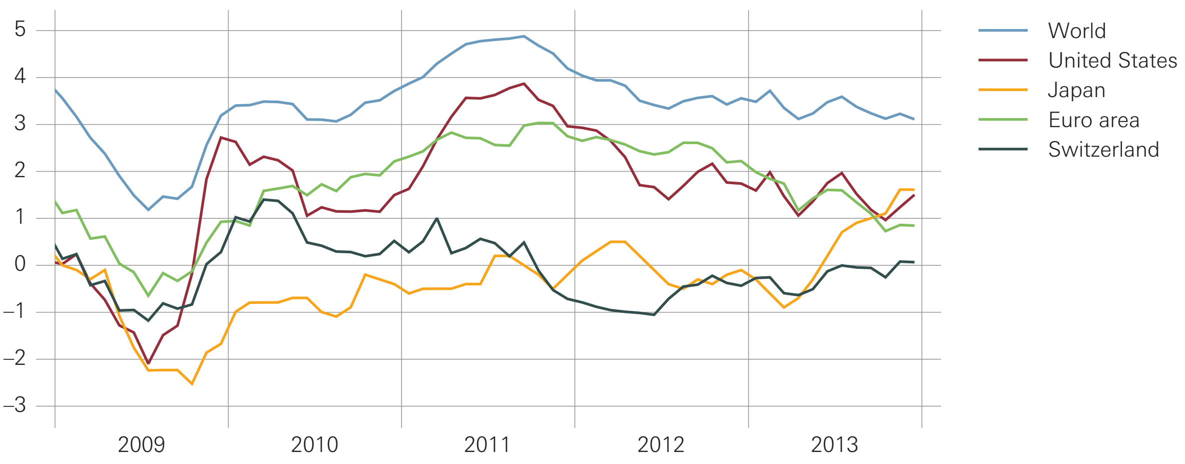
Year-on-year change in percent, in real terms



Sources: SECO, SNB, Thomson Reuters Datastream

INFLATION

Consumer prices, year-on-year change in percent



Sources: IMF, SFSO, SNB, Thomson Reuters Datastream

Lack of momentum in emerging economies

GDP growth remained below potential in most emerging economies in 2013. This was partially attributable to the subdued demand from advanced economies. The Chinese government announced further reforms to promote the transition to a more balanced, consumption-based growth path. In other large emerging economies, tighter monetary policy aimed at combating high inflation weighed on business activity. In late summer, speculation about an imminent change in US monetary policy resulted in a temporary capital outflow in some countries and a significant depreciation in their currencies against the US dollar.

Inflation eases in advanced economies

With the economic situation remaining unsatisfactory, inflation, as measured by the consumer price index, eased across the board in most advanced economies. One exception was Japan, where an end to many years of deflation was becoming apparent, partially as a result of the weakening in the yen. In the euro area, there was a clear drop in annual inflation to an average of 1.4%, which was under the ECB's price stability objective of 'below, but close to 2%'. In the US, too, inflation declined, reaching a low of 1.0% in October; the annual average came to 1.5%.

High inflation in some emerging economies

In China, annual inflation rose slightly, but remained below the government target of 3.5% on average for 2013. In India, Brazil and Russia, by contrast, inflation rates exceeded the monetary policy targets set by the central banks.

Monetary policy in advanced economies remains expansionary

Given the subdued path of the economy and the low level of inflation, central banks in the advanced economies either maintained their expansionary monetary policy or eased it further.

In the US, the target range for the federal funds rate has been unchanged at 0.0–0.25% since December 2008. The US Federal Reserve confirmed its intention of retaining the low rate of interest for at least as long as unemployment exceeded 6.5% and its mid-term inflation forecast did not rise above 2.5%. Due to the encouraging signs emerging from the economy, in mid-December it decided to reduce its monthly securities purchase programme from January 2014.

In December, the ECB lowered its main refinancing rate to a historically low level of 0.25% and announced that the key interest rates would be likely to remain at the levels then prevailing or lower levels for an extended period of time. Furthermore, it decided to provide banks with unlimited liquidity as part of its refinancing transactions until at least mid-2015. The Japanese central bank underwent a change of regime by setting itself the explicit objective of increasing inflation to around 2% within two years. For this purpose, the monetary base is to be doubled by the end of 2014 through purchases of Japanese government bonds.

Tightening of monetary policy in emerging economies

In a number of emerging economies, the conduct of monetary policy was hampered by a combination of high inflation and low economic growth. During the course of the year, the central banks of Brazil and India again tightened their monetary policy in order to combat the persistently high level of inflation. In China, the central bank endeavoured to curb the strong expansion in lending volumes.

1.3 ECONOMIC DEVELOPMENTS IN SWITZERLAND

Moderate recovery in Swiss economy

In 2013, the moderate recovery in the Swiss economy continued. According to the initial estimate by the State Secretariat for Economic Affairs (SECO), GDP increased by 2.0%, after a 1.0% advance in 2012. The utilisation of production capacity improved gradually. This was also reflected in the stabilisation of the labour market situation towards the end of the year. Nevertheless, overall, production capacities in the economy remained underutilised.

Challenging environment for export industry

Export industries continued to suffer from the weak global economy. Manufacturing, for instance, recorded a decline in value added. In hospitality and the hotel industry, business activity was also sluggish. Profit margins remained under pressure in many places because of the high value of the Swiss franc. However, the minimum exchange rate against the euro made it easier for companies to make the adjustments needed to maintain competitiveness.

Robust growth in domestically focused industries

By contrast, many industries whose main client base is in the domestic market recorded robust growth. Value added in wholesale and retail trade increased once again, and business-related services gained momentum. Construction continued to be a major growth driver. Public services and healthcare also expanded, thereby supporting economic growth.

Consumption and residential construction as economic drivers

Private consumption increased strongly again, supported by the positive income trend and by immigration. Residential construction continued to benefit from favourable financing conditions and the ongoing rise in demand for housing resulting from the growth in population.

Subdued export and investment activity

Exports, by contrast, recorded little growth. Goods exports stagnated for the second year in succession, while exports of services advanced slightly. Given the unsatisfactory level of capacity utilisation, the ongoing uncertainty about the further development of the global economy, and the continued high value of the Swiss franc, companies' investment activity was restrained. At the end of 2013, equipment investment was still below the level reached at the beginning of 2008, in other words, before the escalation of the financial crisis.

REAL GROSS DOMESTIC PRODUCT

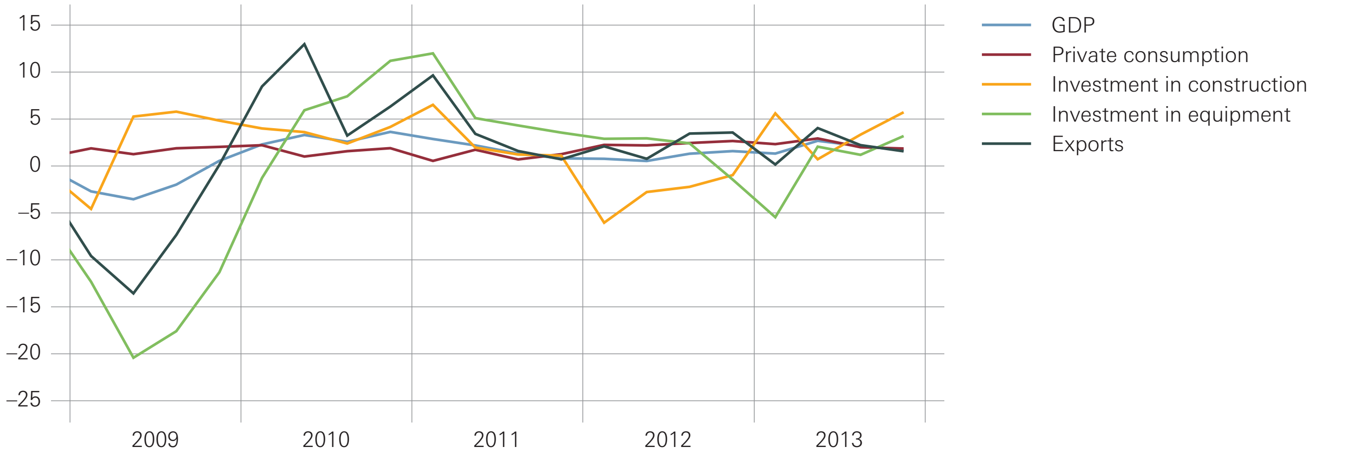
Year-on-year change in percent

	2009	2010	2011	2012	2013
Private consumption	1.8	1.7	1.1	2.4	2.3
Government consumption	3.3	0.2	1.2	3.2	3.0
Investment	–8.0	4.8	4.5	–0.4	1.8
Construction	3.0	3.5	2.5	–2.9	3.8
Equipment	–15.5	5.8	6.1	1.7	0.2
Domestic demand	**0.0**	**2.7**	**1.7**	**1.2**	**1.8**
Exports of goods and services	–7.7	7.7	3.8	2.5	2.0
Aggregate demand	**–2.9**	**4.5**	**2.5**	**1.6**	**1.9**
Imports of goods and services	–5.2	8.4	4.2	3.1	1.6
Gross domestic product	**–1.9**	**3.0**	**1.8**	**1.0**	**2.0**

Sources: SECO, SFSO, SNB

GROSS DOMESTIC PRODUCT AND COMPONENTS

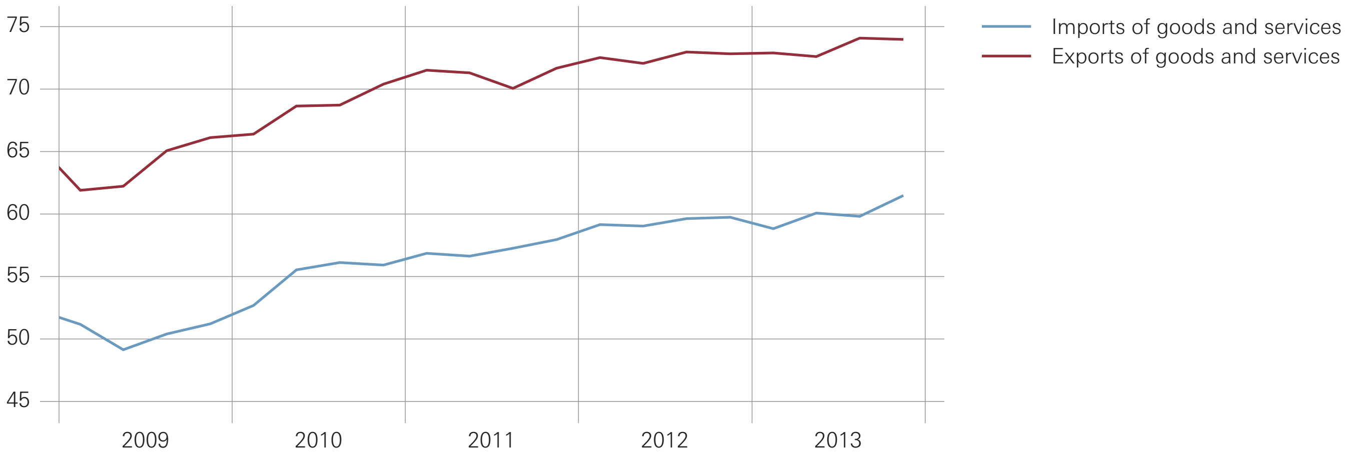
Year-on-year change in percent, in real terms



Sources: SECO, SNB

FOREIGN TRADE

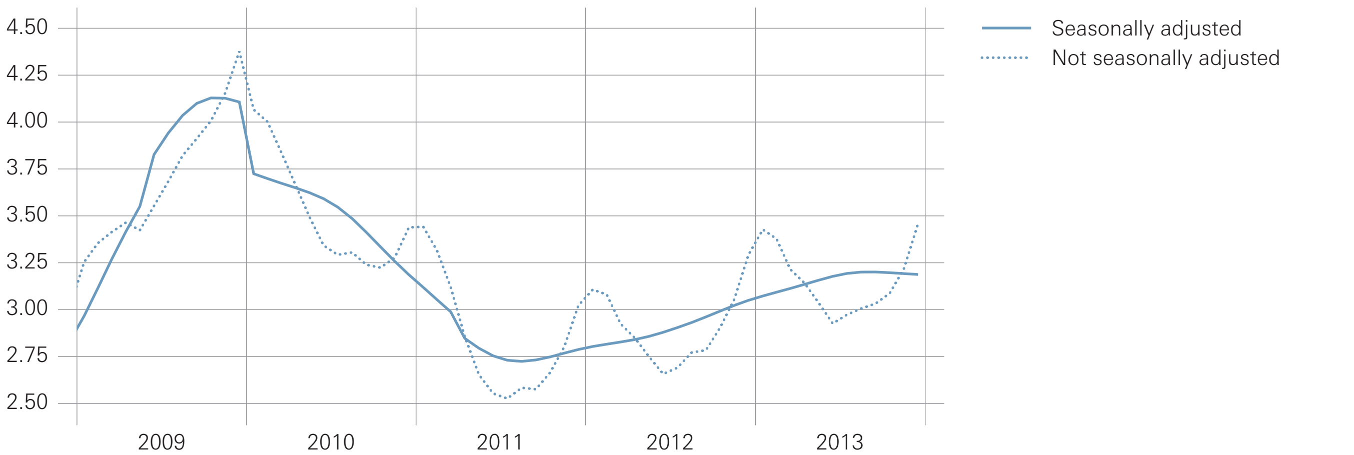
In CHF billions, in real terms, seasonally adjusted



Sources: SECO, SNB

UNEMPLOYMENT RATE

In percent



Sources: SECO, SNB

Restrained momentum on labour market

The number of employed persons registered a moderate increase in 2013. Broken down by industry, however, employment developed unevenly. Further jobs were created in various services industries, public administration and healthcare, which together make up two-thirds of total employment. However, the number of jobs fell again in financial services, manufacturing, retail and hospitality. The seasonally adjusted unemployment rate, which had been 3.1% at the beginning of 2013, rose to 3.2% in the first half of the year and remained at this level to the end of the year.

Slower growth in real wages

In 2013, real wages rose less strongly than in 2012. According to SNB estimates, they increased by almost 1%. This applies to the calculation based on both the Swiss wage index and the national accounts. Together with the slight increase in employment, this resulted in significantly weaker growth in total labour income.

Stable producer and import prices

Producer and import prices remained stable in 2013, after having declined by 1.0% on average in 2012. Fluctuation in the prices of the main components was only minimal during the course of the year. This was also the case for energy prices, which make a major contribution to the volatility of producer and import prices.

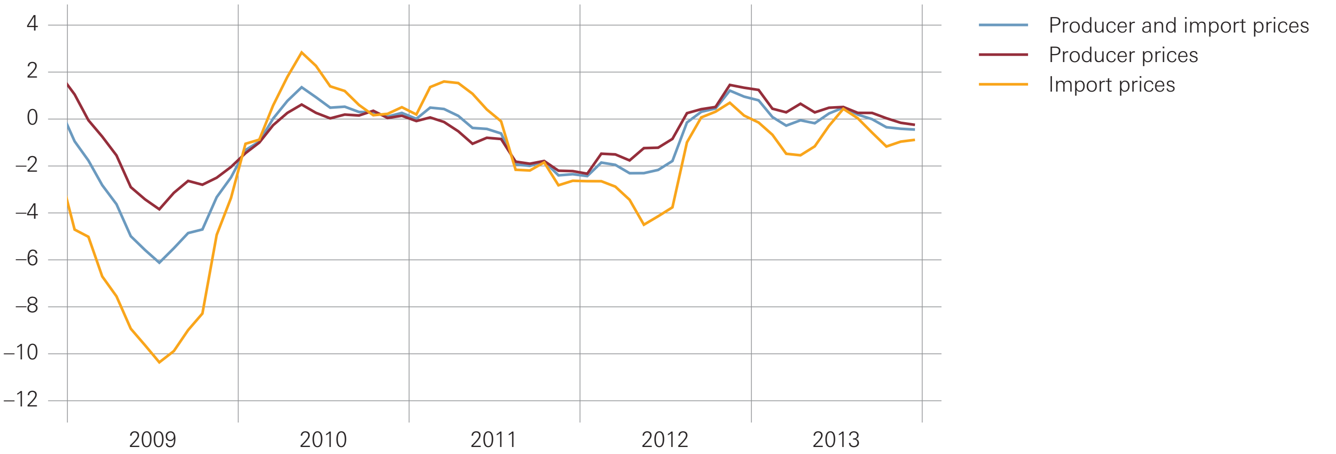
Zero inflation in second half of year

In 2013, the consumer price index (CPI) was down by 0.2% on average, after a decline of 0.7% in 2012. The minimum exchange rate of CHF 1.20 per euro made a substantial contribution to stabilising price developments by curbing the fall in the prices of import goods.

The prices of imported goods and services (excluding oil products) decreased by 1.8% on average in 2013, compared to a drop of 4.2% in the previous year. Consequently, downward pressure on prices for domestic goods also eased. After declining in the first half of the year, these prices advanced slightly in the second half as compared to the previous year. Looking at domestic services, the year-on-year increase in inflation was mainly due to higher rents. In the first quarter of 2013, apartment rentals fell below the previous year's level for the first time since 1998; thereafter they registered strong growth. This substantial increase was partially attributable to statistical base effects.

PRODUCER AND IMPORT PRICES

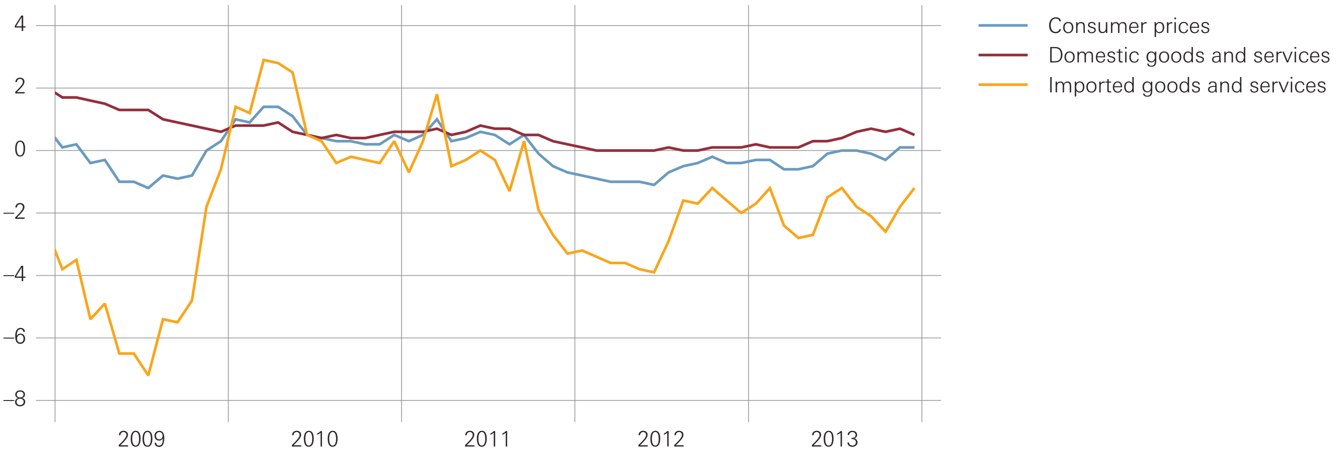
Year-on-year change in percent



Sources: SFSO, SNB

CONSUMER PRICES

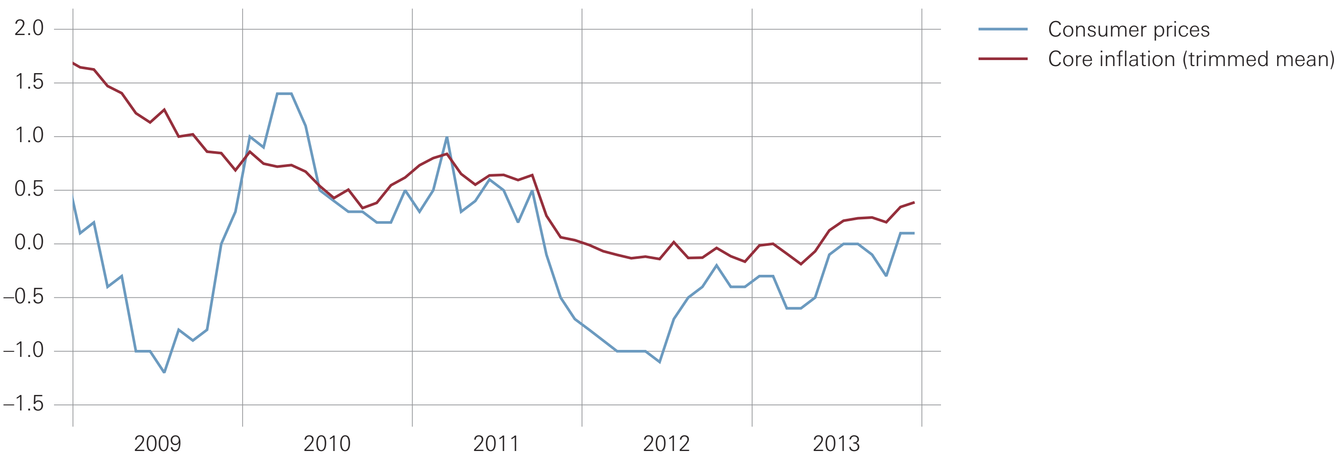
Year-on-year change in percent



Sources: SFSO, SNB

CORE INFLATION

Year-on-year change in percent



Sources: SFSO, SNB

SWISS CONSUMER PRICE INDEX AND COMPONENTS

Year-on-year change in percent

	2012	2013	2013 Q 1	Q 2	Q 3	Q 4
Consumer price index, overall	**–0.7**	**–0.2**	**–0.4**	**–0.4**	**0.0**	**0.0**
Domestic goods and services	0.0	0.4	0.1	0.3	0.5	0.6
Goods	–1.8	–0.3	–0.8	–0.6	0.2	0.1
Services	0.6	0.6	0.4	0.5	0.6	0.7
Private services (excluding rents)	0.6	0.5	0.5	0.6	0.5	0.5
Rents	0.6	0.4	–0.2	0.1	0.7	1.2
Public services	0.4	1.0	1.1	1.1	1.1	0.5
Imported goods and services	–2.7	–1.9	–1.8	–2.3	–1.7	–1.8
Excluding oil products	–4.2	–1.8	–1.9	–1.9	–1.7	–1.6
Oil products	5.0	–2.5	–1.0	–4.3	–1.6	–3.1
Core inflation						
Trimmed mean	–0.1	0.1	0.0	–0.1	0.2	0.3

