finma
Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

FINMA Risk Monitor 2021

Contents

Monitoring risk: central to forward-looking oversight of the financial markets

The Swiss Financial Market Supervisory Authority FINMA is an independent public supervisory authority with the legal mandate to protect investors, creditors and policyholders and ensure the proper functioning of the financial markets. It thereby contributes to enhancing the reputation, competitiveness and future sustainability of the Swiss financial centre.

The main focus of FINMA's work is the supervision of the financial sector. This is designed to ensure that the supervised financial institutions remain stable and successful going forward, given the possible risks they are facing. Assessing the risk position of individual supervised institutions is therefore a critical part of FINMA's supervisory activity. This makes its supervisory focus essentially forward-looking.

FINMA is publishing a Risk Monitor for the third time. This will create additional transparency both for supervised institutions and the wider public about how it fulfils its statutory responsibilities.

The Risk Monitor provides an overview of what FINMA believes are the most important risks currently facing supervised institutions over a time horizon of up to three years. Arrows indicate how these risks have trended since the last Risk Monitor. The Risk Monitor also describes the focus of FINMA's supervisory activity on the basis of prevailing risks. In addition, it contains an update on climate risks, which were explored in detail in the 2019 Risk Monitor based on longer-term trends and risks, with an additional focus here on the issue of "greenwashing".

Six of the seven principal risks cited in last year's Risk Monitor remain the same: the persistently low interest rate environment, a possible correction in the real estate and mortgage market, defaults or corrections in connection with corporate loans and bonds abroad, cyberattacks, money laundering and increased impediments to cross-border market access. The seventh principal risk from last year's Risk Monitor was a disorderly exit from the era of LIBOR reference rates. On the basis of progress made by supervisory entities, this risk has now been downgraded and is no longer considered a principal risk. It is therefore highlighted for a final time in this issue of Risk Monitor without the associated future measures.

Coronavirus pandemic

The financial markets remain heavily influenced by expansionary monetary policy on the part of central banks, which was relaxed even further to combat the consequences of the coronavirus pandemic, as well as by further support measures for the economy. Existing economic imbalances – such as the growing debt of companies and governments alike, and dependency on economic and monetary policy measures – have increased further as a result of the pandemic. The level of vulnerability and the risk of abrupt corrections to these imbalances therefore remain high. The coronavirus pandemic has had an impact on all six principal risks in the Risk Monitor.

Note

The risks referred to above and the focal points of FINMA's supervisory activity are not an exhaustive list. Other risks not cited may also be (or become) very significant. This Risk Monitor is expressly not intended as a basis for investment decisions. Moreover, it should be emphasised that the occurrence of extreme events ("tail risks") is always possible, including in connection with risks that FINMA has categorised as fairly modest and therefore not included in the Risk Monitor.

Principal risks

FINMA takes a risk-based approach to supervision. The intensity of its supervision is dictated firstly by the risk posed by each financial market participant, and secondly by the primary risks apparent in the current environment. This section discusses the six principal risks identified by FINMA for its supervised institutions and the Swiss financial centre over a time horizon of up to three years. The greatest change in risks compared to the last issue of the Risk Monitor relates to LIBOR, which will cease to be published for Swiss francs and euros at the end of 2021. FINMA no longer considers this issue to be a principal risk due to the progress made by financial institutions in preparing for replacement reference rates. The arrows in the section headings indicate changes compared to last year's issue of the FINMA Risk Monitor: The risk has increased (↑), remained the same (→), declined (↓) or no longer appears in the listing of principal risks (has been removed from the list of principal risks altogether).

Low interest rate environment (→)

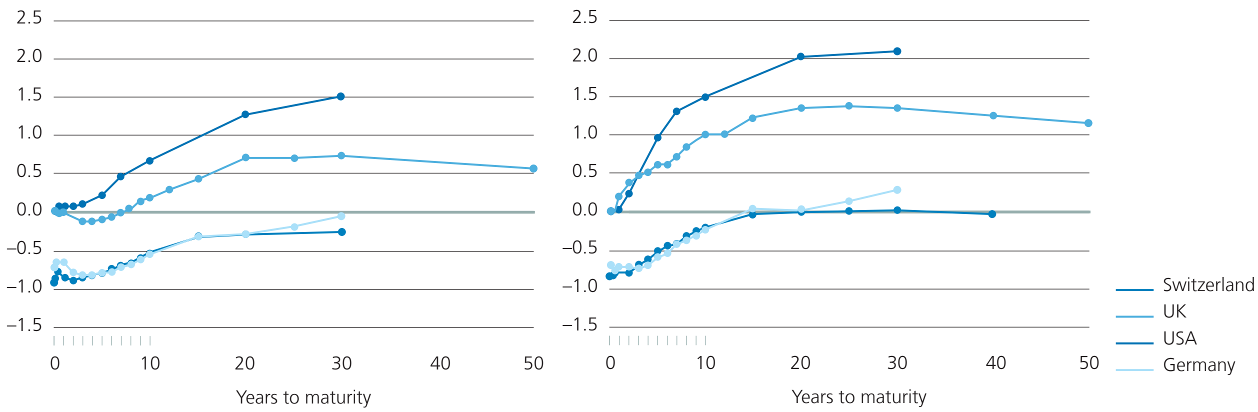
Persistently low interest rates in Switzerland and the main currency regions are adversely affecting the profitability of supervised institutions. This situation increases the risk of price bubbles in various asset classes and the risk of a sudden correction, with the potential to call certain business models into question in the medium term. Moreover, the low interest rate environment may obscure investors' assessment of potential risks – a problem further exacerbated by the ongoing coronavirus pandemic. FINMA is therefore continuing to pay close attention to the associated risks.

