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Introductory remarks by Niklaus Blattner

11 September 2001: a test for the global financial system

For a number of years now so-called systemic risks have received increasing attention from the central banks and from banking and financial market supervisory authorities. In extreme circumstances, systemic risks may ultimately lead to a breakdown of the financial system. They have their origin either in a transmission of liquidity and solvency problems between banks and other financial service providers or in the fact that numerous market participants are simultaneously affected by the same non-diversifiable risks. Examples of such risks are sudden, widespread and massive losses in the value of financial assets (stock market crash), serious malfunctioning of major financial market infrastructures, large-scale natural disasters or terror attacks which obstruct markets and market participants in economic or technical and physical respects. The consequence may be a substantial disruption of economic activity. The damage caused to the affected economies is liable to be correspondingly large.

The terror attacks of 11 September 2001 hit the central nerve of the global financial system - New York, the major trading centre for the world's leading currency and the preferred location of the international banking and financial services industry. Allow me to recapitulate the consequences in a few words: various banks, stock brokerage firms and securities houses lost part or even all of their staff, their business premises, their backup facilities and their lines of communication. The markets remained closed on the following day, the equity markets even until the end of the week. From a systemic point of view, of even greater consequence than the closing of the equity market was the fact that the two markets for US government paper and for commercial paper, the main vehicles for short-term liquidity equalisation between market participants, had ceased to operate. Payment and settlement systems started to break down. Securities and credit balances totalling billions were thus blocked at some banks while lacking at others. Even though the terror attacks were concentrated on New York and Washington, in the beginning they not only paralysed Wall Street but they also threatened to undermine significant parts of the international financial system.

It is much too soon, and this is not the proper place, to make an assessment of the profound human, social and political implications of the terror attacks. The resilience of the banks and the financial markets must be emphasised, however. A week after the attacks, business was almost back to usual again. In most cases, the banks and securities houses affected managed to solve their problems, some of which were immense. Neither a stock market crash nor a breakdown of parts of the financial system set in either in the United States or anywhere else. It was precisely under the extreme pressure that the financial system proved its stability. The market participants mastered the crisis situation spontaneously and networked their efforts: for example, the tasks that would normally have been performed in downtown Manhattan were carried out in New Jersey or in London. Or they agreed to extend the settlement period to five days and to conclude general money market trades at the official Fed rate (instead of fixing prices via brokers, some of whom could not be reached due to the collapse of technology). Furthermore, market participants practised restraint in stock sales and abstained from taking personal advantage of the general state of emergency. Creditors, notably the banks, also endeavoured to fulfil merely implicit commitments as far as possible and to ensure the functioning of the markets. All this would not have been possible without the tireless creative and networked efforts of thousands of shocked and grieving staff of the enterprises concerned and of the international financial community.

The private measures for overcoming the crisis were also actively supported by the central banks, first and foremost by the Fed, which had fully retained its capacity to act from the outset despite being located in the immediate vicinity of "Ground Zero". It injected additional liquidity into the market and allowed the rate for one-day repos to fall to 1%. It also opened its counters to foreign banks operating in the United States and, when necessary, offered foreign central banks one-month dollar swaps. In particular, the Fed communicated clearly from the very beginning that it would meet the increased requirements for dollar liquidity at any time.

Against this background it is not surprising that the terrorist attacks on the United States failed to seriously impair the functioning capacity of the financial markets either in Switzerland or in the rest of Europe. Even though the global financial system had been hit in its very core, the extensive transmission of problems that was theoretically possible did not take place. This is not least due to the fact that the institutions concerned on both sides of the Atlantic comported themselves in an appropriate manner, as did the central banks. The biggest immediate problem for some Swiss banks is likely to have been the inability to act of a major correspondence bank in New York that was hit by a simultaneous power failure in the main supply and the backup system. In such cases, liquidity requirements soar. The Fed's generous supply of USD liquidity to the market also benefited Swiss banks. We did not, however, observe a similarly higher demand for Swiss franc liquidity. Nevertheless, the Swiss National Bank was, of course, present in the CHF money market. (Cf. the remarks of Bruno Gehrig.)

For the time being, I would sum up the situation as follows:

1. The terror attacks of 11 September 2001 did not succeed in destabilising either the US part of the international financial system or those of the rest of the world.
2. The banks and financial markets have overcome the shock of the terror attacks with impressive flexibility, creativity and with a measure of solidarity that commands respect.

3. The central banks, i.e. the US Fed, the European Central Bank and all the other central banks including the Swiss National Bank fulfilled their task as lenders of last resort in times of crisis.

4. The crisis management was facilitated by the fact that the banks, the markets and financial market infrastructures in general were in a sound condition at the time of the terror attack. Their liquidity and solvency provided them with a good basis for successfully passing the extreme "stress test" to which the international banking and financial systems were subjected.

5. This underlines the significance of banking and financial market supervision on both levels of intervention assigned to them, i.e. both in the micro-prudential as well as in the macro-prudential field. While the former primarily serves to secure the banks' solvency, the latter has the task of upholding the liquidity and functioning capacity of the payment systems and of financial market infrastructures in general.

6. The next step is to work through all the events of 11 September and their consequences rapidly and carefully. Even though we have obtained proof of the stability of the global financial system, we cannot simply carry on as though nothing had happened. Lessons must be learned and defensive measures, both on the financial industry and central bank levels, i.e. in banking and financial market supervision, must be further improved.

7. The events of 11 September have strengthened all the parties' awareness of the extent of international integration in a crisis situation. While the benefits of international cooperation have so far been undisputed, at least theoretically, empirical evidence has now been provided. Cooperation among the authorities in the various countries on the level of the Bank for International Settlements, the relevant committees of central bank governors of the Group of Ten and the International Monetary Fund is to be intensified.

8. A current example of such efforts can be found in the payment systems sector. Any strains on the financial system can spread rapidly as a result of the international integration of participants as well as of payment and settlement systems. Increased attention must be paid to devising and linking systems such as Switzerland's SIC (Swiss Interbank Clearing) and the planned CLS (Continuous Linked Settlement) among others.

9. Further problems which must be dealt with in particular by the private financial industry concern the inadequate geographic diversification of production locations and backup facilities, which have proved less than satisfactory in some cases.