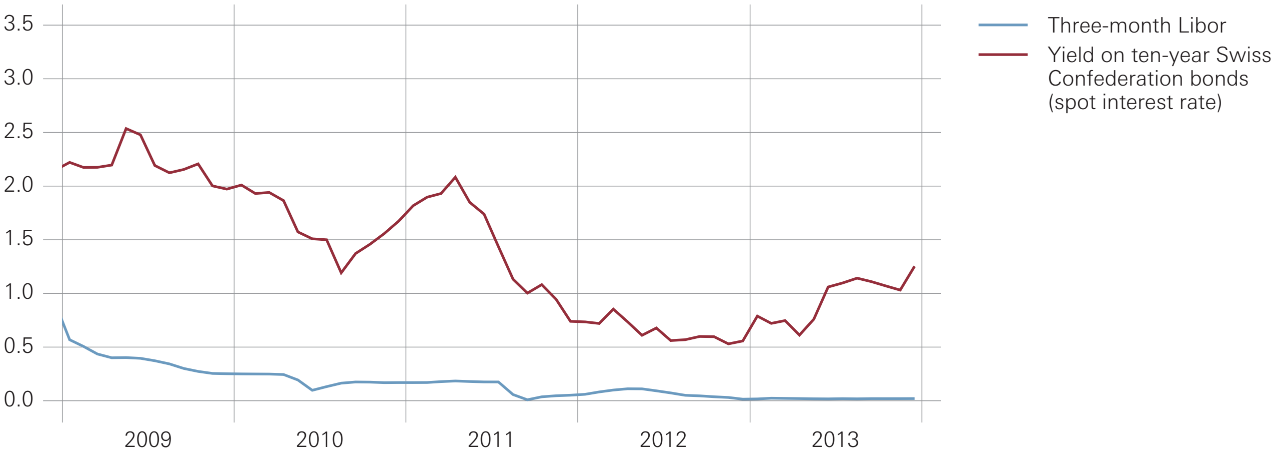
Sources: SFSO, SNB

Core inflation remains low

Various short-term fluctuations can have an impact on inflation as measured by the CPI. In order to analyse the inflation trend, the SNB calculates the core inflation rate with the aid of a trimmed mean. The trimmed mean method involves excluding, each month, those goods with the greatest price changes compared to the same month one year earlier (15% from either end of the distribution). The core inflation rate calculated using the trimmed mean rose slightly to 0.1% in 2013, following a rate of –0.1% in 2012.

MONEY AND CAPITAL MARKET RATES

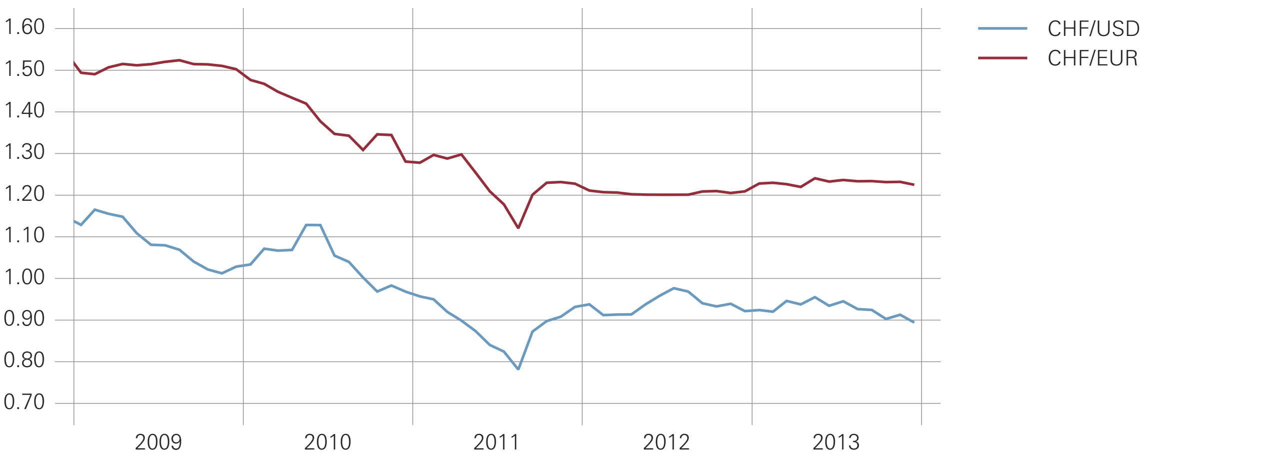
In percent



Source: SNB

EXCHANGE RATES

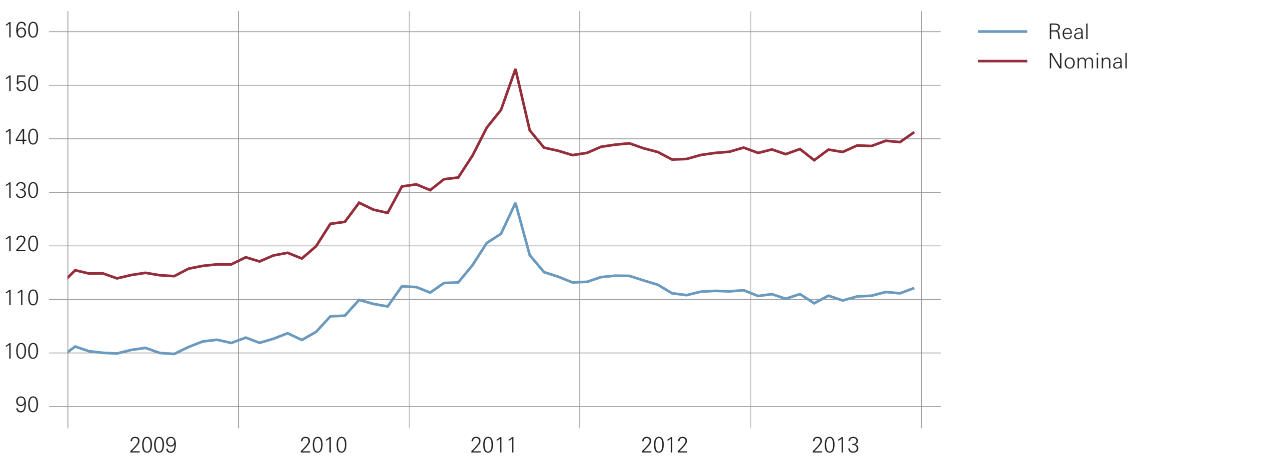
Nominal



Source: SNB

EXPORT-WEIGHTED SWISS FRANC EXCHANGE RATES

40 trading partners; index: January 1999 = 100



Source: SNB

1.4 MONETARY POLICY IN 2013

Adherence to minimum exchange rate

As in the previous year, monetary policy in 2013 was characterised by a three-month Libor close to zero, the minimum exchange rate of CHF 1.20 per euro and a slightly negative rate of inflation. An appreciation of the Swiss franc would have endangered price stability and weighed perceptibly on the economy. With the three-month Libor close to zero, the minimum exchange rate remained the tool for preventing an undesirable tightening of monetary conditions in the event of renewed upward pressure on the Swiss franc.

Enforcement of minimum exchange rate

At its quarterly monetary policy assessments, the SNB therefore confirmed its determination to enforce the minimum exchange rate, if necessary, by buying foreign currency in unlimited quantities, and to take further measures as required. Already in September 2012, when the European Central Bank (ECB) announced it would purchase unlimited quantities of bonds of crisis-hit euro area countries under certain conditions, the financial markets had become somewhat calmer. During the course of the year, the situation eased further, with the result that the Swiss franc always traded above the minimum exchange rate. Consequently, the SNB was not required to enforce the minimum exchange rate through foreign currency purchases.

Target range for three-month Libor unchanged

The target range for the three-month Libor was unchanged at 0.0–0.25% for the entire year. With liquidity in the money market still at a high level, the three-month Libor persisted at 2 basis points, thus remaining at the lower bound of the target range. On average, the interest rate for secured call money (SARON) amounted to –2 basis points.

Scenarios for global economy

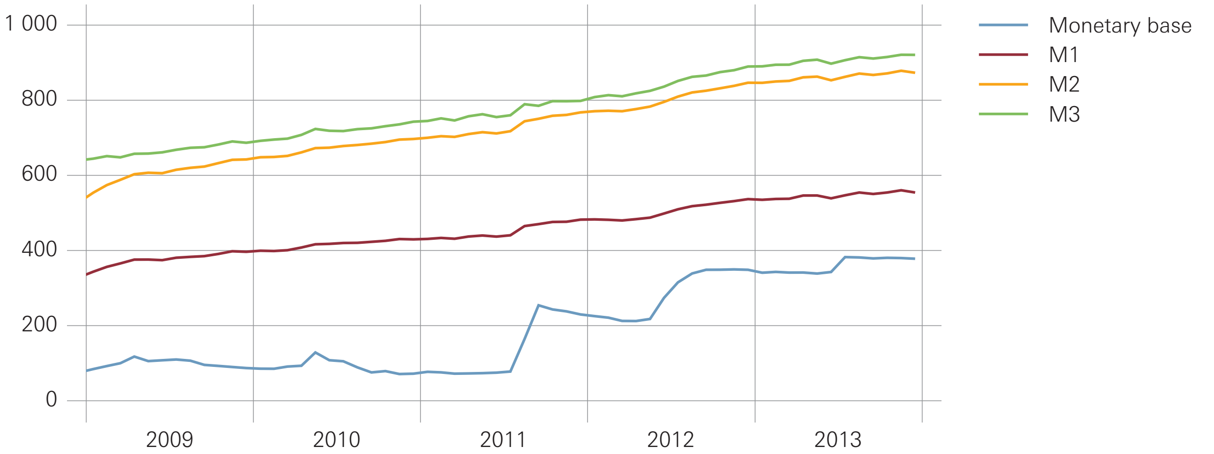
The inflation forecast and the assessment of the domestic economy are based on a scenario for the path of the global economy. In 2013, global economic recovery continued, although this revival was subdued by comparison with past cycles. The SNB carried out simulations of alternative scenarios on a regular basis, in order to take account of the risks in international economic developments.

Economic revival in Switzerland

The economy in Switzerland progressed relatively favourably compared to the international situation. At the beginning of the year, the SNB forecast GDP growth for 2013 of 1.0–1.5%. Following the very favourable results in the second quarter, it increased its growth forecast in September to 1.5–2.0%. The anticipated economic recovery finally set in during 2013, with annual growth of 2.0%, after GDP growth of only 1.0% in the previous year.

LEVEL OF MONETARY AGGREGATES

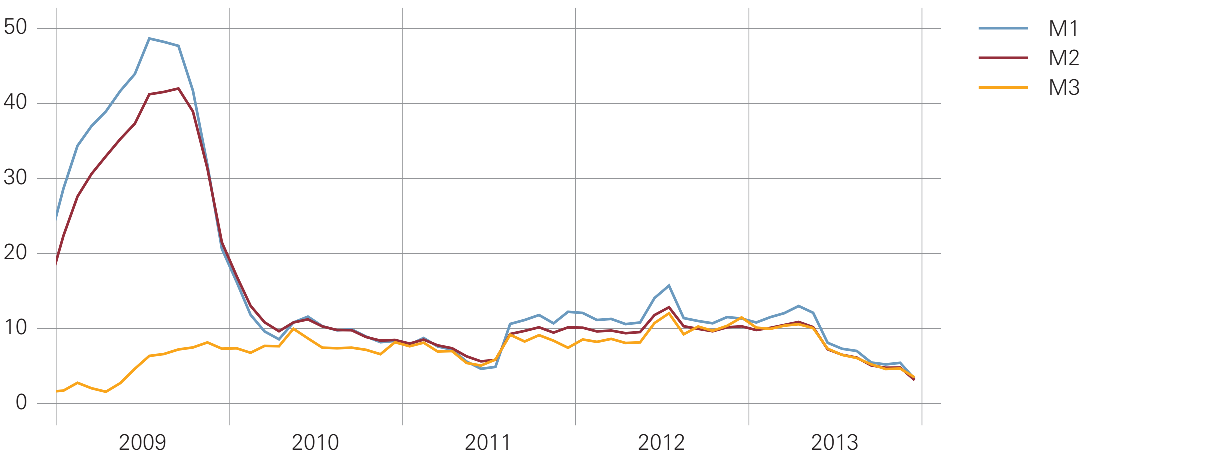
In CHF billions



Source: SNB

GROWTH OF MONETARY AGGREGATES

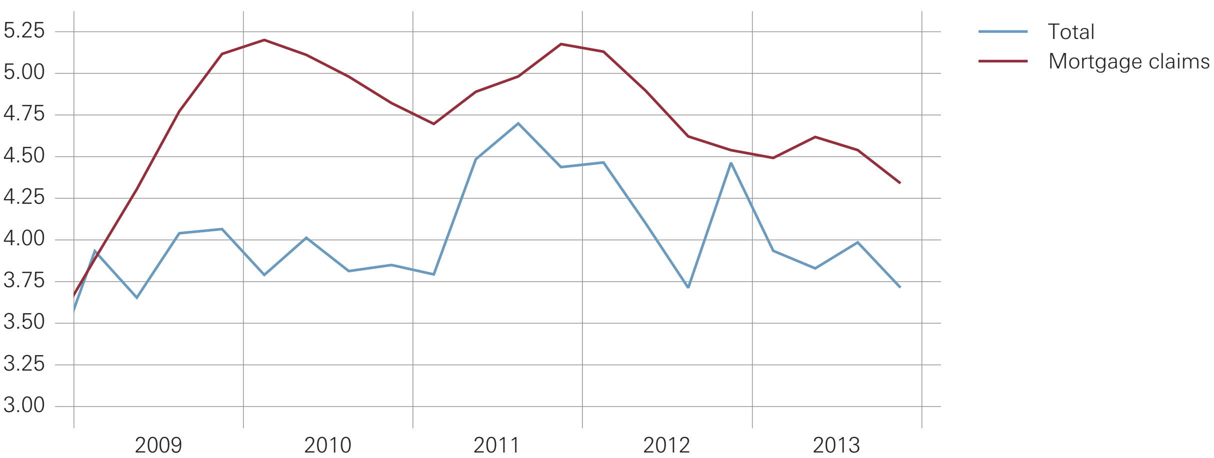
Year-on-year change in percent



Source: SNB

BANK LOANS

Year-on-year change in percent



Source: SNB

Euro above minimum exchange rate

According to market participants' assessments, the risk on financial markets declined at the beginning of January 2013. The Swiss franc thus weakened slightly against the euro, with the rate rising to CHF 1.24 per euro. It lost a little ground briefly in March and April, and then attained a temporary peak of slightly above CHF 1.25 in May. Thereafter it fluctuated in a relatively narrow range of between CHF 1.22 and CHF 1.24 until the end of the year.

Swiss franc still high

Against the US dollar, the Swiss franc weakened somewhat during the summer in connection with expectations of a possible reduction in the US Federal Reserve's bond purchase programme. In autumn it gained value again, so that by the end of the year it was trading slightly higher than at the beginning of the year. The real export-weighted external value of the Swiss franc, which also takes price movements in relation to those of Switzerland's trading partners into account, remained unchanged over the course of the year. In historical terms, therefore, the value of the Swiss franc remained high.

Slight increase in long-term interest rates

After yields on ten-year Confederation bonds had reached a historical low of just under 0.4% in December 2012, they rose in summer following the discussion about the reduction in the Federal Reserve's bond purchase programme. At the end of the year they stood at 1.3%. By contrast, the exchange rate and interest rates in Switzerland were largely unaffected by the ECB interest rate reductions in May and November.

Inflation expectations low

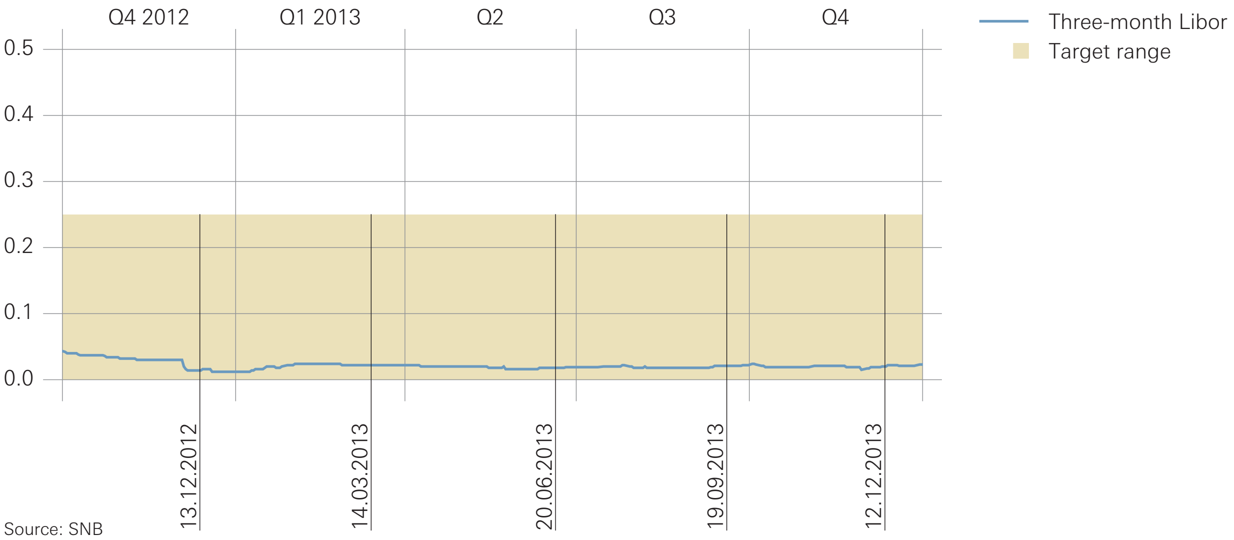
Surveys revealed that medium-term inflation expectations were within a range consistent with the SNB's definition of price stability. Inflation expectations declined during the course of the year to 0.5% for 2014 and to 1.3% for 2018. Thus, the survey participants do not expect that the goal of price stability in Switzerland will be breached in the foreseeable future.

Persistently high sight deposits

In July, sight deposits of domestic banks with the SNB rose by some CHF 40 billion. This was because PostFinance Ltd was granted a banking licence, with the result that its sight deposits with the SNB have since been included under sight deposits of domestic banks. In December, this latter figure was some CHF 25 billion higher than a year previously, at an average CHF 317 billion. Overall, therefore, liquidity remained at a high level.

THREE-MONTH LIBOR

Daily values in percent, dates of monetary policy assessments



Source: SNB

EXCHANGE RATE

Daily rates

Source: SNB

Weaker growth in monetary aggregates

To analyse the path of the M1, M2 and M3 monetary aggregates, the SNB uses time series adjusted for the effect of the change in PostFinance's status. Following a significant increase in the broad monetary aggregates, M2 and M3, in the first half of the year, growth slowed in summer with the rise in long-term interest rates. In December, M2 was 3.1% above the year-back figure and M3 was 3.4% higher. In December 2012, the corresponding rate of growth had still been approximately 10%.

Liquidity held by households and companies still high

Liquidity held by households and companies remained high. In the past, a sustained high level of liquidity generally pointed to inflation risks. However, for the time being, this correlation has disappeared as a result of the financial crisis. Thus, in recent years, the inflation rate has remained exceptionally low despite a high level of liquidity.

