



Banks navigating uncertainty: The imperative of balance sheet optimization



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Why banks must act now: The case for proactive balance sheet optimization

The global banking sector is navigating a complex landscape shaped by evolving regulations, macroeconomic volatility and technology-driven competition. In this dynamic environment, banks face increasing pressure from regulators, investors and markets to maintain resilience, profitability and agility.

Key factors affecting bank balance sheet performance

Regulatory

Basel rule implementation and stress testing

Macroeconomic

Geopolitical uncertainty, interest rate environment and tariffs



Tech-related

Capex on tech/digital advancements

Balance sheet optimization is a key tool to help banks navigate this complex environment.



Forces fuelling uncertainty in banking

The operating environment for banks is rapidly changing. Regulatory frameworks such as Basel III (also known as Basel 3.1 in the UK, CRR3/Basel 4 in the EU or the Basel III endgame in the US) are evolving.* Countries and regions are taking diverse approaches to implementation, driven by evolving regulatory landscapes — for instance, the US is witnessing an easing of the regulatory environment, while Europe continues to enforce stricter measures which are raising the amount of capital required, and increasing the management complexity for international banks.

At the same time, increasing geopolitical tensions and tariff pressures are amplifying the potential for volatility in bank balance sheets, with fluctuating interest rates (such as rate cuts in Europe in 2025 and ongoing uncertainty for rate cuts/increase in the US) further heightening credit, liquidity and concentration risks. These dynamics pose a threat to earnings stability and weaken an organization's capacity to absorb shocks. In addition, shrinking income-generating opportunities and rising investor expectations are also widening the gap between return on capital and cost of capital, creating sustained pressure on long-term profitability.



Pitfalls of not optimizing balance sheets

This complex and dynamic banking landscape demands the deliberate optimization of bank balance sheets — which involves the strategic management of a bank's assets, liabilities, capital and liquidity to maximize returns, manage risk and maintain regulatory compliance.

In this environment, neglecting balance sheet optimization can lead to severe consequences, ranging from inefficiencies and liquidity shortfalls to regulatory breaches and diminished shareholder value/return. Poor asset-liability management also exacerbates these issues, alongside increased funding costs, suboptimal capital allocation and missed growth opportunities.

Without optimization, balance sheet velocity slows down, leaving banks burdened with risks that more agile peers have already offloaded via private credit partnerships, securitization (cash or synthetic) or syndications. This inertia not only increases balance sheet risk but also limits the bank's ability to respond to market opportunities, erodes competitive edge and curtails fee income generation.



Strategic response and way forward

In response to these challenges, banks should strategically shift towards capital-light models as well as focus on risk and revenue diversification. They should enhance capital efficiency via optimization strategies such as cash and synthetic securitization, M&A and forward flow/originate-to-distribute transactions. The leaders are also exploring the private credit landscape, either through partnerships with private credit firms or by building their own private credit capabilities.

In today's market where capital flows to efficiency and innovation, inaction isn't just a missed opportunity — it is a strategic liability. As such, banks should be looking at balance sheet optimization not merely as a defensive tactic, but also as a strategic imperative for enhancing bank balance sheet performance and ensuring long-term resilience.

Strategic benefits of balance sheet optimization



* See [how leading banks are optimizing returns under Basel IV](#) (also known as Basel 3.1 or Basel III endgame)

The path to optimization: Key focus areas for balance sheet management

In response to growing financial and regulatory pressures, banks should focus on four critical areas for effective balance sheet optimization, with each area presenting distinct opportunities to strengthen financial positioning, improve profitability and build a more agile and adaptive institution. While it is best to possess all four attributes at a high level of maturity, many banks are on a journey — continuously developing and enhancing their capabilities over time.

Focus areas for balance sheet optimization



Embed capital-sensitive performance measures

Integrate performance metrics that are sensitive to capital intensity to optimize capital usage and improve returns.

- **Opportunities:** Replace or supplement Net Interest Margin (NIM) with ROTE or Risk Based Capital Requirements (ROIC); integrate capital costs into performance KPIs; link business unit incentives to capital efficiency
- **Levers:** Enhanced performance dashboards; integrated risk-return frameworks; and capital sensitive hurdle rates

Benefits

- Aligns business incentives with shareholder value/returns
- Agile portfolio management
- Reduced reliance on 'originate and hold' models



Adopt dynamic balance sheet modeling

Consider your current balance sheet and potential shifts in the asset-liability mix driven by anticipated market changes or strategic initiatives.

- **Opportunity:** Develop a dynamic tool to forecast and reforecast key financial metrics
- **Levers:** Data inputs from plans/actuals; key single factors to perform driver tree calculation; and optimization calculators for tactical and strategic allocation

Benefits

- Integrated forecasting and planning
- Real time course correction
- ROTE optimization
- Agile financial resource management



Centralize control and allocation

Empower/create central roles for decisions on resource management to ensure efficient and agile capital deployment and redeployment.

