

# Welcome to 5th symposium for small banks

Gstaad Lounge

24 May 2022

# FinTech: overview of DLT-related activities

Risks and opportunities

Matthias Obrecht, Head of Market Analysis (FinTech Desk)

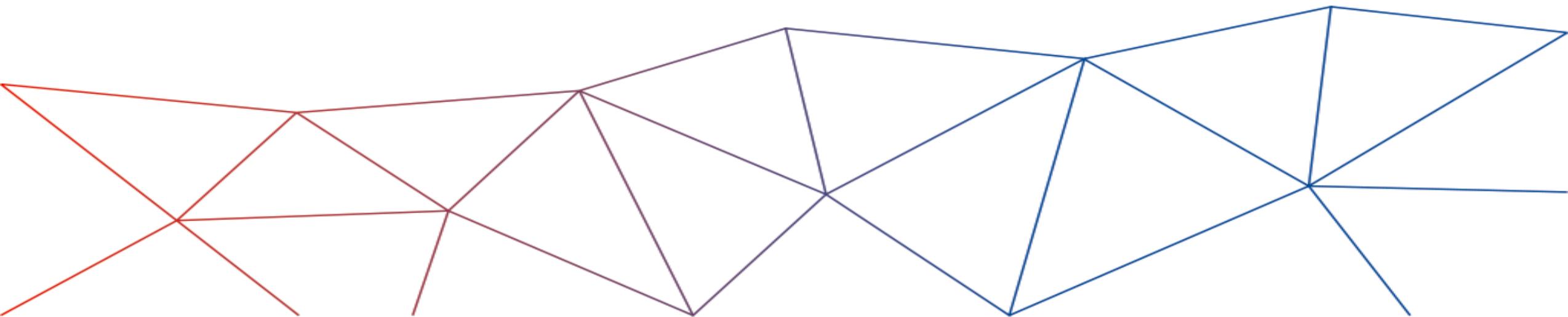
24 May 2022

## Overview of topics

- FINMA: approach to innovation in the financial markets
- Trends in DLT
- Developments in Switzerland

---

# FINMA: approach to innovation in the financial markets



## FINMA's regulatory approach and responsibilities

Protecting individuals

Protecting market functioning

Strengthening the reputation and competitiveness of the Swiss financial centre

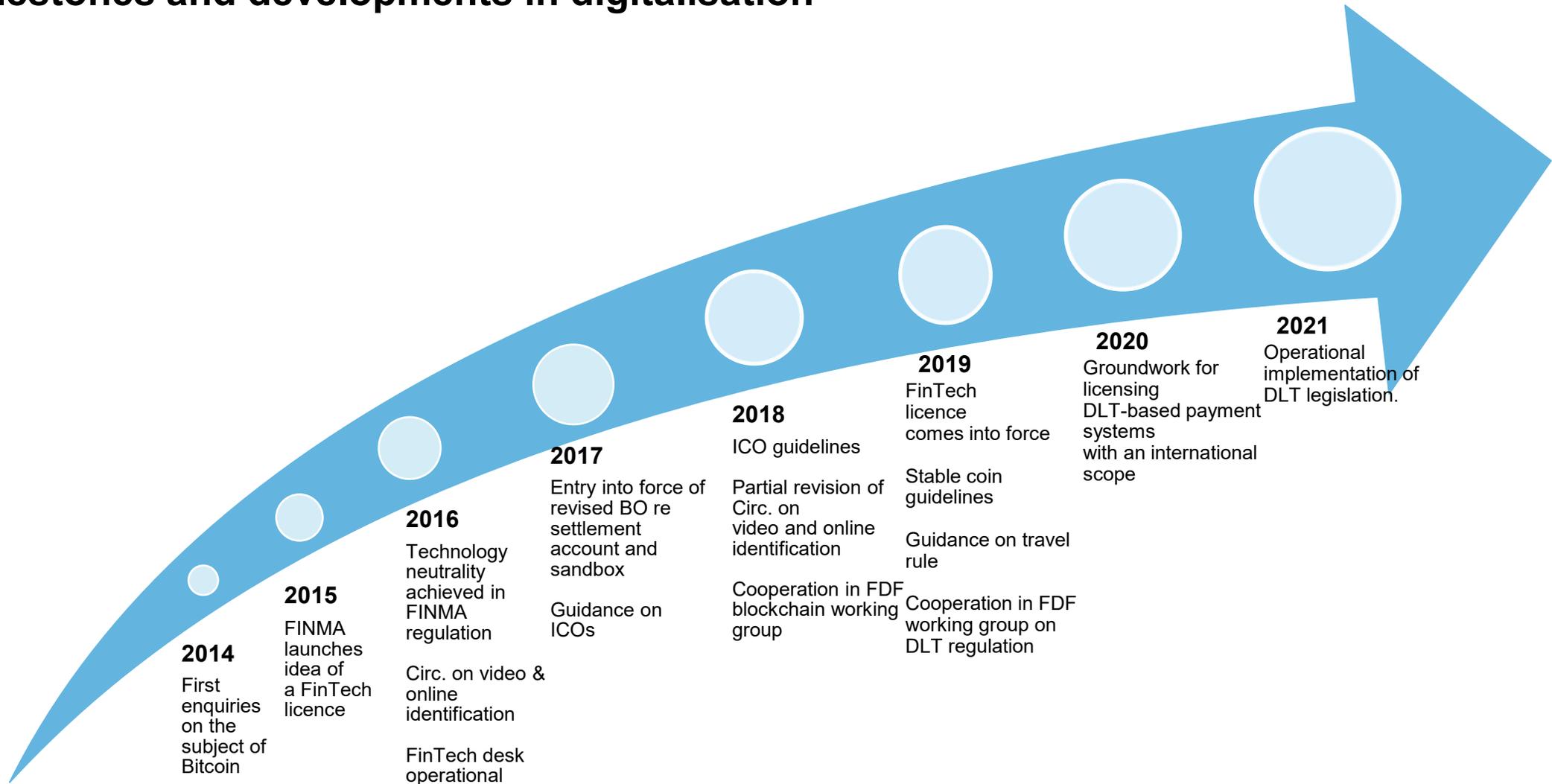
- Neutrality with regard to technology and competition
- Functional approach to assessing new business models (same risks, same rules)
- Elimination of unnecessary obstacles to innovation
- Legal certainty
- Zero tolerance for criminal behaviour

