KPMG's European Central Bank Quarterly Update

February 2017

We start our first newsletter of the New Year with a short look back at 2016 – a highly tumultuous year in which we saw significant political upheaval with elections and referendums in Europe and the US. It is yet unclear how these geo-political uncertainties will affect the market, and what the springtime elections in Europe will bring. In addition, the failure of the oldest bank in the world, Monte dei Paschi di Siena, presents a real test case for the SRB's Resolution framework and we have yet to see how events will unfold there.

KPMG's ECB Office has spent a large part of the first weeks of 2017 analysing SSM priorities and key regulatory issues facing banks across the Eurozone. When comparing the working programs of the EBA, SRB and ECB we can all be glad that their priorities are largely aligned. Some of the EBA's strategic areas, such as business models and credit risk, overlap with the SSM priorities for 2017, while others focus on supporting the SRB's mandate for crisis management. Across the board, technology is rising up on the supervisory agenda: both for the digital integrated market and IT outsourcing, as part of a larger outsourcing review the ECB will initiate this year. Digitalization and integration in the financial services industry are coming to the forefront. Digitalization is changing markets, and this is as much of a challenge for regulators, as it is for banks. Can this be the beginning of the agile banking regulator?

Benchmarking remains a priority among banks and supervisors alike, and therefore a key initiative of the ECB Office. We are pleased to announce the update of KPMG Peer Bank with the latest data from the EBA for banks to run new peer analysis. We also finalized our 2016 SREP Benchmark study – although, according to the ECB, the overall SREP CET1 demand for 2017 remained broadly unchanged compared to the previous year, the composition of the Pillar 2 requirements became more transparent. Besides a P2R, a Pillar 2 Guidance (P2G) was introduced with an average of 2.1%.

This week, the ECB issued new guidance for ICAAP and ILAAP. After the 2016 ICAAP and ILAAP assessments, the ECB observed that there is room for improvement and harmonization across the sector and has prescribed 7 principles for both ICAAP and ILAAP; the supervisor confirms that banks should also take into account publications from the EBA, BCBS, and FSB. We will share further analysis on this soon. The review of ICAAP approaches is a ECB supervisory priority for 2017.

We've also been keeping a close eye on the ECB Guidance on Leveraged Transactions; the consultation period for the Guidance closed on 27 January and the final version is expected to be published in spring 2017, see below for more details. On February 15 the ECB published its second Supervision Newsletter. Among the covered topics such as internal models reviews and key risks for the euro area, was an interview with Sharon Donnery on NPLs, in which Mrs. Donnery stressed that banks with high levels of NPLs will be subject to frequent supervisory inspections and the rule of proportionality will apply

Outsourcing is an ECB priority

According to our June 2016 benchmark on IT risks, IT outsourcing risks were the third most prevalent in the banking sector, right behind cyber and data risks. As part of the supervisory priorities for 2017, the European Central Bank (ECB) will initiate a thematic review of banks' outsourced activities to assess how they are managing the associated risks. IT outsourcing activities will be a large and important part of this review. So how can banks better prepare? What frameworks and standards can guide them to improve and streamline their internal control organization for major outsourcing projects?

Read more | Share on LinkedIn

Three institutions, three working programs for 2017

During each month of Q4 2016, a new work program was published: first the EBA published its work program in October, followed by the SRB at the end of November and finally the ECB published its key priorities in mid-December. Since the EBA, ECB and SRB work programs for 2017 also have implications for the agenda of banks, it is worth having a closer look, not only on each of the programs in isolation, but also to identify the current 'hot topics' of the European banking sector by looking at how they overlap

Read more | Share on LinkedIn

The way forward for Europe's digital integrated market

Digital and integrated – these are the two key words being used to describe the future of Europe's financial services industry at a conference that was jointly organized by the ECB and the EU Commission on January 31. While the speeches and panels focused on single aspects of Europe's future digital integrated market, the conference program itself unveiled the challenging road that lies ahead for the European banking sector.

