KPMG cutting through complexity

The Banking Brief

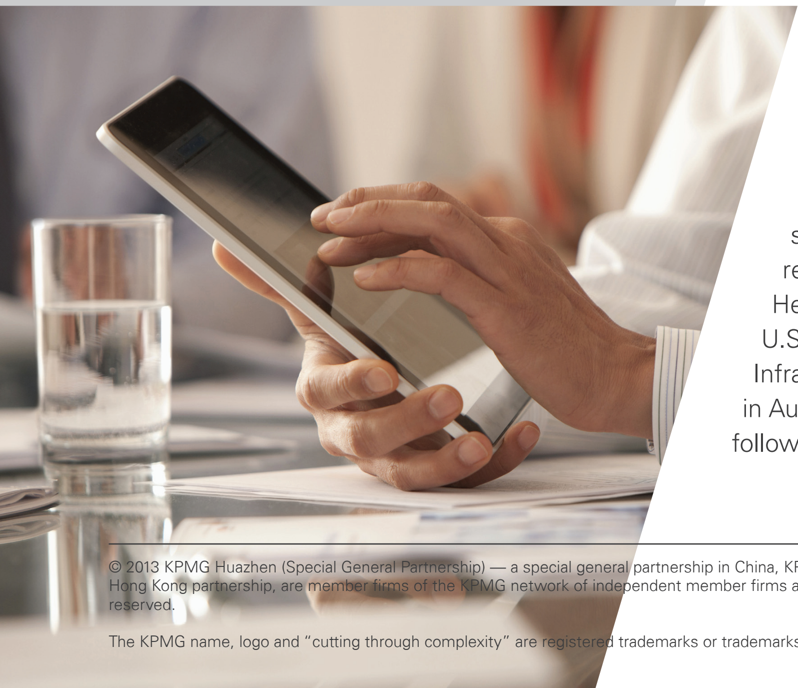
Issue 02 Financial Services

Insights from the CRO roundtable

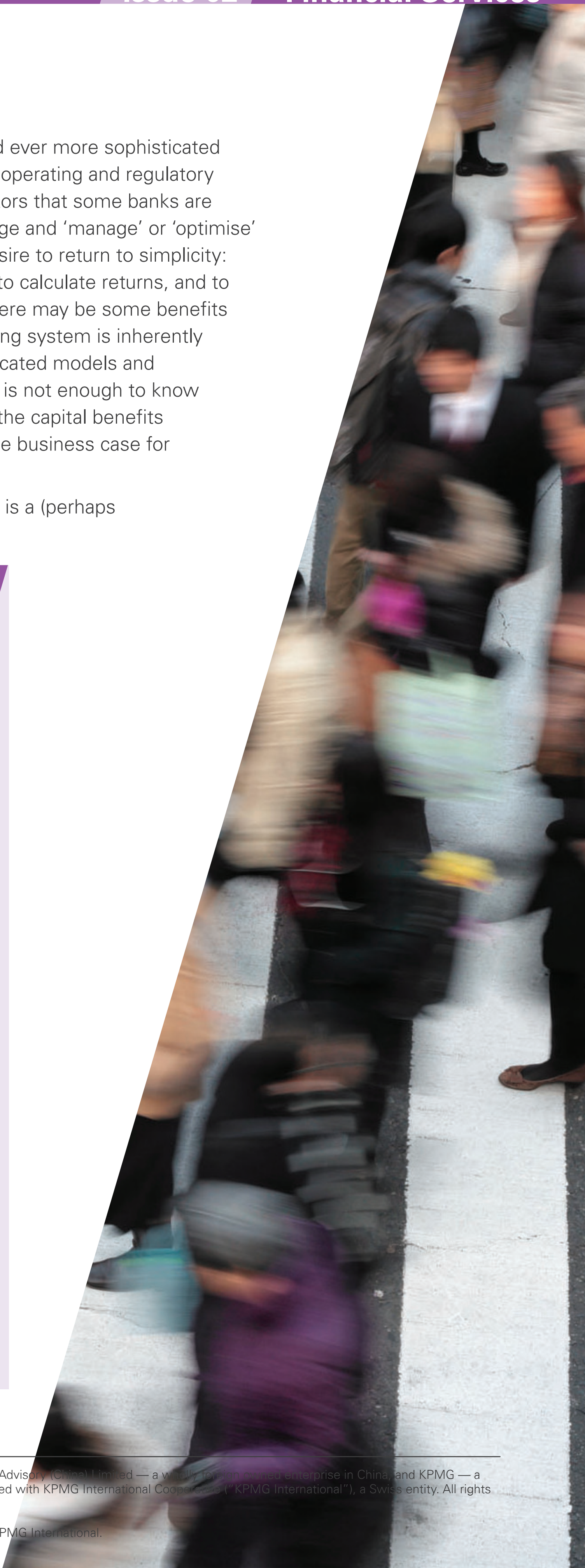
Background

On 4 June, KPMG held the first of a series of roundtables for banks' Chief Risk Officers. Fourteen CROs attended and discussed a range of topics including:

- Current priorities for risk functions in Asia
- The changing role of the CRO
- Key risk and regulatory themes in Asia
- The importance of turning regulatory change into a competitive advantage
- The future of the global banking model.