Licensing

Supervision

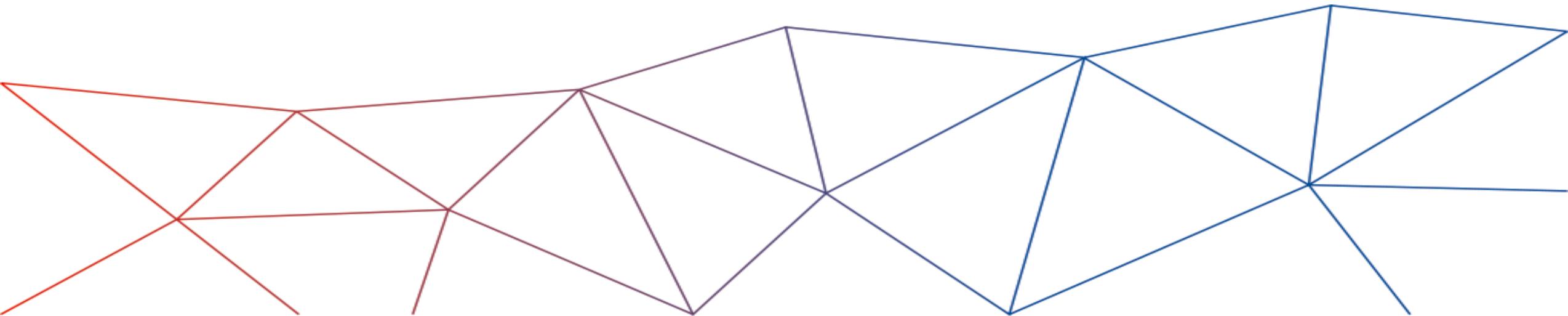
Enforcement

## Milestones and developments in digitalisation



---

# Trends in DLT



## Trends and developments in the market (global)

- Crypto assets: approx. USD 2.3 trillion (estimate as at end-2021)
- 1) Unbacked cryptoassets (95%)
  - direct exposure (Bitcoins,...) or indirect (crypto ETPs,...)
  - means of payment or speculative investment product?
- 2) *Stable coins* (5%)
  - fiat-based: Tether, USD Coin, Pax Coin,...
  - cryptocurrency-based / algorithm-based DAI (Maker DAO), UST (Terra), ...
- 3) DLT-based *settlement services*
  - e.g. payment system or securities settlement system
  - permissionless or permissioned DLT
- 4) Decentralised finance (*DeFi*):
  - traditional financial services on a peer-to-peer basis
  - without a specific provider: *who is responsible?*

## Risks of blockchain-based business models

- *Operational risks* particularly for permissionless blockchains: technical problems, hacker attacks, 51% attacks, forks,...
- High *volatility* of market prices
- Criminal activities:
  - money laundering: example of cryptocurrencies being used as a means of payment on the dark net
  - terrorist financing
  - ransomware attacks: example: Colonial Pipeline
- ➡ Risks for the *integrity* and *reputation* of the financial system
- Political risks: will cryptocurrencies be banned?
- Systemic risks?

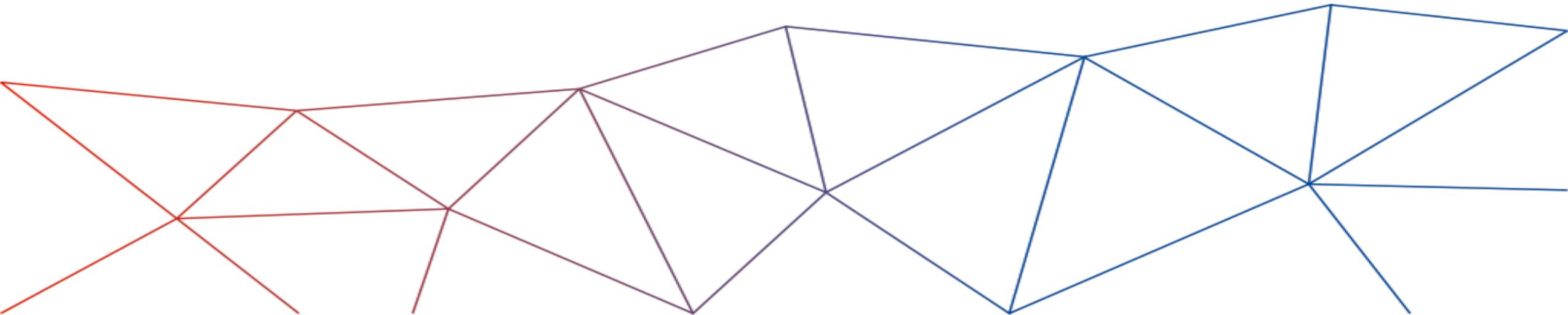
## Developments in the area of international standards

