

Press release

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Raiffeisen: major corporate governance failings

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The Swiss Financial Market Supervisory Authority FINMA has concluded its enforcement proceedings against Raiffeisen Switzerland in relation to corporate governance issues. FINMA has found that the bank's handling of conflicts of interest was inadequate. In addition, Raiffeisen's board of directors failed to adequately supervise its former CEO, thereby enabling him, at least potentially, to generate personal financial gain at the bank's expense. Overall, FINMA finds that there was a serious breach of supervisory law. FINMA has specified measures to improve corporate governance and welcomes the measures already taken by the bank. FINMA will appoint an independent audit agent to monitor the implementation and effectiveness of the measures.

In 2016, FINMA launched investigations into Raiffeisen Switzerland following indications of potential conflicts of interest. In early 2017, FINMA appointed an audit agent to carry out a detailed forensic examination of the bank's corporate governance structures. Based on the results of this probe, FINMA launched proceedings against Raiffeisen in October 2017 and concluded them in June 2018.

The main focus of proceedings was on the bank's holdings in Investnet AG, KMU Capital AG and Investnet Holding AG, which specialise in taking positions in small and medium-sized enterprises. The actions of the former CEO were subject to particular scrutiny due to his role as a minority shareholder in Investnet Holding AG. In addition, FINMA looked into deficiencies in the granting of loans to the former CEO and to individuals with close links to the bank or its holdings; significant overruns in the CEO budget were also scrutinised.

FINMA did not analyse other Raiffeisen Switzerland shareholdings in detail. Holdings in the Aduno Group do not fall within FINMA's supervisory remit. However, the "Investnet case" investigation alone gave FINMA sufficient grounds for reaching conclusions regarding the above-mentioned deficiencies and taking the required steps under supervisory law to prevent any repetition of them.

Shareholding strategy: numerous conflicts of interest, inadequate controls

Under the leadership of its former CEO, Raiffeisen Switzerland had built up a large number of shareholdings. These frequently led to a concentration of roles and conflicts of interest. In a number of its shareholdings, Raiffeisen Switzerland was simultaneously a shareholder, business partner and creditor of companies or their executive bodies, as well as being represented on the board of directors. This exposed Raiffeisen Switzerland to a high level of risk. Shareholdings as such are not problematic from a supervisory perspective, but such concentrations of roles place increased demands on the management and on the monitoring of conflicts of interest.

Former CEO's shareholding in Investnet Holding AG

The Investnet holdings in particular gave rise to a concentration of roles and significant conflicts of interest. Investnet AG, KMU Capital AG and, from 2015 onwards, Investnet Holding AG were majority owned by Raiffeisen Switzerland. In the initial phase, which began in 2012, a consultant to Raiffeisen Switzerland and close associate of the former CEO held an indirect minority stake in the shares of Investnet AG and KMU Capital AG. Raiffeisen Switzerland, with the exception of the former CEO, was unaware of this. In the second phase, beginning in 2015, the companies were restructured and the former CEO also became a minority shareholder by acquiring shares in Investnet Holding AG from his employer, Raiffeisen Switzerland.

Both the former CEO and the consultant in question were involved in the negotiations regarding the restructuring of the group. FINMA's investigation primarily concentrated on the negotiation process and on transactions executed in the context of the restructuring, with a special focus on the role of the former CEO, the role of the board of directors, and the bank's other internal controls.

The former CEO did not adequately disclose to the board of directors his intention to acquire a holding in Investnet Holding AG. Although he, as CEO of the bank, was selling shares in Investnet Holding AG and at the same time, as a private individual, buying the same shares and was therefore involved in a clear conflict of interest, he did not recuse himself, as he should have done under the bank's internal policies. For its part, the board of directors of Raiffeisen Switzerland also failed to investigate the obvious potential conflicts of interest and enforce the internal rules on disclosure and recusal.

The flow of information within the bank relating to the sales process was inadequate. The individuals involved shared information selectively, with the result that decision-makers and key bodies did not have a clear picture of

the overall situation. The board of directors failed to adequately address, discuss and document the decision regarding the sale of the minority stake in Investnet Holding AG to the former CEO. The transaction was dealt with under “Any other business”, with the former CEO making a presentation based on a limited handout, effectively making proper preparation and discussion impossible. Moreover, relevant sections of the minutes were redacted. The board of directors also failed to monitor the subsequent sales process adequately. For example, no written purchasing contract was concluded, and no investigation was conducted into the fairness of the purchase price prior to the sale.

