Banking: assurance just got strategic

June 2016

Banking has become a business of serious consequences. Fines are punitive. The Senior Managers and Certification Regime has added a blanket of accountabilities and risks at the heart of your business. Reputations are on the line. No wonder assurance – internal and external – is charging up your board agenda.

Upheavals in the business model, a sea-change in the operating environment, fundamental reforms to regulation… What are banking's senior personnel and board members to do to make sure they keep on top of their game?

The answer, in fact, is devastatingly simple: assurance. Not the old, tick-box audit of the past, a generally mandatory exercise. True reassurance can only come from nuanced and thoughtful assurance processes that are capable of evolving as bank risks and the industry landscape shifts. They must also:

- Acknowledge the revolution in banking's business models
- Re-think the traditional three-lines-of-defence approach
- Adopt new skills to meet the rapidly evolving requirements

Internal audit functions need greater subject matter knowledge. External assurance is no longer simply driven by regulatory requirement – it is a must. Regulatory changes have put a heavier burden of responsibility on those in charge. This is partly through the new Senior Managers and Certification Regime (SMCR). But there are many other ever-increasing reporting requirements: from RWA to Gender Pay Gap and Modern Slavery Act reporting, and the Prudential Regulation Authority's requirement for assurance over areas such as BCBS 239 compliance and COREP.

And as you undergo business transformation – with new technologies, processes and organisational constructs – assurance is the bridge between your revamped model and regulatory compliance. Assurance is essential to proper board control and oversight during change.

"Assurance is what gives management and the board the confidence that things are happening as they should be," says Banking Audit Partner Pamela McIntyre. "Given the higher stakes now, it would be crazy not to think that assurance is vital."

Business model changes, customer needs, investor expectations and regulatory requirements are all putting pressure on governance mechanisms. So does the assurance framework for each bank remain fit for purpose in this environment? At a minimum, boards should be asking for a review of arrangements and to understand where assurance gaps exist. "Above all", says Risk Management and Banking Internal Audit Partner John Machin, "there needs to be a shift in behaviour and attitudes to align assurance with the fast-evolving environment".

Remember Kerplunk? The children's game that features a transparent container of marbles held in place by sticks beneath them? It's not a bad metaphor for traditional thinking on the three lines of defence. Like the game, the system was self-contained, the risks visible, and even if drawing out the sticks might cause unexpected marbles to drop, at least you knew what action caused which consequence. It was relatively easy to evaluate the risks. It was comfortable.

But the traditional approach to assurance is now out-dated and dangerously complacent. "Many banks have to break through the permafrost of middle management," says Machin. "They need to be able to join the strategic intent at the 'top of the house' to the day-to-day decisions and behaviours taking place, be more aware and take a more holistic view. The big questions too few are asking are: What are we trying to achieve here? What assurance can I truly rely on to make sure that is happening in practice? The governance framework simply has to catch up with new risks, regulations, changes and inter-dependencies in the total environment."

Judgement calls

The first step is to clearly define responsibilities and accountabilities throughout the organisation – not just within the scope of the SMCR. Your main consideration is what you want assurance on, without relying exclusively on existing risk registers. You need to think about your risk appetite for often non-clear-cut measures. Are you looking for assurance on your own terms? Or are you seeking a benchmark to assess your business against your peers, or a regulatory standard?

The latter requires a new approach based on judgement. And it's this, McIntyre thinks, which goes to the heart of the shift in assurance. "BCBS 239, on risk data aggregation and reporting, is very much principles-based. Every organisation has done this differently – and interpreted what it means to be compliant. Simple 'tick and bash' this is not."

New regulation is changing the type of assurance that banks need. This assurance is less well-defined, more nuanced and requires tough judgment calls.

For example, regulators are now asking internal auditors to look at conduct and culture. "There aren't necessarily conduct and culture experts in internal audit, it's not a traditional skill-set," says Machin. "This is one area where turning to external advisers can help. But it's not the only one. Increasingly we find banks are benefitting from the types of skills and benchmarks which an external assurance provider can bring."

Getting a grip

Even with your SMCR in place, there's plenty of work to do. It's time to consolidate: embed in your new processes; assign responsibilities throughout the organisation to really understand what managers do and how. That level of detail, and a systematic approach to gathering and monitoring it, is critical if top management and directors are to get the information – and the assurance – they need.

"Rather than seeing the SMCR as a compliance tick-box exercise, see it as a way to get a better grip on the business," says Director of Assurance Sarah Ward. "Use it as a driver. Think about the areas where you can use internal resources, and where you need third party assurance."

"Discipline is essential", Machin warns. "So is communication with the regulators." He cites the example of an organisation that decided to confess to a problem. "Yes, they received a heavy fine," he says. "But by admitting they had done things wrong and showing they already had a remediation plan in place and were executing it, the regulator saw the bank as a mature and well-run organisation. Regulators are responding positively to this."

The consequences of getting things wrong are serious and personal; the threat of prison sentences alone should force action.

But this is not all "Project Fear" – there are substantial benefits too. Assurance can allow you to exploit new regulatory demands and therefore ease both regulatory and board-level concerns. It can add value through benchmarks, giving much-needed comfort to the board. Above all it can enable banks to get a better grip on running the business as it's going through necessary transformation.

"The benefits are real and palpable," says Ward. "Quite simply a bank with strong assurance processes is a strong bank – an institution best placed to ride out market ups and downs and face the future with confidence."

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CREATE | CRT062457E | June 2016