- FATF: anyone who provides financial intermediary services for virtual assets should be deemed a virtual asset service provider (*VASP*) and be subject to anti-money laundering regulations and also comply with the *travel rule*. In Switzerland, this requirement has been met (see in particular Art. 4 para. 1 let. B AMLO and FINMA Guidance 19/2)
- BCBS: work is currently taking place on standards for the prudential treatment of cryptoassets. An initial consultation took place in 2021
- FSB / CPMI / IOSCO: the topics of stable coins, DeFi and unbacked cryptoassets are being discussed both from the point of view of client protection as well as stability of the financial system and are high on the agenda

International bodies are discussing crypto topics with a focus on risks to the integrity and stability of the financial system

---

# Developments in Switzerland



## Regulatory requirements

Activities related to crypto-based assets can give rise to *obligations under financial market law* (for example, under anti-money laundering, banking, financial market infrastructure or collective investment schemes law). Higher risk activities lead to stricter requirements

- For providers who did not previously operate on the financial market, this can lead to *licensing requirements* or to the need for affiliation to an SRO
- For institutions already licensed (e.g. banks), *changes to internal regulations* (such as organisational regulations, anti-money laundering regulations, new risk controls) or to *capital requirements* may be necessary when new activities in the area of FinTech are commenced

 Early contact with FINMA

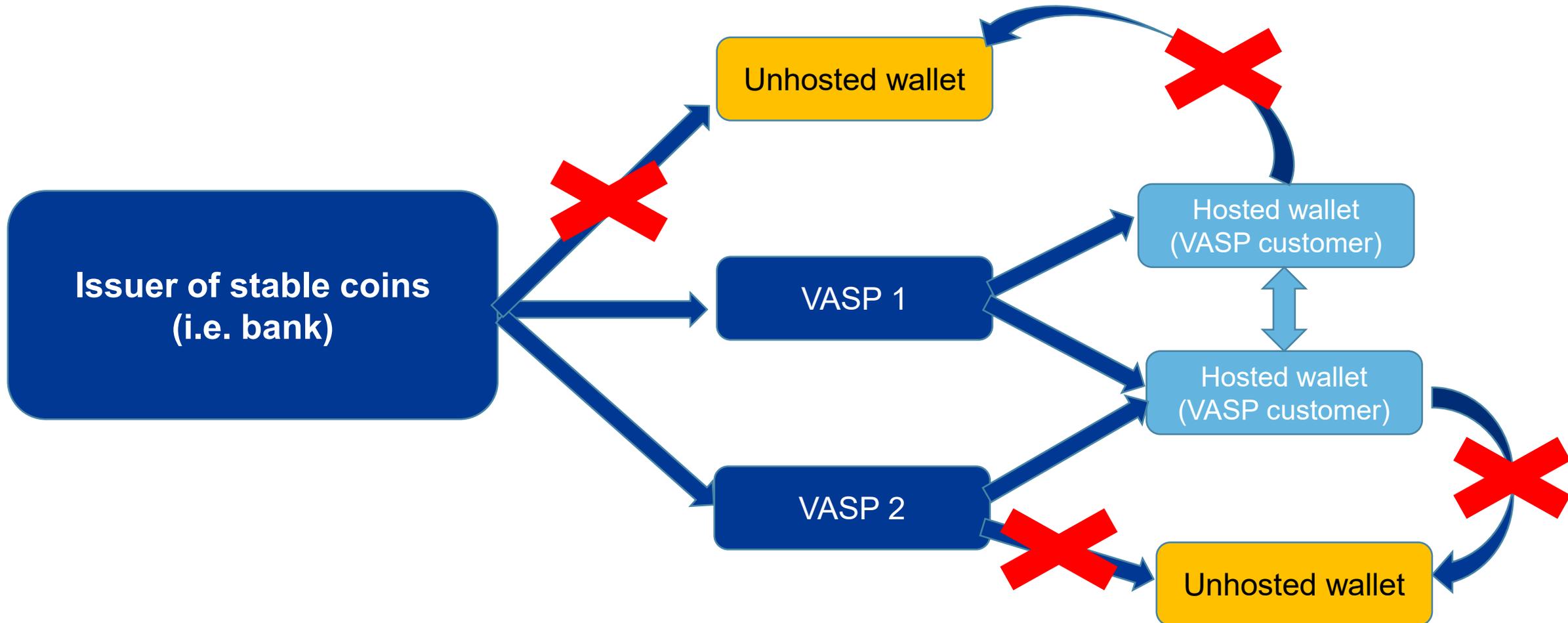
## Issuers of stable coins: licensing requirements

Categories	Indicative supervisory classification (in addition to anti-money laundering legislation <sup>2</sup> )
1. Linked to <i>fiat currency / cryptocurrency</i> with fixed redemption claim	Deposit under banking law <sup>3/4</sup>
2. Linked to <i>basket of fiat currencies / cryptocurrencies</i> with redemption claim dependent on price development	Management of the currency basket and risk-bearing: <ul style="list-style-type: none"> <li>– for the account of the issuer: deposit under banking law<sup>3/4</sup></li> <li>– for the account of the token holder: collective investment scheme</li> </ul>
3. Linked to <i>commodity</i> (incl. "bank precious metals") with contractual claim	Bank precious metals: deposit under banking law <sup>3/4</sup> Commodity: security and possibly derivative <sup>5</sup>
4. Linked to <i>basket of commodities</i> (incl. "bank precious metals") with redemption claim dependant on price development	Collective investment scheme
5. Linked to <i>commodities</i> (incl. "bank precious metals") with ownership rights	No prudential licensing requirement
6. Linked to <i>real estate</i> with redemption claim dependent on price development	Collective investment scheme
7. Linked to <i>specific security</i> with contractual claim	Security and possibly derivative <sup>5</sup>
8. Linked to <i>basket of securities</i> with redemption claim dependent on price development	Collective investment scheme