Strong growth in lending

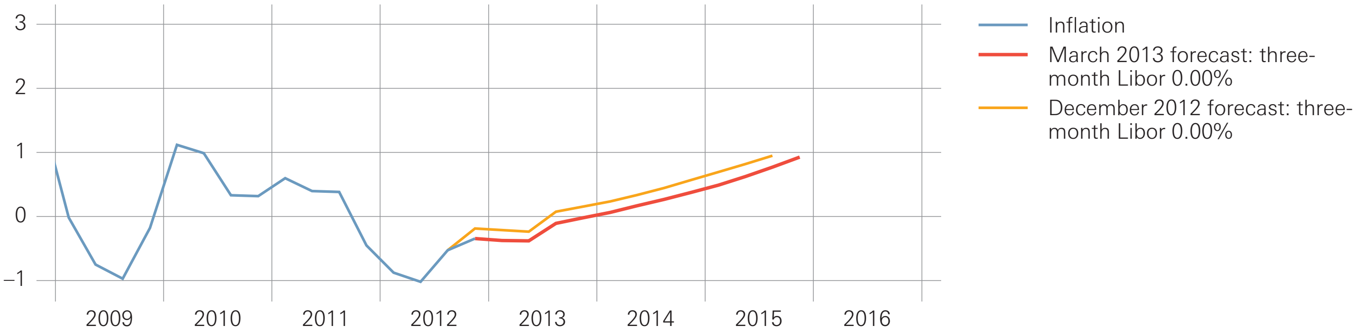
At 3.9%, bank lending – which mainly consists of mortgages – continued growing strongly. This can pose a risk for financial stability. In the past, excessive growth in lending has often represented the point of origin of later difficulties in the banking sector. Consequently, the SNB has expressed its concern about developments in lending on many occasions (cf. chapter 6.4.1).

Conditional inflation forecasts in 2013

The SNB's conditional inflation forecasts showed no risk of inflation at any time during the year. All of the forecasts were based on a three-month Libor of zero over the entire forecast horizon, and indicated a return to positive inflation at the beginning of 2014. Despite the assumption of a Libor at zero, the inflation forecast for the end of the twelve-quarter forecast period did not exceed 1.3%.

CONDITIONAL INFLATION FORECAST OF 14 MARCH 2013

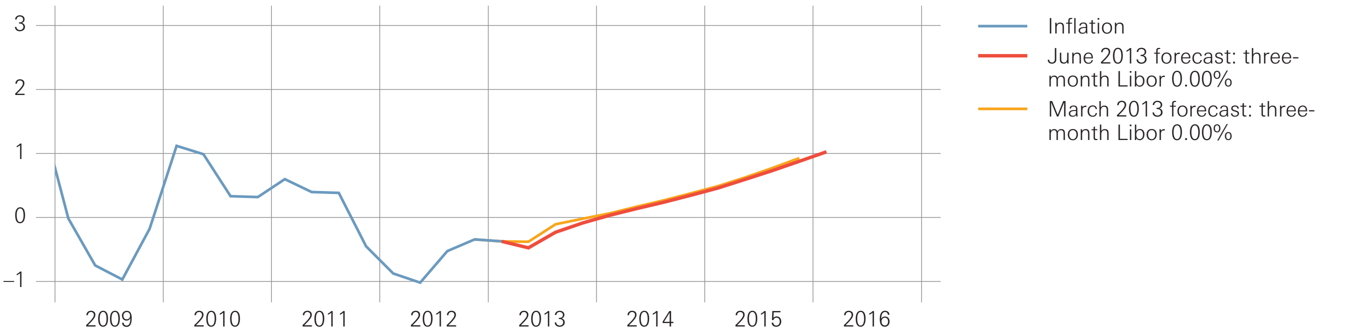
Year-on-year change in Swiss consumer price index in percent



Source: SNB

CONDITIONAL INFLATION FORECAST OF 20 JUNE 2013

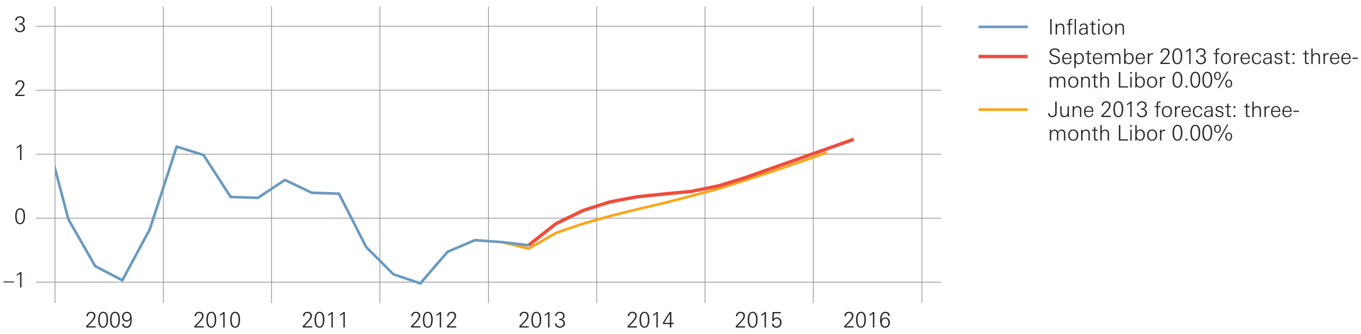
Year-on-year change in Swiss consumer price index in percent



Source: SNB

CONDITIONAL INFLATION FORECAST OF 19 SEPTEMBER 2013

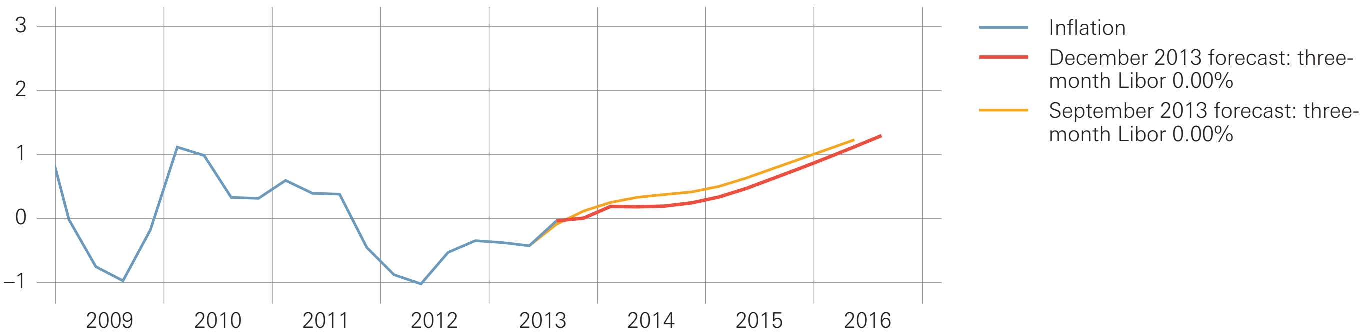
Year-on-year change in Swiss consumer price index in percent



Source: SNB

CONDITIONAL INFLATION FORECAST OF 12 DECEMBER 2013

Year-on-year change in Swiss consumer price index in percent



Source: SNB

The inflation forecasts presented at the quarterly monetary policy assessments changed little during the course of the year. At the March assessment, the conditional inflation forecast was slightly below that presented in December 2012. On the one hand, import inflation continued to decline, so that inflation in the fourth quarter of 2012 was lower than expected. On the other, the economic outlook had once again deteriorated somewhat, especially for the euro area. At the June assessment, the inflation forecast was largely unchanged from March, apart from expected inflation for the current year, which was slightly lower due to a reduction in the price of oil. In September, the inflation forecast was revised slightly upwards for the first time since the introduction of the minimum exchange rate, due to the fact that the oil price was again higher and because of the somewhat more positive assessment of the economy in the euro area. In December, the unexpectedly low rates of inflation in October and November provided a lower point of departure for the forecast. In addition, the decline in inflation in the euro area and the slight fall in the oil price also contributed to a downward shift in the inflation forecast.

High level of uncertainty

The level of uncertainty about developments in the global economy and the financial markets was high throughout the year. The global economy remained vulnerable to shocks, with room for manoeuvre in many advanced economies being restricted by the fact that interest rates were already low and government indebtedness high. Moreover, the danger of tensions in financial markets remained. Overcoming the crisis in the euro area continues to be a major challenge, as does the question of exiting from the current global expansionary monetary policy.

Gold initiative

On 20 March 2013, a popular initiative 'Save our Swiss gold' (gold initiative) was submitted. It demands that the SNB hold at least 20% of its assets in gold and that the central bank no longer be permitted to sell gold. In addition, it calls for mandatory storage of these gold reserves in Switzerland. In its message of 20 November 2013, the Federal Council recommended that the initiative be rejected. The SNB shares the view that acceptance of the initiative would have negative consequences both for the SNB's monetary policy and for its investment policy.

Gold played a key role in the international currency order for a long time, but lost its function as the linchpin of this order when the Bretton-Woods system of fixed exchange rates collapsed in the years 1971–1973. Thereafter, the sole purpose of the Swiss franc statutory gold parity was to report gold holdings on the balance sheet. Finally, in 2000, with the revision of the Federal Constitution, the gold parity was formally abolished. In our present currency system, there is no direct link between the share of gold in the SNB balance sheet and price stability. Instead, price stability is ensured by the SNB as an independent institution that provides the economy with an appropriate supply of money and secures confidence in the stable value of the Swiss franc through a monetary policy geared to stability.

The 20% minimum share of gold in SNB assets called for in the initiative, together with the fact that the gold could not be sold, would have serious consequences for monetary policy. The SNB's monetary policy has a direct impact on the size and composition of its balance sheet. Acceptance of the initiative would severely restrict the SNB's monetary policy capacity to act. This would make it difficult for the SNB to conduct a monetary policy which ensures price stability and contributes to the stable development of the economy. Actions such as the minimum exchange rate against the euro or large-scale preventive measures to secure financial stability could no longer be announced and implemented with the same resoluteness. The latest crisis, in particular, has shown how important it is for the SNB to be able to expand its balance sheet flexibly when needed. In future, the SNB will also need this flexibility to reduce its balance sheet, as necessary. This flexibility would be severely impaired by the measures demanded in the initiative.

2 Implementation of monetary policy

2.1 BACKGROUND AND OVERVIEW

Mandate

It is the task of the Swiss National Bank (SNB) to provide the Swiss franc money market with liquidity (art. 5 para. 2 (a) National Bank Act (NBA)). The SNB implements its monetary policy by managing liquidity on the money market and thereby influencing the interest rate level. The three-month Swiss franc Libor serves as its reference interest rate.

Scope of business and set of instruments

The framework within which the SNB may conduct transactions in the financial market is defined in art. 9 NBA. As lender of last resort, the SNB also provides emergency liquidity assistance.

The 'Guidelines of the Swiss National Bank on monetary policy instruments' set out in detail the SNB's scope of business and describe the instruments and procedures used by the SNB for the implementation of its monetary policy. They also define the conditions under which these transactions are concluded, and which securities can be used as collateral for monetary policy repo operations.

Enforcement of minimum exchange rate

Since 6 September 2011, when the minimum exchange rate of CHF 1.20 per euro was set, the monetary policy instruments have been geared towards its enforcement. In 2013, the SNB did not need to conduct any more foreign currency purchases in order to enforce the minimum exchange rate. The target range for the three-month Libor remained unchanged at 0.0–0.25%.

Sight deposits

A bank's most liquid assets are sight deposits held at the SNB, since they can be used immediately to effect payments and are deemed to be legal tender. Domestic banks hold sight deposits to satisfy minimum reserve requirements. Banks also need them for payment transactions and as liquidity reserves. The SNB influences sight deposits by utilising its monetary policy instruments. Sight deposits at the SNB bear no interest. In addition to sight deposits held by domestic banks, total sight deposits include sight liabilities towards the Confederation, sight deposits of foreign banks and institutions, as well as other sight liabilities.

The level of sight deposits influences activity on the money market. If the supply of liquidity to the banking system is kept low, the individual financial market participants adjust their liquidity positions on the money market. Banks seeking to place funds on a short-term basis provide liquidity in the form of a loan to other banks that require short-term refinancing. These loans can be granted on a secured or unsecured basis. If there is ample liquidity in the banking system, the need for banks to adjust their liquidity positions declines and so too does trading activity on the money market.

2.2 DEVELOPMENTS IN THE MONEY MARKET

Sight deposits virtually unchanged

Swiss franc liquidity remained high in 2013. This was due to the extensive purchases of foreign currency in 2012, which had caused total sight deposits with the SNB to rise to over CHF 370 billion. Since the money market continued to be amply supplied with Swiss franc liquidity, the SNB did not conduct any liquidity-providing open market operations in 2013.

Following the issue of a banking licence to PostFinance Ltd on 26 June 2013, PostFinance's sight deposits, previously reported under other sight liabilities in Swiss francs, are now reported under sight deposits of domestic banks. This latter item had therefore increased by approximately CHF 40 billion as at 26 June 2013, resulting in a decrease primarily in other sight liabilities. Total sight deposits remained unchanged.

Exceptionally low money market rates

In 2013, interest rates on the Swiss franc money market persisted at close to zero. The three-month Swiss franc Libor remained almost unchanged at 2 basis points. Interest rate expectations – derived from three-month Libor futures contracts – stayed low and were, at times, below zero. The Swiss Average Rate Overnight (SARON), the interest rate for secured call money, was mostly just below zero.

Hardly any activity on repo market

With money market rates persistently low and Swiss franc liquidity still high, trading activity on the repo market remained very slight. However, activity on the secured money market did not grind to a complete halt, due to the demand for high-quality securities. The increased importance of these securities is reflected in the trades on the interbank repo market which were concluded at negative repo rates.

High level of compliance with minimum reserve requirements

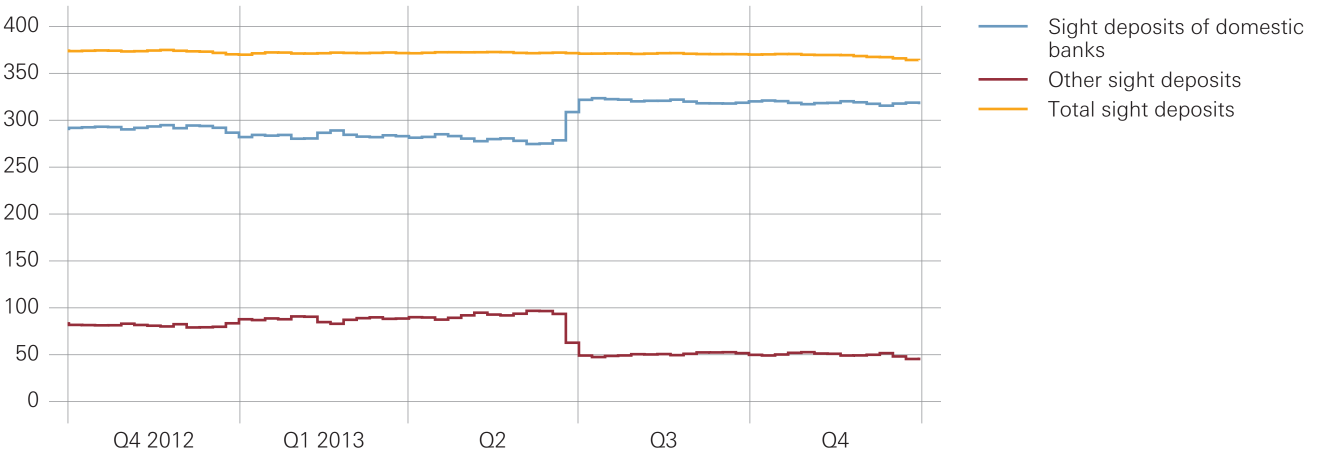
The eligible assets which banks hold to satisfy the statutory minimum reserve requirements, including sight deposits with the SNB, increased to an average of CHF 301 billion. The average level of compliance for the year amounted to 2172%, as compared with 1929% a year earlier (cf. chapter 2.4).

New money market infrastructure

A functioning, secure and efficient infrastructure for the repo market is vital for the implementation of monetary policy, as well as for market participants' access to central bank liquidity. Since 1999, the SNB has been conducting its monetary policy operations, and in particular its repo transactions, via the Eurex trading platform. Due to changes in the stock market and the regulatory environment, the SNB undertook a reassessment of the situation in 2013. Based on this review, the SNB has decided that, as of May 2014, it will conduct its monetary policy operations via a SIX Group Ltd (SIX) trading platform. As a joint undertaking of the banks, SIX operates key parts of the financial market infrastructure (cf. chapter 4). By establishing a trading platform for money market operations, SIX will provide an integrated infrastructure that covers trading, securities settlement and payment processing, as well as opening the way to further developments, in particular the introduction of new products.

SIGHT DEPOSITS AT THE SNB

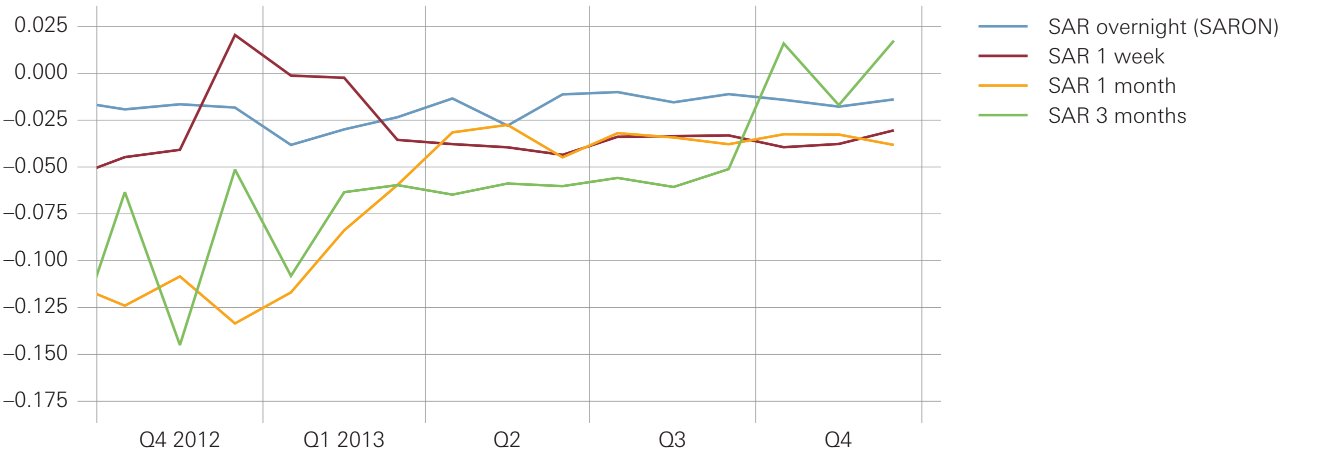
Weekly averages, in CHF billions



Source: SNB

SWISS FRANC REFERENCE RATES (SWISS AVERAGE RATES, SAR)

Monthly averages of daily figures, in percent



Source: SNB

Efforts to reform benchmark interest rates

Following revelations that Libor interest rates had been manipulated, various activities were initiated to reform the Libor and other benchmark interest rates and to reinstate their integrity. The SNB is involved at both international and national level (cf. chapter 6.7).

At national level, the SNB and the Swiss Financial Market Supervisory Authority (FINMA) are talking to financial market participants about ensuring a more robust construction of the benchmark interest rates which are fixed in Switzerland. The focus is on benchmark interest rates for short-term Swiss franc transactions, specifically one-day terms, which form the basis for the Swiss franc yield curve. The two benchmarks involved are, first, the TOIS fixing, which is used for interest rate derivatives in the Swiss franc money market, and, second, SARON, which serves as the basis for the yield curve on the Swiss franc repo market. Although the level of activity on the money market remains persistently low, these benchmark interest rates continue to be available to the market as a basis for interest rate transactions in Swiss francs. However, the Libor retains its position as the most important benchmark interest rates in the money and capital markets. Developing alternatives to the Libor is primarily the responsibility of the private sector.

2.3 USE OF MONETARY POLICY INSTRUMENTS

Foreign exchange transactions

In order to fulfil its monetary policy mandate, the SNB may purchase and sell foreign currency against Swiss francs on the financial markets. Foreign exchange transactions can be conducted with a wide range of domestic and foreign counterparties. The SNB accepts well over 100 banks from around the world as counterparties. With this network of contacts, it covers the relevant interbank foreign exchange market.

In 2013, the exchange rate against the euro was above CHF 1.20 at all times. The SNB was not required to conduct any foreign currency purchases in order to enforce the minimum exchange rate. In its management of foreign exchange reserves, the SNB sold, on balance, foreign currencies for a countervalue of CHF 3.1 billion, thereby offsetting some of the foreign currency income on its foreign currency investments.

Since the introduction of the minimum exchange rate, the National Bank has continuously monitored the foreign exchange market from market opening on Sunday evening to market closing on Friday evening. The opening of the SNB's branch in Singapore in mid-2013 facilitates round-the-clock monitoring of foreign exchange markets.

Foreign exchange swaps

In a foreign exchange swap, the purchase (sale) of foreign currency at the current spot rate and the sale (purchase) of the foreign currency at a later date are simultaneously agreed.

In 2013, the SNB did not conclude any foreign exchange swaps for monetary policy purposes.

Repo transactions

In the case of liquidity-providing repo transactions, the SNB purchases securities from a bank (or other market participant admitted as a counterparty) and credits the associated sum in Swiss francs to the counterparty's sight deposit account with the SNB. At the same time, it is agreed that the National Bank will resell securities of the same type and quantity at a later date. The bank generally pays interest (repo interest rate) to the SNB for the term of the repo agreement. Repo transactions can also be used to absorb liquidity. In this instance, the bank purchases securities from the SNB, and the SNB debits the associated sum in Swiss francs to the counterparty's sight deposit account.

Since the level of Swiss franc liquidity in the financial system was high and the monetary policy instruments were geared towards the enforcement of the minimum exchange rate, there was no need to conduct repo transactions in 2013.