Negative interest rates have been a feature of the Swiss money market for more than a decade. For many years now, almost the entire Swiss franc yield curve has languished in negative territory, as is apparent from the two graphs below. The graphs also show that long-term interest rates in Switzerland are

Government bond yield curves

As at 30 September 2020, in % p.a.

As at 30 September 2021, in % p.a.



Source: Refinitiv Datastream

lower than in other currency areas. An upward movement has been apparent in yield curves since February 2021, but these curves remain at very low levels.

The potential consequences of the low interest rate environment affect four areas in particular:

1. Profitability and business models: A persistently low interest rate environment with negative real interest rates and a flat yield curve could squeeze the banks' profitability due to the erosion of net interest margins, or prompt them to take on excessive risks. Indeed, a number of banks are increasingly attempting to reduce their dependency on the lending business. However, the more frequent response to this problem is the increased use of hedging instruments to stabilise net interest rates. Life insurers are also affected – on the one hand because policies taken out in the past contain significant interest rate guarantees that are becoming increasingly difficult to honour; and on the other hand, because acquiring profitable new business is increasingly onerous. If interest rates were to stagnate at their current low levels for a long time, this would remain a risk for certain business models. Financial institutions will increasingly be forced to reduce their costs or seek economies of scale, either individually or through consolidation. Moreover, there is a danger that such measures will not be sufficient, or that the corresponding strategic decisions will not be taken in time.
2. Customer behaviour: The longer the low interest rate environment persists, the greater the probability that the banks will be inclined to pass negative rates on to broader segments of their client base, or adjust their fee models accordingly. The likelihood of customers resorting to evasive measures – including migration to the FinTech and BigTech sectors – looks set to increase as a result. These alternative sectors may try to tempt customers with products that offer a more attractive service or higher returns than bank deposits. In such a scenario, the banks would see a stable source of refinancing erode. That said, customer behaviour remains a difficult thing to predict.
3. Distorted perception of risks: Low interest rates distort the perception of risk on the part of financial market participants. The risk premium for a product may be perceived as relatively low by investors or the banks, even though the underlying risk is actually significant in reality. This can result in misplaced incentives as well as asset price bubbles as investors chase higher returns. An abrupt rise in interest rates could lead to higher volatility and losses, with the corresponding consequences for investors and financial institutions alike. The latter must counteract this risk, primarily through adequate risk management, sufficient capital and proper client disclosure.
4. Misselling: Misselling denotes the practice of deliberately misleading customers when presenting a financial product or financial service during the advisory process, or failing to alert customers sufficiently to certain product features. The risk of misselling is greater in a low interest rate environment. Financial intermediaries may be tempted to sell products with low risk premiums as "risk-free", even though these products actually come with significant risks attached. Misselling can have legal consequences for financial market participants.

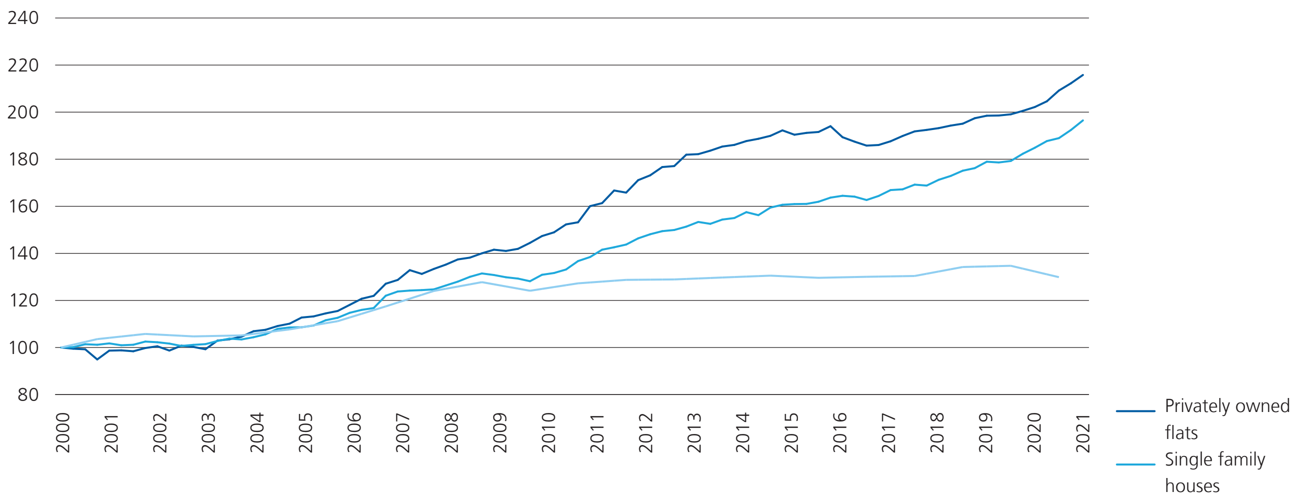
Correction in the real estate and mortgage market (↑)

The real estate market has proved resilient in the face of the coronavirus pandemic, not least thanks to government support packages and monetary policy interventions. Indeed, mortgage volumes have actually increased further. The investment property submarket shows indications of overheating, while investor and user markets have diverged in recent years. By contrast, vacancies have declined over the last year. However, this does not change the general risk appraisal. Price growth has accelerated further in the owner-occupied housing market, with property prices having increasingly decoupled from income development.

Negative interest rates pose a risk of bubbles developing in various asset classes, particularly in the real estate market. In the investor market, property remains coveted as an investment, as it at least promises positive returns in a persistently low interest rate environment. Due to the declining demand for commercial and office premises as a result of the coronavirus pandemic, investors are focusing their attention even more strongly on the residential property segment. This is subjecting residential property prices to upward pressure. Demand in the user market has remained stable over the reporting period. However, there is evidence of a shift in demand towards larger apartments, a phenomenon triggered by the surge in working from home during the pandemic. Vacan-

Real estate prices and income (indexed)

Indexed to Q1 2000 = 100



Change in real estate prices and development of income (GDP per capita). Source: Wüest Partner, IAZI, FSO cies have declined recently in both the rental and ownership segments. On the one hand, net immigration has remained high due to the fall in the number of people emigrating during the pandemic, while on the other construction activity has declined. Risks have not increased in the residential property sub-market as a result. However, it is too early to call a trend reversal in the user market.

