The HOT SPOT

Implications of Currency Policy Change by Swiss National Bank (1/29/2015)

On Thursday, Jan. 15, the Swiss National Bank announced an end to the Swiss currency peg of $1.20 to the euro, a policy adopted in September 2011. The policy change was prompted by the continued devaluation of the euro due to anemic to negative economic growth in the region. On Thursday, Jan. 22, 2014, the European Central Bank (ECB) announced a €60 billion per month government bond purchasing program in hopes of stimulating growth in the Eurozone. The stimulus program would push up government bond prices, thus making it more expensive for the Swiss National Bank to continue the $1.20 peg policy.

Following the announcement of an end to the peg policy, the Swiss franc jumped about 18%. The currency increase benefits some but not others. Anyone receiving francs are beneficiaries because of the increased value. In global trade, Swiss exporters do not benefit, as their products are now more expensive relative to other currencies.

As of year-end 2013, U.S. insurers reported total holdings of about $9.4 billion in book/adjusted carrying value (BACV) of securities issued by companies domiciled in Switzerland. The $9.4 billion in BACV consisted of about $6.7 billion in bonds and $2.7 billion in stock. About $158 million of the bond holdings, or less than 2.5%, was denominated in Swiss francs. About 97% of the total Swiss bond exposure was allocated to corporate bonds. Based on the direct exposure of $158 million to the Swiss franc relative to total cash and invested assets of about $5.5 trillion, there is no major direct risk to U.S. insurers.

Due to the rising Swiss franc, Credit Suisse, whose U.S. subsidiaries were counterparties for $113 billion in notional value of derivatives transactions with U.S. insurers, announced it expects a drop in profits for the first three quarters of 2014, but the company suffered no "material trading losses" from the rise in value. Other large multinational corporations are expected to experience a similar strain on profits. The contagion will affect companies outside of the financial sector, including (among others) Glencore International (commodities), Nestlé (food and beverage) and Novartis (pharmaceuticals). In addition, U.S. companies, including insurers, engaged in derivatives transactions may face increased counterparty risk as a result. Collateral posting, a standard requirement in derivatives transactions, should offset the counterparty risk. Approximately 127 U.S. insurers have Swiss-domiciled corporate parents. Given the negative pressure on earnings and profits, a Swiss parent company is incented to take possession of U.S. dollar-denominated assets held by subsidiaries. Another concern is that earnings not denominated in Swiss francs are now worth less, creating a desire, or need, to increase dividends to offset the currency valuation loss. Such an action by a U.S. insurer's Swiss parent may jeopardize the capital position of the insurer.

The NAIC Capital Markets Bureau will continue to monitor trends in the Swiss franc and report as deemed appropriate.