The Head of KPMG's ASPAC Financial Services Regulatory Centre of Excellence, Simon Topping, gave a regional update on regulatory themes impacting banks, and shared his views on some of the paradoxes in the current regulatory environment. Jitendra Sharma, KPMG's Global Head of Financial Risk Management, gave an update on the U.S. market, while Craig Davis, KPMG Australia's Head of Risk Infrastructure, provided useful insights into the outlook for banks in Australia. Some of the key points are summarised on the following pages.



A regulatory paradox

Complexity vs. Simplicity: In recent years, banks have developed ever more sophisticated risk management models in response to the increasingly complex operating and regulatory environment. Model risk aside, there is a concern amongst regulators that some banks are taking advantage of this complexity to partake in regulatory arbitrage and 'manage' or 'optimise' capital requirements. In response to this, there is an increasing desire to return to simplicity: to simplify rules governing banks, to simplify the models required to calculate returns, and to simplify regulations to focus on areas of highest concern. While there may be some benefits to simplification, participants also acknowledged that today's banking system is inherently complex. As such, it is a challenge to manage risk without sophisticated models and techniques. As one attendee acknowledged: "one or two numbers is not enough to know if a bank is safe". One area of agreement amongst CROs was that the capital benefits of internal models vs standardised approaches will diminish and the business case for further development will be more challenging.

Integration vs. separation: In today's banking environment, there is a (perhaps contradictory) move towards both integration and separation.

Integration	Separation
• Banking supervisors are pushing for the adoption of integrated firm-wide risk management frameworks. • Risk data needs to be aggregated and systems must talk to each other to allow for a better firm-wide view of risk. • The Risk function is becoming more integrated with the business. • There is increased integrated reporting. • Stress testing is increasingly being required on an integrated basis.	• There are various proposals regarding the separation of trading activities from non-trading activities. • The G-SIFI and recovery and resolution planning requirements are being adopted, which means banks need to consider local incorporation, outsourcing and separation of systems in order to demonstrate they can 'stand-alone'. • Regulators are increasingly uncomfortable about offshore risk being booked in their home jurisdictions. As a result, banks are reviewing their global booking models and developing contingency plans to repatriate risk closer to the source (Asian entities for risk originated in the region).

Key themes in Asia

With Asian regulators increasing AML resources and undertaking thematic reviews on the topic, KYC was cited as the number one theme impacting banks. Other key themes include FATCA, tax evasion and conduct risk – not just looking at the selling of products but also suitability throughout the product lifecycle.

Current priorities for risk functions in Asia

Participating CROs shared some of their key priorities. The regulatory burden facing banks is at an all time high and and CROs recognise the need to be dealing with the strategic response to the new regulatory world. However, tactically, many CROs are still preoccupied with responding to a wave of MRAs and consent orders, AML/KYC programs and consumer conduct reviews – often working side by side with Compliance. Basel III is on the radar, but many banks are dealing with short term issues, and have not fully developed their response to Basel III and related regulatory requirements.

Regulation as a driver of competitive advantage

Attendees discussed the importance of strategically responding to regulation to gain a competitive advantage. Those organisations that can move beyond the day-to-day tactical response to regulation, and instead look at opportunities to re-engineer their businesses, will get ahead. Focus areas include:

- Technology (new systems, integration of systems)
- Real-time monitoring/data
- Enhancing end-to-end processing
- Realignment of risk with the business.

Future of the global banking structure?

Participants discussed the viability of the current global model, and what the impacts would be if the current global model broke down in the future. Some of the ideas discussed included:

- Impacts on the global economy and international trade
- Efficiency of the financial system, particularly around the cost of capital
- Impacts on systemic risk
- The competitive landscape and benefits of local vs regional vs global banks due to factors such as funding models, capital constraints and regulatory divergence.

Role of the CRO

Attendees agreed that the CRO profile within banks is being raised, and a key function of the role is to challenge the business and the CEO. However, there were conflicting views regarding what the best career path is for risk professionals. Some believed that the career progression for a risk professional should be through the Risk function, while others thought there should be more cross-pollination between risk and the business. Other questions raised included:

- How can the CRO be best equipped to provide effective challenge?
- Does a direct reporting line to the Board Risk Committee, CEO or CFO work best in substance?

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