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FACTS AND FIGURES TRENDS AND STRATEGIES 2022

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STRATEGY

THE FMA'S MEDIUM-TERM SUPERVISORY STRATEGY (2022–2026)

Austria's Financial Market Authority (FMA) pursues the objectives of maintaining the stability of the Austrian financial market and strengthening confidence in its proper functioning, taking preventive action to ensure compliance with regulatory standards, and protecting consumers as a collective group. In this way it makes an important contribution to the competitiveness and sustainability of Austria as a financial centre and the Austrian economy as a whole.

The FMA pursues these goals in a risk-oriented and principled manner. It applies the relevant rules proportionately according to the scale, complexity and risk propensity of the business model or service, and endeavours to remain neutral from the perspective of competition and technology, while supporting innovation as a driving force for the future viability of financial service providers and the financial centre.

This means being able to identify and analyse new developments, trends and risks in advance in order to be able to act with foresight and to apply preventive measures. Against this background, the FMA draws up a medium-term risk analysis and supervisory strategy for a period of five years, which it evaluates annually and on the basis of which the supervision and inspection priorities for the coming year are defined.

RISK ANALYSIS 2022–2026

While the latest economic forecasts, including for the global economy, are indeed optimistic, they are severely limited by the major uncertainty, unknowns and unanswered questions thrown up by COVID-19 and the future course of the pandemic.

The International Monetary Fund (IMF), for instance, in its latest World Economic Outlook (October 2021) already sees a very strong upswing, forecasting +5.9% global economic growth this year and +4.9% next year. This prediction is based on increasingly broad access to effective vaccines, as well as the fact that policymakers have now learned how to react quickly and effectively to new waves of the coronavirus and the economic consequences. The IMF does, however, concede that the rapid spread of the delta variant and the threat of new mutations of the virus massively increase uncertainty over how quickly the pandemic can finally be overcome.

In the medium term, in other words beyond 2022, the IMF nevertheless expects global economic growth of +3.3%. This means that the forecast for the developed industrialised countries is markedly higher than expected before the pandemic, which is mainly due to the huge investment programmes that the USA and the European Union have set up in order to emerge powerfully from the crisis and make their economies fit for the future.

The IMF therefore expects economic growth of +5.0% (2021) and +4.3% (2022) for the euro area, and +6.0% and +5.2% for the USA.

The Organisation for Economic Co-operation and Development's December forecasts were similarly upbeat, predicting global growth of +5.6% in 2021, +4.5% in 2022 and +3.2 in 2023, with forecasts for the eurozone of +5.2%, +4.3% and +2.5%.

OECD Secretary-General Mathias Cormann has expressed his cautious optimism that, based on the latest developments, the global economy will continue to recover at a slightly weaker rate but still fairly strongly, albeit with very large risks and uncertainties. This can partly be attributed to the fact that global supply chains have not been fully restored, resulting in material bottlenecks not to mention huge increases in the price of raw materials and energy, as well as higher inflation. The main factor, however, is that the pandemic has not yet been overcome. Vaccination efforts have not yet been fast or effective enough to get the health crisis under control.

Austria's economy has also recovered strongly this year, already returning to pre-pandemic levels by the end of July measured in terms of real gross domestic product (GDP) on a month-on-month basis. The two major economic research institutes in Austria, WIFO and IHS, are as optimistic about the country's economic development as the IMF is about the global economy. The economic growth forecasts for 2021 have been raised slightly to +4.4% (WIFO) and +4.5% (IHS), with WIFO revising its forecast for 2022 slightly downwards to +4.8% and IHS sticking with +4.5%. The OECD has a similar view of growth prospects, forecasting +4.1% for 2021, +4.6% for 2022 and +2.3% for 2023. However, its calculation does not yet take account of the hard lockdown in Austria in late November/early December. According to an OECD ad-hoc estimate, this is likely to push the 2021 growth figure down to +3.5%.

Like the OECD, Austrian economists also regard the future course of the COVID-19 pandemic as a major risk in terms of forecasting and economic performance, with ongoing problems in global supply chains, material bottlenecks, huge increases in raw material and energy prices, as well as the resulting further rise in inflation expectations and associated tightening of monetary policy.

Inflation has indeed already risen markedly towards the end of 2021, in some cases to over +3% on a monthly basis. The Oesterreichische Nationalbank (OeNB), in its September forecast, expects an inflation rate of +2.4% for the year as a whole, followed by +2.2% in 2022 and +1.8% in 2023. For its part, the OECD's December forecast is +2.8% (2021), +3.0% (2021) and +2.3% (2023); with predicated rates for the eurozone of +2.4%, +2.7% and +1.8%. The central bankers are agreed, however, that the significant increase in inflation in the euro area will calm down again in the course of 2022, stabilising close to the inflation target of 2%.

Yet it is COVID-19 that remains the biggest concern, with the course of the pandemic in the fourth quarter of the year dramatically demonstrating the fragility of the foundations on which economic optimism is built.

CHALLENGE: COVID-19 PANDEMIC

Many experts were already hopeful that we would soon be over the worst of the pandemic. They were encouraged by the rapid development of effective vaccines, broad vaccination campaigns with billions of doses administered worldwide in the space of

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Eduard Müller and Helmut Ettl, FMA Executive Directors

a few months, and a strong economic upswing over the summer months. Developments towards the end of 2021 have, unfortunately, proved them wrong.

The virus, which had never been completely banished, is back with a vengeance. There has been another surge in cases in many regions around the world, many health systems are again being pushed to the limits of their capacity, and the impact on our social and economic environments has been huge. The latest effects on our economy and society cannot yet be estimated.

The reasons for this are as diverse as they are global. Vaccination rates are not progressing as fast as hoped. In the wealthier countries that have broad access to vaccines, deep-rooted opposition to vaccination in some sections of the population and certain regions, an increasing political divide and the threat of societal division mean that immunisation is progressing too slowly. Meanwhile, due to a lack of international cooperation and solidarity, many poorer countries lack sufficient access to vaccines to be able to effectively vaccinate their populations.

In a globalised world, this means that regional outbreaks of coronavirus will repeatedly flare up and infect other regions. Moreover, the lack of vaccine protection increases the risk of new mutations of the virus, against which the vaccines have limited or no effect. This brings with it the constant danger of new lockdowns, new travel and transport restrictions, new disruptions to supply chains and new distortions in our economic system.

In short, the COVID-19 pandemic continues to keep us on tenterhooks, creating huge challenges for the economy and society.

We are not yet out of the woods. We still have a long, hard road ahead of us.

What COVID-19 has demonstrated, however, is that we, in our capacity as regulators and supervisors, learned the right lessons from the global financial crisis. We were much better prepared for the challenges facing the financial markets this time. Regulation and supervision are now largely Europeanised, and international cooperation worked well from the start. Many regulatory loopholes have now been closed, the market infrastructure is well secured, and the better data and information situation means that economic risks and problems can be identified and tackled at an early stage.

What COVID-19 has demonstrated is that regulators and supervisors learned the right lessons from the global financial crisis. We were much better prepared for the challenges facing the financial markets this time, and we were able to identify and tackle the economic risks and problems at an early stage.

Consistent efforts to deal with legacy burdens and the massive strengthening of institutions' capital base have also created financial service providers that are better prepared for a crisis and that are more robust and resilient.

At the start of the pandemic, banks' capital buffers were more than twice as high as before the global financial crisis, with around 16% CET1 capital, while legacy issues such as non-performing loans had been tackled, creating historically low levels of around 2%. Eighteen months into the pandemic, these levels have more or less been maintained, if not slightly improved. For their part, insurance undertakings were also in a very stable position at the start of the crisis, with solvency ratios of more than 220%, and have been able to maintain their solvency. The significance of the temporary ban on distributions imposed by the FMA in line with a wider European approach should also not be underestimated in terms of maintaining and strengthening the capital base during the crisis.

Meanwhile, pension providers and asset managers were quick to absorb the massive price falls on the capital markets at the height of the crisis, ultimately still recording an acceptable performance. The FMA's swiftly imposed short-selling ban, coordinated across Europe and introduced for a fixed period, certainly helped in this regard. The ban curbed excessive market reactions and helped quickly calm the turbulence on the capital markets.

Additionally, we as supervisors have allowed as much regulatory flexibility as possible during the crisis, yet without compromising on risk identification or risk management. By way of example, the FMA's measures have included simplified credit assessments for existing customers, simplification of the reporting system, extension of deadlines, temporary suspension of inspections and procedures where possible.

The fact that it has so far generally been possible to stop the impact of COVID-19 spreading to the financial sector is, however, primarily due to the rapid and massive intervention of the public sector, shielding and protecting the real economy during a difficult and challenging situation that is almost without precedent. The Federal Government alone has already supported households and businesses to the tune of more than € 40 billion. Short-time work, compensation for lost income, tax deferrals and many other aid measures such as state (but also private) credit moratoria have bought people time, giving households and businesses some breathing space before the economy gathers speed again.

In this way, the state has also protected the financial markets and service providers from many defaults and bankruptcies.

At the same time, all of these measures have created a backlog of problems that have yet to be tackled. Paradoxically, during the depths of the pandemic, the number of bankruptcies has fallen by 40% and the share of non-performing loans in bank balance sheets is slightly down.

Once the aid and support programmes can be scaled back again, once the flexibility and relief measures expire, once the deferred loans, taxes and social security contributions finally have to be paid, these suppressed problems will return to the surface. The fear is that a return to normal will release the backlog of insolvencies – among both companies and private individuals – and that their number will soar. This will in all likelihood also trigger an increase in loan defaults.

The exit from the aid and support programmes will therefore have to be made gradually, calmly and carefully in order to avoid any knock-on effects.

We are not yet at that stage, however. The COVID-19 pandemic, which is still to be overcome, continues to create huge risks and uncertainty, as confirmed by the latest economic forecasts. The unambiguous conclusion drawn by OECD Secretary-General Cormann is that ensuring better access to vaccines for all must be an urgent policy priority. According to Cormann, better international coordination and massively stepping up vaccination programmes worldwide are the only way to overcome the pandemic, which has triggered the crisis in the real economy and is keeping us all on tenterhooks.

CHALLENGE: LOW INTEREST RATES

The hoped-for turnaround has been shelved for the time being. Large-scale interventions by the central banks, which have kept the world's markets stocked with cheap money in recent years, have had an effect. They cushioned the impact of the global financial crisis and also helped to quickly calm the economic turbulence triggered by the COVID-19 pandemic.

The unprecedented challenges posed by the COVID-19 crisis also mean that the low interest rate environment, which has now lasted for a decade and a half, is likely to continue for some time yet. The hoped-for turnaround has been shelved for the time being. Large-scale interventions by the central banks, which have kept the world's markets stocked with cheap money in recent years, have had an effect. These actions cushioned the impact of the global financial crisis and also helped to quickly calm the economic turbulence triggered by the COVID-19 pandemic. Meanwhile, serious economic uncertainties remain.

The policy of cheap money also comes with side effects that get bigger and more profound the longer it lasts. This poses dangers that we need to monitor very closely, especially for banks, insurers and pension companies but also for savers, investors and other financial service users.

- Many financial service providers are struggling to remain profitable in this low interest rate environment as their business models come under severe pressure. In the case of banks, which are heavily dependent on net interest income, their margins from maturity transformation business are being eroded by the very flat yield curve. At the same time, refinancing business based on savings deposits brings little or no income, as the interest margin is growing narrower and narrower, and negative interest rates can hardly be passed on to private customers. Also under pressure are insurers and pension providers that gave their customers capital or nominal interest guarantees during high interest rate phases but that are now struggling to honour such commitments in the current interest rate environment. Relatively safe financial and investment products, such as savings deposits or classic life and endowment insurance policies, are no longer as attractive when interest rates are low, creating real asset losses once costs and/or inflation are accounted for.

- The low interest rate environment is therefore also changing consumer behaviour. Hit by losses associated with traditional and safe financial products, customers are switching in ever greater number to riskier forms of investment: away from savings books to investment funds, shares or certificates, or even to unregulated products such as cryptoassets; away from traditional life and endowment insurance policies to unit-linked and index-linked forms of life insurance, in which they themselves bear the full capital market risk.
- The combination of cheap money and the hunt for yield can also spark irrational overreactions on one market or another. Price bubbles are created, which, when they burst, can trigger renewed turbulence, shocks and crises. The flight into "concrete gold" brings the risk of a real estate bubble. Meanwhile, the booming market of virtual currencies – cryptoassets that are de facto unregulated and thus unsupervised – is also already showing clear signs of bubble formation.