The price of owner-occupied housing has once again risen strongly since the outbreak of the coronavirus pandemic, namely by some 6% annually (see graph on page 7). The pandemic has increased the importance of the home, particularly as working from home allows employees to consider property purchases further away from the workplace. The demand for home ownership has increased as a result, and has been additionally spurred by record-low mortgage interest rates. Supply has been scarce for years, which has further fuelled price growth. But this price momentum has further increased the divergence between property prices and incomes, which suggests a bubble is building.

Whereas economic output slumped during the coronavirus crisis, mortgage volumes increased further. As a result, the mortgage debt to GDP ratio in Switzerland has increased further. Total debt as a proportion of economic output has been increasing for years, which increases risks in the system. On the other hand, the intensification of self-regulation by the Swiss Bankers Association[1] – which took effect on 1 January 2021, and is considered by FINMA as the minimum standard – has had some impact. For example, the risk profile with regard to the loan-to-value ratio of newly granted mortgages for investment properties has improved. In other words, the size of the average new mortgage granted has decreased in relation to property prices. Analysis of the risk profile of existing mortgages is not possible, however, as the corresponding data is lacking. Moreover, the self-regulation guidelines do not apply to the "buy-to-let" segment[2] hence the risk profile here is likely to be higher.

The development of newly granted mortgages continues to exhibit increased affordability risks. In the area of outstanding mortgage loans, the data required to undertake an appraisal of financial stability risks in the mortgage market and an improvement in prudential oversight is lacking. One macroprudential instrument in this area is the countercyclical capital buffer (CCyB), which increases the banks' freedom of manoeuvre and resilience in a crisis. The CCyB counteracts imbalances in the mortgage and real estate market. It is currently suspended, but can be reactivated by the Federal Council subject to an application from the Swiss National Bank following consultation with FINMA.

The consequences of a real estate crisis would be significant for the Swiss financial centre. Stress tests carried out by FINMA show that a real estate crisis involving sharp price corrections could lead to losses in double-digit billion territory, with the result that just under half of the banks in the random sample would no longer fulfil minimum capital requirements. As mortgages are the most important pillar of business for the majority of banks, this would have significant consequences for financial stability. Insurers too would suffer painful losses in their mortgage and real estate portfolios in the event of a real estate crisis. In addition, liquidity measures and a need to reduce risk could force insurers to sell off real estate investments. This would have the effect of further intensifying the slump in property prices. For real estate funds, price corrections would entail valuation losses and the resulting fund outflows, which could in turn trigger liquidity problems.

[1] Guidelines of the Swiss Bankers Association on minimum requirements for mortgage loans, August 2019.
[2] Real estate segment in which a property is purchased with a view to renting it out to a third party.

Defaults or adjustments to corporate loans or bonds abroad (→)

Corporate bond credit spreads have narrowed since their dramatic widening in the first quarter of 2020. Premiums for investment-grade and high-yield borrowers have been at around the average for the last few years. Credit quality continues to be a particular problem for companies that have had to restrict their operations due to health policy measures (such as travel restrictions), e.g. those in the tourism and transport sectors.

The coronavirus pandemic and the associated health policy precautions have led to many companies around the world suffering declines in sales and earnings, in some cases dramatically so. Various economic policy measures have been introduced to cushion the blow, particularly in developed countries. Should the health policy restrictions remain in place for longer or if economic policy measures are withdrawn abruptly, risks could emerge. These would be generally higher in countries with a more constrained policy space. Accordingly, corporate loans and bonds abroad need to be carefully monitored.

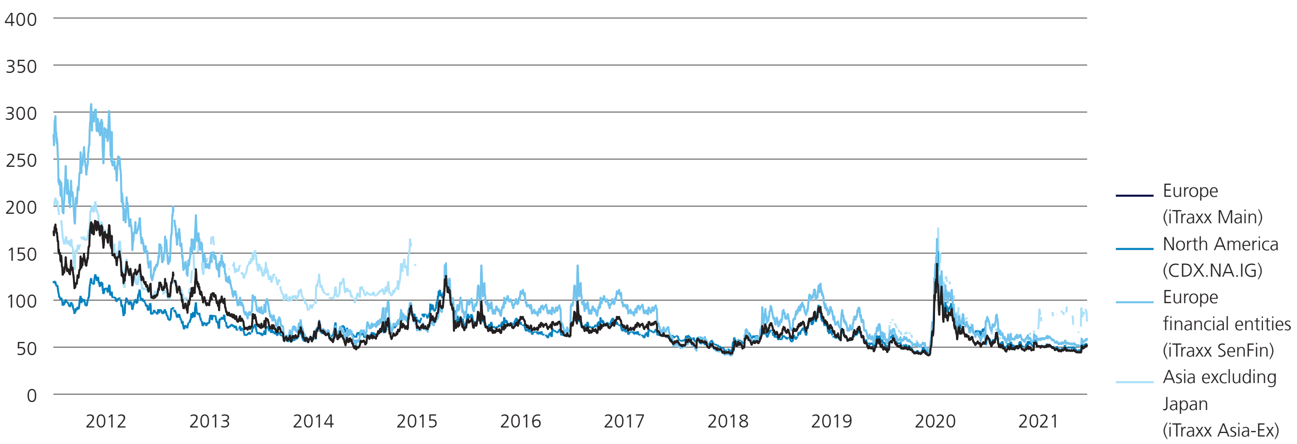
On top of this comes the risk that the economic support measures in place are having the effect of delaying necessary structural change, while at the same time exacerbating corporate indebtedness. Should interest rates rise or the support be withdrawn, these companies could go bankrupt.

