SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
BANCA NAZIUNALA SVIZRA
SWISS NATIONAL BANK

President's address by Hansueli Raggenbass, President of the Bank Council, to the General Meeting of Shareholders of the Swiss National Bank, 17 April 2009

Dear Shareholders

Ladies and Gentlemen

Dear Guests

Last year, the SNB centenary was the focus of the meeting. At the time, I drew attention to the fact that the SNB had been faced with particular challenges, not only in the year it was founded, but also in its major anniversary years. As the particular challenge faced in the centenary year, I mentioned the financial market turmoil that began in August 2007. This turmoil has now mushroomed into the deepest and most complex financial crisis the world has seen since the Great Depression. Furthermore, the financial crisis has widened into a global economic crisis, which has taken full hold of the Swiss economy, too.

Financial crisis deepens and measures taken to reinforce Swiss financial system

In 2008, the financial crisis was a major concern for the SNB. At an early stage, it became clear that Switzerland, with its important financial sector and especially with its two international big banks, is particularly vulnerable. Hardly any other country has a banking system in which individual banks are of such tremendous importance to the economy as the two big banks are for Switzerland. Their sheer size alone assures UBS and CS a key role in the stability of the entire financial system. Consequently, if one of the big banks is at risk, the Swiss financial system as a whole is put at risk.

Article 5 of the National Bank Act stipulates that the SNB shall contribute to the stability of the financial system. Conscious of its shared responsibility for the stability of the financial system, the SNB began drawing up measures for a possible emergency at an early stage – always hoping that such an emergency would not eventuate. In doing so, it was in permanent contact with the Federal Department of Finance and the Swiss Federal Banking Commission (now FINMA). When the financial market crisis deepened further following the collapse of the Lehman Brothers investment bank last September, it became increasingly likely that such an emergency could occur in the Swiss financial system. Consequently, on 16 October, the Federal Council, the SNB and the SFBC announced a package of measures aimed at strengthening the Swiss financial system. This package combined a reinforcement of depositor protection, thorough revision of the deposit guarantee scheme and targeted measures to strengthen the balance sheet of Switzerland's largest bank, UBS. UBS would transfer illiquid assets amounting to a maximum of USD 60 billion from its balance sheet to a special purpose vehicle (SPV) established by the SNB, and would contribute capital equivalent to 10% of the amount to be transferred to the SPV. At the same time, the Swiss Confederation would strengthen the UBS equity base by underwriting mandatory convertible notes (MCN) for CHF 6 billion. The SNB, for its part, would grant the SPV a long-term loan amounting to a maximum USD 54 billion. The SNB loan would be secured by the assets held by the stabilisation fund.

When the package of measures was announced last October, it was assumed that the assets to be transferred would amount to no more than USD 60 billion. Following a detailed examination of the portfolio and the resulting negotiations between UBS and the SNB, a portfolio now amounting to USD 38.7 billion was taken over by the stabilisation fund. Accordingly, the SNB loan to the stabilisation fund was reduced from a maximum of USD 54 billion to USD 34.8 billion. The size of the UBS participation in the SPV fell from USD 6 billion to USD 3.9 billion.

Statutory mandate and powers of the SNB

The SNB's powers to establish and finance the SPV arise out of its constitutional mandate to pursue a monetary policy that is in the interests of the country as a whole. Within this framework, it also has a mandate to contribute to the stability of the financial system. Under article 46 of the NBA, the Governing Board has sole responsibility for the conduct of monetary policy. Thus the decision to establish and finance the SPV fell within the Governing Board's exclusive powers and responsibilities. The NBA specifies that the Governing Board shall render account to the Federal Assembly on the fulfilment of its tasks. These requirements also apply with regard to the SPV. Thus, in its accountability report to the Federal Assembly which constitutes the first part of the *Annual Report*, the SNB provided detailed accounts of the establishment of the SPV, the transfer of the illiquid assets and the granting of the loan. The Chairman of the Governing Board has also informed the relevant Federal Assembly commissions about the SPV at a number of discussion meetings.

The SNB Bank Council has no monetary policy powers, serving rather as the National Bank's supreme supervisory and monitoring body. However, these supervisory and monitoring powers relate not to monetary policy but to the business management of the SNB. This organisation of powers is based on the SNB's special corporate governance model which differentiates clearly between the conduct of monetary policy, on the one hand, and business management matters, on the other. The Governing Board has sole and exclusive responsibility for the conduct of monetary policy. In business management matters, however, the NBA (like the Banking Act), works on the principle that supervisory and executive functions should be separated. Thus, the Governing Board is the supreme management and executive body, while the Bank Council supervises and monitors the management. The individual powers of the Bank Council are listed in the Organisation Regulations. In particular, the Bank Council sets out the basic principles according to which the SNB should be organised, regulates the basic structure of its accounting, financial monitoring and financial planning systems, monitors and assesses risk management and the investment process, and reviews its resource strategies. In addition, the Bank Council approves the business and financial report for submission to the Federal Council and the General Meeting of Shareholders, and prepares the General Meeting.

