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Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
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Best-in-class supervision in times of constant change

Key points

1. With respect to both financial services in the traditional sense and FinTech innovations, financial market supervision must be developed further and equipped with new powers for effective early intervention.

2. Proportionate and risk-based supervision is key, and this is particularly true when it comes to the supervision of innovations. It is more difficult to gauge the risks posed by new business models and technologies. FINMA's involvement ensures that the FinTech sector enjoys a good reputation. An important part of this is making sure that – in both the bank and non-bank space – FINMA has the statutory powers to carry out its own on-site supervisory reviews, as is already the case in insurance supervision.

3. Digitalisation, aggregation and disaggregation, open banking and non-bank financial institutions, or NBFIs – these are just a few of the biggest changes the banking sector has witnessed over recent years. As well as bringing new risks with them, they also accelerate the development of traditional risks.

4. Against this backdrop of accelerated change, in order to safeguard business models against new risks, institutions must invest in a clear business strategy, a robust risk culture, strong governance and proactive risk management.

5. The challenges for financial market supervision are the blurring of boundaries between banks and non-banks, new types of cyber attacks driven by artificial intelligence and quantum computing, geopolitical risks and mistrust triggered by social media.

6. The individual elements for successful financial market supervision in times of constant change are early intervention, a technology-neutral approach, an understanding of interplays, international cooperation and a functional approach.

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“Stability through change.” When I first learned of the theme for the 2024 Finance Forum Zurich, it immediately grabbed my attention. Let me show you over the next few minutes why this was the case.

Ladies and Gentlemen, I am delighted to speak to you today, from Zurich’s impressive Convention Center.

This is because...

- financial stability
- healthy growth in the financial sector
- and innovations and new technologies in the financial centre

...are all topics that I and my colleagues at FINMA focus on each and every day.

So what can you expect to hear over the next few minutes? The title of my speech is “Best-in-class supervision in times of constant change”.

And since we are addressing the issue of change today, let me first set out for you what the banking sector in particular has experienced by way of change over the past few years. Technological progress and innovations feature very prominently here. In a second step, I will address the risks that this change brings with it. And, lastly, I will focus on how FINMA is dealing with the new developments in the financial centre. This is the point where – as in previous speeches I have given – I will talk to you about best-in-class supervision.

For regardless of whether we are talking about the supervision of traditional financial services or of the very latest developments to come out of the FinTech world, one thing holds true: we have to constantly develop financial market supervision further. Particularly in times of change and transition, FINMA must ensure effective supervision – through new powers and the implementation of these powers in early intervention.

With regard to supervision in the area of innovation, let me stress in particular the importance of proportionate and risk-based supervision.

In this context, I would like to begin with a fact that is very important to me personally, or – to be more precise – let me clear something up from the outset:

➔ innovation and supervision are not conflicting elements!

Quite the contrary. For it is only within a framework of robust regulation and supervision that innovation can be successful, make a lasting contribution to the growth of the financial sector and, in particular, guarantee the best possible level of client protection.

It is precisely where risks that are arising through new business models and technologies are still difficult to gauge that we see the value of close involvement by FINMA for the reputation of the sector as a whole.

And as I am sure you can appreciate, ladies and gentlemen, risks are not set to abate against this backdrop of ever-accelerating change and innovation. Among the most major changes of recent years in my view are the following:

- Digitalisation:
  Technology has revolutionised the banking business. Process automation, cloud computing, data analysis and artificial intelligence have increased efficiencies, reduced costs and improved the client experience.

- Aggregation and disaggregation:
  Technological progress and regulatory changes have led to not only aggregation but also disaggregation of value chains in banking services – both inside and outside of the banking sector. While banks are reducing their services to focus on a specific area of their value chain, non-banks are moving into the market and offering clients a personalised and primarily digital experience. One consequence of this development is that traditional business models and income sources are being called into question.

- Open banking:
  Developments in banking have also led to a shift in client behaviour. Today, most of us have more than just one bank account, insurance policy or trading platform. What is new is that, with the open banking concept, with clients' consent third-party providers can use FinTech apps, for instance, to access banking data as well as data from other finance companies, making new, personalised financial services possible.