Read more | Share on LinkedIn

Understanding SREP 2016 decisions

As of 1 January 2017, banks are subject to Pillar 2 requirements determined by the ECB's new SREP methodology. As part of their year-end audit, banks are required to ensure a sound capital planning process based on their Pillar 2 expectations for the following years, which also includes the derivation of a reasonable minimum distributable amount (MDA) for each of the coming years. The increased complexity of Pillar 2 capital components frequently poses a challenge to banks.

Read more | Share on LinkedIn

KPMG Peer Bank – going beyond transparency

Peer group analysis is a key tool for banking supervisors. Quantitative ratings play an important role in the European Banking Authority's (EBA) Guidelines on how supervisors should review and evaluate the banks they supervise; supervisors are focusing increasingly on banks' business models and profitability; and the European Central Bank is using peer analysis to identify 'outliers' within a harmonised model of pan-European banking supervision. KPMG's ECB Office has therefore developed KPMG Peer Bank.

Read more | Share on LinkedIn

Resolution and bail-in capital – what banks, creditors and shareholders should know

Over the last three months, there have been a number of developments in the second pillar of the European banking union, the Single Resolution Mechanism (SRM). Some of those include the too-big-to-fail-dilemma and the EU sovereign-bank nexus. Progress has been made in defining EU resolution and bail-in capital requirements.

Read more | Share on LinkedIn

Reducing non-performing loans (NPLs) in the EU banking sector

Can Europe's €1.05 trillion stock-pile of NPLs be cleared without public sector intervention? Rephrasing the question: will the private sector, alone, be able to cleanse banks' balance sheets? The answer of policymakers in Frankfurt (ECB), Brussels (European Commission) and London (European Banking Authority) appears to be 'No', with an increasing degree of intensity and unity.

Read more | Share on LinkedIn

Further insights

Navigating through uncertainty: European banks' non-financial risks

KPMG recently surveyed 36 banks across Europe to understand better how banks are responding to regulatory developments around non-financial risks. Banks and regulators are clearly turning their attention to this area that can have a huge impact on a bank's bottom line. Most attention is currently being given to IT and compliance risks, whilst business and strategic risks are too often overlooked. In such a politically volatile environment, European banks need to be braced for change and so strategic and businesses concerns should really come higher up the list of priorities. Specific risk management processes should be established, sooner rather than later. Find the report here.

Leveraged Finance

The Consultation period on the ECB's Draft Guidance, including a technical workshop and a public hearing, ended on 27 January. We've held a Leveraged Finance Roundtable and follow-up discussions with the purpose of enabling an open dialogue among European leveraged finance practitioners (read more). One of the key topics in the discussions has been the broad definition of leveraged transactions. The ECB is expecting that banks have a unique and overarching definition of leveraged transactions in place, covering all business units and geographical areas. According to the guidance, any loan with total debt exceeding 4.0 times EBITDA must be considered a leveraged transaction. Core focus in the guidance is on corporate borrowers excluding other structured credits, like commercial real estate and shipping, and loans to natural persons from the scope. For more information on Leveraged Finance or our Roundtable events on this topic, please reach out to the ECB Office.

Basel 4

With the Basel Committee due to meet again on 1-2 March and the Governors and Heads of Supervision in mid-March it is timely to consider possible outcomes. It remains to be seen how far the Basel Committee will amend its earlier consultation proposals to achieve its stated objective that these revised standards should not increase overall capital requirements significantly. As we wrote in The world awaits – Basel 4 nears completion, some banks will certainly be subject to a further increase in their regulatory capital requirements.

Useful Links

- Contact the ECB Office: de-ECB-Office@kpmg.com
- Visit KPMG's ECB Office online

Contacts

Henning Dankenbring
Partner, Co-Head
KPMG's ECB Office

Daniel Quinten
Partner, Co-Head
KPMG's ECB Office

kpmg.com/socialmedia

Designed by CREATE | 180308 | CRT075915