Inadequate risk management when granting loans

Deficiencies were also uncovered in the granting of loans to the former CEO and individuals closely associated with the bank or its shareholdings. Exceptions were made to the bank’s internal lending guidelines, and existing processes and the views of internal control functions were overridden. Contrary to the bank’s policies, a loan to the former CEO for the full financing of his holding in Investnet Holding AG was not approved by the relevant committee of the board of directors. In another case, a substantial unsecured loan, which was granted on non-standard terms and should have been signed off by the board of directors, was approved by the executive board. In this case the bank also failed to identify cluster risks in so far as a member of a governing body of a shareholding and the company in question were not classified as associated counterparties despite their economic interdependence. The bank subsequently also miscalculated the regulatory capital. Overall, the bank’s risk management proved inadequate in these areas.

Inadequate controls on the spending of the former CEO

Supervision of the former CEO was also inadequate in other areas. Over a number of years, the former CEO paid high flat-rate fees to the consultant with whom he was closely associated, sometimes substantially exceeding the budget assigned to him as CEO. The board of directors, although aware of this overspending, never queried it. Moreover, even though some of the amounts involved were substantial, the board did not know what they were being used for.

Serious shortcomings in corporate governance

The board of directors of Raiffeisen Switzerland failed to adequately perform its function as the body responsible for overall managing, supervising and controlling the bank, particularly in the period from 2012 to 2015. The board neglected its duty to oversee the CEO by failing to enforce compliance with internal regulations. There was, for example, no disclosure or monitoring of the CEO’s personal shareholdings from 2012 onwards. As a result, the

board of directors enabled the former CEO, at least potentially, to make personal financial gains at the expense of the bank. In connection with the granting of loans, insufficient compliance with internal regulations caused the bank to take risky financial positions vis-à-vis external related parties. As regards the sale of the bank's stake in Investnet Holding AG to the former CEO, the board failed to recognise the former CEO's conflict of interest and entered into a transaction involving substantial reputational risks, thereby breaching supervisory law and its own conduct of business regulations in relation to conflicts of interest. In their totality, these breaches and failures to act constitute a serious violation of supervisory law.

Raiffeisen takes appropriate action

In the past two years, Raiffeisen Switzerland has taken a range of measures on its own initiative. FINMA is of the opinion that these measures, if rigorously implemented, will enhance the bank's corporate governance and its handling of conflicts of interest. The bank has embarked on an unbundling strategy with the aim of reducing high-risk role concentrations and conflicts of interest. In addition, the bank has announced or already made changes to the personnel of the board of directors. Raiffeisen Switzerland has also commissioned an internal investigation of relevant shareholdings and intends to act on the results of this investigation by the end of 2018.

FINMA orders further action

FINMA has a range of instruments at its disposal for restoring compliance with the law. It has decided, for example, that the board of directors of Raiffeisen Switzerland needs fresh blood and must strengthen its professional expertise. The bank must ensure that at least two members of the board have experience of the banking sector in keeping with the size of the institution. In addition, at least one member must have recognised compliance experience appropriate to the institution's circumstances. Members of the audit and risk committees, for their part, must hold appropriate qualifications. FINMA will appoint an audit agent to assess the appropriateness, implementation and effectiveness of the FINMA-imposed measures and of the action taken by Raiffeisen Switzerland itself to improve corporate governance and unbundle its shareholding structure. Raiffeisen Switzerland is also required to examine in detail the pros and cons of converting Raiffeisen Switzerland into a limited company, since a company's legal form and group structure have a significant impact on corporate governance requirements.

Action against private individuals

In 2017, FINMA launched proceedings against the former CEO of Raiffeisen Switzerland, before dismissing them as obsolete in December 2017. As the former CEO has publicly undertaken not to assume an executive management position in the financial sector at any time in the future, FINMA could not have achieved anything more by continuing with the proceedings and, for example, imposing an industry ban. Continuing with the proceedings would have been no more than a symbolic gesture.

The public prosecutor of Canton Zurich has taken up the case and has benefited from the work that FINMA has already done on it. The criminal proceedings launched by the prosecuting authorities and FINMA's two supervisory proceedings are likely to produce the best outcome in this case.

FINMA will delay decisions on whether to launch further proceedings against individuals in the context of this case until the results of the bank's internal investigation become available. Thus far, FINMA has no evidence that would justify launching enforcement proceedings against current officers of Raiffeisen Switzerland.