## Requirements for issuers of stable coins (I)

- The use of stable coins leads to risks in the areas of money laundering and terrorist financing. This can create reputational damage for both the institution concerned and the entire Swiss financial market
- In order to address these risks, contractual and, where appropriate, technological transfer restrictions are required for the issue of stable coins by supervised institutions
- All persons disposing of stable coins must be sufficiently identified by the issuing institution or by adequately supervised distribution partners in order to comply with the due diligence obligations under the Anti-Money Laundering Act for all transactions with stable coins

## Requirements for issuers of stable coins (II)



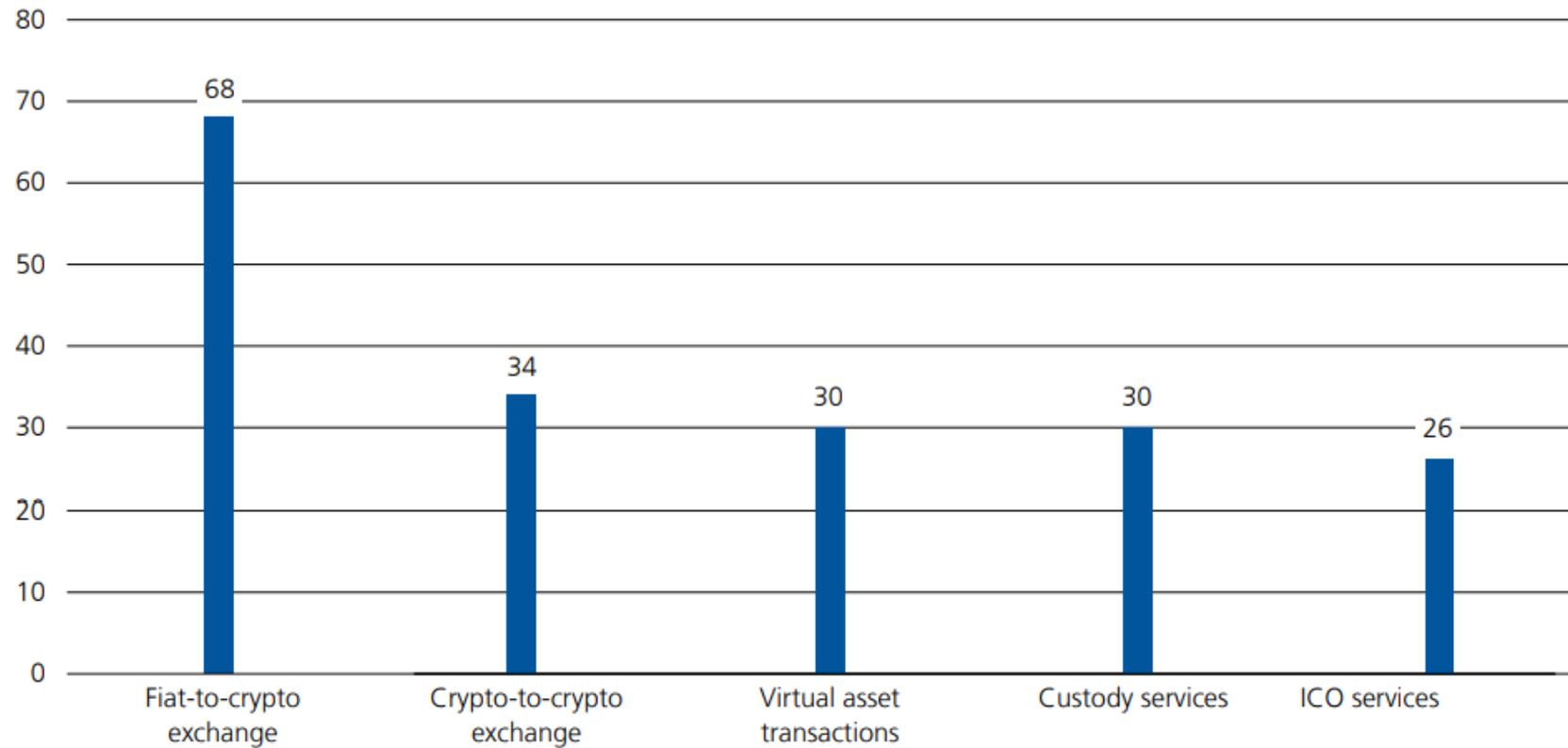
## Developments in the market

- At present, some twenty banks and securities firms have crypto-related projects. These frequently concern:
  - custody services
  - trading and exchanging
  - issuing of products (e.g. structured products on cryptocurrencies)
- Over 100 financial intermediaries with SRO affiliation provide VASP activities (see following slide)

## VASP activities in Switzerland

### Categorisation of virtual asset service providers (VASPs)

Number of institutions as at the end of June 2021, multiple answers possible





---

THANK YOU!