- **Opportunities:** Establish a central capital allocation 'marketplace'; implement real-time forecasting and performance monitoring; and reconcile risk sensitive business targets with the bank's overall ROTE targets
- **Levers:** Balance sheet management feedback loops; centralized data analytics and forecasting platforms; and treasury-led capital allocation frameworks

Benefits

- Reduced inefficiencies from siloed decisions
- Quick adoption to market/regulatory changes
- Dynamic pricing and incentives adjustments



Accelerate balance sheet velocity

Accelerate reallocation of financial resources to optimize capital deployment and enhance ROTE.

- **Opportunities:** Shift away from NIM-based 'originate to hold' models to 'originate to distribute' models; actively manage portfolios based on capital intensity; and reallocate assets internally/externally to distribute risk
- **Levers:** Sale, syndication, securitization (cash/synthetic), credit default swaps, internal asset transfers, partnerships/JVs and platforms, private credit, M&A, and so on.

Benefits

- Capital recycling to accelerate income generation from scarce resources
- Dynamic portfolio rebalancing
- Transition to fee-based from asset heavy revenue models

Unlocking value: Selected levers for effective balance sheet optimization

In this complex environment, many of the leading banks are exploring four key strategies to support their balance sheet optimization — cash securitization, synthetic securitization, M&A and OTD/forward flow models. Together, these propositions can empower banks to operate with greater agility, resilience and strategic reach.

Cash securitization Transfer part of a pooled asset portfolio to an external Special Purpose Vehicle (SPV), enabling a full derecognition from the originator's balance sheet (though the originator may continue as loan servicer). Objectives • Generate liquidity • Meet funding requirements through diversified channels • Achieve capital relief Applicability • Suitable for banks with large, homogeneous loan pools (e.g., mortgages, auto loans) • Banks needing funding, especially in rising interest rate environment Impacts • Optimized risk-weighted assets (RWAs) via asset transfer • Reduced credit risk exposure on balance sheet and freeing up of associated capital Benefits Enables banks to address both funding and capital requirements by selling multiple tranches of notes, thereby achieving full-stack optimization.	Synthetic securitization Transfer of credit risk of a pool of exposures using credit derivatives (like credit default swaps) or guarantees, while the loans stay on the balance sheet. Objectives • Transfer risk through credit risk hedging • Raise and recycle capital Applicability • Suitable for banks with high-quality, capital-intensive assets • Banks seeking both funding and capital • Capital redeployment Impacts • Increased profitability (ROCE and ROE) if capital is re-invested • Reduced RWAs • Accelerated balance sheet velocity • Enhanced lending capacity through strategic offloading of risk exposures • Increased limits Benefits Allows banks to release capital tied to high-risk assets, particularly through significant risk transfer (SRT), thereby enhancing redeployment flexibility.
Mergers & acquisitions Expansion of banks through a combination with another bank or a non-bank lender. Objectives • Diversify asset and liability classes • Increase returns from a 'sleepy' balance sheet • Improve resilience through the cycle • Achieve scale to support the cost base Applicability • Banks requiring a strategic change to their asset or balance sheet composition (e.g., introduction of a new asset or liability type) Impacts • Increased returns on tangible equity (ROTE) • Broaden product/service offering • Economies of scale reduce cost-to-serve • Funding and capital synergies Benefits Helps banks enter new asset niches and diversify product offerings, thus expanding the commercial offering and ROTE potential beyond existing constraints.	Forward flow/Originate to distribute Originate loans with the intent to sell or transfer to third parties (such as investors or securitization vehicles), rather than holding to maturity. Objectives • Effectively transfer risk • Retain client relationships • Earn servicing and origination fees Applicability • Optimal for banks with risky assets • Banks aiming to maximize origination franchise beyond balance sheet capacity Impacts • Reduced RWAs • Free capital, enhanced lending capacity • Improved liquidity and off-balance sheet funding • Enhanced balance sheet velocity Benefits Increases balance sheet velocity through partnerships with counterparties (such as private credit investors, insurers and asset managers), enabling banks to scale origination without proportional capital retention.

How KPMG can help



Cash securitization

- Providing strategic advice on options and impacts
- Arranging private finance
- Advising on listed deals
- Preparing credit analytics, portfolio optimization and investor material
- Executing structuring, negotiation, ratings and offering material



Synthetic securitization

- Advising first time issuers (structuring, governance, data, regulatory)
- Structuring and arranging Significant Risk Transfer (SRT/CRT) trades
- Valuation or SRT positions held by investors
- Verification agency services



M&A

- Advising on buy-side and sell-side M&A as lead advisor
- Due diligence support to acquirers of banks and non-bank lenders
- Supporting public to private transactions or bid defense
- Support with regulatory change in control
- Advising on sales of performing and non-performing portfolios (buy-side/sell-side)



Forward flow/originate to distribute

- Structuring forward flow transactions (buy-side/sell-side)
- Restructuring incentives/KPIs to embed 'originate-to-distribute'
- Creating and improving bilateral and competitive forward flow processes



Bank steering framework

- Advising on most suitable steering framework
- Redesigning top-down/bottom-up reconciliation of profitability targets
- Implementing risk-based steering framework

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