The European Systemic Risk Board (ESRB) explicitly stated at its meeting in September of this year that the risk of sudden price corrections in certain assets has further increased, as the difference between asset prices and fundamentals continues to widen in some market segments. In this context, the ESRB explicitly referred to the residential real estate sector in some countries, mentioning Austria by name.

The longer the low interest rate environment lasts, the more pronounced the side effects will become. In the long term, persistently low rates will also generate structural changes in the financial system. Established providers will be forced to adapt or reinvent their business model, or risk exiting the market altogether. New financial products and services will emerge, new providers – free of legacy costs and with more favourable cost structures – will enter. Certain financial services will migrate from the established financial service providers, to be provided in future by non-regulated providers from the "shadow banking system".

But even the exit from low or even negative interest rates could be a double-edged sword, requiring a very careful balancing act: many finance deals are based on variable interest rates as these tend to be even more favourable than fixed-rate products; any sudden interest rate hike could jeopardise the borrower's ability to service the loan.

The European Central Bank (ECB) has identified four particular risks for the eurozone financial system: mispricing of assets, the high indebtedness of many companies and sovereign borrowers, weak profit outlooks for banks, and an increase in risk appetite, especially outside the banking sector.

It is therefore important to closely monitor these developments, to continuously evaluate them from a regulatory and supervisory perspective, and to take appropriate measures to limit risk. In particular, any newly formed asset bubbles must be iden-

The policy of cheap money also comes with side effects that get bigger and more profound the longer it lasts. This poses dangers that we need to monitor very closely. It may place a question mark over financial products and even entire business models, it changes consumer behaviour, and it may lead to bubbles in certain asset classes.

tified as quickly as possible so that efficient and effective countermeasures can be introduced.

CHALLENGE: MULTILATERALISM IN CRISIS

The world economy is becoming increasingly multipolar. China is on track to become the world's largest economy before the end of this decade, while India may well overtake the economic might of the European Union within the next 20 years. Emerging markets such as Brazil and Indonesia are also gaining weight in the global economy. Russia is increasingly exploiting its strong position in the markets for energy and raw materials for political gain. At the same time, the world's population will grow from around 7.9 billion today to 9.5 billion by 2050, while Europe's population is set to shrink from almost 450 million to 420 million over the same period.

These dynamics are sparking geopolitical tensions as the emerging states campaign for a redistribution of wealth and power. Also at stake is access to markets, goods, services, energy and raw materials, not to mention cut-throat competition created from weak environmental, social or political standards. A study conducted by the European Commission in 2020 shows that around one third of the world's population live in states where democratic standards are eroding, and only 4% of the world's population are in countries where conditions are improving. This is driving an even greater wedge between liberal democratic positions on one side and autocratic state models on the other, a development that has major political, social and economic repercussions for the world economy.

This new multipolarity and the associated power shifts have left multilateralism in crisis. Yet while the global challenges are growing, the required international cooperation is becoming increasingly difficult.

"Multilateralism is under fire precisely when we need it most," is the sobering reflection of Antonio Guterres, Secretary General of the United Nations.

National self-interest is not a purely American phenomenon. It is also gaining ground in Europe, undermining solidarity within the European Union and paralysing its decision-making power and claim to leadership.

It is precisely global challenges such as the COVID-19 pandemic, climate change, migration and fragile statehood, nuclear proliferation and digitalisation that require multilateral cooperation in a globalised world. However, due to the intensification of the superpower conflict between the USA, China and Russia, these states are again increasingly adopting a unilateral approach. All too often, the answers to global challenges are limited to nationalist, egoistic power plays, or to isolation and withdrawal or exclusion from multilateral cooperation.

The crisis of multilateralism as an expression of heightened geopolitical tensions stands in stark contrast to increasing global interdependence, which is manifested:

- in the international division of labour through production and supply chains, as felt only too painfully during the pandemic
- in global mobility through foreign labour, tourism and also migration
- in the digitally networked world by the internet, global social media, but also big data, big tech and big business.

Political cooperation is lagging behind economic and social globalisation.

This poses major risks: firstly, that geopolitical tensions as well as resurgent trade

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conflicts trigger economic shocks and, secondly, that a lack of cross-border coordination and regulation in these globalised areas leads to distortions and cross-border contagion.

In light of the ongoing crisis of multilateralism, fears of a "geopolitical recession" have still not been entirely banished.

CHALLENGE: CLIMATE CHANGE

The COVID-19 pandemic has been dominating the media and politics, pushing the challenges of climate change into the background. Many of the measures that societies around the world and the financial markets need to take to tackle climate change have been delayed or even called off. However, climate change cannot wait, it needs to be dealt with now.

The European Green Deal, designed to make Europe the first climate-neutral continent by 2050 and reduce greenhouse gas emissions by at least 55% by 2030, and the gargantuan NextGenerationEU recovery plan, a 800 billion euro investment package to make Europe more digital and sustainable and thus fit for the future, will push sustainability issues to the foreground again.

The financial sector has an important role to play in all of this. It should redirect financial and capital flows towards a more sustainable economy, embed sustainability in the risk management processes of all market participants, and boost transparency in relation to sustainability risks. These are risks relating to environmental protection, social justice and responsible corporate governance, known as the ESG (environmental, social and governance) factors.

Regulators and supervisors will have to face huge challenges. They are being expected to support the transition process while also limiting the risks arising from it.

First of all, sustainability risks need to be identified and addressed. In the process of transition towards a climate-neutral and sustainable economy, these risks may have a negative impact on the yield or value of individual assets, and consequently also the stability of individual financial market players and potentially even financial stability as a whole.

This needs a classification system that can be used to identify what should, and also what should not, be regarded as ecologically sustainable (taxonomy). A comprehensive reporting regime should then make it possible to assess individual assets and financial flows in terms of their exposure to sustainability risks (disclosure). And, finally, a set of tools such as reference values, standards and quality labels should be developed that can be used to measure and compare individual exposure (benchmarks). The related EU regulations have meanwhile entered into force and now need to be implemented in practice at national level. Further Commission proposals such as for a Corporate Sustainability Reporting Directive (CSDR) or a European green bond standard (EUGBS) broaden and deepen these existing European regulations.

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The FMA and the European supervisory authorities have also begun using scenario analysis and climate and ESG stress testing exercises to examine and disclose certain sectors' and individual financial service providers' exposure to sustainability risks. The ECB, for example, has found that none of the banks it supervises have so far gained a full overview of their climate risks. At the same time it also found that they are already doing relatively well in some areas, such as considering these risks in the context of customer due diligence. The FMA has conducted climate stress tests in the insurance and pension company sectors and found that, while investment portfolios are not fully compliant with the climate goals, they are outperforming the international benchmarks; presently they would be able to absorb the looming losses. The FMA has also looked into the position of asset managers such as corporate provision funds, alternative investment fund managers and investment fund management companies, and whether they are taking account of sustainability aspects in their investment management activities and incorporating sustainability risks into their asset and risk management systems. All of them are in the process of at least implementing appropriate plans, albeit with very different methods.

There is a great deal of interest in sustainable financial products and services on the Austrian market. Investment funds certified with the Austrian Ecolabel for sustainable financial products (UZ49), for example, are the fastest growing market segment. Many providers in the market, particularly banks, are working on the issuance of green bonds in accordance with Austrian and European standards.

One of the biggest challenges to be faced will be "greenwashing". This is the practice of relabelling brown, i.e. carbon-intensive and therefore harmful, products as "green" in order to improve sales. Customers must be able to rely on labels: what's on them should match what's inside. Greenwashing not only damages consumer confidence but also poses legal and reputational risks for providers that should not be underestimated.

Ultimately, global society is only just starting out on the path to reaching its climate goals and transitioning economies towards climate neutrality and sustainability. There are still major challenges ahead for the financial market, its regulation and its supervision.

CHALLENGE: DUBIOUS BUSINESS PRACTICES

Pandora, Paradise and Panama Papers: time and again data leaks reveal dubious financial transactions on an enormous scale, exposing corruption, money laundering and other criminal activities around the globe and shining a bright light on tax fairness. They raise awareness about these issues among the general public, who then put pressure on politicians to end such activities once and for all.

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The Austrian lawmakers mandated the FMA in 2010 to enforce the due diligence obligations in relation to the prevention of money laundering and the financing of terrorism among the companies it supervises, after the international standard setter in the fight against money laundering, the Financial Action Task Force (FATF), had published a highly critical country report of Austria. Huge progress has been made on the financial market in Austria since then.

We have doubled the number of staff working in this area and tripled the number of on-site inspections, with four times as many administrative penal proceedings now taking place. We have prioritised the supervision of high-risk transactions, off-shore centres and politically exposed persons, as well as the cross-border roll-out of strict standards to also include the foreign subsidiaries of Austrian banks. In this way, we have succeeded in raising awareness and mitigating risk. We have halved the number of Austrian banks' off-shore customers from nearly 3 000 to less than 1 500. The number of correspondent banking relationships, which are often used as gateways for dubious transactions, has been cut from nearly 1 500 to less than 300. And back-to-back transactions, which are at high risk of being misused for money laundering purposes, have been completely phased out.

The FMA consistently pursues a zero-tolerance approach to breaches of due diligence obligations: we impose harsh penalties, and if this does not help to change behaviour, we will not hesitate to remove managing directors from their posts or even entire banks from the market. This approach has proved successful: financial service providers are now taking anti-money laundering obligations very seriously, and Austria is regarded as one of the cleanest financial marketplaces in the world today, a status that has been confirmed in recent evaluations by the FATF and IMF.

However, the fight against money laundering is a fight against moving targets. As long as there are criminals, there will always be attempts to launder dirty money in some way or other, to somehow channel illicit funds into the financial sector or to somehow disguise them as money from lawful sources and transactions. The creativity of crim-

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inals knows no bounds. We have to keep up to date with developments all the time, adapting the rules and constantly sharpening our tools and weapons.

In Europe, we are currently working on the next amendment to the Anti-Money Laundering Directive, revising it for the sixth time within the space of a few years. We have taken the first steps to incorporate the world of cryptoassets into the fight against money laundering. Certain providers of trading platforms and electronic wallet providers are now also required to comply with due diligence obligations and have to register with the FMA.

Most importantly, however, a major breakthrough is about to be achieved in relation to cross-border cooperation: powerful European anti-money laundering institutions are finally set to be created, which will drive, intensify and support cross-border anti-money laundering cooperation:

- A new dedicated EU Anti-Money Laundering Authority (AMLA), which will draw on national supervisory authorities' network of contacts, will take over supervision of particularly high-risk providers in the EU, and coordinate and support cooperation among the network and with third countries.
- An Intelligence Unit will analyse cross-border transaction patterns, identify areas of risk and pinpoint problem areas.

This will elevate the fight against money laundering to another level, as this is an international activity with hardly any regard for national borders. The FMA, in its capacity as national competent authority, will be responsible for the implementation and operationalisation of these European initiatives in Austria.

One of the FMA's key tasks is to monitor the Austrian financial market, ensuring that financial services that require a licence or registration are only carried out by companies that hold the requisite authorisation and meet all the necessary legal, economic and organisational prerequisites. Providers that evade regulation and supervision seriously jeopardise the integrity of the Austrian financial market, undermine consumers' confidence in its ability to function properly, and distort competition for properly authorised providers.

Such unauthorised business operations, namely the provision of financial services that require a licence without being in possession of such a licence, have surged over the past few years. While the FMA launched 162 relevant investigations in 2016, this number had risen to 238 by 2020, an increase of 47%. The number of reported offences also grew by 47% to total 72. The number of warning notices, which the FMA publishes to protect market participants, and consumers in particular, nearly tripled over the same period, reaching 84 in 2020. The figures for the first three quarters of 2021 alone already exceed the number for the whole of 2020, with 287 launched investigations and 86 warning notices.

The vast majority of these activities were in fact carried out with fraudulent intent.

In the space of five years, the number of suspected cases of investment fraud reported through the FMA's electronic whistleblowing system has tripled, with 120 such notifications in 2020. Market participants can use this system to flag up suspected irregularities on the financial market anonymously. Two thirds of these reports related to cryptoassets or virtual currencies; an area that accounted for just a handful of cases back in 2016. This surge in numbers is predominantly due to digital offers on the internet and social media that transcend national borders.

The rapid advances in digitalisation, the ever growing use of social media, persistently low interest rates and lockdowns during the pandemic that have also forced people to work from home have all contributed to the rise in cyber and crypto fraud.

