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Introductory remarks by Fritz Zurbrügg

In my remarks today, I will start by presenting our current assessment in the area of financial stability, looking first at the big banks before turning to the domestically focused banks. I will end my remarks with a few words on the new banknote series.

Big banks

Since the *Financial Stability Report* was published in June, the Swiss big banks have improved their capital situation slightly; at the same time, they have substantially increased their holdings of bail-in bonds. Bail-in bonds are debt instruments that can be written off or converted into equity in the event of restructuring or resolution. They form the basis for a crisis-hit bank to be resolved or restructured in an orderly way. Alongside capital requirements, the qualitative and quantitative requirements on such debt instruments are a key component of the revised 'too big to fail' regulations which came into force at the beginning of July.

These revised regulations envisage that the requirements will gradually be increased to the specified level over a phase-in period ending at the beginning of 2020. As regards core capital (Common Equity Tier 1, CET1), both big banks already largely meet the targets that will apply after the end of the phase-in period. There is still a need for action before the transition deadlines expire, as regards bail-in instruments and high-trigger contingent convertible capital instruments – or high-trigger CoCos. These CoCos can be converted into CET1 equity or written off in order to absorb losses in current operations. When accumulating the necessary bail-in instruments and high-trigger CoCos, banks have the opportunity to replace existing instruments with the required higher-quality instruments.

The further strengthening of resilience through the accumulation of high-trigger CoCos, as foreseen by the regulations, is important and necessary. One reason for this is the big banks' loss potential, which continues to be substantial relative to their capitalisation. Given their

significance to the Swiss economy, it is important that the big banks remain adequately capitalised, even in the event of such losses occurring. A second reason is the critical assessment by the markets as regards the resilience of banks, both in Switzerland and worldwide. By strengthening their resilience, banks can convince the markets of their soundness. The likelihood of share price collapses and sharply increased premia for credit default swaps, such as those observed at some banks this year, would thus be reduced.

In addition to a strengthening of resilience, it is also essential that the big banks further improve their resolvability. This requires both sufficient holdings of bail-in instruments and the formulation of credible emergency and resolution plans. Emergency plans are aimed at ensuring that, in the event of imminent insolvency, functions that are important for Switzerland can be maintained. This requires effective cooperation with foreign authorities in a crisis, for which, in turn, the global resolution plans are an important prerequisite.

As regards emergency plans, both Swiss big banks have introduced significant measures by setting up Swiss subsidiaries which combine systemically important functions in one entity. The key point here is that the Swiss units must be sufficiently independent from the rest of the bank, both operationally and financially. Both big banks have to implement their emergency plans by end-2019 at the latest. FINMA is responsible for the definitive assessment on whether the plans allow systemically important functions to be maintained in practice.

Domestically focused banks

I would now like to turn to the domestically focused banks. For these banks, the mortgage and real estate markets still represent the greatest source of risk. Growth on these markets has remained fairly constant over the last six months, and at a relatively low level. At the same time, imbalances on the mortgage and real estate markets have fallen slightly overall, owing to developments in fundamentals.

Despite this most recent development, the risks that have been building in the Swiss banking sector since the beginning of the low interest rate period in 2008 remain considerable. Thus, imbalances on the mortgage and real estate markets are still approximately as high as they were in 2014, when the sectoral countercyclical capital buffer was set at 2%. Moreover, risk appetite at domestically focused banks is still high, as is reflected in the interest rate and affordability risk exposures in their mortgage business.

Stress tests carried out by the Swiss National Bank suggest that these risks are currently sustainable, thanks to good capitalisation overall. Against the backdrop of persistently low interest rates, this is welcome.

In the future, too, a decisive factor for financial system stability will be the banks' ability to maintain risk exposures at a sustainable level. The current low interest rate environment creates strong incentives to increase interest rate or affordability risk exposures in lending business. For instance, there is a public debate about whether the imputed interest rate used to assess affordability should be reduced. The level of this imputed interest rate is not set by the

regulator and varies between banks. However, it does play a key role in affordability assessments. Banks typically use a rate of 5%.

Let me go into this topic in further detail. While today's period of low interest rates could well persist and the rise in interest rates might only be very gradual, mortgages generally influence borrowers' financial situation and banks' balance sheets over a period of decades. As such, when assessing affordability and calibrating risk exposure, long-term interest rate developments are also relevant. Despite the current pressure on interest rate margins, banks should therefore continue to take a long-term view in their risk policy.

In the context of long-term interest rate developments, there are some good arguments which say that, in the future, the average interest rate level could be lower than in the past. But that does not mean we should assume that the current level of interest rates represents the new equilibrium. Even assuming that the average interest rate level will decline, the prevailing level of interest rates in recent years has been exceptional. For example, long-term rates are currently just under 300 basis points lower than the average in the ten years before the onset of the financial crisis. Moreover, experience shows that, depending on economic developments, interest rates can increase very rapidly and unexpectedly, overshooting long-term equilibrium values.

A broad-based reduction in the imputed rate or a further increase in interest rate risk exposures across the board could also lead to a renewed acceleration of momentum on the mortgage and real estate markets. The SNB will continue to monitor developments closely, and will regularly reassess the need for an adjustment of the countercyclical capital buffer.

Announcement of issuance date for 20-franc note

I would like to close with a few remarks about the new banknote series. On 12 April 2016, the SNB successfully released the new 50-franc note. The new note has since proved its worth and its reception among the public and experts alike has been broadly positive. As expected, today – a good six months after the new note was issued – around two-thirds of the eighth-series 50-franc notes originally in circulation have been exchanged.

The next denomination to be released will be the 20-franc note. It will be presented at a press conference on Wednesday, 10 May 2017, and the first notes will be issued one week later, on 17 May 2017. The new 20-franc notes will be put into circulation continuously from that date onwards.

Issuance of the third denomination, the 10-franc note, is planned for autumn 2017. We will announce the exact date in due course.