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KPMG's European Central Bank Quarterly Update

September 2017

Welcome to the autumn edition of our regular ECB Update. The summer months of 2017 have seen the ECB and the EBA pressing forward with their supervisory priorities for the year. KPMG's ECB Office has been equally busy, helping clients to anticipate and respond to the changing environment.

As always, this update aims to alert to readers to the potential impact of forthcoming changes in the supervisory landscape. On this occasion, we put the spotlight on six key areas. They are:

- The likely features of the 2017 SREP – the third since the SSM's creation – including its impact on capital planning;
- The increasingly sophisticated and demanding nature of Business Model Assessments, which now incorporate pan-European benchmarking;
- The EBA's forthcoming guidance on cloud outsourcing, and its potential impact on banks' technology investment plans;
- The disruption to European financial markets that could arise from Brexit's effect on UK-based Central Counterparties;
- The ECB's new guidance on Leveraged Finance, and the need for banks to avoid any disruption to lending; and
- The EBA's 2018 Stress Tests, which introduce new methodology and could prove to be more challenging than ever.

If we take a step back from these individual topics we can see some underlying themes at work. These include the need to respond to political changes, and the desire to adapt to the rapid evolution of technology. And, of course, a continuing focus on harmonisation – typified by the development of pan-European benchmarking.

In short, European supervisors continue to work hard to enhance the quality of banking supervision in a fast-changing world. Of course, the banks they oversee face similar challenges, and we hope that this update can help clients to adapt to this ever-changing picture.

SREP 3.0 – The best is yet to come

The third annual SREP since the SSM's launch should be the most effective yet. We expect 'SREP 3.0' to deliver closer harmonisation and better risk sensitivity within the Single Supervisory Mechanism (SSM). This reflects ongoing improvements to input data, and an ECB drive to enhance transparency. But banks cannot afford to relax. Understanding the SREP's potential impact on capital planning – and communicating this to investors – remain vital.

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Business Model Assessments

Like shareholders and creditors, supervisors are paying growing attention to the strength of banks' business models. Assessments are becoming more rigorous, and now include pan-European peer group benchmarking. Banks need to understand how demanding assessments can be, and prepare accordingly. That means making detailed, credible projections that align with other internal and external statements about the future.

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Cloud Outsourcing

The EBA's guidance on cloud outsourcing will soon be finalised. It is likely to require a significant compliance effort from many banks – and their outsourcing providers. Banks should act now to prepare for implementation. They should also consider the impact of the new guidance on any technology investments they may be planning in response to PSD 2 and Instant Payments.

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Central Counterparties & Brexit

Brexit is creating uncertainty over the future supervision of the UK's central counterparties (CCPs), which represent major concentrations of derivative trading risk. An unexpected change in the status of UK CCPs could be highly disruptive for European capital markets. Banks must be alert to the potential risks, and should prepare for closer scrutiny into their planned responses.

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Leveraged Finance

The ECB's guidance on leveraged finance enters force in November 2017, and JSTs will need implementation reports one year later. Meeting this target will pose significant challenges for many banks, partly because some key definitions and requirements appear unclear. Banks need to act fast to clarify uncertainties, achieve successful implementation and avoid any disruption to their lending activities.

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EBA Stress Test 2018 – Forewarned is forearmed

The EBA's 2018 stress test will not just be a re-tread of previous exercises. Nor will banks simply be able to rely on their internal stress testing models and processes. The arrival of IFRS 9, together with some specific changes to the EBA's approach, will make this a challenging exercise. Given the impact the stress test results will have on the 2018 SREP, banks should start their preparations now.

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Further insights

Recovery planning. What more do banks need to do?

Banks have always had contingency plans. But the financial crisis demonstrated that many banks did not have viable plans to recover from severe shocks. As a result, EU legislation (the Bank Recovery and Resolution Directive "BRRD") has been put in place to require banks to develop credible recovery plans. Contingency planning for more severe and wide-ranging adverse scenarios should enhance the resilience of banks. Banks should develop recovery plans that identify credible options to survive a range of severe but plausible stressed scenarios. This should be part of the good management of a bank, not just a response to a regulatory requirement.

Although this paper focuses on banks, there is a read – across to other types of financial institution – including insurance companies and asset managers – and to financial market infrastructure such as central clearing houses. KPMG member firms can help you navigate the key elements of a bank's recovery plan drawing upon their collective experience and expertise across Europe. Download the paper here.

KPMG Peer Bank – Basel IV Calculator

The ECB Office is pleased to announce the latest update to KPMG Peer Bank is now available. The Basel Committee aim to revise the standards for a number of capital requirements. These new requirements are expected to be more stringent and will include an overall floor to limit the maximum benefit from using internal models to measure Risk. It is important for banks to be able to understand the impact of these new rules on their key financial measures to aid capital requirements planning and inform future strategic business decisions.

KPMG professionals have enhanced the current Peer Bank tool to provide new functionality which is designed to help you understand the impact and model potential scenarios to estimate the effect of the reforms, based on EBA Transparency Exercise data.

For more information about KPMG Peer Bank visit www.kpmg.com/peerbank. For more information and KPMG perspectives on ECB Supervision, please visit www.kpmg.com/ecb.

Useful Links

- Non-performing loans in Europe: what are the solutions?
- The nexus between regulation and technology innovation
- Contact the ECB Office: de-ECB-Office@kpmg.com
- Visit KPMG's ECB Office online

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