Possible defaults or corrections in the market for corporate credits and bonds would affect banks and insurers in equal measure.

– Banks: Defaults in the international corporate credit business will in all probability increase. Globally active Swiss banks, especially the two large banks, grant loans to corporate clients outside Switzerland that are not (or only partially) sold on to investors. As a result, the risks of impairments to these loans remain on the balance sheets of the banks, at least in part. Internationally active Swiss banks are also active in the area of leveraged finance (primary granting of corporate loans for a credit-financed company takeover). They bundle and syndicate loans to sell to investors with relatively high risk appetite, among other things due to low interest rates. Risks can also

Benchmark Credit Default Swap (CDS) Indices Investment Grade

Basis points p.a.



Source: Bloomberg

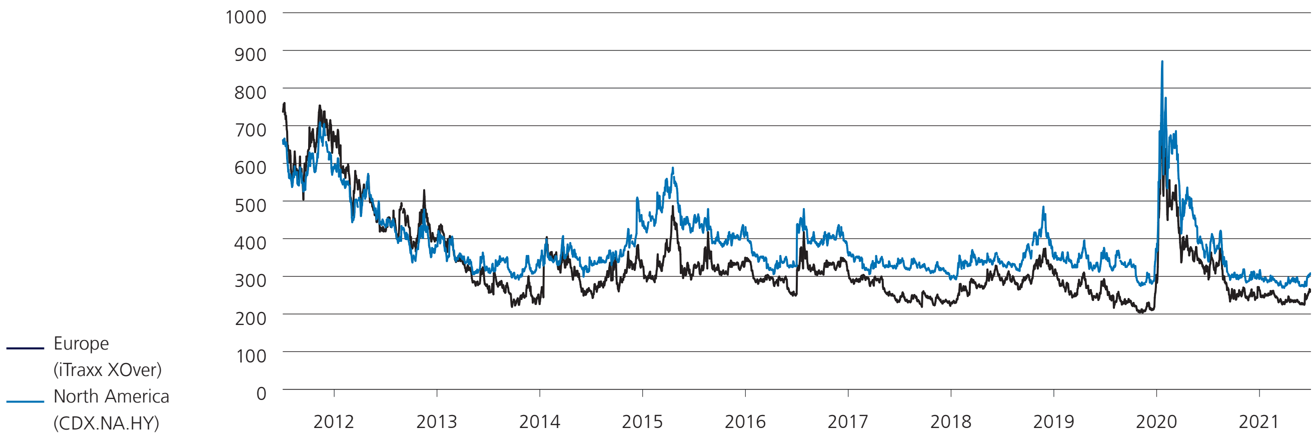
materialise in other areas of investment banking. Examples of major defaults in the international lending business include the family office Archegos, the financing company Greensill and the Chinese real estate company Evergrande. Some Swiss banks were also affected by these developments.

– Insurers: Widening corporate bond spreads have only a moderate impact on tied assets. However, any significant exacerbation of this situation could greatly increase the probability of default with the attendant losses in tied assets too. As bonds tend to account for a large proportion of tied asset portfolios, a certain amount of portfolio switching would be required for insurers to continue meeting their promises. On the basis of market-consistent valuation as per the Swiss Solvency Test (SST), substantial price corrections in corporate bonds would lead to a reduction of both risk-bearing capital and the SST ratio at many insurers. However, as at the end of 2020, an average of less than two per cent of insurers' investments were in sub-investment grade corporate bonds (rated below BBB–).[3]

[3] Includes bonds without a rating.

Benchmark Credit Default Swap (CDS) Indices High Yield

Basis points p.a.



Source: Bloomberg

Cyber risks (→)

The coronavirus pandemic has given an extra boost to digitalisation. However, greater digitalisation also increases the dependency on information communication technologies, which can give rise to significant vulnerabilities at Swiss financial institutions. For example, IT system outages and disruptions, particularly those resulting from cyberattacks, can jeopardise the availability, confidentiality and integrity of critical services and functions. Depending on the nature of the cyberattack in question, this can have repercussions not only for individual financial institutions but on the functioning of the Swiss financial centre as a whole. The pandemic has increased these vulnerabilities, as the proliferation of working from home has opened up new weak spots for attackers, for example. Risk therefore remains high in this area.

Cyber risks have been all too apparent once again in 2021. A number of successful cyberattacks on established companies in Switzerland and elsewhere have made the headlines. Examples of this in 2021 include the successful attacks on the US company Colonial Pipeline in May and on a Swiss municipal administration in August. Attackers are becoming ever more professional, as well as increasingly organised in their approach. This makes the effective prevention and combating of these attacks more important, which in turn poses major challenges.

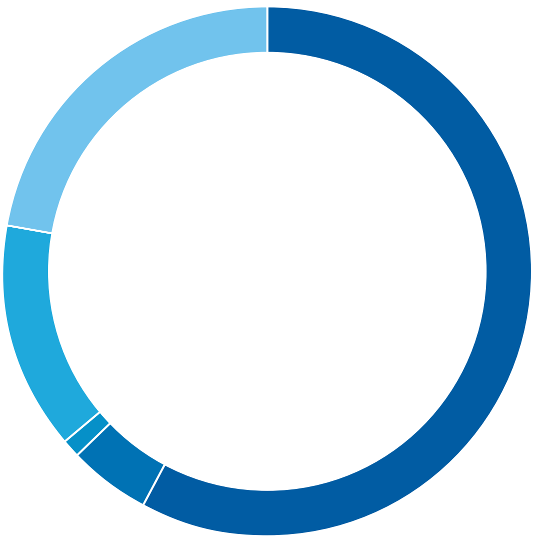
The various reports on cyberattacks received by FINMA in keeping with its Guidance 05/2020 "Duty to report cyberattacks pursuant to Article 29 para. 2 FINMASA" make this all too clear. In the first year since entry into force of this guidance, no fewer than