Regulators and supervisors therefore need to pay particular attention to these developments, closely monitor the market and take appropriate action as soon as possible in order to warn investors and consumers early on about such dubious and fraudulent offers.

CHALLENGE: DIGITAL CHANGE

Innovation is the foundation for any financial centre and makes it fit for the future. Technological progress can be used to make financial services more efficient and customer-friendly, and promotes the development of new products and business models. The digitalisation of business processes – with data centres and cloud solutions, the use of robotics and artificial intelligence, and front-end systems for customers – is reinventing the way in which financial services are provided. Technological progress is opening up the market for new providers that may become new competitors; be they young, creative and dynamic start-ups such as FinTechs, be they established big players from other sectors or regions (big data providers or big tech companies) who are pushing into the financial market with their massive (data) power. This places a question mark over existing business models, and requires constant adaptations and development.

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The digital transformation is therefore a source of both opportunities and risks.
The FMA has been focusing on the digitalisation of financial markets, and of its providers, services and products for many years now. In so doing, we have identified the following trends:

- Products are gradually being adapted to the new digital possibilities. This mostly means the adaptation of existing products and services to the new technologies, radically new types of product are only being launched experimentally, if at all.
- The use of digital channels (e.g. social media, chat functions, video conferences) to stay in touch with customers is growing significantly, both for customer acquisition and ongoing customer service and communication. Conventional distribution channels are becoming less important due to the use of digital distribution platforms, comparison sites and robo advice.
- Digitalisation increases the degree of interlinking among financial players and external service providers. Consequently, supervised companies' IT risk is increasingly shifting to the interface with third parties (cooperation partners, IT service providers). At the same time, the quality of supervised companies' IT safety measures is improving.
- Despite cryptoassets making more and more inroads into the market, supervised companies are rarely investing in this segment at the moment. This holds true for both their own portfolios and for portfolios managed on behalf of customers. Distributed ledger technology (DLT) and blockchains have also yet to become established as the basis for new products and services in the regulated and supervised area.

All of these developments pose a big challenge for regulation and supervision and require special attention. We need to look into the consequences of digitalisation for established providers and their business models, but we also need to keep track of how the new providers and their business models are working out in the market, and how they are impacting on their competitors as well as consumers and investors.
New concentration risks and contagion channels that come with the outsourcing of IT services (cloud, external consultants, databases and the like) need to be identified and addressed. Cyber risks need to be monitored. Corporate governance needs to be adapted to the new digital challenges. Tried-and-tested measures and tools to protect consumer interests, which were developed for the analogue world, need to be expanded to reflect new digital requirements. The dynamic developments in the cryptoasset world need to be closely monitored, with a technology-neutral form of regulation and supervision that guarantees a level playing field for both new, digital and established, analogue providers.
The world of cryptoassets still largely eludes regulation and supervision. The European Commission's Digital Finance Package, which will be adopted and implemented over the next few years, comprises an EU regulation on markets in cryptoassets (Markets in Crypro-Assets Regulation – MiCAR), and a pilot regime for market infrastructures based on distributed ledger technology (DLT), i.e. blockchains, and strengthens the digital operational resilience of the financial sector (Digital Operational Resilience

Act – DORA). The implementation and application of this comprehensive regulatory package will facilitate innovation and technological developments in the financial sector and provide a regulatory framework for identifying and addressing risks early on. This will come with big challenges for the FMA and Austria as a financial market.
Despite the hype around digitalisation, we must not lose sight of one thing, however: not all segments of the population are included in digitalisation, not all of them use these technologies. For example, it is still the case that only two thirds of Austrians use electronic banking, one third still prefer to do their banking in person. Internet banking is used by 90% of customers in the under-35 age group, but by not even half of the over-55s (49%), and by not even a third of the over-65s (29%).
Digitalisation usually comes with a reduced presence on the ground, with bank branches either being closed or consultants and advisors no longer available in person, which means that digitally disadvantaged population groups risk being denied access to certain financial services. This poses a particular risk for older people, the poorly educated and socially disadvantaged, consumers who are hostile to technology and people who live in more remote areas.

The challenges have not got smaller but bigger in 2021. The hope, in particular, that vaccine development and global vaccination campaigns would bring the COVID-19 pandemic to a rapid end has proved misplaced. Coronavirus continues to be the biggest risk and source of uncertainty for national, European and global development.

As shown by our medium-term risk analysis of the financial market between 2022 and 2026, the challenges have only got bigger in 2021. The hope that vaccine development and global vaccination campaigns would bring the COVID-19 pandemic to a rapid end has proved misplaced. Coronavirus continues to be the biggest risk and the biggest source of uncertainty for national, European and global development.
As we have seen, the challenges currently facing the Austrian financial market include persistently low interest rates, the global climate crisis and digitalisation. The concrete steps we have planned to tackle these challenges from a regulatory and supervisory perspective in 2022 are reflected in our supervision and inspection priorities for 2022, which are set out in detail on the following pages.

SUPERVISON

THE PRIORITIES FOR SUPERVISON AND INSPECTIONS IN 2022

The FMA is committed to the principle of transparency, engaging in open dialogue with the market and the supervised companies. It shares the main findings of its annual analysis, provides information on the main risks it has identified on the financial markets for the coming years, and gives updates on its medium-term supervisory strategy based on this analysis. Every year, in its Facts and Figures, Trends and Strategies publication and on its website, the FMA also publishes detailed information on its priorities for supervision and inspections in the coming year. The aim is to alert the supervised entities to the risks applicable to their area of business and to give them an opportunity to prepare in a targeted way for the risk-based priorities set for the year ahead. This raises awareness of risk and creates transparency around the challenges that the supervisory authority has identified and wishes to focus on. In this way, the supervised entities are also given a clear indication of which areas they should be focusing their attention on.

Based on its Medium-term Risk Analysis and Supervision Strategy (2022–2026), as outlined by FMA Executive Directors Helmut Ettl and Eduard Müller in the introduction to this publication, the FMA has set the following supervision and inspection priorities for 2022 *(> Figure 1)*:

- **To strengthen the resilience and stability of the supervised financial service providers and of the Austrian financial market as a whole.**
- **To exploit the opportunities of digitalisation, while at the same time consistently addressing the associated risks.**

Clean financial centre Austria
– Strengthening market integrity
– Focus on cryptoassets
– Prevention of money laundering and terrorist financing

Sustainability
– Sustainability risks in risk management
– Structured dialogue on sustainability issues
– Sustainability in integrated supervision

Collective consumer protection
– Further development of consumer information
– Combating investment fraud
– Risk-oriented market monitoring

Resilience and stability
– Lessons learned from the COVID-19 crisis
– Crisis governance by the supervised entities
– Expansion of early detection measures

Digitalisation
– Digital interconnectivity in the financial market
– Cyber risks and IT security
– Advancement of supervisory tools

New business models
– FinTechs and regulatory sandbox
– Regulatory framework for virtual assets
– Digital business models from established providers

Figure 1: *The FMAs supervision priorities for 2022*

- **To provide regulatory and supervisory support for new business models in order to promote the innovative strength of Austria's financial market.**
- **To further develop collective consumer protection, especially in light of digitalisation and changing consumer behaviour.**
- **To provide regulatory and supervisory support to the financial market and its participants as they make the transition to a sustainable economic model.**
- **To ensure that the Austrian financial market is a clean market at every level.**

These main priorities in operational supervision activities will also be supplemented during the coming year with a diverse range of activities designed to expand and develop the regulatory framework and with numerous supervisory policy initiatives.

In 2022, the FMA will, for example, focus on helping to shape the regulations on sustainable finance as part of its advisory and market-oriented support of a large number of regulatory projects. It will also be focusing on supporting the consistent implementation and application of Basel 3.5 and, in particular, on promoting the deeper inclusion of the universe of cryptoassets in regulation and supervision, especially through the EU regulatory projects MiCAR (Markets in Crypto-Assets Regulation), DORA (Digital Operational Resilience Act) and the DLT (distributed ledger technology) Pilot Regime. Another focus will be strengthening international cooperation across all areas of supervision, particularly within and in collaboration with the European Supervisory Authorities EBA (European Banking Authority), EIOPA (European Insurance and Occupational Pensions Authority) and ESMA (European Securities and Markets Authority). The FMA has a seat and a vote in each of these authorities and plays a proactive role within them in the interests of Austria as a financial centre. We will also be focusing on the European Commission's plan to establish a separate authority at European level in the fight against money laundering and the financing of

We will also be focusing on the Commission's plan to establish a separate authority at European level in the fight against money laundering and terrorist financing. This authority will be given far-reaching powers and will be closely linked to the network of relevant national authorities.

terrorism. This Anti-Money Laundering Authority (AMLA) is to be given far-reaching powers and will be closely linked to the network of relevant national authorities. It goes without saying that intensive dialogue and close cooperation with the FMA's partner authorities in Central, Eastern and South-Eastern Europe (CESEE region) will also be maintained.

Yet the economic, technological and social changes also affect the FMA itself, and that is why we have set the following in-house priorities for 2022 based on our overriding goal of becoming "ever better, ever more efficient and ever more effective".

- The FMA will support the parliamentary implementation of the regulatory reform proposals presented by the Working Group on Banking Supervision set up by the Federal Minister of Finance and bringing together experts from the Ministry of Finance (BMF), the Oesterreichische Nationalbank (OeNB), the FMA and banking expert Prof. Stefan Pichler from the Vienna University of Economics and Business (WU), contributing the FMA's experience from supervisory practice.
- In its "Fit for the future: the FMA in 2025" project, the FMA addressed questions such as "What are the major environmental factors the FMA will have to deal with?", "How should the FMA adapt its mission to this new environment?", "What needs to be done so that future issues can be tackled head on?" and "What benefits can the financial market draw from an evolving FMA?" (see page 61). It is now a matter of drawing the right conclusions from this reflection process and developing the required plans for reform.

As it strives to promote transparency in its regulatory and supervisory work, the FMA publishes its priorities for supervision and inspections for the coming year as part of its operational supervision remit. The aim is to clearly explain to the supervised entities, the public and the market why specific priorities have been set in the field of regulation and supervision, and which goals are being pursued through them. These priorities are set out in detail here.

PRIORITY FOR SUPERVISON AND INSPECTIONS: RESILIENCE AND STABILITY

The COVID-19 pandemic has resulted in massive economic upheaval across the world: months of lockdowns, long-term disruptions in the cross-border movement of goods, services and people, and excessive capital market turbulence have sent shock waves around the globe. Severe economic slumps and shrinking economic output in almost every national economy have been the result, and Austria is no exception. In this exceptionally difficult environment, the Austrian financial market has proven to be very stable thus far. Despite the deep crisis in the real economy, banks, insurance undertakings, investment firms and pension providers have remained in a good economic position, and the financial sector has been able to cope well with the effects to date. In part, this is certainly down to the public sector having supported the real economy – both companies and households – to an unprecedented extent, which has stopped the crisis spilling over into the financial markets. The other reason is that regulators and supervisors learned the right lessons from the global financial crisis of 2008 and have consistently implemented and enforced them: institutions' capital resources have been significantly improved, legacy burdens have been cleaned up, regulatory and supervisory loopholes have been closed, and a well-equipped toolbox has been created with the instruments for efficient and effective preventive intervention.

The COVID-19 crisis has still not been overcome. And even if we do manage to overcome it in the near future, with state and regulatory support and aid programmes coming to an end, there will still be the risk of knock-on effects and stumbling blocks en route to normalisation of the economic cycle, for example due to interruptions in supply chains, bottlenecks in the production of crucial components such as microchips, or excessive mark-ups in commodity and energy prices. Heavy borrowing by governments, companies and households also increases the vulnerabilities in the financial system.

The overall social and economic situation therefore remains fragile, and the actual impact of the pandemic on the real economy and thus also on the financial economy are not yet completely clear. Consequently, the FMA continues to focus its activities on safeguarding the sustainability of business models and the resilience of institutions in as preventive a manner as possible.

The social and economic situation remains fragile. Consequently, the FMA continues to focus its activities on safeguarding the sustainability of business models and the resilience of institutions in as preventive a manner as possible.

