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Marlene Amstad, Chair of the Board of Directors

Stability – the foundation for innovation and sustainability

Ladies and gentlemen

The tragic news from the conflict in Ukraine is uppermost in our thoughts at this time. What would have been unthinkable for most of us until recently – war in Europe – has sadly become a reality. It cannot fail to touch us as human beings. But it also affects our work as a supervisory authority. How we have responded to recent events as supervisors and the tools we are using will be discussed by our Chief Executive Officer Urban Angehrn straight after my remarks. In this first part of today's annual media conference I want to take the opportunity to cast a spotlight on three of FINMA's central strategic objectives: stability, innovation and sustainability. Allow me to address them in turn, starting with what I regard as the foundation for successful supervision – stability.

Stability as a bedrock

Proving the benefits of regulation and supervision is not always easy. But they have been plain for all to see over the last two years. The world and the financial industry have faced two crises that posed and still pose stark challenges – the pandemic and now the war in Ukraine. There have also been some prominent one-off events with serious consequences for particular institutions – Archegos and Greensill, for example. Crises such as these highlight the benefits of adequate capital and liquidity reserves in ensuring the banks' stability.

FINMA's experience with the examples I have mentioned is that the institutions in the Swiss financial centre comfortably meet the stability test. The required buffers – the airbags as it were – were in place. Where necessary these buffers should now be restored to full strength. FINMA's commitment to ensuring the financial sector has adequate safety margins has never wavered since the global financial crisis in 2008.

We therefore know that regulation has helped to stabilise the financial institutions. But it is also worth remembering that a number of important elements of the post-financial crisis reforms have not been implemented yet. The final components of the Basel III reforms were approved in December 2017, which is now more than four years ago. But they have still not been implemented internationally or here in Switzerland. The required amendments to the Swiss Capital Adequacy Ordinance are to be put out for consultation this year. These relate primarily to raising the capital requirements for credit, market and operational risks and setting an output floor for the minimum capital to be held by banks using internal models. I would also like to explicitly mention the enhanced liquidity requirements for systemically important banks, which are set to enter into force in mid-2022, and form part of Switzerland's "too big to fail" regulation. What we saw during the global financial crisis was

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demonstrated once again during the pandemic, particularly in March 2020: cash is king. Banks need solid liquidity buffers as well as solid capital buffers.

The final Basel III reforms now need to be implemented quickly and in full. Let us at last complete the foundations that underpin the long-term stability of the financial institutions and the financial market. The recent past has taught us once and for all how critical it is to be prepared not just for good weather, but also for unforeseen crises.

The commitment to ensuring stable financial players remains FINMA’s core priority. Stable institutions and markets are the bedrock of our financial centre. The more robust these foundations, the more we are able to address the issues of the future, such as financial innovation. This brings me to the second topic I want to talk about today.

Innovation in the industry and supervision

Innovation relates both to how FINMA responds to growing digitalisation in the industry and how FINMA itself is digitalising. As far as digitalisation of the industry is concerned, we see it as our role to support the process constructively, while keeping a close eye on the risks. This is exactly what we have been doing for several years. FINMA was confronted with innovative business models early on. Enquiries about crowdfunding and bitcoin already began to roll in thick and fast from 2014. In response we launched the FinTech licence and set up FINMA’s FinTech desk, which made FINMA something of a pioneer internationally. The guidelines on ICOs and stable coins created clarity about the legal position in this area at an early stage.

FINMA has reached a number of further milestones over the last year, for example approving the first crypto fund under Swiss law. It also issued the first-ever licence for infrastructures that enable trading and settlement of digital securities in the form of tokens. These facilitate the multilateral trading of securities that can be held and transferred on a DLT infrastructure. The enactment of the Swiss DLT legislation is also worth mentioning. DLT trading systems differ from conventional exchanges in two main ways. Firstly, they can allow end-customers to participate and secondly, they can offer settlement and custodial services alongside trading. This combination of previously separate activities creates space for innovative new business models. But of course it also means there are extensive requirements for applicants to fulfil. To clarify the position, FINMA has published detailed guidelines on licensing as a DLT trading facility.

Looking back, much has already been achieved. Looking ahead, we see three main trends in innovation: new financial market participants, new assets and – probably the most challenging of the three – new infrastructures. Briefly on the new market participants first of all: internationally most of the talk is about Big Tech. At the moment Switzerland is only indirectly affected, as so far these players are only serving the Swiss financial market on a cross-border basis, if at all. FINMA’s main concern at present are the supervised financial institutions, which are increasingly offering crypto services. These offerings have become ever more complex and varied. As an example of his, you can see here a list of the virtual asset service providers (VASPs) on the Swiss financial market. These providers offer a whole spectrum of services ranging from fiat-to-crypto and crypto-to-crypto exchange, to transactions and custody of virtual assets, through to ICO services. In the case of new financial market participants FINMA keeps a particularly close eye on the anti-money laundering requirements. FINMA has therefore refined its expectations for auditors of institutions involved in crypto and expanded audit modules on virtual assets (VAs) and virtual asset service providers (VASPs).