Bank Council tasks in connection with special purpose vehicle

What are the consequences of the division of powers between the Governing Board and the Bank Council with regard to the SPV? First, the actual decision to establish and finance the SPV was taken by the Governing Board alone. The Bank Council had no say in the matter. Second, the Bank Council was not obliged to retrospectively review the decision – which was, after all, a decision of a monetary policy nature. Nevertheless, important tasks fall to the Bank Council in connection with the SPV – as part of its supervisory and monitoring functions. These tasks are derived from the Bank Council's responsibility first, for supervising and monitoring the accounts and, second, for monitoring and assessing risk management and the investment process.

In order to fulfil its supervisory and monitoring responsibilities optimally, the Bank Council established an Audit Committee and a Risk Committee back in 2004. Each of the committees consists of three Bank Council members with special knowledge and experience in the specific field. The Audit Committee oversees accounting and financial reporting, while the Risk Committee assesses the suitability and effectiveness of the investment process and oversees risk management. The committees fulfil a preparation and support function with respect to Bank Council decisions. However, the actual supervisory powers lie with the Bank Council itself.

The two committees face particular challenges in connection with the establishment of the SPV and the transfer of the illiquid assets. The Audit Committee is dealing with complex accounting issues, in particular relating to reporting, valuation, entry and presentation in the *Annual Report*. It is working closely with the heads of internal and external audit. The Risk Committee is dealing with questions relating to financial risks and management of the acquired assets. It is monitoring the risk control process and ensuring that it obtains regular risk evaluations. The Risk Committee therefore stays in close contact with the head of SNB risk management. Both committees also ensure that the SNB's resources, expertise and organisation are appropriate for mastering these new tasks. The Audit Committee and the Risk Committee both receive comprehensive quarterly reports on developments in the stabilisation fund.

Illiquid assets – accounting and management

As you will gather from reading the *Annual Report*, the transfer of the illiquid assets and the long-term investment strategy being pursued in this connection have had a fundamental impact on the current financial report. For the first time, we are presenting you with consolidated financial statements in which both the financial accounts of the SNB, as the parent company, and the interim results of the SPV, as the subsidiary company, are presented in consolidated form. All of these financial statements are audited by PricewaterhouseCoopers (PwC), our external auditors.

Financial statements for the stabilisation fund are drawn up in accordance with the International Financial Reporting Standards (IFRS). In view of the long time horizon, the illiquid assets are valued not at market price, but rather (where this is permissible under the accounting standard), at amortised cost. Due to the illiquidity of the assets, market prices are almost non-existent at present and, where they do exist, have little meaning. In other words, fair value has lost a great deal of its significance and is not useful for valuations of the assets in question. Impairment tests are being conducted periodically, however, to determine the recoverable value of the assets. This ensures that, in the medium term, the assets are not stated in the balance sheet at a value higher than the amount they will reach, while, at the same time, due consideration is given to unrecoverable losses in value. An initial impairment test was conducted as per end-2008 and, where necessary, value adjustments were made. Losses on assets in the stabilisation fund will initially be absorbed by the capital contributed by UBS, which corresponds to 10% of the assets that have been transferred. Should there be further losses, secondary loss protection is foreseen. The SNB has a warrant for 100 million UBS shares in the event of a loss on its loan when the assets are liquidated.

The SNB does not value the assets itself. It has outsourced this task to third parties, whose work it monitors and checks carefully. This approach was already adopted at the time that the purchase price was established. The calculation of the purchase price was based on the book value of the assets as stated in the UBS interim balance sheet as at 30 September 2008. In addition, the SNB asked independent experts to provide a valuation of the assets as at the same date. The valuations were carried out by specialised companies with different valuation approaches. This gave rise to two different figures: the book value calculated by UBS and the valuation provided by the SNB's independent experts. The assets were acquired at the lower of these two figures.

The assets are being managed by third parties on the basis of investment guidelines drawn up by the SNB. The SNB is participating in this outsourced work and monitoring it actively. It intends to hold the transferred assets until maturity – or at least until the markets in question have recovered. Should the assets be sold later, the sales strategy will be crucial, since the stabilisation fund is competing with other market participants to realise assets, all of which are similar in nature.

Concluding remarks

The SNB is conscious of its shared responsibility for the stability of the Swiss financial system and the entire Swiss economy. In establishing and financing the SPV, it has not shied away from resorting to exceptional measures. In doing so, it has taken a considerable risk. However, the alternative was to risk a destabilisation of the financial system. The SNB judged the risk to the financial system to be greater than the risk of the UBS operation. It therefore decided in favour of the latter.

Now that this decision has been taken, the principle of separating supervision and management functions applies to the SPV as it does for all business matters at the SNB. In connection with the SPV, the Bank Council takes its function as supervisory and monitoring body very seriously. It bears responsibility for supervising and checking accounting procedures and for overseeing and assessing risk management and the investment process. In order to fulfil its task, the Bank Council receives regular and comprehensive information on developments in the stabilisation fund, and remains in permanent contact with the relevant SNB managers via its two committees.

Within the limits of its constitutional mandate and practical possibilities, the SNB will continue to make its contribution to fighting the crisis and smoothing the way to recovery. I would like to thank you, as shareholders, for supporting and trusting in ‘your’ National Bank in these difficult times.