Monetary policy instruments

The SNB influences the interest rate level on the money market by means of secured liquidity-providing and liquidity-absorbing money market operations and through the applicable conditions. The three-month Swiss franc Libor serves as its reference interest rate. The choice of liquidity management regime depends on monetary policy requirements and the liquidity structure in the banking system. If the banking system shows signs of being undersupplied with liquidity, the SNB provides liquidity through short-term money market operations. If, however, the banking system is oversupplied with liquidity, the SNB absorbs liquidity via short-term money market operations.

Within its set of monetary policy instruments, the SNB distinguishes between open market operations and standing facilities. In the case of open market operations, the SNB takes the initiative in the transaction. Where standing facilities are concerned – these include the liquidity-shortage financing facility and the intraday facility – it merely sets the conditions under which counterparties can obtain liquidity.

Regular open market operations include repo transactions and the issuance of SNB Bills. Further open market operation instruments, such as foreign exchange swaps and foreign exchange transactions, are available if necessary. The SNB can carry out its open market operations in the form of auctions or bilateral transactions. Transactions on the money market are mostly concluded via an electronic trading platform.

In principle, all banks domiciled in Switzerland and the Principality of Liechtenstein are admitted as counterparties in monetary policy operations. Other domestic financial market participants such as insurance companies, as well as banks domiciled abroad, may be admitted to monetary policy operations, provided this is in the SNB's monetary policy interest and the said institutions contribute to liquidity on the secured Swiss franc money market.

The issuance of its own debt certificates in Swiss francs (SNB Bills) allows the National Bank to absorb liquidity.

Own debt certificates

In 2013, no SNB Bills were issued.

Intraday facility

During the day, the SNB provides its counterparties with interest-free liquidity (intraday liquidity) through repo transactions so as to facilitate the settlement of payment transactions via the Swiss Interbank Clearing (SIC) system and the settlement of foreign exchange transactions via Continuous Linked Settlement, the multilateral payment system. The funds received must be repaid by the end of the same bank working day at the latest.

Owing to the exceptionally high level of liquidity on the Swiss franc money market, average utilisation of the intraday facility declined further to CHF 1.9 billion, as compared with CHF 2.3 billion a year earlier.

Liquidity-shortage financing facility

To bridge unexpected liquidity bottlenecks, the SNB offers a liquidity-shortage financing facility. For this purpose, the National Bank grants its counterparties a limit which must be covered at all times by at least 110% collateral eligible for SNB repos. Counterparties have the right to obtain liquidity up to the limit granted until the following bank working day. The liquidity-shortage financing facility is granted in the form of a special-rate repo transaction. The special rate lies 0.5 percentage points above the call money rate and is no less than 0.5 percentage points. The basis for the rate is the SARON of the current bank working day. The special rate is valid until 12.00 noon of the following bank working day.

In 2013, the liquidity-shortage financing facility was hardly used. Averaged over the year, the associated volume amounted to only a few thousand Swiss francs. The limits for the liquidity-shortage financing facility amounted to CHF 34 billion; at the end of the year, 89 financial market participants held limits. In December 2013, the SNB, together with financial market participants, tested the operational procedures for drawing liquidity-shortage financing facilities. These tests ran successfully.

SUPPLYING THE MONEY MARKET WITH LIQUIDITY

Liquidity-related operations in CHF millions[1]

Terms	2013	2012
Open market operations		
Repo transactions[2]	–	+9 423
Up to 3 days	–	–
4 to 11 days	–	+8 175
12 to 35 days	–	+1 248
36 days to 1 year	–	–
Foreign exchange swaps[2]	–	+4 244
Up to 7 days	–	+1 064
8 to 28 days	–	+1 024
29 to 94 days	–	+2 155
SNB Bills[2]	–	–3 011
7 days	–	–
28 days	–	–
84 days	–	–
168 days	–	–55
336 days	–	–2 956
Foreign exchange transactions	–3 111	+187 585
Total	**–3 111**	**+198 241**
Standing facilities		
Intraday facility[3]	+1 858	+2 251
Liquidity-shortage financing facility[2]	+0	+0

1 A plus sign (+) indicates liquidity-providing; a minus sign (–) indicates liquidity-absorbing.
2 Average level of liquidity-providing operations outstanding at the end of the day.
3 Average daily turnover.

Collateral eligible for SNB repos

The SNB enters into credit transactions with banks and other financial market participants, provided that the loans are covered by sufficient collateral (art. 9 NBA). In so doing, the SNB protects itself against losses and ensures equal treatment of its counterparties. The 'Guidelines of the Swiss National Bank on monetary policy instruments' outline the types of securities that are eligible as collateral for SNB transactions. The criteria for securities admitted for repo transactions are detailed in the 'Instruction sheet on collateral eligible for SNB repos'. Only securities included in the 'List of collateral eligible for SNB repos' are acceptable. Since the SNB also admits banks domiciled abroad to its monetary policy operations, it accepts securities in foreign currencies besides those in Swiss francs. By international standards, the SNB sets high minimum requirements with regard to the marketability and credit rating of securities. This obliges banks to hold recoverable and liquid assets. In turn, this is essential if banks are to be able to refinance their operations on the money market, even under difficult conditions.

The SNB did not make any changes to its collateral policy in 2013. Translated into Swiss francs, the volume of collateral eligible for SNB repos at the end of 2013 amounted to CHF 9,781 billion.

2.4 MINIMUM RESERVES

Main features of the regulation

The duty to hold minimum reserves (arts. 17, 18, 22 NBA) ensures that banks have a minimum demand for base money; it thus fulfils a monetary policy objective. Eligible assets in Swiss francs comprise sight deposits held at the SNB, banknotes and regular issue coins. The minimum reserve requirement currently amounts to 2.5% of the relevant short-term liabilities, which are the sum of short-term liabilities (up to 90 days) in Swiss francs plus 20% of the liabilities towards customers in the form of savings and investments.

If a bank fails to fulfil the minimum reserve requirement, it is obliged to pay the SNB interest on the shortfall for the number of days of the reporting period during which the minimum reserve requirement was not observed. The interest rate is 4 percentage points higher than the average call money rate (SARON) over the reporting period in question.

MINIMUM RESERVES

In CHF millions

	2013 Outstanding Average	2012 Outstanding Average
Sight deposits at the SNB	300 764	225 847
Banknotes	6 427	5 680
Coins in circulation	110	95
Eligible assets	307 301	231 623
Requirement	14 150	12 008
Compliance in excess of requirement	293 151	219 615
Compliance in percent	2 172	1 929

In 2013 (between 20 December 2012 and 19 December 2013), statutory average minimum reserves amounted to CHF 14.2 billion. This is an 18% increase year-on-year. Eligible assets rose to CHF 307.3 billion on average, compared with CHF 231.6 billion a year previously. Banks exceeded the requirement by an annual average of CHF 293.2 billion; the average degree of compliance amounted to 2172% (2012: 1929%). The statutory minimum reserve requirement was met by all 273 banks.

2.5 LIQUIDITY IN FOREIGN CURRENCIES

Network of permanent swap arrangements

In October 2013, the SNB – jointly with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the US Federal Reserve – announced that the existing bilateral liquidity swap arrangements, which were temporary, were being converted to standing bilateral arrangements. The swap arrangements introduced in November 2011 had helped to ease strains in financial markets and mitigate their effects on economic conditions. The network of permanent swap arrangements is to remain in place until further notice and allows the participating central banks, where necessary, to provide banks in their jurisdiction with liquidity in any of the relevant currencies and so serve as a prudent liquidity backstop.

In 2013, the SNB offered weekly repo transactions in US dollars with a term of one week, and monthly repo transactions with a term of three months. There was no demand for either of these terms.

Again in 2013, it was not necessary for the SNB to provide liquidity in the other foreign currencies or in Swiss francs within the context of these arrangements.

2.6 EMERGENCY LIQUIDITY ASSISTANCE

SNB as lender of last resort

The SNB can act as a lender of last resort. Within the context of this emergency liquidity assistance, it can provide liquidity to domestic banks if they are no longer able to obtain sufficient liquidity on the market.

Conditions

Certain conditions apply in order for emergency liquidity assistance to be granted. The bank or group of banks requesting credit must, for instance, be important for the stability of the financial system and be solvent. Furthermore, the liquidity assistance must be fully covered by sufficient collateral at all times. The SNB determines what securities it will accept as collateral for liquidity assistance. To assess the solvency of a bank or group of banks, the SNB obtains an opinion from FINMA.

3
Ensuring the supply and distribution of cash

3.1 BACKGROUND

Mandate

The Swiss National Bank (SNB) is entrusted with the note-issuing privilege. Pursuant to art. 5 para. 2 (b) of the National Bank Act, it is responsible for ensuring the supply and distribution of cash (banknotes and coins) in Switzerland. It works to ensure an efficient and secure payment system. The SNB is also charged by the Confederation with the task of putting coins into circulation.

Role of the SNB

Banknotes and coins are supplied to the economy via the two cash distribution services at the Berne and Zurich head offices, as well as 14 agencies operated by cantonal banks on behalf of the SNB. The National Bank issues banknotes and coins commensurate with demand for payment purposes, offsets seasonal fluctuations and withdraws banknotes and coins no longer fit for circulation. Local distribution and redemption of banknotes and coins are performed by commercial banks, Swiss Post and cash processing operators.

3.2 OFFICES, AGENCIES AND CASH DEPOSIT FACILITIES

Turnover at offices

In 2013, the turnover (incoming and outgoing) of the offices in Berne and Zurich amounted to CHF 110.1 billion (2012: CHF 113.8 billion). They received a total of 418.5 million banknotes (2012: 419.3 million) and 1,323 tonnes of coins (2012: 1,510 tonnes). The SNB examined the quantity, quality and authenticity of the notes and coins. The incoming banknotes and coins were offset by an outflow of 433.3 million banknotes (2012: 446.8 million) and 1,987 tonnes of coins (2012: 2,180 tonnes).

Turnover at agencies

The agencies assist the SNB offices by distributing and redeeming cash in their regions. In order for the agencies to do this, the SNB provides them with cash, which remains the SNB's property. With the opening of the Geneva agency in February 2012, the SNB currently has 14 agencies. The Geneva agency now counts among the agencies with the highest turnovers and plays an important role in ensuring the supply and distribution of cash.

The agencies' turnover (incoming and outgoing) amounted to CHF 13.6 billion (2012: CHF 13.8 billion). The share of agency turnover in the SNB's overall turnover was 12.4% (2012: 12.1%).

The concentration of cash handling processes continues, with a growing trend for the SNB's main partners – commercial banks, Swiss Post and cash processing operators – to site their cash handling activities at fewer, centralised locations. This allows them to manage banknotes and coins more efficiently. To ensure the supply of cash in Switzerland at all times, the SNB runs cash distribution centres at the head offices in Zurich and Berne and issues regulations on the manner, place and time for the receipt and delivery of coins. Its activities in this field are based on the Federal Act on Currency and Payment Instruments (CPIA).

Developments in cash distribution services

Since 2003, cash processing operators may apply for cash deposit facilities with the SNB. These storage facilities contain stocks of notes and coins. The SNB sets up the facilities with third parties, while retaining their ownership. The cash processing operators deposit surplus banknotes and withdraw banknotes as required. The corresponding bookings are made to their sight deposit accounts at the SNB. Cash deposit facilities reduce the number of incoming and outgoing banknotes at the SNB, as well as the number of transports made by the operators of cash deposit facilities, which makes for a more efficient supply and distribution of cash. In 2013, there were a total of three cash deposit facilities.

Cash deposit facilities

3.3 BANKNOTES

Pursuant to art. 7 CPIA, the SNB issues banknotes commensurate with demand for payment purposes and takes back any banknotes which are worn, damaged or surplus to requirements due to seasonal fluctuations. It also determines the denomination and design of the notes. Particular attention is paid to their security.

Mandate

Banknote circulation

Banknote circulation averaged CHF 59.7 billion in 2013, which was considerably above the CHF 54.7 billion recorded in the previous year. The demand for large-denomination notes increased at an above-average rate. The total number of notes in circulation averaged 377.1 million (2012: 357.9 million).

The increased demand for banknotes, especially 1000-franc notes, is due to two factors. The first is the persistently low level of interest rates since the cost of holding banknotes, in terms of foregone interest income, is relatively low. The second is the increased demand for cash, since in times of uncertainty (financial and debt crisis), cash is particularly highly prized as a store of value and the risks associated with holding it are manageable. Moreover, the increased demand for small-denomination notes is attributable to positive developments in private consumption and to population growth.

NUMBER OF BANKNOTES IN CIRCULATION

In millions

CHF 10s: **71**
CHF 20s: **80**
CHF 50s: **47**
CHF 100s: **101**
CHF 200s: **42**
CHF 1000s: **36**

Annual average for 2013

Significance of cash

The ratio of cash, i.e. banknotes and coins, to GDP fell steadily throughout the second half of the 20th century in Switzerland and in other countries. This can be put down to the population's improved access to banking services (especially to bank accounts for cashless salary transfers) and advances in cashless payment transactions in the form of card-based payment processes. Nonetheless, cash – especially banknotes – continues to play an important role both as a means of payment and as a store of value. This is underscored by, among other things, the fact that the ratio between banknotes in circulation and GDP has remained largely stable since the 1990s; indeed it has even increased again moderately since the financial crisis erupted in 2008.

In 2013, approximately 60% of cash in circulation, expressed in terms of value, was in the form of 1000-franc notes. Some of these served as a store of value. The 1000-franc note, however, continues to see substantial use as a means of payment. This can been seen in the deposits and withdrawals: With an average of approximately 36 million 1000-franc notes in circulation in 2013, the commercial banks, Swiss Post and the cash processing operators deposited 22 million 1000-franc notes into and withdrew 25 million 1000-franc notes from their SNB sight deposit accounts. Furthermore, the commercial banks, Swiss Post and the cash processing operators immediately re-issue large quantities of cash following processing, which are not reflected in the SNB's turnover figures.

Cash cannot be withdrawn unless an account relationship is in place. Financial intermediaries, e.g. banks, withdraw cash via their sight deposit accounts at the SNB, whereas private individuals and companies withdraw cash via accounts held with financial intermediaries. The same is true in the opposite direction for cash deposits. The circulation of 1000-franc notes thus leaves traces which can be followed. The provisions of the Anti-Money Laundering Act and the corresponding ordinance are in place to prevent any potentially criminal misuse of cash.

Issue and disposal

In 2013, the SNB put 68.6 million freshly printed banknotes (2012: 69.7 million) with a face value of CHF 6.4 billion into circulation (2012: CHF 4.4 billion), and destroyed 59.2 million damaged or recalled notes (2012: 56.8 million) with a face value of CHF 3.5 billion (2012: CHF 3.4 billion).

Counterfeits

Approximately 3,700 counterfeit banknotes were confiscated in Switzerland in 2013 (2012: 4,300). This corresponds to 10 counterfeit notes per million Swiss franc notes in circulation (2012: 12). By international standards, this is a modest figure.

Invalid 1000-franc notes

At the beginning of October, the SNB informed the public that, since autumn 2012, a small number of Swiss 1000-franc banknotes were in circulation which were not issued by the SNB. Approximately 1,800 notes, which had not been through all stages of production, were abstracted during the production process at Orell Füssli Security Printing Ltd (OFS). Out of consideration for the investigation by the Office of the Attorney General, this information was only made public after some of these notes appeared in Switzerland. Those in possession of such banknotes will be reimbursed the nominal value by OFS. For the SNB, security is paramount in the production of banknotes. OFS has reviewed its security arrangements, and has taken the necessary measures to ensure that such incidents are precluded to the greatest possible extent in the future.

New banknote series

The new banknote series has suffered a number of delays, as detailed in previous years' accountability reports. The SNB is committed to putting banknotes into circulation that are state of the art in terms of both design innovation and technology. The current banknote series was unique in this respect when it was issued in the mid-1990s and fulfilled high quality standards. It still has a very high security standard today.

The new series must meet high standards on technical aspects concerning security and production – and will have to do so for at least 15 years after its first release. The new security features, which are complex and have never before been applied to banknote design, must also stand up to the rigours of industrial production processes. Time needs to be invested in order to ensure this. After a comprehensive reassessment was carried out in 2012 and the appropriate measures taken, work on the new series has again progressed. The issue date will be announced as soon as production of the first banknote denomination, the 50-franc note, has been completed.

3.4 COINS

Mandate

The SNB is entrusted by the Confederation with the task of coin circulation. Its role is defined in art. 5 CPIA. It takes over the coins minted by Swissmint and puts into circulation the number required for payment purposes. Coins that are surplus to requirements are taken back against reimbursement of their face value. The SNB's coinage services are not remunerated, as they constitute part of its mandate to supply the country with cash. In its efforts to ensure the supply of coins, the SNB is supported by Swiss Post and Swiss Federal Railways in accordance with the Coinage Ordinance.

Coin circulation

In 2013, the value of coins in circulation averaged CHF 2,905 million (2012: CHF 2,847 million), which corresponds to 5,124 million coins (2012: 5,006 million). The value of coins in circulation has increased relatively consistently by 2.5% annually in recent years.

4
Facilitating and securing cashless payments

4.1 BACKGROUND

Mandate

In accordance with art. 5 para. 2 (c) of the National Bank Act (NBA), the Swiss National Bank (SNB) facilitates and secures the operation of cashless payment systems. Art. 9 of the NBA empowers the SNB to keep accounts (SNB sight deposit accounts) for banks and other financial market participants.

Main feature of SIC

A large part of the cashless payment transactions of banks and other eligible financial market participants in Swiss francs are settled via the Swiss Interbank Clearing (SIC) system. SIC is a real-time gross settlement system. This means payment orders are executed irrevocably and individually in real time through the participants' SIC settlement accounts and are therefore equivalent to cash payments. The prerequisite for participating in SIC is the opening of an SNB sight deposit account.

The SNB's role in SIC

The SNB steers the SIC system and ensures that there is sufficient liquidity by granting, when necessary, intraday loans to banks against collateral. It transfers liquidity from the SIC participants' sight deposit accounts at the SNB to their settlement accounts in SIC at the start of each settlement day and transfers the turnover from the individual settlement accounts back to the respective sight deposit accounts at the end of the settlement day. Legally, the two accounts form a unit. The settlement day in SIC starts at 5.00 pm on the evening before the corresponding calendar day and ends at 4.15 pm.

As a systemically important financial market infrastructure, SIC is overseen by the SNB (cf. chapter 6.6). In 2013, the SNB increased the requirements for systemically important infrastructures (cf. chapter 6.5.3).

Operation by SIX Interbank Clearing Ltd

The SNB has transferred the operation of the SIC system to SIX Interbank Clearing Ltd, a subsidiary of SIX Group Ltd (SIX). The SIC agreement, concluded between the SNB and SIX Interbank Clearing, governs the provision of data processing services for the SIC system by the latter. The relationship between the SNB and the holders of sight deposit accounts is governed by the SIC giro agreement.

Involvement in SIC

Based on the SIC agreement, the SNB requests and approves modifications and upgrades to the SIC system. Furthermore, it has a seat on the Board of Directors of SIX Interbank Clearing, and also exerts its influence by participating in various payment system bodies.

The SNB grants access to the SIC system to banks, but also to other financial market participants. These include securities dealers, insurance companies and institutions which play a significant part either in the processing of payments (such as cash processing operators) or in the implementation of monetary policy. Subject to certain conditions, banks domiciled abroad can also gain access to SIC. While all SIC participants must hold a sight deposit account at the SNB, some SNB sight deposit account holders are not connected to SIC.

Eligibility for SIC

4.2 THE SIC SYSTEM IN 2013

In 2013, SIC settled a daily average of approximately 1.7 million transactions amounting to CHF 127 billion. Compared to the previous year, this represents a 2.8% increase in the number of transactions and a 5.8% increase in the turnover. Peak days saw up to 5.5 million transactions being settled, with turnovers of up to CHF 215 billion.

Transactions and turnover

KEY FIGURES ON SIC

	2009	2010	2011	2012	2013
Number of transactions					
Daily average (in thousands)	1 508	1 542	1 585	1 628	1 673
Peak daily value for year (in thousands)	4 788	5 056	5 477	4 755	5 498
Value of transactions					
Average daily turnover (in CHF billions)	169	154	149	120	127
Peak daily turnover for year (in CHF billions)	360	357	255	228	215
Average value per transaction (in CHF thousands)	112	100	94	74	76
Average liquidity					
Sight deposits at end of day (in CHF millions)	57 886	50 489	101 189	272 952	332 428
Intraday facility[1] (in CHF millions)	6 563	7 352	5 361	2 251	1 858

1 The transaction values are based on a new method of calculation and thus vary from the figures previously reported.

Participants in SIC

The SNB had 468 holders of sight deposit accounts as at 31 December 2013 (2012: 490). Of these, 368 participated in SIC (2012: 378). The majority of SIC participants (257) are domiciled in Switzerland (2012: 260).

4.3 DEVELOPMENTS IN SWISS FINANCIAL MARKET INFRASTRUCTURE

New IT architecture for SIC

The SIC system, which began operations in 1986, continues to be redeveloped to keep pace with technological advances. The main goal of the SIC4 project is to redesign the IT architecture of the SIC system. The project is being managed by SIX Interbank Clearing, with the involvement of the SNB and the banks.