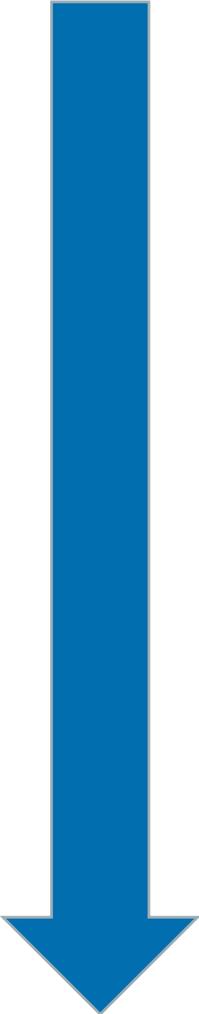
# SupTech update

## Challenges for small banks?

Alain Girard, Head of Supervision of Small Banks and Securities Firms

24 May 2022

## SupTech: international developments

A large, solid blue arrow pointing downwards, positioned on the left side of the slide, spanning the height of the main content area.

***Innovative technology in financial supervision (suptech) – the experience of early users | FSI Insights No 9 (2018)***

- Definitions
- User experiences (development, reasons, challenges, implications)

***The suptech generations | FSI Insights No 19 (2019)***

- Suptech redefined (Glossary)
- Strategies / Use cases

***From data reporting to data-sharing: how far can suptech and other innovations challenge the status quo of regulatory reporting? | FSI Insights No 29 (2020)***

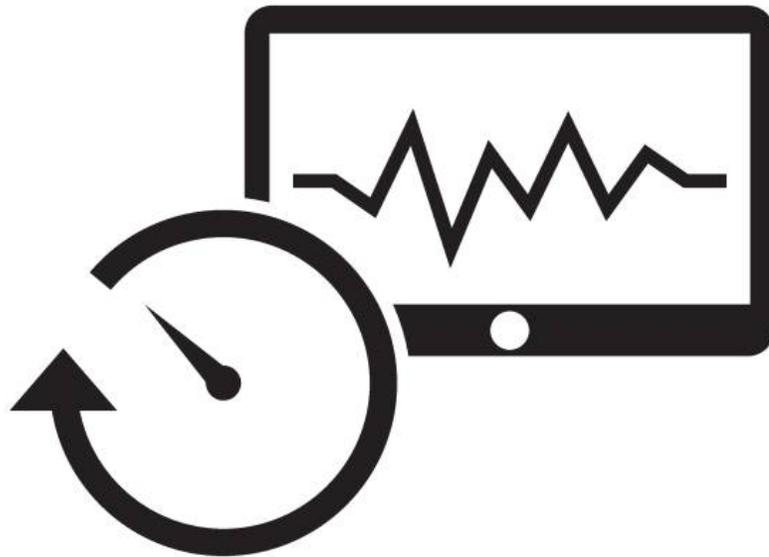
- Innovation in regulatory reporting
- Initiatives, issues and challenges

***Suptech tools for prudential supervision and their use during the pandemic | FSI Insights No 37 (2021)***

- Analyses of textual information in prudential supervision.

## Real-time banking supervision

– Buzz? Trend? Reality?



### Leaders

Oct 23rd 2021 edition >

Instant economics

## A real-time revolution will up-end the practice of macroeconomics

The pandemic has hastened a shift towards novel data and fast analysis



Source: The Economist, October 23<sup>rd</sup> 2021.