Breakdown of cyber reports received by FINMA

Type of attack

in %

- DDoS: 58
- Misused identity: 5
- Misuse/inappropriate use of technology infrastructure: 1
- Malware: 14
- Unauthorised access: 22

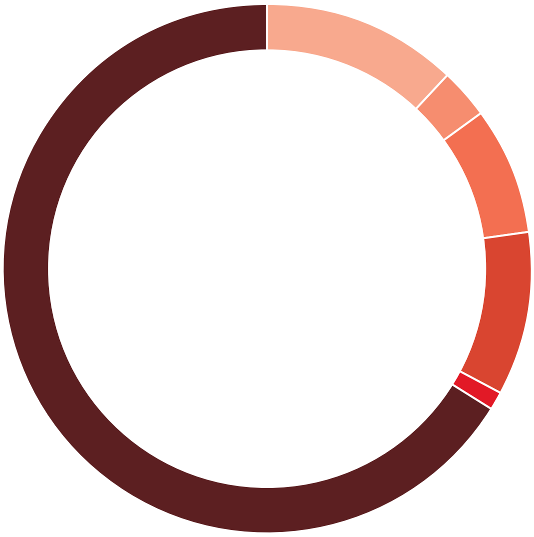


Source: FINMA

Attack vector

in %

- Exploitation of software vulnerability: 12
- Email: 3
- External service provider (outsourcing): 8
- Identity theft: 10
- N/A: 1
- Web-based attack: 66



Source: FINMA

80 cyberattacks have been reported to FINMA. More than a half of the reports received by FINMA relate to attacks on availability through Distributed denial of service (DDoS). This situation occurs when a given infrastructure is blocked by a network of predominantly externally controlled computers. The second-largest type of attack after DDoS attacks is unauthorised access to the infrastructure of supervised entities, followed by attacks involving malware (see graph on page 11). The most frequent attack method was the web-based attack, which in most cases related to the above-mentioned DDoS attacks. A significant number of reports received by FINMA related to the exploitation of security gaps that were not addressed in a timely manner. Identity theft was a very common issue in connection with previous phishing attacks (see graph above). Since the start of 2021 there have been an increasing number of reports of successful attacks on the supply chains of supervised entities, with repercussions for outsourced critical data or key interfaces with third parties. Around 25% of reports submitted to FINMA related to this issue.

A successful cyberattack can have serious consequences for the functioning of the Swiss financial centre. It may, for example, delay the provision of a financial service or even render it impossible. For the financial markets to function properly, institutions that provide integrated or interlinked services are particularly important – e.g. financial market infrastructures, critical service providers of key IT systems for the financial centre and systemically important financial institutions. A successful attack on an institution of this kind could prove damaging not just to other financial institutions, but also to the Swiss economy as a whole. The reputational damage would be substantial, and confidence in the Swiss financial centre would be undermined. The effective prevention and combating of such attacks is therefore extremely important, including in the area of training for cyber risks and in connection with emergency processes for eliminating critical weak points.

Money laundering (→)

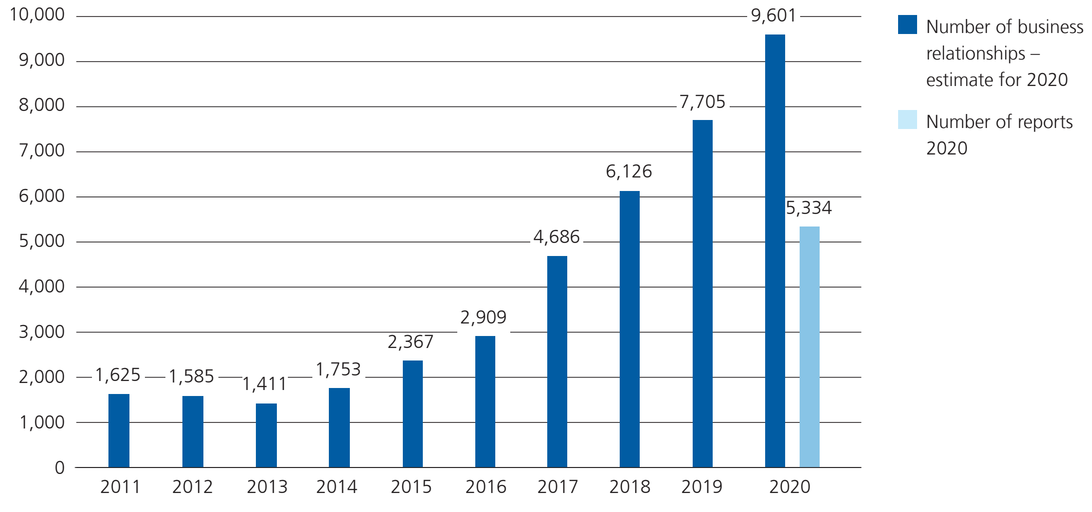
The Swiss financial centre is a leading global cross-border wealth management hub for private clients. This makes it particularly exposed to money-laundering risks. Breaches of due diligence and reporting obligations can result in major sanctions and reputational damage for financial institutions both in Switzerland and abroad. In the past year, money laundering risk has remained high.