EXPANSION OF EARLY DETECTION MEASURES AS PART OF CONTINUED SUPERVISION

In order to identify negative developments in good time and take appropriate countermeasures, the development of new and the expansion of existing effective early detection measures is vital. In 2022, the FMA will therefore be focusing its supervision and inspection activity on the following areas:

- Transparency around the risk and capital situation of Austrian banks will be created through targeted microprudential and macroprudential monitoring in order to be able to identify possible negative consequences for banks or the banking system at an early stage and take official action. These measures will be implemented with due regard for the principle of proportionality based on the level of risk.
- The banks' business models will be analysed with a focus on their sustainability, with appropriate supervisory measures to tackle any identified weaknesses.
- The risks from the financing of residential and commercial real estate are continuously monitored, analysed and mitigated through appropriate prudential measures at a micro and macro level.
- With regard to prudential insurance supervision, the main focus will be the Own Risk and Solvency Assessment (ORSA), which is the regular in-house assessment of the risk and solvency situation as an essential component of the governance system, the analysis of vulnerabilities and post-COVID analysis in the form of stress testing.
- There will also be a focus on identifying vulnerabilities in the business models of insurance undertakings, particularly in relation to the challenges posed by COVID-19 and also the environment of persistently low interest rates.
- Supervision of *Pensionskassen* (pension companies) will involve stress tests to evaluate the impact of changes to the economic environment caused by the pandemic.
- The Securities Supervision Department will conduct stress tests on selected funds and corporate provision funds. Additionally, the data-based supervisory approach will be further developed and intensified, as will dialogue with the relevant stakeholders.

STRENGTHENING GOVERNANCE

The experiences of the pandemic have shown that well-functioning, strong governance in a company is a significant factor in the sustainability of that company's business model and its resilience in a crisis. With this in mind, the FMA continues to focus on strong governance and is using the following measures to go even further:

- Banking supervisors will intensify their dialogue with the relevant bodies and key functions (e.g. BWG compliance officer), and clearly set out and communicate their expectations.
- Insurance supervisors will survey and analyse the internal implementation of fit & proper requirements for the supervisory board of supervised companies and communicate the results and any conclusions to the sector. Any weaknesses will be consistently addressed with regulatory measures.

PREPARATIONS FOR POTENTIAL FUTURE CRISES

The possibility of a crisis occurring at an individual company can never be ruled out. This means that both supervised undertakings and the FMA must be prepared for crisis scenarios, not least in order to minimise any negative effects on other market participants and the financial system as a whole in the event of an emergency. To this end, potential crisis scenarios must be identified, and appropriate measures and instruments for managing and overcoming a crisis developed and put in place. The following priorities have therefore been set for the coming year:

- The regulatory requirements in terms of a bank's resolvability will be defined and communicated to each institution. The FMA will also develop and implement a method for assessing and addressing resolution obstacles.
- The playbooks, which are basically the scripts on how a bank is to be wound up, will be further developed, focusing on transfer strategies in order to strengthen resolvability. At the FMA, the preparatory work for implementation of the transfer instruments will be driven forwards.
- For the first time, the FMA will be conducting on-site inspections of banks in relation to potential resolution obstacles.
- With the involvement of partner authorities from the CESEE region, the FMA will carry out a dry run of the resolution of a cross-border bank in order to identify possible obstacles and barriers in practice and to optimise international cooperation in the event of a crisis.
- The FMA is assuming the new powers and role with regard to the recovery and resolution of central counterparties (CCPs), i.e. the central institutions that ultimately execute and settle stock exchange transactions.

NEW REQUIREMENTS AND NEW METHODOLOGY FOR RESOLVABILITY ASSESSMENTS

Under its remit to update banks' resolution plans every year, the FMA is required to assess their resolvability according to Articles 27 and 28 of the Bank Recovery and Resolution Act (*BaSAG; Bankensanierungs- und Abwicklungsgesetz*).

If the FMA has defined a resolution strategy for a bank, it must use this resolvability assessment to examine whether the selected resolution strategy is credible and feasible were the bank to fail. The FMA assesses in detail whether the resolution strategy for that bank threatens one or more of the resolution targets as defined in Article 48 para. 2 BaSAG (specifically, ensuring critical functions and avoiding significant adverse effects on financial stability) and whether the bank fulfils all of the requirements for implementation of the resolution strategy in practice.

If the FMA finds the bank's resolution strategy credible and feasible, the institution will be deemed resolvable. If, however, the FMA identifies an impediment to resolvability, it will initiate proceedings to specify measures to reduce or remove the impediment pursuant to Articles 29 to 31 BaSAG in order to achieve the bank's resolvability.

REQUIREMENTS FOR RESOLVABILITY ASSESSMENTS

The material requirements for a bank's resolvability can be found in the set of criteria listed in the appendix to Article 27 BaSAG. Two such major criteria are:

Does the bank have the required staff, infrastructures, finances, liquidity and capital to enable it to maintain its core business lines and critical operations in the event of resolution?

Will service agreements be enforceable in the event of resolution, and will access to payment and settlement systems be guaranteed?
These resolvability requirements for banks were specified in detail at European level in the expectation documents drawn up by the Single Resolution Board (SRB) and the European Banking Authority (EBA). The SRB published its "Expectations for Banks" in April 2020, and the EBA Guidelines on resolvability are due to be published by 2022, as of which time the FMA will assess banks' resolvability on the basis of these publications.

METHODOLOGY FOR RESOLVABILITY ASSESSMENTS

When applying the individual expectations, the principle of proportionality should be taken into account. This means that a particular expectation might be fully relevant to a bank, or only partially or even not at all, depending on bank-specific characteristics (business model, structure, cross-border activities, etc.) and a bank's specific resolution strategy. In addition, not all of the expectations for banks will be fully applied right away, but will be subject to a gradual phase-in over the coming years, with banks being expected to build up their capabilities in relation to specific dimensions, and this process being considered in the resolvability assessment.
The assessment of a bank's resolvability should ultimately provide an accurate and transparent overview of that bank's capabilities in relation to the individual expectations, and clarify whether these expectations are even relevant to the bank in question. Furthermore, the assessment should identify impediments to resolvability so that proceedings to specify remedial measures can be introduced if necessary. To this end, the FMA will start using a methodology for resolvability assessment from 2022, which, applying the principle of proportionality, is based on an SRB and EBA method and uses a heat map to present the assessment results. This is a visualisation technique that displays large amounts of data and diverse information in a condensed manner in a standardised colour diagram, meaning it can be absorbed rapidly and easily. The heat map will help to establish the progress made and to identify any problems or obstacles to resolvability, also showing possible courses of action.

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Using the relevant expectations and the methodology based on the heat map, the FMA will pursue a comprehensive approach, with enhanced transparency and efficiency from 2022 to assess banks' resolvability. The approach should meet both European requirements as set forth in the EBA guidelines and SRB expectations, and ensure Austrian banks' full resolvability, to be built up gradually in keeping with the principle of proportionality and bank-specific characteristics.

PRIORITY FOR SUPERVISON AND INSPECTIONS: DIGITALISATION

Just as in other areas of the economy, digitalisation has long since become an established feature of the financial sector too. From the FMA's perspective, it is particularly important to closely follow and accompany this dynamic process so that, firstly, the opportunities can be consistently exploited and, secondly, the associated risks can be just as consistently identified and managed. It is the FMA's role to closely observe and analyse current developments at all levels – financial market level, company level, product level or among consumers – so that its supervisory activities can be adapted in good time to the new challenges and the high quality of supervision maintained.

The digital transformation represents a technological revolution that is affecting almost every area of the financial market. It is disrupting processes and value chains, reorganising and reshaping them, and making them more efficient and more customer-friendly. Workflows are being optimised, workarounds eliminated and completely new paths opened up. Established financial services and products are just as in need of updating as entire business models. New products and financial services are hitting the market, and new competitors are making their presence felt. Consumer behaviour is adapting and changing. The relationship between financial service providers and customers must be redefined and restructured.

Such upheaval is posing major challenges for market participants and supervisors alike: IT infrastructure, IT strategy and IT security are growing even more important; the division of labour has to be reorganised, certain functions and services are being outsourced as well as insourced, creating new interdependencies, risk concentrations and contagion channels; regulation geared to the analogue world is not fit for purpose in many areas of the digital work; there are distortions in competition between analogue and digital solutions; consumer protection, which has proven its worth in the analogue world, needs to be adapted to the digital reality; questions are arising about efficient and effective data use, coupled with concerns about data protection and data security at the same time. And these are just a few headline examples of the challenge that the digital transformation poses to market participants, but also to regulators and supervisors, a challenge that must be addressed together.

The two comprehensive studies on the state of digitalisation in the Austrian financial market conducted by the FMA in 2018 and 2021 (initial results of the current study can be found on page 33 onwards) provide an important basis for analysing the opportunities and risks of digitalisation. The comprehensive data pool paints a precise picture of the current situation and the developments of recent years. It serves as a basis for pinpointing progress and unwanted developments while outlining future challenges and analysing the impact on financial market participants. For our supervision work, we have identified the following particularly relevant topics from the Digitalisation Study:

The two comprehensive studies on the state of digitalisation in the Austrian financial market conducted by the FMA in 2018 and 2021 provide an important basis for analysing the opportunities and risks of digitalisation.

- External provision of IT services, specifically by way of outsourcing, and related risks
- Identification of new contagion channels and concentration risks
- Interaction among supervised and non-supervised market participants and exact definition of which business requires a licence
- Requirements on chairpersons and key function holders in relation to the application of digital business models
- Equivalent safeguarding of customer interests for both digital and traditional forms of sale and communication
- Monitoring the further development of cryptoassets as an investment instrument and stronger focus on cyber risks.

The supervision and inspection priority of "Digitalisation" will therefore be maintained in 2022, focusing on the following projects:

EXPANSION OF THE 2021 DIGITALISATION STUDY

In order to be able to analyse the results of the 2021 Digitalisation Study in the required breadth and depth, it will be widely discussed with the financial industry and interested members of the general public. For this purpose, the FMA will:

- issue a call for input to all relevant stakeholders inviting them to contribute their own experiences, analysis and views. This input will then be taken into account in the specific conclusions drawn from the FMA study and their implementation in supervisory practice.

ADDRESSING CYBER RISKS

The findings from the study and from current supervisory practice will be taken into account in identifying, analysing, addressing and limiting cyber risks. This will involve:

- analysing and addressing the impact of digitalisation on existing business models in specific priority areas, and
- focusing more strongly on cyber risks from an operational perspective, while also implementing measures to review cybersecurity and cyber resilience.

DEVELOPING SUPERVISORY TOOLS

In light of the rapid advance of digitalisation on the financial market, the FMA must also react quickly and in a targeted manner, constantly adapting its own supervisory tools. With this in mind, it will primarily focus on the following areas:

- The findings from the 2021 Digitalisation Study that are relevant to risk will be integrated into the FMA's supervisory activities and processes.
- Cyber Maturity Level Assessments will be extended to include more supervisory areas.
- The FMA will carry out a pilot exercise for future cybersecurity exercises.
- A tool for the structured analysis of key financial statement data in the European Single Electronic Format (ESEF data) will be developed and implemented.

STATUS OF DIGITALISATION ON AUSTRIA'S FINANCIAL MARKET

COVID-19 has tested not only the economic but also the technical resilience of the supervised entities. The fact that companies on the Austrian financial market have been able to adapt so quickly to the pandemic and maintain a high quality of service to customers, even while operating remotely, is primarily thanks to their robust in-house IT infrastructure and effective governance. Meanwhile, the coronavirus crisis has also triggered a wave of new developments, digital solutions and business models.

The fact that companies on the Austrian financial market have been able to maintain a high quality of service to customers, even while operating remotely, is primarily thanks to their robust in-house IT infrastructure and effective governance.

With this in mind, in 2021 the FMA repeated its study, last carried out in 2018, of digitalisation in the Austrian financial market. The aim was to survey and analyse the progress made and the risks facing financial market participants in this ever-changing environment. The initial results, which are briefly outlined here, show that the supervised entities are increasingly aligning their business models with the latest technological developments and stepping up their cyber resilience, not least in response to the FMA intensifying its supervisory activities in this area.

STRATEGIES

Austrian companies continue to expect a steady continuation of digitalisation trends. They are not expecting revolutionary or disruptive changes in their respective industries, but they do anticipate a greater need for external support in the form of consulting, outsourcing and ad hoc assignments.

