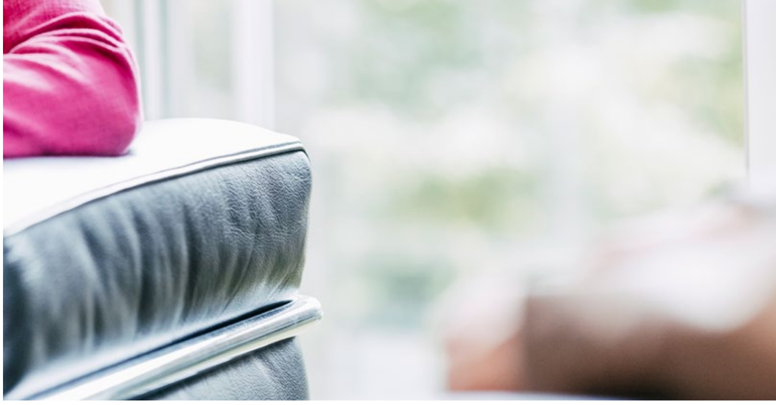
An innovative financial center is built on stability

Interview with Prof. Dr. Marlene Amstad, Chair of the Board of Directors of FINMA

In an interview with Prof. Dr. Reto Eberle, Prof. Dr. Marlene Amstad reflects on the past year. The major challenges for the industry include sustainability and digitalization – two topics that are also relevant for supervision. Recent events have led to a shift in the risk landscape for banks and insurance companies in Switzerland. Prof. Amstad emphasizes the importance of stability as the foundation of a future-oriented financial center and explains which two sustainability topics are particularly relevant in this context.

***Prof. Dr. Reto Eberle:** Professor Amstad, you became Chair of FINMA's Board of Directors on 1 January 2021, right in the middle of the pandemic. Taking over the lead of a strategic governance body is intrinsically challenging. What was particularly important to you in terms of governance of FINMA and the Board of Directors?*

Prof. Amstad: In principle, what applies to the institutions we supervise also applies to FINMA. There need to be independent governance bodies and effective control mechanisms in place, i.e. a strong board of directors and a strong executive board, both of which fulfill their roles. The pandemic was indeed a challenge for many, including us, in terms of how we work. Supervisory work thrives on direct exchange. Besides, personal contact and dialogue with colleagues is also extremely important within our organization. FINMA was well prepared and managed to switch to digital communication and tools very quickly. Our reviews and controls took place digitally rather than on site. In the Board of Directors, we also deliberately took more time for discussions during this phase.



“Strengthening institutions’ risk management and corporate governance is a special focus for us.”

From the FINMA Board of Directors to the boards of supervised institutions – where do you see the differences between corporate governance in general and supervisory corporate governance at banks and insurance companies?
Many principles of corporate governance apply regardless of industry. In the case of financial institutions, however, weaknesses in corporate governance can have consequences that extend far beyond the institution itself. This is a reason why the financial industry is especially well regulated. For example, the executive management of supervised institutions must permanently guarantee irreproachable business conduct – this is a prerequisite for licensing. In order for executive management members to fulfill their roles as ultimate management or supervisory bodies, it is important that the body as a whole is diverse enough. In addition, there are certain requirements that depend on the specific business alignment and complexity of the institution. Also important are the size and composition of the board as well as the qualifications, experience and availability of the individual members. In our experience, the latter criteria regularly trigger discussions in the supervisory conversation when there is a change in the board members at an institution.

Despite the many corporate governance requirements, there have been scandals in the banking sector in recent years (in connection with Petrobras, the Malaysian sovereign wealth fund 1MDB and most recently one of the major banks). To what extent do these have their roots in the board of directors? Could one solution be tightening up personal accountability, as we see in the UK or Hong Kong with the senior managers regime?
FINMA has effective instruments at its disposal to enforce regulatory requirements – and uses them consistently. For example, we conduct an average of around 80 enforcement investigations and around 10 proceedings per year. Statistically, then, we conduct investigations at around 10% of supervised institutions and enforcement proceedings at around 1.5%. Strengthening institutions’ risk management and corporate governance is a strategic goal that FINMA has been pursuing with a special focus for years. In line with this, we are currently analyzing and discussing possible optimizations in this area. For example, issues relating to the personal responsibility of managers, such as the senior managers regime, or the authority’s power to impose fines, both of which have already been initiated by parliament. In principle, we are open to additional requirements or instruments. But no instrument comes only with advantages. It is therefore important that any instrument effectively serves the enforcement of our mandate overall. Ultimately, however, this balancing of interests is the responsibility of the legislature, which decides on our toolbox.

In its annual risk monitor, FINMA provides an overview of the most significant risks for supervised entities. In November of last year, these included the low interest rate environment, a possible correction in the real estate and mortgage market, cyber attacks and the battle against money laundering. The first three risks in particular have become accentuated since the beginning of the year. How well were the banks (and insurance companies) prepared for these risks?