## Technical and financial challenges: showstoppers?

### Technical challenges

- Security
- Standards / interface compatibility
- Data quality
- Validation

### Technically:

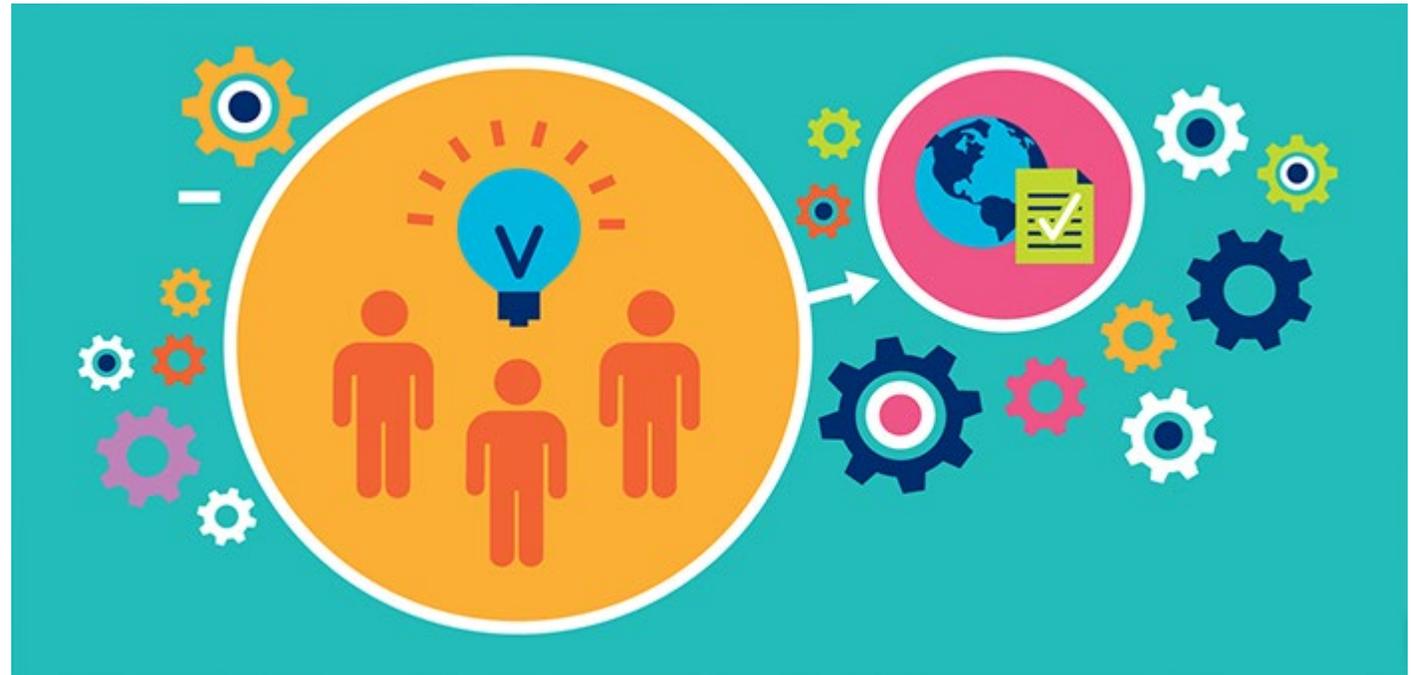
*Short-term showstoppers at most!*

### Financial challenges

- Costs / investments
- Allocation

### Financially:

*Short-term showstoppers at most!*



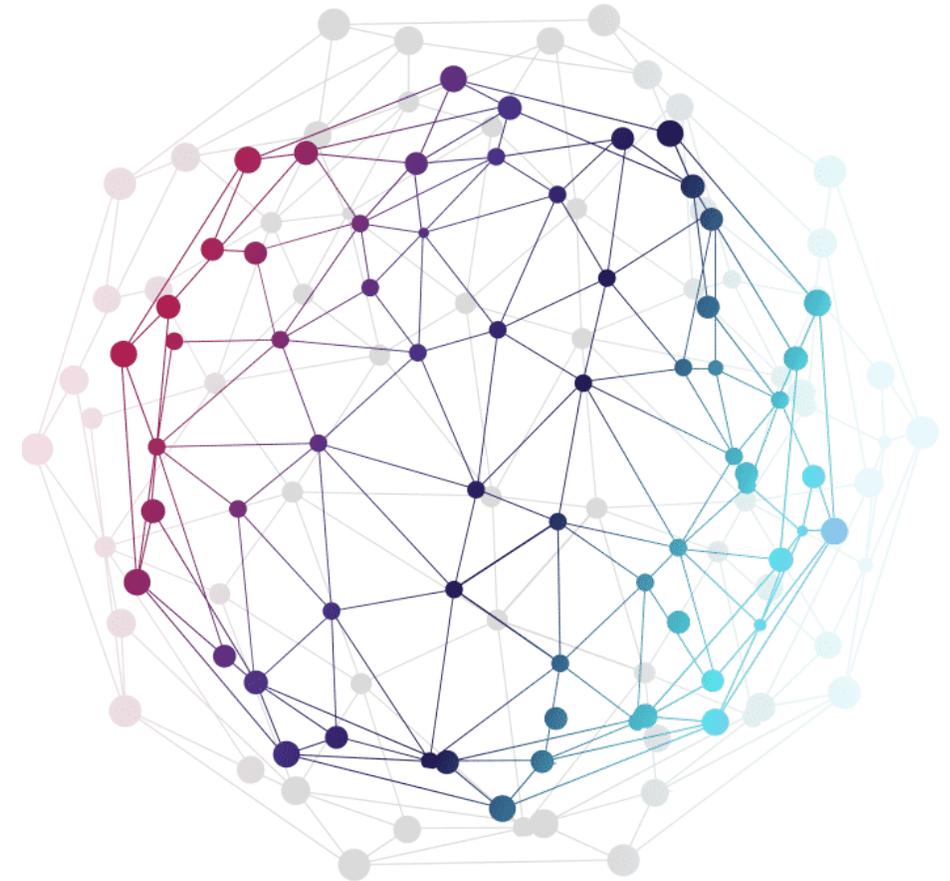
## Real potential challenges

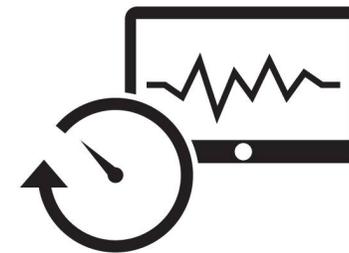
### Impact on supervision

- Increased risk of dilution of responsibility?
- Increased risk of intrusion into market decisions?
- (Non-) Matchable expectations?

### "Get it right challenge"

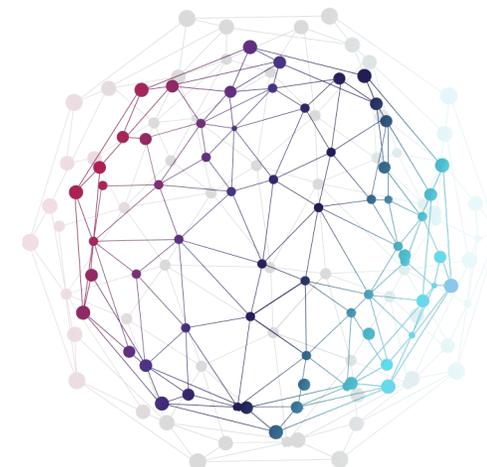
- How important is real-time banking supervision for FINMA's mandate?
  - Crises?
  - Small banks?
  - Time gap?
- How does real-time banking supervision improve decision-making?
- How to make sense of secondary real-time data in banking supervision?
- ... to name just a few





**Leaders**  
Oct 23rd 2021 edition »

**Instant economics**  
**A real-time revolution will up-end the practice of macroeconomics**  
The pandemic has hastened a shift towards novel data and fast analysis

An illustration on a pink background. A hand uses chopsticks to pick up a yellow line graph that is rising out of a cup of instant noodles. The cup has the Chinese characters '即时经济' (Instant Economy) and 'GDP-ENHANCING' written on it. The noodles are steamy, and there are small clouds of steam rising from the cup.

