Switzerland

- SOE with a safe haven currency: the key element of context is not within our control
- Financial stability risks are exclusively home-made
  - External capital flows present an ER and MP challenge - little interaction with financial stability issues
- Two financial stability issues
  - A bubbly real estate market
  - Two SIBs, very large relative to the economy
Roadmap

• Elements of context: the safe haven challenge
• The housing market situation and its perception: a bubble? Or ‘Here and now’, it is different?
• The institutional set-up and the 2012-15 policy response
• A dynamics under control?
• The design of the CCB
• Issue #2: UBS & CS
The corollary of a safe haven currency
Financial crisis: safe haven induced net inflows of private capital

**SWITZERLAND: PRIVATE CAPITAL FLOWS, NET**

Swiss financial account (excluding reserves and derivatives)
Leaning against the wind?
An impossible dream
Roadmap

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Swiss real estate price indices

Asking prices (Q1/2000 = 100)

- single-family houses
- Owner-occupied apartments

Sources: SNB, W&P
Assessment: Significant imbalances according to standard indicators

MORTGAGES-TO-GDP: GAP
BIS reference indicator

PRICE-TO-RENT: ASKING PRICES
Deviation from long term average

Sources: SNB, Wüest & Partner

Macroprudential policy in practice - Jean-Pierre Danthine
...and high risk appetite by lenders

**INTEREST RATE RISK**
NPV losses relative to capital for +200bp, domestically oriented banks

<table>
<thead>
<tr>
<th>%</th>
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<tbody>
<tr>
<td>15.0</td>
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<tr>
<td>2.5</td>
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<tr>
<td>0.0</td>
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<td>-2.5</td>
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**INTEREST RATE MARGIN**
Weighted average, semi-annual data, domestically oriented banks

<table>
<thead>
<tr>
<th>%</th>
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<tbody>
<tr>
<td>2.0</td>
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<td>1.9</td>
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<td>1.8</td>
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<td>1.5</td>
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<td>1.4</td>
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Sources: SNB, Berra
But is it a bubble?

**APARTMENT PRICE INDICES**
In real terms, Q1/2000 = 100

**REGIONAL HOTSPOTS**
Apartments: real transaction prices

Sources: FSO, Fahrländer Partner, IAZI, Wüest & Partner
...strong housing demand...
Chart 9: Price-to-rent ratio: deviation from long-term average

*The average is calculated over the period from 1970 to 2015, or over the period for which data are available. For Switzerland, asking prices are used.

Sources: BIS, OECD, SFSO, Thomson Reuters Datastream, Wüest & Partner
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Institutional set-up

− No single macroprudential authority or Financial Stability Board
  • Division of responsibilities
  • Central bank (SNB) the only institution with an explicit financial stability mandate ("contribute")

− SNB’s instruments
  • Communication/moral suasion
  • Crisis management – liquidity support
  • Regulatory framework: input/expertise, but no formal mandate
  • NEW: CCB: formal responsibility, but no decision taking power
Division of responsibilities – the CCB

- **SNB proposes** activation, modification and deactivation of the CCB
- **Federal Council decides** upon SNB proposition after *consultation* of the financial market supervisory authority

**Procedure**
- The SNB conducts a quarterly assessment of the developments in the mortgage and real estate markets
- If the SNB determines that it is necessary to activate or adjust the level of the buffer, the SNB submits an official proposal to the Federal Council
- **FINMA supervises** the implementation of the CCB at individual bank level
A pragmatic multipronged approach

Self-regulation: increased down-payment + shorter amortization

Activation of sectoral CCB at 1%, effective as of end of Sep 2013

Adjustments of self-regulation guidelines with respect to loan repayments

Permanent increase in the risk-weighting for the loan tranche exceeding LTV of 80%

Increase in sectoral CCB to 2%, effective as of end of Jun 2014

Financial Stability Report: repeated public warnings since 2010


Federal Council & SNB  |  FINMA  |  SNB  |  Banking Association
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Effectiveness – the evidence (I)

- Activation and increase of CCB: Banks responded by increasing capital, making them more resilient
- Difficult to assess whether mortgage lending is directly affected
  - No counterfactual
  - Impact of individual measures cannot be assessed
    - CCB: may impact lending – depends on size/design
    - Self-regulation: down-payment rule likely to impact demand for housing
Effectiveness – the evidence (II)

MORTGAGE GROWTH
Annual growth rate, monthly data

REAL ESTATE PRICE GROWTH
asking price indices, real annual rates

Sources: SNB, Wüest & Partner

1 Activation of CCB  2 Increase to 2%
Real estate price growth

Asking price indices, in real terms: Annual growth rates, quarterly data
Sources: Wüest & Partner, SNB
Real estate price growth

Asking price indices, in nominal terms: Annual growth rates, quarterly data
Sources: Wüest&Partner, SNB
LOAN-TO-VALUE: NEW MORTGAGES

Proportion of new loans with LTV over 80% and between 75% and 80%

Chart 14

* When calculating net figures, pledges from pillar 2 and 3a pension funds used as part of the scheme to encourage home ownership are counted as additional collateral in the LTV calculation.