SIC as part of Swiss financial market infrastructure

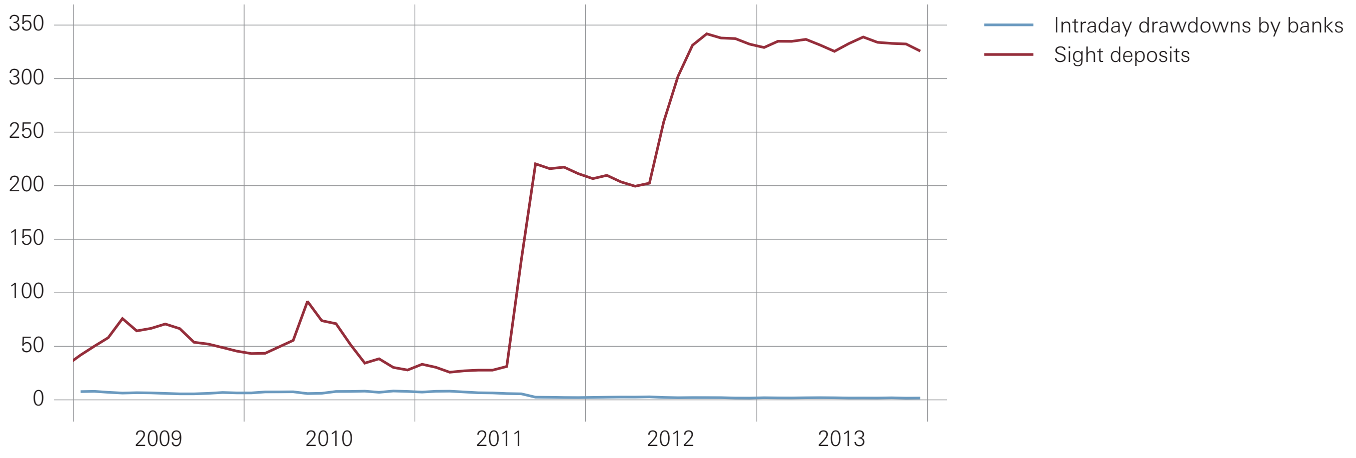
The SIC system is steered by the SNB and is a key element of the Swiss financial market infrastructure, which originated as a joint enterprise among Swiss banks. The Swiss financial market infrastructure is operated by SIX, a company owned by around 140 financial institutions, who are also the main users of the services provided by SIX. As part of its core responsibilities, SIX covers the entire Swiss value chain, comprising securities trading (stock exchange), securities services (including securities settlement), payment services (including SIC) and financial information, independently and in the interest of its owners.

Strategic importance of Swiss value chain

In 2013, SIX reaffirmed its strategic orientation to the Swiss value chain and the interests of its owners. The SNB welcomes this development. A well-functioning, secure and efficient financial market infrastructure is of crucial importance to the SNB. The SNB depends on this infrastructure considerably in fulfilling its statutory mandate, particularly in providing the money market with liquidity as well as facilitating and securing cashless payments. The status of those parts of SIX's financial market infrastructure which are of particular importance to the SNB was further strengthened through organisational measures.

LIQUIDITY IN SIC

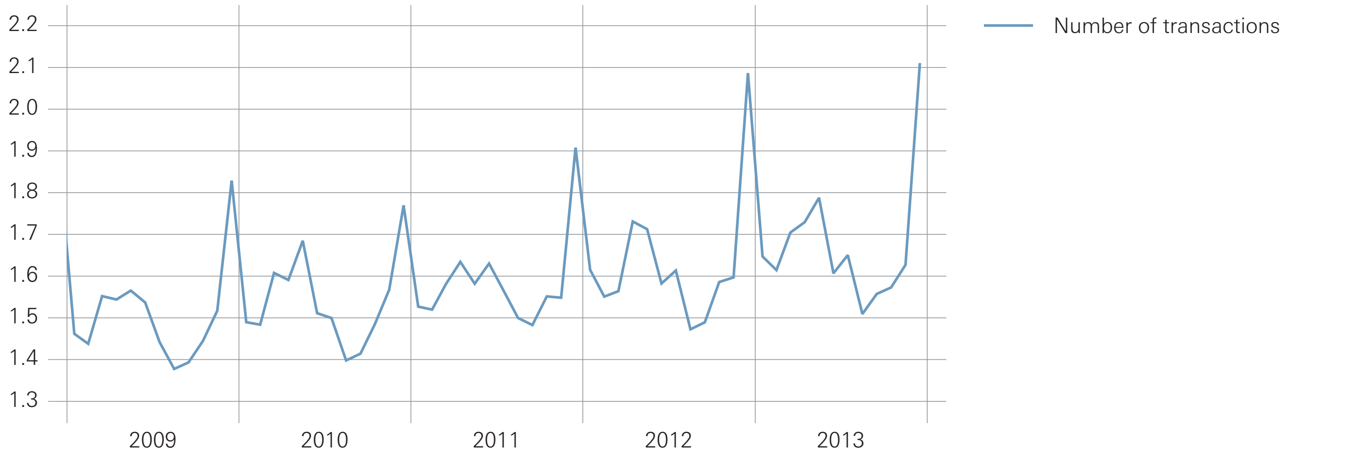
Monthly averages of daily figures, in CHF billions



Source: SNB

TRANSACTIONS IN SIC

Monthly averages of daily figures, transactions in millions



Source: SNB

TURNOVER IN SIC

Monthly averages of daily figures, in CHF billions

Source: SNB

5 Asset management

5.1 BACKGROUND AND OVERVIEW

Mandate

The assets of the Swiss National Bank (SNB) fulfil important monetary policy functions. They consist largely of foreign currency assets, gold and, to a lesser extent, financial assets in Swiss francs. Their size and composition are determined by the established monetary order and the requirements of monetary policy. Under art. 5 para. 2 of the National Bank Act (NBA), the SNB is responsible for managing the currency reserves, part of which must be held in the form of gold (art. 99 para. 3 Federal Constitution).

Currency reserves

The SNB's currency reserves are held primarily in the form of foreign currency investments and gold. The currency reserves also include international payment instruments and the reserve position in the International Monetary Fund (IMF).

The SNB requires currency reserves to ensure that it has room for manoeuvre in its monetary policy at all times. These reserves serve to build confidence, and to prevent and overcome potential crises. At present, the level of the currency reserves is largely dictated by the implementation of monetary policy, i.e. the enforcement of the minimum exchange rate that has applied since September 2011.

Financial assets in Swiss francs

The financial assets in Swiss francs are made up of Swiss franc bonds and sometimes also claims from repo transactions. At the end of 2013, there were no outstanding claims from repo transactions.

Primacy of monetary policy

Asset management is governed by the primacy of monetary policy and is carried out in accordance with the criteria of security, liquidity and return. Assets are selected and managed according to generally accepted asset management principles, while taking into account the specific requirements of the SNB. When selecting assets, care is taken to avoid potential conflicts with the conduct of monetary policy, which is the SNB's core mandate.

Investment criteria and restrictions

The investment policy is based on requirements specific to central banks as well as comprehensive risk/return analyses. The SNB has high standards with regard to the security and liquidity of its assets. It therefore invests a substantial portion of its currency reserves in highly liquid foreign government bonds denominated in the major currencies, as well as in gold. This ensures that it retains its capacity to act even in a crisis. To preserve the real value of the currency reserves over time, the SNB seeks to attain an appropriate diversification of its currency reserves. For this reason, additional currencies and asset classes such as equities, corporate bonds and inflation-linked bonds are also included.

Investment principles

When investing its assets, the SNB bases its decisions on the criteria of security, liquidity and return. The weighting of the individual investment criteria is derived from the functions of the currency reserves. Ensuring room for manoeuvre in the implementation of monetary policy requires, in particular, a high level of liquidity. The criterion of security is taken into account by structuring investments so that at least the real value is preserved over the long term. This requires sufficient returns. To improve the long-term risk/return profile, the foreign currency investments are extended to include investment categories other than government bonds. Since all investments are valued in Swiss francs, a certain positive return must be achieved in the local currencies to compensate for the Swiss franc's long-term upward trend. The returns enable the accumulation of reserves. Furthermore, where appropriate they allow for the financing of distributions. Therefore, as long as it is consistent with monetary policy, currency, interest rate, share price, credit and liquidity risks will be entered into selectively. Equity holdings, in particular, serve to optimise the risk/return profile of the currency reserves in the long term.

Challenges for investment policy

At the end of 2013, the currency reserves amounted to CHF 477 billion. Compared to the period prior to the financial crisis, this level is high, and involves greater demands on currency reserve management and heightened financial risk. The SNB takes care to avoid its investments having any impact on the markets and currency developments in other countries. For this reason, in recent years it has placed part of these inflows with other central banks.

In 2013, the equity portfolio was widened to cover equities from advanced economies that had previously not been included, and equities in small-cap companies. In this way, equity diversification was increased.

The equity portfolios are managed passively, by replicating a combination of different indices. In general, no investments are made in international medium and large-sized banks and bank-like institutions, to exclude possible conflicts of interest.

The increased volume of equity investments has necessitated additional measures to ensure adherence to the stock exchange rules and regulatory requirements in the different countries. The SNB also dealt with further issues relating to the equity holdings over the course of the year. These included the compatibility of exclusion criteria for individual companies with the SNB's index-oriented investment approach. Concerning the exclusion criteria, the SNB decided in 2013 to exclude equities from companies which produce internationally banned weapons, violate fundamental human rights on a massive scale, or systematically cause severe environmental damage.

Branch office in Singapore

On 1 July 2013, the SNB opened its first branch office abroad. The decision on Singapore was taken in view of the sharp expansion in foreign exchange reserves and the growing importance of Asian financial markets. With the new presence, the SNB is closer to the markets in one of the most important financial centres in Asia. The establishment of the Singapore office extends the SNB's market coverage and ensures a more efficient management of its Asian assets through the local presence of internal portfolio managers. Moreover, it facilitates round-the-clock foreign exchange market operations, including the enforcement of the minimum exchange rate. Seven staff members were employed at the branch office at the end of 2013, and its activities, especially trading and portfolio management, have been fully integrated into the existing investment and risk control process in Switzerland.

5.2 INVESTMENT AND RISK CONTROL PROCESS

Responsibilities of Bank Council and Risk Committee

The NBA defines the SNB's responsibilities and describes in detail its mandate with regard to asset management. The Bank Council is charged with the integral oversight of the investment and risk control process. Its role is to assess the underlying principles and monitor compliance with them. The Risk Committee – which is composed of three members of the Bank Council – supports the Bank Council in this task. It monitors risk management, in particular, and evaluates the governance of the investment process. Internal risk management reporting is addressed to the Governing Board and the Risk Committee.

Responsibilities of Governing Board

The Governing Board defines the principles of the investment policy. In particular, it sets out the requirements with regard to the security, liquidity and return of the investments, as well as the eligible currencies, investment categories, instruments and borrower categories. The Governing Board decides on the composition of the currency reserves and other assets, and defines the foreign currency investment strategy. The investment strategy covers the allocation of foreign currency investments to different investment categories and currencies, and determines the scope for active management at operational level.

Responsibilities of Investment Committee and Portfolio Management

The Investment Committee, an internal body, decides on the tactical allocation of the foreign currency investments at operational level. Within the strategically prescribed ranges, it adjusts currency weightings, bond durations and allocations to the different investment categories, to take account of changed market conditions. Portfolio Management administers the individual portfolios. The majority of investments are managed internally. External asset managers are used for benchmarking the internal portfolio management. To avoid conflicts of interest, at operational level the responsibilities for monetary policy and investment policy are largely kept separate.

Responsibilities of Risk Management

Risk is managed and mitigated by means of a system of reference portfolios, guidelines and limits. All relevant financial risks on investments are identified, assessed and monitored continuously. Risk measurement is based on standard risk indicators and procedures. In addition to these procedures, sensitivity analyses and stress tests are carried out on a regular basis.

The SNB's comparatively long-term investment horizon is taken into account in all of these risk analyses. To assess and manage credit risk, information from major rating agencies, market indicators and in-house analyses are used. Credit limits are set on the basis of this information, and adjusted whenever the assessment of counterparty risk changes. To mitigate counterparty risk, the replacement values of derivatives are usually collateralised by securities. Concentration and reputational risks are also factored in when determining risk limits. Risk indicators are aggregated across all investments. Compliance with the guidelines and limits is monitored daily. The risk analyses and the results of risk management activities are submitted to the Governing Board and the Bank Council's Risk Committee in quarterly risk reports. In addition, the annual risk management report is submitted to the Bank Council.

5.3 CHANGES IN AND BREAKDOWN OF ASSETS

Changes in assets

At the end of 2013, the SNB's assets amounted to CHF 490 billion, which was CHF 9 billion lower than one year earlier. Currency reserves fell by CHF 8 billion to CHF 477 billion year-on-year. The decline is attributable to valuation losses of CHF 15 billion on gold holdings. By contrast, foreign exchange reserves rose by CHF 8 billion. This was also supported by the proceeds from the sale of the stabilisation fund to UBS amounting to a little over CHF 3 billion (cf. chapter 6.8 for information on the stabilisation fund, as well as the notes to the annual financial statements in the financial report). Part of the income from foreign currency investments was offset by sales of foreign exchange in the amount of approximately CHF 3 billion. Swiss franc assets consisted of bonds denominated in Swiss francs for just under CHF 4 billion.

Bond portfolios

At the end of 2013, the bond portfolios in the foreign currency investments contained government and quasi-government bonds as well as bonds issued by supranational organisations, local authorities, financial institutions (mainly covered bonds) and other companies. A portion of the foreign currency investments was placed on accounts at other central banks and with the Bank for International Settlements (BIS).

Equity portfolios

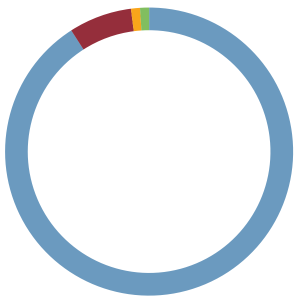
The equity portfolios in the foreign currency investments were comprised of shares from medium-sized and large corporations (excluding banks) in advanced economies and, to a lesser extent, shares of companies with smaller market capitalisation (small caps). The SNB does not regard itself as a strategic investor. Thus, equities are managed passively and according to a set of rules based on a strategic benchmark comprising a combination of equity indices in various currencies. This results in a globally well-diversified equity portfolio of roughly 5,600 individual stocks (approximately 1,400 mid and large caps and around 4,200 small caps). Replicating indices ensures that there is no underweighting or overweighting at operational level in individual sectors or companies. In the long term, equity holdings contribute to both a higher potential return and a more balanced risk profile of the assets.

Swiss franc bonds

The passively managed Swiss franc bond portfolio primarily contained bonds issued by the Confederation, the cantons and foreign borrowers, as well as Swiss Pfandbriefe. The duration of the portfolio was just under seven years.

BREAKDOWN OF SNB ASSETS

In percent



Total: CHF 490 billion
At year-end 2013

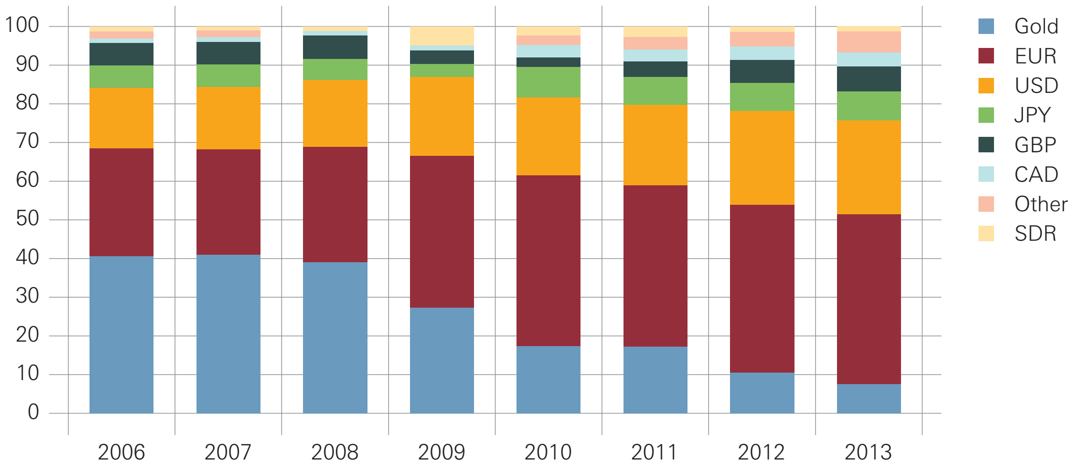
BREAKDOWN OF FOREIGN CURRENCY INVESTMENTS AND SWISS FRANC BOND INVESTMENTS AT YEAR-END

	2013 Foreign currency investments	2013 CHF bond investments	2012 Foreign currency investments	2012 CHF bond investments
Currency allocation (in percent, incl. derivatives positions)				
CHF		100		100
EUR	48		49	
USD	27		28	
JPY	8		8	
GBP	7		7	
CAD	4		4	
Other[1]	6		4	
Investment categories (in percent)				
Investments with banks	0	–	0	–
Government bonds[2]	76	37	82	35
Other bonds[3]	8	63	6	65
Equities	16	–	12	–
Breakdown of fixed income investments (in percent)				
AAA-rated[4]	70	74	78	79
AA-rated[4]	24	26	17	21
A-rated[4]	2	0	2	0
Other	4	–	3	–
Investment duration (years)	3.3	6.5	3.3	6.6

1 Mainly AUD, DDK, SEK, SGD, KRW, plus small holdings of other currencies in the equity portfolios.
2 Government bonds in own currency, deposits with central banks and the BIS; in the case of CHF investments, also bonds issued by Swiss cantons and municipalities.
3 Government bonds in foreign currency as well as bonds issued by foreign local authorities and supranational organisations, covered bonds, corporate bonds, etc.
4 Average rating, calculated from the ratings of the three major credit rating agencies.

BREAKDOWN OF CURRENCY RESERVES

In percent, excluding investments and liabilities from foreign exchange swaps against CHF



Source: SNB

Changes in asset structure

There was little year-on-year change in the structure of the foreign currency investments and Swiss franc bonds. By widening the scope of equities, even broader coverage was reached. The principles of currency and asset category diversification continued to be observed. Compared to one year earlier, the share of the US dollar and the euro decreased slightly in favour of the secondary currencies. Approximately 16% of foreign currency investments were held as sight deposits at other central banks. In spring 2013, the share of equities in the foreign currency investments was increased, amounting to 16% at year-end.

5.4 ASSET RISK

Risk profile

The risk profile of assets is dominated by the currency reserves. The main risk to the currency reserves is market risk, in particular risks related to exchange rates, the gold price, share prices and interest rates. In addition, there is liquidity risk as well as credit and country risks, although these are smaller than market risk. The contribution of Swiss franc bonds to total risk is only marginal.

Market risk

The gold price and exchange rates are the most important risk factors for the currency reserves. Even minor changes in the Swiss franc exchange rate and the gold price lead to substantial fluctuations in investment performance, and thus in the SNB's equity. Currency risk is, in principle, not hedged against Swiss francs because the appropriate measures – e.g. forward sales of foreign currency against Swiss francs – can have a direct impact on monetary policy. To manage currency weightings within foreign currency investments, foreign exchange derivatives can be used, however. Given an equity share of 16% and a duration of just over three years for fixed income investments, the contribution of share price risk and interest rate risk to total risk was comparatively small. Share price risk and interest rate risk are limited through the specification of benchmarks and management guidelines. Various means, including the use of derivative financial instruments such as interest rate swaps, stock index futures and interest rate futures, were used to control these risks.

Liquidity risk

The SNB's liquidity risk arises from the possibility that, should investments in foreign currencies need to be sold, such sales could be effected only partially or after considerable price concessions, or may not be possible at all. By holding a large number of the most liquid government bonds in the major currencies – euros and US dollars – the SNB ensured a high level of liquidity for its foreign currency reserves. Liquidity risk is reassessed periodically.

Credit risk

Credit risk stems from the possibility that counterparties or issuers of securities may be unable or unwilling to meet their obligations. The SNB enters into such risks through bond investments relating to various borrowers and borrower categories. These include bonds issued by public and supranational borrowers, covered bonds and similar instruments as well as corporate bonds (the latter totalling approximately CHF 15 billion). For issuers of bonds, a minimum rating of 'investment grade' is required. Exposure to individual issuers is limited by means of concentration limits. Credit risk arising from non-tradable instruments with respect to banks was very low. Replacement values of derivatives were collateralised, in accordance with the ISDA (International Swaps and Derivatives Association) agreements with counterparties.

Investments mainly took the form of government bonds or holdings at central banks; the bulk of these are in highly liquid bonds issued by euro area core countries and by the US. The large majority of fixed income investments (70%) bore the highest rating (AAA). Investments with central banks are generally awarded the same rating as that of the country concerned. In all, 94% of bonds were rated AA or higher.

Country risk

Country risk arises from the possibility that a country may hinder payments by borrowers domiciled in its sovereign territory or block the right to dispose of assets held there. In order to avoid entering into any unbalanced country risk, the SNB endeavours to distribute assets among a number of different depositories and countries. Gold holdings are stored according to this principle as well. In choosing a location, great attention was paid to both appropriate regional diversification and easy market access. Of the 1,040 tonnes of gold, over 70% are held in Switzerland, approximately 20% at the Bank of England, and roughly 10% at the Bank of Canada. Decentralised storage of gold holdings in Switzerland and abroad ensures that the SNB has access to its gold reserves even in the event of a crisis.

