**Speech**

**Embargo**
24 April 2015, 10 am

# Swiss National Bank – independent and firmly anchored

107th Ordinary General Meeting of Shareholders of the Swiss National Bank

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Swiss National Bank
Berne, 24 April 2015

Dear Shareholders
Ladies and Gentlemen
Dear Guests

I am delighted to be able to welcome you to the Swiss National Bank's (SNB) 107th General Meeting. Today, for the first time in the long history of this event, we also have the pleasure of welcoming a group of secondary school students to attend our proceedings. The students – who join us from two schools, one in Liestal and one in Petit-Lancy – were selected from no fewer than 50 interested classes on the strength of their study of our institution and the way we operate as well as the quality of their application documents. So, let me once again extend a particularly warm welcome to you, dear students! Who knows, perhaps you will feel so inspired by our unique institution that you will one day buy an SNB share yourselves, thereby helping to rejuvenate our shareholder base? Perhaps you will even apply to work for the SNB as an economist or in some other position in the future?

My remarks today will revolve around two topics, both of which will, I trust, be as interesting for secondary school students as for shareholders. First, I shall speak about the institutional role of the SNB in our democracy and society. In doing so, I intend to answer some of the questions that have arisen on this score in recent months. I shall sketch the legislative framework within which the SNB operates, focusing in particular on the interplay between independence and accountability. The second part of my speech will be devoted to a subject that was at the heart of my remarks this time last year, namely the rules governing the calculation and distribution of SNB profits.

## Substantially more interest in institutional matters

As we all know, interest in a range of institutional questions relating to the SNB has increased palpably – and not just since the discontinuation of the minimum exchange rate against the euro on 15 January of this year. The 'gold initiative', for instance, springs to mind. With its rigid provisions on the composition of currency reserves, this initiative, which the Swiss people and cantons thankfully rejected by a clear margin last November, would have massively restricted the SNB's room for manoeuvre. Signatures are still being collected for another initiative known as the *Vollgeldinitiative* ('plain money initiative'), which aims to effect a fundamental reform of our financial and banking system.

However, let us return to 15 January 2015 – the corollary of 6 September 2011, the day the SNB introduced the minimum exchange rate. The minimum exchange rate was one of many exceptional measures adopted by the SNB and most other central banks over the last eight years in response to the financial crisis and its far-reaching consequences. It is quite understandable that this policy of active crisis management on the part of the central banks has triggered a broad public debate on the mandate, independence, responsibility and accountability of such institutions. I shall limit my remarks to Switzerland. As President of the Bank Council, my goal today is to contribute to a reasoned debate about the mandate and role of the SNB and its institutional anchoring in our political system. You will hear more on current monetary policy and the decision to discontinue the minimum exchange rate from the Chairman of the Governing Board – the body officially entrusted with setting monetary policy according to the National Bank Act (NBA).

Let us start by looking at the SNB's mandate. Via its Federal Constitution, the Swiss electorate stipulates that, as an independent central bank, the SNB must 'pursue a monetary policy that serves the overall interests of the country'. The legislature – that is, parliament – sets out this mandate as follows: 'It [the SNB] shall ensure price stability. In so doing, it shall take due account of the development of the economy.' The SNB has defined price stability, which it equates with a rise in the national consumer price index of less than 2% per annum, but not below zero. The SNB aims to keep inflation within the range of price stability or to bring inflation back within the range of price stability over the medium term following a disturbance. It should be noted that exchange rate and oil price shocks in particular may have a major impact on inflation in Switzerland in the short term and that temporary deviations from the price stability range may be unavoidable.

As mentioned, the legislature also requires the SNB to take account of economic developments in formulating its monetary policy. What does this mean in practice? Here, it is important to be realistic about what the SNB can and cannot do. While the SNB cannot be expected to provide fully comprehensive insurance cover for Switzerland's economy, shielding it against all risks and crises, it can be expected to factor in the impact of its monetary policy decisions on the country's economy.

In this connection, the SNB has always explicitly highlighted the limits as well as the possibilities of monetary policy. As is well known, the Switzerland's economy is both open and highly interconnected with Europe and the rest of the world. This means that not just Switzerland's prices but its overall economic performance is invariably highly dependent on international developments. When setting monetary policy, the SNB must always be guided by the long-term interests of the country as a whole. This may include making difficult trade-offs. The SNB cannot turn a blind eye to realities, even if these do not always look the way we would like at first glance. A central bank that wears blinkers cannot act in the long-term interests of the country.

