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Ukraine crisis: complex risks for the financial institutions

Ladies and gentlemen

As Marlene Amstad said, the Ukraine conflict is an issue of concern to us. This war in Europe is affecting all of us – especially the human suffering. As a supervisory authority we have a duty to fulfil our mandate even in such situations. I would like to begin by talking about how this crisis affects us in our supervisory work.

In respect of the Ukraine war, we can summarise by saying that this conflict poses numerous risks for the Swiss financial sector and accentuated risks for individual institutions. We are keeping a watchful eye on these. We currently take the view that the conflict does not constitute a wide-scale threat to the Swiss financial market.

Allow me to briefly explain. As FINMA, our mandate is to safeguard individuals and the financial system. We therefore focus particularly on the risks, which is to say on possible negative scenarios. In the current crisis we are initially interested in which institutions are exposed with which services and to what degree. The aim is to identify any concentration risks and any potential for contagion at an early stage.

We are therefore in close contact with the supervised institutions and request all information relevant for assessing the situation. We are informed about the direct business of the banks and insurance companies we supervise with the affected countries and have looked at the situation in depth for the most affected institutions. Indeed, some financial institutions are more strongly exposed in certain areas in connection with the conflict. However, we do not currently consider the stability of the system to be threatened.

What specific dangers may now result from the conflict for the Swiss banks? On the one hand, FINMA's focus is on prudential aspects, that is to say issues surrounding liquidity and capital resources in relation to the risks involved. On the other hand, we are also interested in how they deal with sanctions and operational risks.

The prudential view considers the financial risks: these include outstanding loans to Russian debtors or direct investments in Russian securities. The Lombard loan or derivatives business with either Russian underlying value or with potentially sanctioned Russian counterparties can also be problematic. There is a danger here of banks not being able to withdraw from these transactions and also not being able to change margins. But also that bank-financed commodities trading with Russian counterparties or with Russian goods may potentially no longer be settled, resulting in losses.

A second group of risks concerns the legal framework and compliance. Correctly enforcing sanctions requires the utmost care. Because there may well be legal uncertainty in dealing with the clients affected. We – and of course SECO, which is responsible for this matter – have received many questions from the supervised institutions: Which banking transactions are still allowed? How should the sanctions be interpreted?

Our expectations here are clear: the sector must conduct its business properly, which includes enforcing sanctions. However, we currently have no reason to believe that this is not the case. On the contrary: the banks take the issue of sanctions very seriously. Dealing with them is by no means new for the institutions, but the scale and complexity have increased sharply.

Regardless of the sanctions, the usual duties in respect of due diligence to combat money laundering apply, particularly to transactions with politically exposed persons. These must also be complied with as usual.

Thirdly, there are operational risks in connection with the Ukraine conflict. Above all, we must anticipate increasing numbers of cyberattacks. We have also questioned the supervised institutions on this topic and can report that there are currently no signs of widespread or systematic attacks. But the institutions must remain very vigilant, because the situation can worsen very quickly. Furthermore, the institutions have a duty to report all incidents to FINMA.

Ultimately operational difficulties can also arise in payment transactions, namely if correspondent banks disappear and no more payments can be made in roubles.

These three risk types – prudential, legal and operational – manifest themselves in very different ways in each individual scenario. As usual, we take a risk-based approach: there is more supervisory focus on larger and more exposed institutions than on smaller or less exposed ones.

Where necessary, FINMA can demand that supervised institutions take specific measures. By doing so it protects a bank’s depositors, for example. FINMA has a range of tools at its disposal for this purpose. It uses these where needed to enforce financial supervisory law. Where there are concentrated financial risks, the primary tool is additional capital requirements. But it can also selectively intervene in business activities and, as appropriate, even restrict or prohibit entirely certain business and transactions on a temporary basis. In particularly time-sensitive cases, FINMA will even order protective measures at short notice, as it recently did at Sberbank Switzerland.

Given everything that we know today, I can say that the Russian business of Swiss financial institutions not insignificant overall, but is relatively small in comparison with other target markets. Of course there are some institutions that are more strongly affected. But overall the risks to the financial centre from first round effects are manageable. We are continuing to monitor the situation to see whether the war has further, indirect effects on the financial markets. Above all, however, we wish and hope that this conflict will be resolved as soon as possible.

Focus on the mortgage market

Let me turn now to a completely different issue, the Swiss mortgage market. The real estate and mortgage markets are today showing clear signs of overheating for residential properties. Various factors point towards such properties being overvalued. For example, real estate prices have risen much more sharply in the last twenty years than consumer prices, salaries or GDP. This trend has accentuated even more since the outbreak of the coronavirus pandemic.

Undoubtedly there are also factors that enhance the stability of the Swiss real estate markets. For example, the moderate fluctuations of the economy by international standards, Switzerland's attractiveness as a business location or continuous immigration.

However, our analyses show that some of the banks and also some of the insurance companies would fall far below the threshold of the capital requirements in force in the event of a severe real estate crisis and would have to be recapitalised as a result. With a volume of over CHF 1,100 billion, the Swiss mortgage market is larger than the balance sheet of a systemically important large bank and one and a half times as large as Switzerland's GDP. A correction of the real estate markets therefore poses a material concentration risk for the Swiss economy as a whole, and particularly for highly exposed institutions.

It has been debated many times in different contexts whether mortgage loans should be made more accessible. But relaxing the award criteria would generate even higher demand for property. Especially today, this would drive up the already high prices even further, while supply is increasing only very slowly.

From our financial stability perspective, we are therefore sceptical of such relaxations. They would further increase the already significant risks in the market.

To conclude, I would like to return to what Marlene Amstad said: the stability of the institutions – that is to say healthy capital and liquidity buffers – plays a central role in any type of crisis. This is true both for upheavals resulting from the Ukraine war or for unfavourable developments on the real estate market. Our actions are always focused on maintaining the stability of the individual institutions and thus the stability of the entire financial system – in the interests of all of us.

Thank you for listening.