---

## Thank you for your attention !

**Alain Girard**

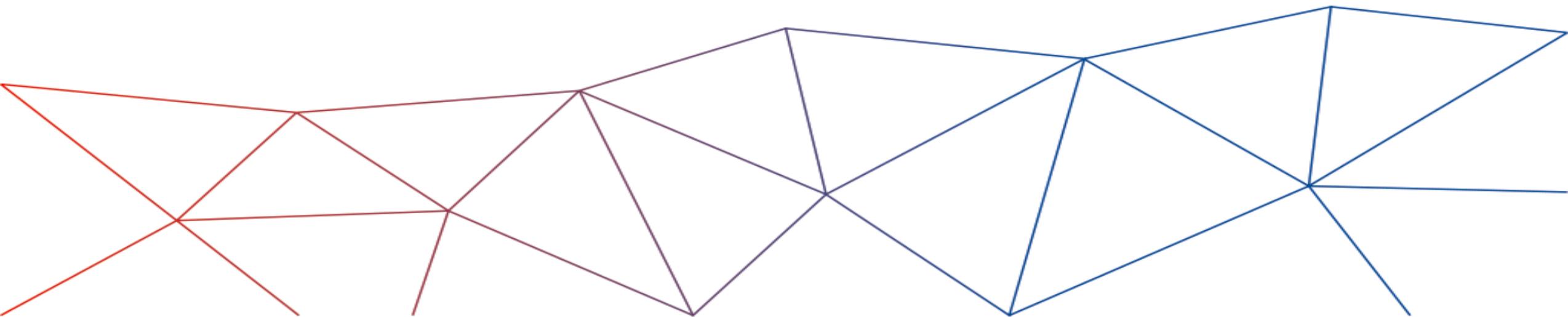
Dr. iur., M.A. in Economics, attorney-at-law, LL.M.

Head of Supervision of Small Banks and Securities Firms

Banks division

Swiss Financial Market Supervisory Authority FINMA

[alain.girard@finma.ch](mailto:alain.girard@finma.ch)



# Time for lunch

Guten Appetit! Bon appétit! Buon appetito! Enjoy your meal!

24 May 2022

# Small banks regime: 2 years after go live

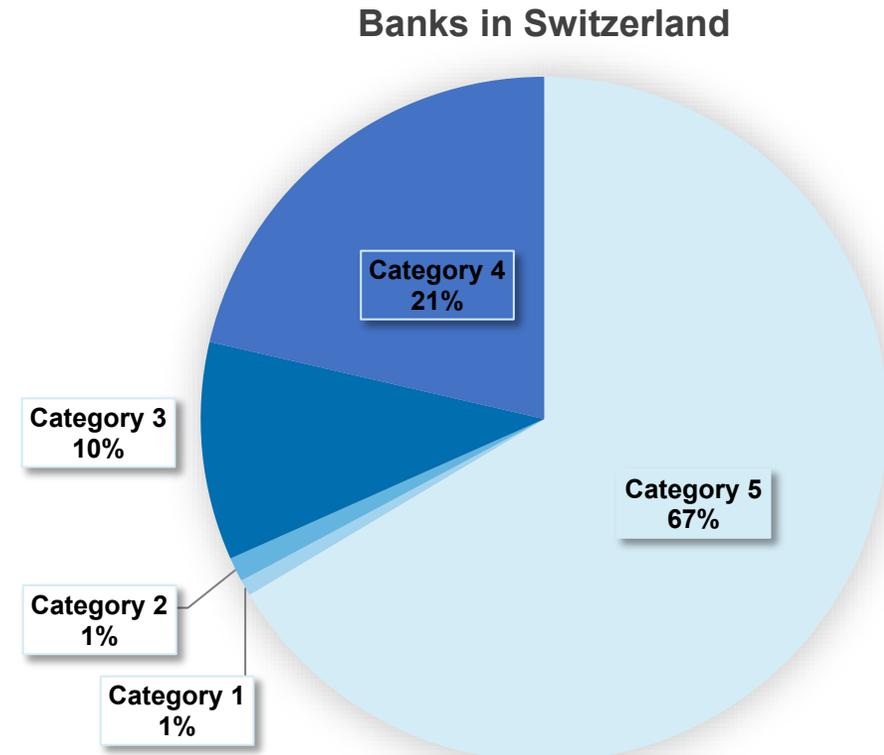
Current situation

Thomas Hirschi, Head of Banks division

24 May 2022

## Small banks in the Swiss banking system

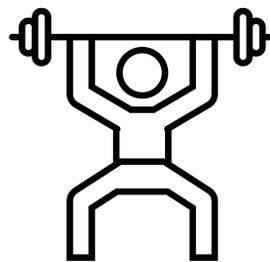
- FINMA essentially defines small banks as Category 4 and 5 banks
- Almost 90% of CH banks are small banks (incl. securities firms) (in total 252)
- They bring diversity (and thus also stability) to the Swiss banking industry
- Great heterogeneity of business models
- In addition to market exits, there are also market entries