The main driver of digitalisation within the companies themselves remains the IT department, in almost all sectors. This highlights the importance of in-house technical expertise, despite high levels of outsourcing, and the fact that many companies' IT departments have a role that extends much further than merely technical administration. Areas with a direct customer interface (sales, customer service, marketing and communication) are viewed as an important driver for digitalisation, with modern communication channels playing a crucial role in marketing and also with regard to consolidating existing relationships. More than 20% of insurance undertakings and banks also already have their own digital innovation department, and almost all supervised companies have at least partially integrated digitalisation into their strategy. Just three years ago the picture was completely different, with digitalisation only featuring in 20% of companies' strategies. In other words, digitalisation has developed into an essential goal over the past few years. Nearly half (44%) of the supervised companies, twice as many as in 2018, have also fleshed out their digitalisation strategy to include measurable goals and budgets.

Across all sectors, efficiency gains and greater customer proximity are regarded as the biggest opportunities presented by digitalisation. The supervised companies see a very wide range of potential uses for digital technologies, but are focusing most keenly on increasing efficiency in their existing processes.

DIGITAL COMPETITION

Most supervised companies still consider other established financial market participants to be their biggest competitors. However, there are marked differences between sectors. These can be attributed to economic and regulatory differences in the business areas, which make the market entry of different competitors more or less likely from the perspective of companies that are already up and running.

While banks, payment institutions and cryptoasset service providers rate the competitive potential of BigTechs highest, insurance undertakings and asset managers expect to face the strongest competition from other established companies in their sector. Only investment firms perceive FinTechs as the greatest competition.

The number of cooperation ventures with start-ups such as FinTechs and InsureTechs is generally on the increase. Some companies that were still classed as "start-ups" in the 2019 study have since been awarded a licence to provide financial services and have succeeded in the market. They have been able to establish themselves in digital niche markets in particular. Interestingly, there is a correlation between the concern that Google, Amazon & Co could enter the financial market as digital game changers with new products and services and the intensity of cooperation arrangements between FinTechs and more established providers. Regardless of some supervised companies' concerns that these start-ups could also turn into future competitors, the Austrian financial market assumes that the number of cooperation ventures will probably also increase over the next three years.

The areas in which cooperation ventures are in evidence varies greatly. Insurance undertakings are focused on processes and tools for marketing, sales and customer service, while other sectors are looking to product design and the provision of the licensed service itself.

Overall, start-ups are establishing themselves as part of the Austrian financial market. In this context, tie-ups with licensed companies are a logical step in overcoming the entry hurdles, be these to do with regulatory expertise or financial in nature. At the same time, these new players are bringing technologies and creative, digital approaches to the market.

Start-ups are establishing themselves as part of the Austrian financial market. Tie-ups with licensed companies are a logical step in overcoming the entry hurdles, be these to do with regulatory expertise or financial in nature.

SOUGHT-AFTER DIGITAL EXPERTISE

Advances in digitalisation are also forcing companies to keep up with the required level of expertise. The digitalisation study shows that a broad range of disciplines is required. Subject to some sector-specific differences, the following trends can be identified:

- The strongest demand is for experts in IT security, an area in which all sectors are interested in expanding their capacities.
- Typically, tech-savvy managers and analysts tend to be in higher demand than pure software developers.
- Among developers themselves, generalists (full-stack developers) are preferred over pure front-end or back-end experts.
- Data structuring and analysis specialists are in particular demand among insurance undertakings, banks, *Pensionskassen* and asset managers.

The huge increase in demand for IT security experts also reflects how much supervised companies are now aware of the growing threat of cyber attacks. The flip side, however, is probably also a certain lack of sufficiently qualified staff on the labour market, which makes it more difficult for companies to implement IT security projects in a timely manner, especially as other sectors are also keen to recruit suitably qualified candidates. Many companies also want to strengthen their in-house capabilities in at least some areas. This can ensure a certain degree of independence from external service providers and also helps avoid concentration risks.

OUTLOOK

The comprehensive FMA Digitalisation Study 2021 will be published before the end of the year, and will again be widely discussed among all stakeholders in a call for input. Given its almost complete market coverage and the intensive participation of the supervised entities, the study represents the most comprehensive information base on digitalisation in the Austrian financial market. For the FMA, it will therefore be an important basis for the supervision and inspection priority of digitalisation in 2022. It will be used to carry out a reliable assessment of drivers, trends and possible future developments in connection with the use of new digital technologies and business models, and for the ongoing development of supervisory instruments in what is a rapidly changing technological environment. The goal remains to safeguard the stability of the Austrian financial market while promoting technological progress and ensuring fair competition for all.

PRIORITY FOR SUPERVISON AND INSPECTIONS: NEW BUSINESS MODELS

Technological innovations are fundamentally changing the way financial services and products are offered. New players in the financial market, who are increasingly focusing on innovations such as distributed ledger technology, using artificial intelligence or developing and offering cryptoassets as part of their business activities, are accelerating this change. Every area of the financial market is affected. However, many of these innovative technologies, services and products are not covered by the terms of supervisory law, which was written in response to analogue activity. In its Digital Finance Strategy, the European Commission has identified the most relevant developments in order to incorporate them into the body of supervisory law. It has classified the following developments as particularly relevant and defined them as strategic priorities: the increasing fragmentation of value chains; the bundling of different sectoral financial services on (online) platforms; risks presented by large groups of companies that combine different regulated activities (mostly internationally).

The European Commission has therefore submitted several legislative proposals in an initial regulatory package. The two most important of these are a dedicated regulatory regime for cryptoassets and certain service providers in this context, the Markets in Crypto-Assets Regulation (MiCAR), and a regulatory regime for the application of distributed ledger technology in the financial markets, the DLT Pilot Regime. These regulatory initiatives will include broad areas of digital financial services and products, though not all areas, in regulation and supervision. For financial market participants, it will therefore remain a challenge to distinguish between regulated and unregulated activities, particularly in the area of financial innovations. The supervisory authority must provide the market with the legal security it needs through interpretations and provide supervisory support to market participants as they implement their innovative business models, especially within the framework of the FMA's FinTech Point of Contact and its regulatory sandbox. It must also protect investors from the typical risks associated with technological innovation.

The strategic goal of new business models is therefore an important component of the FMA's integrated supervisory strategy, with its focus on the following projects in the coming year:

REGULATORY SANDBOX

The FMA's regulatory sandbox enables providers to test how an innovative business model can be implemented in practice in compliance with the regulatory requirements. The first procedures have already been successfully conducted in a joint process between providers and the FMA. In this way, as well as through structured dialogue with providers of innovative business models, the FMA is creating legal certainty and helping to boost progressive innovation in the financial market.

- The entry of further suitable FinTech companies into the sandbox is being promoted.
- The FMA is intensifying its ongoing dialogue and close collaboration with the Federal Ministry of Finance and its institutionalised Regulatory Sandbox Advisory Board in order to lend new impetus to innovative providers.
- The sandbox procedures are analysed, evaluated and optimised based on the experience gained from the early procedures in order to deploy resources as efficiently as possible and to conclude procedures as quickly as possible.
- Within the framework of the European Forum for Innovation Facilitators (EFIF), the FMA is actively involved in the development and implementation of a concept for a European, cross-border sandbox procedure, participating as required in a test phase.

The FMA's regulatory sandbox enables providers to test how an innovative business model can be implemented in practice in compliance with the regulatory requirements. The first procedures have already been successfully conducted in a joint process between providers and the FMA.

REVIEW OF NEW FINANCIAL INSTRUMENTS AND BUSINESS MODELS FOR INNOVATIVE DEVELOPMENTS

The FMA continuously evaluates new technical and economic developments and business models on the financial market, examines and analyses how these intersect with existing regulations and, if necessary, identifies the need for adjustments in the national and European legal framework in order to promote an appropriate legal environment for financial innovations. In this way:

- The FMA actively contributes its expertise to the European legislative debate on the Markets in Crypto-Assets Regulation.
- Through risk-oriented market monitoring in the context of collective consumer protection, current market developments and trends are identified at an early stage, and new business models and novel financial instruments are classified from a regulatory perspective. Similarly, new financial instruments are evaluated in a risk-oriented manner for any necessary product intervention.

- The distinction between financial innovations and related services that are subject to supervision and those that are not is constantly being clarified.

NEW RISKS ASSOCIATED WITH NEW AND INNOVATIVE ORGANISATIONAL FORMS

The FMA is actively involved in the regulatory work of the European Supervisory Authorities (ESAs). In particular, in the cross-sectoral work on:

- the fragmentation of value chains
- the bundling of different sectors' financial services on (online) platforms, and
- the risks posed by large groups of companies that combine different regulated activities.

The FMA monitors such providers and services on the Austrian market, as well as the associated risks.

CROWDFUNDING

The new supervisory regime as defined in the Crowdfunding Regulation means that new supervised entities with novel business models will be subject to supervision by the FMA. The supervisory process from authorisation to operational supervision will be institutionalised, and legal certainty will be created through communication with the market so that the first providers can move into the new supervisory regime.

ARTIFICIAL INTELLIGENCE

Technological progress and the increasing availability of data are boosting the use of artificial intelligence (AI) applications in the provision of financial services. The FMA monitors these developments across all sectors of the financial market.

- The supervisory authority reviews new financial instruments and business models to determine the extent to which new technological developments (such as AI) are being applied and the resulting impact on the risk situation of the providers themselves and of their clients.
- The FMA is actively involved in the European initiative for a regulation on artificial intelligence.

CREATION AND MAINTENANCE OF EXPERTISE

The FMA is building up the requisite expertise and knowledge in a variety of new subject areas that demand not only legal and economic but also technical insight.

FINANCIAL INNOVATION IN THE REGULATED AND UNREGULATED AREAS

Innovation can be both an opportunity and a challenge, when something new is asserting itself in an existing market. The digital revolution has provided a broad and huge boost to innovation in the financial markets during the past few years: the general digitalisation of traditional services (e.g. online banking), complex new phenomena such as cryptoassets, artificial intelligence applications or novel platform economies (e.g. crowdfunding models), and direct or indirect market entries of BigTechs (globally active digital data giants offering cloud outsourcing, for example). These new products, services and providers often do not fit in with the traditional logic or categorisation of financial market law, which is largely aligned with the old, analogue world. New, innovative business models often combine a number of diverse traditional instruments with completely new functionality. Owing to their digital nature, they exceed conventional legal definitions, sector or product boundaries, often also traversing national borders and therefore legal systems too.

New products, services and providers often do not fit in with the traditional logic or categorisation of financial market law. Owing to their digital nature, they exceed conventional legal definitions, sector or product boundaries, often also traversing national borders and legal systems.

REGULATING INNOVATIVE PRODUCTS AND PROVIDERS

Some of these innovative models are already subject to supervisory law: e.g. security tokens that are based on distributed ledger technology (DLT), provided they are regarded as transferable securities; robo advice, the (partial) automation of regulated investment advice and portfolio management; or the outsourcing of IT services, even to unregulated companies.

Technological progress and innovation mean that existing regulatory frameworks need to be constantly evaluated in order to adequately address new risk areas, such as when automated advice is given by a machine, new forms of media are used to inform investors, or when concentration risks arise from cloud outsourcing[1]. Lawmakers at all levels are therefore increasingly being forced to devise new regulations that are sufficiently flexible to allow innovation, while also taking account of investor protection and financial market stability.

Additionally, there are completely new products, services and business models or technological solutions that are only subject to limited supervision, if any at all: the booming cryptoasset market, for example, which has so far been only marginally regulated and supervised; prospectus law, the Alternative Investment Fund Managers Act (*AIFMG; Alternatives Investmentfonds Manager-Gesetz*) or the Financial Markets Anti-Money Laundering Act (*FM-GwG; Finanzmarkt-Geldwäschegesetz*) are only applicable in very specific cases. The core of these business models is usually not subject to regulation, and thus not supervised either.

Supervisors and lawmakers are aware that many of these innovative instruments entail financial risk typical of the market, but because of their technological novelty and their economic features they do not fall under any existing regulatory framework. They are therefore working on customised regulatory and supervisory regimes that support innovation while also giving legal certainty to providers and their customers, and ensuring financial market stability. The proposed Markets in Crypto-Assets Regulation (MiCAR), which is to cover and regulate the broad field of virtual assets, is one example in this regard.

Another phenomenon, which has become an attractive alternative to traditional financial intermediaries, is crowdfunding, i.e. a large number of (retail) investors (a "crowd") providing funding to a business through a crowdfunding platform. This type of financial service has been unregulated (in terms of capital market law) in many EU Member States. Some countries, however, have regulated parts of the market at a national level.[2] These regulatory differences hamper the internal market, and lead to inefficiencies, distortions of competition and inconsistent investor protection. With its Crowdfunding Regulation[3] the European lawmakers have created a legal framework that allows fully harmonised supervision of crowdfunding platforms and helps to remove obstacles that prevent the internal market from functioning properly.

