News conference

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Introductory remarks by Philipp Hildebrand

The new investment policy of the Swiss National Bank

1. The evolution of the new investment policy

The new National Bank Act has been in force since 1 May 2004. The management of monetary reserves is explicitly mentioned in the NBA as part of the Swiss National Bank's mandate for the first time. The management of these reserves is subject to the primacy of monetary policy and implemented according to the criteria of liquidity, security and return. In so doing, the National Bank must guarantee professional, modern asset management and risk management.

Until the mid-1990s, the National Bank only had limited possibilities for managing its assets. Monetary reserves were mainly held in the form of gold and foreign-currency government bonds with a maturity of less than one year. Accounting for approximately 80%, the US dollar was the main reserve currency. An easing of investment regulations came about in 1997 when the legally prescribed maximum term for bonds was repealed and repo and gold lending business was introduced. At the same time, the National Bank began to diversify currency risks on its investments to a greater degree and gradually reduced the US dollar portion. The new Act takes this a step further and leaves the permissible investment universe completely open.

2. Implementation of the investment policy

Our investment policy has not fundamentally changed with the new Act. The monetary reserves continue to constitute core assets for monetary policy. They allow the National Bank to exert an influence on the Swiss franc exchange rate in exceptional situations and are available as an internationally accepted means of payment in a crisis situation. This presupposes a minimum degree of liquidity of these assets. Moreover, monetary reserves enhance the credibility of monetary policy and foster confidence in the Swiss franc. The security of these investments and growth of the monetary reserves in step with the development of the Swiss economy is an important consideration in this context. This is why monetary reserves ought to provide an adequate return, while taking into account the monetary policy restrictions. It is the aim of our investment policy to strike an optimal balance between the criteria of liquidity, security, and return.

We assess and regularly review the National Bank's liquidity requirements – i.e. its need for easily realisable and hence easily accessible assets – on the basis of our experience and taking due account of the current situation. Given the Bank's large portfolio holdings in US dollar and euro government bonds, the liquidity requirements are currently more than met. This creates a certain amount of leeway for investing in instruments that are less liquid but generate a higher return.

The investment criterion "security" must be seen in the context of the monetary reserves as a whole. The National Bank incurs risks on its investments that cannot be hedged based on monetary policy concerns. Losses from gold and foreign currencies in particular can be significant. An adequate volume of reserves allows the National Bank to bear these risks, especially since such fluctuating values tend to correct themselves over the long term. Greater diversification of both the currencies and the investment instruments can bring about the necessary growth of monetary reserves. Diversification effects permit investments in higher-yielding and – from an individual perspective – riskier investments such as equities and corporate bonds without substantially increasing the overall risk.

The return potential of monetary reserves depends on the liquidity and security requirements of the investments in terms of monetary policy considerations. Pursuing an efficient investment policy for the National Bank means achieving a return potential that is as high as possible within the existing restrictions. Under the new Act, the National Bank will pursue a broader diversification of its investments and, in particular, also invest in equities and corporate bonds.

Because of the National Bank's special position as a central bank, the exposure to equities and corporate bonds is subject to some specific considerations: first, a conflict of interest may arise between monetary policy and investment policy. For instance, interest rate hikes by the National Bank can have a negative impact on a company's profits. Second, owing to its responsibilities in the area of system stability, the National Bank has insider information in the financial sector. And third, the National Bank's investments in equities and corporate bonds can have a noticeable impact on risk premiums on the capital markets, especially in illiquid markets.

These considerations primarily concern equities and bonds issued by Swiss firms. They are therefore excluded from the National Bank's investment universe. Holdings of foreign equities and corporate bonds do not present a problem in this regard.

A passive management strategy based on indices with liquid, listed securities is followed for equities portfolios. Consequently, we do not engage in stock picking or sector picking. As a rule, we do not exercise our voting right at annual general meetings. In the case of corporate bonds, attention is given to broad diversification from issuer-specific risk. Despite active management, therefore, the corporate bond portfolio cannot deviate from the market index to any considerable degree.

3. The new investment process: different functions largely separated

The market and credit risks of individual transactions increase as the investment spectrum becomes broader. Operational risks, including conflicts of interest and the problem of insider know-how, also gain in importance as asset management strategy becomes more active. We have therefore evaluated the investment process with a view to the requirements of good governance. Important changes in this process include the following: investment and monetary policy decisions have been largely uncoupled, the definition and implementation of strategy have been segregated, controlling has been made an autonomous function, and the National Bank's Bank Council has been tasked with integral monitoring of the investment and risk processes.

The Governing Board of the National Bank decides on the medium-term investment strategy for the monetary reserves. Taking into consideration the criteria of security and liquidity, an appropriate risk/return profile is targeted. In addition to the strategic allocation to the individual currencies and investment categories, the Governing Board defines the permissible range for implementation.

Department III implements the strategy. Within the defined bandwidths, an internal investment committee decides on positions which deviate from the strategy.

In the risk controlling process, compliance with the strategy guidelines and the operative limits as well as the quality of the debtor categories are monitored. Performance is also measured. With the expansion of the investment spectrum to include issuers with lower credit ratings, risk monitoring is gaining in importance. The Governing Board and the Bank Council's Risk Committee are regularly informed about the results of the risk controlling process. The Bank Council's Risk Committee assesses risk control and also oversees adherence to the principles of the investment process.

4. Transparency: a further element of good governance

The National Bank has an accountability and information obligation not only to the bank authorities but also to the public. Since the monetary reserves ultimately constitute national assets, this obligation also applies to the investment policy. The accountability obligation includes regular reporting on our investment activities.

The National Bank already provides information on the structure of its assets in its Annual Report, including details on currency allocation, holdings of individual investment categories, and on the major risk and return indicators. The Investment Policy Guidelines of the Swiss National Bank, which have just been published for the first time, contain additional information on the investment and risk control process and on the investment universe (cf. www.snb.ch, The SNB, Legal basis). They define the principles of investment policy and the investment categories underlying the strategy, and describe the areas of responsibility. The quantitative information already published in the Annual Report will also be published on a quarterly basis in the future, thus providing the public with even more comprehensive information on our investment activities.

5. Conclusion

The management of the monetary reserves has gained in importance. The National Bank Act requires the National Bank to manage its monetary reserves professionally, subject to the primacy of monetary policy. After the new Act entered into force, we began to further optimise the investment structure. The increased leeway for investment is used for greater diversification. The structure of the National Bank's investments is thus becoming more efficient overall, yet without compromising monetary policy requirements in terms of the liquidity and security of these investments. We will also take advantage of the extended legal scope with regard to the free assets, i.e. the proceeds from the sale of gold reserves no longer required.