Balance sheet and equity

Owing to strong growth in the currency reserves over the past few years, the share of equity in the balance sheet total has seen a considerable decline since 2009. In 2013, the capital ratio decreased further to just under 10%. This was the result of the loss on currency reserves. The SNB's loss-absorbing capital is composed mainly of the provisions for currency reserves and the distribution reserve. As a result of the losses, it was thus reduced by CHF 9 billion. After allocation of CHF 3.0 billion to the provisions for currency reserves, a distributable annual result of CHF –12.1 billion remained in 2013. Since this loss substantially exceeded the CHF 5.3 billion in the distribution reserve, the SNB was not in a position to pay out a dividend to the shareholders or make a profit distribution to the Confederation and the cantons. At year-end, equity after appropriation of profit amounted to CHF 48 billion, or roughly 10% of the currency reserves. This ratio is low by historical standards.

5.5 INVESTMENT PERFORMANCE

Loss on currency reserves

Investment performance is calculated for foreign currency investments, gold and Swiss franc bonds.

In 2013, the overall return on currency reserves was negative, at –2.5%. It was the result of the 30% loss on gold holdings which was not offset by the 0.7% return on foreign currency investments. In local currency terms, i.e. before taking the appreciation of the Swiss franc into account, in particular against the US dollar and the Japanese yen, the return on foreign currency investments amounted to 3.2%. This positive result was solely attributable to the exceptionally high return on equities. By contrast, given the rise in interest rates, fixed income investments registered a loss. The return on Swiss franc bonds amounted to –2.2%.

RETURN ON INVESTMENTS

Cumulated, time-weighted daily returns in percent

	Currency reserves[1]					CHF bonds
	Total	Gold	Foreign currency investments			Total
			Total	Exchange rate return	Return in local currency	
2002	1.4	3.4	0.5	–9.1	10.5	10.0
2003	5.0	9.1	3.0	–0.4	3.4	1.4
2004	0.5	–3.1	2.3	–3.2	5.7	3.8
2005	18.9	35.0	10.8	5.2	5.5	3.1
2006	6.9	15.0	1.9	–1.1	3.0	0.0
2007	10.1	21.6	3.0	–1.3	4.4	–0.1
2008	–6.0	–2.2	–8.7	–8.9	0.3	5.4
2009	11.0	23.8	4.8	0.4	4.4	4.3
2010	–5.4	15.3	–10.1	–13.4	3.8	3.7
2011	4.9	12.3	3.1	–0.8	4.0	5.6
2012	2.3	2.8	2.2.	–2.3	4.7	3.7
2013	–2.5	–30.0	0.7	–2.4	3.2	–2.2

1 In this table, they correspond to gold and foreign currency investments, excluding IMF Special Drawing Rights.

6
Contribution to financial system stability

6.1 BACKGROUND

Mandate

Art. 5 para. 2 (e) of the National Bank Act (NBA) confers upon the Swiss National Bank (SNB) the mandate of contributing to the stability of the financial system. Financial stability means that financial system participants, i.e. financial intermediaries (especially banks) and financial market infrastructures, can perform their functions and are able to withstand potential disturbances. It is an important prerequisite for economic development and effective monetary policy implementation.

In the area of financial stability, the SNB fulfils this mandate by analysing sources of risk to the financial system and identifying areas where action is needed. In addition, it helps to create and implement a regulatory framework for the financial sector, and oversees systemically important financial market infrastructures. In a crisis, the SNB fulfils its mandate by acting as lender of last resort to provide domestic banks with emergency liquidity assistance where necessary, in cases where such banks are no longer able to refinance themselves on the market and where their insolvency would have a severe impact on financial system stability (cf. chapter 2.6).

Collaboration with FINMA, FDF and foreign authorities

At national level, the SNB works together with the Swiss Financial Market Supervisory Authority (FINMA) and the Federal Department of Finance (FDF) to create a regulatory environment that promotes stability. The SNB addresses the issue mainly from a systemic perspective, and its focus is therefore on the macroprudential aspects of regulation. For its part, FINMA is responsible, among other things, for the monitoring of individual institutions, i.e. microprudential supervision. At international level, the SNB participates in the design of the regulatory framework through its membership of the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS) and the Committee on Payment and Settlement Systems (CPSS). In the oversight of cross-border financial market infrastructures, the SNB liaises closely with foreign authorities.

6.2 MAIN ACTIVITIES

Activation and increase of countercyclical capital buffer

Against the background of growing imbalances on the mortgage and real estate markets, the SNB submitted a proposal to the Federal Council to activate, for the first time, the countercyclical capital buffer (CCB) on mortgage loans financing residential real estate located in Switzerland. Acting on this proposal, in February 2013 the Federal Council set the CCB at 1% of the associated risk-weighted positions. In January 2014, the Federal Council increased the sectoral CCB from 1% to 2%, at the proposal of the SNB.

Implementation of 'too big to fail' regulations

In November 2013, the SNB designated Zürcher Kantonalbank as a financial group of systemic importance in accordance with the Banking Act. In addition, the SNB was involved in a number of ongoing activities relating to the implementation of the 'too big to fail' regulations.

Partial revision of National Bank Ordinance

The SNB revised the implementing provisions on the oversight of financial market infrastructures in the National Bank Ordinance (NBO). It strengthened the existing requirements for operators of systemically important financial market infrastructures and introduced additional requirements.

6.3 MONITORING THE FINANCIAL SYSTEM

Financial Stability Report

In its annual *Financial Stability Report*, published in June 2013, the SNB assessed developments and risks in the Swiss banking sector. It reported that economic and financial conditions for the Swiss banking sector continued to be challenging, and that while a number of decisions and measures taken by governments and central banks had relieved tensions in international financial markets since 2012, nevertheless the structural and institutional reforms undertaken would need time to take full effect. The SNB pointed out, moreover, that developments in the real economy contrasted sharply with the improvement on financial markets, and noted the continuing strong momentum on Swiss mortgage and real estate markets.

The SNB also observed that the two globally active Swiss big banks had substantially increased their risk-weighted capital ratios. In this respect, both of these banks were very well placed in an international peer comparison. However, given the prevailing risks in the environment and the losses incurred in the recent financial market crisis, the SNB still considered unweighted capital ratios (leverage ratios) at the Swiss big banks to be low. It therefore recommended that the big banks consistently and fully implement their plans on capital-building, in order to further strengthen their resilience and, in particular, improve their leverage ratios. In addition, it recommended that they increase transparency with regard to the extent of their risk exposure (cf. chapter 6.5.2).

The SNB reported that, measured against the regulatory minimum requirements, capitalisation at domestically focused commercial banks was high overall, and had even improved slightly year-on-year. It warned, however, that figures on regulatory capital may overestimate the true resilience of these banks, in view of the risks on the Swiss mortgage and real estate markets, the high level of interest rate risk in the banking book and the low diversification. Going forward, the SNB recommended that these banks ensure that their resilience is sufficiently high to absorb potential losses, over and above the regulatory requirements, and to exercise greater caution in mortgage lending.

Developments in second half of 2013

In the second half of 2013, both big banks strengthened their capitalisation further, so that their risk-weighted capital ratios continued to be above average for global big banks. Their unweighted capital ratios also improved, although they were still below the international average. Against this background, the SNB still considered it important that the big banks continue to improve their capitalisation as planned, focusing especially on leverage ratios. The SNB continued to regard risks in the mortgage and real estate markets as the most serious challenge to the stability of domestically focused banks.

6.4 RISKS AND MEASURES RELATING TO MORTGAGE AND REAL ESTATE MARKETS

6.4.1 SITUATION AND RISKS

Risk-reducing measures taken up to early 2013

Owing to the strong growth in lending and real estate prices which had been observed for a number of years, in 2012 imbalances on the mortgage and real estate markets had already become so large that, in the SNB's view, they posed a threat to the stability of the banking system and hence to the Swiss economy.

A number of measures were phased in by early 2013, with the aim of reducing the risks associated with these developments. The three main measures were: the revision of self-regulation rules on banks' mortgage lending (with a transition phase until November 2012); increased capital requirements for high loan-to-value (LTV) mortgage loans (in force since the beginning of 2013); and the introduction of a new tool, the countercyclical capital buffer, by the Federal Council as from 1 July 2012. At the proposal of the SNB, the Federal Council activated the CCB in February 2013 (with a transition phase until end-September).

Growing imbalances

Despite these measures, imbalances grew further in 2013, particularly on the mortgage market, where, in the SNB's view, the situation deteriorated markedly. Growth in residential mortgages remained high, and continued to outpace GDP growth by a considerable margin.

The situation on the residential real estate market also deteriorated in 2013. Prices for residential real estate registered a substantial increase, despite signs of a slowdown. They also continued to rise faster than, for example, rents or incomes.

Risk appetite still high

Banks' risk appetite in mortgage lending remained high. The SNB did not observe a reversal of this trend. As regards mortgages for owner-occupied real estate, the proportion of new loans with a high LTV ratio did decline slightly, but there was no discernible decrease in affordability risk. Moreover, interest margins narrowed once again, while banks' interest rate risk exposure continued at exceptionally and historically high levels.

6.4.2 COUNTERCYCLICAL CAPITAL BUFFER

Sectoral countercyclical capital buffer activated

Based on its regular assessment of the situation on the mortgage and real estate markets, the SNB submitted a proposal to the Federal Council for the activation of the sectoral countercyclical capital buffer (CCB) targeted at mortgage loans financing residential real estate in Switzerland. This applied to all mortgage-backed balance sheet positions secured by residential property in Switzerland. On 13 February, the Federal Council acted on the proposal. Banks were obliged, with effect from 30 September 2013, to hold additional capital amounting to 1% of the associated risk-weighted positions.

Rationale

As the SNB explained, the rationale was that, for some years, lending and real estate prices in Switzerland had been growing more strongly than justified by fundamentals. This had resulted in imbalances that posed a risk to the stability of the banking system and hence the Swiss economy.

For this reason, the SNB considered that it was necessary to activate the CCB in order to increase the resilience of the banking sector against the risk of excessive credit growth and to counter excessive credit growth, in accordance with the Capital Adequacy Ordinance (CAO). As the imbalances were concentrated in residential mortgage loans, the SNB proposed that the CCB be specifically targeted towards this market segment.

Countercyclical capital buffer

The legal basis for the introduction of the CCB in Switzerland was provided by the revised CAO, which was put into force by the Federal Council on 1 July 2012. Thus, for the first time, the Swiss authorities had a macroprudential instrument at their disposal. The SNB played an active role in the design of this instrument. The capital buffer is an important component of the Basel III regulatory framework and will take effect in most countries from the beginning of 2016, with a transitional period until the end of 2018. The early introduction in Switzerland was necessary because there was an increased cyclical risk of imbalances building up on the domestic mortgage and real estate markets, partly due to the prevailing low interest rate environment.

The CCB is designed as a preventive measure. If it is activated, banks are obliged to temporarily increase their capital beyond the levels imposed by existing capital requirements, depending on the magnitude of the imbalances observed on the credit market. The aim is, first, to strengthen the resilience of the banking sector against the risk of excessive credit growth and, second, to counter excessive credit growth.

The SNB performs regular assessments of the credit and real estate markets, to determine whether the CCB needs to be activated, adjusted or deactivated. If it identifies a need for action, it submits a proposal to the Federal Council accordingly. The Federal Council makes the final decision on whether to activate, adjust or deactivate the CCB. The SNB consults FINMA before submitting a proposal to the Federal Council.

Impact of activation

The activation of the CCB in February 2013 had a positive impact on the resilience of the banking sector. Over the course of the year, a number of banks, including some larger ones, introduced or announced capital measures; the activation of the CCB was cited as a major reason. However, despite the slowing of momentum, neither the activation of the CCB nor the previously introduced measures, for example in the area of self-regulation, were enough to prevent a further build-up of imbalances on the Swiss mortgage and real estate markets in 2013.

Countercyclical capital buffer increased

In the light of these developments, the SNB submitted a proposal to the Federal Council requesting that the sectoral CCB be increased from 1% to 2% of the associated risk-weighted positions. On 22 January 2014, the Federal Council acted on the proposal. The deadline for banks to comply with the increased requirements is 30 June 2014.

6.5 ADDITIONAL MEASURES TO STRENGTHEN FINANCIAL STABILITY

6.5.1 INTERNATIONAL LIQUIDITY REGULATIONS

Amendments to Liquidity Ordinance

In 2013, the SNB participated in a FINMA-led working group set up to incorporate the Basel III international liquidity standards into Swiss legislation.

The working group prepared a draft amendment of the Ordinance on the Liquidity of Banks (Liquidity Ordinance). The amendments are due to go before the Federal Council for approval in early 2014. In the draft, the existing quantitative liquidity requirements – total liquidity – are replaced by the short-term liquidity coverage ratio (LCR). The LCR is one of the two key liquidity standards under Basel III. It is designed to ensure that banks are able to fulfil their short-term liabilities, even in periods of stress, from their own funds – i.e. without central bank assistance. To this end, banks must have sufficient holdings of highly liquid assets, so as to be able to absorb exceptionally high outflows of funds over a period of at least 30 days. The LCR is scheduled to enter into force in Switzerland on 1 January 2015, in line with the international timetable.

In addition to assimilating the key international requirements on the design of the LCR, the revised Liquidity Ordinance contains provisions on areas whose regulation falls within the remit of individual countries. This mainly concerns issues surrounding scope of application, use of national options for extending the definition of liquid assets, and the fulfilment of the LCR for individual currencies. Further, it contains provisions aimed at minimising unintended consequences of the LCR on the SNB's monetary policy operations and on the interbank money market.

6.5.2 IMPLEMENTATION OF 'TOO BIG TO FAIL' REGULATIONS

Decrees on systemic importance

The revised Banking Act gives the SNB the authority to designate banks and bank functions as systemically important, following consultation with FINMA. A bank is considered to be systemically important if it performs functions in domestic loan and deposit-taking business which are essential to the Swiss economy and cannot be substituted at short notice. Other criteria such as size, risk profile and interconnectedness are also taken into consideration when deciding on systemic importance. The SNB carries out the requisite assessment as part of a formal process. This process culminates in the issuance of a decree.

In November 2013, the SNB issued a decree designating Zürcher Kantonalbank as a financial group of systemic importance in accordance with the Banking Act. It had already issued similar decrees for Credit Suisse and UBS in November 2012.

Specific liquidity requirements

The liquidity agreements concluded between FINMA and the big banks in March 2010, in whose drafting the SNB was closely involved, were subsumed into the Liquidity Ordinance in 2012. These specific requirements for systemically important banks came into force in July 2013, after having been approved by parliament.

Analysis of risk-weighted assets

Risk-weighted assets (RWA) are a key element of both the general capital requirements and the specific requirements for systemically important banks. As already noted by the SNB in its 2012 *Financial Stability Report*, the credibility of RWA based on banks' internal models is increasingly being called into question by market participants, analysts and authorities worldwide. In 2013, the SNB supported FINMA in an analysis of RWA, which was aimed at identifying why, and to what extent, the model-based approach and the standardised approach result in different RWA. The analysis, and any accompanying corrective measures, are aimed at strengthening confidence in the model-based approach.

Resolution and wind-down of systemically important banks

Another important focus of activities to implement the 'too big to fail' regulations is the resolution and orderly wind-down of the big banks. Under the Banking Act, the big banks must demonstrate in their emergency plans that they are able to continue providing systemically important functions in Switzerland. In addition, FINMA, in collaboration with foreign authorities, must draw up resolution plans for the globally active Swiss big banks. The SNB has been supporting FINMA in these efforts.

6.5.3 REGULATION OF FINANCIAL MARKET INFRASTRUCTURES AND DERIVATIVES TRADING

Amendments to NBO

The SNB put the revised National Bank Ordinance (NBO) into force on 1 July 2013. Some of the minimum requirements applicable to systemically important financial market infrastructures (FMIs) were increased, and a number of new minimum requirements were introduced. The deadline for FMIs to comply with the revised minimum requirements is 30 June 2014.

Collaboration on Financial Market Infrastructure Act

The SNB supported the FDF in preparing the draft Financial Market Infrastructure Act (FMIA), which entered the consultation phase in December 2013. The FMIA aims to standardise the regulation of FMIs and bring it into line with market developments and international requirements. Moreover, as regards derivatives trading, it will implement the requirements set by the G20 and the recommendations issued by the Financial Stability Board.

Regulation of financial market infrastructure

The FMIA envisages a general licensing requirement and the creation of specially tailored licensing criteria for trading platforms, central counterparties, central securities depositories (including securities settlement systems) and trade repositories. There is no general licensing obligation for payment systems. Responsibility for licensing and ongoing supervision of FMIs lies with FINMA. However, FMIs that are operated by or on behalf of the SNB are exempt from licensing and supervision by FINMA.

Under the FMIA, the SNB would continue to have responsibility for designating systemically important FMIs. It would also be authorised to set specific requirements for such FMIs and to monitor compliance. Of particular relevance for the stability of the financial system is the planned creation of special insolvency provisions for FMIs, as well as FINMA's obligation to draw up a resolution plan for systemically important FMIs.

Partial revision of National Bank Ordinance

The NBO contains implementing provisions on the sovereign powers of the SNB as set down in the National Bank Act. These powers include the right to conduct surveys of financial market statistics, to set minimum reserve requirements, and to perform oversight of FMIs (arts. 18–39 NBO). The NBO is issued by the SNB Governing Board.

The revision of the NBO provisions on the oversight of FMIs is aimed at strengthening the resilience of systemically important FMIs in Switzerland and at bringing the regulations governing them into line with the international standards drawn up by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO). The revision also helps create a legal and regulatory framework for Swiss central counterparties (CCPs) which is equivalent to that in the EU. This is a prerequisite for such CCPs being able to offer their services in the EU in the future.

The revised NBO introduces a number of new minimum requirements and increases some existing ones. In particular, there are new requirements on procedures in the event of participant default; on the management of custody, investment and general business risks; on indirect participation; and on links with other FMIs. In addition, CCPs are subject to new regulations on the segregation and portability of positions and collateral. Requirements were also increased for credit and liquidity risk management, acceptable collateral and the publication of information.

As well as the existing criteria for determining systemically important FMIs, the NBO now also introduces the concept of systemically important business processes. This refers to processes at an FMI which participants cannot substitute at short notice and whose non-availability could lead to serious problems at financial intermediaries and other FMIs, or result in severe financial market disruption. Operators of FMIs must, in future, prepare a plan to ensure the recovery or orderly wind-down of systemically important business processes in the event of impending insolvency or other threat scenarios. They must also take appropriate organisational and technical measures to recover systemically important business processes within two hours, even in the event of major damage or disruption.

Regulation of derivatives trading

With the advent of the FMIA, derivatives trading would be regulated for the first time. This would impose mandatory reporting, clearing and risk mitigation on derivatives market participants. Mandatory reporting aims to ensure that all derivatives transactions are reported to a trade repository. The clearing requirement stipulates that the applicable derivatives transactions must be cleared via a central counterparty. The risk mitigation requirement applies to derivatives transactions that are not cleared via a central counterparty. It contains a number of different elements, for example the daily valuation of outstanding trades and the exchange of collateral to cover losses in the event of counterparty default. Finally, the draft FMIA sets out the legal basis for requiring market participants to conduct derivatives trading through a trading platform. However, this provision is not due to enter into force until it has also been introduced in other countries.

6.6 OVERSIGHT OF FINANCIAL MARKET INFRASTRUCTURES

6.6.1 BACKGROUND

Mandate

The NBA (art. 5; arts. 19–21) requires the SNB to oversee FMIs (payment systems, securities settlement systems, central securities depositories and central counterparties). It empowers the SNB to impose minimum requirements on the operation of FMIs that might pose a risk for the stability of the financial system and to work in cooperation with FINMA and, if necessary, foreign supervisory and oversight authorities. The NBO lays down the details of the oversight of FMIs.

Focus on systemically important FMIs

At present, the FMIs that could harbour risks for the stability of the financial system include the Swiss Interbank Clearing (SIC) payment system, the SECOM securities settlement system and the central counterparty SIX x-clear. These are operated by SIX Interbank Clearing Ltd, SIX SIS Ltd and SIX x-clear Ltd, which are subsidiaries of SIX Group Ltd.

Other systems that are important for the stability of the Swiss financial system are the Continuous Linked Settlement (CLS) foreign exchange settlement system and the central counterparties LCH.Clearnet Ltd (LCH) and Eurex Clearing. The operators of these FMIs are domiciled in the US, the UK and Germany, and were discharged from the obligation to meet the minimum requirements, as they are already subject to adequate oversight by the authorities in these countries and there is a smooth exchange of information with the SNB.

SIX SIS and SIX x-clear both hold banking licences and are subject to prudential supervision by FINMA as well as to oversight by the SNB. Although FINMA and the SNB exercise their supervisory and oversight powers separately, they coordinate their activities. Oversight of SIC is exclusively the SNB's responsibility.

Collaboration with FINMA and foreign authorities

The SNB cooperates with foreign authorities in the oversight of Swiss FMIs with cross-border activities. In the case of the central counterparty SIX x-clear, which offers its services to various European markets and has clearing links with other central counterparties, the SNB cooperates with the central banks and supervisory authorities in Denmark, Finland, the Netherlands, Norway, Sweden and the UK.