DIGITAL FINANCE STRATEGY

In addition to the above European regulation efforts, the Commission has also published a "Digital Finance Strategy for the EU" in which it identified three priorities for the near future in relation to digital innovation that will transform the financial sector and put supervisory law to the test:

- The increasing fragmentation of value chains

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[1] *The proposal for a Regulation laying down harmonised rules on artificial intelligence, which has recently been published, should provide the necessary legal framework for AI applications.*

[2] *In Austria, parts of the market are regulated in the Alternative Financing Act (*AltFG; Alternativfinanzierungsgesetz*).*

[3] *Regulation (EU) 2020/1503 on European crowdfunding service providers for business.*

- The diversity of financial services sectors and bringing them onto one (online) platform
- The risks posed by large groups of companies that combine different regulated activities (mostly at an international level).

Broad consultations with European and national regulatory institutions have been conducted to advance financial market regulation in this respect too.

The FMA, in its capacity as national competent authority, is pursuing an active role in this dynamic and complex environment. It is closely monitoring current market developments in the interests of collective consumer protection, in order to be able to identify new business models at an early stage and to classify them from a regulatory perspective. At the same time, it provides support to market participants as they implement their innovative business models with its FinTech Point of Contact and regulatory sandbox.

In its capacity as national competent authority, the FMA is pursuing an active role in this dynamic and complex environment. It is monitoring current market developments in the interests of collective consumer protection, in order to be able to identify new business models at an early stage and to classify them from a regulatory perspective.

PRIORITY FOR SUPERVISON AND INSPECTIONS: COLLECTIVE CONSUMER PROTECTION

Many consumers have changed their investment behaviour in response to the environment of persistently low interest rates and the impact of COVID-19. Investors are increasingly switching to riskier forms of investment in the hunt for returns, while many are now much more receptive to financial offers made digitally. This means that the business relationship with financial advisors, traditionally based on personal trust, is increasingly taking a back seat to financial transactions based on anonymous digital information and comparisons. This only increases the need for collective consumer protection through supervision, with the focus on transparency, information and enabling personal responsibility. More and more households are turning their backs on traditional asset classes such as the classic savings account and are switching to the next asset class up or new forms of investment. They are also increasingly turning to digital financing offers via the internet instead of the usual forms of borrowing such as classic consumer loans from a trusted bank branch.

Since the beginning of the pandemic, significantly more retail investors have been investing in the capital market than previously. However, they are investing more conservatively and passively than the investors before them. Blue-chip stocks and exchange traded funds (ETFs) are their main entry products. In contrast, some of the investors who have already been invested in the capital market for a relatively long period of time are switching to riskier investments such as derivatives and structured products. A move towards riskier and more complex financial products can therefore be observed across all investor categories. Even the trading volume of contracts for difference (CFD) has doubled, although here there is a product intervention by the supervisory authority, which imposes additional requirements on providers, such as leverage limits, for the protection of retail investors.

At the same time, the COVID-19 pandemic has given an additional boost to the already rapidly advancing digitalisation of the financial industry. The way in which financial services and products are being offered is fundamentally changing in a wealth of areas as a result, with practically all fields of the financial market affected. Financial supervisors must identify the typical risks associated with the new technologies and address them in the context of collective consumer protection. The goal is to ensure appropriate and fair information as well as to strengthen transparency in the interests of autonomous and appropriate decision-making. To this end, it is necessary for the FMA to consistently advance its priority of collective consumer protection, focusing on the following activities in 2022 in particular:

The goal of supervision is to ensure appropriate and fair information as well as to strengthen transparency in the interests of autonomous and appropriate decision-making.

PRODUCT OVERSIGHT AND GOVERNANCE

Insurance supervisors will be focusing on compliance with the product oversight and governance (POG) rules, in other words the specific implementation of the rules governing product development, review, assessment, recommendation and monitoring by the supervised companies. They will be paying particular attention to the concept of value for money and to exclusions, and their findings will be communicated to the sector, highlighting examples of best practice.

APPLYING BEHAVIOURAL ECONOMICS TO CODES OF CONDUCT

Insights from behavioural economics, and known heuristics in particular, yield valuable data about how consumers perceive and process information, and reach decisions. Heuristics are mental strategies, rules of thumb and shortcuts that help people to make decisions and judgements with limited knowledge and time. This can be incredibly helpful for designing rules of conduct in the best possible way. The result of this supervisory evaluation, identified best practices and the FMA’s expectations around incorporating the findings of behavioural economics will be communicated to the industry.

PROMOTING TRANSPARENCY WITH DEEP-DIVE ANALYSIS AND COMPARISON TOOLS

Transparency in collective asset management will be broadened and deepened by analysing fees and how they are disclosed and presented, as well as through sample surveys of fund documents and their assessment, especially with regard to retail funds. In addition, the FMA will be taking part in joint European priority actions in a range of supervisory fields (such as the supervision of investment firms), which aim to strengthen regulatory and supervisory convergence in the internal market.

The development of an online comparison tool for packaged retail and insurance-based investment products (PRIIPs) is also being evaluated as a way of improving financial literacy and increasing market transparency. These are financial products offered to retail investors where the investment return and thus the amount paid out are dependent on another asset or index, itself subject to price fluctuations.

RISK-ORIENTED MARKET MONITORING

The risk-oriented market monitoring of financial instruments, products and innovations from the perspective of collective consumer protection focuses on changes in retail investor behaviour set against the general backdrop of COVID-19. In addition to the ongoing analysis work, at least one deep-dive analysis is carried out per quarter.

TARGETED CONSUMER COMMUNICATION

The idea behind the new consumer information format “Let’s talk about money” is to engage in cooperation with stakeholders such as the OeNB. Another focus of attention will be short explanatory videos designed to break down complex subject areas.

CONSUMER ENQUIRIES AND COMPLAINTS DATABASE

Development and establishment of a comprehensive database for the collection, categorisation and automated evaluation of all written and telephone enquiries and complaints submitted to the FMA. The goal is for all relevant data gathered from enquiries and complaints to be recorded, categorised, processed and analysed efficiently and effectively. The project is being carried out together with the OeNB, and is being financially backed by the European Commission in recognition of its importance for the development of novel technology-based methods to detect atypical developments in the banking sector using data from public communications, consumer enquiries, complaints and bank reporting.

INTEGRATED CONDUCT AND SALES SUPERVISION OF BANKS

The integrated sales supervision of banks is focused on client information, especially on the quality of its content and its actual added value. The FMA expects its involvement in the study on “Optimally designing financial advice”, which is led by the Institute for Advanced Studies (IHS), to provide new insights for the medium-term development of an outcome-based form of conduct supervision.

Another inspection priority will be compliance with the provisions on cost transparency and fair treatment of borrowers who are facing payment difficulties in accordance with the Markets in Financial Instruments Directive (MiFID).

APPLYING BEHAVIOURAL ECONOMICS TO COLLECTIVE CONSUMER PROTECTION

Many people tend to make their economic decisions not on the basis of careful and rational cost-benefit analysis but after being influenced by a variety of psychological, social and cognitive factors. Behavioural economics, a relatively young branch of economic science, uses field studies and experiments to investigate how people actually arrive at economic decisions and why they behave as they do. Personal preferences, the expectations of others, how the situation is perceived and the overall context all play a crucial role. This discipline therefore combines methods and findings from economics with those from psychology, sociology and neurology.

Behavioural economics has shown that economic subjects develop (or have already developed) mental strategies, rules of thumb or shortcuts that help them to make decisions and judgements with limited knowledge and time. The technical term for this would be heuristics. These are also based on neurological and psychological effects of how information is actually perceived and processed. What this means is that decision-making frequently and systematically deviates from the previously assumed ideal case of always behaving rationally.

Understanding why people make the decisions they do helps to support them make better decisions. Consequently, the findings of behavioural economics, especially those related to financial, pension and investment decisions ("behavioural finance"), are also of enormous interest in the field of collective consumer protection. The focus is on information perception and information processing by consumers and the influences that these processes have on the decision-making process.

Understanding why people make the decisions they do helps to support them make better decisions. This is why insights from behavioural economics are of such profound interest for collective consumer protection.

INFORMATION PERCEPTION

The processes of perceiving information determine which information is selected in the first place and how it is interpreted and classified.

The phenomenon of "selective information perception" refers to the way in which people tend to suppress or at least neglect information that contradicts their own attitudes, intended decisions or decisions they have already made, while positively accepting perceptions that reinforce their position. This is not just a question of content; the way in which the information is presented matters too. How information is presented and prepared determines how much attention is paid to it and how it is classified. This can lead to consumers misinterpreting information.

How information is perceived also depends on the environment in which it is presented. Consumers tend to assess risks or probabilities of occurrence in a distorted or even inaccurate way, depending on the visibility or prominence of related factors at the time of their decision. If an issue is particularly prominent at the time, the probability of occurrence of the associated event tends to be overestimated or underestimated, depending on the connotation. With regard to the perception of risk, there is always a discrepancy between the actual objective risk and subjectively perceived risk.

INFORMATION PROCESSING

Information processing is about how consumers evaluate and rank perceived information. This is an area in which behavioural economics now has very robust experimental evidence to show that people tend to overestimate their own abilities, knowledge and judgement, especially when making financial decisions. This phenomenon is referred to as "overconfidence bias". From the perspective of collective consumer protection, the main aim is to avoid mistakes caused by overconfidence, for example by making information and communication less complex.

DECISION-MAKING

In the final phase of the information and decision-making process for or against an investment or financial transaction, behavioural economics has a number of heuristics, i.e. abbreviated cognitive operation patterns, with the help of which conclusions are drawn and decisions are made without the need for complicated and comparatively lengthy analysis.

An example of this is "herd behaviour", where a consumer simply bases their decision on what a certain group of other people is doing or has already done. There is also the phenomenon of market participants generally being overly optimistic about future scenarios. Or the fact that the complexity of products or complex product features, or a large number of decision options, promote an otherwise innate tendency to put off making a decision altogether.

APPLICATION IN COLLECTIVE CONSUMER PROTECTION

Behavioural economic findings provide important starting points and benchmarks for the proper and legally compliant implementation of information obligations, the stated aim of which is to empower consumers to make well-informed decisions:

- The way in which information is prepared and presented not only influences how easy it is for consumers to understand but also impacts on how the consumer processes that information, if at all.
- If several options are presented, the default option should be selected in a considered and targeted manner and presented clearly, as it has been proven that consumers tend to make choices only hesitantly and unwillingly, often ending up with the default option.
- And, unfortunately, this is still not something that is always guaranteed: important information must be clearly formulated and clearly distinguishable as such.

Another way in which behavioural economic insights are applied in financial market supervision is their use in the product oversight and governance (POG) requirements. The aim must be to take the needs of certain target groups into account by reducing the complexity of products or product features. Insights from behavioural economics are also relevant when it comes to implementing conduct of business obligations.

We are only at the beginning of using behavioural economics in regulation and supervision, which is why we attach great importance to close cooperation with the science and research communities. Against this background, the FMA is also cooperating in a three-year behavioural economics study "Optimally designing financial advice" led by the Institute for Advanced Studies (IHS) on investment advice in accordance with the revised Markets in Financial Instruments Directive (MiFID II). This study focuses on the sustainability preferences of clients, which are to be recorded from the middle of next year. Research is being carried out to determine how different ways of asking about sustainability preferences in the context of investment advice affect investment decision-making and customer satisfaction levels. In this way, science and research provide valuable input for the further development of regulation and supervision, efficiently and effectively protecting and supporting investors, savers and consumers.

The aim must be to take the needs of certain target groups into account by reducing the complexity of products or product features. Insights from behavioural economics are also relevant to implementing conduct of business obligations.

PRIORITY FOR SUPERVISON AND INSPECTIONS: SUSTAINABILITY

Sustainability risks, i.e. risks resulting from environmental, social and governance (ESG) factors, can negatively influence the performance of individual assets, the stability of individual financial market players and potentially financial stability itself. Against this background, the climate crisis and other environmental risks represent one of the biggest global challenges of our time.

With the signing of the Paris Agreement and the UN 2030 Agenda for Sustainable Development with its Sustainable Development Goals (SDGs) in 2015, governments from all over the world, including Austria, committed themselves to a more sustainable path for the planet and the economy and set themselves ambitious goals. The European Union has also entered into a series of even more ambitious commitments, based on the EU Green Deal.