Naturally, the legislature has the right to amend the SNB's mandate at any time. Even back when the relevant articles of the Constitution or legislation were first being debated, politicians wrangled long and hard over the wording. At the time, not only did the legislature give the SNB a clear mandate but, in a far-sighted move, it also gave it considerable freedom within this framework to define the 'how' and the 'when'. The decision was far-sighted because this freedom is essential if the SNB is to be able to fulfil its mandate, especially over the long term. To this end, the legislature makes a broad spectrum of monetary policy instruments available to the SNB, which it may then deploy as it sees fit. I believe this operational flexibility with respect to monetary policy implementation has proved its worth, particularly during the recent, difficult years. Equally, the SNB has shown that it can use this freedom in a prudent, responsible and targeted fashion.

## The SNB's independence: a means to an end

The SNB's independence is a topic that has also attracted increasing attention of late. As already noted, this independence is rooted in the Constitution – a reflection of just how important its drafters considered the issue to be. As with its mandate, the SNB's independence is defined in detail in the NBA. In fulfilling its mandate, the SNB may not seek or accept instructions of any kind from outside entities. The legislature has also built in certain safeguards – for instance, the bank's status as a special-statute joint-stock company – to ensure that the SNB remains independent in practice. You, dear shareholders, are the representatives of this unique institutional structure. Other independence safeguards include the ban on state financing via the central bank's printing press and the relatively long, six-year term of office for Governing Board members. Notwithstanding this, the SNB remains firmly anchored in our political system. The independence argument should not be used to inflate the importance of our institution; rather it is purely a means to an end – ensuring that we are in a position to fulfil our mandate as effectively as possible. These institutional arrangements are informed by the experience that, in the long term, independent central banks achieve the goal of price stability set by the legislature more effectively than central banks that are obliged to obey political instructions.

The counterweight to this independence is the duty of accountability laid down in the NBA. The SNB bears considerable responsibility, as monetary policy decisions – think of the minimum exchange rate – may have profound consequences for each and every one of us. It is only right that those who bear such responsibility should be expected to explain their decisions and their choice of instruments, and that they should be held accountable for their action(s) or inaction. The SNB thus submits a comprehensive accountability report to the Federal Assembly annually. It is called upon to justify its decisions before the relevant parliamentary committees several times a year and holds regular discussions with the Swiss government. The SNB also regularly informs the public about its monetary policy and monetary policy intentions. Our annual General Meeting at which we outline our concerns and put forward motions to our valued shareholders – and at which the Chairman of the Governing Board has another opportunity to explain the SNB's monetary policy – also forms part of our wider accountability obligations. It is not by chance that our shareholders are often described as the 'trustees' of the SNB's independence – a phrase that neatly encapsulates the linkage between independence and accountability.

This brings me to the question of whether the Governing Board's decisions are sufficiently broad-based. It is right that the committee elected by the Federal Council should consist of just three members, but in my view three points require clarification here. Firstly, the Governing Board is a committee of experts, not a government agency in which political currents must be represented. This focus on expertise is articulated in the NBA, which requires candidates for the Governing Board to have ‘an impeccable reputation and a recognised knowledge of monetary, banking and financial issues’. Secondly, the SNB’s staff analyse and supply the Governing Board with a vast amount of data and submit assessments that are potentially relevant to the decision-making process. This data includes first-hand information from Swiss companies from a wide range of industries and regions. Such a procedure ensures that multiple viewpoints are factored into the equation; these are then evaluated and weighed up by the Governing Board. The members of the Governing Board do not live in an ivory tower and do not rely exclusively on information and analysis from within their own ranks. They regularly interact with the public, engage directly with citizens and cultivate relationships with decision makers and representatives of the business, political and academic communities, both in Switzerland and abroad. The impressions gathered from all these meetings round out the overall picture. At the same time, the compact size of the Governing Board is conducive to intense and productive discussions. Only when all this input has been weighed up does the committee take its decision. The Governing Board does not reach its conclusions in a vacuum; on the contrary, its decisions are based on a wide range of information sources. This process allows the SNB to use its independence in matters of monetary policy to full effect.