All four of the risks you mention are still relevant, and some of them are increasing, as you say. Accordingly, we expect supervised institutions to manage them appropriately in light of their specific business model and risk profile. However, it is not possible to make a blanket statement about how well this is being done. Rather, FINMA analyzes the risks with a view to each individual institution. And we dose our supervisory activities and intensity according to the risks of the institutions. We take a closer look at those institutions and areas where we see greater risks and, if necessary, also prescribe measures. The goal is always to ensure that the institutions are stable at all times. This means that they are appropriately organized and have taken precautions, for example in the area of cyber security. But it also means that they have adequate capital and liquidity. This is particularly true with regard to any challenges in the real estate and mortgage markets.

Last year's risk monitor addresses climate risks for the financial sector as a longer-term trend. That insurance companies are affected by growing environmental damage is obvious. As is the likelihood that certain investments will lose value in light of climate policy. What were the reasons behind FINMA's May 2021 circular setting out in more detail the transparency requirements on climate risks? Were the existing (financial reporting) standards not sufficient, especially since the circular is based on the TCFD recommendations?

FINMA is pursuing two strategic directions with regard to the sustainability of the financial center. On the one hand, the focus is on the stability of financial institutions, i.e. the integration of the financial risks of climate change, for example, into risk management. FINMA expects specific disclosure requirements to increase the transparency and comparability of climate risks. In the future, the largest banks and insurance companies will have to describe the main climate-related financial risks and their impact on the business strategy, business model and financial planning. They must also disclose the process for identifying, assessing and managing climate-related financial risks, as well as quantitative disclosures. Finally, institutions must describe the key features of their governance structure in relation to climate-related financial risks. This goes beyond the previous financial reporting standards.

“It’s important to take advantage of digitalization, but the key final decisions must be left to humans.”

... and the second direction?

On the other hand, FINMA wants to protect against abuse, against greenwashing. The main objective here is to ensure that investors are not misled about what may only be the supposed sustainability of financial products or the provision of financial services. With all these measures, FINMA is contributing to the sustainability of the financial center.

In an interview with the newspaper NZZ in February 2021, you talked about the turn of an era and also referred to digitalization, the latter of which plays a major role at FINMA itself. You also outlined what “supervisory technology” means in the magazine “Die Volkswirtschaft.” Now, we know that the use of artificial intelligence and machine learning is highly promising, but it’s also more complicated, time-consuming and costly to implement than expected. What experience has FINMA gained with the use of new technologies in the supervisory context and what are the associated risks?

In view of the ongoing digitalization in the financial market, supervisory authorities can only fulfill their mandate if they understand something about the subject and also become more digital themselves. New technologies can increase the efficiency and effectiveness of supervisory activities, by speeding up or simplifying decisions and by helping our employees pinpoint where to focus their attention. For example, FINMA has used digitalization to significantly shorten the duration of the licensing and monitoring process for collective investment schemes. Another example is supervision: quantitative evaluations make it possible to monitor around 200 smaller banks on a risk-based basis with relatively few employees. But on-site inspections will continue to be carried out by flesh-and-blood FINMA employees and not by some robocop. It’s important to take advantage of digitalization, but the key final decisions must be left to humans.

At last year's "Tag der Versicherer" (Insurers' Day), you mentioned that Switzerland has everything it takes to be a stable, clean, innovative and thus sustainably competitive financial center. What's needed to successfully meet future challenges, including the two we have addressed (sustainability and digitalization)? And how far are we currently along this path, not least against the backdrop of the recent upheaval caused by the war in Ukraine?
Stability is the foundation on which the financial center can build further and stay innovative. By stability, I mean the financial and operational stability of the supervised institutions on the one hand. This is not a foregone conclusion and is something that needs working on day in, day out. Various institution-related events in the recent past have highlighted this, as has the uncertainty caused by the COVID crisis and the war in Ukraine. On the other hand, I also consider stability to include the predictability of the framework conditions, which comes from the provision of principle-based rules and the application of those rules by FINMA. In both areas, I see the Swiss financial center as well positioned to be competitive and innovative.

Reto Eberle: On behalf of the Board Leadership Center and the readers of our newsletter, I would like to thank you for the interesting and insightful discussion.

Prof. Dr. Reto Eberle
Partner, Member of the Board Leadership Center
KPMG Switzerland

+41 58 249 42 43
reberle@kpmg.com

About Prof. Dr. Amstad:

Marlene Amstad (1968) has been a member of FINMA's Board of Directors since 2016, was appointed Vice-Chair in 2018 and Chair in 2021. She is an Honorary Professor at the University of Bern, Senior Fellow at Harvard and a board member of the International Organization of Securities Commissions (IOSCO).
(Source: cv-vr-amstad.pdf (finma.ch))

About FINMA:

FINMA is Switzerland's independent financial-markets regulator. Its mandate is to supervise banks, insurance companies, financial institutions, collective investment schemes, and their asset managers and fund management companies. It also regulates insurance intermediaries. It is charged with protecting creditors, investors and policyholders. FINMA is responsible for ensuring that Switzerland's financial markets function effectively.
(Source: https://www.finma.ch/en/finma/finma-an-overview/)

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