New assets, which mainly means crypto assets based on DLT, also entail elevated money-laundering risks. These assets enable large sums to be moved around largely anonymously anywhere in the world in a matter of seconds. Crypto assets have roughly quintupled worldwide in just one year, while also exhibiting considerable volatility. At present the Financial Stability Board (FSB) does not classify crypto assets as systemically important, but recommends continuing to monitor developments carefully. The same applies to new infrastructures. This includes decentralised finance (or “DeFi”), the umbrella term for DLT-based business models. DeFi involves replacing traditional financial intermediaries with what are referred to as “smart contracts”. This creates a series of new challenges for the supervisory authorities worldwide.

How should we respond to this triple challenge of new financial market participants, assets and infrastructures? Wherever possible, FINMA seeks to apply the “same risks, same rules” principle. This principle enjoys broad consensus. Where regulation is needed, we do not need to reinvent the wheel. With regard to DeFi, the basic principle of responsibility is particularly important. Clear lines of responsibility are essential to protect financial market customers and the functioning of the financial market. Without clear responsibilities there can be no real innovation on the financial market. Offering decentralised services while at the same time being able to identify those responsible at all times will be a challenge.

Of course, digitalisation creates risks as well as opportunities. FINMA has consistently identified cyber risks as one of the main risks facing the financial centre for the last three years. In May 2020 we published guidance on the obligation to report cyberattacks. Around 100 reports have been received since then, with around half of these notifications relating to banks. FINMA also intensified its on-site reviews of IT and cyber risks in 2021 and carried out three times as many inspections as in 2019.

Given the increasing digitalisation of the financial market, supervisory authorities can only fulfil their mandates if they become more digital themselves. The challenges, but also the opportunities, are considerable and FINMA devotes significant resources to this work. One of the questions we are asked most often about FINMA’s digitalisation is whether this means RoboCop is coming. The answer is definitely not! Technology can increase people’s efficiency and effectiveness, but cannot replace human beings. Thus the on-site reviews will continue to be carried out by flesh and blood FINMA staff. But the decision about where our staff focus their attention will doubtless be increasingly supported by technology. Our approach is to exploit the benefits of digitalisation but leave the important final decisions to human beings.

FINMA’s role in sustainability

Alongside stability and digitalisation, sustainability is the hot issue of the moment and the third topic I want to discuss today. Within the space of just a few years, climate change has become a priority for many supervised institutions. So in conclusion, please allow me to share a few strategic thoughts on sustainability.

First of all, many of the issues are not settled and are still under discussion both nationally and internationally. One thing is already clear though: climate risk is a risk *driver*, but not a new risk *category*. The effects of climate change and the steps to protect the climate impact impinge on the classic risk categories of credit, market, insurance and operational risk in the financial sector. This means the financial institutions can build on their existing risk management, although it forces them to expand their toolbox in certain areas. FINMA’s expectations with regard to climate-related financial risks are no different from those in other areas, which is that the supervised institutions manage these risks appropriately. For its part, FINMA is integrating climate risks into its supervisory work following international best practice. It has therefore pledged to implement the recommendations of the Network for Greening the Financial System.

Within its mandate, FINMA has two main roles on the issue of sustainability: stability and preventing market abuse. Stability can on the one hand be affected directly, for example if climate-related natural disasters and their associated costs increase and lead to a rise in the claims ratio. This obviously affects the insurance industry first and foremost. On the other hand stability can also be affected indirectly – via transaction risks. Assets in particular sectors may become more illiquid or more volatile. Both raise valuation risks on financial institutions’ balance sheets. The effects of climate change can therefore lead to significant financial risks for supervised entities in the longer term. As well as managing these risks properly, FINMA expects institutions to disclose their main climate risks. We began enforcing the disclosure obligations on climate risks for large banks and insurance companies last year.

In terms of FINMA’s second role, the prevention of market abuse, in the area of sustainability this primarily means the prevention of greenwashing. In principle what we want to achieve here is pretty straightforward: it has to do what it says on the tin. Transparency is central when it comes to preventing market abuse. FINMA underlined this at the end of 2021 by publishing guidance on preventing and combating greenwashing in the funds industry and at the point of sale. However, FINMA’s supervisory powers are relatively limited when it comes to greenwashing. In retail investments, for example, it can only intervene where investors have clearly been misled. Even so FINMA has already had to intervene here in one or two cases. Allow me therefore to close this discussion with the observation that the potential legacy cases of the future are being created today. It is in the industry’s (and the supervisory authority’s) interest that sustainability is addressed in a manner that stands the test of time.

Looking to the future

In summary, events over the past two years have shown that the Swiss financial centre stands on strong and stable foundations. By this I mean firstly the financial and operating stability of the institutions we supervise. Secondly I mean stability in the sense of the reliability and predictability of the framework created by FINMA’s principles-based rules and how they are applied. Completing the final outstanding work on this framework quickly and in full is essential. Building on these solid foundations, I believe Switzerland is well-positioned to seize the opportunities offered by digitalisation and the inexorable drive for greater sustainability. Switzerland has everything it needs to ensure the financial centre remains stable, sustainable, innovative and competitive in the medium and long term.

Thank you for your attention today. Urban Angehrn will now set out how we as supervisors are responding to the current events surrounding the Ukraine conflict and the tools we have deployed.