It is therefore one of the FMA's central tasks to accompany the supervised companies in the transition to sustainability and to prepare them for the related regulatory change. For this reason, sustainability will continue to be one of the FMA's supervision and inspection priorities in 2022, with a focus on the following projects:

IMPLEMENTATION CHECK OF THE FMA GUIDE FOR MANAGING SUSTAINABILITY RISKS

A structural implementation check across all areas of supervision to determine the extent to which sustainability risks have been integrated into strategy, governance and risk management on the Austrian financial market, in accordance with the requirements of the FMA Guide. This will use findings from the ongoing supervisory activities, and from the ongoing dialogue and exchange with the supervised entities and relevant stakeholders. Based on the results of the implementation check, the FMA will assess whether, how and to what extent the Guide should be revised.

SUSTAINABILITY IN THE BANKING SECTOR

Review of the extent to which climate risk aspects are already being taken into account by credit institutions in their risk management, ensuring that regulatory requirements are met in a timely manner. This involves identifying those credit institutions that are particularly exposed to climate risks, with the supervisory authority addressing any weaknesses in this regard.

SUSTAINABILITY IN THE INSURANCE AND PENSION SECTORS

There are two main aspects relevant to sustainability in the area of insurance and pension supervision.

- Firstly, stress tests are used to evaluate the approach to transition risks arising from climate change.
- Secondly, the carbon footprints and climate paths of portfolios are recorded and analysed.

SUSTAINABILITY ON THE SECURITIES MARKET

The ESG requirements are to be implemented in the regulatory supervisory processes, with opportunities and risks being actively addressed with all market participants.
When approving or reviewing fund documents and capital market prospectuses, special attention will be paid to compliance with ESG criteria.

SUSTAINABILITY IN INTEGRATED SUPERVISION

Supervision of sustainable finance is to be tackled in an integrated way. A cross-divisional Sustainable Finance Committee is to be established and will function as an ex ante coordination platform.
With regard to enforcement, there will also be a focus on the inclusion of sustainability aspects in non-financial reporting.

With the signing of the Paris Agreement and the UN 2030 Agenda for Sustainable Development, governments from all over the world, including Austria, committed themselves to a more sustainable path for the planet and the economy and set themselves ambitious goals.

INTEGRATION OF SUSTAINABILITY RISKS INTO STRATEGY, GOVERNANCE AND RISK MANAGEMENT

The FMA aims to integrate sustainability factors and risks into its supervisory activities, also taking account of current regulatory developments at European level. To create a common understanding of the topic and create a level playing field for all, it has published a Guide for Managing Sustainability Risks, in which it has pooled its knowledge from across all supervision areas. The Guide will be used as a benchmark for supervisory inspections that form part of the FMA's operational activities.

Proper consideration of sustainability risks is currently evaluated in the course of the following supervisory activities in particular:

BANKING SUPERVISION

The FMA has taken the first steps to be able to assess whether sustainability factors and risks are properly included in credit institutions' business strategy, internal governance and risk management and to address them in management talks.

The FMA has taken the first steps to be able to assess whether sustainability factors and risks are properly included in credit institutions' business strategy, internal governance and risk management during the supervisory review and evaluation process (SREP) and in management talks. Qualitative aspects are currently the main focus here. In future, disclosure requirements will also be looked into in greater detail. The FMA found that while sustainability has become an issue in the banking sector, institutions are currently still mostly concerned with expanding their knowledge and planning implementation. No bank has yet managed to gain a full overview of all relevant climate risks. However, good progress has been made in some bank-specific fields of business: climate risks are, for example, increasingly taken into account in customers' due diligence processes.

INSURANCE AND PENSION SUPERVISION

The Austrian insurance undertakings (VU) and *Pensionskassen* (PK) are important players, as institutional investors, in implementing sustainability strategies in investment, while at the same time also being exposed to enhanced risk owing to mounting climate change. The FMA is therefore consistently pushing ahead with its analysis of VU and PK portfolios and these companies' consideration of climate-related risks. It has analysed the shares and corporate bonds of these supervised companies and compared them with indices. The results have shown that there is still much to be done. For example, the overall portfolio of the entire VU sector will only be able to reach the 2°C target[1] by 2100 with regard to shares. Having said that, both the shares and bonds of companies in which investments are made are performing better than the comparison index.

The FMA also conducted a top-down climate stress test to evaluate how vulnerable the PK and VU portfolios are to transition risk, i.e. the risk inherent in changing over to a low-carbon economy *(> Chart 1)*. To reach the 2°C target by 2100, the assumption in the stress testing exercise was that a bundle of measure would have to be taken in 2030, which would come as a shock, if the current measures to fight climate change were continued. This scenario would mean losses of € 94.3 million (shares) and € 19.3 million (corporate bonds) at PK and losses of € 191.3 million (shares) and € 44.2 million (corporate bonds) at VU.

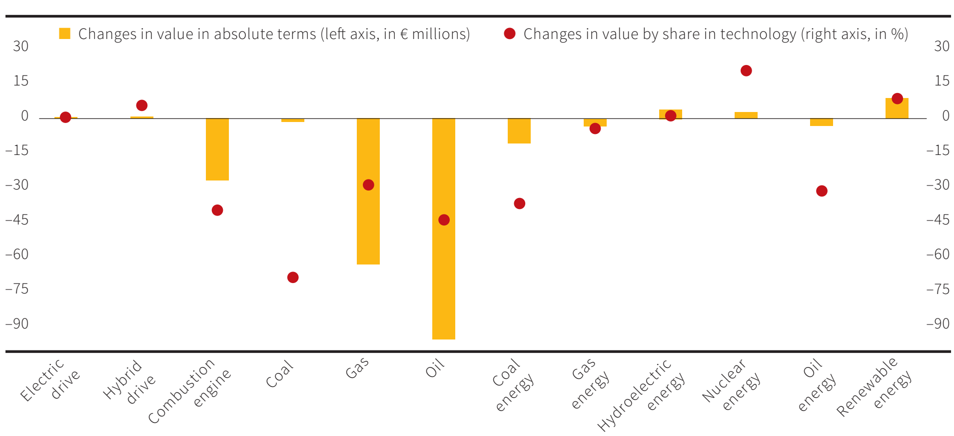

Chart 1: *Changes in share value after stress test per sector (PK)*

SECURITIES SUPERVISION

The FMA not only examines asset managers'[2] current market performance, but also looks into the extent to which they currently consider sustainability risks in their asset management activities as well as the extent to which they have integrated these risks into their strategies.

The past few years have shown a highly dynamic market development for sustainable

[1] *The 2°C target describes the international climate change policy's goal of limiting global warming to less than two degrees Celsius by 2100, compared with pre-industrial levels.*

[2] *Investment fund management companies (KAG), alternative investment fund managers (AIFMs) or corporate provision funds (BVK), for example.*

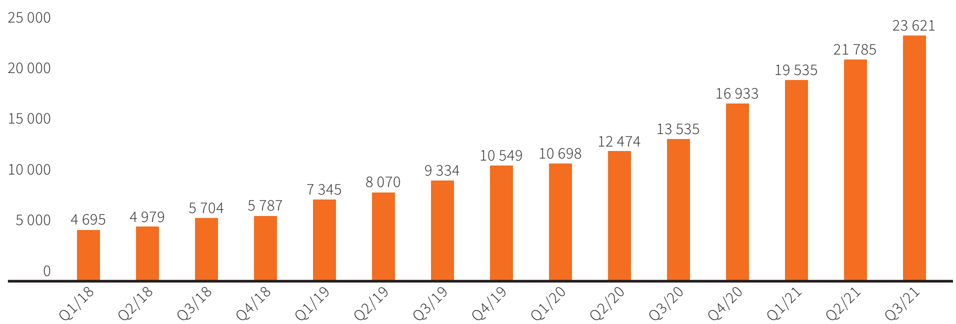

Chart 2: *Austrian funds by UZ49 Ecolabel (in € millions; source: OeKB, Association of Austrian Investment Companies, own calculations)*

investments. As at 30 September 2021, 11.2% of all Austrian investment funds have been classified as sustainability funds in accordance with the Austrian Ecolabel for sustainable financial products (UZ49)[3], an increase of € 10 billion or 75% within one year. In addition, two real estate funds (€ 635 million or 6% of all Austrian funds in this category) have been managed according to UZ49 criteria. All BVK have enshrined sustainability criteria in their investment rules and have been certified by the Austrian Society for Environment and Technology (OEGUT). BVK managed funds amounting to € 15.5 billion as at 30 June 2021 *(> Chart 2)*.

All asset managers are already considering sustainability risks in their asset and risk management or are in the process of doing so. Explicit methods to identify and measure sustainability or climate risks have only been established to a relatively small extent. To enable consideration of sustainability issues, companies primarily rely on external expertise and data, and use various sustainability certifications or standards. The FMA verifies asset managers' integration of sustainability risk, as laid down in its Guide, during formal management talks, and monitoring of sustainability risk integration is also part of an annual analysis priority. In addition, ESMA (European Securities and Markets Authority) stress tests are also used to assess the Austrian fund markets' vulnerability to climate risks.

Furthermore, the FMA has successfully submitted a project entitled "Establishing Forward-looking Cross-sectoral Scenario Analyses, Key Performance Indicators (KPIs) and Key Risk Indicators (KRIs) for the Austrian financial market" to the European Commission (DG REFORM). The project allows the FMA to work on expanding its expertise in relation to environmental risks in particular, with external advisors provided by the Commission supporting the Authority.

IMPLEMENTATION CHECK AND GUIDE UPDATE

As part of a cross-sectoral implementation check to be conducted in 2022, the integration of sustainability risks in strategy, governance and risk management on the Austrian financial market will be evaluated, and the FMA Guide may also be revised as a consequence. This evaluation will be based on findings from ongoing supervision,

[3] *For further details regarding Austria's UZ49 Ecolabel, see https://www.umweltzeichen.at/en/products/start.*

and from continued dialogue with the supervised companies and relevant stakeholders, as well as a cross-sectoral harmonised survey of the status quo.

PRIORITY FOR SUPERVISON AND INSPECTIONS: CLEAN FINANCIAL CENTRE

To ensure confidence in a financial market's proper functioning, in its stability and ability to supply financial services to the real economy and consumers, it is essential for that very market to be "clean". The persistently low interest rate environment, the changed economic and working environment due to the COVID-19 pandemic, as well as ongoing technological innovations in the distribution and design of financial products and services, are creating particularly challenging basic parameters at the current time.

In recent years, this environment has led to a significant increase in dubious or even fraudulent activities on the Austrian financial market as well, especially in digital offerings via the internet or social media as well as from the cryptoasset universe. This ranges from money laundering involving the abuse of the financial system or of unsuspecting consumers to schemes such as advance fee fraud, CEO fraud or fraud involving cryptoassets or trading platforms that are simply fake.

The number of consumer complaints and whistleblower reports to the FMA has increased dramatically, as has the number and scale of losses being reported. Accordingly, the number of investor warnings being published by the FMA, in which consumers are informed about specific dubious providers, has also increased dramatically. Likewise, the number of proceedings to prohibit unauthorised business operations by administrative decision and their enforcement by means of coercive penalties is on the rise.

There have now been many cases of international research networks of journalists using data leaks to expose weaknesses in the international system for the prevention of money laundering and the fight against terrorist financing. The Panama, Paradise, FinCEN and Pandora Papers are just the latest examples of such document leaks, some of which have been on a huge scale.

The FMA must therefore continue to focus on making the financial centre as clean as possible in 2022. It will be prioritising business models operated by providers of virtual currencies and other cryptoassets, compliance with money laundering standards – especially in cross-border financial transactions – and improving the efficiency and effectiveness of whistleblowing systems.

FURTHER DEVELOPMENT OF WHISTLEBLOWING SYSTEMS

Rogue providers and criminals are able to adapt to rapidly changing environmental conditions with breathtaking speed, as also highlighted by the COVID-19 pandemic, with an immediate reaction to lockdowns, working from home arrangements and teleworking, as well as increased internet and social media use. New illegal practices or old ones in a new guise must be identified and exposed by means of consistent market monitoring. Information from market participants, consumers and providers give valuable clues, as do whistleblowers from affected companies or organisations.

The FMA will therefore be closely monitoring the implementation of the terms of the Whistleblowing Directive, incorporating them into its internal processes, and taking the resulting findings into account in its supervisory activities.