Furthermore, SNB monetary policy outcomes over the long term do not suggest that the institutional framework is in urgent need of reform. In recent decades, not only has the SNB successfully managed monetary policy in the interests of Switzerland as a whole but, in particular, it has successfully maintained price stability. The SNB undoubtedly has a strong track record in this field and its performance compares favourably with that of other central banks. Nothing in this world is so good that it cannot be improved, and this holds true for the SNB’s institutional framework as well. The purpose of my remarks today is not to idealise the current system – as President of the Bank Council it is not my business to instruct the legislature; I simply want to lay out my thoughts in the spirit of a reasoned and productive debate. So let us remind ourselves once again of the advantages of the existing institutional framework: it defines the SNB’s mandate precisely and grants it the freedom necessary for fulfilment. The independence the SNB enjoys is a means to an end; it does not give it *carte blanche* to make arbitrary decisions nor does it imply that monetary policy decisions are reached in isolation. The duty of accountability plays an important role in ensuring that the SNB is firmly anchored in our political system and it allows the relevant parties to assess accurately whether the mandate is being fulfilled. Last but not least, the SNB’s record speaks for itself.

## Unequal treatment of shareholders versus the cantons and Confederation

Allow me to move on to my second topic: the rules governing the calculation and distribution of SNB profits. These rules are also part of the institutional framework within which we operate and are extremely important as they ultimately help secure the SNB’s freedom to act in the long term. Understandably, some questions have arisen in relation to these rules, too. It is logical that shareholders in particular should ask: why is the SNB paying a CHF 1 billion supplementary distribution to the Confederation and the cantons for 2014 over and above the ordinary distribution of CHF 1 billion, while shareholders are merely to receive a dividend of CHF 1.5 million? Given that, for the first time in the SNB's history, there was no dividend payout for 2013, it is entirely legitimate that investors should ask this question. This then prompts another, related question: how can the granting of a supplementary distribution be reconciled with the fact that the discontinuation of the minimum exchange rate two weeks after the publication of the annual financial statements could significantly impair the 2015 result? And thirdly: at our General Meeting a year ago, I emphasised that the legislature attaches great importance to ensuring sufficient equity capital in order to guarantee the SNB's room for manoeuvre in the long term. Does the supplementary distribution suddenly invalidate this statement?

Before answering these questions, let me remind you that in recent years the SNB's balance sheet total has increased five-fold to approximately CHF 570 billion today. This balance sheet expansion is a result of the monetary policy measures the SNB had to adopt in order to tackle the strong Swiss franc and fulfil its mandate against a backdrop of multiple crises. We currently hold currency reserves of CHF 560 billion, at least 90% of which is in foreign currency investments, the rest in gold. While one of the goals of our investment policy is to invest in safe assets and diversify as broadly as possible, there is inevitably considerable risk associated with a portfolio of this size. Exchange rate risk – which, for monetary policy reasons, the SNB is unable to hedge – and changes in the gold price are the most notable. However, fluctuations in interest rates and stock prices can also quickly lead to substantial absolute valuation changes.

Having said this, the SNB's large portfolio of currency reserves may not only be associated with large losses, but potentially also with large gains. This was impressively illustrated in 2014 when the SNB reported a profit of CHF 38 billion. How is this profit allocated? Here, the provisions of the NBA are key. They ascribe great importance to the accumulation of sufficient equity capital, which acts as a buffer against financial risks of all kinds. Crucially, having enough equity capital allows the SNB to maintain its ability to conduct monetary policy over the long term. This explains why the legislature gives allocations to provisions (i.e. the creation of equity capital) priority over dividend payments and distributions.

Thus, almost CHF 2 billion of the profit is first being allocated to provisions. A further CHF 6.8 billion is going towards balancing out the distribution reserve, which was negative due to the 2013 loss and had thus become a loss carried forward. From the remaining profit, once again a legally stipulated maximum dividend of CHF 1.5 million can be paid to shareholders, and a distribution of CHF 1 billion can be made to the Confederation and the cantons. As per NBA, the distribution amount is based on the profit distribution agreement between the Federal Department of Finance (FDF) and the SNB. Under this agreement, a supplementary distribution may be made, provided the distribution reserve exceeds CHF 10 billion. As this was the case at the end of 2014, the FDF and the SNB agreed on a supplementary payment of CHF 1 billion.