A large number of new customers of the Swiss asset management industry are to be found in the emerging markets, where there is a significant threat of corruption. Recent global corruption and money-laundering scandals, as well as the numerous violations of money-laundering regulations by financial institutions, show that the risks for financial institutions involved in the cross-border wealth management business remain high. Experience has shown that the financial flows associated with corruption and embezzlement can involve not just affluent private clients, who often qualify as politically exposed persons, but also state or quasi-state organisations and sovereign wealth funds. The risks are increased further by complex structures that may impair transparency when it comes to identifying the beneficial owners of the assets concerned. These structures include the likes of domiciliary companies, fiduciary relationships and insurance wrappers.

In the past year, FINMA has been dealing with five enforcement cases in connection with the Venezuelan oil conglomerate PDVSA,[4] with three of these cases now closed. These cases clearly illustrated the following points: a bank's compliance framework must be adapted in line with risk appetite; institutions must establish the provenance of assets and whether the clients concerned really are the beneficial owners; and they must report any dubious relationships to the Money Laundering Reporting Office (MROS).

The increase in the number of MROS reports indicates a cultural shift as well as better monitoring systems, but also the continued existence of a number of very significant risks. The reports submitted to the MROS and the corresponding calculations reveal an increase

Number of reported business relationships 2011–2020[5]



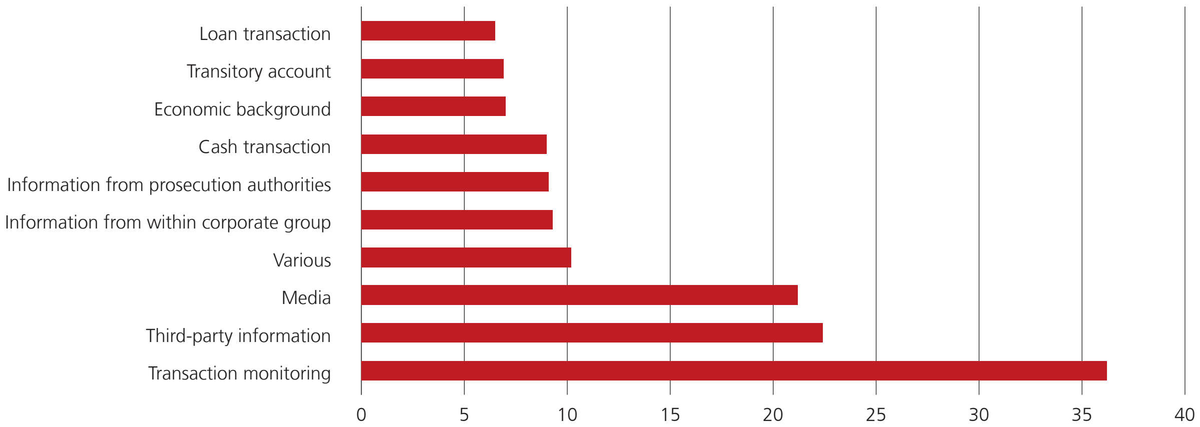
Source: Money Laundering Reporting Office Switzerland (MROS): Annual Report 2020

[4] Cf. breaches of money-laundering provisions: FINMA investigated the responsibility of various Julius Baer managers; https://www.finma.ch/en/news/2021/01/20210121-mm-jb/.

[5] As "goAML", a new system for reporting suspicious activities, was introduced in 2020, the calculation method changed. To facilitate comparison with the statistics from previous years, the MROS relies on the assumption that any report of suspicious activity submitted to the MROS by Swiss financial intermediaries for the 2019 financial year encompasses an average of 1.8 business relationships.

Main factors arousing suspicion in 2020

in %



Source: Money Laundering Reporting Office Switzerland (MROS): Annual Report 2020

of around 25% for the year 2020 (see graph on page 13). For the first time, moreover, transaction monitoring was the method that most frequently revealed suspicious conduct on the part of financial intermediaries (36%, see graph above). For many years, media reports were the primary source of information. This development could point to greater awareness and a more proactive approach on the part of banks when exercising their reporting obligations.

In addition to the well-established money-laundering risks (especially in connection with cross-border asset management), risks in the crypto area are becoming increasingly apparent, particularly in connection with cryptocurrencies. While new technologies facilitate efficiency improvements in the financial area, the threats of money laundering and the financing of terrorism are also heightened due to the potential for greater anonymity along with the speed and cross-border nature of transactions. In particular, cryptocurrencies are often used in connection with cyberattacks, or as a means of payment for illegal trading on the dark web. Money laundering risks can be significant for FinTech companies too. Financial institutions active in this area that do not have adequate money-laundering risk defences could seriously damage the reputation of the Swiss financial centre.

Market access (→)

Changes to and restrictions on access to foreign target markets that are of importance to Swiss financial institutions may have repercussions for the revenue streams of the Swiss financial centre. The risk of restricted market access has barely changed in 2021, and remains high.

Over the last few years, there has been increasing evidence of a trend towards the fragmentation of financial markets. Thus, the market access regimes applicable to foreign providers in a number of different jurisdictions have been tightened up accordingly. Among other things, foreign authorities are imposing more rigorous requirements regarding the availability of information on the supervision of financial institutions with cross-border business. This, for example, encompasses the direct transfer of information by Swiss financial institutions as well as cooperation with FINMA.

At a European level, there have been no changes in respect of the market access situation over the last year. This applies in particular to the equivalence procedure with Switzerland, including the stock market equivalence that ceased to be recognised in 2019. The risk of more complicated access to the EU market has become more pronounced for Switzerland as a non-EU state – due on the one hand to Brexit and, on the other, to the absence of a regulated relationship with the EU in financial market matters. It is also still possible that the EU will tighten up its rules for the provision of cross-border financial services to clients outside of the EU. One example of this is the delegation norm that applies in asset management and allows certain funds to be managed from Switzerland, but has now been called into question.