- NBFIs:
  NBFI stands for non-bank financial institution. Such institutions offer financial services but are not banks in the traditional sense. A combination of digitalisation and the unbundling of banking services is a distinguishing feature of NBFIs. This combination blurs the boundaries between traditional banks and the non-bank sector. NBFIs are thus reshaping the traditional banking sector by offering their clients a broad range of financial services such as lending, payment services and asset management, without necessarily being subject to the same regulatory supervision as traditional banks. This also poses risks for financial stability, as the NBFI sector is closely linked with the banking sector.

So as you can see, a lot has happened. Exciting and, in part, of major benefit for clients on the one side. On the other, however, linked with new risks that it would be wise to supervise.

And one thing that we must not forget: not only do traditional financial risks continue to exist, but they can unfold even more rapidly due to the combined effect of digitalisation, social media, artificial intelligence and high-performance computing, sparking, for instance, even faster liquidity outflows.

Technological change is increasingly leading to a shift in the business models of banks and non-banks, where fee-based income is playing a more important role, causing non-financial risks to move increasingly to the fore. These include cyber risks, risks of money laundering and sanctions, risks through third-party providers and reputational risks. Lastly, there is the risk that business models become obsolete much more rapidly – either through inaction or the pursuit of a non-sustainable strategy.

To cope with this accelerated pace of change and the attendant risks, institutions need, in particular, a clear business strategy coupled with a strong risk culture, good governance and proactive risk management. Robust compliance and the safeguarding of an institution’s own reputation are essential. It is only in this way that business models can be secured over the long term in this dynamic environment.

The challenges have increased for financial market supervision, too. By way of a few examples:

- The blurred boundaries between banks and non-banks make the monitoring of activities and processes more difficult. In spite of the fast pace of change, it is important that we do not lose sight of certain fundamentals. For the systemic risks that are connected with bank-like activities will not go away. We have to understand how credits are arranged outside of the banking sector and how banks and non-banks are networked with one another. And, if we are to ensure appropriate regulation and supervision, we must be in a position to identify all institutions that offer bank-like or equivalent services and recognise the boundary between banks and non-banks.

- Over and above this, the past few years have seen the emergence of a number of new risks that have the potential to destabilise the financial system. For example, if technologies such as artificial intelligence or quantum computing are used for new types of cyber attacks. Or if social networks amplify a crisis of confidence, sparking a digital bank run and leading to panic withdrawals within a very short space of time.

- Geopolitical risks call for a strong focus on the interplay between sanctions and money laundering risks.
  Such risks have also increased the frequency and intensity of cyber attacks, in particular by government agencies. Furthermore, geopolitics also give rise to risks for economic development.

How does the supervisory authority deal with these challenges? I believe we have to focus on the following elements:

Early intervention:

In order to meet the challenges, solid regulation and early intervention are vital crisis prevention instruments. The supervisory authorities must apply an approach that is more heavily geared to quality-based factors and focus more intensively on further aspects such as corporate culture, corporate governance and business models.

It is here that the root of the problems experienced by banks and other financial institutions can generally be found; namely, in weaknesses in risk culture, governance and business models.

Here, typical red flags make it possible for the supervisor to identify problems early on. For time is of the essence in such cases, and suitable intervention instruments may need to be deployed. Early intervention and targeted measures allow problems to be resolved at an earlier stage, before they impact the entire institution and – in extreme cases – taxpayers.

Risk-based and proportionate supervision:

The supervisory authority must use its resources effectively and in a risk-based manner. This means applying a differentiated approach depending on the risk, scale and level of systemic importance involved. Where we see potential risks, however, we must also be able to go into sufficient depth by – inter alia – making greater use of our own on-site reviews.

At this point, let me mention the approach involving “known knowns”, “known unknowns” and “unknown unknowns”. This concept has proved its worth and is very relevant for dealing with supervisory-related risks. “Known knowns” are – as the name suggests – risks that are already visible – for example an undershooting of minimum capital and liquidity requirements – where the supervisor essentially has to decide how to react appropriately. Then there are “unknown unknowns”. These are risks that could not have been anticipated, such as the coronavirus crisis. The only way to prepare for such unknown unknowns in advance is to increase the resilience of institutions and the system in general, with, for instance, sufficient capital and liquidity buffers.

Above all, however, it is with “known unknowns” that the supervisory authority has to go more in-depth on a precautionary basis. “Known unknowns” are risks that we are know are already lurking somewhere just below the water line or starting to gain momentum. What we have to do to find these is apply a smart approach. By this I mean that, among our body of institutions, there are no doubt some that have concentration risks in their credits, that do not capture their credit or underwriting risks properly or that have serious shortcomings in the entry and reviewing of their money laundering or sanctions risks. There are no doubt also differences between institutions when it comes to preparedness for cyber risks, and many more examples from other risk areas.