## Small banks in the Swiss banking system

### Strengths

- Strong regional roots
- Lean structures
- Profitability solid overall



### Challenges

- Adaptability
- Diversification
- Digitalisation



## Top risks for small banks

- The following principal risks from the FINMA Risk Monitor also affect small banks:
  - Low interest rate environment
  - Correction on real estate and mortgage market
  - Cyber risks (approx. 50% of cyber reports received by FINMA concern small banks)
  - Money laundering
  
- Overall, the following risks are less material:
  - Defaults or adjustments to corporate loans or bonds abroad
  - Market access
  
- Longer-term risks are also relevant to small banks:
  - Climate risks
  - Greenwashing risk

## Proportionality in Swiss banking regulation

- (Supervisory) categorisation leads to relaxed requirements (regulatory requirements and supervisory intensity)
- Auditing “reformed”, cost reduction achieved
- Risk-based supervisory activities
- Consistent implementation of the proportionality principle in regulation (e.g. Circ. 22xx/xx Operational risks and resilience – banks)
- Principle-based regulation
- Introduction of small banks regime
- Problem: distinction between “prudential” and “conduct” requirements

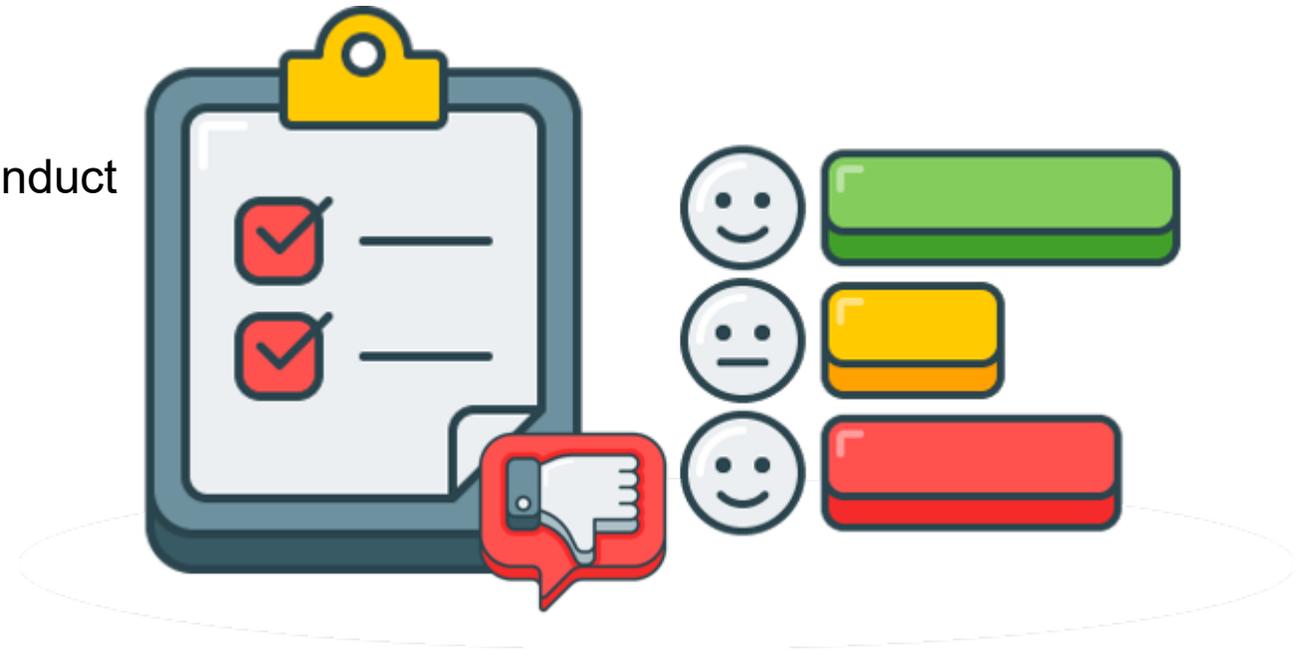
## Small banks regime

- Today includes 56 institutes
- Has established itself
- Dialogue with the supervised institutions is key (and promotes trust)
- Crisis has not led to a destabilisation
- Data-driven evaluation is efficient
- Exits do not call the small banks regime into question
- Further development is needed, as the situation is not static



## Pain points in the small banks regime

- Simplified leverage ratio
  - Central bank reserves?
  - RWA, as alternative criterion?
- Qualitative requirements in the area of conduct
- Tomorrow's pain points?



## Further developments in the small banks regime

- Ex-post evaluation of the small banks regime
- Plan an inventory of exemptions, among other things as a basis for making decisions (FINMA website)
- Dialogue with the supervised institutions should be continued!



---

THANK YOU!

# Where are we with the proportionality approach today and what do we need tomorrow?

Panel discussion

24 May 2022

## Participants panel discussion

- Barbara Vannotti-Holzrichter, CEO, Scobag Privatbank AG
- Daniel Pfanner, CEO, Bank EEK AG
- Dimitri Vaharis, CEO, Kendra Securities House SA
- Jörg Gasser, CEO, Swiss Bankers Association
- Thomas Hirschi, Head of Banks division FINMA
- Moderation: Tobias Lux, Spokesperson FINMA

---

THANK YOU!