To improve cross-border market access for a broad spectrum of financial services in the insurance, banking, asset management and capital market infrastructure areas,[6] Switzerland has been seeking closer collaboration with the United Kingdom.[7] This initiative could bring about some improvement in market access. Overall, however, developments remain shrouded in legal uncertainty, which could give rise to additional costs for Swiss financial institutions. Restrictions on cross-border financial services could restrict the business opportunities open to financial institutions and asset managers in Switzerland and lead to a possible outsourcing of jobs abroad.

Discontinuation of LIBOR
(now removed from list of principal risks)

The LIBOR era is set to expire at the end of 2021. Ever since the UK's Financial Conduct Authority (FCA) announced in 2017 that it would no longer be supporting LIBOR after 2021, supervisory authorities at both a national and international level have been working to develop a plethora of instruments to ensure the orderly replacement of LIBOR. On 5 March 2021, the ICE Benchmark Administration (IBA) and the FCA finally regulated the details of the replacement of LIBOR in the five major currencies. To deal with the remaining "tough legacy" agreements, US dollar LIBOR is to be continued for the most frequently used tenors until the end of June 2023. "Tough legacy" is the term used to describe LIBOR-based agreements without robust fallback clauses that cannot be converted to an alternative mechanism before the end of 2021. A synthetic LIBOR rate for 1-month, 3-month and 6-month contracts in pounds sterling and yen will be made available for a limited period of time. By contrast, no safety cushion will exist for CHF LIBOR and EUR LIBOR.

In its Guidance 10/2020, FINMA set out a LIBOR transition roadmap, and has closely monitored its implementation at the most heavily exposed institutions over the course of 2021. These supervised institutions have made a key contribution to preventing a disorderly exit from the LIBOR era by launching products based on alternative reference rates (such as the SARON mortgage, for example).

Overall, the efforts of all involved parties have resulted in a 70% reduction in the volume of LIBOR-based agreements without robust fallback clauses falling due after 2021 across all currencies since the start of 2020 (status as at end of July 2021). In the case of agreements based on CHF and EUR LIBOR, the reduction even amounts to almost 90%. Thanks to this progress, a disorderly LIBOR transition no longer con-

[6] See FINMA news "Trading in Swiss shares: recognition of various UK trading venues".
[7] Mutual Recognition Agreement, cf. also https://www.sif.admin.ch/sif/en/home/bilateral/lander/vereinigtes-koenigreich-uk-.html.

stitutes a principal risk, even if further work on the part of supervised entities is required in the last few weeks of 2021.

At the same time, FINMA has pointed out that the downgrading of the appraisal of this risk does not mean that risks no longer exist in this area. Indeed, certain supervised entities with residual "tough legacy" agreements in place could still be substantially exposed to legal, valuation and operational risks at the year-end. FINMA will therefore continue to closely monitor the most impacted banks and securities firms in 2022 too, particularly the reduction in the number of residual "tough legacy" agreements.[8]

[8] For more detail on this, please see Guidance 03/2021.

FINMA's supervisory focus

FINMA aligns its supervisory focus with the risks described above. In doing so, it concentrates on the following key areas in particular:

The *low interest rate situation* remains a key topic in the supervisory dialogue between FINMA and the institutions it supervises. FINMA observes whether the banks are passing on negative interest rates to their clients, and how these clients respond. In addition, FINMA supervises the implementation of interest rate risk stress tests at the banks. Low interest rates also affect the various segments of the insurance industry. FINMA is therefore continuing to analyse the appropriateness of reserves, particularly in the case of life insurance providers.

The *real estate and mortgages market* has been another key focus of FINMA's supervisory activities for many years. The development of the market and credit portfolios for investment properties remain a specific point of focus. Owing to the coronavirus pandemic, value adjustments, depreciation and at-risk receivables are under particularly close scrutiny. FINMA reviews a comprehensive credit register in order to obtain – in the sense of data-based oversight – a complete overview of mortgage portfolios and mortgage volumes. FINMA continues to conduct stress tests for mortgage risks with certain banks. It selects banks in a risk-based way in order to analyse their resilience in the event of a real estate crisis. With regard to the Basel III final reform package, FINMA is advocating appropriate implementation in order to reduce the risks in the mortgage market through greater differentiation. In the area of asset management, FINMA conducts in-depth analysis of Swiss real estate funds. Further stress tests are taking place in the insurance area with a view to understanding the influence that real estate held in insurers' portfolios may have on these companies' solvency.

From time to time, FINMA investigates possible *defaults on or adjustments to corporate loans* with the banks under its supervision. It has established its own internal warning system for country risks. If there is a material exposure to countries in financial difficulties, FINMA also critically explores the banks' risk appetite in relation to such countries. For particularly exposed financial institutions, a sensitivity analysis of the overall capital ratio is conducted. In addition, FINMA has opened enforcement proceedings in connection with the latest events surrounding the companies Archegos and Greensill.[9] When calculating the capital requirements that apply to insurance companies, FINMA takes into account the increased credit risks attached to corporate bonds as a result of the coronavirus pandemic. Where necessary, it addresses this topic with the companies that are particularly affected.

Where the combating of *cyber risks* is concerned, FINMA communicates to supervised entities what it expects in terms of the approach that should be taken to combat such risks. FINMA continues to focus primarily on improvements to the crisis management toolkits of supervised financial institutions and their stakeholder groups. FINMA has further expanded its resources in the cyber area, and has increased the number of cyber-specific on-site supervisory reviews in this area this year, just as it did in 2020. It is conducting cyber stress scenarios with a number of institutions. In addition, FINMA evaluates the cyberattack reports it receives in line with FINMA Guidance 05/2020, and supervises institutions as they take the corresponding measures.