## Not possible to ‘catch up’ on unpaid dividends retroactively

In answer to the first question: unfortunately, it is not possible to ‘catch up’ on an unpaid dividend at a later date as there is no legal basis for making such a claim. The maximum dividend is fixed in the NBA. This in no way detracts from the fact that we hold our shareholders in the highest esteem; indeed, we regard our General Meeting as the highlight of our financial year. Nonetheless, the Confederation and the cantons are legally entitled to receive all profit remaining after the allocation to provisions and the payment of the dividend.

As to the second question regarding potential losses due to the discontinuation of the minimum exchange rate: the calculation and distribution of profits is always based on the result of the previous financial year; the rules exclude taking account of events in the current year. Indeed, doing so would be quite impractical, as the result can fluctuate very substantially in a very short space of time depending on developments on the financial markets; there have been years in which the last couple of weeks proved crucial in determining whether the SNB closed with a profit or a loss. This is one of the reasons why the SNB does not issue earnings forecasts in the course of the year.

There is – and this brings me to the third question – no contradiction between the supplementary distribution and my words at the last General Meeting. Irrespective of performance, provisions are always set up first; any remaining profit is allocated to the distribution reserve. A distribution *per se* is only possible if this reserve is in positive territory. Moreover, when profits are as high as they were in 2014, only a relatively small proportion of the total will be distributed; the bulk of what remains is held back in the distribution reserve, which, like provisions, qualifies as equity capital and may thus be used to absorb future losses. Generally speaking, the distribution of the previous year’s profits via the distribution reserve influences how profit is calculated for the current year. Whatever was distributed in the previous year is no longer available for the coming year.

The Bank Council bears considerable responsibility on this score. It approves the level of provisions and monitors the investment and risk management process. Rather like the Governing Board’s duties in monetary policy, the Bank Council must take account of the realities with which it is confronted. As early as 2009, for example, it passed a resolution, which has proved far-sighted in light of subsequent developments. In the context of building up provisions given incipient balance sheet expansion and the associated risks, the Bank Council decided at that time to take a figure of twice Switzerland’s GDP growth (rather than simple GDP growth) as its indicator for economic development.

## Outlook and concluding remarks

Dear shareholders, cantonal representatives and students: I started by exploring the monetary policy mandate conferred upon the SNB by the Swiss legislature. This mandate ensures that the SNB faces reality head-on and cannot shrink from taking the requisite measures. The fact that the legislature grants the SNB considerable flexibility in monetary policy implementation in order to fulfil its mandate has proved invaluable.

This independence is essential if the SNB is to conduct monetary policy successfully and fulfil its mandate; however, the SNB also has a duty to inform the public about its monetary policy decisions at all times and to account for its actions. Independence and accountability are two sides of the same coin. Only if the SNB is accountable can stakeholders gauge to what extent the SNB is fulfilling its mandate and pursuing a monetary policy that serves the interests of the country as a whole. The institutional framework ensures that the SNB is making proper use of its independence, that it is firmly anchored, and that it never 'loses touch' with developments in the real economy. It is right and important that these questions are discussed regularly and openly. Equally, it is right and important that we debate issues rationally; we must weigh potential reform proposals carefully and ask ourselves whether these are really necessary and constructive.

In this speech, I have also tried to explain the legal framework governing dividend payments. I hope you will appreciate that there is no scope for the SNB to change its position on this matter. I can, however, assure you that the Bank Council will continue to do everything in its power to maintain a healthy balance sheet, thereby guaranteeing the SNB's ability to conduct monetary policy over the long term. In doing so, we ensure that our institution remains on a solid footing in fulfilling the mandate bestowed on it by the legislature.

On behalf of the entire Bank Council, may I once again thank you sincerely for the trust you have placed in us. I would also like to thank the Governing Board, with whose members we maintain a close and productive dialogue. Lastly, I should like to express my gratitude to the SNB's staff who work tirelessly in the service of our institution.

Thank you for your attention.