Source: SNB
LOAN-TO-INCOME: NEW MORTGAGES

Proportion where imputed costs exceed one-third of income (owner-occ.) or rents (inv. prop.) at an interest rate of 5%

Chart 15

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
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<tbody>
<tr>
<td>Owner-occupied</td>
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</tr>
<tr>
<td>real estate</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential investment property (private individuals)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential investment property (commercial borrowers)</td>
<td></td>
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</tr>
</tbody>
</table>

Source: SNB
INTEREST RATE MARGIN OF DOMESTICALLY FOCUSED COMMERCIAL BANKS

Weighted average

Sources: FINMA, SNB
INTEREST RATE RISK OF DOMESTICALLY FOCUSED COMMERCIAL BANKS

Losses in NPV with 200 bp interest rate rise and different replication assumptions; as percentage of Tier 1 capital

Chart 18

%  


Bank internal assumptions  Fixed assumptions*

* Assumed repricing maturities of 1.5 years for savings deposits and variable rate mortgage claims, and of 15 days for sight deposits.
Sources: FINMA, SNB
RISK-WEIGHTED CAPITAL RATIOS OF DOMESTICALLY FOCUSED COMMERCIAL BANKS

Capital surplus with respect to the Basel III 8% minimum requirement for risk-weighted total capital ratios

Chart 19

Market share

%  
70  
60  
50  
40  
30  
20  
10  
0  

Surplus in percentage points

0-2.5  
2.5-5  
5-7.5  
7.5-10  
10-12.5  
12.5-15  
15-17.5  
>17.5  

* Share of domestically focused banks’ total leverage ratio exposure.
Sources: FINMA, SNB
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Basic characteristics of Swiss CCB

• The CCB can be applied on a broad basis or to exposures to specific sectors

• The maximum level of the CCB is set at 2.5% of total domestic RWA
  • On aggregate, mortgage credit amount to about 50% of domestic RWA

• Banks are given between 3 and 12 months to fulfill the requirements, depending on assessment of the situation
  • Transition period at first activation: 8 months
  • Transition period for the increase: 5 months

• First experience regarding the frequency of CCB decisions: one decision per year is realistic
CCB decision-making process: A ‘guided discretion’ approach

• The approach combines a rule component...
  • Mechanical guidance built on 4 key indicators

• ...with a discretionary component
  • The mechanical guidance can be ‘overruled’ based on an analysis of additional (“secondary”) indicators
  • Discretion important given the substantial uncertainty and complexity of measuring imbalances in the credit market
Key indicators

• The key indicators play a major role in the decision regarding turning the CCB on/off and regarding its size

• SNB relies on a combination of mortgage credit variables and residential real estate price indicators

• Pragmatism needed: only limited experience with indicators to assess position on the financial cycle
  • Calibration is, necessarily, based on one crisis only
Additional indicators

• Monitored on a regular basis to provide information used as part of the discretionary decision making process
• The greater the heterogeneity among the key indicators, the more weight is put on the discretionary component
• Additional indicators include
  • Indicators of bank risk
  • Alternative measures of credit conditions and real estate prices
  • Measures of general economic conditions
  • Soft indicators: qualitative survey data from SNB’s regional network
Financial stability: the Swiss lesson

• In the restricted context of the Swiss economy
• A stable financial system is not an impossible dream
• It is a matter of political will
• Build on the conviction that there is a need to act
• And the readiness to accept paying the price of precaution when knowledge is limited
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Financial Stability Problem #2: UBS & CS

• TBTF but also Too Big to Save
• Make them safe to fail
• At the forefront since 2009 (largely under the impulse of the SNB) but slowed down by the international environment
• Capital and liquidity requirements with ‘Swiss Finish’
  • RWA up to 19% with progressive component (including Cocos)
  • Leverage ratio of 5%
  • Liquidity requirements “Swiss regime” in effect since 2012
  • TLAC
  • Limits to internal models
  • Living wills (both banks are now Holding company and have separate Swiss entities)
A measure of success ...

Risk-weighted assets Basel III (phase-in)
As reported by banks based on their own calculations

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2011</th>
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<tbody>
<tr>
<td>UBS</td>
<td>350</td>
<td>250</td>
<td></td>
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<tr>
<td>CSG</td>
<td></td>
<td></td>
<td>300</td>
<td>250</td>
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bn CHF

EIEF - May 2016
A closing Window?

• Strong resistance, internal and external
• Ferocious lobbying