In its supervision of *measures to combat money laundering,* FINMA prescribes an audit programme that takes account of various business models. The scope and content of the audit depend on the specific risk of money laundering at the financial institution under scrutiny. FINMA continues to focus on risk management at financial institutions that look after politically exposed or quasi-state clients. It continues to report on good practices in its Annual Report. Where nec-

[9] Press release of 22 April 2021.

essary, FINMA also continues to pursue enforcement proceedings. An additional focus now lies on the complex structures and activities found in the crypto area. Specific measures are being taken to reduce money laundering risk in this sphere. The threshold for foreign exchange transactions in cryptocurrencies was reduced from CHF 5,000 to CHF 1,000 in FINMA's revised Anti-Money Laundering Ordinance (AMLO-FINMA) in 2020, while FATF standards on dealing with so-called virtual asset service providers were implemented in mid-2019. In addition, FINMA published guidance in 2019 to illustrate how it applies prevailing Swiss anti-money-laundering regulations to cryptocurrencies and the blockchain area generally. Furthermore, the supervisory audit report has been supplemented with the new audit item "Virtual assets / virtual asset service providers". This will allow audit companies to place a specific focus on cryptocurrency transactions when carrying out the supervisory audit.

FINMA continues to closely monitor the legal and reputational risks associated with *access to foreign markets* and to raise awareness of this problem at the affected institutions as part of its supervisory dialogue. It also assists the relevant political bodies in Switzerland in their efforts to ensure equivalence at a technical level, including in the context of the current negotiations with the United Kingdom on a Mutual Recognition Agreement in the finance area. Furthermore, like its partner authorities elsewhere in Europe, FINMA recommends the prompt implementation of the Basel III standards as comprehensively as possible.[10] This is conducive not just to resilience but also to market access.

[10] See https://www.fi.se/contentassets/2a225429b12e471488dbfcd4b7531cf4/joint-letter-concerning-basel-iii.pdf.

Longer-term trends and risks

FINMA has also identified risks that could have an impact on the Swiss financial centre over the longer term. Below, FINMA provides an update on climate risks – last addressed in its 2019 Risk Monitor – with a supplementary appraisal of the issue of greenwashing. In this section last year, we discussed risks relating to the use of extensive data collections ("big data") in the insurance sector that can lead to "transparent" insurance clients.

Climate risks and greenwashing risk

FINMA continues to scrutinise climate-related financial risks closely. Although it should be possible to identify and mitigate climate risk via existing risk categories, the various specific risk factors concerned[11] mean that this long-term risk driver must nonetheless be carefully monitored. Accordingly, this topic is also now part of FINMA's strategic goals for the period 2021–2024.

The more precise capturing of the relevant climate-related risks by supervised institutions is a focus of FINMA's oversight. In a pilot project with the Swiss National Bank, which involved measuring transaction risks at the two big banks, it has been carrying out analyses of exposure to sectors with particular sensitivity to climate policy, as well as future-oriented climate scenario analyses. These initiatives facilitate a better appraisal of the corresponding risks, provide a useful basis for discussions with supervised entities and should help the authorities to develop the necessary expertise. An analysis of the exposure of internationally active insurance companies to sectors with particular sensitivity to climate policy, which was carried out at the start of 2021, makes the current challenges very clear. FINMA shares the view of the insurers involved that further efforts are needed to establish robust methods and metrics in this area.

In 2021, FINMA also launched a multi-year project on the integration of climate risks into its supervisory practice. The initial concepts for the oversight of the largest banks and insurers will be finalised by the end of 2021, providing a commensurate and risk-based foundation for supervisory activity in the area of climate risks from 2022 onwards. These concepts will then be further developed on an ongoing basis, taking into account the recommendations of the relevant international bodies. Particular emphasis will be placed on analysing the first climate-risk-related disclosures based on the requirements specified in FINMA circulars.

Where climate risks are concerned, another risk that needs to be addressed is that of greenwashing – which affects investor protection in particular. FINMA's investigations show clearly that greenwashing practices in the sale of financial products and financial services need to be monitored, and that providers often make product promises that range from the vague to the misleading. FINMA's mandate includes the task of protecting financial market clients and investors from inadmissible business practices. With regard to the prevention of greenwashing, in the absence of specific rules on the transparency of financial products and financial services that claim to be sustainable, FINMA relies on guidelines of a general nature. The prohibition of misleading claims in the marketing of Swiss collective investment schemes plays a key role here. Investors should also be able to make informed investment decisions with respect to products that are marketed as sustainable. For example, FINMA has set out the specific information that Swiss fund documentation should contain if a fund is claimed to be sustainable. In applications for product approvals, fund managers are asked for additional information on the sustainability targets pursued, their implementation and their intended impact. This makes it easier for FINMA to evaluate whether potential investors are being misled and whether the corresponding action is required. All in all, however, FINMA's freedom of manoeuvre when it comes to the efficient prevention of greenwashing is limited. For instance, there is a lack of sustainability-related trans-

[11] See FINMA Risk Monitor 2019.

parency obligations and effective supervisory bases for taking action at the point of sale. Specific regulatory measures could provide FINMA with additional instruments for tackling greenwashing practices in a broader and more effective way.

Abbreviations

CCyB Countercyclical capital buffer
CDS Credit default swap
Cf. Compare
DDoS Distributed denial of service
EU European Union
FATF Financial Action Task Force on Money Laundering
FCA Financial Conduct Authority (UK)
FINMA Swiss Financial Market Supervisory Authority
FINMASA Swiss Federal Act of 22 June 2007 on the Swiss Financial Market Supervisory Authority (Financial Market Supervision Act; SR 956.1)
FSO Swiss Federal Statistical Office
GDP Gross domestic product
IBA Intercontinental Exchange Inc. (ICE) Benchmarking Administration
IT Information technology
LIBOR London Interbank Offered Rate
MROS Money Laundering Reporting Office Switzerland
p.a. per annum
PDVSA Petróles de Venezuela S.A.
SARON Swiss Average Rate Overnight
SST Swiss Solvency Test
UK United Kingdom
USA United States of America

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