For the oversight of those FMIs domiciled abroad, namely CLS, Eurex Clearing and LCH, the SNB cooperates with the relevant national authorities in the US, Germany and the UK. The SNB also participates in the oversight of the Belgium-based Society for Worldwide Interbank Financial Telecommunication (SWIFT), which operates a global network for the transmission of financial information.

6.6.2 MAIN FOCUS OF OVERSIGHT

High degree of compliance with current minimum requirements

With regard to the current regulatory requirements, the operators SIX Interbank Clearing, SIX SIS and SIX x-clear continue to demonstrate a high degree of compliance. The operators are appropriately structured, well managed, and have adequate internal control systems. The FMIs have appropriate rules and procedures in place and satisfy the high standards with respect to information and IT security.

Increased minimum requirements in future

With the revised NBO, the minimum requirements for systemically important FMIs were increased (cf. chapter 6.5.3). The operators were requested by the SNB to ascertain at an early stage whether there was a need for action with regard to the revised requirements. All the operators identified a need for action, namely in the areas of governance, transparency and the management of liquidity and general business risks, as well as with respect to developing plans to ensure the recovery or orderly wind-down of systemically important business processes. An additional need for action was identified in the case of SIX x-clear regarding the segregation and portability of collateral and positions, and for SIX SIS concerning the exclusion procedure for participants and the management of risk from indirect participation. Working closely with the SNB, the FMIs determined the measures necessary to fulfil the revised minimum requirements. Some measures were already implemented in 2013, and the remainder should be in place by mid-2014.

Verification of network security

To assess the information and IT security of FMIs, the SNB relies mainly on external auditors. In 2013, the audits – whose scope and degree of detail are determined by the SNB – concentrated on network security and on authentication and encryption. The audits showed that, on the whole, the systems, processes and controls implemented by the operators of the FMIs are adequately designed in terms of minimising the effects of possible security incidents and identifying and addressing vulnerabilities.

Other focal points

The SNB maintains an intensive dialogue with the operators of the FMIs subject to oversight, in order to ensure that projects impacting the business activities or the risk profile, and thereby the fulfilment of the minimum requirements, are assessed at an early stage.

In 2013, the SNB focused its activities, among other things, on SIX SIS's direct link to TARGET2-Securities, the European securities settlement platform, and on the planned business expansions. In addition, it assessed SIX x-clear's various plans to extend its range of services and their individual impact on risk management.

The SNB also addressed SIX Group's plans to adapt its computer centre strategy. It determined that both the location combinations evaluated by SIX Group and the individual computer centres essentially fulfil the regulatory requirements, provided the organisational and technical operational concepts are adequately drawn up during the course of the outstanding project work.

6.7 INTERNATIONAL COOPERATION ON FINANCIAL MARKET REGULATION

At international level, the SNB participates in a number of different bodies in the area of financial market regulation. It is a member of the FSB, the BCBS and the CPSS (cf. chapter 7.3).

Financial Stability Board

The FSB brings together national authorities responsible for financial stability (central banks, oversight authorities, ministries of finance), international organisations and standard-setting bodies. Switzerland is represented in the Plenary Assembly by the SNB and the FDF. The SNB is also a member of the Steering Committee. In addition, Switzerland participates in other FSB committees and working groups. This representation is shared between FINMA, the FDF and the SNB, who collaborate closely to develop Switzerland's position. In April 2009, the G20 gave the FSB a mandate to promote financial stability and formulate appropriate regulatory and oversight measures.

New legal form for FSB

In January 2013, the FSB was newly established as an association under Swiss law, with domicile in Basel. In so doing, the FSB implemented a G20 recommendation to strengthen its institutional foundation and internal governance. The SNB joined the FSB association. The FSB retains strong links with the Bank for International Settlements (BIS), which will continue to secure financing for the next five years.

Wide range of topics at FSB

In 2013, the FSB again addressed a broad range of topics. From the viewpoint of financial stability, the various activities surrounding the 'too big to fail' issue were of central importance. The main focus was on the resolution of global systemically important banks; a topic on which the FSB published guidelines, including the development of resolution strategies. Furthermore, the method of determining global systemically important insurers was published, as well as a preliminary list of such institutions.

Another topic was shadow banking. On this subject, the FSB published its third monitoring report, together with recommendations on improving the oversight and regulation of the shadow banking system. With regard to reforming over-the-counter derivatives trading, the focus was on the global coordination of reform efforts.

Efforts to reform benchmark interest rates

The FSB also coordinated international activities to reform benchmark interest rates; the objective being to improve the credibility and acceptance of these rates. The SNB participated in these activities. They involve not only central banks and supervisory authorities, but also an international group of private sector financial market participants, including Swiss representatives. First, they are examining the extent to which the existing Libor interest rates fulfil the requirements of the securities supervisors dated July 2013 (IOSCO standards). Second, they are investigating whether there are alternative benchmark interest rates which would better meet the needs of the market and the requirements of supervisory authorities in the longer term. The FSB plans to present the results in mid-2014.

At international level, activities are also under way to regulate the determination of benchmark interest rates as well as other important reference variables on the financial markets. In London, the Libor is already now subject to a supervisory regime. In February 2014, the stock exchange operator Intercontinental Exchange (ICE) will replace the British Bankers' Association as the new administrator responsible for the Libor rates. The ICE reports to the UK's Financial Conduct Authority. In Brussels, a bill has been proposed which would regulate all benchmark interest rates used in the EU. In Switzerland, too, a need for regulatory action is likely to emerge in this area.

Basel Committee on Banking Supervision

The BCBS brings together high-ranking representatives of banking supervisory authorities and central banks from 27 countries. It develops recommendations and sets standards in the area of banking supervision.

In 2013, the BCBS's activities included dealing with parts of the Basel III reform package whose effects are still being monitored, especially the finalisation of the short-term liquidity coverage ratio, as well as the revision of the net stable funding ratio and the unweighted capital ratio (leverage ratio). The BCBS also worked on a fundamental review of banks' trading book capital requirements. Finally, it examined measures to reduce the complexity of the Basel capital standards and improve comparability between banks.

IMF financial sector assessment (FSAP)

Within the context of bilateral economic policy surveillance, Switzerland participated in the International Monetary Fund's (IMF) Financial Sector Assessment Program (FSAP). The subject of the in-depth examination is the resilience and stability of the financial sector. This is the third time that Switzerland has participated in the programme (previously in 2001 and 2007). The results are expected in May 2014 (cf. chapter 7.2).

6.8 STABILISATION FUND

The SNB StabFund Limited Partnership for Collective Investment (stabilisation fund), set up by the SNB in autumn 2008 to take over illiquid assets from UBS, was sold to UBS in November 2013. In addition to profits of USD 3.8 billion from the sale, the SNB earned USD 1.6 billion in interest income over the term of the loan to the stabilisation fund.

A major challenge, successfully met

The stabilisation fund fulfilled its primary objective: making a significant contribution to the strengthening of the Swiss financial system during a difficult period. With the total reduction of risks, the repayment of the loan and the transfer of the stabilisation fund to UBS, the SNB was able to bring an exceptional and challenging undertaking to a successful conclusion. However, from the SNB's perspective, it is essential that a repetition of these events be avoided to the extent possible. For this reason, over the past few years it has been actively involved in work on alleviating the 'too big to fail' issue, as well as in the implementation of the associated legislation.

The main events in the history of the stabilisation fund following its establishment are summarised below. In particular, the circumstances are described which permitted the loan to be repaid and the stabilisation fund sold in 2013.Comprehensive information on the features and business activities of the stabilisation fund can be found in the SNB's annual reports for 2008–2012.

Stabilisation fund established in autumn 2008

The stabilisation fund was set up in autumn 2008 during the international financial crisis, when UBS, one of Switzerland's big banks, ran into considerable difficulties. This posed a threat to financial stability both nationally and internationally, necessitating intervention by the authorities. In October 2008, the Federal Council, the Swiss Federal Banking Commission (SFBC; now FINMA) and the SNB adopted measures to strengthen financial stability. The core element of these measures was the stabilisation fund, which took over illiquid assets from UBS. To finance the asset transfer, the SNB granted an interest-bearing loan of USD 25.8 billion to the stabilisation fund. In addition, contingent liabilities amounting to, initially, USD 8.8 billion were transferred. UBS provided the fund with equity corresponding to 10% of the transferred assets, in the form of the purchase price for the option to repurchase the stabilisation fund at a later date. Moreover, to strengthen UBS's capital base, the Confederation subscribed to mandatory convertible notes in the amount of CHF 6.0 billion. In 2009, the Confederation sold the equities arising out of the conversion of these notes to institutional investors, thereby ceasing its involvement.

The SNB as lender of last resort during the financial crisis

By extending a loan to the stabilisation fund for the transfer of illiquid assets, the SNB was exercising its role as lender of last resort in a crisis. The prerequisite for such a loan being granted is that the bank seeking credit is important for financial system stability and is solvent. Moreover, the liquidity assistance must be backed by sufficient collateral (cf. chapter 2.6).

UBS was indisputably of systemic importance, since its failure would have had serious consequences for the Swiss financial system and the economy as a whole. In autumn 2008, the SFBC confirmed that UBS was solvent. The assets of the stabilisation fund were used as collateral for the liquidity assistance. The SNB loan was secured through the conservative valuation of the illiquid assets (performed by external experts) and UBS's injection of equity into the stabilisation fund, which served as primary loss protection.

The stabilisation fund was managed by the SNB, which held three seats on the five-member Board of Directors. The remaining two board members were appointed by UBS.

Transfer and financing of assets

Between December 2008 and April 2009, the stabilisation fund took over assets from UBS totalling USD 38.7 billion. The assets were divided into the following three categories: securities, loans, derivatives. They were denominated in five currencies, with the US dollar accounting for the lion's share, at 67%. The bulk of the assets consisted of securitisations, mainly backed by residential and commercial mortgages. The loan portfolio was largely composed of commercial mortgages. The derivatives were primarily credit default swaps (CDS) sold by the stabilisation fund, with which UBS was able to hedge itself against existing exposures, i.e. the default of a specific security or loan.

A total of 90% of the asset transfer was financed by the SNB loan; the remaining 10% was financed by a capital injection from UBS. Once the asset transfer was concluded, the stabilisation fund's Board of Directors adopted a liquidation strategy for the portfolio, which served as a basis for asset management. The primary objective was to ensure that the loan was fully repaid to the SNB. The maximisation of the stabilisation fund's equity was taken into consideration only insofar as it did not jeopardise the full repayment of the loan.

Disciplined management strategy

Right from the outset, the stabilisation fund applied a disciplined management strategy. This entailed holding assets over a period of several years until their intrinsic value was realised. Intrinsic values were calculated using cash flow models. This medium to longer-term approach allowed the stabilisation fund to hold back, both in the initial phase following the asset transfer and later during market declines, and only engage in significant sales once prices had sufficiently recovered.

The portfolio was managed jointly by the SNB and UBS; other third parties were also involved. The complex management of the assets also included the establishment of complicated legal structures, the use of legal action to protect creditors' interests, active loan management, the transfer, management and sale of real estate, and, not least, the management of securitisation and derivatives structures.

Markets recover further in 2013

The recovery on real estate and securitisation markets continued in 2013. Prices for residential and commercial real estate rose markedly in most regions of the US. In the UK, gains were also registered on markets outside London. As a result, prices of securitised loans in the US and Europe increased significantly. The increase was particularly pronounced in the first four months of the year; thereafter, prices stabilised at these higher levels.

High sales volume until May

The pronounced upturn on US and European securitisation markets allowed the stabilisation fund to achieve a high volume of asset sales between January and May 2013. These sales were in line with the liquidation strategy adopted in 2009, which was based on achieving the assets' intrinsic value.

Owing to these healthy sales proceeds, and future expected financial inflows, by the spring it was already clear that the stabilisation fund would be able to fully repay the SNB loan during the course of 2013. The question of UBS repurchasing the stabilisation fund thus presented itself.

LOAN TO STABILISATION FUND 2008–2013

In USD billions

	Funded	Contingent liabilities	Overall risk
Total as at 30 September 2008	25.8	8.8	34.7
Total as at 31 December 2009	20.3	3.8	24.1
Total as at 31 December 2010	12.6	2.1	14.7
Total as at 31 December 2011	8.1	0.9	9.0
Total as at 31 December 2012	**4.8**	**0.8**	**5.6**
Interest on SNB loan	0.1	–	0.1
Sales[1,2]	–8.9	–1.9	–10.8
Repayments	–0.8	–	–0.8
Interest received	–0.2	–	–0.2
Other factors	–1.5	1.1	–0.4
Total as at 30 September 2013	**–6.5**	**0.0**	**–6.5**

1 Including active liquidation of CDS (net).
2 Including sales of USD 0.5 billion effected in September, but not settled until October.

Accelerated sales as of June

Against this background, the stabilisation fund's Board of Directors adopted a strategy of accelerated liquidation, which was put into practice in June. The aim was to liquidate as large a volume of risky assets as possible prior to selling the stabilisation fund to UBS, in order avoid material adverse effects on the latter's balance sheet and risk-weighted assets. Just as with all previous sales, these too were carried out with minimum impact on the market. For UBS, the focus was on ensuring that the liquidation of the stabilisation fund would be as fast and as complete as possible, while for the SNB the priority was the sales proceeds. Therefore, the accelerated liquidation strategy included a special protection mechanism for the SNB, under which sale prices were benchmarked against an external valuation agent's reference prices. If, overall, the proceeds from these sales had been lower than the benchmark valuation, UBS would have had to make a compensation payment.

Complete reduction of total risk by mid-August

The accelerated sales strategy permitted the sale of assets for a value of USD 7.9 billion between June and September. As these proceeds exceeded the external valuation overall, the compensation mechanism was not invoked.

Together with the sales from the preceding months, the stabilisation fund sold assets worth USD 10.8 billion in 2013. Furthermore, the portfolio benefited from interest and principal repayments amounting to around USD 1 billion. The associated cash inflows and the reduction in contingent liabilities allowed the total risk to the SNB to be completely eliminated. The loan was repaid on 15 August 2013.

Transfer back to UBS in November

The repayment of the SNB loan by the stabilisation fund was a prerequisite for the activation of the option transaction to sell the stabilisation fund to UBS. UBS had been granted this purchase option when the stabilisation fund was set up in autumn 2008. In return, it had paid USD 3.9 billion (10% of the price of the assets transferred to the fund), an amount which the SNB then paid into the stabilisation fund as equity.

The option reference date was set at 30 September 2013, i.e. this was the date on which the economic risk passed to UBS. The contract was signed on 7 November 2013, and the transaction was completed during that same month.

At the reference date, the stabilisation fund had a net asset value of USD 6.5 billion. The bulk of the assets was in the form of liquid assets held in money market funds at the custodian. Of the risky assets originally transferred, only USD 2 million worth remained. Thus UBS did not have to buy back any legacy assets and its purchase of the stabilisation fund strengthened the bank's capitalisation.

UBS paid a purchase price of USD 3.8 billion, corresponding to the SNB's contractual share in the stabilisation fund equity as at end-September 2013. According to the arrangements agreed in autumn 2008, the first billion of the equity went to the SNB, while the remainder – USD 5.5 billion – was divided equally between the SNB and UBS.

The sale of the stabilisation fund had a positive impact on the SNB's annual result for 2013. Moreover, following the sale of the stabilisation fund, the SNB was no longer a group and did not therefore have to present consolidated results as at end-2013.

7 Involvement in international monetary cooperation

7.1 BACKGROUND

Mandate

Art. 5 para. 3 of the National Bank Act (NBA) stipulates that the Swiss National Bank (SNB) shall participate in international monetary cooperation. The objective of this cooperation is to promote the functioning and stability of the international monetary system and help overcome crises. As a globally integrated economy, Switzerland derives particular benefit from these aims.

Participation in different institutions

Together with the Confederation, the SNB is involved in international monetary cooperation though its participation in the International Monetary Fund (IMF), on the Financial Stability Board (FSB) and in the Organisation for Economic Co-operation and Development (OECD). Furthermore, it is a member of the Bank for International Settlements (BIS). Upon invitation of Russia, which held the G20 presidency in 2013, the Confederation and the SNB for the first time also took part in some of the G20 meetings.

7.2 INTERNATIONAL MONETARY FUND

Participation in the IMF

The SNB contributes to IMF activities and decisions in collaboration with the Confederation. Switzerland exercises its influence through its representation on the Board of Governors, in the International Monetary and Financial Committee (IMFC) and on the Executive Board of the IMF.

Persistently high lending

The European financial and sovereign debt crisis was once again a focal point of the IMF's activities in 2013. Together with the European Commission and the European Central Bank (ECB), the IMF remained committed to its activities with regard to the European countries affected by the crisis and made financial contributions to the economic adjustment programmes concerned. The aim of these programmes is to put state budgets on a sustainable path by using structural reforms.

IMF lending to members in economic difficulties remained on a high level. In 2013, the IMF Executive Board approved seven new regular (non-concessional) loan agreements totalling SDR 34.7 billion, or CHF 47.5 billion. At the end of 2013, the IMF had regular loan programmes in 15 countries amounting to a total of SDR 135.5 billion, SDR 77.3 billion of which were accounted for by insurance facilities (mainly the Flexible Credit Lines), which allow countries, under certain conditions, to preventative access to the IMF's resources as a precautionary measure. A total of SDR 83.8 billion was outstanding on regular loans at the end of 2013.

Switzerland in the IMF

The IMF is the central institution for international monetary cooperation. It works to promote the stability of the global monetary system as well as macroeconomic and financial stability in its member countries. Its main fields of activity are surveillance, granting loans to countries faced with balance of payments difficulties, and technical assistance.

Switzerland is jointly represented in the IMF by the Federal Department of Finance (FDF) and the SNB. The Chairman of the SNB's Governing Board is a member of the IMF's highest decision-making body, the Board of Governors, which consists of a representative from each member country. The Head of the FDF is one of the 24 members of the International Monetary and Financial Committee (IMFC), the IMF's most important advisory body.

The IMF has 188 member countries. Switzerland has been a member since 1992 and is part of a voting group (constituency) whose other members are Azerbaijan, Kazakhstan, the Kyrgyz Republic, Poland, Serbia, Tajikistan and Turkmenistan. Switzerland currently occupies the post of the constituency's executive director, who holds one of the 24 chairs on the Executive Board, the IMF's most important operational body. In future, Switzerland will share this chair with Poland. The Swiss position on the Executive Board is held alternately by a representative of the FDF and the SNB. The FDF and the SNB determine Switzerland's policy in the IMF and support the Swiss executive director in his or her activities.

The unit of account used by the IMF is the Special Drawing Right (SDR). It is calculated on the basis of weighted exchange rates for the US dollar, euro, yen and pound sterling. At the end of 2013, one SDR was equivalent to CHF 1.37 or USD 1.54.

IMF financing and lending capacity

The IMF can finance its lending through the quotas assigned to each member country and through the New Arrangements to Borrow (NAB). In 2013, total quotas amounted to SDR 238.1 billion and the NAB up to SDR 370 billion. Of these funds, which together totalled SDR 608.1 billion, only SDR 562.9 billion was available at the end of 2013, because countries with an IMF programme or with balance of payment difficulties are not obliged to provide the IMF with funds. Of these available resources, the IMF was able to make over SDR 269.7 billion available for new lending at the end of 2013. The remainder was used for credit lines which had already been granted or promised, and as liquidity buffers.

As a result of the strong rise in demand for loans due to the financial crisis, the Board of Governors decided in 2010 to provide the IMF with more funds and, notably, to double the quotas. The doubling of quotas, which will bring them to a total of SDR 476.8 billion, still requires ratification by some member countries. It is part of a comprehensive package of quota and governance reforms and involves a major realignment of quota shares in favour of emerging economies and developing countries. The reform package also aims to reduce the number of executive directors representing advanced European economies by two. In Switzerland, participation in the IMF's quota increase requires the approval of the Federal Assembly, which approved the quota and governance reform in the 2012 summer session.

Quota and governance reform

For Switzerland, the proposed augmentation and realignment of the quota resources will mean an increase in its quota from approximately SDR 3.5 billion to SDR 5.8 billion, and a decrease in its quota share from 1.45% to 1.21%. However, owing in particular to the fact that Poland and Kazakhstan's quota shares will increase, the overall quota share of the Swiss-led constituency will hardly change. In future, Switzerland will share its chair on the Executive Board with Poland as part of the IMF's aim to reduce the number of executive directors representing advanced European economies. Both countries will take it in turns to appoint an executive director every two years. Poland is expected to do so for the first time in 2016. Switzerland will continue to represent the constituency in the IMFC.

Implications for Switzerland

Quota

When a country joins the IMF, it is assigned a quota based broadly on its relative position in the world economy. The quota is expressed in Special Drawing Rights, the unit of account used by the IMF. GDP, the degree of economic and financial openness, the degree to which trade and capital flows are prone to fluctuations, and the level of reserve positions are all used in the formula to calculate the quota. The quota fulfils three important functions. Firstly, a member's quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF. Secondly, the quota largely determines a member's voting power in IMF decisions. Thirdly, the amount of financing a member can obtain from the IMF is in principle based on its quota. The quota is thus decisive for the financial and organisational relationship between a member country and the IMF. Quotas are reviewed at regular intervals and adjusted as necessary. At the end of 2010, it was decided to review the quota formula itself and, if necessary, to revise it. This review has not yet been concluded, as the interests of the member countries diverge significantly.