To identify and alleviate these “known unknowns” ahead of time, the supervisory authority has to apply risk-based filters using data and interactions with the institution and, if any warning lights start to flash, has to itself become active at an early stage. For example, in the case of valuation risks in lending business, the supervisory authority may have to test a random sample of credits in order to ascertain whether value adjustments are prudent enough to cover the default risk. At institutions where risk-based filters are potentially signalling increased risks of money laundering, an in-depth on-site review must also encompass a representative random sample of clients and determine whether, for example, the necessary onboarding checks were carried out. In the absence of such risk-based on-site reviews, “known unknowns” remain just that: unknowns. And the risk for the financial institution and, in extreme cases, for Switzerland’s financial system remains unnecessarily high.

In-depth on-site reviews are standard procedure for the world's major supervisory authorities. In Switzerland, although on-site reviews have been available to us as an instrument for some time now, in the banking sector the involvement of audit firms is subject to certain statutory requirements. Unlike in the insurance sector, where there are no restrictions, Article 23 of the Banking Act limits the supervisory authority's discretionary scope for carrying out in-depth on-site reviews at supervised institutions on a preventive basis. Removing this legal hurdle allows the supervisory authority to carry out in-depth reviews at its own discretion wherever it judges the risks as being too high – even if there is as yet no obvious sign of a fire risk. Where it continues to rely on auditors, it must be able to appoint them directly to avoid conflicts of interests as much as possible.

Technology-neutral approach:

At FINMA, supervision and regulation takes place independently of any technology, and we neither favour nor penalise any innovation based on the technology on which it is built. Key for us is that we develop clear rules with which new business models in the financial sector need to comply.

Understanding the interplays:

Given the level of interconnectedness in the financial system, it is essential that the supervisory authorities understand the relationships between not only banks, but banks and non-banks as well. Assessing potential systemic risks is also part of this.

International cooperation:

The global nature of the financial system means that more intensive international and cross-sector cooperation is required between the supervisory authorities. Elements that are involved here are the exchange of information, coordinated regulatory measures and the development of uniform standards.

Functional approach:

Lastly, in light of the pace of technological advances, the supervisor must be in a position to rapidly adapt to new situations. Legislation takes time, and – particularly in the area of FinTech – supervisory authorities have to react swiftly when faced with new developments.

The functional approach, which can be summed up with “same business, same risks, same rules”, enables FINMA to apply the existing principle-based elements to new developments. And although the existing regulation makes many different instruments available to us and the functional approach ensures timely reactions, fairness and consistency, there are still gaps that need to be closed. In Switzerland, for example, one such area where there is scope for improvement is the fact that stablecoin issuers are not supervised by FINMA if the claims of stablecoin holders are guaranteed by a bank. This gives rise to subsequent risks for both issuers and holders of stablecoins, as well as the guarantor.

Ladies and gentlemen, allow me to summarise:

Innovation and technological change have fundamentally altered the way financial services are delivered in the bank and non-bank sector, and this change is not only ongoing, it is accelerating.

This is giving rise to new risks, especially of a non-financial nature, and the institutions will need to proactively manage these risks, by means of – in particular – a strong risk culture, governance and risk management.

FINMA is helping to ensure that the use of innovative technologies in the financial market is taking place in line with the regulatory framework and that the protection and trust of clients as well as the reputation of Switzerland as a financial centre remain at a high level over the long term.

A focus on risk mitigation and clear, binding rules creates trust. And trust is the key to the lasting success of innovations in Switzerland’s financial centre.

We must drive qualitative supervision and early intervention forward, on the foundation of robust but proportionate regulation.

This is especially true where problems usually begin with financial institutions, namely in weaknesses in risk culture, governance and in business models. The supervisory authority can use typical red flags to spot problems in these areas early on and then to act swiftly and – where necessary – intervene appropriately. Risk-based on-site reviews are an important instrument here, if we are to ensure that supervision reaches the necessary depth.

To do this, however, FINMA also needs new instruments, a clearer statutory basis and, most likely, more resources. In other words, it needs the full range of powers – a complete toolbox – to be able to intervene early on and in a proportionate manner at the qualitative and quantitative level.

Thank you for your attention.