Rogue providers and criminals are adapting to rapidly changing environmental conditions with breathtaking speed, as also highlighted by the COVID-19 pandemic, with an immediate reaction to lockdowns, working from home arrangements and teleworking, as well as increased internet and social media use.

CRYPTOASSETS

One particular priority area will be the provision of virtual currency services by virtual asset service providers (VASPs) and by providers that are operating without being registered to do so. VASPs are subject to the regulatory provisions to combat money laundering and must comply with the due diligence obligations for prevention. If they wish to operate on the Austrian market, they must register with the FMA.

- VASPs are closely monitored on the Austrian market to ensure that they are complying with the requirements imposed by the Financial Markets Anti-Money Laundering Act (*FM-GwG; Finanzmarkt-Geldwäschegesetz*).
- In the case of VASPs that are operating without a licence, the relevant procedures to shut down their operations must be implemented promptly, quickly and efficiently.
- In the case of registered VASPs that are not operating in accordance with the legal requirements, the option of revoking their registration should always be used.
- Dialogue on VASPs must be intensified with the relevant partner authorities at national and international level and, in particular, with the criminal investigation and prosecution authorities, such as the A-FIU, the former Financial Intelligence Unit at the Austrian Federal Office of Criminal Investigation.

PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING

In response to numerous international money laundering cases, the global standards to prevent money laundering are constantly being tightened up. The EU is working intensively on establishing a separate institutional framework to combat money laundering with the aim of better coordinating cross-border cooperation and making it more effective and efficient.

In order to play an active role in shaping this new EU framework, the FMA will be focusing not only on operational national supervision in 2022, but also on its proactive efforts in the relevant bodies at European level.

- The FMA's proven zero-tolerance policy in the fight against money laundering and the financing of terrorism will be consistently expanded while taking into account international regulatory and supervisory developments.
- The organisation of home colleges and participation in host colleges will be stepped up in accordance with the EBA rules.
- The FMA will take over responsibility for sanctions, exploiting the corresponding synergies with money laundering supervision.
- The tried-and-tested risk analysis tools used in the fight against money laundering and the financing of terrorism will be taken a stage further by developing analysis software to derive trends and produce reports.

THE EUROPEANISATION OF ANTI-MONEY LAUNDERING MEASURES

If financial service providers are misused for money laundering or the financing of terrorism, this can massively damage their solidity, integrity and stability, while also harming the reputation of the financial market concerned and eroding trust in that market. High-profile international money laundering scandals have exposed structural weaknesses in cross-border efforts to prevent and combat money laundering in Europe. This prompted the European Commission to draw up a comprehensive action plan[1] in May 2020 to further develop the relevant EU rules, to ensure that they are actually implemented uniformly, and to create a European supervisory system for their efficient and effective enforcement.

High-profile international money laundering scandals have exposed structural weaknesses in cross-border efforts to prevent and combat money laundering in Europe.

In July 2021, the European Commission presented a package of legislative proposals designed to fundamentally overhaul the existing regulatory and supervisory approach to tackling money laundering. Until now, the legislative framework has been defined by EU directives (currently the 5th Anti-Money Laundering Directive), which must first be transposed into the national law of each Member State. In future, EU regulations will be used, i.e. directly applicable European law. This should prevent significant differences in the concrete transposition into national law and will create a genuinely uniform legal framework throughout the European Economic Area. In addition, a separate EU authority to fight money laundering will be established. This authority will be given far-reaching powers in order to be able to quickly detect sus-

[1] *Communication from the Commission on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing.*

picious transactions and activities as well as to implement and enforce efficient and effective measures for the harmonised prevention of money laundering throughout Europe.

A DEDICATED ANTI-MONEY LAUNDERING AUTHORITY FOR THE EUROPEAN UNION

The new Anti-Money Laundering Authority (AMLA) will be created by a Regulation establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism. The aim is to ensure a uniform regulatory framework as well as its coherent application, with the AMLA analysing cross-border transactions and developing strategies to contain money laundering risks, thereby supporting and coordinating the work of the national supervisory authorities. The new Authority should also strengthen cross-border money laundering supervision of financial service providers, while institutionalising and intensifying mechanisms for data and information exchange, including with institutions outside the financial sector.

To this end, the new Authority, as the European central authority, will perform the following functions:

- Create a single integrated system for EU-wide measures to combat money laundering and terrorist financing, based on common supervisory methodologies and convergent supervisory standards at a high level
- Directly supervise the riskiest financial institutions operating in several Member States, which will mean that only one AML/CFT authority will now be responsible for them within the EU
- Indirectly supervise the remaining obliged entities (that are subject to national supervision)
- Demand immediate action in the event of imminent risks
- Develop a uniform methodology for the risk classification of obliged entities
- Support the national central money laundering reporting offices, the Financial Intelligence Units (FIUs), with regard to analysis and coordination so that they can optimally prepare the findings and evidence for law enforcement authorities
- Coordinate with the relevant supervisory authorities in relation to non-financial companies.

The AMLA is to be established in 2023 and begin its work – with the exception of direct supervision – in 2024. The plan is for it to be fully staffed with approximately 250 employees by 2026 at the latest, at which point it will also exercise the direct supervisory agendas. For this purpose, it will set up joint supervisory teams, incorporating employees from the national supervisory authorities.

A GENUINELY UNIFORM EU RULEBOOK

There is to be a new Regulation on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing which, as directly applicable EU law (i.e. without requiring transposition into national law), will harmonise the rules applicable across the EU. It will include, for example, more detailed provisions on customer due diligence, beneficial owners and a revised EU list of those businesses and entities subject to money laundering rules (the “obliged entities”).

A new Directive to combat money laundering and terrorist financing, namely the 6th such Directive, will replace the existing 5th Anti-Money Laundering Directive[2] and include those provisions that cannot be included in a regulation. These include, for example, the provisions on the tasks and remit of the national supervisory authorities, the Financial Intelligence Units (FIUs), and the exchange of information between authorities as well as various registers (e.g. registers for beneficial owners). The aim is also to link up these national registers across the European Union.

FULL INCLUSION OF CRYPTOASSETS

Currently, only certain service providers in the area of virtual currencies are covered by EU rules to combat money laundering and terrorist financing. A new version of the 2015 Funds Transfer Regulation[3] will make all crypto asset service providers (CASPs), in other words the entire crypto sector, subject to due diligence requirements for the prevention of money laundering, particularly with regard to proof of customers' identity. This will implement the “Travel Rule” developed by the global standard-setter in the fight against money laundering, the Financial Action Task Force (FATF). Consequently, in future, the originator and recipient will also have to exchange certain information (e.g. on the true identity of the originator/recipient) for transfers of cryptoassets, in a system comparable to the information provided during SEPA or SWIFT transfers. Anonymous wallets will also be banned, in order to ensure that, even in the case of cryptoasset transfers, the owners as well as the ultimate beneficial owners can be traced at any time.

This package of measures will intensify and further strengthen European and international cooperation in the fight against money laundering and terrorist financing, making it even more effective. It will close supervisory and regulatory gaps in this area, and it will provide the authorities with new instruments and levers in order to implement even more effective preventive measures while at the same time efficiently uncovering transactions aimed at laundering the proceeds of crime through the financial system or that are designed to finance terrorist acts. Furthermore, it will make a significant contribution to fair competition conditions across national borders within the EEA and support the FMA's successful zero tolerance policy in the fight against money laundering.

This package of measures will intensify and further strengthen European and international cooperation in the fight against money laundering and terrorist financing, making it even more effective.

[2] *Directive (EU) 2015/849.*
[3] *Regulation (EU) 2015/847.*

OUTLOOK

FIT FOR THE FUTURE: THE FMA IN 2025

We are living in rapidly changing times, as demonstrated so strikingly over the past few years. Issues that seem barely relevant, negligible even, can bring about huge, far-reaching change within the space of just a few weeks. The FMA wants to contribute to shaping the future, so it is paramount that it deals with the major changes that could potentially occur in the coming years and prepares for them in good time. We are aware of the responsibility that comes with being part of this transformation process and have carried out an in-depth analysis of the major trends of the future.

Based on our medium-term risk analysis, we launched a programme, internally known as the "Fit for Future – FMA 2025" project, to identify the trends and developments that will drive success in regulation and supervision in future. The programme aims to answer the following questions:

- What are the major environmental factors the FMA will have to deal with?
- How should the FMA adapt its mission to this new environment?
- What needs to be done so that future issues can be tackled head on?
- What benefits can the financial market draw from an evolving FMA?

In the coming years we will encounter a wide range of developments, and we will have to consider complex interconnections. Some of the major challenges to be tackled in the next few years are already becoming apparent today. They range from geopolitical to economic issues such as trading or territorial conflicts or rising government debt, and structural economic questions such as demographic developments or unemployment caused by automation, to sudden and surprising crisis situations such as pandemics, blackouts or natural disasters.

These factors will seriously affect the financial markets, or at least have the potential to put them at risk. From this wide range of issues, the FMA has identified six core topics that it expects to have the greatest impact on its fields of activity as a regulator and supervisor: climate change, sustainability, digital revolution, information and communication technologies, data and new business models.

Supervisory authorities must adapt to these fundamental changes and must evolve on an ongoing basis. When trying to design concrete measures to address these challenges efficiently and effectively, we need to keep the following targets for 2025 in mind:

1. **The FMA is one of the most modern supervisory authorities in Europe.**
2. **The FMA sets an example for the market participants to follow.**
3. **The FMA presents itself as an attractive employer.**

The FMA will only be able to achieve these targets if its organisation, human resources and technical infrastructure also evolve at the same pace. New cross-sectoral topics and a changing environment require a flexible organisational structure, while new supervised companies and business models require new and interconnected specialist knowledge.

The FMA will expand its strategic alliances with partner authorities, universities, cyber-security platforms, research institutions, the Environment Agency, statutory auditors and similar institutions both to benefit from their examples of best practice and to tap into their wealth of knowledge and experience.

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In a new and changed environment we also need to understand technologically complex issues in order for supervision to be effective. With digitalisation being as significant as it is, this means that, as a priority, our staff of the future need to have the requisite technological skills. The skills and knowledge needed are:

- Data quality management, data processing and analysis
- Merging in-house software with external applications
- Lean digitalisation, knowing how to successfully implement digital strategies and digital transformation processes in companies, with lean thinking and in a targeted manner, for example by combining tried-and-tested lean management methods with innovative lean start-up approaches
- New business models: DLT, AI applications, Green FinTechs
- ICT and cybersecurity
- Climate risks and sustainable finance
- Prevention of money laundering and terrorist financing.

Finding appropriately skilled staff means considering these areas of expertise and knowledge at the recruitment stage.

SupTech and RegTech tools, i.e. innovative digital solutions for regulatory and supervisory challenges and routine tasks, can help improve operational efficiency. The aim is to use existing resources more productively and thus enable FMA staff to concentrate even more on higher-level activities. Repetitive or time-consuming tasks such as data cleansing or the acceptance and processing of documents, data or complaints are examples of activities that could be automated, freeing up resources for more demanding tasks.

The systems used internally at the FMA should also be state of the art, ensuring that the Authority remains an attractive employer.

The organisational structure of the FMA can be a driver of innovation, as talented employees favour a modern working environment that is always evolving and advancing. The FMA is a role model for the financial market, and as such it must also ensure that its organisation moves with the times. To increase productivity and to retain talented, expert staff, it is important to convey the message that these employees are a valued part of the organisation. Contemporary staff management is of paramount importance, as is consideration of the following aspects:

- Equal opportunities: equal professional opportunities for everyone with the same qualifications regardless of gender, age, sexual orientation, disability, social background, etc.
- Diversity and inclusion: appreciation of staff's diversity and variety of opinions to avoid staff members feeling excluded because of their identity.

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To be prepared for the digital future, the FMA needs the right technical equipment. Data volumes will surge, meaning that ICT capacities will have to be permanently developed and modernised. The goals will be:

- To process and analyse the enormous data volumes in resolution cases rapidly and effectively
- To identify and interpret new data as part of an automated process for the efficient prosecution of market abuse, money laundering and terrorist financing
- To optimise market supervision with machine-learning tools
- To detect trends using automated reporting analysis (quantitative and qualitative).

Obviously, IT security at the FMA itself is a key priority. The FMA will continue to guarantee the highest security standards, not least in light of digitalisation, and is planning for the IT infrastructures of the future today.

A modern supervisory authority that is fit for the future is a hallmark of quality for every financial market. It boosts confidence in the financial market among the general public, investors and market participants, and it also contributes to its "clean" status and its attractiveness as a business location.