Temporary expansion of NAB

Since the implementation of the quota increase requires a certain amount of time, a temporary expansion of the NAB was agreed in March 2011. As a result, the number of lenders was increased from 26 to 40 member countries, and the maximum amount of resources available for lending was extended from SDR 34 billion to SDR 370 billion. For the SNB, this meant an increase in its maximum loan commitment from SDR 1.54 billion to SDR 10.9 billion. Its share in the total, however, fell from 4.5% to 2.9%. The intention is to reduce the NAB to SDR 182 billion once the quota increase has been implemented. The SNB's maximum loan commitment will then decrease to SDR 5.5 billion, a share of 3.0%.

NAB and GAB

The New Arrangements to Borrow (NAB) form a financial safety net for the IMF. Following the most recent increase, the IMF can currently be provided with up to SDR 370 billion in addition to its regular resources by means of the NAB. The NAB are activated for a specified period (six months at most) and a specified amount. The amount activated is based on an estimate by the IMF of the expected contingent liabilities. There are now 40 member countries participating in the NAB. The SNB is the institution representing Switzerland.

In an exceptional crisis and in the event of a shortage of funds, the General Arrangements to Borrow (GAB) permit the IMF to borrow funds in the amount of SDR 17 billion from the G10 countries according to an agreed distribution key. The GAB can only be activated if agreement has not been reached under the NAB. The SNB is also the institution representing Switzerland in the GAB.

Exceptional increase of IMF resources

In addition to the expansion of the NAB, after the crisis in the euro area had grown more acute and the stability of the international currency and financial system had come under threat, an exceptional, temporary increase of IMF resources through bilateral borrowing was approved at the Spring Meeting in April 2012. Within six months, the IMF received bilateral loan commitments of USD 461 billion from 38 member countries. By the end of 2013, the IMF had entered into bilateral loan agreements worth over USD 436 billion with 33 countries. At year-end, 30 agreements in the total amount of USD 424 billion were in force.

Switzerland's participation

Switzerland pledged a contribution of up to USD 10 billion in April 2012 for the additional increase of the IMF's resources. It is on the basis of the Monetary Assistance Act of March 2004 that Switzerland participates in concerted international actions to ensure global financial stability. To this purpose, the two chambers of parliament approved an increase of the credit facility for monetary assistance from CHF 2.5 billion to CHF 10 billion on 11 March 2013. Subsequently, no bilateral loan agreement with the IMF has been entered into.

Concessional lending facilities

The IMF supports concessional, i.e. subsidised, lending facilities in low-income countries. At the end of 2013, concessional lending facilities amounting to SDR 2.1 billion had been entered into force with 20 member countries. In total, concessional loans in the amount of SDR 6.2 billion were outstanding at the end of 2013. To finance its concessional lending facilities, the IMF can avail itself of the Poverty Reduction and Growth Trust (PRGT). In June 2009, the IMF Executive Board decided to augment the PRGT's loan resources by SDR 10.8 billion. By the end of 2013, 14 countries had committed to provide loans to the PRGT totalling SDR 9.8 billion for this purpose, SDR 500 million of which was pledged by Switzerland. The loan to the Trust is granted by the SNB and guaranteed by the Confederation. Switzerland is also involved in financing the interest subsidy for these loans. This participation is provided by the Confederation.

Switzerland's reserve position

Both Switzerland's IMF quota and the NAB are funded by the SNB. The used portions of the Swiss quota and of the Swiss contribution to the NAB together equal Switzerland's reserve position in the IMF. This reserve position represents a liquid asset of the SNB vis-à-vis the IMF and thus forms part of the currency reserves. At the end of 2013, Switzerland's reserve position amounted to SDR 1,673.0 million, compared with SDR 1,998.3 million a year earlier. The decline is due to the fall in outstanding IMF loans in 2013.

SNB's financial commitment to the IMF

In CHF millions

	Maximum	End-2013 Amount drawn
Quota	4 744	346
GAB and NAB	14 960	1 950
Concessional lending facilities[1] (PRGT)	930	244
SDR[2]	2 255	–217

1 With federal guarantee.
2 The SDR is not only a unit of account, but also a means of international payment. As part of the two-way arrangement with the IMF, the SNB has committed itself to purchase (+) or sell (–) SDRs against foreign currencies (USD, EUR) up to an agreed maximum.

Article IV consultation

Within the context of its Article IV consultations, the IMF regularly reviews the economic policy of its member countries and issues recommendations. On 8 May 2013, the IMF Executive Board concluded the annual Article IV consultation with Switzerland. The IMF confirmed that Switzerland pursues a stability-oriented economic policy and that it has a sound economic basis. It considered a resurgence of the euro crisis as the main risk and recommended that the SNB maintain its minimum exchange rate at CHF 1.20 per euro as long as there are still question marks about the economic recovery and price stability is not threatened. In the event of renewed upward pressure, the SNB should – according to the IMF– consider introducing negative interest rates on the commercial banks' excess reserves kept at the SNB. Given the strong expansion of the SNB's balance sheet, the IMF encouraged it to step up capital-building. The IMF welcomed the steps taken by the authorities to contain risks in the mortgage and real estate markets, especially the activation of the countercyclical capital buffer. It also recognised the rapid progress made with regard to financial market regulation, particularly in the banking and insurance sectors. It noted, however, that further progress was needed, especially to reduce the leverage ratio of big banks and to develop plans to ensure their cross-border resolution.

The IMF also conducted a comprehensive evaluation of Switzerland's financial sector in 2013. Participation in the IMF's Financial Sector Assessment Program (FSAP) is compulsory for countries with globally significant financial sectors and is conducted roughly every five years. As part of the FSAP, the IMF analyses and assesses the stability of the financial sector and the compliance of the Swiss regulatory framework with the international standards in banking and insurance supervision and securities trading regulations. The findings of this assessment will be discussed by the IMF Executive Board in spring 2014 together with the report of the annual Article IV consultation and will subsequently be published.

Assessment of Switzerland's financial sector

In May 2013, the SNB and the IMF jointly hosted a conference on the reform of the international monetary system for the fourth time. The event brought together high-level representatives of central bank and finance ministries, as well as leading economists and economic commentators.

Conference on international monetary system

7.3 BANK FOR INTERNATIONAL SETTLEMENTS

The Bank for International Settlements (BIS) is an international organisation that has its head office in Basel. It fosters international monetary and financial cooperation and serves as bank and forum for central banks. The SNB has occupied one of the seats (currently 20) on the BIS Board of Directors since its foundation in 1930.

BIS as bank and forum for central banks

The governors of member central banks convene for several meetings every two months to discuss developments in the global economy and the international financial system, and also to guide and oversee the work of the various committees. The SNB participates in four standing committees of the BIS: the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the Committee on the Global Financial System and the Markets Committee. In addition, it was actively involved in an ad hoc working group which published a report on the main requirements for reliable and robust reference rates from a central bank perspective in March 2013. Participation in different groups of experts also gives the SNB the opportunity to exchange views.

The Basel Committee on Banking Supervision serves as a platform for regular cooperation in matters of banking supervision. Its activities are described in more detail in chapter 6.7.

Basel Committee on Banking Supervision

Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) is concerned with developments in the area of national and international financial market infrastructures. In 2013, the CPSS – in collaboration with the International Organization of Securities Commission (IOSCO) – proposed guidelines to regulate authorities' access to data held in trade repositories. Another joint CPSS/IOSCO report contained recommendations for the development of recovery plans for financial market infrastructures. Such plans should enable a financial market infrastructure to continue providing the services critical to its participants and the financial markets in the event of a crisis threatening its viability as a going concern.

Committee on the Global Financial System

The Committee on the Global Financial System (CGFS) monitors developments in the international financial markets and analyses their impact on financial stability. In 2013, the CGFS dealt with topics such as the use of ratings by central banks, regional financial integration, trade financing and global liquidity. One area of focus was the implications of the increasing use of collateralised funding of financial transactions. The Committee published a report on this topic. In particular, it addressed the issue of a possible shortage of assets that can be used as collateral in the financial markets.

Markets Committee

The Markets Committee serves as a platform for central bank officials responsible for financial markets and thus also for monetary policy operations. It examines current developments in money, currency, capital and commodity markets, as well as the functioning of these markets. Among the most important topics of discussion in 2013 were the effects of the increased liquidity on the global banking and financial system. Against the backdrop of higher market volatility during the summer months, the Markets Committee focused on how monetary policy changes in big countries might impact on the asset prices and the economy of smaller countries. It also discussed the reform efforts in the area of reference rates as well as the influence of regulatory changes on the monetary policy operations of central banks. Moreover, it examined the findings of a BIS triennial survey of global foreign exchange and interest rate derivatives markets.

7.4 OECD

Participation

Switzerland is a founding member of the Organisation for Economic Co-operation and Development (OECD). On the organisation's intergovernmental committees, it works to promote the development of relations among the 34 member countries with regard to economic, social and development policies.

Together with the federal government, the SNB represents Switzerland on the Economic Policy Committee (EPC), the Committee on Financial Markets (CFM) and the Statistics Committee (CSTAT). On a political and academic level, the EPC and its working groups deal with current developments in the global economy as well as with structural policy. The CFM analyses developments in the international financial markets and deals with regulatory issues. The CSTAT drafts standards for the national accounts in association with other international organisations.

The OECD publishes its *Economic Outlook* twice a year, a report which includes a forecast summary assessing the growth outlook and economic policy for Switzerland.

OECD recommendations for Switzerland

Every two years, the OECD also performs a detailed analysis of the economy of every member country. The Swiss economy was subject to an in-depth evaluation in 2013, which, as always, was conducted in close cooperation with the Confederation and the SNB. In its November report, the OECD recommended that, in view of weak underlying price pressures, interest rates should be kept close to the zero bound, in order for monetary policy to continue supporting the economy. It recognised that the appreciation of the Swiss franc continues to pose difficulties for companies. It was critical of the rise in real estate prices and the growth in mortgage loans, and suggested that macroprudential measures should be envisaged, especially for the cantonal banks, which are heavily exposed to the housing sector. Moreover, due to the continuing high level of global financial market risks, the loss-absorbing capital of the two big banks should be increased.

7.5 TECHNICAL ASSISTANCE

Principles

Upon request, the SNB provides technical assistance to other central banks. Technical assistance includes the transfer of knowledge specific to central banks and contributes to maintaining good relations between central banks worldwide. The SNB primarily provides assistance to the central banks from the group of countries with which it forms a constituency in the IMF (cf. chapter 7.2).

Main focus of technical assistance

In 2013, the SNB provided a large proportion of its technical assistance to the central banks of Azerbaijan, Kazakhstan and the Kyrgyz Republic. As in recent years, it supported the Central Bank of the Republic of Azerbaijan in the areas of monetary policy, internal auditing, human resources and, additionally, financial stability. In-depth discussions took place with the staff of the National Bank of Kazakhstan, covering the subjects of payment systems, statistics as well as asset and risk management. In Kyrgyzstan, the SNB concluded a long-term project, introducing a new trading platform for open market operations and thus contributing to a more efficient financial market in the country. In addition, the National Bank of the Kyrgyz Republic received assistance in the areas of cash, monetary policy, risk management and banking operations. Interaction with the other central banks in Switzerland's IMF constituency was sporadic.

International events

In June, the SNB and the National Bank of Poland again organised a conference for central bankers from Central and Eastern Europe, the Caucasus and Central Asia, which took place in Zurich. It focused on the transmission mechanism of monetary policy. In November, the SNB and the BIS jointly hosted a meeting of the central bank governors of the Swiss IMF constituency and other countries.

Study Center Gerzensee

The Study Center Gerzensee, an SNB foundation for the training of central bankers, bankers and business specialists from Switzerland and abroad, organised six courses on the subjects of monetary policy and financial markets for employees of foreign central banks in 2013. As in the previous year, the courses were attended by approximately 170 participants from over 80 countries.

8 Banking services for the Confederation

Mandate

The Swiss National Bank (SNB) provides banking services to the Swiss Confederation (art. 5 para. 4 and art. 11 of the National Bank Act).

Remuneration for banking services

The SNB provides these banking services to the Swiss Confederation in return for adequate compensation. However, they are provided free of charge if they facilitate the implementation of monetary policy. Services subject to remuneration comprise: payment transactions, liquidity management, the custody of securities and the issue of money market debt register claims (MMDRCs) and Confederation bonds. Details of the services to be provided and the remuneration are laid down in an agreement concluded between the Confederation and the SNB.

Issuing activities

In 2013, the SNB issued both MMDRCs and Confederation bonds on behalf of and for the account of the Confederation. MMDRCs amounting to CHF 238.6 billion were subscribed (2012: CHF 191.4 billion), of which CHF 42.0 billion was allocated (2012: CHF 44.7 billion). The corresponding figures for Confederation bonds were CHF 13.7 billion (2012: CHF 11.6 billion) and CHF 6.0 billion (2012: CHF 6.8 billion) respectively. As on previous occasions, the issues were effected by auction via an electronic trading platform.

Negative MMDRC yields continue

In 2013, money market rates on the Swiss franc money market once again remained at exceptionally low levels, and, in some cases, at levels well into negative territory. In this environment, MMDRC yields also persisted in the negative range. Taken over the whole year, the yields ranged from –0.04% to –0.22% and thus above the lows of last year.

Payments

The SNB carried out roughly 84,000 (2012: 70,000) payments in Swiss francs and approximately 25,000 (2012: 19,000) payments in foreign currencies on behalf of the Confederation.

9 Statistics

9.1 BACKGROUND

Purpose of activities in field of statistics

The Swiss National Bank (SNB) collects the statistical data it requires to fulfil its statutory mandate on the basis of art. 14 of the National Bank Act (NBA). It collects data for the conduct of monetary policy and the oversight of financial market infrastructures, for safeguarding the stability of the financial system and preparing both the balance of payments and the statistics on the international investment position. Statistical data compiled for purposes relating to international monetary cooperation are transmitted to international organisations. The National Bank Ordinance (NBO) lays down the details of the SNB's activities in the field of statistics.

Institutions required to provide data

Banks, stock exchanges, securities dealers and investment funds are required to provide the SNB with figures on their activities (art. 15 NBA). The SNB may also collect statistical data on the business activities of other private individuals or legal entities where this is necessary to analyse trends in the financial markets, obtain an overview of payment transactions or prepare the balance of payments or the statistics on Switzerland's international investment position. This applies in particular to insurance companies, occupational pension institutions, investment and holding companies, and operators of financial market infrastructures as well as Swiss Post.

Survey activity kept to minimum

The SNB limits the number and type of surveys to what is strictly necessary. It seeks to minimise the demands placed on those required to provide information.

Confidentiality and exchange of data

The SNB is required to ensure the confidentiality of the data it collects and may only publish them in aggregated form. However, the data may be supplied to the relevant Swiss financial market supervisory authorities.

9.2 PRODUCTS

Surveys and statistics

The SNB conducts statistical surveys in the areas of banking statistics, collective investment statistics, the balance of payments and payment transactions. An overview is contained in the appendix to the NBO and on the SNB website. The SNB publishes the results of its surveys in the form of statistics. It also maintains a data bank with around 6 million time series in the fields of banking, financial markets and economics.

A large proportion of the statistics are published in the *Monthly Statistical Bulletin*, the *Monthly Bulletin of Banking Statistics*, and in *Banks in Switzerland*, which appears annually. The SNB also publishes data in its reports on the balance of payments, the international investment position, direct investment, and on the financial accounts and household wealth in Switzerland. The SNB's statistical publications appear in German, French and English, and can also be accessed on the SNB website. In some cases, more extensive versions are provided online. Data are also available online as Excel or text files, generally with longer time series than in the printed publications.

Statistical publications

The SNB publishes monthly data on its website in line with the International Monetary Fund's (IMF) Special Data Dissemination Standard (SDDS). The data include information on the monetary aggregates and the reserve assets. Key balance sheet positions are also posted on the website on a monthly basis.

Special Data Dissemination Standard

9.3 PROJECTS

Balance of payments

In 2013, the content-related revision of surveys in connection with financial flows was completed. Reporting institutions will submit data according to the new concept for the first time for the third quarter of 2014. The new surveys aim, inter alia, to meet the requirements of the bilateral statistical agreement between Switzerland and the EU. This means in particular that more details on the breakdown of financial flows by country will be collected.

Change to BPM6 for balance of payments

To date, the presentation of Switzerland's balance of payments has been based on the fifth edition of the IMF's *Balance of Payments Manual* (BPM5). In 2013, preparatory work was undertaken to place the publication of the balance of payments on the methodological basis of the sixth edition (BPM6) as of the first quarter of 2014. The change has led to certain changes in terminology, to reclassifications (merchanting reported under goods trade instead of services), to a new sign convention (omission of minus sign in front of goods and services imports and capital outflows) and to new or revised concepts (e.g. reporting of receipts and expenses in connection with merchanting). The SNB will reclassify the old data series in line with BPM6 when publishing the balance of payments data for the first quarter of 2014, in order to ensure that data are comparable and that long data series are available.

Locational banking statistics/consolidated banking statistics

In 2013, reporting banks submitted data for the revised locational banking statistics and consolidated banking statistics surveys for the first time. The aim of the two surveys is to statistically reflect the cross-border linkages of the domestic banking sector, for example by breaking down claims and liabilities by country. These surveys are conducted in collaboration with the Bank for International Settlements (BIS).

Cashless payment transactions

The surveys on cashless payment transactions are currently being thoroughly revised. The prime aim of the revision is to enable a full reflection of the technological innovations of the past few years in the area of cashless payment transactions. The reporting institutions concerned were consulted in this matter in mid-2013. The results of these consultations were built into the definitive survey documents published in January 2014. Reporting institutions are obliged to submit the revised surveys for the first time as at 31 December 2014 (reference date).

FSB Data Gaps Initiative

In 2013, in connection with the FSB Data Gaps Initiative, the SNB began transmitting data to the central data hub specially set up for the purpose and hosted by the BIS. Participants in this initiative are countries in which global systemically important banks are headquartered. The aim of the initiative is to establish an exchange of data between these countries for better assessment of international financial stability issues.

At the beginning of 2014, the Federal Council informed the IMF that Switzerland was likely to participate in the new, extended statistical standard SDDS Plus. With SDDS Plus, the IMF has addressed the data gaps revealed during the financial crisis. Implementing the requirements of SDDS Plus in Switzerland – a task in which the SNB is to play a role – will take several years.

SDDS Plus

9.4 COLLABORATION

With regard to organisational and procedural issues, and when new surveys are introduced or existing ones modified, the reporting institutions – together with their associations – are given the opportunity to comment.

Reporting institutions

The SNB is advised on the content of its banking surveys by the banking statistics committee. This committee is made up of representatives of the Swiss commercial banks, the Swiss Bankers Association and the Swiss Financial Market Supervisory Authority (FINMA). A group of experts under the direction of the SNB participates in the compilation of the balance of payments. It comprises representatives from manufacturing, banking, insurance, various federal agencies and the KOF Swiss Economic Institute at ETH Zurich. In 2013, the group of experts gave special attention to the revision of the surveys in connection with financial flows.

Groups of experts

In compiling statistical data, the SNB collaborates with the relevant federal government bodies, particularly the Swiss Federal Statistical Office (SFSO) and FINMA, as well as with the authorities of other countries and international organisations.

Public institutions

The SNB has a close working relationship with the SFSO. Reciprocal data access is governed by a data exchange agreement; this agreement also covers the collaboration between the two authorities in drawing up the Swiss financial accounts. Moreover, the SNB belongs to a number of bodies that work with Swiss federal statistics. These include the federal statistics commission (*Bundesstatistikkommission/Commission de la statistique fédérale*) and the group of experts for economic statistics (*Expertengruppe für Wirtschaftsstatistik/Groupe d'experts de statistique économique*).

Swiss Federal Statistical Office

Federal Office for Housing

The SNB collects quarterly data on mortgage rates from about 80 banks on behalf of the Federal Office for Housing (FOH). Based on these data, the FOH calculates the reference interest rate for tenancies. The sole responsibility for the contents of this survey lies with the FOH, which also publishes the reference interest rate.

FINMA

Under the agreement with FINMA on the reciprocal exchange of data in the financial sector, the SNB collects information, including data on the capital base, liquidity and interest rate risk of banks and securities dealers. The year 2013 was marked by the implementation of Basel III. In this connection, data collection related to the more stringent capital requirements for banks was introduced and preparations were made for the reporting of the short-term liquidity coverage ratio (LCR).

Principality of Liechtenstein

The SNB also surveys Liechtenstein-based companies when preparing its balance of payments figures and its statistics on Switzerland's international investment position. It works with the relevant authorities in Liechtenstein (the Office of Economic Affairs and the financial market supervision authority).

EU

SNB collaboration with the EU is based on the bilateral statistical agreement that came into effect in 2007. It covers the financial accounts, parts of the banking statistics as well as, since 2010, the balance of payments. The SNB plays a role in various bodies of the EU statistical office (Eurostat).

Other international organisations

In the area of statistics, the SNB works closely with the BIS, the Organisation for Economic Co-operation and Development (OECD) and the IMF. This collaboration is aimed at harmonising statistical survey methods and analyses. In 2013, the SNB participated in several international working groups concerned with closing data gaps in financial market statistics. Improving the statistical basis will help identify undesirable trends (such as those that emerged prior to the financial crisis in 2008) at an early stage.